Comments
to the
Federal Trade Commission
Holder Rule Review
File No. P164800

By
The National Consumer Law Center (NCLC)
on behalf of its low-income clients
Americans for Financial Reform (AFR)
The Center for Responsible Lending (CRL)
Consumer Action
Consumer Federation of America (CFA)
Consumers for Auto Reliability and Safety (CARS)
Consumers Union
NAACP
The National Association of Consumer Advocates (NACA)
The Institute for College Access & Success (TICAS)
U.S. Public Interest Research Group (U.S. PIRG)
Alabama Appleseed
Arizona Community Action Association
Arkansans Against Abusive Payday Lending
Arkansas Community Organizations
Community Legal Services (Philadelphia)
Connecticut Association for Human Services
Connecticut Citizens Action Group
Housing and Economic Rights Advocates (HERA)
Kentucky Equal Justice Center
LAF (formerly known as The Legal Assistance Foundation of Metropolitan Chicago)
The Legal Assistance Resource Center of Connecticut (LARCC)
North Carolina Justice Center
Public Justice Center
Public Law Center (PLC)
Veterans Education Success
Virginia Citizens Consumer Council
Woodstock Institute

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I. Summary

The National Consumer Law Center (on behalf of its low income clients), Americans for Financial Reform (AFR), The Center for Responsible Lending (CRL), Consumer Federation of America (CFA), Consumer Action, Consumers for Auto Reliability and Safety (CARS), Consumers Union, NAACP, the National Association of Consumer Advocates (NACA), The Institute for College Access & Success (TICAS), U.S. Public Interest Research Group (U.S. PIRG), Alabama Appleseed, Arizona Community Action Association, Arkansans Against Abusive Payday Lending, Arkansas Community Organizations, Community Legal Services (Philadelphia), Housing and Economic Rights Advocates (HERA), Alabama Appleseed, Connecticut Association for Human Services, Connecticut Citizens Action Group, Kentucky Equal Justice Center, LAF (formerly known as The Legal Assistance Foundation of Metropolitan Chicago), The Legal Assistance Resource Center of Connecticut (LARCC), North Carolina Justice Center, Public Law Center (PLC), Public Justice Center, Veterans Education Success, the Virginia Citizens Consumer Council, and the Woodstock Institute appreciate the opportunity to submit comments in connection with the Federal Trade Commission's (FTC) review of the Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses (known as the "Holder Rule"), 16 C.F.R. Part 433.[1]

The Holder Rule is one of the most important actions the Commission has ever taken in preventing and remedying unfair and deceptive practices in the marketplace. When a seller of a good or service originates or helps arrange credit, the Rule allows consumers to raise the seller's misconduct as a basis for bringing claims or defenses against the entity holding the debt. Specifically, the Rule requires a notice in the credit documents that assignees in credit sales and direct lenders related to sellers are subject to claims and defenses that the consumer has against the seller of the goods or services. Thus for virtually all consumer transactions, from car loans to certain types of student loans to home improvement contracts, consumers have a viable consumer remedy for seller misconduct even when their obligation is owed to a creditor and not to the seller.

When a consumer is being sued by a creditor, it is rarely practical for the consumer to sue the seller in a separate action, particularly when the seller is insolvent or distant. It is far more practical and fair to be able to raise seller-related claims and defenses against the party collecting on the debt. The creditor is also in a far better position than is the consumer to recover from the seller (e.g. through recourse agreements) and to police the seller's conduct.

Because of the Rule's enormous impact in preventing and remedying unfair and deceptive seller practices, we urge the Commission to retain the Holder Rule's strong provisions and to take eight steps that will further facilitate the Rule operating as it should:

1. Reiterate the Commission's 2013 statement that the Holder Rule gives a consumer the right to an affirmative recovery in circumstances beyond those where the consumer could rescind the transaction or where the goods or services were totally worthless;

2. Clarify that large transactions (over $25,000) are covered by the Rule;

3. Clarify that the Rule applies to leases, or use the FTC's streamlined rulemaking authority concerning motor vehicles to adopt a parallel rule applying to motor vehicle consumer leases;

4. Clarify that the Rule's cap on recovery does not apply to attorney fees for which the holder is liable because of the holder's own litigation conduct;

5. Clarify that state law does not trump the Holder Rule;

6. Formally adopt the previously published "Holder II" Rule, which would require creditors, not just sellers, to include the Holder notice in any contract they originate or purchase. (Holder II in 1979 was adopted and published seeking only stylistic comments, but the Commission then took no action and finally withdrew the Rule in 1988);

7. Enumerate prohibited unfair or deceptive practices that creditors should not take to evade the rule's operation; and

8. Step up FTC enforcement of Holder Rule violations.

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[1] The descriptions of the organizations joining this comment are listed in the appendix to these comments. The comments were written by Jonathan Sheldon, jsheldon@nclc.org, and Carolyn Carter, ccarter@nclc.org, National Consumer Law Center.

II. Benefits and Continuing Need

The FTC Holder Rule is one of the most important actions the Commission has ever taken in preventing and remedying unfair and deceptive practices in the marketplace. The need for the Rule to protect consumers has if anything increased over time and will continue to be of critical importance for the foreseeable future.

One effective consumer remedy where goods or services are not delivered, are defective, or are not as promised is simply refusing to pay the seller for the goods or services. This simple mechanism of withholding payment is probably the most widespread means of preventing and remedying fraud.

Before promulgation of the Holder Rule, fraudulent merchants' solution to counter this consumer remedy was to arrange for the consumer to pay on credit and then separate the requirement to pay from the consumer's claims against the seller. The merchant received full payment or close to it from a creditor and the creditor sought payment from the consumer. Defense cut-off devices prevented the consumer from raising the merchant's fraud against the lender. The consumer had little recourse against the seller, who may have disappeared or shifted assets to become insolvent. In any event, it was difficult for an often unsophisticated consumer to obtain legal representation and successfully litigate against the merchant.

The lender made a profitable loan and the merchant received immediate payment even before any goods or services were delivered. The consumer was left holding the bag, owing for full payment when goods or services were never delivered or were defective or not as promised.

The Holder Rule Eliminates Harmful Incentives in Four Different Ways

The Holder Rule effectively eliminates many incentives for merchants to engage in unfair or deceptive practices and creates effective and practical remedies when merchants do engage in such practices, at least when credit is involved in a sale. The rule has four important practical effects.

First, the seller may be judgment proof, such that consumers would be left without a remedy if they had to pay the note holder and then try to recover all or some of this amount from the original seller. As one court has said, without the Holder Rule, creditors could in effect run a laundry for fly-by-night retailers.[2] Without the Rule, consumers would owe on the credit obligation even though they cannot recover from the fraudulent seller. The Rule helps stop this practice in its tracks.

Second, even if the seller is solvent, it is usually impractical to expect a consumer to defend a collection action and simultaneously bring an affirmative suit against the seller. The Commission has stated this itself: "Consumers are not in a position to police the market, exert leverage over sellers, or vindicate their legal rights in cases of clear abuse. . . . Redress via the legal system is seldom a viable alternative for consumers when problems occur."[3]

The collection suit may be resolved years before the affirmative suit, and it is often not feasible for a consumer to bring an affirmative action for the small amount of money at stake. Many contracts today force consumers to raise claims in arbitration, and not in court, and studies have shown that the impediments for bringing an action in arbitration are normally insurmountable.[4] By far the most practical action for the consumer is to defend the collection action by raising against the collecting creditor the consumer's claims and defenses against the seller. Perhaps of even greater importance is that the consumer can apprise a collector that defenses exist if the collector were to attempt a collection lawsuit.

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2 State *ex rel*. McGraw v. Scott Runyan Pontiac-Buick, Inc., 461 S.E.2d 516, 526 (W. Va. 1995).

3 Fed. Trade Comm'n, Statement of Basis and Purpose, Trade Regulation Rule Concerning the Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,523 (Nov. 18, 1975).

4 Consumer Fin. Prot. Bureau, Arbitration Study, Report to Congress Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (Mar. 2015), available at www.consumerfinance.gov.

Third, making related lenders liable for the acts of the original seller serves the additional goal of establishing a market-based incentive for creditors to inquire into the merchants for whom they finance sales and to refuse to deal with those merchants whose conduct would subject the creditor to potential claims and defenses. It is far more practical for the market to police itself than to ask enforcement officials to police every consumer transaction. There are literally billions of consumer transactions each year, and it would be unreasonable—and impossible—to ask federal, state and local agencies to be responsible for monitoring all such transactions. Clearly, self-policing mechanisms are to be preferred so that enforcement agency responsibilities are manageable.

Fourth, the related creditor is in a much better position than the consumer to recover money from the seller. The Commission has recognized this itself: "As a practical matter, the creditor is always in a better position than the buyer to return seller misconduct costs to sellers, the guilty party."[5] The creditor is in an excellent position to recover money from the seller: the holder "has recourse to contractual devices which render the routine return of seller misconduct costs to sellers relatively cheap and automatic . . . The creditor may also look to a 'reserve' or 'recourse' arrangement or account with the seller for reimbursement."[6]

Holder Rule Benefits Are Now Widely Recognized by the States and Congress

The benefits and effectiveness of the FTC Holder Rule are now widely recognized. All 50 states have enacted the version of the Uniform Commercial Code that states that the FTC Holder Notice should as a matter of law be implied into an assigned contract when the seller should have, but did not include the holder notice in the contract.[7] It is important to note that such state laws do *not* replace the need for the FTC Holder Rule, but instead rely on it and provide a state remedy where the federal requirement is evaded.

While the FTC Rule does not apply to credit card transactions, Congress has seen the same need to protect consumers in credit card transactions, and federal law provides that consumers who use their credit cards to make purchases can raise with the card issuer their claims and defenses against the seller.[8]

Evidence of the Need

Evidence of the need for the Holder Rule is found in situations where the Rule was not in effect. Most obviously, before the Rule's effective date, problems with home improvement contractors, door-to-door sellers, and other fly-by-night sellers were pervasive. Since the rule, this form of consumer fraud has significantly lessened.

The most telling example of what happens when holders are insulated from origination fraud was the market for first and second home mortgages earlier in this century. Mortgage loan brokers and loan originators were given a green light for fraud on a scale never before seen in this country. Those financing the mortgage loans (often securitization trusts) claimed immunity from liability from origination fraud and had no incentive to police it. Instead, entities involved with the financing of the mortgages actually fostered the fraudulent origination practices, instead of policing them.[9]

Another example occurred throughout the 1980s when the Holder Notice was not included in notes when banks made guaranteed student loans. The result was fraud on a scale hard to comprehend, as over a thousand scam vocational schools eventually closed. Millions of the most vulnerable students were ripped off with no remedy, but were still required to repay their student loans.[10]

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5 Fed. Trade Comm'n, Statement of Basis and Purpose, Trade Regulation Rule Concerning the Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,523 (Nov. 18, 1975).

6 *Id.*

7 UCC §§ 9-403(d), 9-404(d).

8 15 USC 1666i-.

9 *See e.g*. K.. Engel & P. McCoy, The Subprime Virus: Reckless Credit, Regulatory Failure, and Next Steps (Oxford U. Press 2011).

10 Later Congressional action eventually provided relief to some students, but without such action the failure to include the Holder Notice allowed fraudulent schools to obtain easy financing while giving students no effective defense to the requirement that they repay loans for fraudulent services.

III. Costs to Consumers and Businesses

The Holder Rule has resulted in no cost to consumers and only minimal cost to businesses. Before the Rule's adoption, industry argued that the Rule would cut off consumer access to credit, or that consumers would be forced to find credit independent of the seller. But the opposite has been the case. Seller originated or arranged financing is now the norm in most consumer transactions. Credit card use has also grown dramatically as a means of financing purchases, even though federal law allows consumers to raise seller-related claims as a defense to credit card repayment. The Holder Rule has had no adverse effect on consumers' access to credit.

The Rule's costs for businesses must be divided between the costs of rule compliance and the fact that the Rule makes holders and not consumers bear the burden of a seller's misconduct. Cost of compliance is minimal, only requiring inclusion of a notice in contracts. Since the rule has been in effect for almost forty years, by now there would be greater costs to remove the language from contracts than to leave it in.

Of course, the operation of the Holder Rule does mean—as intended—that consumers will find it easier to remedy their damages caused by illegal practices, and remedying these damages means that someone will be held legally accountable. These are the very costs on business that the Commission was hoping for in adopting the Rule. The burden of those costs will rest on holders, though only to the extent that they do not recover them from the seller. But holders are well equipped to take care of this. First they have an incentive not to enter business relationships with sellers engaged in fraud. Second, they are more likely to have ongoing business relations with sellers, and can further protect themselves by establishing arrangements such as reserve accounts so that they can easily recover any seller-related claims for which they are held liable, instead of requiring consumers to engage in costly litigation with fraudulent sellers.

IV. Rule Modifications to Increase Benefits for Consumers

We recommend eight clarifications or changes concerning the Holder Rule. It is our experience that court rulings in this area too often misconstrue the Rule and that sellers, holders, attorneys and consumers too often misunderstand its requirements. Clarification of the rule's requirements could alleviate these problems.

1. ***Reiterate Commission's Advisory Opinion Concerning Limits on Consumer Recoveries***

The Commission clarified an important issue in an opinion letter of May 3, 2013, to the National Consumer Law Center.[11] The Commission opinion clarified that a consumer's rights to an affirmative recovery are not limited to circumstances where the consumer could rescind the transaction or where the goods or services are totally worthless.

While the opinion provides that the Rule is unambiguous on this point and that the Rule's plain language should be applied, the opinion acknowledges that a number of courts have been confused on this point and have ruled to the contrary. As that opinion further states, these courts have taken out of context and misapplied language from the Rule's statement of basis and purpose.

Because of the widespread nature of this misconception, we urge the Commission to reiterate this opinion in any *Federal Register* notice that the Commission issues related to this proceeding, to further publicize the Rule's correct interpretation.

[11] Letter Jonathan Sheldon and Carolyn Carter, available online at https://www.ftc.gov/policy/advisory-opinions/16-cfr-part-433-federal-trade-commission-trade-regulation-rule-concerning.

2. Clarify that the Rule Applies to Large Transactions

We ask the Commission to correct a clearly erroneous statement in the 1976 FTC staff guidelines on the Rule. The guidelines state that "a purchase involving an expenditure of more than $25,000 is not affected by the Rule."[12] The guidelines reach this conclusion because terms used in the Rule—"financing a sale" and "purchase money loan"—expressly refer to the Truth in Lending Act (TILA) and its Regulation Z. The guidelines state that they "thus incorporate the limitations contained in these laws."[13]

The staff's 1976 statement is misconceived. The FTC Holder Rule defines "financing a sale" as extending credit in connection with a credit sale "within the meaning of the Truth in Lending Act and Regulation Z."[14] The TILA and Regulation Z define a "credit sale" as any sale in which the seller is a creditor. The TILA and Regulation Z also define creditor and credit.[15] None of these definitions mentions a dollar limit.

The Rule also defines "purchase money loan" as one involving a finance charge "within the meaning of the Truth in Lending Act and Regulation Z."[16] "Finance charge" is defined in Regulation Z as the cost of consumer credit as a dollar amount. Again, neither Regulation Z's definitions of consumer, consumer credit, or finance charge in any way refer to a dollar limit.[17]

Instead, the TILA has a separate section that exempts certain transactions from the scope of the Act. One of these exemptions applies to *certain* transactions that in 1976 had an amount financed of more than $25,000. This exemption amount was increased in 2011 and is now indexed for inflation, and now exempts from TILA certain transactions with an amount financed over $54,600.[18] This exemption in no way refers to finance charges or the term "credit sale."[19] The exemption does not provide that transactions over $54,600 are not credit sales or do not have finance charges.

TILA excludes large transactions in an exemption section and not in the definition of finance charge and credit sale because the exempted transactions all have finance charges or involve credit sales. A credit sale over $54,600 still involves a seller who is a creditor. A loan over $54,600 still has a finance charge. The Holder Rule thus applies to transactions with an amount financed over $54,600 as long as they have finance charges or are credit sales within the TILA's definitions.

1976 guidelines as a staff statement are not binding on the Commission and may not reflect the views of the Commission. The Commission should correct the mis-conceived staff statement concerning an exemption for expenditures over $25,000.[20]

A dollar exemption from the FTC Holder Rule has never been announced by the Commission. The exemption is found neither in the Rule nor in the lengthy Commission statement of basis and purpose for the Rule. Instead, the exemption is found only in one 1976 staff interpretation. We urge the Commission to

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12 Staff Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 41 Fed. Reg. 20,022 (May 14, 1976).

13 *Id.*

14 16 C.F.R. § 433.1(e).

15 15 U.S.C. § 1602 (f), (g), (h); 12 C.F.R. § 1026.2(a)(14), (16), (17).

16 16 C.F.R. § 433.1(d).

17 12 C.F.R. § 1026.2(a)(11), (12) , 1026.4(a); *see also* 15 U.S.C. § 1605(a).

18 Effective July 21, 2011, the exemption applied only when the amount financed exceeded $50,000. *See* 15 U.S.C. § 1603(3); *see also* 76 Fed. Reg. 18,354 (Apr. 4, 2011). 15 U.S.C. § 1603(3) also provides that the $50,000 amount is adjusted annually for inflation. *See* 80 Fed. Reg. 73947 (Nov. 27, 2015) (retaining the exemption level at $54,600 for 2016).

19 15 U.S.C. § 1603(3).

[20] As further evidence the staff at that time may not have fully understood how Truth in Lending operates, the staff statement refers to "expenditure" which is very different than "amount financed." Nowhere in TILA (or in the Rule) is there any reference to "expenditures." In addition, the staff guidelines fail to recognize that TILA's dollar amount exemption only applies to certain forms of credit: it does not apply to credit secured by a dwelling or involving a student loan.

explicitly reject this statement and instead reaffirm what the Rule has always provided, that there is no dollar limit for transactions within the Rule's scope.

3. Clarify that the Rule Applies to Leases

The FTC Holder Rule's application to leases is unclear. On the one hand, the first words of the first substantive section of the Rule, § 433.2, are: "In connection with any sale or lease." On the other hand, the Rule requires the Holder Notice be placed in a "consumer credit contract." "Consumer credit contract" is a defined term that refers to the TILA definition of a finance charge and a credit sale.

Courts generally resolve this ambiguity by finding that the Rule does *not* apply to lease transactions,[21] and virtually no consumer leases today include the Holder Notice. On the other hand, there are very good reasons why the Rule should apply to leases.

While consumer leasing was rare in the marketplace when the Holder Rule was promulgated in 1976, consumer leasing today is widespread. The number of new vehicle sales involving leasing has been growing rapidly so that now about one-third of all financed new vehicles involve leases,[22] and there is even a growing amount of leasing in the used car market.

The Holder Rule's protection is just as essential for consumer leases as it is for consumer credit and purchase money loans. During the lease term, the policy considerations are identical as to whether the consumer should be able to raise dealer-related claims in a credit sale, purchase money loan, or a lease.

Many leases are originated by a seller and then assigned to a financial institution or other assignee. The assignee owns the leased property and lease payments are made to the assignee. State law typically allows lessees to bring seller-related *defenses* but not *claims* against the assignee's collection action.[23] Moreover, some leases today provide that the consumer waives the right to bring even seller-related defenses against the holder.[24] In addition, the consumer has no right under most state laws to bring seller-related claims or defenses against a third party lessor, where the seller refers the consumer to the third party lessor, but the lessor (not the seller) originates the lease.

In fact, the need for the Holder Rule's protection may be even greater for leases than for credit transactions because state law provides fewer rights to consumer lessees than consumer debtors as to the ability to raise claims and defenses against a holder. While state laws vary, in general state "holder" statutes and statutes concerning waiver of defenses and assignee liability were enacted before the widespread use of consumer leasing and often do not include leases in their protections.[25]

That leases should have the same protections as credit sales and purchase money loans has been recognized by the Uniform Laws Commission (formerly the National Conference of Commissioners on Uniform State Laws or NCCUSL). The Uniform Consumer Leases Act § 305(b) (2001) is a provision

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21 *See* Marchionna v. Ford Motor Co., 1995 U.S. Dist. LEXIS 11408 (N.D. Ill. Aug. 9, 1995) (rule does not apply to pure lease); Bescos v. Bank of Am., 129 Cal. Rptr. 2d 423 (Cal. Ct. App. 2003) (same); LaChappelle v. Toyota Motor Credit Corp., 126 Cal. Rptr. 2d (Cal. Ct. App. 2002) (same); Jarvis v. South Oak Dodge, 747 N.E.2d 383 (Ill. App. Ct. 2000) (same), *rev'd on other grounds*, 773 N.E.2d 641 (Ill. 2002); Fifth Third Bank v. Roberts, 55 U.C.C. Rep. Serv. 2d 378 (Ohio Ct. App. 2004) (same); *cf.* Ford Motor Credit Co. v. Jones, 2009 WL 1912626 (Ohio Ct. App. July 2, 2009) (when FTC notice not found in lease, no derivative liability).

22 Zabritski, State of the Automotive Finance Market Third Quarter 2015 (Experian Automotive 2015) (31.9% of financed new cars were leases, up from 24.4% three years earlier).

23 That is the consumer as a defendant in a collection action can seek to offset the amount sought because of the dealer's conduct, but can neither raise counterclaims in that action for an affirmative recovery or bring a separate affirmative action.

24 *See* Mooneyham v. Provident Auto Leasing Co., 655 S.E.2d 640 (Ga. Ct. App. 2007).

25 These state laws are listed at National Consumer Law Center, Federal Deception Law § 4.5 (2d ed. 2016).

modeled on the FTC Holder Rule, but explicitly applicable to consumer leases.[26] The Uniform Laws Commission explained this provision:

> The rationale is that, as a matter of policy, the risk that the lessor will not perform properly under the lease and this Act is better borne by the entity that finances the transaction than by the relatively powerless lessee. Assignees can, and do, contract for recourse and indemnity rights against the dealers they support, which shift the cost of consumer financial injury back to the dealer or earlier holder whose malperformance caused the injury.[27]

This provision, modeled on the Holder Rule, is just one provision of a wide-ranging uniform law covering many aspects of consumer leasing. However, since its proposal as a model uniform law 15 years ago, it has only been enacted in Connecticut.[28] So it is important for the Commission to clarify that the Holder Rule applies to consumer leases.

If the Commission determines that rulemaking is required to clarify the Rule's applicability to consumer leasing, the Commission could do so using the streamlined Administrative Procedures Act rulemaking procedures, and not the Magnuson-Moss Act procedures. By far, the most significant application of the Holder Rule to consumer leasing would involve motor vehicle leasing. If the FTC determines that clarification that the Rule applies to consumer leasing requires additional rulemaking, the FTC could limit the scope of that rulemaking to consumer motor vehicle leases and proceed using its streamlined rulemaking authority granted by 12 USC § 5519(d). The Rule would essentially mirror the Holder Rule, but apply just to consumer motor vehicle leases.

4. Clarify That the Rule's Recovery Cap Does Not Apply to Attorney Fees

The Rule provides that "recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." It is important for the proper operation of many state and federal consumer statutes that this limitation be interpreted to apply just to the consumer's damage recovery for the seller's conduct and not to any attorney fee award provided for by statute to reflect the cost of the holder's litigation activity. Clarification of this point is necessary because, while many courts allow fees above the cap, [29] others do not.[30]

The holder's liability for the consumer's attorney fees will be based on a fee-shifting statute that requires the *defendant* to pay fees. The holder's liability for fees is not a derivative liability from the seller, but is based on its own actions in refusing to resolve the consumer's claim. Because the liability is not derivative, the amount the holder must pay in fees is not pursuant to the Holder Notice, and is not a "recovery hereunder" that is subject to the cap.

Thus, attorney fees are awarded not because of the seller's conduct but because of the holder's

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[26] Available at http://www.uniformlaws.org/shared/docs/consumer_leases/ucla_final_01.pdf.
[27] The Uniform Consumer Leases Act § 305(b) , Comment #2 (2001) .
[28] Conn. Gen. Stat. §§ 42-411(b).
29 *In re* Stewart, 93 B.R. 878 (Bankr. E.D. Pa. 1988); Home Sav. Ass'n v. Guerra, 733 S.W.2d 134 (Tex. 1987); Kish v. Van Note, 692 S.W.2d 463 (Tex. 1985); Reliance Mortgage Co. v. Hill-Shields, 2001 Tex. App. LEXIS 140 (Tex. App. Jan. 10, 2001); Oxford Fin. Cos. v. Velez, 807 S.W.2d 460 (Tex. App. 1991); Briercroft Serv. Corp. v. Perez, 820 S.W.2d 813 (Tex. App. 1990), *aff'd in relevant part, rev'd in part on other grounds*, 809 S.W.2d 216 (Tex. 1991); Green Tree Acceptance, Inc. v. Pierce, 768 S.W.2d 416 (Tex. App. 1989); *see also* Diaz v. Paragon Motors of Woodside, Inc., 2008 WL 2004001 (E.D.N.Y. May 7, 2008) (awarding attorney fees far in excess of the cap, but without discussion of a cap); Diaz v. Paragon Motors of Woodside, Inc. 2007 WL 2903920 (E.D.N.Y. Oct. 1, 2007) (same).
30 Griffor v. Airport Chevrolet, Inc., 2009 WL 151696 (D. Or. Jan. 22, 2009); Riggs v. Anthony Auto Sales, Inc., 32 F. Supp. 2d 411 (W.D. La. 1998); Simpson v. Anthony Auto Sales, Inc., 32 F. Supp. 2d 405 (W.D. La. 1998); Scott v. Mayflower Home Improvement Corp., 831 A.2d 564 (N.J. Super. Ct. Law Div. 2001) (plaintiffs may not recover attorney fees in excess of amounts they paid); Alduridi v. Community Trust Bank, 1999 Tenn. App. LEXIS 718 (Tenn. Ct. App. Oct. 26, 1999); Patton v. McHone, 1993 Tenn. App. LEXIS 212 (Tenn. Ct. App. 1993).

conduct. It is the holder who is refusing to settle the claim and who insists on litigating the issues. The purpose of fee-shifting statutes is to encourage settlement, make it economically feasible for consumers to bring small claims, and discourage businesses from using their superior legal resources to wear down the consumer. All of these purposes would be thwarted if attorney fees were lumped in with the recovery on the merits and capped at the amount of the creditor's maximum liability under the Holder Rule.

The FTC has clearly stated that the holder is not only derivatively liable under the Holder Rule, but also liable over and above that for its own conduct independent of any Holder cap: "The words 'recovery hereunder' . . . refer specifically to a recovery under the Notice. If a larger affirmative recovery is available against a creditor as a matter of state law, the consumer would retain this right."[31]

The Holder Rule's cap should not interfere with the congressional or state legislative purpose of encouraging consumers to utilize certain statutes and deterring defendants from needlessly prolonging litigation under those statutes. For these reasons, the Commission should clarify that "recovery hereunder" does not include attorney fees for which the defendant is liable based on the defendant's conduct, and that such attorney fees do not fall within the cap.

5. Clarify that State Law Does Not Trump the Holder Rule

While it is axiomatic that state law does not trump the operation of the FTC Holder Rule, it would be helpful for the Commission to reiterate this because of a sixteen year old Eighth Circuit ruling to the contrary in *LaBarre v. Credit Acceptance Corp.*[32] That court held that state law should be used to determine when claims can be brought under the Holder Rule. Since Minnesota law allowed consumers to raise seller-related claims as *defenses* to the assignee's collection action, but not as affirmative claims, the court concluded that the consumer could not bring affirmative claims under the Holder Rule.

The decision of course is incorrect. It would mean that the Holder Rule, promulgated because state law was not adequate, would have only the same reach as preexisting state law. As the FTC made clear in the Rule's statement of basis and purpose, applicable state law determines whether a seller is liable for certain conduct, but the Rule determines whether a holder is derivatively liable.[33]

The *LaBarre* decision would mean that the FTC Holder Rule is not only a nullity (providing no greater rights than already provided by state law), but it is a deceptive nullity, because the notice mandated by the FTC Holder Rule clearly informs consumers they can bring *all* claims and defenses against the assignee, while *LaBarre* rules they cannot. The FTC itself in the statement of basis and purpose for the Rule indicates the consumer can "maintain an affirmative action"[34] and explicitly rejected a creditor proposal that the consumer only be able to use the FTC Holder Rule defensively.[35] The Commission should explicitly reaffirm its longstanding view.

6. Enact "Holder II"

In 1979, the FTC adopted and published for stylistic comment an amendment to the Holder Rule

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31 Staff Guidelines, 41 Fed. Reg. 20,023 (May 14, 1976) (mechanism of the Rule).

32 175 F.3d 640 (8th Cir. 1999); *see also* Pescia v. Auburn Ford-Lincoln Mercury, 68 F. Supp. 2d 1269 (M.D. Ala. 1999) (construing FTC Holder Notice to nullify holder-in-due-course status, but holding that there still must be independent state grounds for holder's liability), *aff'd without op. sub nom.* Pescia v. Ford Motor Credit Corp., 2001 WL 1711051 (11th Cir. Dec. 17, 2001).

33 Fed. Trade Comm'n, Statement of Basis and Purpose for the Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,524 (Nov. 18, 1975).

34 Id.

35 Id at 53,524, 53,526, 53,527.

that would extend compliance responsibilities not just to sellers but to creditors.[36] Despite this rule being adopted in principle in 1979, with comments open only for stylistic comment, no further action was taken on the Rule amendment until it was withdrawn in 1988.[37]

The Rule amendment would have made it an unfair or deceptive practice for a creditor to acquire a contract not in compliance with the Rule or to originate such a contract. Of course, Holder II would only apply to creditors within the FTC's jurisdiction. If the FTC adopted Holder II now, we would ask the Consumer Financial Protection Bureau to adopt a similar rule for financial institutions that are outside the FTC's jurisdiction.

Holder II made sense because it is the lender, not the seller, who as a practical matter is most involved in inclusion of the Holder Notice. By definition, purchase money loans are drafted by the third party lender and not the seller. Moreover, the realities of the marketplace are that most credit sale documents are not drafted by the seller, but by the assignee, because this makes the contract readily saleable to the assignee. It makes most sense to place joint responsibility on both the seller and lender to include the Holder Notice, rather than on the seller alone.

Enforcement of rule violations by the FTC, CFPB, state attorneys general, and consumers is facilitated where the action can be brought not just against the seller, but also against the party who actually failed to insert the notice into the credit documents. And of course it is easier to shape a remedy when the person actually inserting the notice is a party to the lawsuit. Even if the FTC did not now adopt Holder II, it should certainly announce that lenders engage in unfair and deceptive acts when they draft documents not including the Holder Notice where such Notice is required, as described in the next section. The FTC should also step up enforcement against such lenders, as described in section 8, below.

7. Enumerate Unfair and Deceptive Practices That Evade the Rule's Proper Operation

Any unfair or deceptive act or practice relating to the operation of the FTC Holder Rule is a violation of the FTC Act. Nevertheless, compliance with the Act would be facilitated if the FTC enumerated specific practices that are unfair and deceptive in relation to the Rule's operation. Examples of such unfair and deceptive practices are:

- A holder representing to a consumer that it is not subject to seller-related claims and defenses when the Holder Notice is included or required to be included in the operative documents.[38]
- A holder representing to a consumer that the consumer's only avenue of relief is with the seller, even though the Holder Notice is in or required to be in the documents.
- A holder representing that the consumer is legally required to continue paying the holder even if the consumer has complaints with the seller and the Holder Notice is in or required to be in the documents.
- Representing that the Holder Rule's cap applies even to the holder's own misconduct.
- A seller or other party drafting a loan agreement containing the FTC Holder Notice that also contains language directly contradicting the Notice, such as providing that the holder is not liable for the seller's oral representations or the quality of the service provided by the seller.
- A creditor's failure to include the Holder Notice in forms it drafts where such notice is required, including in credit sales using documents drafted by the creditor.

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[36] 44 Fed. Reg. 65771 (Nov. 15, 1979).
[37] 53 Fed. Reg. 44457 (Nov. 3, 1988).
[38] *See* Jaramillo v. Gonzales, 50 P.3d 554 (N.M. Ct. App. 2002) (holder's refusal to accept liability under FTC Holder Notice is violation of state deceptive practices statute).

8. Step Up Enforcement Where Notice Improperly Omitted

The Commission should step up enforcement where the Holder Notice is improperly omitted. Without the notice, the consumer will have no way of knowing of the right to raise seller-related claims and defenses against the holder.

Improperly omitting the notice can also take away from consumers the right to bring seller related claims against the holder. The Holder Rule does not have a private right of action, and instead operates by the notice being included in the agreement, making it an enforceable contract term. When the seller violates the rule and fails to include or arrange for the inclusion of the notice, the consumer's rights become muddied.

In a credit sale, UCC Article 9, in effect in all 50 states, requires that the notice be implied into the contract whenever the notice is required but not included.[39] But consumer rights are more complicated where the notice is not included in a purchase money loan. The latest version of UCC Article 3 implies the notice into the contract just as Article 9 does,[40] but this Article 3 version with the Holder Notice provision has only been adopted in ten jurisdictions.

When the notice is missing from a purchase money loan, consumers can raise other state law theories, such as under a state deceptive practices statute or a state mini-FTC holder statute. But national banks have argued that such state law is preempted as to claims brought against them.[41]

Other complications also arise because the FTC never finalized "Holder II," which would have made lenders, not just sellers, directly subject to the Rule's requirements. As a result, a state deceptive practices claim against the lender must be based upon the lender's participation in the seller's violation of the Rule.

For these reasons, the FTC should be vigilant in discovering where the Rule has been violated and to bring enforcement actions against such sellers. Investigation and enforcement should be straightforward—is the notice in the contract and is the contract covered by the Rule? While Rule violations are not widespread, they do occur. Private loans extended to students to pay for attendance at for-profit schools appears to be a category of transactions particularly prone to Rule violations.[42]

The failure to include the Holder Notice is not a mere technical violation, but one that can deprive consumers of important substantive rights. Enforcing compliance should be a priority for the Commission.

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[39] UCC §§ 9-403(d), 9-404(d).

[40] UCC § 3-305(e).

[41] See Kilgore v. Keybank, N.A., 712 F. Supp. 2d 939 (N.D. Cal. 2010), *vacated on other grounds* 673 F.3d 947 (9th Cir. 2012).

[42] Various National Collegiate Student Loan Trusts hold billions of dollars in private student loans, but few if any of these loans include the Holder Notice. Since many of the loans involve for-profit schools referring students to bank originators who then sold the loans to the trusts, there is the possibility of widespread violations of the FTC Holder Rule. *See also* Kilgore v. Keybank, N.A., 712 F. Supp. 2d 939 (N.D. Cal. 2010), *vacated on other grounds* 673 F.3d 947 (9th Cir. 2012).

V. Conclusion

The Holder Rule is of critical importance to consumers. We urge the Commission to maintain the Rule, resist any calls to weaken it, and strengthen it in order to provide greater protection for consumers. Thank you for this opportunity to comment. For further clarification on these comments, please contact Jonathan Sheldon (jsheldon@nclc.org, 617-542-8010) or Carolyn Carter (ccarter@nclc.org, 617-542-8010).

Respectfully Submitted,

The National Consumer Law Center (NCLC) on behalf of its low-income clients
Americans for Financial Reform (AFR)
The Center for Responsible Lending (CRL)
Consumer Federation of America (CFA)
Consumers for Auto Reliability and Safety (CARS)
Consumers Union
NAACP
The National Association of Consumer Advocates (NACA)
The Institute for College Access & Success (TICAS)
U.S. Public Interest Research Group (U.S. PIRG)
Consumer Action
Alabama Appleseed
Arizona Community Action Association
Arkansans Against Abusive Payday Lending
Arkansas Community Organizations
Connecticut Association for Human Services
Connecticut Citizens Action Group
Community Legal Services (Philadelphia)
Housing and Economic Rights Advocates (HERA)
Kentucky Equal Justice Center
LAF (formerly known as The Legal Assistance Foundation of Metropolitan Chicago)
The Legal Assistance Resource Center of Connecticut (LARCC)
North Carolina Justice Center
Public Justice Center
Public Law Center (PLC)
Veterans Education Success
Virginia Citizens Consumer Council
Woodstock Institute

Appendix Describing Commenting Organizations

The National Consumer Law Center (NCLC) joins these comments on behalf of its low income clients. Since 1969, the nonprofit NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC since 1982 has written about and compiled case law concerning the FTC Holder Rule. See e.g. NCLC's *Federal Deception Law* ch. 4 (2d ed. 2016). NCLC has also participated in FTC rulemaking proceedings and commented on a number of FTC proposals in the past.

` ***Americans for Financial Reform (AFR)*** is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

`The ***Center for Responsible Lending (CRL)*** is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund.

Consumer Action has been a champion of underrepresented consumers since 1971. A national, nonprofit 501(c)3 organization, Consumer Action focuses on financial education that empowers low to moderate income and limited-English-speaking consumers to financially prosper. It also advocates for consumers in the media and before lawmakers to advance consumer rights and promote industry-wide change particularly in the fields of consumer protection, credit, banking, housing, privacy, insurance and utilities.

` ***Consumer Federation of America (CFA)*** is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.

` ***Consumers for Auto Reliability and Safety (CARS)*** is a national, award-winning non-profit auto safety and consumer advocacy organization that works to save lives, prevent injuries, and protect consumers from auto-related fraud and abuse. CARS has led numerous successful campaigns to enact landmark laws to improve protections for both new and used car buyers at the state and federal level. Congress has repeatedly invited the President of CARS to testify on behalf of American consumers.

Consumers Union is the public policy and advocacy division of Consumer Reports. Consumers Union works for telecommunications reform, health reform, food and product safety, financial reform, and other consumer issues. Consumer Reports is the world's largest independent product-testing organization. Using its more than 50 labs, auto test center, and survey research center, the nonprofit rates thousands of products and services annually. Founded in 1936, Consumer Reports has over 8 million subscribers to its magazine, website, and other publications.

NAACP: The National Association for the Advancement of Colored People is our nation's oldest, largest, and best-known grassroots based civil rights organization. With more than 2,200 units, the NAACP has members in every state in our country, as well as on military bases overseas in Europe and Asia**.**

The ***National Association of Consumer Advocates (NACA)*** is a nonprofit association of more than 1,500 consumer advocates and attorney members who represent hundreds of thousands of consumers victimized by fraudulent, abusive and predatory business practices. As an organization fully committed to promoting justice for consumers, NACA's members and their clients are actively engaged in promoting a fair and open marketplace that forcefully protects the rights of consumers, particularly those of modest means.

The Institute for College Access & Success (TICAS) is an independent, nonprofit organization that works to make higher education more available and affordable for people of all backgrounds. Our Project on Student Debt works to increase public understanding of rising student debt and the implications for our families, economy, and society.

U.S. Public Interest Research Group (U.S. PIRG) serves as the Federation of State PIRGs, which are non-profit, non-partisan public interest advocacy organizations that take on powerful interests on behalf of their members. For years, U.S. PIRG's consumer program has designated a fair financial marketplace as a priority. Our advocacy work has focused on issues including credit and debit cards, deposit accounts, payday lending, student loans, credit report accuracy, privacy of customer information (including data breaches) and, generally, any unfair and deceptive practices.

` ***Alabama Appleseed*** is a non-profit, non-partisan public interest legal advocacy organization whose mission is to work for systemic policy reforms that achieve justice and fairness for low-income, unrepresented, and other vulnerable populations that usually have little, or no, voice in developing or changing policies that impact their lives.

Arizona Community Action Association is a non-profit agency created in 1967 to address poverty across Arizona. Through a collaboration of nearly 300 organizations and individuals, ACAA develops and implements strategies to address and ultimately eliminate poverty.

Arkansans Against Abusive Payday Lending is a broad-based coalition of non-profit, consumer, community, civic, military and faith-based organizations dedicated to ridding our community of the abuses of payday lending. Payday lending tends to prey on low-to-moderate income families, college students, military personnel and the elderly.

Arkansas Community Organizations is a membership organization of low-income and working families who work together to win more power for our communities so that we can changes that benefit the people living in our neighborhoods and open doors that create more opportunity.

Community Legal Services, Inc. was established by the Philadelphia Bar Association in 1966. Since then, CLS has provided legal services to more than one million low-income Philadelphia residents, representing them in individual cases and class actions, and advocating on their behalf for improved regulations and laws that affect low-income Philadelphians. As the city's largest provider of free legal services, CLS assists more than 11,600 of Philadelphia's poorest residents with their legal problems each year.

Connecticut Association for Human Services, founded in 1910, promotes family economic security strategies that empower low-income working families to achieve financial stability. Our mission is to end poverty and engage, equip and empower all families in Connecticut to build a secure future. CAHS plays a unique role as a catalyst and convener. CAHS works to reduce poverty and build family economic success (FES) through outreach, education, and policy work.

Connecticut Citizen Action Group (CCAG) is a statewide membership based organization dedicated to involving the residents of CT in building a more just society. Founded 45 years ago CCAG currently has nearly 15,000 member families.

Housing and Economic Rights Advocates (HERA) **i**s a California statewide, not-for-profit legal service and advocacy organization dedicated to helping Californians — particularly those most vulnerable — build a safe, sound financial future, free of discrimination and economic abuses, in all aspects of household financial concerns. We provide free legal services, consumer workshops, training for professionals, community organizing support and engage in policy work, statewide.

` ***Kentucky Equal Justice Center*** is a non-profit poverty law advocacy center. We work in partnership with the civil legal aid programs and other community groups to represent the interests of low-income Kentuckians in the legislature, in before state and federal agencies, and in the courts. We focus on health, public benefits, consumer protection, housing, worker's rights and immigration.

LAF (formerly known as The Legal Assistance Foundation of Metropolitan Chicago) represents each year more than 20,000 low-income clients with non-criminal legal problems. Our Client Screening Unit interviews approximately 60-80 callers a day, many of whom are then provided with follow-up appointments and extended representation by one of LAF's five practice groups, including our Consumer Practice Group (CPG). CPG focuses on the representation of homeowners facing foreclosure or other loss of the home, debtors in bankruptcy, victims of consumer fraud, and other consumers facing debt collector harassment or abuse. For decades, CPG has been the leading voice for low-income consumers in the Chicago area.

The Legal Assistance Resource Center of Connecticut (LARCC) is the advocacy and support center for the legal aid and legal services programs in Connecticut. Among other functions, it speaks on behalf of low-income consumers concerning consumer credit issues.

North Carolina Justice Center is the state's preeminent voice for economic, social and political justice. As a leading progressive research and advocacy organization, our mission is to eliminate poverty in North Carolina by ensuring that every household in the state has access to the resources, services and fair treatment it needs to achieve economic security.

` ***Public Justice Center*** works with people and communities to confront the laws, practices, and institutions that cause injustice, poverty, and discrimination. We advocate in the courts, legislatures, and government agencies, educate the public, and build coalitions, all to advance our mission of "pursuing systemic change to build a just society."

` ***Public Law Center (PLC)*** is a 501(c)(3) non-profit organization that provides free legal services to low-income residents of Orange County, California. In 2014, PLC staff and volunteers provided over 67,000 hours of free legal services in handling more than 4,600 cases, benefiting more than 8,000 low-income children, adults and seniors in Orange County. Our Consumer Law Unit regularly assists individuals defending debt collection lawsuits, including those filed to collect on student loans, who benefit from the application of the FTC Holder rule.

Veterans Education Success (VES), whose mission is to protect the integrity and promise of the GI Bill and other federal education programs for veterans and servicemembers. VES provides policy expertise to policy makers as well as free legal services to veterans and servicemembers who felt defrauded or deceived by their college.

Virginia Citizens Consumer Council speaks for consumers to legislators and other policy makers at the Virginia General Assembly to improve laws that protect consumers, in State Corporation Commission cases on utility and telephone services, and to law enforcement agencies to make sure consumer protection laws are enforced.

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Our key tools include: applied research; policy development; coalition building; and technical assistance.