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## TRUTH IN LENDING: *CAVEAT VIATOR*

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The Truth in Lending Act<sup>1</sup> was enacted in 1968 for the purpose of enabling wise consumer selection from various credit options<sup>2</sup> by compelling creditors to make "meaningful disclosures" prior to the time a consumer credit transaction is consummated.<sup>3</sup> In the past decade, that seemingly simple and clear statement of congressional intent has led to a regulatory and case law morass that has puzzled both consumers and creditors. Terms that should have been clear in order to put consumers and creditors on notice of their rights and duties have eluded definition. Litigants on both sides have demonstrated ingenuity in their attempts to gain victories for their side while skirting the spirit of the Act. Consequently, the courts have derided both sides for abusing the legislation.<sup>4</sup>

One recurring issue in litigation serves as a sample of some errors in enforcement. It revolves around an inadequate definition of the term "transaction"<sup>5</sup> when applied to consumer credit sales.<sup>6</sup> The facts of the reappearing complaint are these: a consumer selects an automobile to purchase, makes a downpayment (sometimes partial), and signs a bill of sale after which financing is procured for the balance. If the seller helps to arrange the financing, and does so on a regular basis, either accepting compensation for the service or having knowledge of

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1. Consumer Credit Protection Act, Subch. I, Consumer Credit Cost Disclosure, 15 U.S.C. §§ 1601-1667e (1976) [hereinafter referred to as the Act].

2. *Id.* § 1601(a). See text accompanying notes 19-33 *infra*.

3. *Id.* 12 C.F.R. §§ 226.1-226.2(kk), 226.8(a) (1979).

4. See, e.g., *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 889-90 (7th Cir. 1976) (Moore, J., dissenting); see generally *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356 (1973).

5. 12 C.F.R. §§ 226.2(kk), 226.8(a) (1979).

6. This article deals primarily with closed-end consumer credit sales which are governed by 15 U.S.C. § 1638 (1976) and with regulation Z, 12 C.F.R. § 226.8(a), (b), and (c) (1979). Closed-end consumer credit sales are distinguished from consumer loans governed by 15 U.S.C. § 1639 (1976), and from open-end credit plans, governed by 15 U.S.C. § 1637 (1976). Open-end credit plans are ones in "which credit terms are initially established with the opening of the account, but no fixed amount of debt is incurred at that time," *Goldman v. First Nat'l Bank*, 532 F.2d 10, 17 n.11 (7th Cir.), *cert. denied*, 429 U.S. 870 (1976), and include, *inter alia*, revolving charge accounts. 12 C.F.R. § 226.2(x) (1979).

credit terms and participating in preparation of credit extension documents,<sup>7</sup> and is thus a "creditor" under the Act,<sup>8</sup> the question is raised whether the disclosures required in section 1638(a)<sup>9</sup> and regulation Z<sup>10</sup> must be made prior to the time the purchase contract is signed or merely before the contract to finance is executed.

Section 1638(b) of the Act provides, with respect to consumer credit sales, that: "the disclosures required under subsection (a) of this section shall be made *before the credit is extended*. . . ."<sup>11</sup> At least one court has interpreted the Act literally and held that so long as disclosure was made prior to the consumer's commitment to the financing, regardless of the prior unconditional commitment to purchase, the creditor/seller has met with the requirements of the Act.<sup>12</sup>

Other courts have held that the disclosure requirement is triggered by an irrevocable sales contract, made in contemplation of the seller's assistance in securing financing.<sup>13</sup> These latter decisions appear to be predicated on an assumption, probably correct, that a commitment to purchase will coerce the consumer's acceptance of credit offered; the courts so holding construe the Act liberally in order to effectuate congressional intent.<sup>14</sup>

These contrasting holdings evidence ambiguity in regulation Z, equivocation in interpretative opinions issued by the Federal Reserve Board<sup>15</sup> and its staff, charged by Congress with carrying out the purpose of the Act,<sup>16</sup> and disagreement among courts as to the process of construing the statute and applying it to the facts before them. Thus, Congress' attempt to alter the doctrine of *caveat emptor* has ill-served those parties intended to benefit from the Act.

### LEGISLATIVE HISTORY AND INTENT

The Act's legislative history is significant, for courts have frequently resorted to legislative intent in order to determine the validity

7. These are elements of the definition of "creditor," which includes one who arranges credit, as provided in the Act, 15 U.S.C. § 1602(f) (1976) and in regulation Z. 12 C.F.R. § 226.2(h), (s) (1979).

8. 15 U.S.C. § 1602(f) (1976).

9. *Id.* § 1638(a).

10. 12 C.F.R. § 226.8(b), (c) (1979).

11. 15 U.S.C. § 1602(b) (1976) (emphasis added).

12. *Alvarez v. Galassi AMC-Jeep, Inc.*, No. 78C 3802, slip. op. at 14-15 (N.D. Ill. July 9, 1979).

13. *See, e.g., Gonzalez v. Schmerler Ford*, 397 F. Supp. 323 (N.D. Ill. 1975).

14. 15 U.S.C. § 1601(a) (1976). *See* text accompanying notes 19-30 *infra*.

15. *See* text accompanying notes 49-74 *infra*.

16. 15 U.S.C. § 1604 (1976); 12 C.F.R. § 222.1 (1979).

of regulations implementing the Act<sup>17</sup> or to make findings where there is no clear direction from the Act or regulations interpreting the legislation.<sup>18</sup>

The Act, pioneered by the late Senator Paul H. Douglas of Illinois, promised aid to victims of “unscrupulous,”<sup>19</sup> “predatory,”<sup>20</sup> and, “at times, fraudulent”<sup>21</sup> creditors.<sup>22</sup> The most obvious prey was the consumer, especially the relatively unsophisticated, and particularly those of modest means<sup>23</sup> who “remained remarkably ignorant of the nature of their credit obligations and the cost of deferring payment,”<sup>24</sup> who were the least equipped to evaluate credit proposals,<sup>25</sup> and who were most likely to assume liabilities they could not meet.<sup>26</sup>

Congress intended that, under the Act, the consumer would be armed with clear, sufficient, and readily comparable information in order to “shop” for the best credit deal available.<sup>27</sup> In addition, the legislation promised protection to the “honest businessman from unethical forms of competition”<sup>28</sup> and practices from which no one segment of the industry felt it could depart or unilaterally reform.<sup>29</sup> Finally, Congress noted that: “[e]conomic stabilization would be 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.”<sup>30</sup> With those needs in mind, Congress pro-

17. See, e.g., *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356 (1973).

18. See, e.g., *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323 (N.D. Ill. 1975); *Pastow v. Oriental Build. Ass'n*, 390 F. Supp. 1130, 1139 (D.D.C. 1975).

19. H.R. REP. NO. 1040, 90th Cong., 2d Sess. 1, 18, reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1975.

20. *Id.* at 20, reprinted in [1968] U.S. CODE CONG. & AD. NEWS at 1977.

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

22. Testimony before congressional subcommittees evidenced that the credit industry had grown at a rate four and one-half times that of the economy, with automobile purchase paper the largest single element, and that the industry was continuing to expand at an extremely rapid rate. *Id.*

23. H.R. REP. NO. 1040, 90th Cong., 2d Sess. 1, 18, reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1975.

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

25. H.R. REP. NO. 1040, 90th Cong., 2d Sess. 1, 108, reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1993.

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

27. H.R. REP. NO. 1040, 90th Cong., 2d Sess. 1, 106, reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1990. The House Committee on Banking and Currency noted, *inter alia*, the variety in computation and expression of “rate;” additional fees and charges, permitting a lower “rate” but a higher yield to creditors; and the disclosure of cost but not rate, or vice versa. *Id.* at 13, reprinted in [1968] U.S. CODE CONG. & AD. NEWS at 1970.

28. *Id.* at 18, reprinted in [1968] U.S. CODE CONG. & AD. NEWS at 1975.

29. *Id.* at 15, reprinted in [1968] U.S. CODE CONG. & AD. NEWS at 1970.

30. 15 U.S.C. § 1601(a) (1976). The late President Johnson heralded the legislation as one which “would strengthen the efficiency of our credit markets, without restraining them.” H.R.

vided mechanisms for uniform and meaningful disclosure—rather than for regulation of the industry<sup>31</sup>—and provided for civil<sup>32</sup> and criminal<sup>33</sup> penalties for violation of its proscriptions.

## REGULATION Z

The Act is broadly structured and grants extensive rule-making power to the Federal Reserve Board<sup>34</sup> “to deal not only with the myriad forms in which credit transactions [now occur] but also with those . . . devised in the future.”<sup>35</sup> Based on its judgment as informed by experience in the field,<sup>36</sup> the Board may define conforming and prohibited conduct with greater specificity than that outlined in the Act<sup>37</sup> in order to effectuate Congress’ purpose<sup>38</sup> and prevent circumvention of it through apparent technical compliance.<sup>39</sup> Pursuant to that power, the Board has published what is known as regulation Z,<sup>40</sup> the validity of which is tested by whether a rule is reasonably related to the purposes

REP. NO. 1040, 90th Cong., 2d Sess., 1, 6-10, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 1962, 1965. The committee noted that the Act “neither regulates the credit industry nor does it impose ceilings on credit charges. It provides for full disclosure of credit charges, rather than regulation of the terms and conditions under which credit may be extended.” *Id.* at 6-10, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS at 1962-65.

A United States Department of Treasury official, testifying before a Senate subcommittee considering the legislation, said that the “blind economic activity” of uninformed consumers seeking credit was “inconsistent with the efficient functioning of a free economic system such as ours, whose ability to provide desired material at the lowest cost is dependent on the asserted preferences and informed choices of consumers.” *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 363-64 (1973) (paraphrasing the remarks of Under Secretary Joseph Barr).

31. *See* text accompanying note 30 *supra*.

32. 15 U.S.C. § 1640(a) (1976) provides in the case of an individual action that a creditor in violation of the Act may be liable to a consumer for a sum of twice the amount of the finance charge, but not less than \$100 nor more than \$1,000, together with costs of the action and reasonable attorney’s fees. *Id.* §§ 1640(a)(2)(A)(i), 1640(a)(3).

33. *Id.* Section 1611 provides for a fine of \$5,000, imprisonment for not more than one year, or both, for a willful and knowing violation.

34. *Id.* § 1604 provides:

The Board shall prescribe regulations to carry out the purposes of this subchapter. These regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

*Id.*

35. *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 365 (1973).

36. *Id.* at 372.

37. *Id.* at 371-73. *See also* McGowan v. King, Inc., 569 F.2d 845, 849 (5th Cir. 1978) (referring to the *Mourning* decision).

38. *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 369 (1973).

39. *Id.* at 365.

40. 12 C.F.R. §§ 226.1, 226.1503 (1979).

of the enabling legislation.<sup>41</sup>

Section 226.2(t) of regulation Z<sup>42</sup> defines a credit sale<sup>43</sup> as “any sale with respect to which consumer credit is extended or arranged by the seller.” Section 226.8(a) of regulation Z requires that disclosures be made “before the transaction is consummated” and section 226.2(kk)<sup>44</sup> provides that: “A transaction shall be considered consummated at the time a contractual relationship is created between a creditor and a customer . . . irrespective of the time of performance of either party.”<sup>45</sup>

In the fact situation referred to above, two contracts or “transactions” exist, one for sale and the other for financing. With the execution of the first one, a purchase is made and the seller/arranger initiates attempts to find financing for the purchaser. By execution of the second, credit is in fact extended to the consumer.

The problem is determining which “transaction” triggers the disclosure requirement. Both fit the broad language of section 226.2(kk), since both are contractual relationships between a creditor<sup>46</sup> and a customer. One interpretive source is the Act itself, and the language of section 1638(b) would indicate that the transaction which constitutes the extension<sup>47</sup> of credit requires prior disclosure of its terms.<sup>48</sup>

#### FEDERAL RESERVE BOARD STAFF OPINIONS

A second source for interpretation is opinions of the Federal Reserve Board and its staff. Section 226.1(d) of regulation Z<sup>49</sup> provides

41. *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 369 (1973). See *Garner & North Roofing & Siding Corp. v. Board of Governors*, 464 F.2d 838, 842 (D.C. Cir. 1972).

42. 12 C.F.R. § 226.2(t) (1979) which follows the language of 15 U.S.C. § 1602(g) (1976).

43. See text accompanying note 6 *supra*.

44. Formerly 12 C.F.R. § 226.2(cc) and so designated in early cases and Board letters.

45. 12 C.F.R. § 226.2(kk) (1979).

46. The fact situation implicitly includes two “creditors,” for the terms as defined in the Act and regulation Z encompasses both sellers who “arrange” credit and others, sometimes sellers, who “extend” it. See note 7 and accompanying text *supra*.

47. Regulation Z does not define “extension” of credit; because several sections distinguish between “extend” and “arrange,” it would appear that the Board considers them separate acts and considers those who do them separate actors. See, *e.g.*, notes 7 and 46 and accompanying text *supra*.

48. In some variations of the fact situation, the first “transaction” may be found to be an extension of credit as well as a sale because the circumstances indicate that the seller offered, and the buyer accepted, the future extension of credit to be arranged, conditioned only on its availability from a lender. The court in *Coto v. Bert Weiman Ford, Inc.*, No. 77C 3348 (N.D. Ill. May 25, 1978), found an indication that some terms had been discussed, or at least noted by the seller on the sale document. *Id.* at 2. Whether such a contract exists must be determined in accord with the law of the state in which the transaction was made.

49. 12 C.F.R. § 226.1(d) (1979).

for official<sup>50</sup> and unofficial<sup>51</sup> interpretations in response to specific requests for public comment, to be issued at the staff's discretion.

Creditors may avoid civil penalties by proving that they acted in good faith conformity with an official Board or staff interpretation.<sup>52</sup> There is no such guarantee for the unofficial opinions. Some courts have considered the unofficial letters, while not binding, are entitled to great weight because they represent the "informed experience and judgment of the agency to whom Congress delegated appropriate authority."<sup>53</sup> Others, while perhaps calling them a "valuable tool" to inform the public of the law's requirements,<sup>54</sup> consider them "merely the opinion of one staff member,"<sup>55</sup> not even binding on the Board itself,<sup>56</sup> and to be disregarded where judicial interpretation may differ.<sup>57</sup>

50. *Id.* § 226.1(d)(2)-(4). Official staff interpretations are to be published in the Federal Register to become effective thirty days after the publication date. Any official staff interpretations issued after opportunity for public comment shall become effective upon publication in the Federal Register. *Id.*

51. *Id.*

52. 15 U.S.C. § 1640(f) provides that:

No provision . . . shall apply to any act done or omitted in good faith conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations . . . .

One commentator urges that an administrative agency's interpretations must be considered binding in opinions as to its own regulations. 1 R. CLONTZ, *TRUTH IN LENDING MANUAL* § 3.11(6)(a) (4th ed. Cum. Supp. 1979) [hereinafter referred to as CLONTZ], citing *Bowles v. Seminole & Sand Rock Co.*, 325 U.S. 410, 413-14 (1945). In *Bowles*, the Court held that administrative construction of regulations to be "of controlling weight unless . . . plainly erroneous or inconsistent with the regulation." *Id.* at 414. In *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), the Court noted that: "The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Id.* at 140.

53. See *Philbeck v. Timmers Chevrolet, Inc.*, 499 F.2d 971, 976-77 (5th Cir. 1974), and cases cited therein. The *Philbeck* court remarked that: "We are not free to substitute our own discretion for that of the administrative officers who have kept within the bounds of their administrative powers." *Id.* at 977, quoting *A.T. & T. Co. v. United States*, 299 U.S. 232, 236 (1961). See also *Allen M. Campbell Co. v. Lloyd Wood Constr. Co.*, 446 F.2d 261, 265 (5th Cir. 1971), where the court noted: "If the agency interpretation is merely one of several reasonable alternatives, it must stand even though it may not appear as reasonable as some other." *Id.* at 977 n.11. *Accord*, *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 378 (1973).

54. *Pedro v. Pacific Plan*, 393 F. Supp. 315, 323 (N.D. Calif. 1975). The court labeled them "informal in nature." *Id.*

55. *Franklin v. First Money, Inc.*, 427 F. Supp. 66, 71 (E.D. La. 1976), *aff'd*, 599 F.2d 615 (5th Cir. 1979).

56. *Thomas v. Myers-Dickson Furniture Co.*, 479 F.2d 740, 747 (5th Cir. 1973). The court noted that a Federal Reserve Board opinion printed in its Annual Report to Congress did "not purport to be an official Board interpretation, was not promulgated pursuant to the Board's rule-making or legislative function, and is not binding on the Board itself;" it was merely a suggestion of the "more likely" meaning of the statute." *Id.*

57. See *Stefanski v. Mainway Budget Plan, Inc.*, 326 F. Supp. 138 (S.D. Fla. 1971), *rev'd*, 456 F.2d 211 (5th Cir. 1972), and cases cited at notes 52-54 *supra*. One court commented:

Only unofficial Federal Reserve Board letters<sup>58</sup> on the issue framed existed prior to the events that gave rise to the cases here discussed. The earliest ones interpret the word "transaction" and the timing of disclosures incident to it in relation to consumer loans<sup>59</sup> and not credit sales.<sup>60</sup> The former invariably dealt with situations in which the subject of the loan was a real estate transaction, and the letters make clear that the extension of credit, and not a mere sale, triggers the disclosure requirement.<sup>61</sup>

Federal Reserve Board letters interpreting "transaction" incident to closed-end credit sales rely upon and follow those for consumer loans. Board letter 623, issued in 1972,<sup>62</sup> concerns financing in connection with the sale of an automobile and recognizes that in some credit sales there may be two "'consummations' one of the sale and one of the financing."<sup>63</sup> Referring to letters on consumer loans, letter 623 provides:

[I]n some cases the sale and financing may be so interrelated that they occur simultaneously. In those circumstances the disclosures

While such correspondence releases by the Federal Reserve Board are persuasive to this Court, they are not binding authority as to questions of interpretations of federal law. This Court does not agree with that interpretation because (1) it cannot determine whether the agreement interpreted in that letter was identical, or even similar, to the agreement executed and sued upon in this matter and (2) the letter does not provide any information as to state law which may or may not affect the factual determination of the status of the agreement.

*Id.* at 142.

58. The term "FRB letters" is employed by many courts when referring to the unofficial opinions issued by the Federal Reserve Board staff. *See, e.g.,* *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323, 327 (N.D. Ill. 1975).

59. Consumer loans are governed by 15 U.S.C. § 1639 (1976). Section 1639(b) uses the same language to indicate the timing of disclosures as used in section 1638(b) regarding credit sales. The same sections of regulation Z apply to the timing of disclosures in consumer loans as in credit sales. *See* note 44 and accompanying text *supra*.

60. Closed-end consumer credit sales are governed by 15 U.S.C. § 1638 (1976).

61. *CLONTZ supra* note 52. Letters 92 and 93 provide that consummation occurs when a creditor has agreed to extend and a customer has agreed to utilize the credit. While both apply to a loan commitment to a lender, letter 92 adds that were a builder (seller) to agree, by the purchase contract, to take a second mortgage, that agreement to extend credit would have been consummated by the signing of the sales contract, requiring disclosures at its execution.

In addition, letter 778 makes clear that the rules enunciated in letters 92 and 93 assume that the customer is under no obligation in the contract of sale to accept financing offered by the builder. Moreover, the fact that the seller ultimately prepares the note and mortgage documents for the credit transaction does not in itself constitute consummation of the credit transaction. *See id.* Thus, where a consumer is free to turn down the credit offered in favor of a different offer or full cash payment, no "transaction," as defined in 12 C.F.R. § 226.2(kk) (1979) requiring disclosure, has been consummated. A seller's preparation of credit documents—evidencing knowledge of the credit terms—does not constitute a violation of the Act when the consumer is not bound to accept the credit offered. *CLONTZ supra* note 52. Letters 1041 and 1241 reiterate that disclosure is triggered by execution of the contract obligating the consumer to enter the loan transaction. *Id.*

62. *Id.* at app. E.

63. *Id.*



would need to be made prior to the execution of the sale documents. Staff believes that where the sale is conditioned on the seller arranging specific financing whose terms are known to the seller, so that the financing is an integral part of the sale to the extent that a contractual relationship has been created with regard to that financing, 'consummation' of the credit transaction may have occurred at the time of execution of the sale documents and disclosures should be made at that point.<sup>64</sup>

It would appear that even with the cautionary words regarding transactions by sellers who are active arrangers of credit and knowledgeable about its terms, the act that requires disclosure is considered still a financing transaction, not a mere sale. Thus, the opinion clearly coincides with the only event designated in section 1638(b)—the extension of credit.

Federal Reserve Board letter 841<sup>65</sup> concerned a situation in which a customer selected merchandise, made a refundable deposit, and applied for the extension of credit.<sup>66</sup> The letter referred the recipient to letter 623 and concluded that "no contractual relationship is created until the customer accepts and signs the security agreement," unless under state law a contractual relationship is created when the deposit is made.

The language of these two letters acknowledges circumstances associated with credit sales that less often accompany consumer loans<sup>67</sup>—active involvement of the seller/arranger with the extender of credit. Letter 623 indicates conditions in which the extension of credit coincides with the sale. The sale is conditioned only upon the seller's arranging credit for the buyer's purchase of the seller's merchandise and that arrangement constitutes a condition precedent to the execution of the contract, the occurrence of which cements the original contract as one for financing and, thus, one requiring disclosure prior to its execution. By noting that this occurred "in some cases,"<sup>68</sup> the Board implied that not all credit sales are transactions requiring disclosure.

Letter 841 stresses that the consumer must be free to walk away from the financing.<sup>69</sup> Some authorities have suggested that the con-

64. *Id.*

65. *Id.*

66. Clontz notes that: "The deposit is fully refundable, and there is no contractual obligation to buy until the customer has been accepted and a security agreement stating the credit terms is signed by the customer." *Id.*

67. *But see* letter 778 *supra* note 61.

68. *See* text accompanying notes 63 and 64 *supra*.

69. Clontz has interpreted this letter as stating that "[c]onsummation occurs when customer becomes bound to purchase. . . ." CLONTZ, *supra* note 52, at 1239. While that is indeed where the Board was heading, that is not the subject of letter 841.

sumer has to be free to decline to purchase, but others have concluded that while a consumer might be free to substitute cheaper financing (or draw upon savings if no financing available was a deal the consumer considered wise), a consumer's commitment to a purchase might obligate a seller, if it also aided in arranging financing, to disclose the required terms prior to execution of the sale documents. Indeed, some courts relied upon the letters to reach such a holding.<sup>70</sup>

In an official Federal Reserve Board staff opinion letter issued subsequent to the events forming the basis for the cases discussed below,<sup>71</sup> the Board's position was made unequivocal for the first time. Where a customer selects a car and requests financing, but the terms of the installment credit contract and the identity of the finance company are uncertain, the seller may defer "consummation" of the transaction, as that term is defined by section 226.2(kk) of regulation Z, and the required disclosures may be made when financing is accepted by the customer.<sup>72</sup> The sales contract must clearly provide that the order is not binding on the buyer and buyer may cancel it and recover the deposit. No contractual obligation to purchase may exist until the disclosures are made and the customer accepts financing. Where the seller wishes to provide a customer with a car immediately, before financing can be arranged and the appropriate disclosures made, it may be done only so long as the consumer is not obligated to purchase the vehicle.

The staff opinion intimates that this is a position of long-standing with the Board, referring parenthetically to Board letters 623 and 841. In other words, the author implies that letters 623 and 841 should have made clear that "transaction" refers to any closed-end "credit sale" and not merely to an agreement to extend credit.

It can be argued, however, that letter 623, by indicating that the sale and financing occur simultaneously "in some cases," points to quite the opposite. Perhaps all that can be concluded is that letters 623 and 841 should not have been depended upon, not only because they were unofficial<sup>73</sup> but also because they were unclear.<sup>74</sup> As a result of

70. See notes 76-84, 108 and accompanying text *infra*.

71. Official Staff Interpretation No. FC-0130, reprinted in CLONTZ, *supra* note 52, at supp. 2. The letter is dated November 2, 1977. By operation of 12 C.F.R. § 226.1(d)(2)(ii) (1979), it would have become effective no earlier than December 2, 1977, several weeks following the events giving rise to Alvarez v. Galassi AMC-Jeep, Inc., No. 79C 3802 (N.D. Ill. July 9, 1979), the most recent case in this area.

72. Official Staff Interpretation No. FC-0130, reprinted in CLONTZ, *supra* note 52, at supp. 2.

73. See text accompanying notes 53-57 *supra*.

74. For an extensive recounting of unclear and inconsistent staff opinions, see St. Germain v. Bank of Hawaii, 413 F. Supp. 587 (D. Hawaii 1976), *rev'd*, 573 F.2d 572 (9th Cir. 1977). The

the official interpretation, the word "transaction" now means "credit sale" when applied to section 1638 and "loan" for section 1639. In the process, the phrase "extension of credit" has become meaningless to the construction of section 1638.

### JUDICIAL CONSTRUCTION

As with the Federal Reserve Board letters on loans, cases construing the timing of disclosures in connection with consumer loans under section 1639(b) appear to agree that a binding contract for the extension of credit, and not merely a purchase contract, trigger the Act's disclosure requirements.<sup>75</sup> In contrast, the majority of cases construing timing under section 1638(b) have held that the sales contract triggers the disclosure requirement where the contract is binding on the consumer, where both parties contemplate that the purchase will be financed, and the seller arranges credit that the buyer subsequently uses.<sup>76</sup> Some decisions do so by finding the sales contract to be an agreement for the extension of credit as well as for purchase.<sup>77</sup> Others focus merely on the fact that both parties contemplated a "credit sale."<sup>78</sup>

Indicative of those opinions is *Gonzalez v. Schmerler Ford*,<sup>79</sup> wherein the court found that the parties intended a credit sale, not a cash purchase,<sup>80</sup> and that a credit sale necessitated disclosure on the day the buyer signed the purchase document.<sup>81</sup> The court was also persuaded in its findings by the seller's close relationship with the extender of credit<sup>82</sup> and the seller's credit manager's experience.<sup>83</sup> The *Gonzalez* court quoted extensively from Board letter 623<sup>84</sup> and regarded the sale and financing as so interrelated that they occurred si-

United States Court of Appeals for the Ninth Circuit acknowledged the Board's issuance of "conflicting signals," and resolved the issue (one in conflict among the circuits) according to what made "more sense to us in trying to achieve the congressional purpose." *Id.* at 575-77.

75. See, e.g., *Waters v. Weyerhaeuser Mortgage Co.*, 582 F.2d 503, 505 (9th Cir. 1978); *Bissette v. Colonial Mortgage Corp.*, 477 F.2d 1245, 1248 (D.C. Cir. 1973); *Wachtel v. West*, 476 F.2d 1062, 1065 (6th Cir.) *cert. denied*, 414 U.S. 874 (1973).

76. See notes 80-84, 89-94, 98-107 and accompanying text *infra*.

77. *Hardin v. Cliff Pettit Motors, Inc.*, 407 F. Supp. 297, 299 (E.D. Tenn. 1976).

78. *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323, 328 (N.D. Ill. 1975).

79. 397 F. Supp. 323 (N.D. Ill. 1975).

80. *Id.* at 324-26.

81. *Id.* at 324.

82. *Id.* at 328. The extender of credit was Ford Motor Credit Corporation.

83. *Id.* at 328. The court noted that the defendant must have been able to predict which customers would receive credit as well as the terms.

84. See generally notes 62-74 and accompanying text *supra*.

multaneously.<sup>85</sup> Further, the court noted that the purpose of requiring disclosure—to enable informed credit “shopping” by consumers in a competitive market<sup>86</sup>—would be undermined by permitting sellers to bind their customers to purchase goods for which the true cost of acquisition is only known at a later date when the consumer “has a choice of either signing the creditor’s conditional sales contract form or of having collection procedures instituted against him because he is unable to come up with the cash.”<sup>87</sup>

The decision in *Gonzalez* appears to be based on an equation of the Act’s term “credit sale”<sup>88</sup> and the regulation’s term “transaction.”<sup>89</sup> The opinion does not make this position totally clear. Thus, without finding the first contract one that legally bound the buyer to accept credit arranged by the seller, the court appears convinced that the buyer’s perception that he must make good his commitment to purchase by accepting the credit, or be subject to suit for the cash price, constitutes circumstances requiring disclosure in order to effectuate the Act’s purpose and to prevent a seller from circumventing Congress’ intent through mere technical compliance.<sup>90</sup>

In *Hardin v. Cliff Pettit Motors, Inc.*,<sup>91</sup> the court reached the same result by a different process. On the first date, the buyer signed a partially completed bill of sale, noting a partial downpayment, and took possession of the car, much as in *Gonzalez*. The court concluded that, since neither party contemplated a cash sale, those actions constituted an agreement to extend credit, the terms of which were to be provided by the seller,<sup>92</sup> and the validity of which was not dependent on the

85. 397 F. Supp. at 327.

86. See notes 19-30 and accompanying text *supra*.

87. 397 F. Supp. at 327, quoting R. JOHNSON, R. JORDAN & W. WARREN, ATTORNEY’S GUIDE TO TRUTH IN LENDING III (1969). The court noted that Professor Johnson was a consultant on the Truth in Lending Regulations for the Federal Reserve Board, and further quotes Johnson: “The purpose of the purchase order procedure is only to allow a salesman to get a floor commitment from the buyer that can be used to counteract the buyer’s remorse while he awaits clearance at the credit office.” *Id.*

88. 15 U.S.C. § 1638(a) (1976).

89. *E.g.*, 12 C.F.R. § 226.8(a) (1979).

90. See *Partida v. Warren Buick, Inc.*, 454 F. Supp. 1366, 1369 (N.D. Ill. 1978), where the court refers to *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323 (N.D. Ill. 1975), and states:

The [*Gonzalez*] court found that [at the signing of the purchase document] both parties contemplated a credit sale and therefore a consumer credit transaction was consummated within the meaning of the Act. . . . The basis of the court’s holding was that the seller should not be allowed to bind the buyer to what is in fact a credit sale by the execution of what purports to be merely a sales contract without disclosing to the buyer what the credit terms will be when the installment contract is ultimately signed.

454 F. Supp. at 1369.

91. 407 F. Supp. 297 (E.D. Tenn. 1976).

92. Full disclosure was made at the signing of the note. *Id.* at 298.

fulfillment of conditions precedent to performance, such as purchaser's completion of the downpayment and execution of the note.<sup>93</sup> Since disclosure must have been made to a purchaser before he became committed to any particular lender,<sup>94</sup> the court concluded that disclosure must have preceded execution of the first agreement.<sup>95</sup>

It is possible to decide instead that a purchaser is free to turn down the credit offered and suffer the consequences<sup>96</sup> of having prematurely agreed to buy goods for which the person does not have available money. One could assert that while Congress intended to protect consumers from the many disguises of credit reporting,<sup>97</sup> it did not intend to protect consumers from renegeing on agreements to purchase. A further assertion could be made that the purchaser could shop for other available credit in the time between the commitment to purchase and the commitment to take the credit arranged by the seller unless the prior agreement constituted a clear commitment to take the credit arranged by the seller.

That is the effect of the decision in *Alvarez v. Galassi-AMC Jeep, Inc.*<sup>98</sup> There, the court noted that section 1638(b)<sup>99</sup> of the Act merely requires disclosure before the credit is extended and that sections

93. *Id.* at 299-300, referring to RESTATEMENT OF CONTRACTS § 250(a) (1932).

94. 407 F. Supp. at 299, quoting *Wachtel v. West*, 476 F.2d 1062, 1065 (6th Cir.), cert. denied, 414 U.S. 874 (1973).

95. 407 F. Supp. at 299.

96. Many of the purchase orders or bills of sale forming the bases of the actions discussed provide that any money paid may be kept by the seller as liquidated damages to cover expenses or losses incurred as a result of the purchaser's failure to complete the purchase. See, e.g., *Alvarez v. Galassi-AMC Jeep, Inc.*, No. 78C 3802 (N.D. Ill. July 9, 1979); *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323 (N.D. Ill. 1975).

97. See note 27 and accompanying text *supra*.

98. No. 78C 3802 (N.D. Ill. July 9, 1979). See also *Philbeck v. Timmers Chevrolet, Inc.*, 361 F. Supp. 1255 (N.D. Ga. 1973), *rev'd on other grounds*, 499 F.2d 971 (5th Cir. 1974). In *Philbeck*, the court did not face the issue squarely since it found that the installment sales contract extending credit contained deficient disclosure. But since the buyer had contended that the purchase order constituted the contract to which Truth-in-Lending disclosures applied, the court dismissed it in a footnote. The court noted that because the order was conditional on obtaining financing and those arrangements were not complete, the document "made no pretense of complying with the Act." 361 F. Supp. at 1257 n.1. When the United States Court of Appeals for the Fifth Circuit reversed on other grounds, it was silent on this point. The appellate court opinion noted that the Federal Reserve Board staff was aware of the trial court opinion and had commented negatively on its treatment of optional credit life insurance. See 499 F.2d at 980 n.18. But the staff was silent on sale document holding. While this silence can be construed as approval of the district court's analysis, neither the district court nor the appellate court disturbed the only reported decision agreeing with the conclusions of the court in *Alvarez*. See also *Baxter v. Sparks Oldsmobile, Inc.*, 579 F.2d 863 (4th Cir. 1978) (per curiam), in which the court held that the sale document did not require prior disclosures. The *Baxter* court, however, did not properly have the issue before it because the buyer had successfully repudiated the sale and credit was never extended. *Id.* at 864.

99. 15 U.S.C. § 1638(b) (1976).

226.8(a) and 226.2(kk)<sup>100</sup> cannot be construed without reference to the Act. The court was of the opinion that cases in the mold of *Gonzalez* and *Hardin* went beyond the dictates of the Act and the regulations.<sup>101</sup>

Each court's interpretation of the meaning and effect of the Act and regulations rests on, or colors, each court's preliminary finding regarding the nature of the first contract. In *Alvarez*, the court found the contract only an obligation to purchase,<sup>102</sup> although the document revealed that both parties contemplated a credit sale. The *Alvarez* court did not find that it bound the buyer to use the credit that the seller could arrange.<sup>103</sup> The court in *Coto v. Bert Weinman Ford, Inc.*<sup>104</sup> found that the inclusion of credit terms in (or notations on) the purchase order signaled a contract to extend credit at a later date.<sup>105</sup> *Gonzalez* and *Hardin* emphasized that the documents evidenced that both parties contemplated a credit sale and that the buyer's possession of the car immediately upon signing the agreement to purchase on credit was further indication of a contract to extend credit.<sup>106</sup> *Gonzalez* and *Coto* concluded, in the language of and with reference to Board letter 623,<sup>107</sup> that the purchase and signing of the loan were too interrelated to be considered two distinct transactions.

Thus, the majority of most courts facing the issue, in effect, have construed the word "transaction" of section 226.2(kk) of regulation Z to mean "sale" when it is applied to consumer credit sales under section 1638(b) of the Act. Most courts do so in order to effectuate the purpose of the Act.<sup>108</sup> But courts applying the regulation section to consumer loans under section 1639(b) find "transaction" to apply to the extension

100. 12 C.F.R. §§ 226.8(a), 226.2(kk) (1979).

101. *Alvarez v. Galassi-AMC Jeep, Inc.*, No. 78C 3802, slip op. at 12 (N.D. Ill. July 9, 1979).

102. *Id.* at 6.

103. *Id.* at 14. The purchase order showed a total "cash delivered" or purchase price of \$2,100, a deposit of \$10 submitted with the order, \$250 cash to be paid at time of delivery, and \$1,840 "balance to be financed." *Id.* at 2. The court found that the indication on the purchase order that the balance would be financed and that no credit was extended to the purchaser for the purchase of the motor vehicle except as appeared in writing on the face of the agreement and did not constitute a contract between plaintiff and defendant for the latter to extend credit or for the former to be bound to financing arranged. *Id.* at 7, 14.

104. No. 77C 3348 (N.D. Ill. May 25, 1978).

105. *Id.* at 12.

106. *Hardin v. Cliff Petit Motors, Inc.*, 407 F. Supp. 297, 299 (E.D. Tenn. 1976); *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323, 328 (N.D. Ill. 1975).

107. See notes 62-74 and accompanying text *supra*.

108. The United States Court of Appeals for the Seventh Circuit appears willing to overlook specific provisions of the Act in order to effectuate broad legislative intent. In *Goldman v. First Nat'l Bank*, 532 F.2d 10, 20 (7th Cir.), cert. denied, 429 U.S. 870 (1976), the court held that, in determining a limitations issue, the intent of the Act was effected only if the limitations period was measured from the time of a meaningful event other than that specified by the Act. 532 F.2d at 21. But see the dissenting opinion of then Judge Stevens, noting that while it might have been

of credit.<sup>109</sup> The word is ambiguous in the regulation and in the unofficial staff opinion letters, and the decisions and official staff opinion construe it only by implication.

### RAMIFICATIONS

Many consumers' attorneys consider the technical construction in opinions like *Alvarez* as providing unfair barriers to enforcement of legislative intent behind which those wishing to avoid the paperwork of regulation Z or to deceive a consumer safely may hide from liability. These attorneys join with the apparent rationale of the majority of courts which have considered the problem: The buyer, caught between the Scylla of expensive credit and the Charybdis of an otherwise unaffordable financial obligation and the potential for suit, by the prior execution of a binding contract to purchase goods, was committed also to purchase credit terms without knowledge of their cost. Unsophisticated buyers, for whom the legislation was enacted,<sup>110</sup> especially may not understand their right to "shop" and substitute more reasonable terms.

That the obligation should be considered a transaction to which a consumer's rights under the Act attach is probably an appropriate judicial gloss. Congress "intended to enact remedies that reflected consumer realities."<sup>111</sup> It empowered the Board to promulgate regulations to accomplish those ends<sup>112</sup> and such a regulation would seem appropriate and within the authority of that agency.<sup>113</sup> Had the Board or a court<sup>114</sup> stated the proposition that clearly, this discussion would be unnecessary.

Because the Board and courts have not done so, one must inquire

wise for Congress to enact a different provision, it did not do so and the plaintiff may not avail himself of the remedy created by this statute. *Id.* at 22 (Stevens, J., dissenting).

109. See note 75 and accompanying text *supra*.

110. See notes 23-26 and accompanying text *supra*.

111. *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 265 n.16 (3d Cir. 1975). See also *Hickman v. Cliff Peck Chevrolet, Inc.*, 566 F.2d 44, 46 (8th Cir. 1977) (the substance rather than the form of credit transactions should be examined); *Meyers v. Clearview Dodge Sales, Inc.*, 384 F. Supp. 722, 728 (E.D. La. 1974), *aff'd in part, rev'd in part*, 539 F.2d 511 (5th Cir.), *cert. denied*, 431 U.S. 929 (1975) (focus on substance of transaction, not form).

112. 15 U.S.C. § 1604 (1976).

113. *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 365-66, 369-72, 377 (1973).

114. *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323 (N.D. Ill. 1975), approached that position in dicta. See notes 86-87 and accompanying text *supra*. But the decision is premised on what this writer would suggest was a premature equation of "credit sale" and "transaction" bolstered by the close association of the lender and seller.

A comparison of the language of Board letter 623 and Official Staff Interpretation No. FC-0130 demonstrates that the Board staff did not so define "transaction" prior to the publication of the latter document. See CLONTZ *supra* note 52. See also notes 68 and 71-74 and accompanying text *supra*.

whether the Act and regulations fairly put a creditor on notice of the consequences of the acts described in the instant problem. While the Act is remedial and not penal<sup>115</sup> and thus may be broadly construed in light of its purpose,<sup>116</sup> the prohibited conduct should be clearly set out<sup>117</sup> for both lender and borrower.<sup>118</sup>

In pursuit of protection for the consumer, one can reflect on whether it is fair for the seller/creditor to join justice behind the blind-fold. It was because Congress found the consumer unable to clearly view the cost of credit that the Act became law. Should the consumer appear to have been given more than a fair deal, and the creditor now be seen as acting in the blind, a move to balance the scale could undo the consumer's gain.

A source of difficulty with the enforcement of the Act lies with Congress' scheme to eliminate the need for the consumer to prove fault in order to establish violation of the Act and the judicial move to reinsert it where subversion of the Act is perceived. In order that suits under the Act be more readily maintainable, Congress made it unnecessary for consumers to prove deception, fraud, or other malevolent intent by the creditor. Similarly, proof that the consumer was in fact either deceived or harmed was not included as an element of the action.<sup>119</sup> Prosecution<sup>120</sup> requires only proof that a creditor failed to make disclosures in the form prescribed and at a time prior to the consumer's commitment to borrow, with the burden of compliance resting upon the creditor.<sup>121</sup> Thus, fault and motive were replaced by regulations against which one would measure actions.

One of the consequences flowing from the scheme is that suits have been brought for what courts have characterized as mere "technical" violations of the Act, where none of the harm Congress sought to

115. *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 375 (1973).

116. *Id.* at 376. See generally *McGowan v. King, Inc.*, 569 F.2d 845, 848-49 (5th Cir. 1978); *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 262 (3d Cir. 1975); *Littlefield v. Walt Flanagan & Co.*, 498 F.2d 1133, 1136 (10th Cir. 1974); *Thomas v. Myers-Dickson Furn. Co.*, 479 F.2d 740, 748 (5th Cir. 1973); *Gardner & North Roofing & Siding Corp. v. Board of Governors*, 464 F.2d 838, 842 (D.C. Cir. 1972); *Sanders v. Auto Assocs., Inc.*, 450 F. Supp. 900, 902 (D.S.C. 1978); *Starks v. Orleans Motors, Inc.*, 372 F. Supp. 928, 932 (E.D. La. 1974); *Ratner v. Chemical Bank N.Y. Trust Co.*, 329 F. Supp. 270, 280 (S.D.N.Y. 1971).

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

118. *Hickman v. Cliff Peck Chevrolet, Inc.*, 566 F.2d 44, 48 (8th Cir. 1977).

119. E.g., *Charles v. Krauss Co., Ltd.*, 572 F.2d 544, 546 (5th Cir. 1978); *McGowan v. King, Inc.*, 569 F.2d 845, 848-49 (5th Cir. 1978).

120. Courts have referred to the Act as having created a system of private attorneys general to aid in enforcement. See *McGowan v. King, Inc.*, 569 F.2d 845, 848 (5th Cir. 1978).

121. *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 877 n.8 (7th Cir. 1976); *Sneed v. Beneficial Fin. Co.*, 410 F. Supp. 1135, 1143 (D. Hawaii 1976).



avoid was present.<sup>122</sup> On the other hand, courts have resorted to the subjective test of legislative intent where they considered either a consumer harmed by actions not specifically prohibited or a creditor attempting evasion of the law's intent through mere technical compliance.<sup>123</sup> Thus, creditors have been caught both ways.

What is perhaps most interesting is that courts purporting to construe the Act and regulations in light of congressional intent have been less than thorough. For example, the Act's goal of encouraging credit shopping is undermined by construction that finds compliance with the requirement for the timing of disclosures satisfied by mere delivery of the terms immediately prior to a consumer's commitment to a loan.<sup>124</sup> Although such practices do inform the consumer of the total cost of purchase, they do not encourage comparison of the figures with other available credit and thus defeat the goal of a competitive economy providing desired service at the lowest cost.<sup>125</sup> Some have begun to question whether regulations that remove considerable responsibility from buyers serve the purpose of educating consumers either of the wisdom of a particular transaction or of the general nature of their marketplace.

#### CONCLUSION

It is not argued here that the Board's now official position or the opinions of courts that predated it are ill-founded or unfair. The effect is to eliminate some coercion, and sellers are not greatly disadvantaged since the Act allows for estimated disclosure should finality of the purchase, rather than a mutually conditional sale, be desirable by either party.<sup>126</sup> Further, the Act provides that creditors may adjust accounts within fifteen days of discovery of an error and prior to institution of an action or receipt of written notice of error.<sup>127</sup> The legislative history of the Act reflects Congress' intent to protect from devious creditors not only consumers but also honest businesses put at a

122. See, e.g., *Stefanski v. Mainway Budget Plan, Inc.*, 456 F.2d 211, 213 (5th Cir. 1972) (questioning appropriateness of imposition of penalty in such a case); *Bird v. Goddards Discount Furn.*, 443 F. Supp. 422, 424 (S.D. Ill. 1978) (indication that penalty unfair but required by Act).

For criticism of use of the Act for "harassment, oppression, or unjust enrichment," see *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 889-90 (7th Cir. 1976) (Moore, J., dissenting); *Redhouse v. Quality Ford Sales, Inc.*, 511 F.2d 230, 237 (10th Cir. 1975).

123. See *Gonzalez v. Schmerler Ford*, 397 F. Supp. 323 (N.D. Ill. 1975).

124. *Waters v. Weyerhauser Mortgage Co.*, 582 F.2d 503 (9th Cir. 1978).

125. See note 29 and accompanying text *supra*.

126. 12 C.F.R. § 226.6(f) (1979).

127. 15 U.S.C. § 1640(b) (1976). However, such error must be borne by the creditor and adjustment must be made in favor of the consumer. *Villanueva v. Motor Town, Inc.*, No. 79-1271 (7th Cir. Apr. 7, 1980).

competitive disadvantage by those who would successfully use a crevice in the regulatory scheme while running roughshod over its intended goal.

