

As you know consumer protection is one of the staples of the offices of state Attorneys General and it has long been a top priority of my tenure as Iowa Attorney General. Therefore, I appreciate this opportunity to comment on a significant consumer right, the FTC Holder Rule ("Holder Rule").

The Holder Rule has been in effect for approximately forty years, and in that time, has become ingrained in the American marketplace as a valued consumer right. The Holder Rule effects basic fairness, insulating consumers from liability to a creditor for debt incurred in a sale involving seller misconduct. The Holder Rule ensures that a purchase-money creditor cannot collect repayment for funds obtained through the seller's fraud or noncompliance with other consumer rights and must repay such funds to the consumer.

The Commission's Statement of Basis and Purpose for adoption of the Holder Rule says it well:

Between an innocent consumer, whose dealings with an unreliable seller are, at most, episodic, and a finance institution qualifying as 'a holder in due course,' the financier is in a better position both to protect itself and to assume the risk of a seller's reliability. 40 Fed. Reg. 5306, 53509 (November 18, 1975).

The rule is directed at what the Commission believes to be an anomaly. . . . The creditor may assert his right to be paid by the consumer despite misrepresentation, breach of warranty or contract, or even fraud on the part of the seller, and despite the fact that the consumer's debt was generated by the sale. *Id.*, at 53507.

Of relevance to state Attorneys General is that claims and defenses originating from states' various consumer protection statutes can be asserted against creditors under the Holder Rule. See, e.g., *Williams v. ITT Fin. Servs.* 1997 Westlaw 346137 (Ohio App. 1 Dist.); *Nations Credit v. Pheanis*, 656 N.E.2d 998 (Ohio App. 1995).

My Consumer Protection Division has relied on the Holder Rule on several occasions to help consumers avoid liability to creditors in situations where imposing liability would be inherently unfair or to seek repayment of funds to consumers from creditors due to seller misconduct.

For example, in 2006, an Iowa couple purchased a vehicle from an Iowa franchised dealer paid for, in part, by the proceeds of a loan arranged for them by the dealer with a national auto finance company. Included in the loan proceeds was a substantial sum the dealer was to forward to the state for tax, title, license, and lien filing fees. Unfortunately, as sometimes happens, the dealership went out of business, closing its doors leaving certain legal obligations unfulfilled. One of those unfulfilled obligations was to forward these funds to the state. Without access to these funds, the buyers had to come up with the funds from other sources in order to pay the taxes and title, license and lien filing fees. Without paying such taxes and fees

they could not lawfully operate the vehicle on Iowa roadways. Yet they also remained liable on their purchase loan for the same amount - \$1575.<sup>1</sup> In other words, they had to pay twice for the same legal obligations due to the seller's failure to honor its contractual obligation.

Iowa law is designed to protect consumers from such losses, requiring auto dealers to obtain motor vehicle dealer bonds, the proceeds of which are payable to the state and intended to be used to compensate buyers for losses caused by dealer violations of certain state laws. Bond proceeds could unquestionably have been used to compensate the consumers in the above example. However, here, no bond was available as the bond issuer had previously cancelled it and the dealer had not obtained another. The dealer operated in violation of Iowa law by remaining in business without bond, selling vehicles to unwitting consumers such as the above couple.

When my staff discovered that no bond was in effect to compensate the buyers, and that they had fully repaid the purchase money loan, my staff contacted the creditor-lender, asserting that under the Rule a refund was due. Fortunately, the creditor agreed and refunded the \$1575. Without the existence of the Holder Rule, the only possibility of the consumers seeking recompense would have been a likely fruitless lawsuit against the owner of the defunct dealership, and the consumers would have had to pay their own attorney fees. Thus, there really was no reasonable alternative.

Through experience, we've learned that the Holder Rule has substantial benefits for consumers. The Holder Rule effectively deters unlawful conduct, given that creditors who cannot collect on buyer-debtors for debts incurred through fraud and other consumer rights violations will seek recompense from the offending sellers. Thus, it helps foster a more truthful, fair and competitive marketplace, ultimately resulting in lower prices for consumers. I strongly urge that you retain the Holder Rule and that you adopt the suggested changes to improve it included in the Comment filed by the New York Attorney General in which I have joined.

Again, thank you for this opportunity to comment.

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<sup>1</sup> The \$1575 included the sum for tax, title, and lien filing fees, charges for late payment of those fee and a charge for documentary services that were not provided by the dealer.