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ARTICLE

RESCISSION UNDER THE SIMPLIFICATION ACT WHAT'S NEW (AND NOT SO NEW) FOR CREDITORS

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I. FROM COMPLEXITY TO "SIMPLIFIED" COMPLEXITY, A BRIEF HISTORY OF TRUTH IN LENDING OR TIL:

The Congress finds that economic 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. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.¹

With this lofty declaration of purpose, Congress in 1968

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1. Consumer Credit Protection Act, Pub. L. No. 90-321, § 102, 82 Stat. 146 (1968), (codified at 15 U.S.C. §1601 (a) (1976)).

passed the Truth in Lending Act² (hereinafter referred to as the old TIL), a seminal attempt at comprehensive consumer legislation at the federal level. In the battle for the original passage, a loose coalition of labor leaders and consumer groups, led by Senator Paul Douglas of Illinois, triumphed over a coalition of American business groups and creditor association.³ The basic premise underlying the Act was that meaningful disclosure of credit costs could only be made through a method of stating such costs on a uniformly computed annual percentage rate⁴ (APR). As noted by Professor Landers, an important commentator in the consumer credit field, the statement of the cost of credit as an annual rate could not become meaningful until the definition of other basic credit terms, (i.e., finance charges and amounts financed) were determined in the same way.⁵ With the uniform disclosure of such basic credit information, Congress anticipated a consumer public making informed choices among many available credit opportunities,⁶ resulting in benefits from both increased and uniform information and from heightened competition in the consumer credit area.⁷

2. Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. § § 1601-1613, 1631-1641, 1661-1665, 18 U.S.C. § 891 (1976 of West Supp. 1980)) [hereinafter cited as old TIL]. Major alterations of the Truth in Lending Act were made with the signing into law of the Truth in Lending Simplification and Reform Act by President Carter on March 31, 1980. Pub. L. No. 96-221, 94 Stat. 168 (1980) (codified as amended at 15 U.S.C. § § 1602-07, 1610, 1612, 1613, 1632, 1635, 1637, 1638, 1640, 1641, 1643, 1663-67, 1691 (1982 & Supp. 1983)) [hereinafter cited as Simplification Act].

3. Landers, *Some Reflections on Truth in Lending*, 1977 U. ILL. L.F., 669, 670.

4. *Id.* at 671; see also Replansky & Kauffman, *The Truth in Lending Simplification and Reform Act of 1980: A New Deal for the Creditor*, 13 U.C.C. L.J. 200, 201 (1980). Cf. *Ford Motor Co. v. FTC*, 120 F.2d 175 (6th Cir. 1941) (illustration that the capacity to deceive is inherent in advertisement of credit costs expressed as APRs calculated by the "add-on and then discount" computation method instead of using actuarial or "simple" interest); § 1607 of the Simplification Act contains the uniform APR computation method under the TIL.

5. Landers, *supra* note 3, at 671.

6. 15 U.S.C. § 1601(a) (1982).

7. Replansky & Kauffman, *supra* note 4, at 201; see also Rohner, *Truth in Lending "Simplified?" Simplified?*, 56 N.Y.U. L. Rev. 999, 1003-05 (1981). Rohner points out that even at the time of the passage of the original legislation, knowledgeable commentators in the consumer credit area (notably Professor Kripke) were emphatic that the credit disclosures provided by TIL would be virtually useless in poverty markets and only marginally useful in middle class markets. Kripke, *Gesture and Reality in Consumer Credit Reform*, 44 N.Y.U. L. Rev. 1 (1969).

However, the "Achilles heel" of the old TIL, at least from the creditor's standpoint, was that the fundamental disclosures (APR, finance charges, amount financed) were submerged in additional disclosures of terms relating to the transaction. The old TIL was no longer merely a credit cost disclosure law, but had become a law requiring selective disclosure of additional terms and computational figures only collaterally related to the fundamental credit cost disclosures.⁸

The implementation of the old TIL regulatory scheme during the 1970's, with its emphasis on "full disclosure,"⁹ together with the promulgation by the Board of Governors of the Federal Reserve System of Regulation Z¹⁰ (which supplemented the statutory disclosurescheme with more detailed requirements),¹¹ created increasingly burdensome complexity,¹² and resulted in dramatic compliance problems for creditors.¹³

To an important extent, the figures tell the story. During the period from 1968 to 1980, the Federal Reserve Board (FRB) published more than 1,500 staff interpretations of Regulation Z.¹⁴ Even more amazing is that, for the period 1969-1980, some 13,000 truth in lending suits were heard in federal courts, about 100 per month.¹⁵ This litigation, almost uniformly based on hypertechnical issues under Regulation Z, has been aptly characterized by one commentator as "'academic'

8. Landers, *supra* note 3, at 672.

9. Boyd, *The Truth-in-Lending Simplification and Reform Act—A Much-Needed Revision Whose Time Has Finally Come—Part I*, 23 ARIZ. L. REV. 1, 3 (1981).

10. Rohner, *supra* note 7, at 1005-07.

11. *Id.*

12. See e.g., Griffith, *Closed-End Transactions and the Revised Truth in Lending—Some Highlights*, 33 MERCER L. REV. 723 (1982); Miller, *Truth in Lending Act*, 34 BUS. LAW. 1405, 1420 (1979); O'Conner, *Truth in Lending Simplification*, 35 BUS. LAW. 1221 (1980). The above citations provide but a representative smattering of the universal agreement as to the burdensome complexity of the original Act. Further, Rohner notes that "[b]y 1980, the Federal Reserve had issued more than sixty official Board interpretations and more than 1500 official and unofficial staff letter interpretations of Regulation Z." Rohner, *supra* note 7, at 1005 (citations omitted).

13. 1980 FED. RESERVE BOARD ANN. REP. 3-4 [hereinafter cited as ANN. REP.]; see also Brandel, *An Overview and Introduction to the Annual Survey of Consumer Law Developments*, 34 BUS. LAW. 1401 (1979); Rohner, *supra* note 7, at 1005.

14. See *supra* note 13.

15. ANN. REP., *supra* note 13, at 3.

litigation that has had anything but academic results."¹⁶ In addition to the onerous burden placed on creditors in attempting to keep abreast of agency interpretations of the Act, creditors had the further burden of defending themselves in the onslaught of truth in lending litigation.

At the same time, consumers also encountered serious problems.¹⁷ As a result of the complexity of the old TIL and Regulation Z, disclosure forms rapidly passed an information saturation point for consumers, resulting in what has been aptly described as an "information overload"¹⁸ of disclosed transaction terms.

Despite congressional intent to assist the consumer in comparison credit shopping¹⁹ through mandatory disclosure, TIL litigation was in fact used to remedy consumer grievances of virtually every type.²⁰ The so-called "academic"²¹ litigation was engendered in the great proportion of cases to remedy consumer credit transaction problems such as bankruptcy, insolvency, or quality of goods or service disputes, with the original suit motivation only rarely involving disclosure issues.²²

However, not all experiences with the old TIL during the 1968-80 period were bad. The Act did achieve increased consumer awareness of basic credit terms, especially the interest rate.²³ Perhaps as a result of this heightened consumer aware-

16. Miller, *supra* note 12, at 1420.

17. See e.g., SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, REPORT ON TRUTH-IN-LENDING SIMPLIFICATION AND REFORM ACT, S. Rep. No. 73, 96th Cong., 1st Sess. 2 (1979) [hereinafter cited as SENATE REPORT].

18. Rohner, *supra* note 7, at 1006; see also Replansky & Kauffman, *supra* note 4, at 201.

19. 15 U.S.C. § 1601(a) (1982).

20. Landers, *supra* note 3, at 676.

21. Miller, *supra* note 12, at 1420.

22. Landers, *supra* note 3, at 676-79.

23. Replansky & Kauffman, *supra* note 4, at 201; Brandt & Day, *Information Disclosure and Consumer Behavior: An Empirical Evaluation of Truth-in-Lending*, 7 U. MICH. J.L. REF., 297, 326 (1974). Interestingly, Brandt and Day concluded that consumer knowledge of interest rates improved most among middle and upper income groups, with less favorable results for lower income groups. Such a result was predicted by Professor Kripke in 1969. Kripke, *Gesture and Reality in Consumer Credit Reform*, 44 N.Y.U. L. REV. 1 (1969). See also Garwood, *Truth in Lending - Real Estate Transactions*, 87 BANKING L.J. 985 (1970). Garwood, as an attorney for the FRB in the early 1970s had responsibility for the Board's TIL function. He stresses improvement of consumer awareness (especially of APR) in upper and middle income groups, but acknowledges less effectiveness in regard to the low income

ness, creditors charging the highest APRs have, since 1969, lost substantial shares of the consumer credit market. Based on intuition rather than conclusive proof, some opinion has been expressed that TIL interest rate disclosures had a hand in the market shift.²⁴

By the end of the 1970s it was clear that consumer disclosure benefits under the old TIL were outweighed by the detrimental effects of creditor compliance problems and the litigation explosion which resulted.²⁵ Against this background, enter the new player on the TIL legislative stage, the Truth in Lending Simplification and Reform Act of 1980.²⁶ The Simplification Act, as it is called, amended the original Truth in Lending Act to provide consumers with simpler and more meaningful disclosures (an attempt to resolve the consumer information overload problem), to ease creditor compliance, and to limit creditor liability.²⁷ To achieve these goals, the number of required disclosures was reduced, together with the length and detail of the remaining disclosures.²⁸ Model forms for common credit transactions were promulgated as appendices to the Revised Regulation Z.²⁹

The Simplification Act addressed the problem of burgeoning Federal Reserve Board staff interpretations under the

consumer.

24. SENATE REPORT, *supra* note 6, at 2.

25. Boyd, *Part I*, *supra* note 9, at 35; Miller, *supra* note 12, at 1405; O'Connor, *Truth in Lending Simplification*, 35 BUS. LAW. 1221-23 (1980); Replansky & Kauffman, *supra* note 4, at 201; Rohner, *supra* note 7, at 1002-07. *But cf.* Garwood, *supra* note 23 (minimizing compliance and litigation concerns with TIL and emphasizing the benefits of increased consumer awareness of basic credit terms).

26. 15 U.S.C. § § 1602-1607, 1610, 1612, 1613, 1632, 1635, 1637, 1638, 1640, 1641, 1643, 1663-1667, 1691 (1982 & Supp. 1983).

27. ANN. REP., *supra* note 13, at 2.

28. O'Connor, *Truth in Lending Simplification*, 36 BUS. LAW. 1161-64 (1981); Comment, *Consumer Credit: Disclosure Requirements under the Federal Truth in Lending Act*, 22 WASHBURN L.J., 564, 568-69 (1983).

29. Distinction is made between what will be hereinafter referred to as Old Regulation Z, promulgated under the original TIL Act (the old TIL), 12 C.F.R. § 226.1-.29 (1980) and the Revised Regulation promulgated under the Simplification Act, hereinafter referred to as Revised Regulation Z, 12 C.F.R. § 226.1-.29 (1981). The model forms and clauses appear as Appendix H (Closed-End) and Appendix G (Open-End). Section 1604(b) of the Simplification Act authorizes the Federal Reserve Board to promulgate the forms. Further, the Revised Regulation has been restructured and simplified in many significant ways. For a detailed analysis of Revised Regulation Z, see O'Connor, *supra* note 28.

old TIL and Regulation Z by the promulgation of an Official Staff Commentary to the Revised Regulation Z.³⁰ The FRB has attempted to incorporate virtually the entire body of published material on truth in lending into the Revised Regulation and its accompanying Commentary.³¹ However, the Board has acknowledged that "[t]he incorporation of the extensive interpretive material is at odds with the goal of simply shortening the regulation."³²

The Introduction to the Commentary proclaims that good faith compliance affords creditors protection from liability.³³ The efficacy of reliance on Commentary positions is buttressed by two United States Supreme Court decisions, *Ford Motor Credit Co. v. Millhollin*,³⁴ and *Anderson Brothers Ford v. Valencia*.³⁵ In *Millhollin*, dealing with a pre-Commentary staff interpretation, the Court held that courts should follow Board staff interpretations unless "demonstrably irrational."³⁶ To the same effect is *Valencia* in which the primacy of the staff interpretation is affirmed unless there is "obvious repugnancy to the statute."³⁷ The Commentary supercedes all previous Board and staff interpretations except in regard to issues to be decided under the old regulation.³⁸ Although the Commentary greatly reduces the bulk of staff interpretation and at least greatly slows³⁹ the flow of additional interpretations, the specificity of the older system is to some extent sacrificed to the more generalized approach of the Commentary.

30. See Fed. Reserve Board, Official Staff Commentary on Truth in Lending Regulation Z, 46 Fed. Reg. 50,288 (1981) (codified as 47 Fed. Reg. 41,338 (1982), 47 Fed. Reg. 51,732 (1982) at 12 C.F.R. pt. 226, Supp. I (1983)) [hereinafter cited as Commentary]; see also COMPLIANCE HANDBOOK FOR CONSUMER CREDIT 87-98 (7th ed. 1981); 46 Fed. Reg. 20,848 (1981).

31. ANN. REP., *supra* note 13, at 3.

32. *Id.*

33. 12 C.F.R. pt. 226, Supp. I.

34. 444 U.S. 555 (1980).

35. 452 U.S. 205 (1981).

36. 444 U.S. at 565.

37. 452 U.S. at 219; see Rohner, *supra* note 7, at 1008-10.

38. Commentary, *supra* note 30; 12 C.F.R. pt. 226, Supp. I.

39. 48 Fed. Reg. 14,882-83 (1983). The FRB plans to update the Commentary annually. A proviso is given, however, that revisions may be made more frequently if the occasion demands it. Obviously, if the FRB does choose to make frequent revisions in the future, a revisitation of the staff interpretation problems under the old TIL will occur.

Only time will establish whether simplification by this general method is compatible with providing adequate creditor compliance directives so as to reduce technical creditor violations.

The FRB, in a section of its 1980 Report to Congress appropriately entitled "The Realities of Simplification," acknowledged the inherent limitations in "simplification" of regulations of consumer credit.⁴⁰ The Board cited three factors which contribute to the continuing complexity of Revised Regulation Z and the Commentary. First, the scope of TIL has passed beyond basic credit disclosure and has expanded into all underlying items of the credit transaction.⁴¹ Second, there is recognition of the ongoing necessity for extensive interpretive material which will forever remain at odds with true simplification.⁴² Finally, the complexity of the credit system itself, together with constantly evolving credit extension variations, will mandate additional and probably more complex regulatory supplements and interpretations in the future.⁴³

II. RESCISSION UNDER THE SIMPLIFICATION ACT

Against the historical tapestry (patchwork?) of the old TIL and the passage of the Simplification Act, this article will focus on one of the most controversial⁴⁴ and unique⁴⁵ provisions of the TIL regulatory scheme: the rescission section set forth at section 1635 of the Act.⁴⁶ Specifically, an examination will be made of the metamorphosis of section 1635 from the

40. ANN. REP., *supra* note 13, at 2-3.

41. *Id.* at 3-4; see also Landers, *supra* note 3, on the expansion of the scope of TIL from disclosure of basic credit terms to *all* important terms of the transaction, many of the terms not directly relevant to the credit decision.

42. ANN. REP., *supra* note 13, at 3.

43. *Id.* at 3-4.

44. Boyd, *The Truth in Lending Simplification and Reform Act—A Much-Needed Revision Whose Time Has Finally Come—Part II*, 23 ARIZ. L. REV. 549 (1981); Garwood, *supra* note 23; e.g., Griffith, *Rescission and Civil Liability: Some Peculiarities of Truth in Lending and Real Estate Transactions*, 6 REAL EST. L.J. 275-76 (1978); Comment, *Who Can Win in Truth in Lending Rescission Transactions?*, 43 OHIO ST. L.J. 693 (1982) [hereinafter cited as Comment, *Who Can Win?*].

45. 15 U.S.C. § 1635 (1982). The provision is unique because it is the only TIL provision in which the remedy is rescission of the transaction in addition to statutory damages under § 1640. 15 U.S.C. § 1635(g).

46. 15 U.S.C. § 1635 (1982).

old TIL to its present form in the Simplification Act.

In brief, section 1635 creates a mandatory three-day "cooling-off" period in any consumer credit transaction in which a security interest is retained or acquired in any property which is used as the principal dwelling of the person to whom credit is extended.⁴⁷ During the three-day period, the consumer has the unconditional right to rescind the transaction simply by notification of the creditor.⁴⁸ A rescission procedure is then specified by the statute which requires various actions on the part of both the creditor and consumer to return to the status quo.⁴⁹ In the event that the creditor fails to properly disclose the right to rescind the transaction or fails to make other appropriate material disclosures in regard to the credit transaction, the consumer may exercise the rescission right at any time within three years after the consummation of the transaction, or until the sale or transfer of the property, whichever first occurs.⁵⁰

It is important to note that under the Simplification Act, section 1635 does not apply to "residential mortgage transactions,"⁵¹ which are defined as "security interests created or retained in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling."⁵² Thus, mortgages and liens associated with the original purchase of the dwelling are removed from the rescission disclosure requirements. However, the rescission rights of section 1635 will apply to the creation of subsequent security interests. Funding for home improvements subsequent to the original purchase, and bank loans for consumer credit purchases where a lien on the dwelling is taken for collateral, are typical examples of consumer credit transactions included within the scope of the statute.

Perhaps the most unusual feature of section 1635 is that it restructures the transaction so that the consumer has the opportunity for additional reflection during the three-day

47. 15 U.S.C. § 1635(a) (1982).

48. *Id.*

49. 15 U.S.C. § 1635(g) (1982).

50. 15 U.S.C. § 1635(a), (f) (1982).

51. 15 U.S.C. § 1635(e)(1) (1982).

52. 15 U.S.C. § 1602(w) (1982).

"cooling-off" period.⁵³ No other provision affords such a luxury.

Section 1635 is a perfect case-in-point to illustrate Professor Lander's thesis that TIL has evolved from a simple credit cost disclosure statute to a scheme in which all terms relevant to the credit decision must be disclosed, even "those terms not directly relevant to the credit decision . . . but that . . . might become useful if the transaction broke down."⁵⁴ The previously discussed 1980 FRB Report to Congress, in which the FRB candidly described the realities of TIL simplification, utilized section 1635 as an example of the expansion of the TIL legislative scheme beyond simple credit cost disclosure.⁵⁵ Further, it is important to keep in mind that a creditor found to be in violation of section 1635 is faced with a double whammy: in addition to rescission, damages may be awarded for TIL violations not relating to the rescission right.⁵⁶

Suffice it to say that, from the perspective of the creditor, many serious difficulties arise when the creditor is confronted with a transaction which falls within the purview of section 1635. Not the least of the creditor's problems initially is to identify the transaction as one in which rescission notification is required.⁵⁷ Assuming that the creditor has correctly identified the rescission transaction, he must then identify those persons to whom the rescission notice must be delivered. Pursuant to section 1635, the rescission notices and other disclosures may be required for persons who often are only collaterally related to the principals in the basic credit transaction.⁵⁸ Failure to give complete and accurate material disclosures, even though the rescission notice is properly provided, can result in the extension of the rescission period for up to three

53. Spanogle & Rohner, *CONSUMER LAW, CASES AND MATERIALS*, 169-71. (1979).

54. Landers, *supra* note 3, at 673-74.

55. ANN. REP., *supra* note 13, at 2.

56. Simplification Act, 15 U.S.C. § 1635(g) (1982).

57. *See infra* text accompanying notes 60-184.

58. Simplification Act, 15 U.S.C. § 1631(a) (1982). Note that Revised Regulation Z defines a "consumer" in the rescission situation to include "natural person[s] in whose principal dwelling a security interest is or will be retained or acquired, if that person's ownership interest in the dwelling is or will be subject to the security interest. . . ." Revised Reg. Z, 12 C.F.R. 226.2(a) (11) (1983).

years from the consummation of the transaction.⁵⁹ In the event that the consumer exercises his rescission right, courts interpreting the old TIL section 1635 have given greatly different interpretations of the actual rescission procedure to be followed.⁶⁰

It must be remembered that the purpose of section 1635 is to protect the consumer from rash decisions which result in encumbrance on his dwelling,⁶¹ and this purpose is, indeed, a commendable one. But the history of section 1635 under the old TIL shows that such protection was purchased at a high cost to the creditor in terms of compliance difficulty and litigation.⁶² Thus, it is pertinent to ask whether the revision of section 1635 under the Simplification Act will allow creditors to chart a safer course through the definitional and procedural maze of the TIL rescission transaction.

III. GENERAL SCOPE CONSIDERATIONS AFFECTING § 1635

A. *The Creditor*

The general scope of TIL is encompassed in the definition of consumer credit transaction.⁶³ Within the consumer credit

59. Simplification Act, 15 U.S.C. § 1635(f) (1982); *see infra* text accompanying notes 205-32.

60. Simplification Act, 15 U.S.C.A. §§ 1635(g), 1640 (West 1983); *see infra* text accompanying 255-67.

61. Boyd, *The Federal Consumer Credit Protection Act—A Consumer Perspective*, 45 NOTRE DAME LAW. 171, 188 (1970).

62. Morrinan & Schellie, *Truth in Lending Simplification*, 37 BUS. LAW. 1297, 1308 (1982); *see also* Boyd, *Part I, supra* note 9, at 2-3.

63. The term "consumer credit transaction" is an amalgam of terms defined in the TIL Act and Regulation Z. "The term 'credit sale' refers to any sale in which the seller is a creditor." Simplification Act, 15 U.S.C. § 1602(g) (1982); Revised Reg. Z, 12 C.F.R. § 226.2(16) (1983). A key concept is the Simplification Act's definition of "consumer", when used in reference to a credit transaction: "the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes." 15 U.S.C. § 1602(h) (1982). Revised Reg. Z defines "consumer" as a "cardholder or natural person to whom consumer credit is offered or extended." Note that the Revised Reg. Z "consumer" definition is extended for purposes of rescission to cover "natural persons in whose principal dwelling a security interest is or will be acquired, if that person's ownership interest is subject to the security interest." Revised Reg. Z, 12 C.F.R. § 226.2 (11) (1983). Revised Reg. Z defines "consumer credit" as "credit offered or extended to a consumer primarily for personal, family, or household purposes." § 226.2(12). "The term 'credit' means the right granted by a creditor

transaction, the creditor is the person obligated in the TIL legislative scheme to disclose the credit information specified by the Act.⁶⁴ Under the old TIL, "creditor" was defined as a "person who regularly extends or arranges for the extension of consumer credit . . . which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required."⁶⁵ Under this definition, several difficulties arose in determining who was a creditor subject to disclosure responsibilities.⁶⁶

Neither the old TIL nor Regulation Z defined the term "regularly."⁶⁷ The old Regulation Z added the requirement that the person must be "acting in the ordinary course of business."⁶⁸ The creditor definition under the old TIL was designed to exclude occasional or casual extenders of credit and place disclosure responsibilities on professional financiers. However, the line between the casual and professional credit extender was often difficult to draw, depending upon the weight given by the courts to various factors such as frequency and amount of credit transactions, nature of the creditor's business, and size of the transactions.⁶⁹

Under the old TIL, besides those persons or entities who actually extended the credit, arrangers of credit were also considered creditors.⁷⁰ The arranger assisted consumers to obtain credit from a financier or financial institution, in many cases pursuant to a pre-established arrangement between the arranger and the credit extender. In a consumer credit transaction in which an arranger facilitated consumer financing with a credit extender, more than one creditor for TIL disclosure

to a debtor to defer payment of debt or to incur debt and defer its payment." Simplification Act, 15 U.S.C. § 1602(e) (1982); *see also* Revised Reg. Z, 12 C.F.R. § 226.2(14) (1983).

64. 15 U.S.C. § 1631(a) (1982); *see also* Revised Reg. Z, 12 C.F.R. §§ 226.6-.7 (creditor disclosure responsibilities for initial and periodic disclosure statements in open-end transactions), § 226.17 (creditor enclosure requirements in closed-end transactions) (1983).

65. The old TIL, 15 U.S.C. § 1602(f) (1980); *see also* Old Reg. Z, 12 C.F.R. § 226.2(s)(1980).

66. Griffith, *supra* note 12, at 725; Rohner, *supra* note 7, at 1010-15.

67. Old TIL, 15 U.S.C. § 1602(f) (1980); Old Reg. Z, 12 C.F.R. § 226.2(s) (1980).

68. Old Reg. Z, 12 C.F.R. § 226.2(s) (1980).

69. *See* Boyd, *Part I*, *supra* note 9, at 17.

70. Old Reg. Z, 12 C.F.R. § 226.2(s) (1980).

purposes would exist in the transaction, each was responsible for making those disclosures "within the knowledge . . . of that specific creditor . . . and the purview of his relationship with the customer."⁷¹ This imprecise "extender-arranger" creditor definition led to extensive litigation to determine, in a given transaction, who would be identified as a creditor responsible for disclosure, and thus subject to suit for failure to properly disclose.⁷²

Under the Simplification Act and Revised Regulation Z, the creditor definition was altered significantly to correct many of the vague aspects of the old definition. For example, the term "regularly" has been precisely defined as credit extension "more than 25 times (or more than 5 times for transactions secured by a dwelling) in the preceding calendar year."⁷³ The Revised Regulation Z further specifies that there must be a *written* agreement to pay in more than four installments (not counting the downpayment) if no finance charge is imposed.⁷⁴

The problem of overlapping disclosure duties of multiple creditors is addressed in the Simplification Act by redefining "creditor" as the one "to whom the obligation is initially payable . . . on the face of the note or contract, or by agreement if there is no note or contract."⁷⁵ The purpose of this revision is to assure that in any transaction there will be only one creditor responsible for disclosure.⁷⁶

In addition to the multiple creditor issue, the "arranger

71. *Id.* at § 226.6(j).

72. Rohner, *supra* note 7, at 1010-15. Professor Rohner describes in detail the lines of case law which developed under the old TIL to identify creditors. Rohner asserts that the "extender-arranger" definition of creditor under the old Act resulted in "considerable judicial free-lancing in deciding what [disclosure] responsibilities rested on whom". *Id.* at 1011; *see also* Boyd, *supra* note 9, at 17-28; Miller, *supra* note 12, at 1416-20.

73. Revised Reg. Z, 12 C.F.R. § 226.2(17)(i) n.3 (1983).

74. *Id.* at § 226.2(17)(i).

75. *Id.*

76. Rohner, *supra* note 7, at 1012; Boyd, *Part I, supra* note 9, at 25. Professor Boyd points out that the FRB, while trying to create a creditor definition narrow enough to ensure only one creditor per transaction, nevertheless has established procedures in situations where multiple creditors might exist. The procedures establish that only one set of disclosures need to be given, and creditors shall agree among themselves which creditor must comply. Revised Reg. Z, 12 C.F.R. § 226.5 (open-end), § 226.17 (close-end) (1983).

as creditor" concept of the old TIL had to be addressed also. The original Simplification Act solution was to continue to include the arranger within the scope of the creditor definition, but to narrowly define the term as "a person who regularly arranges for the extension of consumer credit by another person if . . . the person extending the credit is not a creditor."⁷⁷ The effect of the definition was to limit the application of the arranger classification to only those situations where the credit extender did not qualify as a creditor. If the extender's name initially appeared on the contract creating the indebtedness and credit (either more than four installments or assessing a finance charge) was extended, then the only way the extender could escape the creditor classification would be failure to regularly extend credit (i.e., fall below the 25-5 transaction rule).⁷⁸ Thus, an arranger responsible for disclosure under the Revised Regulation Z was a person who regularly brokered credit between consumers and non-professional financiers.⁷⁹ A common situation in which the arranger could be treated as a creditor was an arrangement by a real estate agent for an owner-financed sale of real estate.⁸⁰

To eliminate the possibility that such potential arrangers might fall within the Simplification Act disclosure requirements, the Garn-St. Germain Depository Institutions Act completely removed the arranger concept from the creditor definition retroactively effective to October 1, 1982.⁸¹ In a single stroke, the arranger concept, one of the most litigated areas of the old TIL, was eliminated in the first round of the Simplification Act amendments. If one of the principal rea-

77. 12 C.F.R. § 226.2(a)(3)(ii)(1983).

78. Boyd, *Part I*, *supra* note 9, at 25; Rohner, *supra* note 7, at 1012.

79. Boyd, *supra* note 9, at 20; Rohner, *supra* note 7, at 1013. Note that under the Revised Reg. Z. definition, the arranger must "regularly" arrange for the extension of consumer credit, and the same 25-5 creditor numerical formula is utilized to determine whether the person falls within the definition. Revised Reg. Z, 12 C.F.R. § 226.2(3) n.2 (1983).

80. 1 R. CLONTZ, *TRUTH IN LENDING MANUAL*, 1-9 (5th ed. Supp. 1983); *see also*, Rohner, *supra* note 7, at 1014.

81. Pub. L. No. 97-320, 96 Stat. 1538 (1982) (codified as 12 U.S.C. § 226 (1983)). To implement the statutory amendment, the Fed. Reserve Board has removed the definition "arranger of credit" from the "creditor" definition. In addition, those portions of the Commentary relating to "arrangers of credit" are removed. 48 Fed. Reg. 14,883, 14,886 (1983) (codified at 12 C.F.R. § 226.2(a)(3), (17) (1983)).

sons for passage of the Simplification Act was to stabilize the basic consumer credit disclosure groundrules, it is curious that the Act has already been altered in this fundamental respect.

The identification of a party as a creditor constitutes a major aspect of any consumer credit transaction which falls within the scope of section 1635. Consider the following fact pattern: a contractor enters into an agreement with a homeowner to build an additional room on the family residence. To finance the addition, the consumer executes a promissory note and a second mortgage on the residence to the contractor. Assuming that the contractor regularly extends credit pursuant to the numerical formula provided in Revised Regulation Z, the contractor is a creditor under the Simplification Act definition because he has extended consumer credit (for personal, family, or household purposes) that is subject to a finance charge payable by written agreement, and the obligation is initially payable on the face of the note and mortgage to the contractor.⁸² Note that the consensual lien created is not to finance the acquisition or initial construction of the consumer's dwelling. Therefore, the rescission disclosure provisions of section 1635 apply since the transaction is not a residential mortgage transaction exempted from section 1635.⁸³

If the contractor takes the note and mortgage and simultaneously assigns them to a bank, who is the creditor for disclosure purposes under the Simplification Act? Even though the contractor makes a simultaneous assignment of the note and mortgage and, in point of fact, does not actually extend the credit, he will nonetheless be treated as the creditor for disclosure purposes.⁸⁴ It is the contractor to whom the note and mortgage are initially payable, and thus the contractor

82. Revised Reg. Z, 12 C.F.R. § 226.2(17) (1983).

83. Revised Reg. Z, 12 C.F.R. § 226.2(24) (1983); *see also* Simplification Act, 15 U.S.C. § 1635(e)(1)(A) (1982) (exemption of residential mortgage transaction from scope of § 1635). To the same effect, *see* Revised Reg. Z, 12 C.F.R. § 226.15(f)(1) (open-end), § 226.23(f)(1) (close-end) (1983); *see also* Commentary, *supra* note 30, at § 226.15 (f)(1), § 226.3(f)(1).

84. Commentary, *supra* note 30, at § 226.2(a)(17)(i)(2). The example provided in the Commentary of a simultaneous assignment of credit sale contracts from an auto dealer to a bank would be analogous to the contractor-bank hypothetical in the § 1635 context.

will be treated as the only creditor in the transaction.⁸⁵ Professor Rohner, in commenting on the simultaneous assignment situation, noted that "one must accept the notion that the [assigner] . . . does extend credit, even if merely temporarily."⁸⁶ Since in most forms of assignment contracts, the assignment is made with recourse, the treatment of the assignor as the creditor is logical.⁸⁷

Let us alter the facts in our hypothetical home improvement situation a second time. Assume that the contractor assists the consumer in locating a bank who will extend credit to the consumer and that the contractor continues to advise and assist the consumer with all arrangements for completion of the credit extension. If the note and mortgage are initially payable to the bank, then the bank is the creditor even though the contractor brokered the credit transaction between the consumer and the bank.⁸⁸

In the event that the contractor arranges financing with a credit extender who does not regularly extend credit under the Revised Regulation Z definition, neither the contractor nor the credit extender will be creditors under the Act, and thus the transaction will now fall outside of the Act's protection.⁸⁹ With the complete elimination of the arranger concept from the Simplification Act, there can be no doubt that such brokers are effectively eliminated as creditors under the Act.

B. The Purpose of Credit

As previously noted, a necessary jurisdictional factor in the consumer credit transaction is the purpose for which the credit is extended.⁹⁰ Section 1602(h) of the Simplification Act defines "consumer" as follows:

The adjective "consumers" used with reference to a credit transaction, characterizes the transaction as one in which the party to whom credit is offered or extended is a

85. *Id.*

86. Rohner, *supra* note 7, at 1013.

87. *Id.*; see also Griffith, *supra* note 12, at 726.

88. Revised Reg. Z, 12 C.F.R. § 226.2(17)(i) (1983); see Rohner, *supra* note 7, at 1013.

89. Revised Reg. Z, 12 C.F.R. § 226.2(17)(i) (1983).

90. Simplification Act, 15 U.S.C. § 1601 (1982).

natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes.⁹¹

Business transactions are exempted from TIL coverage under both the old TIL and the Simplification Act.⁹²

The test adopted in the Simplification Act for determination of the purpose of the transaction is whether the credit acquisition is *primarily* for business or commercial purposes as opposed to a consumer purpose.⁹³ Under the Simplification Act "primacy of purpose" test, some protection is afforded the creditor where a question exists in regard to the primary purpose of a credit extension. The creditor may disclose without concern that such disclosure will be controlling on the question of whether the transaction was exempt.⁹⁴ While no precise formula for determination of primary purpose is provided, the Commentary isolates certain factors for consideration, among them "the relationship of the borrower's primary occupation to the acquisition . . . the degree to which the borrower will manage the acquisition, the ratio of income from the acquisition to . . . borrower's total income, size of the transaction . . . and the borrower's statement of purpose for the loan. . . ."⁹⁵

91. 15 U.S.C. § 1602 (h) (1982); *see also* the Revised Reg. Z definition of consumer credit, § 226.2(12). Under the old TIL, consumer credit included agricultural purposes, but agricultural purposes were excluded from TIL coverage under the Simplification Act. 15 U.S.C. § 1603(1) (1982); 15 U.S.C. § 1602(h) (1983); 15 U.S.C. § 1602(h) (1980).

92. The old TIL, 15 U.S.C. § 1603(1) (1983); 15 U.S.C. § 1603(1) (1980). Exempted transactions include credit extension "primarily for business, commercial, or agricultural purposes, or to government, or governmental agencies or instrumentalities, or to organizations." *Id.* In addition, securities or commodity transactions by a broker-dealer registered with the SEC and various public utility tariff transactions are exempted. The final exemption excludes credit transactions exceeding \$25,000, unless the credit transaction is secured by a security interest in real property or personal property and expected to be used as the principal dwelling of the consumer. 15 U.S.C. § 1603(2)-(4) (1983). Since a § 1635 transaction necessarily involves a security interest taken on the consumer's principal dwelling, the \$25,000 limitation does not limit the application of § 1635. Commentary, *supra* note 30, at § 226.2 (a)(19)3; *see also* Revised Reg. Z, 12 C.F.R. § 226.3; Boyd, *supra* note 9, at 11-13.

93. Commentary, *supra* note 30, at § 226.3(a)1.

94. *Id.*

95. *Id.* On the "all factors" approach, *see generally* Griffith, *supra* note 12, at 727; Boyd, *supra* note 9, at 8-11.

Greater specificity is provided by the Commentary with regard to certain real estate transactions.⁹⁶ Credit for acquisition, improvement, or maintenance of rental property which is not owner-occupied is deemed to be for business purposes, regardless of the number of units involved.⁹⁷ For rental property which is, or will become, owner-occupied in the coming year, credit extended for *acquisition* will be treated as a business purpose if the property contains more than two units. Credit for *maintenance* or *improvement* will be deemed to be for business purposes if the property contains more than four units.⁹⁸

For owner-occupied rental property of four or less units, the Commentary specifically preserves the right of rescission in transactions extending credit for maintenance or improvement purposes.⁹⁹ Even in this situation, the determination must still be made whether the credit is extended for business or consumer purposes, using the "factors" analysis to establish the *primary purpose*.¹⁰⁰

In *Tower v. Moss*,¹⁰¹ a case decided under the old TIL, the borrower, who resided in Michigan, inherited a home located in Alabama. The borrower took out a loan on the Alabama house in order to make necessary repairs. To repay the loan, she rented the house at a nominal rate. The borrower intended, at some indefinite time in the future, to retire and reside in the Alabama house. On these facts, the court held that the transaction was primarily consumer in nature.¹⁰² Thus TIL disclosure requirements, which allowed the consumer to rescind, were found by the court to apply to the transaction.¹⁰³ If this case had been decided utilizing the Commentary, the result would have been altered: the Alabama home was non-owner occupied rental property, and any credit extended would therefore have been deemed to be for

96. Commentary, *supra* note 30, at § 226.3(a)3,4.

97. *Id.* at 3(a)3. If the owner expects to occupy the property for more than 14 days in the subsequent year, the rule does not apply. *Id.*

98. *Id.* at 3(a)4. A "Dwelling" is defined to include one to four units. Revised Reg. Z, 12 C.F.R. § 226.2(a)(19).

99. Commentary, *supra* note 30, at § 226.3(a)3.

100. *Id.* at § 226.3(a)4.

101. 625 F.2d 1161 (5th Cir. 1980).

102. *Id.* at 1167.

103. *Id.*

business purposes, unless the owner could prove that she expected to occupy the property for more than fourteen days during the year subsequent to the loan date.¹⁰⁴

Another difficult area concerns business-purpose credit which is subsequently rewritten for consumer credit purposes. In *Toy National Bank of Sioux City v. McGarr*,¹⁰⁵ McGarr executed a note in 1974 to Toy National to purchase a pleasure boat. In 1975, McGarr executed a second note to Toy National, with the loan proceeds deposited to the account of a business corporation wholly owned by McGarr. In May, 1976, the business loan was refinanced, McGarr and his wife executing a second mortgage on their residence to secure the loan. Finally, in September, 1976, the remaining amount due on the business loan (approximately \$12,000) was consolidated with the remaining balance on the boat (approximately \$1,000). This consolidated note was secured by a new second mortgage on the McGarr residence executed jointly by the McGarrs.¹⁰⁶

The McGarrs contended that the May and September, 1976, refinancings were consumer credit transactions in which security interests were created in the family residence. Hence, in the absence of TIL disclosures, the McGarrs would be entitled to rescind.¹⁰⁷

The first question posed was whether the May, 1976, refinancing of the business loan became a consumer credit transaction because Mrs. McGarr had joined in the execution of the mortgage on the residence, supposedly to help her spouse out of his business difficulties.¹⁰⁸ Mrs. McGarr argued that her purpose in executing the mortgage was personal (to assist her spouse) and, therefore, that the transaction was for consumer credit purposes.¹⁰⁹ In a cogent rejection of Mrs. McGarr's contention, the court stated:

We . . . reject as unworkable Mrs. McGarr's argument that as to her the May . . . 1976, refinancing was of a "personal" nature. This would also operate to swallow the business pur-

104. Commentary, *supra* note 30, at § 226.3(a)3.

105. 286 N.W.2d 376 (Iowa 1979).

106. *Id.* at 377.

107. *Id.* at 378.

108. *Id.*

109. *Id.*; see also, 1 R. CLONTZ, TRUTH IN LENDING MANUAL, 82-83 (5th ed. 1982).

pose exception. Many family-run businesses are operated by one or the other of the spouses, but not by both. Yet, under Iowa law both spouses must join in order to execute a valid mortgage. . . . [T]hus, all such transactions would be subject to the argument that as to the nonbusiness spouse the loan is for personal purposes (to help the other spouse) and, thus, the transaction is a consumer credit loan The decision to pledge one's home as security for a business loan does not lose its quality as a business decision merely because of the nature of the collateral.¹¹⁰

The second important issue facing the court was the determination of the status of the September, 1976, loan which consolidated the consumer (boat) loan with the business loan.¹¹¹ The court concluded that the primary purpose was business, based on the fact that the ratio of private purpose funds to business purpose funds in the consolidation was slightly greater than one to twelve.¹¹²

The Commentary has dealt with the issue of business-purpose credit later rewritten for consumer purposes.¹¹³ It provides simply that "[s]uch a transaction is consumer credit . . . only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor."¹¹⁴ The Commentary is less than clear in providing specific guidelines for mixed purpose transactions, and it would seem that the courts will ultimately be thrown back to the basic "all factors" primary purpose test of the Commentary¹¹⁵ to make the conclusive determination. Again, good advice for the creditor confronted with this nebulous situation, especially where the possibility of rescission rears its

110. 286 N.W.2d at 378 (citations omitted); see also Griffith, *supra* note 12, at 728. In *Anderson v. Lester*, 382 So. 2d 1019 (La. App. 1980), the property owner entered into a loan transaction secured by a mortgage on his home. The loan transaction was entered into to prevent seizure of the home by the business creditors. The court nonetheless concluded that the transaction was not for business purposes and thus not exempt from TIL, and the consumer was thus entitled to rescind. See also Boyd, *supra* note 44, at 556.

111. 286 N.W.2d at 378.

112. *Id.*

113. Commentary, *supra* note 30, at § 226.3(a)5.

114. *Id.*

115. *Id.* at § 226.3(a)1, 2.

head, is to disclose.¹¹⁶

C. Cash or Credit?

As previously noted, the Simplification Act and Revised Regulation Z define credit as "the right . . . to defer payment of debt or to incur debt and defer its payment."¹¹⁷ Although there are many considerations concerning the basic nature of credit under TIL¹¹⁸ which are beyond the scope of this article, some specific considerations relating to the application of section 1635 are worthy of comment.

First, the Commentary excludes from the TIL credit definition "home improvement transactions that involve progress payments, if the consumer pays, as the work progresses, only for work completed and has no contractual obligation to continue making payments."¹¹⁹ This exclusion is of obvious significance in the section 1635 context, where a great proportion of the typical rescission situations involve home improvement contracts.

In certain situations, a need for further clarification of the scope of the exclusion may arise. The facts of *Donnelly v. Mustang Pools, Inc.*¹²⁰ illustrate the concern. In *Donnelly*, a homeowner entered into a contract for the construction of a swimming pool, the terms of the contract calling for a down payment plus loan installments. The court characterized the contract as a cash transaction, payable on completion, and thus, no TIL disclosure was required.¹²¹ In dicta, the court made it clear that the four installments were not enough to bring the transaction within the ambit of the "Four-Installment Rule," but that if an additional installment had been included in the contract, the contract would clearly fall under the Four-Installment Rule, and TIL disclosure, including a re-

116. See *supra* note 91 and accompanying text.

117. Simplification Act, 15 U.S.C. § 1602(e) (1982); Revised Reg. Z, 12 C.F.R. § 226.2(a)(14).

118. For an excellent discussion on the basic nature of credit, see Boyd, *supra* note 9, at 6-8.

119. Commentary, *supra* note 30, at § 226.2(a)(14)1.

120. 84 Misc. 2d 28, 374 N.Y.S.2d 967 (N.Y. Sup. Ct. 1975).

121. *Id.* at 969, 971.

scission notice, would be necessary.¹²² Under the *Donnelly* rationale, even a cash transaction would require TIL disclosure if the four installment provision of the creditor test is met. Query: Does the Commentary home-improvement exclusion extend to progress payment contracts which technically fall within TIL coverage because of the Four-Installment Rule? This is one of the questions which the court leaves unanswered.

In another variation involving the question of credit in the home improvement situation, a contractor did improvement work on a residence pursuant to a contract calling for cash within sixty days after completion.¹²³ At the expiration of the sixty day period, the property owners were unable to pay and the contractor took a note and a mortgage. The property owners then attempted to rescind, taking the position that the execution of the note and mortgage constituted an extension of credit mandating full TIL disclosure, including notification of the right to rescind. The court held that the original nature of the transaction (cash, not credit) continued to control: thus the subsequent mortgage transaction was not within the scope of TIL.¹²⁴ However, this decision has been the subject of some criticism,¹²⁵ and the cautious creditor would be well advised to disclose, especially where the possibility of rescission exists.

IV. SPECIFIC SCOPE CONSIDERATIONS AFFECTING § 1635

A. *The Principal Dwelling*

Under the old TIL, the rescission right was available in any consumer credit transaction "in which a security interest

122. *Id.* at 971-72. In *Mourning v. Family Publications Serv. Inc.*, 411 U.S. 356 (1973), the plaintiff challenged the constitutionality of the Four-Installment Rule as exceeding the authority of the Fed. Reserve Board. The Four-Installment Rule is actually the "more than four installment" provision of the creditor definition. Old Reg. Z, 12 C.F.R. § 226.2(s); Revised Reg. Z, 12 C.F.R. § 226.2(a)(17). The creditor definition provides that a person must regularly extend consumer credit subject to a finance charge or payable by written agreement in more than four installments, not including the downpayment.

123. *Florida State Contractors Serv., Inc. v. Randall*, 368 So. 2d 421, 422 (Fla. Dist. Ct. App. 1979).

124. *Id.* at 422.

125. Willenzik & Laymaster, *Recent Trends in Truth in Lending Litigation*, 35 BUS. LAW. 1197, 1211 (1980).

. . . . is or will be retained or acquired in any real property which is used or expected to be used as the residence of the person to whom credit is extended."¹²⁶ In the Simplification Act, the right of rescission, as previously noted, is available in a consumer credit transaction "in which a security interest . . . is or will be retained or acquired in any property which is used as the principal dwelling of the person to whom credit is extended"¹²⁷ The new "principal dwelling" language significantly affects the range of TIL transactions to which section 1635 is applicable.

The most obvious change is that the term "dwelling" is now defined to include residential structures of one to four units "whether or not . . . attached to real property . . . [including] individual condominium unit[s], cooperative unit[s], mobile home[s], and trailers if . . . used as a residence."¹²⁸ Congress apparently could see no reason why section 1635 should be limited to real estate transactions, since a large segment of the American public purchased mobile homes, and the like, as lifetime residential investments.¹²⁹ Hence, rescission rights are now extended to all who purchase principal residences of practically any description, whether or not they happen to be affixed to real property.¹³⁰

While the "dwelling" language expands the types of transactions affected by section 1635, at the same time the Simplification Act removes section 1635 application from an important class of transactions involving security interests in vacant land.¹³¹ "Residence" was defined, under the old Regulation Z, to be "any real property in which the consumer resides or expects to reside."¹³² The residence definition, cou-

126. The old TIL, 15 U.S.C. § 1635(a) (1980).

127. Simplification Act, 15 U.S.C. § 1635(a) (1982).

128. Revised Reg. Z, 12 C.F.R. § 226.2(a)(19); *see also* Commentary, *supra* note 30, § 226.2(a)(19)1,2.

129. SENATE REPORT, *supra* note 17; *see also* Boyd, *supra* note 44, at 550.

130. Note that the Commentary provides that if the dwelling is the principal residence of the consumer, almost any structure, mobile or immobile is included, even boats. However, recreational vehicles, campers, and the like not used as residences are not considered dwellings for rescission purposes. Commentary, *supra* note 30, at § 226.2(a)(19)2.

131. Boyd, *Part II*, *supra* note 44, at 550; 1 R. CLONTZ, TRUTH IN LENDING MANUAL (5th ed. 1982).

132. Old Reg. Z, 12 C.F.R. § 226.2(ff).

pled with the old statute's provision that the rescission right was available when a security interest was or would be retained in any real property "*used or expected to be used as the residence*"¹³³ of the consumer, left no doubt that vacant land could become the subject of rescission rights. The Simplification Act applies only to transactions where security interests are or will be retained or acquired in any property "*used as the principal dwelling of the person to whom credit is extended. . . .*"¹³⁴ Thus, vacant land purchased with the expectation of immediate residential development will fall outside of the Simplification Act's rescission rights.¹³⁵

It is clear that under the Simplification Act a consumer can have only one principal dwelling at a time.¹³⁶ The sole exception to this rule is the situation in which the consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction. The new dwelling is considered a principal dwelling when the acquisition or construction loan is secured.¹³⁷ Vacation homes or other kinds of second homes are not considered principal dwellings.¹³⁸

The Comments describe a special rule for principle dwellings that could become a trap for the unwary creditor.¹³⁹ When a new principal dwelling is being acquired or constructed, any loan secured by the consumer's present residence (i.e., a bridge loan) is still subject to the rescission right.¹⁴⁰

133. The old TIL, 15 U.S.C. § 1635(a) (1980) (emphasis added).

134. Simplification Act, 15 U.S.C. § 1635(a) (1982).

135. See Boyd, *Part II*, *supra* note 44, at 550-51. Boyd is critical of the removal of the rescission remedy from vacant land purchase situations, believing that the right of rescission has served as an important deterrent for widespread wrongdoing in land sales and that the elimination of the right in the vacant land situation should be cause for future concern.

136. Commentary, *supra* note 30, at § 226.15(a)(1)5.

137. *Id.*

138. *Id.*

139. Commentary, *supra* note 30, at § 226.15(a)(1)6.

140. *Id.*

B. Security Interests

The possible severe consequences attending the creation of a lien against a consumer's principal dwelling is at the core of the rationale behind the TIL rescission right.¹⁴¹ Thus, as has often been previously noted, one of the principal conditions for the application of section 1635 to a consumer credit transaction is that a security interest must be retained against the consumer's principal dwelling.¹⁴²

Revised Regulation Z defines "security interest" to be "an interest in property that secures performance of a consumer credit obligation and that is recognized by State or Federal law."¹⁴³ The security interest definition makes an important distinction peculiar to section 1635 transactions. For consumer credit transactions not involving the rescission right, the term "security interest" does not include interests which arise solely by operation of law (principally, mechanic's and materialman's liens).¹⁴⁴ However, for purposes of the right of rescission, such liens are included within the definition.¹⁴⁵ Therefore, even though liens arising by operation of law are not considered security interests for typical disclosure purposes, nevertheless, if the principal dwelling is subject to such liens, the rescission right attaches.¹⁴⁶ It is important to understand that in most cases, such non-consensual security interests as mechanic's and materialman's liens are not in existence at the time of the consummation of the transaction, but come into effect only upon performance of the obligation.¹⁴⁷

A critical limitation on the scope of security interests, as applied in the rescission transaction, is that such liens must arise from the transaction.¹⁴⁸ The most straightforward exam-

141. See *supra* notes 58-59 and accompanying text.

142. Simplification Act, 15 U.S.C. § 1635(a) (1982).

143. Revised Reg. Z, 12 C.F.R. § 226.2(a) (25).

144. *Id.*; see also *Revised Truth in Lending Regulation Z*, CONSUMER CRED. INSTALLMENT CRED. GUIDE (CCH) No. 319 (Dec. 4, 1980).

145. Revised Reg. Z, 12 C.F.R. § 226.2(a)(25); see also Commentary, *supra* note 30, at § 226.15(a)(1)3, § 226.23(a)(1)1.

146. Commentary, *supra* note 30, at § 226.15(a)(1)3, § 226.23(a)(1)1.

147. Boyd, *Part II*, *supra* note 44, at 551. Boyd stresses that under the Simplification Act the right of rescission will only exist at the time that the security interest is created.

148. Commentary, *supra* note 30, at § 226.15(a)(1)3, § 226.23(a)(1)1.

ple of a lien retained as part of the credit transaction is a security interest acquired by a contractor who also extends credit in the transaction.¹⁴⁹ A less obvious example is a mechanic's or materialman's lien retained by the subcontractors or suppliers of the contractor-creditor, even though the contractor has waived his own lien rights.¹⁵⁰

However, a mechanic's or materialman's lien obtained by a contractor who is not a party to the original transaction, but who is paid from the proceeds of a consumer's loan from a third-party creditor, is outside the credit transaction and is not subject to rescission.¹⁵¹ Also, where all liens which may arise in connection with the credit transaction are validly waived, the rescission right will not attach.¹⁵² Nonetheless, a creditor confronted with the possibility that liens might arise by operation of law and attach to the consumer's principal residence should recognize that discretion in this situation, if not the better part, is certainly the cheaper part of valor, and provide disclosure.

C. The Residential Mortgage Transaction and Other Exemptions

The exemption for residential mortgage transactions is the most important scope readjustment made in the rescission transaction under the Simplification Act.¹⁵³ Old Regulation Z exempted transactions in which a first lien was acquired to finance the acquisition or construction of the consumer's residence.¹⁵⁴ Under the new residential mortgage exemption, no extension of credit for the initial acquisition or construction of a principal dwelling will be rescindable, regardless of its priority.¹⁵⁵ The distinctions between old TIL and the Simplifica-

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.* The Commentary provides a helpful hint to a creditor who wishes to avoid rescission possibilities. The advice? Obtain a lien and completion bond which will satisfy any lien which may arise from the credit transaction.

153. Simplification Act, 15 U.S.C. § 1602(w) (1982).

154. Old Reg. Z, 12 C.F.R. § 226.9(g)(1),(2).

155. Revised Reg. Z, 12 C.F.R. § 226.1(a)(24); Willenzik & Schmelzer, *Truth in Lending Simplification*, 37 BUS. LAW. 1193 (1981); see also Boyd, *Part II*, *supra* note 44, at 552.

tion Act, in this regard are illustrated by *Arnold v. W.D.L. Investments, Inc.*¹⁵⁶

In *Arnold*, decided under the old TIL, the Arnolds sought to rescind a second mortgage on their home. The principal financing for the purchase of the home was provided by a savings and loan association and secured by a first mortgage. To aid the Arnolds in their purchase, W.D.L. Investments, the developer of the property, provided the downpayment and in exchange, took a second mortgage on the home.¹⁵⁷ The court, under the old TIL, found that the second mortgage was rescindable even though it was executed as a part of the original acquisition of the Arnold's home.¹⁵⁸ Under the Simplification Act, the second mortgage would not be rescindable, because the second mortgage is attributable to the initial acquisition of the home.¹⁵⁹ Its priority is irrelevant.¹⁶⁰

An additional characteristic of the residential mortgage exemption is that it applies to any transaction to acquire a principal dwelling, whether real or personal property is involved.¹⁶¹

Certain transactions in which the consumer had previously purchased a principal dwelling and acquired some title to the dwelling, even though full title was not acquired, are treated by a recently promulgated Commentary provision as being outside the scope of the residential mortgage exemption.¹⁶² The FRB does not construe these transactions as financing the acquisition of the principal dwelling.¹⁶³ Hence, such transactions are not within the exemption.¹⁶⁴ Examples provided are the financing of a balloon payment under a land

156. 703 F.2d 848 (5th Cir. 1983).

157. *Id.*

158. *Id.* at 853.

159. *Id.*

160. Commentary, *supra* note 30, at § 226.2(a)(24)2, § 226.23(f)2.

161. Commentary, *supra* note 30, at § 226.23(f)1. Some examples of non-rescindable credit transactions involving personalty are acquisitions of boats and mobile homes. *Id.* Boyd observes that under the Simplification Act, and Revised Reg. Z, it is questionable whether interest in fixtures attached to a dwelling could give rise to the right of rescission. Boyd, *Part II*, *supra* note 44, at 554.

162. Commentary, *supra* note 30, at § 226.2(a)(24)5 (amended 48 Fed. Reg. 14886 (1983)).

163. *Id.*

164. *Id.*

sale contract and an extension of credit to buy out a joint owner's interest.¹⁶⁵ Since the transactions are not treated as residential mortgage transactions, they are rescindable.¹⁶⁶ The right of rescission does not apply where a home buyer, as a part of the financing package, assumes a previous mortgage between the creditor and the seller.¹⁶⁷

A combined-purpose loan for acquiring a principal dwelling and making improvements on it is considered to be a residential mortgage transaction *if* the loan is treated as a single transaction.¹⁶⁸ However, if the acquisition loan and subsequent advancements for improvements are treated as separate transactions, then only the original provision is exempt from section 1635.¹⁶⁹ The combined-purpose transaction will most likely occur where a consumer acquires an older home and, at the time of acquisition, secures financing for the home plus additional funds to finance improvements which will be completed subsequently. The Commentary provides no clear guidance as to what financing arrangements will constitute a single (as opposed to separate) transaction.¹⁷⁰

The combined-purpose transaction should be differentiated from the situation in which the homeowner, subsequent to acquisition of the principal dwelling, enters into a home improvement loan with provisions for advancement of funds based on construction progress.¹⁷¹ In the latter instance, disclosure at the time of initial financing is all that is required. The right of rescission does not arise with each advance, except in the case where the advances are treated as separate transactions.¹⁷²

The Simplification Act further exempts from rescission any "transaction which constitutes a refinancing or consolida-

165. *Id.*

166. *Id.*

167. *Id.*

168. Commentary, *supra* note 30, at § 226.23(f)3.

169. *Id.*

170. *Id.*

171. Revised Reg. Z, 12 C.F.R. § 226.23(f)4; *see* Commentary, *supra* note 30, at § 226.23(f)6.

172. Revised Reg. Z, 12 C.F.R. § 226.23(f)4; *see* Commentary, *supra* note 30, at § 226.23(f)6. The FRB should consider further Commentary clarification of the distinction between separate and single transactions in both the combined purpose and multiple advance situations.

tion (with no new advances) of the [unpaid] . . . principal . . . and finance charges of an existing extension of credit secured by an interest in the [consumer's principal dwelling]."¹⁷³ However, if the new amount financed exceeds the previous outstanding principal balance and finance charge, the exemption protects only the original debt and its attendant security interest.¹⁷⁴ In *Brown v. National Permanent Federal Savings and Loan Association*,¹⁷⁵ Brown purchased a home, financing the purchase with a loan secured by a first mortgage on the residence. Some years later, Brown executed a new note and mortgage on the residence sufficient to pay off the remaining balance of the original mortgage and provide an additional \$30,000 for rehabilitation of the residence.¹⁷⁶ The court, under the old TIL, allowed rescission of the second mortgage and the promissory note insofar as the second note exceeded the remaining balance of the original loan at the time of refinancing.¹⁷⁷ The same result would occur under the Simplification Act.¹⁷⁸

A somewhat different situation is presented where the underlying mortgage on the consumer's principal dwelling contains a "dragnet" or "spreader" clause. In such cases, subsequent loans are treated as separate transactions and are subject to rescission rights unless the creditor unequivocally waives its security interest for such subsequent transactions.¹⁷⁹

A significant, albeit temporary, exemption from the scope of section 1635 is provided for advances under a pre-existing open-end credit plan, if a security interest affecting the principal residence has been retained or acquired and the advances are in accordance with a previously-established credit

173. Simplification Act, 15 U.S.C. § 1635(e)(1)(b) (1982); see Revised Reg. Z, 12 C.F.R. § 226.23(f)(2); see also Commentary, *supra* note 30, at § 226.23(f)4. A model rescission Form (H-9) to utilize in the refinancing-consolidation situation is included in the closed-end appendix. 12 C.F.R. § 226.23 App. H-9.

174. Commentary, *supra* note 30, at § 226.23(f)4.

175. 526 F. Supp. 815 (D.C. Colo. 1981).

176. *Id.*

177. *Id.* at 822.

178. 15 U.S.C. § 1635(e); see Revised Reg. Z, 12 C.F.R. [§ 226.23(f)2.

179. Commentary, *supra* note 30, at § 226.23(f)7.

limit.¹⁸⁰ However, this exemption will terminate three years from the effective date of the Simplification Act,¹⁸¹ unless Congress determines that the exemption is helpful for consumers and has not been abused by creditors.¹⁸²

Finally, transactions in which a state agency is a creditor are exempt from rescission.¹⁸³ However, cities and other political subdivisions of states acting as creditors are not exempt.¹⁸⁴

V. THE MECHANICS OF NOTICE

In general, the notice scheme adopted under the old TIL and the old Regulation Z has been preserved in the Simplification Act.¹⁸⁵ The Simplification Act provides that each "obligor" has the right to rescind the transaction.¹⁸⁶ The Act mandates that the creditor must disclose to any obligor his or her rescission right and accompany the disclosure with the forms to exercise that right within the three day period.¹⁸⁷ In Revised Regulation Z, the obligor entitled to disclosure disappears and is transmogrified as a "consumer."¹⁸⁸ A consumer, for rescission purposes, now includes "a natural person in whose principal dwelling a security interest is or will be retained or acquired, if that person's ownership interest in the dwelling is or will be subject to the security interest."¹⁸⁹

The entire disclosure package to be delivered to each consumer includes not only the two copies of the rescission notice, but also one copy of the material disclosures relating to the transaction.¹⁹⁰ The disclosures need not be provided

180. Simplification Act, 15 U.S.C. § 1635(e)(1)(D) (1983).

181. *Id.* at § 1635(e)2 (1982).

182. Boyd, *Part II*, *supra* note 44, at 553.

183. Simplification Act, 15 U.S.C. § 1635(a)(1)(C) (1983).

184. Commentary, *supra* note 30, at § 226.15(f)2, 226.23(f)5.

185. Compare the old TIL, 15 U.S.C. § 1635(a) (1980) and Old Reg. Z, 12 C.F.R. § 226.9(b) with Simplification Act, 15 U.S.C. § 1635(a) (1983) and Revised Reg. Z, 12 C.F.R. § 226.15(b), 226.23(b); see Boyd, *Part II*, *supra* note 44, 557-58.

186. Simplification Act, 15 U.S.C. § 1635(a) (1983).

187. *Id.*

188. Revised Reg. Z, 12 C.F.R. § 226.15(b), 226.23(b). Note that the "obligor" under the statute became the *consumer*, entitled to rescind under the Reg. Z provisions.

189. Revised Reg. Z, 12 C.F.R. § 226.2(11).

190. Revised Reg. Z, 12 C.F.R. § 226.15(a)6, 226.23(a),(b); see also Commentary,

before the consummation¹⁹¹ of the transaction, but the three day rescission period will not begin to run until the disclosures are provided.¹⁹² Since a rescission by any one of the consumers entitled to rescind is effective for all,¹⁹³ the creditor must exercise special caution to ensure that all persons who have an ownership interest in the principal dwelling are provided with proper disclosure, whether or not they are parties to the transaction creating the security interest.¹⁹⁴

VI. WAIVER OF RESCISSION

The basic statutory test for waiver of the three-day rescission period under both the old TIL and the Simplification Act is evidence of a "bona fide personal financial emergency."¹⁹⁵ Old Regulation Z utilized a standard under which the financial emergency must be accompanied by a situation in which persons or property were endangered.¹⁹⁶ The Revised Regulation eliminates the requirement that persons or property must be endangered, and provides that the consumer

supra note 30, at § 226.15(b)1, 226.23(b)1. The format and content of the open-end and closed-end rescission notices are spelled out in the above Revised Reg. Z and Commentary provisions. Model forms are provided in 12 C.F.R. § 226.15 Appendix G (open-end) and 12 C.F.R. § 226.23 Appendix H (close-end). The essential information disclosed to the consumer in the notice includes: the disclosure of the acquisition or retention of a security interest in the consumer's principal dwelling, the right to rescind, how to rescind (together with a form for that purpose designating the creditor's address), the effects of rescission and the date that the (3 day) rescission period expires. The Commentary provides that the notice may include additional information such as: a description of the property subject to the lien, a statement that a rescission by one joint owner is effective for all, and the name and address of the credit or to receive the rescission notice. Commentary, *supra* note 30, at § 226.15(g)3, 226.23(g)3. The model forms should alleviate notice format problems for creditors. The term "material disclosure" and its significance is discussed *infra*, notes 207-13 and accompanying text.

191. The term "consummation" has important ramifications for many aspects of the rescission transaction and is defined and explained *infra*, notes 214-20 and accompanying text.

192. Commentary, *supra* note 30, at § 226.15(g)4, 226.23(g)4.

193. Commentary, *supra* note 30, at § 226.15(b)3, 226.23(b)3.

194. Commentary, *supra* note 30, at § 226.15(b)3, 226.23(b)3; *see also* Boyd, *Part II*, *supra* note 44, at 558. Such natural persons as sureties, guarantors or the persons with an ownership interest whose home is subject to risk of loss are consumers for disclosure purposes in the rescission transaction. 46 Fed. Reg. 20, 850 (1981).

195. Simplification Act, 15 U.S.C. § 1635(d) (1983); the old TIL, 15 U.S.C. § 1635(d) (1980).

196. Old Reg. Z, 12 C.F.R. § 226.9(e)1, 2.

need only determine that the credit extension is necessary to meet a "bona fide personal financial emergency," the basic statutory standard.¹⁹⁷ To waive or modify the rescission right, all of the consumers entitled to rescind must sign a dated, written statement (printed forms are prohibited) which describes the emergency and expressly waives or modifies the right.¹⁹⁸

Criticism of the new waiver standard reads like a good news-bad news joke: the good news is that the waiver test has been reduced to a single basic criterion;¹⁹⁹ the bad news may be that no one seems to know just what a bona fide personal financial emergency is.²⁰⁰ The Commentary is singularly unhelpful in determining what constitutes a valid waiver situation under the Revised Regulation;²⁰¹ the FRB takes the position that emergency waivers should be available only in rare circumstances.²⁰² The Commentary makes the further point that the mere existence of the waiver will not automatically insulate the creditors from liability.²⁰³ Such enigmatic Revised Regulation and Commentary provisions will certainly contribute to the limited use of the emergency waiver, at least by knowledgeable creditors concerned about limiting liability.

VII. THE RESCISSION PERIOD

The provision in section 1635 for a three-day "cooling-off" period creates a critical question which must be resolved in every case: how long may the consumer exercise his rescission right?

The time in which the consumer may elect to rescind extends until midnight of the third business day following the

197. *Id.*

198. Revised Reg. Z, 12 C.F.R. § 226.15(e), 226.23(e).

199. Revised Reg. Z, 12 C.F.R. § 226.15(e), 226.23(e).

200. Merrinan & Schellie, *Truth in Lending Simplification*, 37 BUS. LAW. 1297, 1308 (1982).

201. Commentary, *supra* note 30, at § 226.15(e)1, 2, 226.23(3)1, 2.

202. 46 Fed. Reg. 20,885 (1981). The reasoning of the FRB appears to be that the burden to establish that the waiver reasons are substantial and credible rests with the creditor. This, accompanied by the prohibition of printed forms, will reduce the possibility of abusive practices in the emergency situation. *Id.*

203. *Id.* at §§ 226.15(e)1, 226.23 (e)1.

last of three events: consummation,²⁰⁴ delivery of all material disclosures,²⁰⁵ and delivery of the rescission notice.²⁰⁶

To eliminate difficulties which arose under the old TIL, the Simplification Act provides a concise definition of the term "material disclosures":

[T]he disclosure . . . of the annual percentage rate, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total of payments, the number and amount of payments, and the due dates or periods of payments scheduled to repay the indebtedness.²⁰⁷

Although the enumeration of relevant material disclosures will be of great benefit to the creditor, it is not a sinecure. *Harris v. Tower Loan of Mississippi, Inc.*,²⁰⁸ decided under the old TIL, is instructive on this point. In *Harris*, the borrower received a loan secured by various collateral, including a deed of trust on her home. In the TIL disclosure documents, the creditor failed to include in the calculation of the finance charge certain insurance premiums relating to the dwelling. Thus, the amount of the finance charge was inaccurate. The court determined that the statement of the finance charge was a relevant material disclosure. Therefore, the bor-

204. Simplification Act, 15 U.S.C. § 1635(a) (1983); Revised Reg. Z, 12 C.F.R. § 226.15(a)3. Notice is considered given when mailed, filed for telegraphic transmission, or if sent by other means, when delivered to the creditor's place of business. 12 C.F.R. § 226.15(a)2, 226.23(a)2.

205. 15 U.S.C. § 1635(a) (1983). In open-end transactions, consummation is replaced by an occurrence which gives rise to the right to rescind. Revised Reg. Z, 12 C.F.R. § 226.15(a)(3). Such occurrences under an open-end plan are: each credit extension made under the plan, the plan when the plan is opened, a security interest when added or increased to secure an existing plan, and the increase when a credit limit on the plan is increased. *Id.* at § 226.15(a)(1)(i). An important provision is that the consumer does not have the right to rescind each credit extension if the extension is made in accordance with a previously established credit limit. *Id.* at § 226.15(a)(1)(ii). Occurrences giving rise to the right to rescind are, in most instances, more susceptible of precise determination than the fuzzier "consummation". *Id.*

206. 15 U.S.C. §§ 1635(a), 1602(u) (1983).

207. Simplification Act, 15 U.S.C. § 1602(u) (1983). Further description of the term "material disclosure" for open-end transactions is found in Revised Reg. Z, 12 C.F.R. § 226.15(a)3 n.36. For closed-end transactions, see Revised Reg. Z, 12 C.F.R. § 226.23(a)3 n.48.

208. 609 F.2d 120 (5th Cir. 1980).

rower's right of rescission had not expired because she had not received all (accurate) material disclosures to which she was entitled.²⁰⁹ This same result would occur under the Simplification Act.²¹⁰ The disclosure of consumer insurance rights and options is not, per se, treated as a material disclosure for rescission purposes; nevertheless, where the consumer's voluntary insurance options are not properly disclosed, the insurance premium must be included in the calculation of the finance charge, which is a material disclosure.²¹¹ Therefore, as in *Harris*, the understatement of the finance charge operates to extend the rescission period for up to three years after the consummation of the transaction. It is this type of disclosure error which will continue to cause creditors to bemoan the complexities of TIL disclosure procedures.

There is an identifiable relationship between terms included as material disclosures in the Simplification Act²¹² and the most frequent creditor TIL violations. The 1982 Report to Congress cited inaccurate APRs, erroneous finance charges, inaccurate numbers, periods, and amounts of payments, and failure to include insurance charges in the calculation of finance charges where appropriate, as the most frequent violations under old Regulation Z.²¹³

In the event that the rescission notice and/or material disclosures are not delivered (or are otherwise inaccurate or improper), the right to rescind in closed-end transactions will expire three years after consummation, transfer of all interest

209. *Id.* at 122-24.

210. See Simplification Act, 15 U.S.C. § 1602(u); *infra* note 211 and accompanying text.

211. See Revised Reg. Z, 12 C.F.R. § 226.4. Premiums for credit life, accident, health, or loss of income insurance may be excluded from the finance charge if the insurance coverage is not required by the creditor and this fact is disclosed. Further, the premium for the initial term must be disclosed and the consumer must sign a written request for the insurance after he received the disclosure. Revised Reg. Z, 12 C.F.R. § 226.4(d)1. Premiums for insurance against loss or damage to property or liability insurance may be excluded from the finance charge if it is disclosed that the insurance can be obtained from a person of the consumer's choice. If the insurance is obtained through the creditor, the premium for the initial term must also be disclosed. Revised Reg. Z, 12 C.F.R. § 226.4(d)2. It is hoped that the model forms which include insurance rights sections will reduce the number of creditor violations in this area.

212. See Simplification Act, 15 U.S.C. § 1602(u) (1983).

213. 1982 FED. RESERVE BOARD ANN. REP. 96, 732.

in the consumer in the property, or sale of the consumer's interest in the property, whichever occurs first.²¹⁴ In open-end transactions, the occurrence giving rise to the right of rescission is substituted for consummation.²¹⁵

In the closed-end context, "consummation" as defined in the Simplification Act is "the time that a consumer becomes contractually obligated on a credit transaction."²¹⁶ As such, it is an important departure from interpretations of the term under the old TIL. The focus is now on the point at which the consumer becomes bound to the credit terms as determined by state or other applicable law.²¹⁷ A recent update of the Commentary section on consummation is designed to make the FRB's position clear on that point.²¹⁸ Consummation does not occur "merely because the consumer has made some financial investment in the transaction (for example, by paying a non-refundable fee)."²¹⁹

A sale or transfer of the consumer's property need not be voluntary to terminate the rescission right.²²⁰ However, partial transfer conferring co-ownership on a spouse, does not terminate the rescission right.²²¹ The FRB has recently revised the Commentary to clarify that consumer-financed property sales

214. Simplification Act, 15 U.S.C. § 1635(f) (1983); Revised Reg. Z, 12 C.F.R. § 226.23(a)(1).

215. Revised Reg. Z, 12 C.F.R. § 226.15(a)3; *see also* 609 F.2d 120 (in which occurrences giving rise to the right of rescission are more completely discussed).

216. Revised Reg. Z, 12 C.F.R. § 226.2(a)13.

217. Commentary, *supra* note 30.

218. *See* Commentary, *supra* note 30, at § 226.2(a)13. *Update of Official Staff Commentary to Truth-in-Lending Regulation Z, CONSUMER CRED. INSTALLMENT CRED. GUIDE*, (CCH) No. 740, at § 226.2(a)13 (Sept. 28, 1982) reads:

1. *State law governs.* When a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; Regulation Z does not make this determination. *A contractual commitment agreement, for example, that under applicable law binds the consumer to the credit terms would be consummation.* Consummation, however, does not occur merely because the consumer has made some financial investment in the transaction (for example, by paying a nonrefundable fee) unless, of course, applicable law holds otherwise.
(emphasis added).

219. *Id.* Even though the consumer has made a deposit, consummation has not occurred until he contracts for financing and applicable law binds the consumer to the credit terms. 1 R. CLONTZ, *TRUTH IN LENDING MANUAL*, 1-9 (5th ed. Supp. 1983).

220. Commentary, *supra* note 30, at § 226.15(a)(3)4, 226.23(a)(3).

221. *Id.*

terminate the right to rescind.²²² Thus, where the consumer sells his principal dwelling and takes back a mortgage, or retains legal title through the use of an installment sales contract, the rescission right terminates.²²³

A recent bankruptcy case²²⁴ raises the interesting question of whether property sold or transferred must be a principal dwelling in order to terminate the rescission period. In that case, a bank financed the purchase of a motor home under a retail installment contract, upon which the obligor defaulted. To avoid repossession of the motor home, the borrowers negotiated a refinancing in which a second mortgage on their residence was given as additional collateral. Subsequently, the consumer returned the motor home, either unable or unwilling to make the payments. Six months later, the erstwhile borrowers, now bankrupt, served a notice of rescission on the bank and commenced a Chapter 13 bankruptcy proceeding. The bank filed a secured claim based on the second mortgage. The bankruptcy court decided that when the motor home was returned to the bank, the borrowers effectively transferred all interest in the property pursuant to Revised Regulation Z. Thus, their subsequent rescission attempt was not timely.²²⁵ Even though the transferred property (the motor home) was not the principal dwelling subject to the security interest, nevertheless, its transfer was treated as sufficient to terminate the rescission right.²²⁶

Under certain conditions, the three-year rescission period provided by the Simplification Act may be extended.²²⁷ When any agency empowered to enforce the Act institutes an enforcement proceeding within three years after the date of the transaction, the agency finds a violation of section 1635, and the consumer's right to rescind is based at least in part on any matter involved in the proceeding, then the rescission period (assuming the three year period has expired) is extended for

222. Revised Commentary, 48 Fed. Reg. 14,887 (1983) (codified at §§ 226.15(a)(3)4, 226.23(a)(3)3 (1983)).

223. *Id.*

224. *In re Rineer*, 25 Bankr. 264 (N.D. Ill. 1982).

225. *Id.* at 268.

226. *Id.*

227. Simplification Act, 15 U.S.C. § 1635(f) (1983).

one year following the conclusion of the proceeding or judicial review thereof, whichever is later.²²⁸

The Revised Regulation, like its predecessor, instructs the creditor not to disclose loan proceeds, begin performance of the contract, or deliver materials to the consumer until the creditor is *reasonably satisfied* that the rescission period has expired.²²⁹ Good advice for the cautious creditor is found in the Commentary section which explains how a creditor may satisfy himself that the rescission period has, in fact, expired.²³⁰ The Commentary advises either taking no action until a reasonable time after expiration of the rescission period to allow delivery of the mailed notice, or obtaining a written statement from *all* consumers who could exercise the rescission right²³¹ asserting that their rights of rescission have not been exercised.

VIII. THE RESCISSION PROCEDURE

Of all the difficult and complex aspects of the rescission transaction under the old TIL, the rescission procedure itself has proven to be the most troublesome and confusing for creditors and consumers alike.²³² When the consumer exercises the right of rescission months or even years after the consummation, the creditor is often confronted with some critical questions. First, is the consumer entitled to rescind? If the creditor takes a cautious approach and responds to the rescission claim, he gives up a finance charge and other profits on what may be a perfectly proper TIL transaction.²³³ However, if the creditor stands his ground and the court subse-

228. *Id.*

229. Revised Reg. Z, 12 C.F.R. § 226.15(c), 226.23(c). The open-end reg. provision provides that a creditor is not in violation if he is a third party with no knowledge of rescission rights and does not delay in providing goods and services as long as the debt incurred is not secured by the property subject to rescission. *See also* Commentary, *supra* note 30, at § 226.14(c)4.

230. Commentary, *supra* note 30, at § 226.15(c)5, 226.23(c)4.

231. *Id.*

232. Boyd, *Part II*, *supra* note 44, at 562; Comment, *Who Can Win?*, *supra* note 44, at 693; Comment, "Consumer Protection": *Judicial Approaches to Rescission and Restoration under the Truth in Lending Act*, 53 WASH. L. REV. 301, 306-08 (1978) [hereinafter cited as Comment, "Consumer Protection"].

233. For an excellent discussion on practical creditor difficulties upon receipt of the rescission notice, *see* Comment, *Who Can Win?*, *supra* note 44.

quently determines that proper rescission notice or material disclosures have not been provided, that wrong decision will have grave consequences.²³⁴ In spite of these concerns, and others,²³⁵ the same basic rescission scheme is left intact in the Simplification Act, with a few potentially significant modifications.²³⁶

Under the Act, at the time a consumer gives timely notice that the transaction is rescinded, the security interest giving rise to the rescission right becomes void.²³⁷ Within twenty calendar days²³⁸ after receipt of the notice (ten days under the old TIL)²³⁹ the creditor must "return any money or property that has been given to anyone in connection with the transaction and . . . take any action necessary to reflect the termination of the security interest."²⁴⁰ In the meantime, the con-

234. Simplification Act, 15 U.S.C. § 1635(g) (1983) provides that "in addition to rescission, the court may award relief under section 1640" for TIL violations if not relating to the right to rescind. Section 1640 provides for actual damages, the assessment of an additional award of twice the amount of the finance charges, except that the amount shall not be less than \$100 nor more than \$1,000 in any individual action, and attorney's fees. It should also be noted that, pursuant to § 1641(c), "any consumer who has the right to rescind a transaction under section 1635 of this title may rescind the transaction as against any assignee of the [credit] obligation."

235. See *infra* text accompanying notes 258-62.

236. Compare the old TIL, 15 U.S.C. § 1635(b) (1980) with the Simplification Act, 15 U.S.C. § 1635(b) (1983).

237. Simplification Act, 15 U.S.C. § 1635(b) (1983); see also Revised Reg. Z, 12 C.F.R. § 226.15(d)1, 226.23(d)1. The Statute and Regs. above cited provide that at the time the consumer exercises his rescission right he is not liable for any amounts connected with the transaction, including the finance charge.

238. Simplification Act, 15 U.S.C. § 1635(b) (1983); see also Revised Reg. Z, 12 C.F.R. § 226.15(d)2, 226.23(d)2.

239. The old TIL, 15 U.S.C. § 1635(b) (1980).

240. Revised Reg. Z, 12 C.F.R. § 226.15(d)2, 226.23(d)2. In closed-end transactions, the creditor is responsible for the return of any amount paid by the consumer either to the creditor or to a third party as part of the credit transaction, including such items, in addition to finance charges, such as application and commitment fees or title or appraisal fees. It is irrelevant that such awards may not represent profit to the creditor. However, the creditor need not refund any amount paid by the consumer to third parties outside the credit transactions, such as a building permit or a zoning variance. Commentary, *supra* note 30, at § 226.23(d)(2)1,2. There are some minor variations for open-end transactions. *E.g.*, Commentary, *supra* note 30, at § 226.15(d)(2)1,2.

The Commentary also provides that the creditor during the 20 day period must *begin* the process of termination of the security interest, but it is not required that all steps be completed, although the creditor must see the process through to completion. Commentary, *supra* note 30, at § 226.15(d)(2)3, 226.23(d)(2)3.

sumer may retain possession of any money or property received from the creditor pursuant to the transaction.²⁴¹ Once the creditor has performed his obligations, the consumer must "tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value."²⁴²

Property tender may be made at the location of the property or the consumer's residence.²⁴³ Tender of money must be made at the creditor's place of business.²⁴⁴ If the creditor fails to take possession within twenty calendar days²⁴⁵ of the tender, (ten days under the old TIL),²⁴⁶ the consumer can keep the money or property without further obligation.²⁴⁷ The Simplification Act adds a potentially important section which provides that the rescission procedures may be modified by court order.²⁴⁸

Statutory TIL rescission and traditional common-law rescission only have their subject in common.²⁴⁹ Under the traditional rule, the rescinding party must give notice of election to rescind, accompanied by unconditional tender of the money or property.²⁵⁰ Once notice and tender are provided, the contract is void and the rescinding party may bring an action for recovery of money or property delivered in the transaction.²⁵¹ The statutory scheme reorders the traditional sequence. The security interest becomes void at the moment

241. Simplification Act, 15 U.S.C. § 1635(b) (1983); Revised Reg. Z, 12 C.F.R. §§ 226.23(d)3, 226.15(d)3.

242. Revised Reg. Z, 12 C.F.R. §§ 226.23(d)3, 226.15(d)3.

243. *Id.*

244. *Id.*

245. *Id.*

246. The old TIL, 15 U.S.C. § 1635(b) (1980).

247. Although the Simplification Act has expanded the period in which the creditor must take possession of the money or property tendered by the consumer, when confronted with the *Sosa* tender problem, (see text accompanying notes 257-62) the additional 10 day period provides only minor relief for the creditor.

248. Simplification Act, 15 U.S.C. § 1635(b) (1983); Revised Reg. Z, 12 C.F.R. § 226.15(d)4, 226.23(d)4.

249. Note, *Truth-in-Lending: Judicial Modifications of the Right of Rescission*, 1974 DUKE L. J. 1227, 1229 [hereinafter cited as Note, *Judicial Modifications*]; e.g., Comment, *Who Can Win?*, *supra* note 44, at 1229.

250. Note, *Judicial Modification*, *supra* note 249.

251. *Id.*

notice is given of intent to rescind, and the consumer has no obligation of tender until the creditor has accomplished the release of the security interest and returned all money or property previously received, including the finance charge.²⁵² It is clear that under the statutory scheme, the consumer is placed in "a much stronger bargaining position than he enjoys under the traditional rules of rescission."²⁵³

Courts interpreting the operation of the rescission sequence under the old TIL have split into two camps.²⁵⁴ The "pro-consumer" or "literalist" jurisdictions, led by the Fifth Circuit, take the position that the statutory sequence mandated by Congress in section 1635 is clear and must be literally followed to carry out the legislative intent to protect the consumer.²⁵⁵

In the leading Fifth Circuit case of *Sosa v. Fite*,²⁵⁶ decided under the old TIL, the consumer rescinded some months after the consummation of the transaction. At the time she delivered her rescission notice, she also tendered the property (aluminum siding) back to the creditor. The creditor refused to complete the statutory obligation or accept tender of the property. The court held that section 1635 required the creditor to release the lien and return all property within ten days of the notice. More importantly, the court further held that since Sosa also made a proper tender at the time of the rescission notice, the creditor had forfeited his right to return

252. *Id.* at 1231; e.g., Simplification Act, 15 U.S.C. § 1635(b) (1983).

253. Note, *Judicial Modification*, *supra* note 249, at 1234.

254. See *infra* notes 256-67 and accompanying text.

255. Pro-consumer or literalist jurisdictions are generally recognized as follows: D.C. Cir., e.g., *Brown v. National Permanent Fed. Sav. & Loan Ass'n*, 526 F. Supp. 815 (1981); First Cir., e.g., *French v. Wilson*, 446 F. Supp. 216 (D.C.R.I. 1978); Fifth Cir., e.g., *Sosa v. Fite*, 498 F.2d 114 (1974); Colo., *Strader v. Beneficial Fin. Co. of Aurora*, 551 P.2d 720 (Colo. 1976); (See Comment, *Who Can Win?*, *supra* note 44, at 701; Comment, *"Consumer Protection," supra* note 232, at 309.

256. 498 F.2d 114 (5th Cir. 1974). The *Sosa* facts are particularly egregious. *Fite*, a home improvement contractor of dubious repute (to use the description of the *Sosa* court) entered into a contract with Mrs. Sosa to install aluminum siding on her home. Mrs. Sosa, unversed in the English language, was apparently unaware that included in the contract documents she executed was a deed of trust in favor of a savings and loan to secure payment. Mrs. Sosa made payments for nearly two years. Finally, dissatisfied with the craftsmanship and the quality of the siding, she stopped further payments. The Savings and Loan foreclosed against the property and sold the property to a third party.

of the property or proceeds by the consumer.²⁵⁷ Hence, the infamous "Sosa tender" was conceived.

In those jurisdictions recognizing the *Sosa* tender, the creditor is placed between the proverbial rock and hard place. If tender is made at the time of notice, the creditor (pursuant to the Simplification Act) has twenty days to accept the tender and complete the rescission, or risk all in the event that he believes the attempted rescission is invalid.²⁵⁸

In subsequent Fifth Circuit cases, the court has been clear that the *Sosa* tender is invalid unless an express tender of the complete loan proceeds or property is made by the consumer.²⁵⁹ However, reports of the demise of the *Sosa* tender have been, to use Mark Twain's turn of phrase, greatly exaggerated.²⁶⁰ In the 1983 Fifth Circuit case of *Arnold v. W.D.L. Investments, Inc.*,²⁶¹ previously discussed, the court upheld the validity of a *Sosa* tender, and the creditor suffered the forfeiture of an \$11,200 second mortgage. There is nothing in the Simplification Act, the Revised Regulation, or the Commentary to prevent the continued use of the *Sosa* tender. Thus, it is likely that creditors will continue to confront the practical difficulties of coping with this troublesome dilemma.

A second group of jurisdictions, characterized variously as "discretionist" or "pro-creditor," have exercised equitable powers to convert the statutory rescission sequence, under certain circumstances, into a procedure in which the court may condition the creditor's performance on the consumer's return of property or money originally conveyed by the creditor.²⁶² The Ninth Circuit Court in *Palmer v. Wilson*²⁶³ de-

257. *Id.* at 120.

258. *Id.*; e.g., Comment, *Who Can Win?*, *supra* note 44, at 702-03.

259. See e.g., *Gerasta v. Hibernia Nat'l Bank*, 575 F.2d 580 (5th Cir. 1978); *Bustamente v. First Fed. Sav. & Loan Ass'n*, 619 F.2d 360 (5th Cir. 1980).

260. See e.g., *Harris v. Tower Loan*, 609 F.2d 120 (5th Cir. 1980). *Harris* reaffirms the *Sosa* tender doctrine. It is crystal clear that the Fifth Circuit will not hesitate to invoke the *Sosatender* doctrine. See *Arnold v. W.D.L. Investments, Inc.*, 703 F.2d 848 (5th Cir. 1983); *supra* text accompanying notes 156-61.

261. 703 F.2d at 853. It does not appear from the case facts that any of the egregious circumstances of the *Sosa* case were present. Further, today under the Simplification Act the *Arnold* lien would constitute a residential mortgage transaction and would thus be exempt from § 1635 coverage. See *supra* notes 157-60 and accompanying text.

262. Pro-creditor jurisdictions include the Fourth Cir., e.g., *Powers v. Sims &*

scribed the discretionist rationale as follows:

[T]he court may condition the granting of rescission on the debtor's compliance with the court's order to tender to the creditor the principal of the loan that the debtor has received. The propriety of such a conditional decree of rescission, of course, will depend on the equities present in a particular case, as well as consideration of the legislative policy of full disclosure that underlies the Truth in Lending Act and the remedial-penal nature of the private enforcement provisions of the Act.²⁶⁴

It is anticipated that the Simplification Act provision allowing judicial modifications of the statutory rescission sequence will be treated by "discretionist" jurisdictions simply as an affirmation of the sequence adjustments they have been making all along.²⁶⁵ The response of the "literalist" jurisdictions is unclear, but congressional intent to allow modification in appropriate circumstances is clearly established.²⁶⁶

Levin, 542 F.2d 1216 (4th Cir. 1976); Sixth Cir. *e.g.*, *Rudisell v. Fifth Third Bank*, 622 F.2d 243 (6th Cir. 1980); Ninth Cir., *e.g.*, *Palmer v. Wilson*, 502 F.2d 860 (9th Cir. 1974); *see also* Comment, *Who Can Win?*, *supra* note 44, at 701-03; Comment, "Consumer Protection," *supra* note 232, at 311-14.

263. 502 F.2d 860 (9th Cir. 1974). Pro-consumer courts have been criticized for conceptual confusion created by using the phrase "conditional rescission." *See* Comment, "Consumer Protection," *supra* note 232, at § 1635(b) (under both the old TIL and the Simplification Act) clearly provides that rescission is complete at the time of notice. If the court finds that the consumer was properly within the rescission period at the time notice is given, then the rescission is complete. The discretionist courts in fact modify only the procedure to effect the already extant rescission.

264. *Palmer v. Wilson*, 502 F.2d at 862.

265. Note the organization of Revised Reg. Z §§ 226.15(d), 226.23(d). Paragraph 1 simply recognizes the statutory mandate that rescission is complete at the time of notice. Paragraph 4 restates the power given to the courts under § 1635(b) to modify the statutory procedures outlined in paragraphs 2 and 3. Therefore, it is clear that there is no such thing as conditional rescission. Rather, there is simply recognition of the power of the courts to modify the procedures to effect the rescission.

266. The following enigmatic language appears in *Arnold v. W.D.L. Investments, Inc.*:

[the] appellants further contend that the strict interpretation of the statute in *Sosa v. Fite* is no longer controlling.

We find nothing, however, in either *Bustamente* or *Tower Loan* which authorizes this court to judicially carve out an equitable exception to the TILA (as it applied prior to the 1980 amendments). Furthermore, in *Tower Loan*, we expressly reaffirmed "the statutory language and the holding" in *Sosa*, a case with which this court and judge [Garza] are intimately familiar.

Unfortunately, the Commentary provides little guidance on the question of appropriate circumstances for modification.²⁶⁷ The sole example given is the situation in which the consumer is involved in bankruptcy proceedings which prohibit the consumer from returning money or property previously tendered by the creditor. In such a case, says the FRB, modification would be appropriate, although the exact measures to be taken are not specified.²⁶⁸

The Fifth Circuit, as the originator of the *Sosa* tender, has hardly endeared itself to creditors. However, it has been partially redeemed in the eyes of at least some creditors by its decision in the *Harris* case.²⁶⁹ In *Harris*, the court permitted the creditor to offset the balance of the sum still owed by the consumer against the sum previously paid to the creditor.²⁷⁰ In allowing the offset, the court noted that:

Such an arrangement prevents a perfunctory exchange of funds and protects the lender from a dissipation of the money while it is in the hands of the obligor. We believe this to be an acceptable course because it is the only means to insure the accomplishment of the congressional purpose of restoring the parties to the status quo ante while affording the statutory remedies to the obligor.²⁷¹

The Revised Regulation and Commentary are silent on the question of whether the creditor can use a *Harris* offset or place funds in escrow where the consumer is unable or unwilling to re-tender to the creditor.²⁷² In explanatory comments prior to the adoption of the Revised Regulation, the FRB took the position that because of the Act's specificity regarding rescission procedures, it would be inappropriate in the Revised Regulation or Commentary to authorize the use of "offsets, escrows, or similar methods."²⁷³ However, a strong argument

703 F.2d at 850-51 (citations omitted).

267. Commentary, *supra* note 30, at § 226.15(d)(4)1, 226.23(d)(4)1.

268. *Id.*

269. 609 F.2d at 124.

270. *Id.*

271. *Id.* at 123.

272. Revised Reg. Z, 12 C.F.R. §§ 226.15(d), 226.23(d); Commentary, *supra* note 30, at 226.15(d).

273. REVISED TRUTH IN LENDING REGULATION Z, CONSUMER CRED. INSTALLMENT CRED. GUIDE (CCH) No. 319, at 65, 93 (Dec. 4, 1980).

can be made that the failure of the FRB to legitimize the use of such methods contravenes the expressed congressional intent to allow greater flexibility in the procedure.²⁷⁴ As other commentators have suggested, the authority now expressly given to the courts to modify the procedure may well be utilized to allow the continued use of such methods in appropriate circumstances.²⁷⁵

IX. CONCLUSION

Has the Simplification Act truly struck a reasonable balance between meaningful disclosure of essential credit terms on one hand and the problems of creditor compliance and liability on the other? The issue remains in doubt, and the treatment of the rescission transaction in the Simplification Act is illustrative.

The Simplification Act has provided some important clarifications of jurisdictional terms relevant to the rescission transaction, including the more precise identity of the creditor obligated to disclose,²⁷⁶ and what constitutes a consumer credit transaction,²⁷⁷ security interests,²⁷⁸ the residential mortgage transaction exemption,²⁷⁹ and the definition of material disclosures.²⁸⁰

The creditor's use of model forms, combined with the statutory limitation of material disclosures as they affect the rescission transaction, should provide significant protection for creditors.²⁸¹ Disclosure, although not foolproof, is less risky under the Simplification Act. Therefore, in marginal cases, where it is not clear at the commencement of the transaction whether rescission rights might arise, creditors should now

274. See Simplification Act, 15 U.S.C. § 1601(b) (1983). It occurs to the author that offsets and escrow agreements would be the most obvious modifications of the statutory rescission procedures. Thus, the FRB would be well within permissible bounds of congressional intent to recognize such devices in the Regulation or Commentary.

275. See Boyd, *Part II*, *supra* note 44, at 564.

276. See *supra* notes 63-125 and accompanying text.

277. *Id.*

278. *Id.*

279. *Id.*

280. See *supra* notes 126-84 and accompanying text.

281. *Id.*; see also *supra* text accompanying note 28.

feel more confident that, if they choose to disclose, the rescission time will be limited to the minimum statutory period, and will not be extended by a technical format or material disclosure violation.²⁸²

At the outset of the transaction, meaningful assistance has been provided to creditors in identifying the rescission transaction and disclosure format. Unfortunately, the Simplification Act does little to resolve the serious practical problems which arise when the consumer elects to rescind long after the consummation of the transaction.²⁸³ The respective rights and responsibilities of creditors and consumers under the statutory rescission sequence are no more clear now than before.²⁸⁴ The common-sense procedural adjustments of offset and escrow are not recognized by the FRB,²⁸⁵ even though the offset has been approved by the Fifth Circuit, generally recognized as the foremost pro-consumer jurisdiction.²⁸⁶

The Simplification Act has now specifically provided that courts may modify the statutory rescission procedure where appropriate. However, given the great variance of interpretation of the procedure under the old TIL, the creditor must take his chances on a jurisdiction to jurisdiction basis.

Important reforms have been accomplished. Nevertheless, especially in the area of rescission procedure, critical questions remain unanswered.

282. *Id.*

283. *See supra* notes 204-31 and accompanying text.

284. *Id.*

285. *See supra* text accompanying notes 269-74.

286. *Id.*