UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

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Dear Mr. Sheldon:

This responds to your request for our views as to the application of the Commission's trade regulation rule titled *Preservation of Consumers' Claims and Defenses* (16 CFR Part 433, the "Rule" or "Holder Rule") to cases where the consumer asserts a claim that exceeds the amount remaining to be paid on an installment loan or sales contract covered by the Rule.

The Holder Rule is designed to allow consumers to assert, against third party creditors, any claims they may have against merchants from whom they buy goods or services. To that end, it requires that any seller that arranges for (or offers) credit to finance consumers' purchases of goods or services must include in its form contracts the following provision:

> ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED [PURSUANT HERETO OR] WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER. 16 CFR § 433.2 (emphasis added).

In our view, the provision is quite clear. The consumer may recover his or her down payment (all deposits and trade-ins given to the seller),[1] and all instalment payments made pursuant to the contract, but no more. There are no other limitations on the creditor/assignee's liability under the required contractual language. The line of cases stemming from Ford Motor Co. v. Morgan, 536 N.E.2d 587, 589-90 (Mass. 1989),[2] interpreting the provision to allow a consumer an affirmative recovery only if he or she is entitled to rescission or similar relief under state law, are inconsistent

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[1] Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 41 Fed. Reg. 20022, 20023 (May 14, 1976).

[2] The court faced extensive misconduct by the debtor in that case. Mr. Morgan concealed the automobile, removed the battery, removed or deflated the tires, and surrendered the vehicle only after being found in contempt by the trial judge. He then managed to delay the sale of the vehicle, during which time the vehicle was extensively vandalized. It resulted in a total loss, which was not recoverable due to the consumer's failure to obtain insurance. 536 N.E.2d at 588.

with our position. Although no "rescission" (or similar) limitation can be found in either the contractual provision or the text of the Holder Rule, the Morgan court (and its successors)[3] instead quote from the Statement of Basis and Purpose ("SBP") issued at the time the Rule was promulgated. The SBP asserts that an affirmative claim by a consumer (as opposed to a defense in the nature of a set-off against a creditor claim for payment of the balance due) "will only be available where a seller's breach is so substantial that rescission and restitution are justified"[4] and that consumers "will not be in a position to obtain an affirmative recovery from a creditor unless they have actually commenced payments and received little or nothing of value from the seller."[5] We believe that the point made in these SBP excerpts is simply that affirmative recoveries will be rare because they occur only if only if the consumer has a claim large enough to more than extinguish the balance due. If the Commission had meant to limit recovery to claims subject to "rescission" or similar remedy, it would have said so in the text of the Rule and drafted the contractual provision accordingly.

Our view is best stated by the court in Oxford Finance Companies v. Velez, 807 S.W.2d 460, 463 (Tex. App. 1991):

> The clear and unambiguous language of the contractual provision notifies all potential holders that, if they accept an assignment of the contract, they will be "stepping into the seller's shoes." The creditor/assignee will become "subject to" *any* claims or defenses the debtor can assert against the seller. The (provision) does not say that a seller will be liable for the buyer's damages only if the buyer received little or nothing of value under the contract. Nor does the (provision) purport to limit a creditor/assignee's liability in such fashion." (Emphasis in original)

The views set forth in this informal staff opinion letter are not binding on the Commission.

Yours truly,

David Medine

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[3] Mount v. LaSalle Bank Lake View, 926 F. Supp. 759, 763-64 (N.D. Ill. 1996); In re Hillsborough Holdings Corp., 146 B.R. 1015, 1021 (M.D. Fla. 1992); Felde v. Chrysler Credit Corp., 580 N.E.2d 191, 197 (Ill. App. 1991); Mardis v. Ford Motor Credit Co., 642 So.2d 701, 703 (Ala.1994).

[4] 40 Fed. Reg. 53506, 53524 (Nov. 18, 1975).

[5] Id. at 53527.