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Recent Developments

Edited by RALPH J. ROHNER*

This feature of the Annual Survey briefly reviews a number of significant recent developments in the regulation of consumer financial services. Items noted here include federal preemption of state usury laws, debt collection caselaw, FTC rulemaking standards, the FTC's staff recommendations for its Credit Practices rule, and consumer cases under the new bankruptcy code.

I. THE NEW FEDERAL USURY LAW: By William M. Burke**

A. Introduction

On April 1, 1980, the Depository Institutions Deregulation and Monetary Control Act of 1980¹ became effective. Title V of that Act enacted a federal usury law for certain credit transactions. Where applicable, the new federal usury law preempts state interest rate limitations that would otherwise apply to the credit transactions encompassed by the law. The Act was amended in important respects by the Housing and Community Development Act of 1980² which became effective on October 8, 1980. This article will briefly describe the new federal usury law.³

B. First Mortgage Transactions

Section 501 of the Act provides that state laws limiting interest, discount points or finance charges are not applicable to any loan, mortgage, credit sale or advance made by a qualified creditor after March 31, 1980 which is secured by: (1) a first lien on residential real property or (2) a purchase money lien on stock in a residential cooperative housing corporation, or (3) a first lien on a residential manufactured home.⁴

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1. Pub. L. 96-221, 94 Stat. 164 (March 31, 1980).

2. Pub. L. 96-399, 94 Stat. 1614, 42 U.S.C. 5301 (October 8, 1980).

3. All references in this article to the "Act" shall refer to Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 as amended by the Housing and Community Development Act of 1980.

Federal regulation of interest rates is not a novel concept. Interest rate regulation, or deregulation, can also be found in the National Bank Act, 12 U.S.C. § 85; the Veterans' Housing Amendments Act of 1976, Pub. L. 94-324, 90 Stat. 720; the Veterans' Disability Compensation and Survivors' Benefits Amendments of 1979, Pub. L. No. 96-128, 93 Stat. 982; the Housing and Community Development Amendments of 1979, Pub. L. No. 96-153, 93 Stat. 1101; and the Ship Mortgage Act, 46 U.S.C. § 911 *et seq.*

4. Act, § 501(a)(1)(A).

Those creditors who qualify for preemption under section 501 include certain federally related creditors,⁵ certain creditors when making federally related loans,⁶ any creditor as defined in the Truth in Lending Act⁷ who makes or invests in residential real estate loans aggregating more than \$1,000,000 per year,⁸ and any individual creditor who finances the sale or exchange of residential real property which such individual owns and occupies as his principal residence.⁹

The states are given the right under section 501 for a three year period beginning April 1, 1980 to enact a law stating that the state does not want section 501 to apply in the state.¹⁰ Any credit transaction entered into after the date of enactment of such a state law will not qualify for preemption under section 501.¹¹ Several states as well as Puerto Rico have already acted to override section 501.¹² Section 501 also permits the states at any time to enact laws limiting discount points or other charges in credit transactions covered by the federal usury law.¹³

Creditors who wish to take advantage of section 501 for credit extensions secured by a first lien on a residential manufactured home must comply with certain consumer protection regulations promulgated by the Federal Home Loan Bank Board.¹⁴ The Board's regulations place limitations upon late charges, deferral fees, prepayment penalties and balloon payments; require

5. This includes: (i) any lender whose deposits or accounts are insured by any agency of the federal government; (ii) any lender who is regulated by any agency of the federal government; and (iii) any lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act, Act, § 501(a)(1)(C), incorporating by reference 12 U.S.C. § 1735f-5(b).

6. This includes: (i) any lender when making a loan which is insured, guaranteed, supplemented or assisted by the Secretary of Housing and Urban Development or any other officer or agency of the federal government; (ii) any lender when making a loan under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other officer or agency of the federal government; and (iii) any lender when making a loan that is eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association or the Federal Home Loan Mortgage Corporation, Act, § 501(a)(1)(C), incorporating by reference 12 U.S.C. § 1735f-5(b).

7. 15 U.S.C. § 1602(f).

8. The requirement that the creditor make or invest in loans aggregating more than \$1,000,000 per year does not apply to a creditor selling residential manufactured homes financed by loans or credit sales secured by first liens on the residential manufactured homes if: (i) the creditor has an arrangement to sell such loans or credit sales to an institution that qualifies as a creditor under the Act, or (ii) the creditor in fact sells such loans or credit sales to an institution that qualifies as a creditor under the Act, Act, § 501(a)(1)(C)(v).

9. This additional class of qualified creditors was added by the amendments to the Act in the Housing and Community Development Act of 1980.

10. Act, § 501(b)(2).

11. The federal preemption, however, will continue to apply to any loan made after the date of enactment of such a state law overriding the federal law if the loan is made pursuant to a commitment entered into during the federal preemptive period or is a rollover of a loan made during the preemptive period. Act, § 501(b)(3).

12. As of January 1, 1981, the states were Hawaii, Iowa and Kansas.

13. Act, § 501(b)(4)

14. Act, § 501(c).

use of the actuarial method in computing the rebate of unearned finance charges upon prepayment of the indebtedness; and require the creditor to provide the debtor with a 30 day notice of default and right to cure before taking enforcement action under the credit instrument.¹⁵

Under the Board's regulations, state laws that regulate matters covered by the Board's regulation are preempted by the regulation unless the Board determines that the state laws provide greater protection to consumers. The Board's determinations in this respect are made upon petition by interested persons, are published in the Federal Register, and operate prospectively.¹⁶ State laws that regulate the credit transaction as to matters not covered by the regulation are not preempted.¹⁷

This condition upon the applicability of the federal usury law in mobile home financing could have important implications for any future federal preemption of consumer credit interest limitations. It has been argued that any future federal preemption should likewise be conditioned upon the credit extension meeting certain minimum consumer protection requirements.

The Federal Home Loan Bank Board is given express regulatory and interpretive authority under section 501.¹⁸ The Board has exercised this authority by adopting regulations implementing section 501¹⁹ and by issuing formal Board interpretations construing the section.²⁰ The regulations of the Board are of critical importance in understanding and taking advantage of section 501. As already noted, the federal preemption applicable to mobile home financing is conditioned upon the creditor complying with the Board's consumer protection measures. And, in the regulations the Board has defined the term residential real property to mean "real estate improved or to be improved by a structure or structures designed primarily for dwelling, as opposed to commercial use."²¹ This means that a loan made by a qualified creditor secured by a first lien upon vacant land intended for residential development would qualify under section 501 and would not be subject to state interest rate limitations. Under the Board's regulations, the federal preemption would also apply to a loan secured by a first lien upon a multiple story apartment structure or land intended for development in this manner. The Board has also recently proposed for comment a regulation that would

15. 12 C.F.R. § 590.4. The debtor is not entitled to receive the notice of default more than twice in any one-year period. 12 C.F.R. § 590.4(h).

16. 12 C.F.R. § 590.4(b)(2).

17. *Id.*

18. Act, § 501(f).

19. 12 C.F.R. § 590.

20. As of January 1, 1981, the Board had issued 12 interpretations of § 501. 45 Fed. Reg. 2840 (1980), 45 Fed. Reg. 6165 (1980), 45 Fed. Reg. 8000 (1980), 45 Fed. Reg. 15,921 (1980). These interpretations had been issued by the Board under Pub. L. No. 96-161 which contained provisions almost identical to § 501 and was adopted on a temporary basis while the Act was under consideration in Congress. In construing § 501, the Board has adopted those 12 interpretations by reference.

21. 12 C.F.R. § 590.2(f).

provide first mortgage treatment to certain purchase money "wraparound" mortgages.²²

The staff of the Federal Home Loan Bank Board has been issuing informal, unpublished interpretations of section 501. Although these interpretations are often helpful in understanding the law, they lack the express interpretive authority given in the Act to Board regulations and interpretations.

Section 501 also preempts any state interest rate limitations applicable to deposits, accounts or other obligations of depository institutions as defined in the Act,²³ thus making it clear that a depository institution, as a borrower, may not plead usury as a defense against the enforcement of its obligations. Concern has been expressed that state usury laws might apply, for example, to a certificate of deposit issued by a bank to its depositor with the depositor being viewed as a usurious lender of the funds to the bank.

In a recent case, the Arkansas Supreme Court, in a 4-3 opinion, declared section 501 unconstitutional.²⁴ While conceding the power of Congress to regulate interstate commerce through the Commerce Clause, the court stated that it could "find nothing in any of the legislation involved here that pertains to the regulation of interstate commerce."²⁵ The court found the state "opt out" provisions of section 501 to be evidence that Congress was not purporting to regulate interstate commerce. In dissent, Justice Stroud, who was joined by two other Justices, stated: "I feel sure the Congress will be as surprised as I to learn that there is 'nothing in any of the legislation involved here that pertains to the regulation of interstate commerce' for regulation of the flow of money between the states seems clearly within its scope."²⁶ On rehearing, the court

22. 45 Fed. Reg. 86,500 (1980). The term, "wraparound mortgage," is defined under the proposed regulation as a purchase money loan that is secured by a lien on property subject to a prior lien securing prior indebtedness if the purchase money loan: (i) matures no earlier than the latest maturity date of the prior indebtedness; (ii) equals in principal amount the aggregate of the outstanding prior indebtedness plus the additional funds advanced; (iii) requires periodic payments by the borrower sufficient to meet required current payments on the prior indebtedness; (iv) requires the lender to make payments due on the prior indebtedness as long as payments are received from the borrower; (v) gives the lender the right to cure defaults with respect to any prior indebtedness or to satisfy such indebtedness; and (vi) obligates the borrower to reimburse the lender for sums advanced in order to secure or protect the lender's lien. First mortgage treatment would be provided for such loans under the proposed regulation only if the lender at all times has sufficient funds available to satisfy the prior indebtedness. Lenders regularly examined and supervised by a state or federal authority would be deemed to have sufficient funds available if the amount of prior indebtedness is recorded as a liability on the lender's books.

23. Act, §501(a)(2)(A). The term "depository institution" includes insured banks, mutual savings banks and savings banks as defined in the Federal Deposit Insurance Act; insured credit unions as defined in the Federal Credit Union Act; savings and loan associations as defined in the Federal Home Loan Bank Act; and insured institutions under the National Housing Act. *Id.*

24. *McInnis v. Cooper Communities*, No. 80-254 (Ark. Sup. Ct., slip op., Dec. 29, 1980), *rev'd on rehearing* (February 23, 1981).

25. *Id.* at 4 of the majority opinion.

26. *Id.* at 1 of dissenting opinion. Neither the majority or the dissenting opinion discussed the power of Congress to enact a national usury law under article I, § 8, cl. 5 of the United States Constitution which permits Congress "[t]o coin Money, regulate the Value thereof, and of foreign Coin, and to fix the Standard of Weights and Measures." (U.S. Const. art. I, § 8, cl. 5.).

reversed its earlier decision by a 4–3 majority, citing the supremacy clause of the United States Constitution.

C. Business and Agricultural Credit

Section 511 of the Act establishes a federal rate of interest that may be charged by any person²⁷ on any loan, credit sale, forbearance or advance²⁸ where: (1) the state rate of interest that would otherwise apply to the credit extension is *lower* than the federal rate of interest, (2) the credit extension is for business or agricultural purposes in an amount of \$1,000 more,²⁹ and (3) the credit is extended during the 3 year preemptive period from April 1, 1980 to April 1, 1983³⁰ and before the state has enacted a law stating that it does not want section 511 to apply in the state.

The federal rate of interest is 5 percent above the discount rate, including any surcharge thereon, on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the credit extender is located. As of January 1, 1981 the discount rate in all Federal Reserve bank districts was 13 percent and the surcharge was 3 percent, thus establishing a 21 percent interest rate under section 511.

Where section 511 is applicable and the federal rate is knowingly exceeded, a federal usury penalty applies, preempting any state usury penalty. The federal penalty is forfeiture of all interest and recovery of double the interest paid within two years preceding the filing of the action.³¹

D. Loans by State Chartered Institutions

Sections 521 to 523 of the Act provide for a federal rate of interest that may be charged by state chartered banks insured under the Federal Deposit Insurance Act (section 521), state chartered savings and loan associations insured under the National Housing Act (section 522), and credit unions insured under the Federal Credit Union Act (section 523). Those sections

27. The amendments to the Act in the Housing and Community Development Act of 1980 make it clear that § 511 applies to all credit extenders including natural persons.

28. Prior to the Housing and Community Development Act of 1980, § 511 only applied to loan transactions.

29. Prior to the amendments to the Act in the Housing and Community Development Act of 1980, this threshold amount was \$25,000. These amendments also clarify the status of an advance made pursuant to an agreement or a line of credit. Under the amendments, an advance of less than the threshold amount required by § 511 will qualify the credit extension for purposes of that section if the aggregate of all sums advanced, or agreed to be advanced, or contemplated to be advanced pursuant to a commitment or agreement equals or exceeds the threshold amount. Act, § 512(b)(2).

30. In an important series of amendments, the Housing and Community Development Act of 1980 amended the Act to provide that a credit extension will be deemed to have been made during that 3 year preemptive period if it was: (i) funded in whole or in part during the period regardless of whether pursuant to a commitment or other agreement entered into before April 1, 1980; (ii) made before April 1, 1980 and bears a fluctuating rate of interest; or (iii) a renewal, extension or modification during the period of a pre-April 1, 1980 credit extension provided the debtor consents in writing to the renewal, extension or modification. Act, § 512(b)(1).

31. Act, § 511(c).

provide that if the state rate of interest that would apply in the absence of sections 521 to 523 is *lower* than the rate of interest permitted under those sections, these institutions may charge on any loan the greater of: (1) 1 percent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the institution is located, or (2) the rate allowed by the laws of the state where the institution is located. This new federal interest rate is permanent, subject again, however, to the right of any state to enact a law declaring that it does not want the federal rate to apply in the state. Where the federal interest rate is applicable, a federal usury penalty, identical to the penalty under section 511 of the Act, is also applicable.

Sections 521 to 523 were patterned, in part, after section 85 of the National Bank Act³² and were intended to allow state chartered institutions to compete with national banking associations in the interest rates that they charge. There has been much recent debate about whether these sections should therefore be interpreted in the same manner as section 85. For example, under section 85, national banking associations have been afforded "most favored lender" status which allows them to charge interest at the maximum rate permitted to any competing lender located in the same state.³³ National banking associations have also been permitted under section 85 to charge the interest rates allowed by the laws of the state in which they are located in connection with their interstate lending activities.³⁴

An expansive reading of sections 521 to 523 would also provide state chartered insured institutions with most favored lender status and would permit them to export interest rates in interstate lending in the same manner as national banking associations. Those who support this interpretation rely upon the similarity in language between sections 521 to 523 and section 85 of the National Bank Act and the purpose of sections 521 to 523 which was to equalize competition between national banking associations and other deposi-

32. 12 U.S.C. § 85.

33. See *Tiffany v. National Bank of Missouri* 85 U.S. 409 (1974). This "most favored lender" status is expressed in a ruling by the Comptroller of the Currency as follows:

(a) A national bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. If State law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate. For example, a national bank may lawfully charge the highest rate permitted to be charged by a State-licensed small loan company or Morris plan bank, without being so licensed.

(b) A national bank located in a State the law of which denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by such borrower.

12 C.F.R. § 7.7310.

34. *Marquette National Bank v. First of Omaha Corp.* 439 U.S. 299 (1978).

tory institutions.³⁵ Those who support a more narrow interpretation of sections 521 to 523 argue that the only intent of those sections was to permit these other depository institutions to charge 1 percent in excess of the discount rate on 90-day commercial paper if that rate is higher than the state interest rate that would apply in the absence of the sections.

By letter dated September 29, 1980, the staff of the Federal Home Loan Bank Board interpreted section 522 of the Act as providing state chartered savings and loan associations with most favored lender status where the state rate of interest that would otherwise apply is less than one per cent in excess of the discount rate.³⁶ The National Credit Union Administration has issued an identical interpretation of section 523 of the Act which applies to credit unions.³⁷ Since these agencies were not given interpretive authority with respect to these sections of the Act, these issues are likely to persist until Congress acts by adopting clarifying legislation, or until there is a definitive judicial resolution.³⁸

E. Conclusion

The new federal usury law represents an important step taken by Congress both to nationalize and to deregulate interest rates applicable to a variety of credit extensions. The law seeks to facilitate the free flow of capital into states with restrictive interest rates. At the same time, however, Congress recognized the right of the states to set their own interest rate limitations and therefore permitted the states to "opt out" of the federal law.

As interest rates continue to rise, it can be expected that Congress will be asked to preempt state interest rate limitations even further, especially as they apply to consumer credit transactions. The new federal usury law should provide a means by which the effectiveness of interest rate deregulation may be judged and could serve as a model for future legislation.

35. They also point out that the federal rate permitted by §§ 521 to 523 only applies where the state interest rate applicable to the institution is lower than the federal rate. From this premise, they argue that the reference in the federal rate to the rate allowed by state laws must mean the rate allowed to other competing lenders.

36. Unpublished letter from the General Counsel of the Federal Home Loan Bank Board dated September 29, 1980. This interpretation would permit a state-chartered savings and loan association to charge the rates permitted to competing state lenders but only when the state rate of interest applicable to savings and loan associations is less than 1% in excess of the discount rate. Since the discount rate is subject to constant change, this interpretation, in effect, confers "sometimes most favored lender" status on state-chartered savings and loan associations. This strange result does not seem to follow logically from the language of § 522 and finds no support in the legislative history of the Act.

37. Statement of Interpretation and Policy dated November 19, 1980, 45 Fed. Reg. 78,624 (1980).

38. An action has been filed in Maryland in which some of the plaintiffs are state-chartered banks. These banks are seeking a judicial declaration that such institutions are afforded most favored lender status by § 521. *Equitable Trust Co. v. Stephens H. Sachs*, Equity No. 60063, Doc. No. 120-A (Cir. Ct., Baltimore City). On January 28, 1981, the trial court filed its Memorandum Opinion and Order concluding that state-chartered banks have most favored lender status under section 521.

II. DEBT COLLECTION: By Toby J. Rothschild*

In the three years since the Fair Debt Collection Practices Act (FDCPA)³⁹ was enacted as part of the Consumer Credit Protection Act, a number of courts have begun to address the issues raised by the Act and to answer some of the questions involved. This section is intended as a review of the developments in this area since the last such effort in 1979.⁴⁰ There will also be a brief review of other developments related to debt collection law.

A. Coverage of the FDCPA

One of the most active areas of litigation in the young history of the FDCPA relates to questions of who and what are covered by it. As to what is covered, the cases have held that taxes are not a "debt,"⁴¹ but that student loans are.⁴² Cases addressing the definition of "debt collection" have upheld the statutory language exempting governmental employees,⁴³ and made clear that an assignee of the original creditor is exempt as long as the assignment was made prior to default on the obligation.⁴⁴

At least one court, however, has interpreted the exemption provisions of the FDCPA so as to limit their scope. The Seventh Circuit, in *FTC v. Shaffner*⁴⁵ was called on to interpret the exemption for attorneys.⁴⁶ In addressing that definition, the court stated:

Needless to say, many who hold licenses to practice law, do not practice law, but engage in other businesses. We do not believe Congress intended to shield one debt collection business from investigation simply because it is owned by an attorney, while subjecting other debt collectors to scrutiny by the FTC. . . .

For instance, appellee may advertise his business as a debt collection agency rather than a law practice, and might employ several employees for the purpose of soliciting debt collection business or contacting debtors to secure payment of accounts; activities which may not fall within the statutory exclusion.⁴⁷

*Member of the California bar.

39. 15 U.S.C. 1692-1692(o) (1976).

40. Rothschild, *Debt Collection*, 34 Bus. Law. 1459 (1979).

41. *Staub v. Harris*, 626 F. 2d 275 (3d Cir. 1980).

42. *Carrigan v. Central Adjustment Bureau*, 494 F. Supp. 824 (N.D. Ga. 1980).

43. *Gary v. Spires*, 473 F. Supp. 878 (D.S.C. 1979), interpreting 15 U.S.C. § 1692a(6)(C) (1976).

44. *Kizer v. Finance America Credit Corp.*, 454 F. Supp. 937 (N.D. Miss. 1978), construing 15 U.S.C. §§ 1692(a)(6)(A) and (G)(iii) (1976).

45. *FTC v. Shaffner*, 626 F.2d 32 (7th Cir. 1980).

46. 15 U.S.C. § 1692(a)(6)(F) (1976).

47. *FTC v. Shaffner*, *supra* n. 45, at 36.

B. Substantive Provisions

Among the basic elements of the FDCPA are the sections which prohibit harassment or abuse,⁴⁸ false or misleading representations,⁴⁹ and unfair practices.⁵⁰ Each of these sections includes a list of prohibited practices, and indicates that the list is not exclusive. In *Rutyna v. Collection Accounts Terminal, Inc.*,⁵¹ the court, citing both the language of the Act and the legislative history⁵² found that defendant had violated the prohibition against harassment even though its conduct did not fall within one of the enumerated prohibitions.⁵³

In another of the few cases which have addressed the substantive provisions of the FDCPA, a court has held that the required notice regarding the debtor's right to require validation of the debt cannot appear on the back of a collection demand unless a clear reference is made on the front side of the demand letter.⁵⁴

C. Liability and Damages

One important holding in the *Rutyna* case⁵⁵ is that the facts of the debt collector's conduct establish the violation of the FDCPA, without regard to the effect of that conduct on the consumer.

Without doubt defendant's letter has the natural (and intended) consequence of harassing, oppressing and abusing the recipient. The tone of the letter is one of intimidation, and was intended as such in order to effect a collection. The threat of an investigation and resulting embarrassment to the alleged debtor is clear and the actual effect on the recipient is irrelevant. The egregiousness of the violation is a factor to be considered in awarding statutory damages (§ 1692k(b)(1)). Defendant's violation of § 1692d is clear.⁵⁶

Two cases have addressed the "bonafide error" defense to civil liability.⁵⁷ Both cases hold that this defense is analogous to the similar defense in the Truth in Lending Act.⁵⁸ One holds that the defense only applies where defendant intended to prevent the conduct constituting the violation but failed to do so, rather than to errors of law.⁵⁹ The other case makes clear that the debt

48. 15 U.S.C. § 1692(d) (1976).

49. 15 U.S.C. § 1692(e) (1976).

50. 15 U.S.C. § 1692(f) (1976).

51. *Rutyna v. Collection Accounts Terminal, Inc.*, 478 F. Supp. 980(N.D. Ill. 1979) [hereinafter "*Rutyna*"].

52. 1977 U.S. Code Cong. & Admin. News at 1698.

53. *Rutyna v. Collection Accounts Terminal, Inc.*, *supra* n. 51, at 981-82.

54. *Ost v. Collection Bureau, Inc.*, 493 F. Supp. 701 (D.N.D. 1980).

55. *Rutyna*, *supra* n. 51.

56. *Rutyna*, *supra* n. 51, at 982.

57. 15 U.S.C. § 1692k(c) (1976).

58. 15 U.S.C. § 1640(c) (1976).

59. *Rutyna*, *supra* n. 51, at 982.

collector must prove that proper procedures designed to prevent such errors were maintained if liability is to be avoided.⁶⁰

D. Procedural Issues

One important issue decided by the Third Circuit in the *Staub* case⁶¹ was the effect of opinion letters issued by the FTC staff. The court held that the value of such letters is "limited," and, although entitled to "some weight," are clearly not binding or even due the "considerable respect" normally accorded to interpretations by the agency charged with enforcement of a statute.⁶²

Two cases have looked at the class action provisions of the FDCPA. One district court has certified a class action alleging a practice of wrong-venue filing.⁶³ And in another case, a district court cited with approval the provision⁶⁴ permitting the named plaintiff in a class action to obtain a recovery greater than the unnamed class members.⁶⁵

E. Federal Enforcement Activities

Perhaps as significant as the litigation developments reported above are the increasing number of enforcement cases being initiated by the Federal Trade Commission or by the Justice Department on its behalf. Both federal agencies have successfully taken non-litigated consent decrees or judgments calling for corrective action by respondents, including the payment of significant fines.

For example, in one case⁶⁶, the Commission accepted a consent decree in which the respondent agreed to advise consumers that it is a credit reporting agency and inform them of their rights under the FDCPA. Several consent judgments have included proscriptions on false or "idle" threats by collection agencies.⁶⁷ Another addressed the practice, by several groups of physicians, of using a fictitious corporate name for their collection work.⁶⁸ Still another prohibits a collection agency from routinely adding collection fees not provided for in the credit contract.⁶⁹ Several other pending cases involve various

60. Carrigan v. Central Adjustment Bureau, Inc., *supra* n. 42, at 827.

61. Staub v. Harris, *supra* n. 41.

62. *Id.* at 279. The FTC staff has issued many informal opinion letters stating the current enforcement position of the staff regarding the FDCPA. These letters, called "Staff Interpretatives," are public information, and are available for public examination at most FTC offices.

63. Coulston v. United Service Bureau (D. Ida. 1979), reported at 13 Clearinghouse Review 682 (January, 1980).

64. 15 U.S.C. § 1692k(a)(2)(B) (1976).

65. Brame v. Ray Bills Finance Corp., 85 F.R.D. 568 (N.D.N.Y. 1979).

66. Hooper Holmes, Inc., FTC Consent Order, 45 Fed. Reg. 23,466 (1980) (proposed order), 45 Fed. Reg. 44,260 (1980) (final order).

67. U.S. v. United Compucred Collection, Inc., No. C-1-80-103 (U.S.D.C. S.D. Ohio, 1980); U.S. v. Central Adjustment Bureau, Inc., No. CA 3-80-, 1671-R (U.S.D.C. N.D. Tex. 1980).

68. U.S. v. Radiology Consultants, Civ. No. 80-559W (U.S.D.C. W.D. Okla. 1980).

69. U.S. v. MacMen Financial Service, Inc., No. _____ (U.S.D.C. W.D. Va. 1980).

misrepresentations by collectors of their identity or of the nature and kinds of consequences that will be visited on delinquent debtors.⁷⁰

By the end of 1980, these prosecutions had generated upwards of \$300,000 in fines. Although the FTC is apparently dissatisfied with its enforcement effort,⁷¹ the continuing flow of these voluntarily-settled cases provides another level of interpretative guidance for the FDCPA.

F. Other Collection Law Developments

Two recent Court of Appeals decisions affect the application of the principles of the FDCPA to creditors collecting their own debts. In *Trans World Accounts, Inc., v. FTC*,⁷² the Ninth Circuit upheld the Commission's challenge to several practices of Trans World, a collection agency.⁷³ The practices which violated the FDCPA were attacked not under the FDCPA, but under the general jurisdiction of section 5 of the FTC Act. Thus, the conduct found improper on the part of Trans World would be equally subject to attack if committed by anyone else, whether or not they were subject to the FDCPA. There seems little reason to doubt that the Commission will take the same position with respect to creditors collecting their own obligations in their own names—thus effectively extending the FDCPA to original creditors through section 5 of the FTC Act.⁷⁴

In a totally different context, the Fourth Circuit suggested that the standards of the FDCPA may have application to people collecting debts who are not "debt collectors."⁷⁵

Changes in tort law also may affect debt collection practices. Courts in Florida and California recently have thrown out restrictions on recovery for mental distress. The Florida Court of Appeals permitted, for the first time, a cause of action for intentional infliction of emotional distress independent of

70. *U.S. v. Cash Flow, Inc.*, No. B-80-485 (U.S.D.C. Conn. 1980); *U.S. v. Utah Bureau of Collections, Inc.*, No. _____ (U.S.D.C. Utah, 1980).

71. A trade letter reported the \$300,000 figure, and indicated that "the Commission and its staff are huddling to see if there is any way to streamline enforcement of the FDCPA in the highly balkanized collection industry." *1980 Issues Summary*, Capitol Reports, Inc., Washington Credit Letter, at 14 (Dec. 22, 1980).

72. 594 F.2d 212 (9th Cir., 1979).

73. The court did remand part of the case to the FTC, finding that the remedy ordered by the Commission was vague and overbroad. *Id.* at 217. For the Commission's order on remand, see 44 Fed. Reg. 66,576 (1979).

74. 15 U.S.C. § 45 (1976). The Commission also has relied on § 5 in other prosecutions of debt collectors. See, e.g., *U.S. v. Floersheim*, No. CV 74-484-RF (U.S.D.C. C.D. Cal. 1980); *U.S. v. American Collection Services, Inc.*, No. 7906691-Civ-ACH (U.S.D.C. S.D. Fla. 1979), both involving the enforcement of orders entered prior to the effective date of FDCPA.

75. *Phillips v. Bergland*, 586 F.2d 1007, 1009 n.1, (4th Cir. 1978). For further discussion of the interrelationship of the FDCPA and § 5, see Goldston, *Federal Regulation of Debt Collection Practices—The Fair Debt Collection Practices Act and Section Five of the Federal Trade Commission Act*, 13 U.S.F.L. Rev. 575 (1979).

any other intentional tort.⁷⁶ And the California Supreme Court ruled that recovery may be obtained for negligently inflicted emotional distress, even where there is no accompanying physical manifestation of the injury.⁷⁷

III. STANDARDS FOR FTC RULEMAKING: By Christopher Smith*

On May 28, 1980, the President signed into law the Federal Trade Commission Improvements Act of 1980.⁷⁸ A number of the Act's provisions modify the Commission's rulemaking initiatives. Future trade regulation rules, including the amendment to the Holder in Due Course Rule⁷⁹ and the proposed Credit Practices Rule,⁸⁰ may be overturned within 90 days after promulgation by a two-House legislative veto. The legislation restrains—but does not eliminate—the Commission's authority to issue trade regulation rules relating to children's advertising, funeral industry practices and voluntary standards and certification activities. The Act also requires several procedural changes in FTC rulemaking proceedings, including publication of advance notices of proposed rulemaking and preparation of regulatory analyses of proposed and final rules.

Also during 1980, two FTC trade regulation rules promulgated under the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act⁸¹ have been scrutinized by appellate courts. The opinions indicate that the "substantial evidence" standard of review incorporated into section 18 of the FTC Act will likely be the subject of judicial debate.

A. FTC Rulemaking in Historical Perspective

Beginning in the early 1960s, the Commission asserted its authority under section 6(g) of the FTC Act to promulgate industry-wide trade regulation rules defining unfair methods of competition and unfair or deceptive acts or practices. Although the Commission's authority to issue trade regulation rules under section 6(g) was upheld in *National Petroleum Refiners Association v. FTC*,⁸² no other court of appeals reviewed the same question.

Amendments to the FTC Act in 1975⁸³ established the Commission's authority to promulgate rules which "define with specificity acts or practices

76. *Ford Motor Credit Co. v. Sheehan*, 373 So. 2d 956 (Fla. 1st D.C.A., 1979). For a discussion of this case, see Chopin, *Emotional Distress Caused by Outrageous Conduct, A New Tort In Florida?*, 54 Fla. B.J. 262 (1980).

77. *Molien v. Kaiser Foundation Hospitals*, 27 Cal.3d 916, 167 Cal. Rptr. 831, 616 P.2d 813 (1980).

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78. Pub. L. No. 96-252, 94 Stat. 374 (1980) (hereinafter "Improvements Act").

79. *Cf.*, *Recent Developments*, 1980 Annual Survey, 35 Bus. Law. 1311, 1318 (1980).

80. *Cf.*, *Recent Developments*, this year's Annual Survey, *infra*.

81. Pub. L. No. 93-637, 88 Stat. 2183 (1975), codified at 15 U.S.C. §§ 2301-12 (1976). For an analysis of this legislation, see Kintner & Smith, *The Emergence of the Federal Trade Commission as a Formidable Consumer Protection Agency*, 26 Mercer L. Rev. 651 (1975).

82. *Nat'l. Petroleum Refiners Ass'n. v. FTC*, 482 F.2d 672 (D. C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974).

83. Pub. L. No. 93-637, § 202(a), 88 Stat. 2193.

which are unfair or deceptive” and to include in such rules “requirements prescribed for the purpose of preventing such acts or practices.”⁸⁴ The 1975 amendments also prescribed new rulemaking procedures designed to ensure meaningful hearings with cross-examination and rebuttal rights afforded to interested parties, and made violations of final rules subject to civil penalties of up to \$10,000 per violation and consumer redress.

Many of the Commission rulemaking proceedings under the 1975 amendments were viewed as being unnecessarily broad and heavy-handed, and the procedures were considered unfair and biased. The Administrative Conference and the American Bar Association both issued reports criticizing the Commission’s rulemaking practices as, among other things, too unfocused and involving inadequate opportunities for participation by interested parties at early stages.⁸⁵ The FTC Improvements Act of 1980 was designed in part to meet the wide-ranging criticisms of Commission rulemaking proceedings.

B. 1980 Legislative Changes

The new legislation establishes a 90-day Congressional review period for Commission trade regulation rules, after which the rule becomes effective unless both Houses of Congress have passed a resolution disapproving the rule: the so-called two-House legislative veto. The statute establishes procedures to ensure that both Houses will have an opportunity to vote on the rule prior to the expiration of the review period. Because of questions concerning the constitutionality of this procedure, the Act provides for expedited judicial review should the constitutionality of the legislative veto be challenged. The legislative veto provision remains in effect until September 30, 1982.⁸⁶

The Act makes a number of changes in Commission rulemaking procedures. Prior to commencing a rulemaking proceeding in the future, the Commission must publish an advance notice of proposed rulemaking for public comment. The advance notice must set forth a description of the proposed rule, the objective sought to be achieved by the proposal and alternatives under consideration. The Commission is also required to submit any notice of proposed rulemaking to the Senate and House Commerce Committees 30 days in advance of its *Federal Register* publication.⁸⁷

In the future any notice of proposed rulemaking must include the text of the proposed rule and any alternatives under consideration.⁸⁸ The notice must be

84. 15 U.S.C. § 57a(a)(1)(B) (1976).

85. Administrative Conference of the U.S., *Trade Regulation Rulemaking Procedures of the Federal Trade Commission* (May 1979) (adopted recommendations published at 44 Fed. Reg. 33,817 (1979)); American Bar Association Antitrust Section, *Federal Trade Commission Structures, Powers and Procedures* (Feb. 1980) (reprinted in 951 BNA Antitrust & Trade Regulation Rep. Supp. (Feb. 14, 1980)).

86. Improvements Act §21.

87. Improvements Act §8.

88. Improvements Act §11. This change removes the Commission’s discretion to initiate a proceeding without publishing a specific text of the proposed rule, the procedure that was followed

accompanied by a preliminary regulatory analysis, and any final rule must include a final regulatory analysis. Regulatory analyses are not subject to judicial review (thereby limiting their usefulness, except in the case of Congressional review), although a court may set aside a rule if the Commission has failed entirely to prepare a regulatory analysis.⁸⁹

The Act recognizes the adversarial nature of the rulemaking process by requiring the Commission to promulgate procedural rules for rulemaking proceedings that permit *ex parte* contacts between outside parties and Commissioners, or between rulemaking staff and Commissioners and their personal staffs, provided those contacts are made public and summaries of the contacts are placed on the rulemaking record.⁹⁰ The amendments change previous practice, under which outside parties have not been permitted to meet the Commissioners, with no comparable restrictions on staff *ex parte* contacts.

The Act also contains provisions intended to increase the independence of Commission employees who preside over rulemaking proceedings.⁹¹ In addition, the amendments limit to \$75,000 the amount of compensation each participant (such as a consumer organization or small business group) can receive in a rulemaking proceeding, and prohibit any person from receiving more than \$50,000 per year for all rulemaking proceedings in which that person participates. Under the legislation the Commission must earmark 25 percent of its public participation funding for small businesses and initiate a small business outreach program to increase small business participation in Commission rulemaking proceedings.⁹²

C. Judicial Developments

In the first decision to review a trade regulation rule promulgated under the 1975 amendments to the FTC Act, the Second Circuit remanded the vocational schools rule⁹³ to the Commission because it found a "combination of procedural and substantive errors."⁹⁴ The court concluded that the Commission must define *in the rule* the acts or practices which the FTC found to be unfair or deceptive. In the vocational schools rule the Commission did not first specify the unfair acts or practices before prescribing the remedial changes necessary to alter the schools' prior business practices. The Second Circuit held that the statutorily specified "substantial evidence" review required it to

in the proceedings concerning children's advertising and advertising for over-the-counter antacids.

89. Improvements Act §15.

90. Improvements Act §12. Final implementing regulations were published at 45 Fed. Reg. 78,626 (1980).

91. Improvements Act § 9. Interim implementing regulations were published at 45 Fed. Reg. 36,337 (1980).

92. Improvements Act § 10.

93. 16 C.F.R. § 438 (1980).

94. *Katherine Gibbs School, Inc. v. FTC*, 612 F.2d 658, 662 (2d Cir. 1979).

find “a rational connection between the facts found and the choice made.”⁹⁵ By stating that a court reviewing a rule is required to take a “close look” at what the FTC had done, the Second Circuit made clear that judicial review should include an almost independent assessment of FTC policy choices. Applying this careful scrutiny standard, the court rejected both the tuition refund formula that penalized every school for every drop-out regardless of cause, and the requirement for job-placement disclosures that did not allow certain relevant additional information to be included.

In the second decision reviewing a post-1975 trade regulation rule, the District of Columbia Court of Appeals⁹⁶ remanded the “eyeglass” rule to the FTC due to intervening changes in state law resulting from the *Bates*⁹⁷ decision. The major part of the opinion discusses the effect of the Supreme Court’s recent decisions on state regulation of professional advertising and how that effect has removed much of the need for the FTC rule to curtail the ability of the states and professional associations to restrict the advertising of eye examinations or of ophthalmic goods and services.

The opinion, however, discusses the scope of judicial review of an FTC rule in more detail than the *Katherine Gibbs* decision. In the opinion of the District of Columbia Circuit, the substantial evidence review applies only to the Commission’s “factual determinations;” all other decisions, such as a policy choice concerning remedies, are to be reviewed under the arbitrary or capricious standard of traditional Administrative Procedure Act review.⁹⁸ Hence, the D.C. Circuit has seemingly established a more lenient standard for review of the FTC trade regulation rules than the Second Circuit.

The D.C. Circuit also attempts to resolve the conflict between one section of the FTC Act, codified at 15 U.S.C. § 57a(e) (3), which requires a reviewing court to examine the whole rulemaking record,⁹⁹ and another, codified at 15 U.S.C. § 57a(e) (5) (C), which states that the statement of basis and purpose accompanying an FTC rule, while part of the rulemaking record pursuant to 15 U.S.C. § 57a(e) (1) (B), is exempt from judicial review. The court concluded:

We will therefore seek to resolve the conflicting commands of the statute by consulting the statement of basis and purpose where the statement is helpful in understanding the Commission’s reasoning, but, nevertheless

95. *Id.* at 664, citing *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962). The dissent sharply disagreed that the Commission had failed to fully articulate a rational basis for the remedial portions of the rule. *Id.* at 679, 682. The dissent also argued that the statutory mandate would be met if the unfair or deceptive practices were defined in the statement of basis and purpose instead of in the rule itself. *Id.* at 675.

96. *American Optometric Ass’n v. FTC*, 626 F.2d 896 (D. C. Cir. 1980).

97. *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977).

98. *American Optometric Ass’n v. FTC*, *supra* n. 96, at 904–05.

99. *See* 15 U.S.C. § 706 (1976).

being careful not to impose upon the statement the unreasonable demands about which Congress was concerned.¹⁰⁰

In summary, although the sea of issues surrounding FTC trade regulation rules still exists, some progress has been made in charting the unknown waters.

IV. FEDERAL TRADE COMMISSION CREDIT PRACTICES RULE:

By George H. Braasch*

The Federal Trade Commission has finally issued the Staff Report and Recommendation¹⁰¹ covering the proposed Credit Practices Trade Regulation Rule. In its report, the staff recommends a number of revisions to the original 1975 proposal. The revisions were made on the basis of the record including the findings in the Presiding Officer's Report¹⁰² filed in 1978 after the conclusion of 51 days of public hearings.¹⁰³ Shortly after the staff report was filed, a separate report, prepared by the FTC Bureau of Economics, was also filed with the Commission.¹⁰⁴ The Bureau of Economics report, though generally supportive of the staff recommendations, comes to some different conclusions and suggests a number of alternative formulations to several provisions of the proposed rule designed to achieve the same objectives at a substantially reduced cost. Public comment on these reports, as well as the entire rulemaking record, was invited through January 16, 1981. The potential impact of the rule on creditor practices, plus the sometimes sharply differing views of the Commission's own staff, suggest that this rule will continue to receive close scrutiny before it is ever finalized.

A. Background

The proposed Credit Practices Rule originated from the survey and report of the National Commission on Consumer Finance¹⁰⁵ and an investigation of the consumer finance industry conducted by the FTC Bureau of Consumer Protection from the fall of 1972 through the spring of 1974.¹⁰⁶ The staff then submitted a proposed rule and accompanying memorandum to the Commis-

100. *American Optometric Ass'n v. FTC*, *supra* n. 96, at 906 (footnote omitted).

*Member of the Illinois bar.

101. Staff Report and Recommendations on Proposed Trade Regulation Rule 16 CFR Pt. 444; Public Record 215-42, FTC Bureau of Consumer Protection (August 1980)(hereafter "Staff Report.")

102. Report of the Presiding Officer on Proposed Trade Regulation Rule 16 CFR Pt. 444; Public Record 215-42, Henry B. Cabell (August 1978)(hereafter "Presiding Officer's Report").

103. Public hearings were held in Dallas, Chicago, San Francisco and Washington, D. C., from September 1977 through January 1978.

104. Division of Consumer Protection Bureau of Economics, Comments on Credit Practices Rule, Memorandum to Commission dated August, 18, 1980 (hereafter "Bureau of Economics Memo").

105. Consumer Credit in the United States, Report of the National Commission on Consumer Finance (1972).

106. Staff Report at 1.

sion with a recommendation that a proceeding be conducted to determine whether the use of certain collection remedies was an unfair practice under section 5 of the FTC Act. The initial rulemaking notice was published on April 11, 1975.¹⁰⁷

Public hearings were held from September 1977 through January 1978 in Chicago, Dallas, San Francisco and Washington. Three hundred nineteen witnesses testified; over 12,400 pages of testimony were taken; over 1,300 written comments were submitted. The interests represented at the hearings included finance companies, banks, retailers, credit unions and their respective associations; legal service attorneys; governmental entities; consumers and consumer groups.¹⁰⁸

B. Scope of the Proposed Rule

The proposed rule is based on the staff's determination that most consumer credit contracts are contracts of adhesion in which consumers cannot bargain over particular provisions. The staff argues that in such circumstances consumers are at a disadvantage which is not offset by a reasonable measure of value received in return.¹⁰⁹ Thus, in drawing the rule, the staff focused on a number of specific collection remedies and contractual provisions commonly used in consumer credit agreements. These include confession of judgment clauses, waivers of exemption, wage assignments, blanket security interests including cross-collateral clauses and failure to specifically identify encumbered property, provisions allowing for the recovery of attorneys fees, late charges, judgments for deficiency balances, communications to third parties and the use of co-signer provisions.

While space does not permit a detailed analysis of the entire scope of the proposed rule, the following discussion highlights the findings of the reports filed by the Presiding Officer and the FTC staff and raises some of the major questions and concerns expressed by creditors who will be most seriously affected.

*1. Confession of Judgment Clauses*¹¹⁰

Both the staff report and the Presiding Officer's report recommend prohibiting the use of confession of judgment clauses in consumer credit contracts. This recommendation is based on the conclusion that such clauses in standard form contracts unfairly deprive consumers of their right to notice and an opportunity for a hearing after a default. The record appears to support this conclusion.

107. 40 Fed. Reg. 16,347 (1975).

108. Staff Report at 49.

109. 40 Fed. Reg. 16,349 (1975). *See also*, Staff Report at 39-44.

110. Revised proposed rule, § 444.2(a)(1); Staff Report at 87; Presiding Officer's Report at 79.

2. *Waivers of Exemption*¹¹¹

Again, both reports essentially are in agreement and recommend prohibiting the use of blanket executory waivers of state property exemptions from attachment, execution or other process on real or personal property. The record indicates that the degree of consumer harm here is occasioned more by the threatened use or *in terrorem* effect of waivers rather than instances of an actual seizure.¹¹² The revised rule, however, would allow the use of waivers applying solely to specific property subject to a security interest executed in connection with the obligation.

3. *Wage Assignments*¹¹³

The staff report recommends prohibiting the irrevocable assignment of future wages on the grounds that such clauses deprive consumers of notice and an opportunity for a hearing after default and that they cause injury to the employer-employee relationship. Previously earned income would not be covered by this prohibition. The Presiding Officer's report, while recognizing the potential abuse of wage assignments, did see some usefulness to low income consumers. His report recommended (largely followed in the revised rule) that the prohibition be more definitive as to the type of income and assignment to which it applies. Accordingly, the proposed rule has been drafted to allow the assignment of earned wages or the revocable assignment of unearned wages. The Bureau of Economics report recommends also allowing the use of wage assignments when the creditor gives the debtor prior notice as to where and how the debtor could contest the attachment.¹¹⁴

4. *Blanket Security Interests*¹¹⁵

The staff report, while finding substantial abuse of blanket security interests, now recommends prohibiting nonpurchase money security interests only with respect to household goods. This is a change from the original proposal which would have prohibited all nonpurchase money security interests. This change would allow consumers the unrestricted ability to borrow on the equity in their homes, stocks, bonds, and the like. The Presiding Officer's report, however, found little actual abuse of blanket security interests, noting that repossessions of property covered by such interests were infrequent and that such clauses had some utility among consumers who have no other collateral. The Bureau of Economics report deviates further and indicates that consumers should be allowed to use personal property as security in both purchase

111. Revised proposed rule, § 444.2(a)(2); Staff Report at 118; Presiding Officer's Report at 98.

112. Staff Report at 126.

113. Revised proposed rule, § 444.2(a)(3); Staff Report at 138; Presiding Officer's Report at 115.

114. Bureau of Economics Memo at 59.

115. Revised proposed rule, § 444.2(a)(4); Staff Report at 192; Presiding Officer's Report at 131.

money and nonpurchase money transactions, provided that such property is specifically designated.¹¹⁶

5. *Cross-Collateral—Security Interests*¹¹⁷

While this was a secondary issue in the proceeding, both the staff report and the Presiding Officer's report found potential consumer injury from the use of cross-collateral provisions to secure payment of purchase money obligations where the contract does not provide for a proper allocation of payments. Thus the rule has been drawn to require that payments be applied to purchases on a first-in, first-out basis.

6. *Specific Identification of Secured Property*¹¹⁸

The underlying basis for requiring specific identification of collateral is to allow consumers to know what specific property is securing the credit and to insure that unenforceable after-acquired property clauses are not used. Both of the reports found that descriptions frequently used are generally inadequate, even though legally sufficient under the Uniform Commercial Code. However, the staff report, in following the recommendation of the Presiding Officer, now recommends that enumeration by serial numbers should not be required. The rule now requires identification, with specificity, of each type and item of encumbered property, except where a security interest in fixtures or accessions otherwise meets the requirements of the Uniform Commercial Code.

This requirement of the Proposed Rule appears to be difficult, if not impossible, for many creditors, especially retailers who take security interests under open end charge account agreements. In that situation, the creditor would be unable to identify property to be purchased and encumbered in the future.

7. *Deficiency Balances—Fair Market Value*¹¹⁹

This has been one of the most controversial issues under the proposed rule. The staff maintains that the practice of seeking deficiency judgments (typically in automobile repossessions) is unfair and that repossessed automobiles are usually in good or fair condition at the time of repossession. The original proposal to restrict deficiency judgments has now been somewhat narrowed. The staff now recommends that security agreements involving personal property contain a clause that releases the consumer from any liability for a deficiency judgment unless the debtor is credited with the fair market retail

116. Bureau of Economics Memo at 60.

117. Revised proposed rule, § 444.2(a)(5); Staff Report at 205; Presiding Officer's Report at 150.

118. Revised proposed rule, § 444.2(a)(6); Staff Report at 246; Presiding Officer's Report at 153.

119. Revised proposed rule, § 444.2(a)(7); Staff Report at 249; Presiding Officer's Report at 205.

value of the repossessed collateral as determined by sale in an established retail market. By implication, a creditor who does not, or cannot, sell or determine the equivalent fair market retail value of repossessed goods in an established market, must choose between repossession with no possible deficiency claim, or suit as an unsecured creditor. The revised rule does not specifically require a retail sale in order to recover a deficiency judgment, but only the crediting of the equivalent value.¹²⁰

The Presiding Officer's report had concluded that the proposed fair market retail value rule was unlikely to produce any substantial consumer benefit and suggested an election of remedies approach similar to that now proposed by the staff. His report also indicated that some property has no retail market value and that creditors generally do attempt to get the best possible price for repossessed property.

The Bureau of Economics report suggests that fair market value after repossession be determined by the wholesale value rather than the retail value and argues that a retail value standard would impose substantial bookkeeping costs on finance companies.¹²¹

One of the underlying problems with the staff's proposed remedy is that it would force *all* creditors to amend their contracts to advise consumers of their rights prior to the commencement of a suit for a deficiency balance, even though not all creditors use or seek deficiency judgments. This is especially true in the retail industry, where the effect of the rule will force most retailers into an election of remedies situation because of the unavailability of an established secondary retail market for the sale of repossessed appliances, furniture and other types of general merchandise.

8. Attorneys Fees¹²²

The staff report argues that the use of attorneys fees clauses is unfair to consumers by punishing them or threatening to punish them for defaulting or asserting their legal rights, and recommends a total ban on their use. The staff has adopted a modified alternative provision, however, which would allow such clauses provided that the recovery of fees is limited to contested cases and paid only [to]¹²³ the prevailing party upon a judicial determination of reasonableness measured by the value of the actual legal services performed by an attorney who is not a salaried employe of either party. The alternative rule would specifically prohibit such clauses in all consumer loan agreements for \$1,000 or less where the rate of finance charge is more than 18 percent.

120. Staff Report at 323. *See also*, Bureau of Consumer Protection Comments on Staff Report, Memorandum to Commission dated August 4, 1980 (Staff Report Appendix D at 5).

121. Bureau of Economics Memo at 62.

122. Revised proposed rule, § 444.2(a)(8); Staff Report at 328; Presiding Officer's Report at 167.

123. In the text of the revised rule at § 444.2(a)(8)(ii)(A), the staff used the preposition "by" which in this writer's view is a typographical error.

The Presiding Officer's report found that the record did not support a total ban on attorneys fees clauses and that there appears to be no legal reason for not imposing such fees on those responsible for such charges. His recommendation was that the losing party should pay the fees. The Bureau of Economics' report also suggests that attorneys fees should be paid by the losing party, but only in contested cases.¹²⁴

As far as the alternative remedy is concerned, the staff has taken a somewhat convoluted approach in framing the modification. The staff's alternative would only permit an attorneys fees clause to operate after a judicial determination of reasonableness. This raises questions as to the circumstances which would give rise to a violation and the degree of liability for civil penalties. The protective conditions in the alternative proposal attach only when and if attorneys fees are actually sought. If the creditor's only responsibility is to spell out those conditions in the contract, this would cut against the staff's own argument that it is the threat of recovering attorneys fees, or the *in terrorem* use of an attorneys fees clause, that often results in consumer injury.

9. *Delinquency and Late Charges*¹²⁵

The staff report, following the Presiding Officer's recommendation, has now concluded that the record does not justify prohibiting the contractual imposition of all late charges, as originally proposed, or otherwise limiting such charges to the amount derived from application of the annual percentage rate of finance charge. The staff now recommends prohibiting only the "pyramiding" of delinquency charges and has revised the proposed rule to this effect.

This is another instance, however, where the revised rule requires an affirmative obligation on the part of all creditors to amend their contracts to alert consumers to a limitation of a contractual remedy which many creditors do not use or purport to use.

10. *Third-Party Contacts*¹²⁶

The staff report recommends prohibiting creditors from contacting unobligated third-parties in an effort to collect debts on the ground that such contacts cause substantial injury. The only exception is for the purpose of locating a debtor or confirming assets or employment. The Presiding Officer's report indicated there was evidence in the record that third-party contacts frequently did cause embarrassment and pressure on debtors resulting in payment of an obligation notwithstanding the availability of a legal defense. He suggested that the original rule be redrafted to allow such contacts only for

124. Bureau of Economics Memo at 63.

125. Revised proposed rule, § 244.2(a)(9); Staff Report at 364; Presiding Officer's Report at 193.

126. Revised proposed rule, § 244.2(a)(10); Staff Report at 377; Presiding Officer's Report at 251.

a genuine business purpose. The Bureau of Economics Report essentially agrees with the staff's proposal, but suggests allowing third-party contacts as authorized in the contract, provided the authorization is revocable.¹²⁷

Among the concerns of the credit industry with the revised rule, aside from the mandatory notice requirement, is the apparent inability of a creditor to contact or discuss the status of an obligation with the debtor's spouse or to make any contact with an unobligated third-party after a default without a court order, even if the consumer is willing to allow the creditor to discuss the problem with such third party.¹²⁸

11. *Cosigners*¹²⁹

The staff report has come out strongly in favor of extensive notification requirements concerning the rights and obligations of cosigners. In addition, the staff report recommends both a three-day cooling-off period whenever a consumer is asked to cosign a loan already in default and that an advance written notice be given to any cosigner of a delinquency of 30 days or more or any anticipated repossession or acceleration of indebtedness. The staff also proposes that the creditor must first exhaust his remedies against the debtor prior to proceeding against a cosigner and that all cosigners must sign a document indicating the maximum liability or line of credit for which they may be responsible under an open end account.

The Presiding Officer's report basically agrees with the threshold requirement of providing cosigners with a clear statement of potential liability, but does not support a limitation of their liability or a three-day cooling-off period.

C. Conclusion

The proposed Credit Practices Rule is one of the most protracted, voluminous and controversial trade regulation proceedings ever to have emerged from the Commission. The record spans at least eight years of investigation and development, including a number of legal challenges to the Commission's rulemaking authority.¹³⁰ The reports filed with the Commission alone contain over 1,600 pages of findings and recommendations and the end does not yet appear in sight.

The Bureau of Consumer Protection has itself recognized the significance of the ultimate impact the proposed rule will have on the marketplace and has solicited yet further comment on the extent of potential consumer injury, the interaction and incremental effect of various rule provisions as well as the cumulative effect of the rule on low-income consumers. It has also raised the

127. Bureau of Economics Memo at 66.

128. It should be noted that the Fair Debt Collection Practices Act presently permits third-party contacts with the debtors consent. Fair Debt Collection Practices Act § 805(b), 15 U.S.C. 1692c (1976).

129. Revised proposed rule, § 244.2(b); Staff Report at 420; Presiding Officer's Report at 264.

130. Staff Report at 4.

possibility of applying the rule only to those areas which the record shows produce the most consumer injury and particularly, if such a rule would be less costly, the possibility of alternative rule provisions that offer substantial protection for consumers at less cost.¹³¹ Thus, it appears probable there will be further modification to the proposed rule and there is a possible Congressional veto beyond that.

It comes as no surprise that a proposed trade regulation rule of this magnitude has generated a groundswell of concern by the credit industry. Perhaps the most pervasive objection to the proposed rule is the inclusive attempt to cover a multitude of heretofore lawful creditors' remedies and to apply the rule without exception to all types of consumer credit. In so doing it invites a tenacious challenge by those creditors where the record lacks sufficient evidence to sustain such widespread application. It also raises questions of the impact the rule will have on some low-income consumers who may be precluded from securing credit, and of the ultimate costs of compliance which will have to be borne by all consumers.

The FTC appears bent on regulating contractual rights based on concepts of unequal bargaining power.¹³² Conceding that most consumer credit contracts are form contracts and that consumers are generally unable to bargain over boilerplate provisions, there are few instances anywhere in the commercial world where consumers are not met with take it or leave it situations. Everything from the price of a taxi cab or hotel room to the cost of a newspaper is offered on that basis. If concepts of bargaining power or contractual disadvantage are to become synonymous with concepts of deceptiveness or unfairness under section 5 of the FTC Act, the FTC will have reached a new plateau of rulemaking authority.

V. BANKRUPTCY CODE: By Vernon L. Evans*

During the first year under the 1978 Bankruptcy Code, 400,000 individuals filed bankruptcy petitions.¹³³ This represents a 100 percent increase over the preceding twelve month period. There are many factors contributing to this unprecedented surge in filings—economic conditions, changing social attitudes, and attorney advertising—and opinions differ as to the extent each one is contributing to the increase. The expanded concept of the “fresh start” for individual debtors under the Code is also generally conceded to be a factor in the increased use of bankruptcy as a means of alleviating individual financial difficulties, although the extent to which the Code has contributed to the increase has not yet been accurately quantified.

131. Bureau of Consumer Protection comments on Staff Report, Memorandum to Commission dated August 4, 1980 (Staff Report Appendix D).

132. Staff Report at 33. Presiding Officer's Report at 55.

*Member of the District of Columbia and Illinois bars.

133. Data supplied by Administrative Office, U.S. Courts (1980).

Aside from the greater number of individual filings, the enactment of the Code has also been accompanied by a period of uncertainty and even confusion as to the interpretation and implementation of key provisions of both "straight" bankruptcies under Chapter 7, and adjustment of Debts of Individuals with Regular Income under Chapter 13.

The Code represents the first complete revision of the bankruptcy laws of the United States in 40 years, and is the result of over four years of legislative effort during which hundreds of witnesses produced a record of more than 5,000 pages of testimony. A certain lack of consistency in what is intended to be a uniform law of bankruptcy is perhaps, therefore, to be expected, given the sheer magnitude of the effort undertaken by Congress. The fact that there are, at this writing, no Federal Bankruptcy Rules implementing the Code, and none expected in the near future, also contributes to the problems being encountered by the consumer credit bar.

These problems are of two types: first, those resulting from differences in interpretations by the various bankruptcy courts and second, those resulting from deficiencies in statutory drafting.

A. Lack of Uniformity in Interpretation

The lack of consistent application of Code provisions to consumer bankruptcy cases stems from both drafting oversight and the absence of clearly ascertainable Congressional intent.

For example, under section 1325(a)(3) of the Code, a Chapter 13 plan must be proposed by the debtor in "good faith" in order to be confirmed. Controversy has arisen over the question of what payments, if any, a Chapter 13 debtor must make on unsecured claims to satisfy this "good faith" standard. During the first year under the Code, unsecured creditors have been dealt with in a variety of ways. "Good faith" has been interpreted to mean that the Chapter 13 plan does not have to provide any payment to unsecured creditors as long as they do not receive less than they would in liquidation under Chapter 7.¹³⁴ Another court found such a proposed plan to violate the "good faith" requirement.¹³⁵ Plans proposing to repay small percentages of unsecured claims have been found to be "illusory"¹³⁶ or not "meaningful."¹³⁷ When some payment to unsecured creditors has been required, different tests have been used to determine how much. Payments must be "substantial"¹³⁸ but need not be the "best effort" of the debtor.¹³⁹ Other courts do require a

134. *In re Thebeau*, 3 B.R. 537 (E.D. Ark. 1980).

135. *In re Terry*, 630 F.2d 634 (8th Cir. 1980).

136. *In re Bloom*, 3 B.R. 467 (C.D. Calif. 1980).

137. *In re Montano*, 4 B.R. 535 (D.D.C. 1980). See also, *In re Barnes*, 5 B.R. 376 (D.D.C. 1980) (1% is not good faith). (The case also held that a plan which did not consider the effect of inflation and which used all available income was not feasible.)

138. *In re Campbell*, 3 B.R. 57 (S.D. Calif. 1979).

139. *In re Powell*, 2 B.R. 314 (E.D. Va. 1980). The plan proposed to pay unsecured creditors 50% of their allowed claims.

“best effort.” In some cases the “best effort” standard includes a minimum percentage payment on unsecured claims consistent with the bankruptcy discharge provision of section 727.¹⁴⁰ In others, it does not include such a percentage. It may be a “reasonable effort at debt reduction”¹⁴¹ or there may be a “rule of thumb” of paying 10 percent of take-home pay to unsecured creditors.¹⁴² Many decisions stress the importance of examining each plan on a case by case basis¹⁴³ in the absence of a statutory standard more precise than “good faith.”¹⁴⁴

Secured creditors have also discovered a lack of uniformity in treatment under the Code. Under the “cram down” provision of Chapter 13¹⁴⁵ a plan can be confirmed if it provides that the secured creditor retain its lien and be paid the value of its collateral as of the effective date of the plan. A secured creditor may demand that the Chapter 13 plan adequately protect it and for such purposes the creditor becomes less protected or less secured if the collateral depreciates faster than the payments are made. Since interest on a secured claim generally stops with the filing of a petition in bankruptcy, the problem remains of how to protect the creditor’s security over the term of the plan. One court resolved the problem by making a “rough approximation” and allowing interest on the amount of the allowed secured claim of 10 percent per annum.¹⁴⁶ Another court allowed interest at 9 percent, the state legal rate of interest.¹⁴⁷ Others have allowed the discount rate of interest established by the Federal Reserve Board¹⁴⁸ or the contract rate.¹⁴⁹

The exemption provisions of section 522 have also been a source of widely divergent case law. Sixteen states have opted out of the federal schedule of exempt property.¹⁵⁰ Tools of trade under section 522(d) and (f) have been variously interpreted to include automobiles,¹⁵¹ or to exclude automobiles.¹⁵² In one case, a truck was held to be a tool of trade,¹⁵³ and in another it was

140. 70%.

141. *In re Cook*, 3 B.R. 480 (S.D. W. Va. 1980).

142. *In re Curtis*, 2 B.R. 43 (W.D. Mo. 1979).

143. See *Montano*, *supra* n. 137.

144. The Technical Amendments bill, S. 658, considered but not enacted in the 96th Congress, attempted to remedy this deficiency by redefining the standard as requiring either a “best effort” by the debtor (Senate bill), or a good faith plan proposed in good faith (House bill), or a “bona fide effort” (second Senate version).

145. § 1325.

146. *In re Lum*, 1 B.R. 187 (E.D. Tenn. 1979).

147. *In re Crockett*, 3 B.R. 365 (N.D. Ill. 1980).

148. *In re Ziegler*, 6 B.R. 3 (S.D. Ohio 1980).

149. *In re Smith*, 4 B.R. 12 (E.D. N.Y. 1980).

150. Alabama	Illinois	Louisiana	South Dakota
Arizona	Indiana	Nebraska	Tennessee
Florida	Kansas	Ohio	Virginia
Georgia	Kentucky	Oklahoma	Wyoming

151. *In re Dubrock*, 5 B.R. 353 (W.D. Ken. 1980).

152. *In re Damron*, 5 B.R. 357 (W.D. Ken. 1980).

153. *In re Pockat*, 6 B.R. 24 (W.D. Wis. 1980).

not.¹⁵⁴ The extent to which the wild card provision of section 522(d)(5) which allows a \$400 exemption in "any property" may be limited, has also been questioned.¹⁵⁵

A more fundamental question has been raised regarding the status of nonpurchase-money, nonpossessory liens in household goods and furnishings, books, tools of the trade, etc. under section 522(f). Such liens may be avoided to the extent they impair exemptions claimed by the debtor. One court¹⁵⁶ has held that section 522(f) applies prospectively only from the effective date of the Code (October 1, 1979) and that to apply it retrospectively to avoid liens created prior to that date would violate the Fifth Amendment protection against the taking of property without adequate compensation.

B. Statutory Deficiencies

In making the concept of "fresh start" more meaningful, the Code has attempted to protect the individual debtor from his creditors. The filing of a petition operates as a stay of "any act" to collect, assess, or recover a claim.¹⁵⁷ This provision, when strictly construed, prohibits any communication by the creditor, even for the limited purposes of determining the status of the parties with respect to disposition of collateral, exemptions, reaffirmation, etc. Inasmuch as a large number of the petitions in bankruptcy are filed *pro se*, and the debtor fails to communicate his intentions to the creditor, the creditor is often left with no alternative but to initiate an adversary proceeding to determine the debtor's intentions.

The automatic stay of any action against a co-debtor in Chapter 13 is another example of a restriction on creditor conduct that is unnecessarily broad. Section 1301(a) provides for a stay of any act to collect a claim from a codebtor of the Chapter 13 debtor. Section 1301(c), however, requires the bankruptcy court to grant relief from such a stay to the extent the plan proposed by the debtor proposes not to pay the claim, but only after notice and a hearing. In most cases, there is no question whether the plan proposes to pay the claim, so there is no need for a hearing if the plan proposes not to pay the claim.¹⁵⁸

The discharge hearing is another area that has given rise to controversy. Like the meaning of "good faith" in Chapter 13, the requirement of a discharge hearing has brought forth a variety of interpretations. Section 524(d) requires that when the bankruptcy court has determined whether or

154. *In re Meyers*, 2 B.R. 603 (E.D. Mich. 1980).

155. *In re Smith*, 5 B.R. 500 (C.D. Ill. 1980), construing § 522(d)(5) to apply only to property of the type listed in § 522.

156. *In re Schulte; In re Hunter*, ____ B.R. ____ (D. Kan. 1980).

157. § 362.

158. The Technical Amendments bill (S. 658), which passed the Senate on December 1, contained provisions for amending § 1301 by the addition of a new subsection (d) as follows:

The confirmation of a plan shall automatically grant relief from the stay provided by subsection (a) of this section to the extent that the plan proposes not to pay such claim.

not to grant a discharge under Chapter 7 or Chapter 13, it must hold a hearing at which the debtor must appear in person.

This straightforward and seemingly reasonable provision has led to several problems. One concerns the attendance of the debtor at such discharge hearings. Some courts attempt to compel the debtor's attendance by continuing the hearing if the debtor fails to appear or by threatening contempt for nonappearance. Others simply conduct the required hearing—frequently for the benefit of many debtors in combined or consolidated hearings—without determining whether the debtor is in fact in the courtroom. Another problem concerns the content of the hearing. Except in cases where there is a proposed agreement to reaffirm a debt, there is nothing for the court to do at the discharge hearing beyond informing the debtor that a discharge has been granted or the reason why a discharge has not been granted. Where a discharge is granted and no reaffirmation agreement is involved, there would seem to be no reason to require the court to hold such a hearing. Requiring attendance at such a hearing, at least where it is only a perfunctory one, does nothing to enhance the proceeding in the eyes of the consumer.

Another problem encountered in discharge hearings relates to reaffirmation of consumer debts. Section 524 allows a debtor to reaffirm dischargeable debts but only when certain specific requirements are met—including the receipt of advice from the court about the nature of reaffirmation and, in cases of debts that are not secured by real estate, the specific approval of the court. The court grants such approval if it finds the reaffirmation 1) does not impose “undue hardship” on the debtor or his dependents and 2) is in the “best interests” of the debtor or was entered into in good faith and in settlement of litigation or in redemption of collateral.¹⁵⁹ Courts have struggled with the requirement that they tell the debtor what is in his or her best interest.

For example, some have questioned whether they should approve reaffirmation of a consumer debt based on an apparently voidable lien, or only those based on otherwise valid contracts. Others simply decline to interfere with the debtor's desires and approve the reaffirmation agreement.

Some judges have recommended that the statutory requirement of a discharge hearing be repealed altogether. Others suggest retaining it only where a reaffirmation or redemption is involved. A third alternative would be to allow the courts more discretion to deal with the hearings and with attendance of debtors.

C. Conclusion

The problems that have been encountered with the discharge hearing and the others discussed above are among those that have occurred most frequently under the Bankruptcy Code. They, and others, will presumably be the subject of Congressional hearings that are to be held in the 97th Congress. As

159. § 524(c)(4).

indicated, the Technical Amendments bill was not enacted in the 96th Congress (primarily because of a dispute between the Senate and House of Representatives over the bankruptcy judge pension provisions) and will again be before Congress in 1981. Industry-supported proposals to correct substantive as well as technical problems will undoubtedly be offered and considered. These will reflect the growing concerns that affordable consumer debts are being discharged and that Chapter 13 plans need more definite standards with respect to confirmation and discharge. When these matters are considered there will be a substantial body of experience upon which to draw for both technical and substantive improvements in the 1978 Bankruptcy Code.