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TRUTH-IN-LENDING LITIGATION: WHEN THE BORROWER GOES BANKRUPT

The primary enforcement mechanism of the Truth in Lending Act is the damage remedy available to consumer borrowers. Special problems arise when a violation of the Act's disclosure provisions does not surface until an overextended borrower resorts to bankruptcy court. The author argues that the rationale used by courts to justify a desirable result—passage to the trustee in bankruptcy of the bankrupt's right to seek statutory damages from a violating creditor—is inconsistent with the purposes of the Truth in Lending Act and could frustrate its enforcement in the bankruptcy context. He offers an alternative rationale—based on an analogy between Truth-in-Lending actions and usury actions—that should effectuate more fully the objectives of the Act.

INTRODUCTION

A READING of the newspaper advertisements for legal services might lead a person to assume that a personal bankruptcy adjudication is as nonlitigious a legal event as a simple business incorporation or an uncontested divorce proceeding.¹ From the bankrupt's perspective, the matter might appear to be relatively uncomplicated. First, a petition is filed with the bankruptcy court.² A court-appointed trustee then marshals the bankrupt's assets, liquidates them, and distributes dividends to claiming creditors.³ If the bankrupt has been honest,⁴ he will be left with his exemptions,⁵ freed from debt, and ready for a "fresh

1. See, e.g., *The Plain Dealer* (Cleveland), Aug. 30, 1978, at 10, col. 1 (advertising "bankruptcy (individual)" at the same fee as "incorporation" and "uncontested divorce").

2. R. BANKR. PROC. 101. Filing the petition operates as an automatic stay of suits by and against bankrupts, Bankruptcy Act § 11a, 11 U.S.C. § 29(a) (1976) (original version at ch. 541, § 11a, 30 Stat. 544 (1898)). The stay precludes actions on unsecured debts, R. BANKR. PROC. 401(a), and enjoins the enforcement of liens on property in the bankrupt's possession. R. BANKR. PROC. 601(a). The bankrupt thus receives immediate relief from harassment by creditors.

3. 11 U.S.C. § 75(a)(1), (11) (1976); R. BANKR. PROC. 308, 605(a). The Bankruptcy Act grants the trustee wide-ranging powers to enable him to gather assets for the estate. This Note deals with the powers of the trustee under § 70a of the Bankruptcy Act, 11 U.S.C. § 110(a) (1976), as successor to a bankrupt's Truth-in-Lending action.

4. Liability for credit which was extended in reliance upon a false statement by the debtor with respect to his financial condition and for debts created by "fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity" is not dischargeable. 11 U.S.C. § 35(a)(2), (4) (1976).

5. At present, most bankruptcy exemptions are determined with reference to state law. 11 U.S.C. § 24 (1976). The breadth of the states' exemptions varies considerably; they typically include household furniture, wearing apparel, tools of the trade, a homestead

start."⁶ In many cases, little complex legal maneuvering is necessary and litigation seldom develops.

With increasing frequency, however, personal bankruptcy proceedings involve the assertion of a Truth-in-Lending action⁷ against one of the claiming creditors. The action may be initiated by the trustee in bankruptcy—either as a counterclaim to the lender-creditor's claim against the bankrupt's estate,⁸ or as a separate action outside the bankruptcy court.⁹ If the trustee declines to sue the lender, the former debtor may pursue the matter personally after he is adjudged bankrupt.¹⁰ The Truth in Lending Act authorizes suit in any court of "competent jurisdiction";¹¹ the bankruptcy court itself often has jurisdiction over a bankrupt's Truth-in-Lending action brought by the trustee.¹²

allowance, and insurance policies. See J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY 155-56 (1956).

6. See *Lines v. Frederick*, 400 U.S. 18, 20 (1970); *Local Loan Co. v. Hunt*, 292 U.S. 243, 245 (1933).

7. Truth in Lending Act, Pub. L. No. 90-321, tit. I, 82 Stat. 146, as amended by Fair Credit Billing Act, Pub. L. No. 93-495, tit. III, 88 Stat. 1511; by Act of Feb. 27, 1976, Pub. L. No. 94-222, § 3, 90 Stat. 197; and by Consumer Leasing Act of 1976, Pub. L. No. 94-240, 90 Stat. 257 (codified at 15 U.S.C. §§ 1601-1667e (1976)). In order to achieve "meaningful disclosure of credit terms" and to enable consumers to "compare more readily the various credit terms available . . . and avoid the uninformed use of credit," the Act provides consumers a civil damage action. 15 U.S.C. §§ 1601, 1640 (1976). Lenders who fail to make the required disclosures are liable to borrowers for actual and statutory damages; in some cases rescission is available. *Id.* §§ 1635, 1640(a).

8. See, e.g., *Liberty Loan Corp. v. Boyajian (In re Dunne)*, 407 F. Supp. 308 (D.R.I. 1976). Rule 13 of the Federal Rules of Civil Procedure (counterclaim and cross-claim) applies generally to proceedings in bankruptcy court. R. BANKR. PROC. 713.

9. See, e.g., *Murphy v. Household Fin. Corp.*, 560 F.2d 206 (6th Cir. 1977); *Porter v. Household Fin. Corp.*, 385 F. Supp. 336 (S.D. Ohio 1974).

10. See, e.g., *Newton v. Beneficial Fin. Corp.*, 558 F.2d 731 (5th Cir. 1977).

11. 15 U.S.C. § 1640(e) (1976).

12. Bankruptcy courts currently have jurisdiction over trustees' Truth-in-Lending claims in any of the three following circumstances:

(1) When the lender-defendant files with the bankruptcy court a proof of its claim against the bankrupt estate. See *Meehan v. Nelsonville (In re Warren)*, 387 F. Supp. 1395 (S.D. Ohio 1975). As creditor, it must file a proof of claim with the court if it wishes to participate in any distributions from the estate. 11 U.S.C. § 93(a) (1976); R. BANKR. PROC. 302(a).

(2) When the secured lender-defendant files a petition to reclaim its security. See *General Fin. Corp. v. Garner (In re Garner)*, 556 F.2d 772 (5th Cir. 1977) (bankruptcy court has jurisdiction over counterclaim alleging Truth-in-Lending violation filed by debtor pursuant to creditor's reclamation petition in chapter XIII extension proceeding). The bankrupt's original petition for discharge operates as an automatic stay against enforcement of any liens on property in his possession. R. BANKR. PROC. 601(a). Secured creditors wishing to reclaim their collateral must petition the bankruptcy court for relief before they may repossess the property. R. BANKR. PROC. 601(c).

(3) When the lender-defendant fails to object to the jurisdiction of the bankruptcy court

An underlying premise of this Note is that a bankruptcy proceeding is an opportune time for uncovering violations of the Truth in Lending Act's disclosure requirements and for enforcing the Act.¹³ The Bankruptcy Act requires thorough inquiry by the trustee in bankruptcy and by the court itself into the bankrupt's financial affairs—particularly into the causes of the bankruptcy.¹⁴ In addition, the trustee has the responsibility generally to locate and liquidate as much wealth as possible for the benefit of all the creditors.¹⁵ Consequently, a bankruptcy proceeding can prompt an investigation into whether the bankrupt overextended himself due to a particular lender's failure to disclose information concerning credit terms and whether damages may be recovered from that lender for the estate and, ultimately, for distribution to the properly disclosing creditors.¹⁶

The achievement of effective and fair enforcement of the Truth in Lending Act in the bankruptcy context requires the reso-

over the trustee's Truth-in-Lending claim. 11 U.S.C. § 11(a)(7) (1976); R. BANKR. PROC. 915(a); see *Liberty Loan Corp. v. Boyajian (In re Dunne)*, 407 F. Supp. 308, 310 (D.R.I. 1976). If none of these three circumstances are present, the trustee must file a separate civil action in federal district court or state court. 11 U.S.C. §§ 29(e), 46 (1976).

The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 389 BANKR. L. REP. (CCH) pt. 2, will establish new bankruptcy courts with expanded jurisdiction. These new courts will have the powers of "court[s] of equity, law, and admiralty . . ." *Id.* § 241(a) (to be codified in 28 U.S.C. § 1481). Their jurisdiction will extend over "all civil proceedings . . . related to cases under [the Bankruptcy Act]." *Id.* § 241(a) (to be codified in 28 U.S.C. § 1471(b)). After April 1, 1984, when the jurisdictional provisions of the new Act become effective, a trustee pursuing a bankrupt's Truth-in-Lending claim should never have to resort to state courts or federal district court. Even if none of the foregoing jurisdiction-conferring circumstances are present, resolution of the Truth-in-Lending matter could proceed directly in bankruptcy court. Of course, opportunities to pursue Truth-in-Lending claims are likely to continue to devolve upon trustees under the Bankruptcy Reform Act. See notes 34 & 83 *infra*.

13. See Boyajian, *The Trustee in Bankruptcy and the Federal Truth in Lending Act*, 51 AM. BANKR. L.J. 63 (1977); Dilenschneider, *Regulation, Another Role for the Trustee*, 48 AM. BANKR. L.J. 209 (1974).

14. The statutory language provides: "The bankrupt shall . . . submit to an examination concerning . . . the cause of his bankruptcy [and] his dealings with his creditors. . . ." 11 U.S.C. § 25(a)(10) (1976). Disclosure violations may also be discovered when the bankrupt's attorney inspects the loan documents while preparing the petition for bankruptcy adjudication. The official bankruptcy forms require the listing of any claims that the bankrupt may have as assets of the estate. See *Official Forms in Bankruptcy*, form 6, schedule B-2, item q (Collier pamph. ed. 1975).

15. See 11 U.S.C. § 75(a)(1) (1976).

16. The trustee has an additional incentive to augment the estate through the prosecution of causes of action on behalf of the estate since his fee is determined as a percentage of the estate. 11 U.S.C. § 76(c) (1976). When the trustee acts as his own attorney, the possibility of a liberal award of attorney's fees further enhances the incentive for him to pursue a bankrupt's Truth-in-Lending action. See note 68 *infra*.

lution of two thorny issues. First, a court must determine that the right to pursue the Truth-in-Lending action passes to the trustee along with the bankrupt's other nonexempt property rights. Otherwise, the bankrupt retains the right to sue the lender after he is declared to be bankrupt and receives his discharge from indebtedness. If he wins the postbankruptcy suit, he may retain the proceeds free of all creditors' claims, leaving him with an unjustifiable windfall.¹⁷ Second, the violating creditor should not be permitted to set off the amount of its Truth-in-Lending liability against the amount of its claim to the bankrupt's estate. Although set-off is allowed by the Bankruptcy Act,¹⁸ the deterrent force of the Truth in Lending Act would be vitiated when a borrower who had received inadequate information concerning credit terms becomes bankrupt.¹⁹

Paradoxically, the reasoning used by courts to prevent lenders from setting off their Truth-in-Lending liability conflicts directly with the rationale advanced to allow the Truth-in-Lending claim to pass to the trustee.²⁰ This Note proposes an alternative rationale based on an analogy between Truth-in-Lending actions and usury actions. The proposed rationale would permit Truth-in-Lending claims to pass to trustees in bankruptcy without jeopardizing through set-off the deterrent objectives of the Truth in Lending Act.

I. PASSAGE OF THE RIGHT TO PURSUE A BANKRUPT'S TRUTH-IN-LENDING ACTION TO THE TRUSTEE IN BANKRUPTCY

When a person petitions a bankruptcy court for discharge from indebtedness, title to all his nonexempt transferable property, as well as the right to pursue certain of his causes of action, vests in the trustee in bankruptcy. Neither the Bankruptcy Act

17. See *Cumberland Glass Mfg. Co. v. DeWitt*, 237 U.S. 447 (1915); *Newton v. Beneficial Fin. Corp.*, 558 F.2d 731 (5th Cir. 1977).

18. 11 U.S.C. § 108 (1976). See *General Fin. Corp. v. Garner (In re Garner)*, 556 F.2d 772, 780 (5th Cir. 1977).

19. See text accompanying notes 77-83 *infra*.

20. Confusion has resulted because judicial decisions on both issues have turned on an elusive determination of whether the cause of action created by the Truth in Lending Act is penal or remedial. Compare *Murphy v. Household Fin. Corp.*, 560 F.2d 206 (6th Cir. 1977) (Truth-in-Lending action passes to trustee because it is not penal) with *Newton v. Beneficial Fin. Corp.*, 558 F.2d 731 (5th Cir. 1977) (Truth-in-Lending liability not set off against debt discharged in bankruptcy because Truth in Lending Act creates a penal cause of action). See text accompanying notes 56-74 *infra*.

nor the Truth in Lending Act speak directly to the issue of whether the bankrupt's Truth-in-Lending action passes to his legal representative. Therefore, the language and judicial interpretations of the Bankruptcy Act that define the trustee's rights must be analyzed closely.

Section 70a of the present Bankruptcy Act²¹ provides:

The trustee of the estate of a bankrupt . . . shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located: . . . (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered . . . ; (6) rights of action arising upon contracts, or usury

The language is sweeping,²² but two general exceptions have been created. First, bankrupts have convinced the courts that deprivation of some items, such as vacation pay and the right to future wages, would unfairly impede the bankrupt's "fresh start" after bankruptcy.²³ Accordingly, these items have emerged as limitations on the meaning of "property" which vests in the trustee pursuant to section 70a(5). The other exception centers on the language in section 70a(5) relating to the transfer of rights of action to the trustee. The trustee is likely to pursue any promising rights of action for the benefit of the estate and, ultimately, for distribution of the proceeds to creditors. Yet under section 70a(5), only the bankrupt's transferable rights of action pass to the trustee. Consequently, parties sued by the trustee may assert that the right of action involved is not transferable, that it remains with the bankrupt, and that the trustee therefore has no standing to bring the suit.²⁴

21. 11 U.S.C. § 110(a)(5)-(6) (1976).

22. The Supreme Court stated in *Segal v. Rochelle*, 382 U.S. 375, 379 (1966):

"The main thrust of § 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end the term 'property' has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed."

23. See *Lines v. Frederick*, 400 U.S. 18 (1970); *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934).

24. See 1 R. CLONTZ, TRUTH-IN-LENDING MANUAL ¶ 3.10[9][a][iii], at 3-216 to 3-222 (4th ed. 1976).

A. *The Fresh Start Policy: No Impediment to Truth-in-Lending Enforcement in Bankruptcy Cases*

At one time the fresh start policy, with its restrictive interpretation of what "property" passes to the trustee pursuant to section 70a of the Bankruptcy Act, was interpreted as a possible hindrance to the passage of a bankrupt's Truth-in-Lending claim to the trustee.²⁵ The United States Supreme Court's recent discussions of the fresh start policy suggest, however, that the bankrupt should not retain the right to sue to the exclusion of the trustee.

The judicially-created fresh start policy enables a bankrupt to retain certain property and rights which otherwise would pass to the trustee under a literal reading of the bankruptcy statute.²⁶ In order to give the bankrupt a "new opportunity in life and [a] clear field for future effort, unhampered by the pressure and discouragement of preexisting debt,"²⁷ the Supreme Court has carved a narrow class of exceptions into section 70a. Thus, accrued but unpaid vacation pay does not pass to the trustee, since depriving the bankrupt of such a benefit would hinder his ability to achieve an "unencumbered fresh start."²⁸ For similar reasons, an assignment of wages does not pass to the trustee.²⁹ Bankruptcy relief would have little meaning if the bankrupt were required perpetually to hand over his wages to his creditors.

Recently, however, the Supreme Court has taken a narrower view of bankrupts' fresh start requisites and a broader view of trustees' rights. In *Kokoszka v. Belford*,³⁰ the Court unanimously decided that the right to receive an income tax refund passes to the trustee for distribution to creditors. As the Court explained, an income tax refund differs from accrued but unpaid vacation pay since a tax refund is not "designed to function as a wage substitute at some future period . . . to 'support the basic requirements of life for [the debtors] and their families. . . .'"³¹ Thus, even though it is derived directly from wages, the income tax refund passes to the trustee as "property" under section 70a because it is so "rooted in the prebankruptcy past" that depriving the

25. Dilenschneider, *supra* note 13, at 216 n.25.

26. See J. MACLACHLAN, *supra* note 5, at 88.

27. *Lines v. Frederick*, 400 U.S. 18, 20 (1970) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 245 (1934)).

28. 400 U.S. at 20.

29. *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934).

30. 417 U.S. 642 (1974).

31. *Id.* at 648 (quoting in part *Lines v. Frederick*, 400 U.S. at 20).

bankrupt of it would not hinder his "fresh start."³²

After *Kokoszka* it is unrealistic to suggest that the fresh start policy affords the bankrupt an argument that he should retain the exclusive right to pursue his Truth-in-Lending claim in a post-bankruptcy suit.³³ That right is not even remotely related to wages; the transaction upon which it is based—namely, borrowing money from a commercial lender—is clearly "rooted in the prebankruptcy past." In sum, the fresh start policy should present no obstacle to enforcement of the Truth in Lending Act by trustees in bankruptcy. The present Bankruptcy Act's other restriction on the trustee's rights to a bankrupt's causes of action—the requirement of transferability—presents more substantial difficulties.³⁴

B. *Transferability of the Cause of Action: The Survival-of-Actions Rationale*

Under sections 70a(5) and 70a(6) of the current Bankruptcy Act, only those rights of action which (1) the bankrupt "could by any means have transferred,"³⁵ (2) "might have been levied upon and sold under judicial process against him, or otherwise seized,

32. *Id.* Cynical observers point out that a tax refund check payable to the bankrupt for \$150 is just enough to cover the trustee's discretionary fee, see 11 U.S.C. § 76(c)(1) (1976), which, under the Bankruptcy Act's priority scheme, 11 U.S.C. § 104(a)(1) (1976), is deducted from the estate before distributions, if any, are made to creditors. HOUSE COMM. ON THE JUDICIARY, BANKRUPTCY LAW REVISION, H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 94 (1977).

33. With the approval of the court, however, the trustee may abandon the Truth-in-Lending claim, allowing it to revert to the bankrupt. R. BANKR. PROC. 608. If the claim has not been adjudicated when the estate is closed, it is deemed to have been abandoned with the court's approval. *Id.* Under these circumstances, the discharged debtor is free to pursue the claim in a postbankruptcy suit. See *Newton v. Beneficial Fin. Corp.*, 558 F.2d 731 (5th Cir. 1977); Note, *Abandonment of Assets by a Trustee in Bankruptcy*, 53 COLUM. L. REV. 415 (1953).

34. The Bankruptcy Reform Act of 1978, effective October 1, 1979, eliminates the provision of the current Bankruptcy Act that only "transferable" property rights of the bankrupt may pass to the trustee. See 11 U.S.C. § 110(a) (1976). The new Act considerably streamlines the language defining the trustee's title; the estate is comprised generally of "all legal or equitable rights of the debtor in property. . . ." Bankruptcy Reform Act, *supra* note 12, § 101 (to be codified in 11 U.S.C. § 541(a)(1)). No express reference to the passage of causes of action appears in the new Act. It seems clear, however, that the right to bring a Truth-in-Lending action for statutory damages constitutes a "legal or equitable interest . . . in property" and therefore would pass to the trustee. The demise of the transferability requirement leaves little margin for arguing that *any* right of action of a bankrupt is beyond the trustee's grasp, regardless of the personal or punitive characteristics of the right. See text accompanying notes 54-56 *infra*.

35. 11 U.S.C. § 110(a)(5) (1976).

impounded, or sequestered,"³⁶ (3) arise upon contracts;³⁷ or (4) arise upon usury³⁸ pass to the trustee. The cause of action authorized by the Truth in Lending Act presents special problems because it does not fall squarely into any of these four categories. Courts confronted with the issue of passage of a Truth-in-Lending claim to the trustee have focused almost exclusively on the transferability of the claim rather than considering the other three possible grounds for passage to the trustee.³⁹ *Murphy v. Household Finance Corp.*,⁴⁰ the first United States court of appeals decision to hold that a Truth-in-Lending action passes to a trustee in bankruptcy, is typical of this line of analysis.

In *Murphy*, Randy and Carol Westbrook had obtained a consumer loan in the amount of \$894.91 from Household Finance Corporation.⁴¹ Ten months after receiving the loan the Westbrooks filed a voluntary petition in bankruptcy. When the trustee appointed for the Westbrooks examined their financial records, he discovered that Household Finance had provided them with illegible credit disclosure statements. The trustee filed suit in district court alleging violations of the Truth in Lending Act and regulation Z⁴² and seeking statutory damages under section 130(a) of the Act.⁴³ Household Finance stipulated that the illegible forms did

36. *Id.*

37. *Id.* § 110(a)(6).

38. *Id.*

39. See *Murphy v. Household Fin. Corp.*, 560 F.2d 206 (6th Cir. 1977); *Porter v. Household Fin. Corp.*, 385 F. Supp. 336 (S.D. Ohio 1974). But see *Liberty Loan Corp. v. Boyajian (In re Dunne)*, 407 F. Supp. 308 (D.R.I. 1976).

40. 560 F.2d 206 (6th Cir. 1977), noted in *Dilenschneider, Truth in Lending Actions Pass to Trustee in Bankruptcy*, 51 AM. BANKR. L.J. 371 (1977).

41. 560 F.2d at 207.

42. 12 C.F.R. §§ 226.1-1002 (1977). The illegible documents constituted a violation of § 226.6(a) (general disclosure requirements).

43. 15 U.S.C. § 1640(a) (1976). This section provides:

Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this part of 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 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

not comply with the Act's disclosure requirements but challenged the standing of the trustee to sue.⁴⁴

The sole issue, as the district court viewed the case, was whether the Westbrook's cause of action passed to the trustee as part of the estate.⁴⁵ Following *Porter v. Household Finance Corp.*,⁴⁶ the district court held that the Westbrook's Truth-in-Lending action did pass to the trustee.⁴⁷ The Sixth Circuit affirmed.⁴⁸

Putting aside momentarily the court of appeals' mode of analysis, one can see that its conclusion is a desirable one. If the cause of action cannot pass to the trustee, the bankrupt simply would retain it.⁴⁹ After receiving his discharge from indebtedness, he then could sue the Truth-in-Lending violator in his own right. Any recovery he obtained in the postbankruptcy suit would escape distribution to creditors.⁵⁰ It would be difficult to justify such a windfall to the bankrupt who, once in bankruptcy court, discovers he was fortunate enough to have been the victim of improper credit disclosure. Moreover, the debtor's assumption of liabilities beyond his means and his consequent bankruptcy may indeed be attributable to his lack of information concerning credit terms.⁵¹ It is thus appropriate that any recovery resulting from improper disclosure practices be distributed among those scrupu-

costs of the action, together with a reasonable attorney's fee as determined by the court.

44. 424 F. Supp. 176, 177 (S.D. Ohio 1976).

45. *Id.*

46. 385 F. Supp. 336 (S.D. Ohio 1974). In *Porter*, the court held that the right to pursue a bankrupt's Truth-in-Lending action does pass to the trustee; it found, however, that no violation of the Act's disclosure requirements had occurred. Having prevailed on the merits, the lender was precluded from appeal, and the *Porter* case stood as an important precedent for trustees wishing to pursue bankrupts' Truth-in-Lending claims.

47. 424 F. Supp. at 179.

48. *Murphy v. Household Fin. Corp.*, 560 F.2d 206 (6th Cir. 1977).

49. *See Cumberland Glass Mfg. Co. v. DeWitt*, 237 U.S. 447 (1915) (effect of a confirmation in a composition proceeding is to reinvest the bankrupt with all his property, including rights of action, free from creditors' claims).

50. *Newton v. Beneficial Fin. Corp.*, 558 F.2d 731 (5th Cir. 1977). A discussion of the problems associated with the retention of causes of action by bankrupts appears in King, *Post-Bankruptcy Suits Against Proving Creditors on Claims Abandoned by the Trustee in Bankruptcy*, 37 N.Y.U. L. Rev. 250 (1962).

51. Reviewing the congressional hearings and studies which preceded enactment of the Truth in Lending Act, the Supreme Court has noted the connection between improper disclosure practices and the inability to meet financial obligations: "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 Publications Serv., Inc.*, 411 U.S. 356, 363 (1973) (footnote omitted).

lous creditors who bear the loss when bankruptcy eventuates. That allocation is possible only if the trustee acquires the right to sue on behalf of the estate. Thus, the result in *Murphy* seems fair. The way in which the court reached that result, however, presents difficulties.

The district court held that the Westbrooks' Truth-in-Lending action fell within each of the four forms of property which pass to the trustee pursuant to sections 70a(5) and 70a(6) of the Bankruptcy Act.⁵² Rather than exploring all four alternative grounds presented by the district court, however, the court of appeals based its decision solely on its finding that a Truth-in-Lending claim "is a right of action which the bankrupt 'could . . . have transferred' prior to bankruptcy within the meaning of § 70a(5)"⁵³

The appellate court accepted the parties' stipulation that "a cause of action is transferrable [*sic*] for Bankruptcy Act purposes if the action would 'survive' the death of the holder, but that actions for penalties . . . do not survive and thus are not transferable [*sic*]."⁵⁴ The court thus adopted a mode of analysis entirely dependent upon common law rules concerning the survival of actions. The court considered a Truth-in-Lending action to be one for "tortious interference with property," an action that would survive at common law.⁵⁵ Yet the court's inquiry did not end here; in addition, the action had to be construed as remedial

52. 424 F. Supp. at 179. In particular, the district court viewed the Truth-in-Lending action as a right of action which (1) the bankrupt "could by any means have transferred," 11 U.S.C. § 110 (a)(5) (1976); (2) "might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered," *id.*; (3) arose upon contract, *id.* § 110(a)(6); and (4) arose upon usury, *id.* See text accompanying notes 35-38 *supra*.

The characterization of a Truth-in-Lending claim in the alternative as an action which might have been levied upon and sold under judicial process against the bankrupt under § 70a(5) does not resolve the passage question, but merely repeats it, since only transferable causes of action are subject to judicial process. See *In re Schmelzer*, 350 F. Supp. 429 (S.D. Ohio 1972), *aff'd sub nom.* *Schmelzer v. Cesner*, 480 F.2d 1074 (6th Cir. 1973).

53. 560 F.2d at 208.

54. *Id.*

55. *Id.* The court of appeals thereby affirmed the district court's reliance on the *Porter* court's similar conclusion. 385 F. Supp. at 344. The *Porter* court stated that "[w]hen a federal statute is silent about survivability, it survives or not according to the principles of the common law." *Id.* at 343. That court thus adopted the common law rule of survivability that "tort actions for personal wrongs (*e.g.*, slander, libel and malicious prosecution) do not survive, while actions affecting property rights or monetary interests do survive." *Id.* at 344. *Porter* maintained that a Truth-in-Lending action was for a "tortious interference with property rights or monetary interests," and therefore, that it survived and was assignable at common law. *Id.*

rather than penal since under the common law penal actions do not survive.⁵⁶ This analysis poses problems because a Truth-in-Lending action has both remedial and penal aspects.

In drawing the necessary distinction between penal and remedial statutory schemes, the *Murphy* court employed a three-pronged test. First, the court considered "whether the purpose of the statute [is] to redress individual wrongs" and thus remedy an isolated, particular injury, or to rectify "more general wrongs to the public" and thereby impose a penalty on the wrongdoer for the benefit of the public.⁵⁷ The court concluded that the wrong addressed by the Truth in Lending Act is "primarily a wrong to the individual" and that a Truth-in-Lending action is thus intended to serve as a remedy rather than a penalty.⁵⁸

This conclusion, however, belies the factual context in which Truth-in-Lending actions arise and overlooks the purpose of the Act. The "wrong" frequently has wide ramifications. Institutions which extend credit to consumers do not draft completely new contracts for each individual loan transaction; rather, mass-printed forms are used.⁵⁹ Copies of the same defective disclosure statement may be given to a large number of borrowers.⁶⁰ Even when a single borrower is furnished with an illegible or incorrectly completed disclosure statement, the misrepresentation of credit terms may have prevented that borrower from purchasing less expensive credit from a competing lender. Enforcement of the Truth in Lending Act induces lenders to print and complete their forms in accordance with the disclosure requirements of the Act. In this way, the Act benefits the public—including both borrowers and lenders—by facilitating the selection of the most favorable credit terms.

The language of the statute itself evinces a congressional purpose to serve interests of the widest public concern. Section 1601 states:⁶¹

The Congress finds that economic stabilization would be

56. 560 F.2d at 208, 210.

57. *Id.* at 209. See also *Porter v. Household Fin. Corp.*, 385 F. Supp. 336, 341 (S.D. Ohio 1974).

58. 560 F.2d at 210.

59. For a collection of sample loan contracts with suggested forms for disclosure statements, see 1 R. CLONTZ, *supra* note 24, ¶ 7.03, at 7-14 to 93 (4th ed. 1976).

60. The Act recognizes the class action as an effective device for enforcement and redress when a single violation results in numerous borrowers' receiving insufficient information concerning credit terms. See 15 U.S.C. § 1640(a)(2)(B) (1976).

61. *Id.* § 1601(a).

enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. 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.

Congress determined that uninformed borrowing has wide impact. By failing to disclose credit costs accurately, lenders hinder comparison shopping, thus inhibiting competition and harming the national economy. Broader legislative concerns can hardly be imagined. In short, the line separating conduct which harms only a few individuals from conduct which harms society as a whole is often imprecise. Consequently, determining whether a cause of action is remedial or penal by looking to the number of people affected by a single wrong is inappropriate when commercial practices and consumer-oriented legislation are involved.

The second element of the *Murphy* court's test of whether a cause of action provides a remedy (and thus survives) or imposes a penalty (and thus does not survive) is "whether recovery under the statute runs to the harmed individual or to the public."⁶² The distinction drawn here is not especially discriminating; obviously the recovery in *any* successful civil action goes to the plaintiff. Nonetheless, in order to maintain its thesis that the Truth-in-Lending action is not penal and for that reason passes to the trustee, the court had to emphasize that in the instant case no criminal fines were imposed for the benefit of the public coffers.⁶³

Finally, the court looked to "whether the recovery authorized by the statute is wholly disproportionate to the harm suffered."⁶⁴ The court concluded that "[t]he cause of action is not made penal by the fact that the statute allows cumulative recoveries. . . ."⁶⁵

62. 560 F.2d at 209. The question posed by this element of the test is loaded: it assumes that unacceptable credit practices harm only the individual plaintiff.

63. *Id.* at 210.

64. *Id.* at 209.

65. *Id.* at 210. Although the *Murphy* court recognized that the cumulative recovery provisions were designed to encourage private enforcement of the Act, *id.*, both *Murphy* and *Porter* assumed the view that Truth-in-Lending liability is primarily compensatory. In *Porter*, the trustee asserted that the annual percentage rate of interest on the bankrupt's loan was misstated, in violation of § 1605(b) of the Act, because the lender had not included mandatory credit life insurance charges as interest when computing the annual percentage interest rate. 385 F. Supp. at 342. The *Murphy* court adopted the reasoning of *Porter*:

A review of the operation of the Act indicates, however, that the effect of its enforcement may in fact be as punitive as it is remedial or compensatory. The Act allows for recovery in excess of any pecuniary loss of the plaintiff.⁶⁶ A plaintiff may recover not only his actual damages, but also twice the amount of his finance charge, plus costs and attorney's fees.⁶⁷ Numerous cases have involved awards of attorney's fees in excess of \$10,000.⁶⁸ A borrower furnished with inadequate disclosure material may recover even though no finance charge was imposed in the credit transaction.⁶⁹ Furthermore, an aggrieved debtor may recover even if he suffered no actual damages as a result of the nondisclosure.⁷⁰ And courts frequently have given borrowers rescission and damage awards concurrently.⁷¹ Results such as these, which clearly do more than make the borrower whole, strongly suggest a punitive purpose whose ultimate end is deterrence: civil liability is provided to encourage private enforcement by consumers to deter unacceptable credit practices.⁷²

If the allegations are true, the debtor's monetary interests were adversely affected in that the cost of credit was greater than represented. The misrepresentation of the cost of credit may have prevented the debtor from obtaining cheaper credit after comparison shopping. The debtor's actual damages are difficult to ascertain. Nonetheless, the creditor has injured the debtor in his monetary interests by misrepresenting the cost of credit. And the Truth-in-Lending Act avoids the difficulty in calculating damages by providing for liquidated damages of twice the amount of the finance charge.

385 F. Supp. at 342 (footnote omitted), *quoted in* Murphy v. Household Fin. Corp., 560 F.2d 206, 210 (6th Cir. 1977). *See also* Bostwick v. Cohen, 319 F. Supp. 875 (N.D. Ohio 1970).

66. In addition to recovery for "any actual damage sustained . . . as a result of [information] failure," Truth-in-Lending plaintiffs may recover "twice the amount of any finance charge in connection with the transaction" with minimum and maximum recoveries of \$100 and \$1,000. 15 U.S.C. § 1640(a) (1976).

67. *Id.*

68. *See, e.g.,* Baker v. Shaker Sav. Ass'n, 5 CONS. CRED. GUIDE (CCH) ¶ 98,794 (N.D. Ohio 1974) (\$1000 damages, \$18,537.53 attorney's fees); Welmaker v. W.T. Grant Co., 365 F. Supp. 531 (N.D. Ga. 1972) (nominal damages, \$17,500 attorney's fees); Ratner v. Chemical Bank N.Y. Trust Co., 329 F. Supp. 270 (S.D.N.Y. 1971) (\$100 damages, \$20,000 attorney's fees).

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

70. In Ratner v. Chemical Bank N.Y. Trust Co., 329 F. Supp. 270 (S.D.N.Y. 1971), the court said, "[Congress] invited people like the present plaintiff, *whether they were themselves deceived or not*, to sue in the public interest." *Id.* at 280 (emphasis added).

71. Sellers v. Wollman, 510 F.2d 119 (5th Cir. 1975); Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974). *Contra*, Bostwick v. Cohen, 319 F. Supp. 875 (N.D. Ohio 1970). For discussions of this conflict, see Note, *Truth in Lending 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).

72. *See* Ratner v. Chemical Bank N.Y. Trust Co., 329 F. Supp. 270, 280 (S.D.N.Y.

As the foregoing suggests, pigeonholing Truth-in-Lending liability as either a penalty for a public wrong or a remedy for a private wrong is a futile, inconclusive endeavor. If liability is imposed for improper lending practices, not only is the plaintiff compensated by the remedy provided, but also consumers as a whole benefit from the deterrent effect of that remedy. The *Murphy* court recognized this duality: "The Truth in Lending Act ultimately serves the dual purpose of providing a remedy for harm to the monetary interests of individuals while serving to deter undesirable lending practices."⁷³ Indeed, the court noted the broad, societal goals of the Act to enhance "economic stabilization" and to strengthen "competition among . . . financial institutions."⁷⁴ Yet, having adopted the survival-of-actions rationale as the justification for the clearly desirable result of allowing the trustee to recover for the estate, the court was forced to engage in an attenuated labeling process. The chameleon-like nature of the labels makes the remedy-penalty dichotomy a precarious ground on which to base the passage to the trustee of the right to sue. It makes more sense to acknowledge the actual nature of the Act as being both penal and remedial than to dichotomize its purposes as primarily one or the other.

Evaluation of a Truth-in-Lending action in the context of whether it "survives" the "death" of the bankrupt unnecessarily complicates the issue of whether the cause of action passes to the bankrupt's trustee. The policies underlying the survival-of-actions rule were not formulated with reference to bankruptcy law and do not conform to the debtor-creditor context.⁷⁵ The fiction that the

1971). Only by emphasizing the penal, deterrent objectives of the Act can the instances observed in the text be justified. Those results would be unlikely under the *Murphy* view of Truth-in-Lending liability as being primarily remedial and compensatory.

73. 560 F.2d at 211.

74. *Id.* at 209.

75. See J. MACLACHLAN, *supra* note 5, at 171. Although their precise origin is obscure, the survival rules seem to have developed from the conceptual intermingling of tort compensation with the crown's administration of criminal punishment in the early common law. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 898 (4th ed. 1971). If a defendant were convicted of a crime of homicide, the crown would execute him and confiscate all his property. No assets remained to compensate the victim's family in a tort action. And if the plaintiff died, he could not be made "whole" again, and his cause of action was deemed to have died with him. *Id.*

The survival of personal tort actions has also been limited for fear of creating a market in lawsuits and encouraging needless litigation. Thus the ancient sanctions against champerty, maintenance, and barratry limited the transferability of such actions. See J. MACLACHLAN, *supra* note 5, at 171. Today, in the bankruptcy situation, the passage of a bankrupt's personal injury action is looked upon with disfavor as an encouragement of a

bankrupt has "died" with respect to his causes of action is misleading. After all, the bankrupt still breathes. If his cause of action is deemed not to have "survived" his "death" in bankruptcy court, the result is simply that the trustee does not acquire it as part of the estate. After his discharge the former debtor may sue with renewed vitality and, if successful, may retain the proceeds free from the claims of the former creditors.⁷⁶

In that light, the court of appeals' conclusion in *Murphy* that the trustee has standing to pursue a bankrupt's Truth-in-Lending action is correct. But employing the survival-of-actions rationale to achieve this result seems an artificial mode of analysis. Once a court determines, as did the *Murphy* court, that the common law rules relating to the survival of actions provide the only touchstone for passage of Truth-in-Lending actions to the trustee, the deterrent, punitive aspects of the statutory liability must be dismissed in order to permit the trustee to recover for the estate. And the real difficulty with the characterization of Truth-in-Lending actions as "not penal" is that it seriously impedes the satisfactory resolution of those Truth-in-Lending problems in which a recognition of the Act's punitive aspects is crucial. One such problem in the bankruptcy context is that of set-off.

II. SET-OFF IN BANKRUPTCY

In consumer bankruptcy cases, set-off takes on an unusual significance. Special problems arise when the lender who has furnished insufficient information in a credit transaction is also a creditor with a claim against the estate. If the bankruptcy court allows set-off, the creditor merely reduces his claim against the bankrupt's estate by the amount of the judgment against him. When that occurs, the creditor's liability on the Truth-in-Lending claim is effectively vitiated by a simple exercise of arithmetic.

For example, if the bankrupt owed a creditor \$2,500, and the trustee recovered maximum damages of \$1,000 from that creditor for violations of the Truth in Lending Act, the creditor's claim after set-off would be \$1,500. Since in most personal bankruptcies no assets remain after exemptions for distribution to general cred-

market "in the pain and suffering of unfortunate persons. . . ." *In re Schmelzer*, 350 F. Supp. 429, 437 (S.D. Ohio 1972), *aff'd sub nom.* *Schmelzer v. Cesner*, 480 F.2d 1074 (6th Cir. 1973). This view is inappropriate, however, when the cause of action is based on a purely commercial transaction. Therefore, it should present no obstacle in analyzing the passage of a Truth-in-Lending action to the trustee.

76. *Newton v. Beneficial Fin. Co.*, 558 F.2d 731 (5th Cir. 1977).

itors,⁷⁷ the violating creditor would receive nothing, regardless of whether the amount of his claim against the bankrupt estate was \$1,500 or the full \$2,500. The Truth-in-Lending liability is simply swallowed up: the bankrupt's debt absorbs it. When that debt is discharged in bankruptcy, the Truth-in-Lending liability will disappear. Because of the operation of set-off, the creditor is never made to satisfy the Truth-in-Lending judgment.⁷⁸

If, on the other hand, the court did not permit set-off, the violating creditor's net loss in the present example would be \$3,500. In addition to the discharge of the \$2,500 outstanding on the loan, the creditor would have to pay the estate \$1,000 in satisfaction of the Truth-in-Lending judgment. The other creditors would receive pro rata shares⁷⁹ of this additional amount. The loss suffered by the violating creditor over and above the bad debt loss would provide an incentive to comply with the Act.⁸⁰

It is evident that permitting the set-off of Truth-in-Lending liability against a worthless debt would frustrate the deterrent purposes of the Act and render litigation of the Truth-in-Lending claim a futile performance. However, no language in the Bankruptcy Act limits the operation of set-off. Section 68 of the Act simply provides: "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."⁸¹ This would appear to allow set-off in every case involving mutual claims between the bankrupt and one of the creditors.⁸² Disallowing set-off when the

77. J. MACLACHLAN, *supra* note 5, at 15. In addition to the exemption allowances, priorities, such as administrative expenses and tax liabilities, contribute to this result. *Id.*; see 11 U.S.C. § 104(a) (1976). See also Countryman, *The Bankruptcy Boom*, 77 HARV. L. REV. 1452 (1964):

"No asset" cases, in which there is nothing for administrative expenses after the allowance of the debtor's exemptions, account for three-quarters of the straight bankruptcy cases terminated other than by dismissal. "Nominal asset" cases, in which there is something for administrative expenses but nothing for creditors, constitute another 12%. Thus, only 13% of the straight bankruptcy cases are "asset" cases in which there is something for creditors.

Id. at 1453 (footnote omitted).

78. Even if some assets do remain—after exemptions and priorities are taken out—for distribution to general creditors, allowing the violating creditor to set off his Truth-in-Lending liability against his claim in the estate would only reduce his pro rata share of the estate, a share which is likely to be insignificant in any event.

79. 11 U.S.C. § 105 (1976).

80. Occasionally, an award of sizable attorney's fees to the trustee imposes a significant burden upon the violating creditor. See note 68 *supra*.

81. 11 U.S.C. § 108(a) (1976).

82. Recently, courts have practically disregarded the requirement in § 68 of mutuality

bankrupt and the creditor have mutual debts would impose a punishment on the creditor, adding insult to the injury of the bad debt loss he has already suffered. Indeed, it is to further the penal objectives of certain kinds of liabilities that courts occasionally read section 68 narrowly and disallow set-off, in spite of the apparently mandatory statutory requirement to the contrary.⁸³

Recognition of the punitive, deterrent aspects of liability is the *sine qua non* of denying set-off. However, the *Murphy* court's conclusion that a Truth-in-Lending claim by nature is not penal will lead to a critical impasse when the set-off issue arises. Had that issue been pressed in *Murphy*, the court would have had to allow set-off to be consistent with its assertion that the claim is not penal.

Newton v. Beneficial Finance Co.,⁸⁴ a case from the Fifth Circuit decided almost contemporaneously with the Sixth Circuit's *Murphy*, illustrates the conflicting conceptions of Truth-in-Lending liability among the circuits. In *Newton*, Beneficial Finance

between the respective claims of the estate and the creditor. *See, e.g.*, *Diplomat Elec., Inc. v. Westinghouse Elec. Supply Co.*, 499 F.2d 342 (5th Cir. 1974) (allowing set-off of creditor's liability to bankrupt for defamation against bankrupt's contractual liability to creditor). History suggests, however, that the mutuality requirement might not be met in every case. *See, e.g.*, *In re Becker Bros.*, 139 F. 366 (M.D. Pa. 1905) (only claims arising from the same transaction can be "mutual debts" or "mutual credits"). *See also* *Texas Tool Traders v. W.E. Grace Mfg. Co.*, 488 S.W.2d 498 (Tex. Ct. App. 1972) (set-off of creditor's liability for charging usurious interest denied because such liability is not a "mutual debt" owed to the estate).

83. *E.g.*, *McCullum v. Hamilton Nat'l Bank*, 303 U.S. 245 (1938); *Newton v. Beneficial Fin. Co.*, 558 F.2d 731 (5th Cir. 1977); *Texas Tool Traders v. W.E. Grace Mfg. Co.*, 488 S.W.2d 498 (Tex. Ct. App. 1972). The right of set-off is based on equitable principles, 4A W. COLLIER, COLLIER ON BANKRUPTCY ¶ 68.02, at 851-52 (14th ed. 1978), and despite the mandatory language of § 68 of the Bankruptcy Act, the courts have considered the application of set-off in bankruptcy to be a discretionary matter. *See Cumberland Glass Mfg. Co. v. DeWitt*, 237 U.S. 447, 455 (1915), where the Court stated: "The provision is permissive rather than mandatory, and does not enlarge the doctrine of set-off, and cannot be invoked in cases where the general principles of set-off would not justify it."

The Bankruptcy Reform Act of 1978 should not significantly change the current practice regarding set-off. The new Act provides:

[T]his title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case

Bankruptcy Reform Act, *supra* note 12, § 101 (to be codified in 11 U.S.C. § 553(a)). The new language clarifies the permissive, discretionary nature of set-off; the "general principles" espoused in *Cumberland Glass*, 237 U.S. at 455, should continue to govern its application. Therefore, it will still be necessary in practice under the new Bankruptcy Act to emphasize the penal objectives of the Truth in Lending Act—rather than its remedial aspects—in order to preclude set-off.

84. 558 F.2d 731 (5th Cir. 1977).

had loaned Newton \$672. When Newton filed his petition in bankruptcy, \$612 was outstanding on the loan.⁸⁵ Newton listed the money owed to Beneficial on his schedule of debts and listed a Truth-in-Lending claim against Beneficial Finance as an asset of his estate. The trustee abandoned the claim and it reverted to the bankrupt, thus precluding litigation over its transferability.⁸⁶ The debt owed to Beneficial Finance was included in Newton's discharge in bankruptcy.

Later, in a separate action, Newton personally brought suit against Beneficial Finance in federal district court alleging violations of the Truth in Lending Act. He recovered under the civil liability section of the Act.⁸⁷ Beneficial Finance appealed, arguing that the underlying debt on the loan contract should have been used to offset the Truth-in-Lending judgment instead of being fully discharged. The Fifth Circuit disagreed. The court of appeals reasoned that the punitive purpose of the Truth in Lending Act precludes the use of set-off to decrease the amount of a debt discharged.⁸⁸

Since *Newton* involved a postbankruptcy suit, the Fifth Circuit could have avoided the remedy-penalty discussion by resorting to the rule that a debt discharged in bankruptcy may not be revived to offset a judgment recovered by the bankrupt in a subsequent suit against a former creditor.⁸⁹ Instead, the court focused on the penal nature of Truth-in-Lending liability and emphasized that the Act's deterrent objective would not otherwise be effectuated in bankruptcy. This raises the question how a trustee can acquire the right to bring a Truth-in-Lending action in a jurisdiction that follows the *Newton* court's conception of the action as penal since only remedial actions may pass to the trustee. The correlative question also arises: How can set-off be avoided in a jurisdiction following *Murphy* or *Porter* since only penal judgments escape set-off? Resolution of this dilemma necessitates the development

85. *Id.* at 731-32.

86. *Id.* at 732. For a discussion of abandonment of property by the trustee, see 4A W. COLLIER, *supra* note 83, ¶ 70.42[3], at 504-12; J. MACLACHLAN, *supra* note 5, at 119-20.

87. 15 U.S.C. § 1640(a) (1976).

88. 558 F.2d at 732.

89. See *Cumberland Glass Mfg. Co. v. DeWitt*, 237 U.S. 447 (1915). The *Newton* court perceived no significance in the fact that the case involved a postbankruptcy suit. The reasoning in *Newton* would therefore operate to preclude set-off respecting Truth-in-Lending actions brought by the trustee during the pendency of the bankruptcy case. Cf. *Texas Tool Traders v. W.E. Grace Mfg. Co.*, 488 S.W.2d 498 (Tex. Ct. App. 1972) ("disciplinary nature" of penalty for charging usurious interest precludes its characterization as a "mutual debt" within Bankruptcy Act § 68 (relating to set-off)).

of an alternative rationale for the passage issue. The solution proposed in this Note is based upon an analogy between usury laws and the Truth in Lending Act.

III. THE TRUTH IN LENDING ACT AND USURY

Newton relied principally on a 1938 Supreme Court case, *McCullum v. Hamilton National Bank*.⁹⁰ There the Court disallowed the setting-off of a judgment won by the trustee in bankruptcy in a usury action brought against one of the claiming creditors. *McCullum* should be controlling on the issue of set-off of Truth-in-Lending liability.

In *McCullum*, a trustee in bankruptcy sued a creditor to recover the statutory penalty for the charging of usurious interest.⁹¹ The creditor prevailed on his assertions that the trustee's usury claim was subject to set-off and that it should be applied as a credit upon the underlying debt, thus merely reducing the creditor's claim against the estate.⁹² The Supreme Court reversed. The crux of Justice Butler's opinion for a unanimous Court highlighted the deterrent purpose and the penal nature of the usury action:

To allow respondent to satisfy the judgment for penalty by mere deduction from its claim against the bankrupt's estate is to detract from the punishment definitely prescribed. The sentence specifically required by the law may not be cut down by implication, set-off or construction; for that would narrow the statute and tend to defeat its purpose.

. . . .

. . . Liability for the penalty does not arise in contract but is laid *in invitum* as a disciplinary measure.

. . . It follows that respondent is not entitled to satisfy petitioner's judgment by deducting the amount of it from respondent's claim against the bankrupt's estate.⁹³

This statement obviously conflicts with the *Murphy* court's insistence that the Truth in Lending Act "is not the sort of statutory

90. 303 U.S. 245 (1938).

91. The trustee in *McCullum* acquired the right to sue pursuant to the usury statute. The statute provided that in case of violations "the person by whom [the excessive interest] has been paid, or his legal representatives, may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid. . . ." 303 U.S. at 246 n.2 (emphasis added) (current version at 12 U.S.C. § 86 (1976)). *McCullum* was litigated before the Bankruptcy Act was amended in 1938 to provide expressly for the passage of usury actions to the trustee.

92. 303 U.S. at 246.

93. *Id.* at 248-49.

scheme properly characterized as penal.”⁹⁴ Although the *Murphy* court was not faced with the problem of set-off, it would have been inconsistent for it to have adopted the reasoning of *McCollum* as authority for denying set-off after allowing a trustee to bring the action on the ground that it is not penal.⁹⁵

It is possible to avoid this morass by looking to section 70a(6) of the Bankruptcy Act instead of section 70a(5). Section 70a(6) provides that the trustee succeeds to all the bankrupt’s “rights of action arising upon contracts, or usury”⁹⁶ A court could determine that a Truth-in-Lending action passes to a trustee in bankruptcy on the basis of this section alone and ignore the entanglements engendered by the transferability requirement of section 70a(5).

Of course, usury and liability under the Truth in Lending Act are not identical. The Act does not place an express ceiling on lawful interest rates as do the usury statutes.⁹⁷ Some analogizing is necessary, and not all courts have been willing to draw the analogy. When the court of appeals affirmed the district court’s decision in *Murphy*, for example, it declined to accept the lower court’s finding that a Truth-in-Lending action passes to the trustee as a usury action would.⁹⁸ Instead, it limited its discussion to the survivability of actions at common law in order to meet the requisites of section 70a(5). Similarly, in *Porter*, the court suggested that a Truth-in-Lending cause of action “may well” pass to the trustee under section 70a(6), but rested its holding solely on the

94. *Murphy v. Household Fin. Corp.*, 560 F.2d 206, 211 (5th Cir. 1977).

95. Of course a court could respond that liability such as that created by the Truth in Lending Act is penal for some purposes and remedial for others. See *Derdiarian v. Futterman Corp.*, 223 F. Supp. 265, 271 (S.D.N.Y. 1963), quoted in *Porter v. Household Fin. Corp.*, 385 F. Supp. 336, 342 n.7 (S.D. Ohio 1974): “The use of labels such as ‘penal’ or ‘remedial’ is, of course, unsatisfactory unless it is recognized as a shorthand way of expressing relevant considerations.” Within the context of a single decision, however, the remedy-penalty debate produces either inconsistent reasoning or unsatisfactory results.

96. 11 U.S.C. § 110(a)(6) (1976). For discussions of the passage of a bankrupt’s usury action to the trustee, see 4A W. COLLIER, *supra* note 83, ¶ 70.28[7], at 414; Krause, *The Treatment of Usury in Bankruptcy Proceedings*, 29 N.Y.U. L. REV. 1083 (1954).

A Truth-in-Lending action is not sufficiently similar to a contract action to justify passage on that ground under § 70a(6). It is true that liability may arise from the most important terms of the loan contract—the finance charge and the annual percentage rate of interest. See 15 U.S.C. §§1605, 1606 (1976); 12 C.F.R. §§226.4, .5 (1977). Nevertheless, the theoretical underpinnings of the statutory liability clearly rest upon information failure and nondisclosure and not upon the existence or breach of the contract. See *Sellers v. Wollman*, 510 F.2d 119, 122 (5th Cir. 1975); 1 R. CLONTZ, *supra* note 24, ¶ 3.10 [9][a], at 3-218.

97. See 45 AM. JUR. 2d *Interest and Usury* §314 (1969); Tanner, *Truth in Lending and Regulation—A Primer*, 6 GA. ST. B.J. 19 (1969).

98. 560 F.2d at 208.

demands of section 70a(5).⁹⁹

One court, however, has wholeheartedly adopted the usury rationale. *Liberty Loan Corp. v. Boyajian (In re Dunne)*¹⁰⁰ held that the right to prosecute a bankrupt's Truth-in-Lending action passes to the trustee "under the plain language of [section 70a(6)]," that is, as a "right of action arising upon. . . usury."¹⁰¹ By avoiding the penalty-remedy discussion, *Dunne* did not complicate the set-off issue. The punitive aspects of Truth-in-Lending actions remain uncompromised for the purpose of preventing set-off, yet are properly deemed irrelevant in determining the trustee's right to sue. *Dunne*, however, does not explore the usury analogy. It is worth discussing.

The purposes of the Truth in Lending Act and usury statutes are identical: the protection of debtors from overreaching by creditors. Both provide sanctions against unacceptable practices associated with the extension of credit while leaving the underlying loan (without regard to credit charges or interest rates) untouched. Both impose liability based on multiples of the finance charge or interest rate.¹⁰² Both include criminal sanctions,¹⁰³ yet encourage private enforcement by allowing recoveries which far exceed actual damages.

It is arguable that widespread compliance with the Truth in Lending Act can actually prevent the imposition of excessive interest rates. The Act requires "a meaningful disclosure of credit terms" so that potential borrowers will be able to compare the terms offered by several lenders and thereby avoid the uninformed purchase of credit.¹⁰⁴ Congress acted on the assumptions that borrowers will shop for "the best terms available"¹⁰⁵ and that informed borrowers will be less likely to assume liabilities they cannot meet than those who are ignorant of the true costs of their loans.¹⁰⁶ Consequently, as Congress concluded, "the competition

99. 385 F. Supp. at 344.

100. 407 F. Supp. 308 (D.R.I. 1976).

101. *Id.* at 310.

102. Compare 12 U.S.C. § 86 (1976), providing for recovery of twice the amount of the interest charged from national banks charging usurious interest with 15 U.S.C. § 1640(a)(2)(A)(i) (1976), allowing Truth-in-Lending plaintiffs twice the amount of the finance charge.

103. 15 U.S.C. § 1611 (1976) (criminal liability under Truth in Lending Act for willful and knowing violation); 45 AM. JUR. 2d *Interest and Usury* § 357 (1969) (a collection of cases which hold that usury is punishable by statute as a crime).

104. 15 U.S.C. § 1601 (1976).

105. *Mourning v. Family Publications Serv. Inc.*, 411 U.S. 356, 363 (1973).

106. *See id.*

among the various financial institutions . . . engaged in the extension of consumer credit [will] be strengthened. . . ."¹⁰⁷ This is because, other factors being equal, informed borrowers will patronize lenders offering the lowest credit rates, forcing other lenders to lower their rates or lose business.¹⁰⁸ Thus, by discouraging excessive interest rates, the Truth in Lending Act indirectly accomplishes the same objective as the usury laws; yet it does so without jeopardizing the availability of credit to high-risk borrowers.

Support for the view that Truth-in-Lending actions may pass to the trustee because they are similar to usury actions is also found in the history of the Bankruptcy Act. As originally enacted in 1898, section 70a(6) did not refer to usury actions.¹⁰⁹ It was amended to include a specific reference to usury when the Bankruptcy Act was overhauled by the Chandler Act in 1938.¹¹⁰ The reasons underlying the 1938 amendment to section 70a(6) strongly suggest that Truth-in-Lending actions should be included within the scope of that section.

There is a remarkable historical parallel between the early cases involving usury in bankruptcy and the current developments concerning Truth-in-Lending actions in the bankruptcy context. Before the amendment, there was considerable doubt whether actions for usury could vest in the trustee in bankruptcy.¹¹¹ The conflict focused on the question whether liability for usury was

107. 15 U.S.C. § 1601(a) (1976).

108. Of course, the risk of lending to a particular borrower influences the cost of credit in particular transactions. It is questionable whether those consumers who go bankrupt are, as a class, high-risk borrowers. The Commission on the Bankruptcy Laws of the United States found that:

While a significant number of consumer debtors may have squandered limited earnings on extravagances, most studies of nonbusiness bankrupts show that debts incurred were for necessities or near-necessities for family living. A fair picture of consumer bankrupts appears to be one of living close to the edge, *i.e.*, of personal economies in which all earnings must be devoted to immediate needs and the payment of installment debts, without savings or uncommitted income reserved for the contingencies of health expenses not covered by insurance, of reductions in income through loss of overtime or a second job, or of the added expenses of household disruption through divorce, separation, or other family strife.

REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, Pt. 1, 93d Cong., 1st Sess. 55 (1973). In any event, market pressures should reduce credit costs for informed borrowers presenting similar lending risks.

109. See Bankruptcy Act, ch. 541, § 70(a)(6), 30 Stat. 566 (1898) (current version at 11 U.S.C. § 110(a)(6) (1976)).

110. Act of June 22, 1938, ch. 575, 52 Stat. 840.

111. See 4A W. COLLIER, *supra* note 83, ¶ 70.03, at 36 n.14.

penal or remedial,¹¹² thus foreshadowing the current discussion of Truth-in-Lending liability. Some courts regarded the statutory right of action based upon a usurious transaction as a purely personal right, that is, as a penalty enforceable only by the debtor.¹¹³ Others took the view that the right of action could pass to the trustee; these cases, however, involved usury statutes that expressly authorized recovery by the borrower's legal representatives.¹¹⁴ The widely-accepted common law rule was clear: absent a statutory provision to the contrary, the right to recover penalties such as those imposed by usury laws was not assignable or transferable.¹¹⁵

This conflict spurred congressional action in 1938. Section 70a(6) of the Bankruptcy Act, dealing with the scope of the trustee's title, was amended to include "rights of action arising upon . . . usury."¹¹⁶ Section 70c was amended to ensure that the trustee would have the benefit of "all defenses available to the bankrupt as against third persons, including . . . usury, and other personal defenses."¹¹⁷ The 1938 amendments thus evince a congressional intent to enlarge the group of bankrupts' rights that pass to the trustee. By analogy, it is reasonable to conclude that other rights of action arising from credit transactions should pass from the bankrupt to the trustee for the benefit of the estate.

When the 1938 amendments relating to usury were enacted, the sanctions against usury were the only means, short of equitable relief, of preventing the inequities that can result from the unequal distribution of bargaining power often present in consumer credit transactions. But the traditional conception of the term "usury" has become inadequate to describe the array of legislation enacted since 1938 to regulate consumer credit transactions. The Rules of Bankruptcy Procedure themselves recognize the inadequacy of the term and update its meaning. Consider how the Rules clarify section 656(b) of the Bankruptcy Act. Section 656(b)

112. See Annot., 82 A.L.R. 1008 (1933).

113. *E.g.*, *Lafountain v. Burlington Sav. Bank*, 56 Vt. 332 (1883); *Nichols & Bliss v. Bellows*, 22 Vt. 581 (1849).

114. *E.g.*, *Lasater v. First Nat'l Bank*, 96 Tex. 345, 72 S.W. 1057 (1903), *aff'd*, 196 U.S. 115 (1905) (usury statute). *McCollum v. Hamilton Nat'l Bank*, 303 U.S. 245 (1938), discussed at text accompanying notes 90-93 *supra*, involved such a provision, currently at 12 U.S.C. § 86 (1976) (authorizing recovery by borrowers' legal representatives of usurious interest from national banks).

115. See 36 AM. JUR. 2d *Forfeitures and Penalties* § 56 (1968).

116. Act of June 22, 1938, ch. 575, § 70a(6), 52 Stat. 880 (codified at 11 U.S.C. § 110(a)(6) (1976)).

117. *Id.* § 70c, 52 Stat. 881 (codified at 11 U.S.C. § 110(c) (1976)).

provides with respect to chapter XIII wage earners' plans:¹¹⁸ "Before confirming any such plan the court shall require proof from each creditor filing a claim that such claim is *free from usury* as defined by the laws of the place where the debt was contracted."¹¹⁹ When the Rules of Bankruptcy Procedure were adopted in 1973, rule 13-301 of the chapter XIII Rules, prescribing the content of the proof of claim required by section 656(b), modified the original terminology: "A proof of claim shall consist of a statement in writing setting forth a creditor's claim and setting forth facts showing that such claim is *free from any charge forbidden by applicable law*."¹²⁰ The Advisory Committee's Note to rule 13-301 explains: "The term 'charge forbidden' is substituted for 'usury' in order to take account of the varying terminology of small loan laws, retail installment sales laws, the Uniform Consumer Credit Code and the Federal Consumer Credit Protection Act."¹²¹ Thus, to the framers of the Rules, the term "usury" embraced more than simply the charging of excessive interest rates.

The courts have recognized that this expansive conception of usury includes Truth-in-Lending actions. Although the court in *Porter* did not rely heavily upon the similarity between the usury statutes and the Truth in Lending Act in concluding that the action passes to the trustee, the court commented that the Truth in Lending Act may be "but a sub-type of usury law."¹²² Yet so far only the *Dunne* court has concluded that the Truth in Lending Act and usury laws are of the "same genre,"¹²³ stating unequivocally that "[r]ights of action involving the [Truth in Lending Act] should pass to a trustee in the same way as do those involving usury."¹²⁴ The *Dunne* court acknowledged that it might agree with the bankruptcy judge's decision that the right to sue passes to the trustee under section 70a(5), but concluded that a "clearer case is made . . . under subdivision (6) of [that] section."¹²⁵

118. "Wage earners' plans" under chapter XIII of the Bankruptcy Act feature, instead of an outright discharge, a composition of debts, with creditors taking an amount smaller than the original liability, an extension of time for payment, or both. See Bankruptcy Act § 606(7), 11 U.S.C. § 1006(7) (1976).

119. 11 U.S.C. § 1056(b) (1976) (emphasis added).

120. R. BANKR. PROC. 13-301 (emphasis added).

121. The Truth in Lending Act is title I of the Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (codified at 15 U.S.C. §§ 1601-1692o 1976)).

122. *Porter v. Household Fin. Corp.*, 385 F. Supp. 336, 345 (S.D. Ohio 1974).

123. *Liberty Loan Corp. v. Boyajian (In re Dunne)*, 407 F. Supp. 308, 310 (D.R.I. 1976).

124. *Id.*

125. *Id.* See text accompanying note 116 *supra*.

Because of its straightforward approach, the *Dunne* decision stands as the most sound authority on the passage of Truth-in-Lending actions to trustees in bankruptcy. The court engaged in no attenuated discussion of whether a Truth-in-Lending claim is more accurately characterized as a remedy or a penalty. In a jurisdiction following the *Dunne* court's approach, the Truth in Lending Act's deterrent purposes may be more fully effected when it becomes necessary to confront the issue of set-off.

IV. CONCLUSION

The analogy between usury actions and Truth-in-Lending actions is not perfect. Yet it is sufficiently close to provide convincing justification for allowing trustees in bankruptcy the right to pursue bankrupts' Truth-in-Lending claims. Unfortunately, most courts still resort to antiquated and fictitious survival-of-actions principles to justify passing the right to sue to the trustee. The result in these cases is satisfactory since the trustee is in an opportune position to enforce consumer credit protection legislation. Yet such reasoning necessitates labeling the liability as exclusively remedial, thus dismissing its deterrent, punitive purposes and complicating the resolution of the problem of set-off in bankruptcy. Acknowledgment of the penal aspects of a Truth-in-Lending action is the sine qua non of disallowing set-off of a Truth-in-Lending judgment against a violating creditor's claim in the bankrupt's estate.

Bankruptcy and consumer-creditor protection legislation are bound to intersect, perhaps with greater frequency as such legislation broadens in scope.¹²⁶ Although no one wins in bankruptcy, its occurrence should not permit a Truth-in-Lending violator to escape civil liability by setting it off against a practically valueless claim in the estate. If the courts treat the Truth in Lending Act simply as a modern species of usury law, effective enforcement of its disclosure requirements may be more fully achieved.

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126. The most recent addition to the increasingly comprehensive Consumer Credit Protection Act is the Fair Debt Collection Practices Act, Pub. L. No. 95-109, 91 Stat. 874 (codified at 15 U.S.C.A. §§ 1692-1692o (Supp. 1978)).