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Cover Page Footnote

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CONSUMER CREDIT: ABOLITION OF THE HOLDER IN DUE COURSE DOCTRINE

INTRODUCTION

The doctrine of the *holder in due course*, hereinafter referred to as HIDC, first articulated by Lord Mansfield in *Miller v. Race*,¹ provided for the protection of a burgeoning commercial paper market by holding that a bona fide purchaser of an instrument, negotiable on its face, should not be required to look behind the obligation to validate its negotiability. This decision was prompted by fear of the adverse "consequences to trade and commerce"² should holders of such instruments be subjected to the claims and defenses of prior transferors, a proposition which would serve to defeat the economic viability of treating such instruments as cash equivalents.³ The legal consequence of the *Miller* decision was to allow a bona fide purchaser for value of a note or draft, negotiated to him in an arms-length transaction, to enforce the instrument against a maker, drawer, or endorser free of most claims and personal defenses.⁴ It is this unique legal position which has given rise to the terms "super plaintiff"⁵ and "emperor of bona fide purchasers"⁶ in identifying one having the status of a HIDC.

For two centuries this doctrine has served the dual role of providing both liquidity and confidence in the commercial paper market.⁷ Its judicial origins were supplanted by various legislative codifications⁸ which provided the framework for commercial interaction and prompted the comment that the doctrine is the oil in the wheels of commerce without which they would grind to a halt.⁹ Recently, however, the doctrine has come under attack from all directions in its application to consumer credit transactions.

1. 97 Eng. Rep. 398 (K.B. 1758).

2. *Id.* at 401.

3. *Id.*

4. See generally W. BRITTON, *THE LAW OF BILLS AND NOTES* (2d ed. 1961); J. WHITE & R. SUMMERS, *THE LAW UNDER THE UNIFORM COMMERCIAL CODE* (1972) [hereinafter cited as WHITE & SUMMERS]. For the principal statutory provisions on holder in due course see UNIFORM COMMERCIAL CODE §§ 3.301-07 [hereinafter cited as UCC].

5. *Illinois Valley Acceptance Corp. v. Woodard*, 304 N.E.2d 859, 863 (Ind. Ct. App. 1974).

6. WHITE & SUMMERS, *supra* note 4, at 456.

7. 40 FED. REG. 53507 (1975).

8. The legislative enactments of most significance are the English Bills of Exchange Act of 1882, the Uniform Negotiable Instruments Law of 1896, and the Uniform Commercial Code, 1952.

9. WHITE & SUMMERS, *supra* note 4, at 457.

Although a relatively nonexistent phenomenon prior to World War II, consumer credit has increased dramatically during the past thirty years.¹⁰ In response to this increase, the various institutional financiers who are the purchasers of this new flux of commercial paper have sought the relative security of the HIDC status as a means of reducing the risk of nonrecovery.¹¹ By taking the paper free from most claims and defenses,¹² financiers have shifted to the consumer the risk of a merchant's misconduct or insolvency. In this manner the consumer's duty to pay the financier has been severed from the merchant's duty to perform according to the terms of the contract. It is this separation of duties, inherent in consumer credit contracts involving a HIDC, which has produced the most vociferous criticism of the doctrine.¹³

The assault upon this commercial citadel, initiated by the judiciary,¹⁴ has gained increasing impetus from state legislatures,¹⁵ commissions¹⁶ and agencies¹⁷ alike. Recently, the Fed-

10. Total consumer credit has increased from 7 billion dollars in 1939 to over 190 billion dollars in October, 1975, the last month for which this statistic was provided. 61 Fed. Res. Bull. A45 (Dec. 1975).

11. Rohner, *Holder In Due Course In Consumer Transactions: Requiem, Revival, or Reformation?* 60 CORNELL L. REV. 503, 505 (1975) [hereinafter cited as Rohner].

12. The Uniform Commercial Code, § 3-305, provides:

To the extent that a holder is a holder in due course he takes the instrument free from

- (1) all claims to it on the part of any person; and
- (2) all defenses of any party to the instrument with whom the holder has not dealt except
 - (a) infancy, to the extent that it is a defense to a simple contract; and
 - (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
 - (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
 - (d) discharge in insolvency proceedings; and
 - (e) any other discharge of which the holder has notice when he takes the instrument.

Common defenses, otherwise called "personal defenses" in which the HIDC takes the instrument free from consumer claims and defenses include: failure or lack of consideration, breach of warranty, unconscionability and fraud in the inducement. WHITE & SUMMERS, *supra* note 4, at 487.

13. 40 FED. REG. 53507 (1975).

14. See, e.g., *Unico v. Owen*, 50 N.J. 101, 232 A.2d 405 (1967); *Commercial Credit Co. v. Childs*, 199 Ark. 1073, 137 S.W.2d 260 (1940).

15. As of 1972 some 34 jurisdictions had modified the HIDC doctrine by barring or limiting the use of negotiable instruments in consumer transactions and 37 jurisdictions had dealt with waiver of defense clauses. For a discussion of these statutes see Crandall, *The Wisconsin Consumer Act: Wisconsin Consumer Credit Laws Before and After*, 1973 WIS. L. REV. 334, 387-99.

16. NATIONAL COMM'N ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES xvii, 34-38 (1972) [hereinafter cited as NCCF REPORT].

17. 40 FED. REG. 53510 (1975).

eral Trade Commission joined in the attack by promulgating a Trade Regulation Rule¹⁸ which effectively eliminates the application of the doctrine of the HIDC to consumer credit transactions. By providing that the holder of a consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller, the ruling reallocates the risk of seller misconduct to the financier who in turn must obtain recourse from the seller.¹⁹ This article will provide an analysis of the new Trade Regulation Rule and market conditions which prompted its promulgation. It will also suggest the anticipated effect of the Rule on the consumer, the financier, and the merchant.

SEPARATION OF DUTIES

In March, 1977, consumer installment credit outstanding in the United States totaled 179 billion dollars.²⁰ This figure represents more than a doubling of such credit within the previous nine years, and an increase of over seventy-four times the total outstanding in 1945.²¹ It is hardly surprising that given the volume of consumer credit outstanding, purchasers of commercial paper have sought the favored position of a HIDC. The two methods most often used to gain this status have been discount financing and vendor-related loans.²²

Discount Financing

Frequently the consumer is required to execute a negotiable promissory note²³ which is separate or separable from the underlying sales agreement.²⁴ This instrument together with the sales agreement is then discounted to a bank or finance company. To the extent that a financier has taken the instrument for value,²⁵ in good faith,²⁶ and without notice,²⁷ he may assert the protec-

18. FTC Trade Regulation Rule on Preservation of Consumers' Claims and Defenses §§ 433.1-2, 40 FED. REG. 53506 (1975).

19. *Id.* at 53522.

20. 63 FED. RES. BULL. A 42 (May 1977).

21. 32 FED. RES. BULL. 1404 (Dec. 1946).

22. 40 FED. REG. 53507.

23. The requirements for negotiability under UCC § 3-104(1) are as follows:

(1) Any writing to be a negotiable instrument within this Article must

- (a) be signed by the maker or drawer; and
- (b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and
- (c) be payable on demand or at a definite time; and
- (d) be payable to order or to bearer.

24. Rohner, *supra* note 11, at 506.

25. UCC § 3-303.

26. *Id.* §§ 1-201(19), 3-302(1)(b).

27. *Id.* § 3-304.

tive status of a HIDC.²⁸ This privileged position allows the financier to collect on the instrument free from all personal defenses²⁹ of parties with whom he has not dealt.³⁰ Thus, if the consumer subsequently discovers a product-based defect of sufficient import to justify rescission of the contract, he still remains obligated on the instrument.

The waiver of defense clause³¹ operates in a manner similar to that of a negotiated promissory note. In this instance the sales contract executed by the consumer will contain a clause to the effect that the consumer agrees to assert any claim or defense only against the merchant and not against an assignee of the contract. At this point the contract is assigned by the merchant to an institutional financier who is thereby contractually insulated from most claims and defenses of the consumer.³² Although subject to abuse,³³ the use of this device in commercial agreements receives its support from the Uniform Commercial Code.³⁴ Boilerplate waiver of defense clauses frequently are used in conjunction with promissory notes, thereby further strengthening the financier's ability to collect vis-à-vis the consumer's obligation to pay.³⁵

Vendor-Related Loans

Operating on the assumption that a consumer is free to

28. See note 12 *supra*.

29. The party, however, is still subject to the five real defenses as set forth in UCC § 3-305(2).

30. To the extent that a party qualifies as a HIDC he will take the instrument free only of the personal defenses of parties with whom he has not dealt. See WHITE & SUMMERS, *supra* note 4, at 487.

31. A typical example of a waiver of defense clause would read:

Buyer understands and agrees that Buyer will settle directly with the Original Seller all claims, setoffs, counterclaims and other defenses there may be against the Original Seller and that Buyer shall not setup any such claim, setoff, counterclaim or other defense against any such subsequent holder.

See *Block v. Ford Motor Credit Co.*, 286 A.2d 228, 230 (D.C. App. 1972).

32. UCC § 9-206(1) provides:

Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the Article on Commercial Paper (Article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

Therefore, an assignee of a consumer credit contract which contains a waiver of defense clause is insulated to the same extent from consumer claims and defenses as the HIDC of a negotiable instrument.

33. For a categorical listing of such abuse, see 40 FED. REG. 53509-10 (1975).

34. See note 32 *supra*.

35. 40 FED. REG. 53507 (1975).

obtain a direct personal loan from a lending institution, it is asserted that subsequent consumer dissatisfaction with a product purchased with the proceeds of that loan should present no legal basis for refusal to pay the lender. In essence, the lender is seeking judicial recognition and support for the proposition that two separate agreements have transpired. It is contended that a claim arising from the second agreement should cause no legal repercussions as to the first.³⁶

Although this contention is fundamentally correct, it presupposes the existence of two completely independent transactions. Frequently a business arrangement between the merchant and the lender is established long before the consumer enters the scene.³⁷ The resulting loan to the consumer has been prearranged and the lender's check is often made payable to both the consumer and the merchant.³⁸ Notwithstanding the close affiliation of the merchant with the lender, the number of referrals, or even the knowledge of questionable merchant sales practices, the law recognizes two distinct transactions.³⁹ Thus, the obligation of the consumer to repay the loan is wholly independent of any sales agreement entered into between the merchant and the consumer. Again, the consumer's duty to pay has been separated from the merchant's duty to perform.

CONSUMER REDRESS: PRE-FTC RULING

Judicial Response

Sympathetic to the plight of the commercially naive consumer,⁴⁰ and aware of the fact that the doctrine of the HIDC was initially a creature of the courts, the judiciary was the first to provide consumer redress. In *Commercial Credit Co. v. Childs*,⁴¹ for example, the Supreme Court of Arkansas held that an assignee of a promissory note was not able to insulate itself from the malfeasance of the merchant due to the fact that the assignee was "so closely connected with the entire transaction . . . that it could not be heard to say that it, in good faith, was an innocent purchaser of the instrument."⁴² In this manner the close connection between the merchant and the financier was

36. Rohner, *supra* note 11, at 508.

37. 40 FED. REG. 53515 (1975).

38. *Id.*

39. Rohner, *supra* note 11, at 508.

40. *Id.* at 517.

41. 199 Ark. 1073, 137 S.W.2d 260 (1940).

42. *Id.* at 262 (emphasis added). Plaintiff, a finance company, prepared the instrument before it was executed by the consumer. The court held the company a party to both the agreement and the instrument from the beginning.

used by the court to negate the good faith prerequisite to becoming a HIDC.⁴³ Moreover, this concept is sufficiently versatile to accommodate the finding that no transfer has taken place,⁴⁴ or that the merchant's knowledge of a defense has been imputed to the financier.⁴⁵ Either of these alternatives is sufficient to prevent the financier from obtaining the status of a HIDC.

Two interrelated problems have arisen with respect to the "close connectedness" doctrine. First, the circumstances which constitute the connection are more adequately described as a combination of variables which may or may not tip the judicial scales in the favor of the consumer.⁴⁶ Second, while this theory allows the court extensive latitude in arriving at its decision, it offers little certainty for the consumer who must rely on the argument, nor does it provide the merchant or financier adequate guidance as to the permissible parameters of their relationship.⁴⁷ For these reasons it has proved to be a less than satisfactory solution to the consumer credit problem.

Legislative Action

The response of the various state legislatures to the problems of the consumer has provided a multitude of statutory limitations on the application of the HIDC doctrine.⁴⁸ However, few jurisdictions have actually eliminated the application of the doctrine to consumer credit transactions.⁴⁹ While some states have elected to restrict or prohibit the use of negotiable

43. See note 26 *supra*.

44. *Jones v. Approved Bancredit Corp.*, 256 A.2d 739, (Del. 1969).

45. *Cf. Waterbury Sav. Bank v. Jaroszewski*, 4 Conn. Cir. Ct. 620, 238 A.2d 446 (1967). The court, in acknowledging this defense, explained that the facts of this particular case fell short of creating a principal-agent relationship whereby knowledge may be imputed from a merchant to a subsequent holder of a promissory note.

46. The five factors most often emphasized by the courts are:

- (1) Drafting by the lender of forms for the seller.
- (2) Approval or establishment or both of the seller's procedures by the lender (*e.g.*, setting of the interest rate, approval of a referral sales plan).
- (3) An independent check by the lender on the credit of the debtor or some other direct contact between the lender and the debtor.

- (4) Heavy reliance by the seller upon the lender (*e.g.*, transfer by seller of all or a substantial part of his paper to one lender).

- (5) Common or connected ownership or management of seller and lender.

WHITE & SUMMERS, *supra* note 4, at 481.

47. It has been suggested that the relative "rawness" of the deal that the seller gives the defendant consumer is a highly relevant though often unarticulated factor. WHITE & SUMMERS, *supra* note 4, at 481.

48. See note 15 *supra*.

49. Among those jurisdictions which have enacted comprehensive legislation which has effectively eliminated the doctrine of the HIDC are Massachusetts, New York, New Jersey, and Wisconsin. 40 FED. REG. 53522 n.55 (1975).

instruments and waiver clauses, others have banned one but not the other.⁵⁰ In addition, waiver clauses are frequently deemed enforceable if the consumer fails to notify the assignee of the contract of any claim or defense he possesses within a specified time period.⁵¹

There is reason to doubt the extent of the success of this piecemeal approach to the problem. Empirical studies have been conducted which indicate that if restrictions are placed on the use of negotiable instruments or waiver of defense clauses, the effect will be to increase the use of direct vendor loans.⁵² The end result is the same—a separation of duties. This lack of uniformity in approach, resulting in a circumvention of the legislative intent of state legislatures, has prompted the response that “the statute law of the various states is a patchwork quilt.”⁵³ It has also underscored the need for a more comprehensive uniform approach to this particular consumer credit problem.

One attempt at such uniformity in legislative response was manifested by the adoption of the Uniform Consumer Credit Code in 1968, by the National Conference of Commissioners on Uniform State Laws.⁵⁴ Section 2.403 of the 1968 version of the UCCC prohibited the use of negotiable instruments other than checks in consumer credit sales.⁵⁵ This exemptive treatment for checks, together with the fact that a lender who was not aware of the merchant's violation of section 2.403 could still enforce the obligation to the same extent as a HIDC, seriously diminished the impact of the UCCC.⁵⁶ Add to this the fact that the UCCC offered each state an alternative as to whether to prohibit waiver of defense clauses⁵⁷ and the fact that there was no provision

50. *E.g.*, Connecticut, Mississippi, Nevada, Texas and New Mexico. *Id.* at 53521.

51. See Willier, *Need for Preservation of Buyer's Defenses—State Statutes Reviewed*, 5 U.C.C.L.J. 138-39 (1972) [hereinafter cited as Willier].

52. *A Case Study of the Impact of Consumer Legislation: The Elimination of Negotiability and the Cooling-Off Period*, 78 YALE L.J. 618, 654 (1969).

53. Willier, *supra* note 51, at 140.

54. The original Uniform Consumer Credit Code [hereinafter cited as UCCC], approved in 1968, severely miscalculated the strength of the opposition to the HIDC doctrine. A subsequent version, approved in 1974, contains much stronger provisions including treatment of vendor-related loans and credit card transactions. UCCC §§ 3.403, 3.405 (1974).

55. UCCC § 2.403 (1968).

56. The “fence-straddling” attitude adopted by the National Conference of Commissioners in promulgating this Code prompted severe criticism and was responsible for the subsequent 1974 amendment. See Rohner, *supra* note 11, at 523.

57. Alternative A would effectively prohibit the use of waiver clauses, however, Alternative B contained a time-notice provision. UCCC § 2.404 (1968).

whatsoever pertaining to vendor-related loans,⁵⁸ and the ease of circumvention became apparent. Clearly, any effective constraints placed upon the application of the HIDC would have to adopt an across-the-board approach to provide effective relief.

FEDERAL TRADE REGULATION

Such an approach was taken by the Federal Trade Commission in its recent addition of Part 433 to Subchapter D, Trade Regulation Rules, Chapter I, Title 16 of the Code of Federal Regulations.⁵⁹ The provisions of this rule operate to prevent financiers from foreclosing consumer equities in credit sales transactions by denying the lender the position of a HIDC.⁶⁰ This is accomplished by the provision that one who takes or receives a credit contract for the sale or lease of goods or services affecting interstate commerce must insure that the following notice provision is contained within the contract:

NOTICE

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.⁶¹

In like manner, acceptance by the seller as full or partial payment of the proceeds of any purchase money loan⁶² shall be an unfair trade practice,⁶³ unless the credit contract made in connection with such loan contains the required notice provision. The seller is thus in the position of having to insure that the claims and defenses of a consumer are preserved vis-à-vis a subsequent holder of a credit contract as well as the lender of a vendor-related loan.

Shift in the Marketplace

The primary concern underlying the new trade regulation

58. UCCC §§ 2.403 and 2.404 applied only to "consumer credit sales," therefore the 1968 Code did not preserve defenses in direct loan or lender credit card situations.

59. 40 FED. REG. 53506 (1975).

60. *Id.*

61. *Id.*

62. Purchase money loan has been defined in the new regulation as:

A cash advance which is received by a consumer in return for a "Finance Charge" within the meaning of the Truth in Lending Act and Regulation Z, which is applied, in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, or business arrangement.

40 FED. REG. 53506 (1975).

63. 15 U.S.C. § 45 (1975).

has been to reallocate the cost of seller misconduct from the consumer to the seller, and where necessary, to the lender.⁶⁴ It is contended that such a return of the costs to the party who generated them will result in a more accurate reflection of the true cost of engaging in a credit sale transaction.⁶⁵ This will allow the seller, through an increase in the cost of goods, and the lender, through an increase in the cost of credit, to redistribute the cost of seller misconduct to consumers as a group, as opposed to having a comparatively small number of consumers bear the entire financial burden.⁶⁶

The Federal Trade Commission has expressed the view that from a practical standpoint, the creditor is in a better position than the consumer to affect a reallocation.⁶⁷ It premised this contention upon the following considerations: (1) creditors engage in many transactions while consumers deal infrequently; (2) creditors have access to more information pertaining to the business practices of a particular merchant than do consumers and therefore are in a better position to refrain from dealing with one whose reputation is suspect; (3) a creditor has recourse to contractual devices which renders the return of the cost of seller misconduct *cheap* and *automatic*; and (4) the creditor possesses the means to initiate a law suit and prosecute it to judgment when necessary.⁶⁸ These considerations represent the basis upon which the marketplace role of the institutional financier has been redefined to include the role of policeman of unscrupulous merchants.

This police activity will presumably take a dual course. First, due to the financier's new exposure to liability for seller misconduct, he has a vested interest in refusing to buy paper from a merchant who has not demonstrated his ability to stand behind his merchandise.⁶⁹ Although this refusal will serve to insure that the unscrupulous seller will lose his standing in the marketplace

64. Frequently the seller leaves the scene before the lender has an opportunity to pass the cost of the seller's misconduct back to the seller. In these situations the lender is forced to absorb the cost of such misconduct.

65. It is the Commission's position that only when the price of goods approximates the real social cost of such goods do consumer choices in the market tend toward an optimal allocation of society's resources. 40 FED. REG. 53523 (1975).

66. Prior to this ruling only those unfortunate consumers who experienced firsthand the misconduct of sellers bore the financial burden.

67. 40 FED. REG. 53523 (1975).

68. *Id.* The statement by the Commission that recourse agreements available to the financier represent a cheap and automatic means by which the cost of seller misconduct is returned to the seller is too simplistic. See Rohner, *supra* note 11, at 537-38.

69. In this sense the financier is expected to wield a club to prod the seller into complying with various product warranties or contractual agreements entered into with the consumer.

(heretofore guaranteed by his ability to transfer paper free of claims and defenses), it will also serve to increase the difficulty of a businessman just beginning a business to obtain adequate financing.⁷⁰ This will be particularly true for the minority businessman with no established course of conduct.⁷¹

Second, the availability to the financier of a vast assortment of devices⁷² by which he can shunt back to the merchant the cost of merchant misconduct will serve to promote a higher standard of business conduct. Utilization of such devices will also assist in the redistribution of the cost of remaining misconduct to *all* consumers by an increase in the price of goods.⁷³

Effect of the Ruling

Consumers

From the consumer standpoint, this new trade regulation provides a means of defending a creditor's suit for payment of an obligation by asserting any defense which would be valid against the seller.⁷⁴ It also permits affirmative action against a creditor who has received payments to the extent of such payments received.⁷⁵

On the negative side, however, the consumer will have to bear the burden of a marginal increase in the cost of goods which will reflect the additional factor of seller misconduct.⁷⁶ Finally, the consumer may expect an increase in the cost of credit or a decrease in its availability. However, data provided by those states which have previously abolished the HIDC doctrine indicate that the impact of this factor will be slight.⁷⁷

Financers

From a practical standpoint this new ruling will serve to inhibit the negotiation of consumer credit contracts and promissory notes by depriving the financier of his status as a HIDC. In addition, it imposes upon the financier the burden of screening prospective borrowers to insure that any loan agreements made pursuant to the purchase of a consumer product contain the

70. 40 FED. REG. 53518 (1975).

71. *Id.*

72. Examples of such devices include reserve accounts, incentive plans, recourse agreements, and warranties of prior transferors as set out in UCC 3-417(2).

73. 40 FED. REG. 53523 (1975).

74. See text accompanying note 61 *supra*.

75. *Id.*

76. 40 FED. REG. 53523 (1975).

77. *Id.* at 53519-20.

required notice provision.⁷⁸ Also, financiers will incur the additional expense of investigating merchants prior to establishing a business relationship with them involving the purchase of consumer paper.

The anticipated response of the financier to this new vulnerability to consumer claims and defenses will be the imposition of various restrictions upon the merchant in an attempt to reduce losses due to misconduct.⁷⁹ Such restrictions are expected to include, at least initially, a hesitancy to accept commercial paper,⁸⁰ more comprehensive recourse agreements,⁸¹ and, to a small extent, a fluctuation in the discount rates.⁸² In addition, to the extent that banks are unable to shunt the risk of loss back to the seller, a slight increase in the cost of credit may be expected.⁸³

Sources representing financial institutions in the city of Chicago indicate that to date there has been little reliance by consumers on the preserved claims and defenses provided by this promulgation. Concern has been expressed, however, due to the fact that interest on uncollateralized loans is presently at limits established by state usury laws.⁸⁴ Therefore, to the extent this promulgation interjects a new element of uncompensated risk in consumer credit transactions, it is expected that either the usury limits will have to be readjusted or credit will become increasingly unavailable. Either prospect presents an unattractive alternative to the consumer. In addition, the ruling appears to have prompted a substantial withdrawal from the purchase of paper from home improvement companies. Such companies have provided a continuing source of consumer dissatisfaction thus exposing this paper to a higher degree of risk.⁸⁵

Merchants

The immediate effect upon the merchant will be an increase in the amount of "red tape" required to effectuate a

78. See text accompanying note 61 *supra*.

79. *A Case Study of the Impact of Consumer Legislation: The Elimination of Negotiability and the Cooling-Off Period*, 78 YALE L.J. 618, 653-54 (1969).

80. *Id.* at 655.

81. Rohner, *supra* note 11, at 537.

82. It is to be expected that the initial hesitancy of financiers to purchase the paper of marginal sellers will result in an increase in the discount percentage currently in use.

83. Rohner, *supra* note 11, at 535.

84. ILL. REV. STAT. ch. 74, §§ 1-6 (1975).

85. See generally *A Case Study of the Impact of Consumer Legislation: The Elimination of Negotiability and The Cooling-Off Period*, 78 YALE L.J. 618, 628-30 (1969).

consumer credit sale.⁸⁶ Of more consequence, however, will be the difficulty in marketing consumer paper, as well as an anticipated increase in hard line negotiations to be conducted between the financier and the merchant in arriving at various discount rates and recourse agreements. Data is now available to indicate that in those states which have removed the HIRC status from assignees of contracts, the sources of financing have been reduced.⁸⁷ For this reason, it is clear that whatever the actual effect of the ruling, its impact on those merchants who do not have an established track record will be magnified.⁸⁸

CONCLUSION

As one commentator has noted, "when you find courts using silly distinctions to avoid the application of a rule of law, the reason may be that the rule has outlived its usefulness."⁸⁹ Clearly, one result of the Federal Trade Commission promulgation abolishing the HIRC in consumer credit transactions will be to free the courts from having to resort to devices such as "close connection" to circumvent foreclosing consumer equities in this area of commercial law. Of more consequence, however, is the fact that this ruling will result in an elimination of the piecemeal approach to consumer credit problems heretofore adopted by the states. To this extent it will serve to effectively standardize consumer claims and defenses which fall within the jurisdictional ambit of the Federal Trade Commission.⁹⁰

Bedell A. Tippins, III

86. For a discussion of the arguments in opposition to the Rule, see 40 *FED. REG.* 53517-19 (1975).

87. See generally *A Case Study of the Impact of Consumer Legislation: The Elimination of the Cooling-Off Period*, 78 *YALE L.J.* 618 (1969).

88. See text accompanying notes 70-71 *supra*.

89. Leary, *Timely Demise of Holder in Due Course Doctrine*, 5 *U.C.C.L.J.* 119 (1972).

90. 15 *U.S.C.* § 45 (1975) provides: "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful." The term "commerce" is meant to be specifically limited to "Commerce among the several states". 15 *U.S.C.* § 41 (1975). To the extent the ruling is utilized to reach what may arguably be considered intrastate consumer credit transactions, the application of the ruling will be subject to attack on jurisdictional grounds.

One recent decision attacking the regulation is *National Auto. Dealers Ass'n v. FTC*, 421 *F. Supp.* 31 (M.D. La. 1976). In this case, the federal district court judge declined to hear the case on its merits due to a lack of subject matter jurisdiction. The court held that the statutory forum for review of a Federal Trade Commission regulation, promulgated pursuant to § 18(a)(1)(B) of the Federal Trade Commission Act, rests exclusively with the United States Courts of Appeal. 15 *U.S.C.A.* § 57a(e)(5)(B) (1975).