

and form in which they have complied with this order.

IN THE MATTER OF
CHARNITA, INC., ET AL.

ORDER, OPINIONS, ETC., IN REGARD TO THE ALLEGED VIOLATION OF THE
TRUTH IN LENDING AND THE FEDERAL TRADE COMMISSION ACTS

Docket 8829. Complaint, Jan. 11, 1971—Decision, June 6, 1972***

Order requiring a Fairfield, Pennsylvania, real estate firm to cease violating the Truth in Lending Act by failing to disclose to customers the total cash price, the total downnpayment, the unpaid balance of the cash price, the finance charges, the annual percentage rate, failing to give customers notice of their right to rescind within three days, and other disclosures required by Regulation Z of the said Act.

COMPLAINT

Pursuant to the provisions of the Truth in Lending Act and the implementing regulation promulgated thereunder, and the Federal Trade Commission Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Charnita, Inc., a corporation, and Charles G. Rist, individually and as an officer of said corporation, hereinafter referred to as

* Complaint reported as amended by hearing examiner's order of April 6, 1971.

** Respondent filed Petition to Review on August 11, 1972 with the U.S.C.A., 3rd. Cir.

respondents, have violated the provisions of said Acts and implementing regulation, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Charnita, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania, with its principal office and place of business located at Route 1, Fairfield, Pennsylvania.

Respondent Charles G. Rist is an officer of corporate respondent. He formulates, directs and controls the policies, acts and practices of the corporate respondent, including the acts and practices hereinafter set forth. His address is the same as that of the corporate respondent.

PAR. 2. Respondents are now and for some time last past have been, engaged in the advertising for sale and sale of real property to the public.

PAR. 3. Since July 1, 1969, in the ordinary course and conduct of their business as aforesaid, respondents regularly extend, and for some time last past have regularly extended, consumer credit as "consumer credit" is defined in Regulation Z, the implementing regulation of the Truth in Lending Act, duly promulgated by the Board of Governors of the Federal Reserve System.

PAR. 4. Subsequent to July 1, 1969, respondents, in the ordinary course and conduct of their business and in connection with their credit sales, as "credit sale" is defined in Regulation Z, have caused and are causing their customers to execute personal loan notes, installment loan contracts, or retail installment contracts, each hereinafter referred to as the "contract." By and through the use of the contract respondents:

1. Failed, in a number of instances, to designate the amount of cash price for the property as "cash price," as required by Section 226.8 (c) (1) of Regulation Z.

2. Failed, in a number of instances, to disclose the amount of the downpayment in money, and to designate it as the "cash downpayment," as required by Section 226.8(c) (2) of Regulation Z.

3. Failed, in a number of instances, to disclose the difference between the cash price and the total downpayment, and to designate that difference as the "unpaid balance of cash price," as required by Section 226.8(c) (3) of Regulation Z.

4. Failed, in a number of instances, to disclose the sum of the cash price, all charges other than the cash price which are included in the amount financed but which are not part of the finance charge,

Complaint

80 F.T.C.

and to designate that sum as the "deferred payment price," as required by Section 226.8(c)(8) of Regulation Z.

5. Failed, in a number of instances, to identify respondent Charnita, Inc. as the creditor, as required by Section 226.8(a) of Regulation Z.

6.* By providing in the contract for seller's retention of the deed to the real property until buyer has made scheduled payments under the contract for four months, which provision is a security interest retained by the creditor under Section 226.2(z) and Section 226.8(b)(5) of Regulation Z, failed to make such identification together with all other required disclosures, as required by Section 226.8(a) of Regulation Z.

PAR. 5. Subsequent to July 1, 1969, respondents in the ordinary course and conduct of their business and in connection with their credit sales, as "credit sale" is defined in Regulation Z, have extended and are extending to their customers a five percent (5%) discount from the stated price of the property in the event they pay for that property in cash or on or before a specified date. Respondents thereby:

1. Fail to make the separate disclosures required by Section 226.8(o), as amended, of Regulation Z, on the invoice or other evidence of sale, as required thereby.

2. By failing to deduct the amount of the discount for the purpose of computing and disclosing the cash price, as required by Amended Section 226.8(o)(7) of Regulation Z, fail to state accurately the amount of the cash price, as required by Section 226.8(c)(1) of Regulation Z.

3. Fail to itemize the amount of the discount as part of the finance charge, as required by Section 226.8(c)(8)(i) and Section 226.8(o), as amended, of Regulation Z and to include that amount in the finance charge, when disclosing the amount of the finance charge as required by Section 226.8(c)(8)(i) of Regulation Z and when computing the annual percentage rate, as provided in Section 226.8(b)(2) and Section 226.8(o), as amended, of Regulation Z.

PAR. 6. Subsequent to July 1, 1969, respondents have disseminated and are disseminating to prospective purchasers a multi-page brochure which constitutes an advertisement to aid, promote, or assist directly or indirectly extensions of consumer credit, as "advertisement" is defined in Regulation Z.

By and through the use of the statement "Up to five years to pay" in said advertisement, respondents have stated the period of repayment without also disclosing all of the following items, in termin-

* Added to the complaint by hearing examiner's order of April 6, 1971.

892

Complaint

ology prescribed under Section 226.8 of Regulation Z, as required by Section 226.10(d) (2) of Regulation Z.

- (a) The cash price;
- (b) The amount of the downpayment required or that no downpayment is required, as applicable;
- (c) The number, amount, and due dates or period of payments scheduled to repay the indebtedness if credit is extended;
- (d) The amount of the finance charge expressed as an annual percentage rate; and
- (e) The deferred payment price.

PAR. 7. Subsequent to July 1, 1969, respondents in the ordinary course and conduct of their business and in connection with their credit sales, as "credit sale" is defined in Regulation Z, have caused, and are causing, their customers to execute a promissory note containing a confession of judgement clause (also known as a cognovit note provision), hereinafter referred to as "the note."

*Additionally, respondents have caused and are causing their customers to execute an agreement of sale containing a provision that seller shall deliver to buyer the deed to the real property four months after consummation of the credit sale provided that buyer is not in default on said contract.

*Pursuant to Sections 226.9(a) and 226.2(z) of the Regulation Z, the note and the agreement of sale provision each constitutes a security interest which respondents retain in real property used or expected to be used by some customers as their principal residence. Therefore, pursuant to Section 226.9(a) of Regulation Z, those customers have the right to rescind the credit transaction as provided therein.

*Respondents have failed, and are failing, to provide those customers with the required notice of right to rescind, in manner and form specified in Section 226.9(b) of Regulation Z, in violation of that section.

PAR. 8. Pursuant to Section 103(k) of the Truth in Lending Act, respondents' aforesaid failures to comply with the provisions of Regulation Z constitute violations of that Act and, pursuant to Section 108 thereof, respondents thereby violated the Federal Trade Commission Act.

Mr. Ronald J. Dolan and Mr. Lewis H. Goldfarb supporting the complaint.

Mr. Leroy W. Preston, O'Connor and Preston, Baltimore, Maryland and *Mr. H. Thomas Pyle*, Gettysburg, Pennsylvania for respondents.

* Added to the complaint by hearing examiner's order of April 6, 1971.

Initial Decision

80 F.T.C.

INITIAL DECISION BY WALTER K. BENNETT, HEARING EXAMINER

MAY 14, 1971

PRELIMINARY STATEMENT

This is a proceeding brought by the Federal Trade Commission by complaint served January 22, 1971. The complaint charges that Charnita, Inc., a real estate development company, and Charles G. Rist, one of its officers, violated the Truth in Lending Act title of the Consumer Credit Protection Act¹ and the regulations issued thereunder,² and hence the Federal Trade Commission Act.³

By answer filed February 18, 1971 the corporate respondent admitted substantially all of the allegations of the complaint, except that it denied that any purchasers of real estate from it were entitled to rescission because the land was not purchased for a home; the individual respondent admitted that he was an officer of the corporate respondent but denied the other allegations of the complaint. Several affirmative defenses were interposed in the answer alleging: that the lots sold were not intended by the purchasers to be used as principal residences; that the alleged violations were unwitting and had been corrected; and that no right to grant certain relief had been delegated to the Commission by the Act.

A public prehearing conference was held on February 26, 1971. During the conference the parties agreed that: (1) there were no issues of fact regarding the corporate respondent, except regarding the purpose for which properties were purchased and its action to comply with Regulation Z after alleged violations were brought to its attention; (2) the only issue of law related to the last three paragraphs of the proposed order annexed to the complaint. It was also agreed that the individual respondent should reconsider his answer. A timetable was set up for discovery in the event the individual respondent decided not to file an answer which paralleled that of the corporate respondent. The initial hearing and subsequent post-hearing procedures were also scheduled.⁴

Complaint counsel served respondents' counsel with a Motion to Amend the Complaint a few days prior to the scheduled formal hearing held March 16, 1971. Respondents at the hearing consented to the amendment on condition that they be granted until March 26, 1971, to answer the amendment and to introduce any evidence

¹ 15 U.S.C. 1601, *et seq.*

² Regulation Z, 12 C.F.R. § 226, issued by the Federal Reserve Board.

³ 15 U.S.C. 41, 45.

⁴ Prehearing Order No. 1 dated February 26, 1971.

deemed necessary. Thereupon the complaint was amended as requested⁵ and a stipulation agreed upon by the parties was incorporated in the record as CX 1⁶ and the exhibits referred to therein were also received in evidence (Tr. 18-21). The hearing was then adjourned.

On March 25, 1971, respondents filed their answer to the amended complaint in which they deny that the provisions of the agreement constitute a security interest or that any purchaser is entitled to the right of rescission by reason of the use of a note or the contract or either of them. The answer repeated the original answer in other respects.

On March 26, 1971, the hearing reconvened and an amendment to the stipulation (CX 1) was incorporated in the record (Tr. 27). Thereafter, the hearing was concluded and the record closed (Tr. 27). Findings, conclusions and briefs were filed April 14, 1971, and comments thereon April 23, 1971.

BASIS FOR DECISION

This decision is based solely on the admissions contained in the answer, the stipulations of the parties and the exhibits received pursuant thereto.

The hearing examiner has studied the proposed findings, conclusions and order submitted and the briefs filed. All findings not adopted in terms or in substance are denied as irrelevant, immaterial or erroneous. The following are the findings of fact, reasons for decision, conclusions and order.

FINDINGS OF FACT

1. Respondent Charnita, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania, with its principal office and place of business located at Route 1, Fairfield, Pennsylvania. Charnita, Inc., was originally 97 percent owned by respondent Charles G. Rist and all directors, save one, were employees. In October 1970, an independent board of direc-

⁵ The amendment, among other matters, added allegations to Paragraphs 4 and 7 of the complaint that the seller's contract provided for the retention of the deed for 4 months after consummation of the sale and its delivery if the buyer was not in default, (see order filed April 7, 1971, confirming order on the record (Tr. 16)).

⁶ The following abbreviations will sometimes hereafter be used:

C.—Complaint
A.—Answer
S.—Stipulation
CX—Commission Exhibit
RX—Respondents Exhibit
Tr.—Transcript

Initial Decision

80 F.T.C.

tors was elected. Respondent Rist whose stock was diluted to 62 percent in 1969, trustee 80 percent thereof in November 1970 (CX 1; RX 1).

According to respondent Charnita's annual report, its sale of land in the fiscal year 1970 amounted to \$4,280,747 and it had contracts receivable in the amount of \$1,723,474. As of September 30, 1970, \$1,325,000 of the net receivables had been pledged to banks as collateral on loans amounting to \$996,910. The sales figure reported includes sales where a downpayment of 10 percent of the sale price was received (CX 7, Consolidated Balance Sheet, Consolidated Statement of Operations and Notes 2 and 3).

2. Respondent Charles G. Rist is president and a member of the board of directors of the corporate respondent. Prior to October 29, 1970, he formulated, directed and controlled the policies, acts and practices hereinafter set forth. His address is the same as that of the corporate respondent. Respondent Rist is beneficial owner of some 62 percent of the stock of the corporate respondent and previously owned 97 percent of it (CX 1; RX 1).

3. Respondents are now, and for some time last past have been, engaged in the advertising for sale and sale of real property to the public (CX 1).

4. Since July 1, 1969, in the ordinary course and conduct of their business as aforesaid, respondents regularly extend, and for some time last past have regularly extended, consumer credit as "consumer credit" is defined in Regulation Z, the implementing regulation of the Truth in Lending Act, duly promulgated by the Board of Governors of the Federal Reserve System (CX 1).

5. Subsequent to July 1, 1969, respondents, in the ordinary course and conduct of their business and in connection with their credit sales, as "credit sale" is defined in Regulation Z, have caused and are causing their customers to execute promissory notes and agreements for sale, hereinafter referred to as the "contract." By and through the use of the contract, respondents:

(a) Failed, in a number of instances, to designate the amount of the cash price for the property as "cash price," as required by Section 226.8(c)(1) of Regulation Z.

(b) Failed, in a number of instances, to disclose the amount of the downpayment in money, and to designate it as the "cash downpayment," as required by Section 226.8(c)(2) of Regulation Z.

(c) Failed, in a number of instances, to disclose the difference between the cash price and the total downpayment, and to designate

that difference as the "unpaid balance of cash price," as required by Section 226.8(c)(3) of Regulation Z.

(d) Failed, in a number of instances, to disclose the sum of the cash price, all charges other than the cash price which are included in the amount financed but which are not part of the finance charge, and the finance charge, and to designate that sum as the "deferred payment price," as required by Section 226.8(c)(8)(ii) of Regulation Z.

(e) Failed, in a number of instances, to identify Charnita, Inc., as the creditor as required by Section 226.8(a) of Regulation Z.

(CX 1.)

In the promissory note (CX 4B) the following language appears in the authority to confess judgment "provided however that all real estate used or expected to be used as the principal residence of the undersigned shall be exempt from the lien of a confessed judgment hereunder." In the Agreement of Sale the following question appears with space for a Yes or No answer. "Do you expect to use this lot as your principal residence?". (CX 4.)

6. Subsequent to July 1, 1969, respondents in the ordinary course and conduct of their business and in connection with their credit sales, as "credit sale" is defined in Regulation Z, extended to their customers a five percent (5 percent) discount from the stated price of the property in the event they pay for that property in cash on or before a specified date. Respondents thereby:

(a) Failed to make the separate disclosures required by Section 226.8(o), as amended, of Regulation Z, on the invoice or other evidence of sale, as required thereby.

(b) By failing to deduct the amount of the discount for the purpose of computing and disclosing the cash price, as required by Amended Section 226.8(o)(7) of Regulation Z, failed to state accurately the amount of the cash price, as required by Section 226.8(c)(1) of Regulation Z.

(c) Failed to itemize the amount of the discount as part of the finance charge, as required by Section 226.8(c)(8)(i) and Section 226.8(o), as amended, of Regulation Z and to include that amount in the finance charge, when disclosing the amount of the finance charge as required by Section 226.8(c)(8)(i) of Regulation Z and when computing the annual percentage rate, as provided in Section 226.8(b)(2) and Section 226.8(o), as amended, of Regulation Z.

(CX 1.)

7. Subsequent to July 1, 1969, respondents disseminated to prospective purchasers a multi-page brochure accompanied by a letter. The

Initial Decision

80 F.T.C.

brochure constituted an advertisement to aid, promote, or assist directly or indirectly extensions of consumer credit, as "advertisement" is defined in Regulation Z. (CX 1.)

8. By and through the use of the statement "Up to five years to pay" in said brochures (CX 6), respondents stated the period of repayment without also disclosing all of the applicable items, in terminology prescribed under Section 226.8 of Regulation Z, required by Section 226.10(d) (2) of Regulation Z. (CX 1.)

9. Subsequent to July 1, 1969, some customers have purchased and do purchase lots on credit from respondents with the intention of building a principal residence thereon at some future date (CX 1). The corporate respondent's sales brochure on its cover described the property offered as "A Residential and Recreation Community." (CX 6.)

10. Subsequent to July 1, 1969, and prior to March 20, 1970, in connection with their credit sales, respondents have caused their customers to execute and deliver to respondent Charnita, Inc., a promissory note containing a confession of judgment clause, as represented by CX 2 and CX 3. (CX 1.)

11. From July 1, 1969, through March 20, 1970, approximately 470 customers purchased property from respondent Charnita, Inc. on credit (CX 1).

12. Subsequent to November, 1970, as provided in the Agreement of Sale (CX 5), when a customer finances the purchase of real property through Charnita, Inc., by the execution of a promissory note, Charnita, Inc., shall make, execute and deliver the deed for such real property, four months from the date of said agreement, provided that buyer is not in default on the note. This provision does not appear on the same page as the Truth in Lending disclosure statement (CX 1). The Agreement of Sale (CX 5) contains no representation that the lot is to be used or not used as a residence but the promissory note contains the following proviso in the clause authorizing a confession of judgment: "provided however that all real estate used or expected to be used as the principal residence of the undersigned shall be exempt from the lien of confessed judgment hereunder." (CX 5, 5A.)

REASONS FOR DECISION

Since there are not factual questions of credibility because this record is based entirely on a stipulation and on the exhibits introduced in connection with the stipulation, the hearing examiner's task in expressing his reasons is largely one of stating his opinion con-

cerning the impact of the facts and applicable law and the terms of the order.

At the outset the problem is whether or not respondent Charles G. Rist, the entrepreneur of respondent Charnita and originally the owner of substantially all of the common stock, should be held individually as well as an officer of the corporation. For almost the entire period under consideration, that is from July 1, 1969 until October 29, 1970, it was stipulated that respondent Rist formulated, directed and controlled the policies, acts and practices of the corporate respondent including the acts and practices set forth in the balance of the stipulation. He signed the letter accompanying the respondent's advertising brochure and until the independent board of directors was selected late in 1970, he presumably controlled the board of directors which consisted, save for an accountant, entirely of employees of the company. At the time the complaint was served, his stock interest had been substantially diluted, he had trustee'd his stock (for what purpose we have no information) and an independent board of directors was in control. The corporation is a substantial one although its assets are heavily pledged and there is no indication that it will be dissolved for the purpose of avoiding the order. However, since the corporate respondent is dependent upon continued financing and there were continuing violations for a long period of time under the individual respondent's direction and control, it appears to the hearing examiner that the order should include respondent Rist as well as the corporate respondent. This opinion is reinforced by counsel's decision to stipulate the facts rather than to litigate the question; because, in the stipulation the acts described as the basis for the violations are described as those of respondents.

The next serious question is the authority of the Federal Reserve Board to make its rulings under Regulation Z. This hearing examiner considered substantially the same problem in the matter of *Zale Corp.*, Docket No. 8810 [78 F.T.C. at 1223-1224], and reached the conclusion that if the regulations were designed to implement the underlying intent of the Act, then clearly the Federal Reserve Board had the power to promulgate them and its regulations must be meticulously observed. Since the *Zale* matter is before the Commission on appeal and it has published no decision as yet, the hearing examiner adheres to his position taken in that case.

The third serious question deals with the power of the Commission in 1971 to grant a right of rescission to a purchaser who may have bought his property right after the effective date of the Truth in Lending Act, that is sometime in July of 1969. The language of

the Act and of the regulation, Section 226.9 which gives the right of rescission for three business days from the date of consummation of the transaction "or the date of delivery of the disclosures required under this section, whichever is later," make it clear that the right of rescission continues to the date when the disclosures are made and three days thereafter. The disclosure of the right of rescission being one of the disclosures required, the regulation seems to be very clear on this subject.

Thus, wherever the right of rescission attaches, it continues for three days after the notification of the right of rescission is supplied the purchaser as well as all the other disclosures. Having been required to make such a disclosure, respondents continue in violation of the Act and the regulations until they have made it.

Some practical problems are likely to occur but these can be avoided by the form of the order which has been changed from the form proposed. The first practical problem that comes to mind is that there must be some provision for notification by the purchaser to the seller of the fact that he intends to use the parcel of land purchased for the purpose of a principal place of residence. For a time respondents provided for such notification in the agreement of sale. Thus, as to these purchasers respondents cannot now claim that they did not know to whom they were required to send out a notice of rescission. At a later time, respondents changed the form of their agreement and did not provide for any such notification. Because of the change and in order that the right may not hereafter be confused because of confusion concerning the intention of the parties at the time the sale is made, it seems that the order should provide that the seller require notification to be given by the purchaser at the time of signing the contract as to his intention, so that notice of the right of rescission can be given if the property is intended for use as a residence. To the extent that the corporation has a record, and it is a corporate record rather than that of the individual, the corporation should be required to cease remaining in violation of the Act by delivering the appropriate notice of rescission to owners of property from whom it has obtained a security interest. This will mean an examination of all of the sales agreements on credit since July 1969, a determination of whether the papers show that a security interest was retained and a determination of whether there was notification by the purchaser that he intended to use the property as a principal place of residence. If the particular papers fail to disclose that a security interest was retained or to be retained; then, of course

the notice of rescision was not required and none should hereafter be required. The order should not require a notice of rescision where the facts were not clear. If it did, disgruntled purchasers would be tempted to claim an intent they never had.

Another practical problem concerns persons who have sold the property after paying the entire purchase price. It would seem to the hearing examiner that since the Act was intended to protect the home owner who was purchasing his home on credit with a security interest reserved that the right of rescision is a personal right of the original owner and is not transferred to a subsequent purchaser. It seems to this examiner also that when the promissory note expressly excludes a lien on the property to be used as the principal residence of the purchaser, there would not be a security interest on that home and it would not be within the terms of the Act. On the other hand, if, as respondents seem to admit, there is a lien for the purchase price until the delivery of the deed arising by reason of a contract (see respondents' findings of fact and conclusions of law filed April 14, 1971, page 22), it would seem clear that under the present agreement which calls for delayed delivery of the deed there is retention of a security interest for a period of four months. Hence, the notice of the right of rescision should have been given.

The final question deals with the right of the Commission to require that respondents now place themselves in a position of compliance with the Act and the regulations. In the proposed order this is couched as an affirmative obligation. An identical effect, however, is secured by amending the order and requiring the corporate respondent to cease remaining in violation of the Act by delivering the notice of rescision it was originally required to deliver. This portion of the order has been further amended to limit it to the corporate respondent and to cases where the customer notified the respondent that he expected to use the property as his principal place of residence. There is a further statement that this portion of the order shall not apply to customers who have sold the property purchased. It seems to the hearing examiner that the Federal Trade Commission has ample power to require that the respondent cease violating the act and that this is all that the order following prescribes. For the foregoing reasons the following conclusions and order are made.

CONCLUSIONS

1. The Federal Trade Commission has jurisdiction over the respondents and the subject matter of this proceeding.

Initial Decision

80 F.T.C.

2. Respondents have violated the provisions of Regulation Z and of the Truth in Lending Act title of the Consumer Credit Protection Act (15 U.S.C. 1061 *et seq.*).

3. The following order should issue.

ORDER

It is ordered, That respondents Charnita, Inc., a corporation, and its officers, and Charles G. Rist, individually and as an officer of said corporation, and respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with any consumer credit sale of real property or in any advertisement to aid, promote, or assist directly or indirectly any extension of credit, as "credit sale" and "advertisement" are defined in Regulation Z (12 CFR § 226) of the Truth in Lending Act (Pub. L. 90-321, 15 U.S.C. 1601 *et seq.*), do forthwith cease and desist from:

1. Failing to use the term "cash price" to designate the cash price of the property which is the subject of the transaction, as required by Section 226.8(c)(1) of Regulation Z.

2. Failing to disclose the amount of any downpayment in money as the "cash downpayment," using that term, as required by Section 226.8(c)(2) of Regulation Z.

3. Failing to disclose the difference between the cash price and the cash downpayment using the term "unpaid balance of cash price," as required by Section 226.8(c)(3) of Regulation Z.

4. Failing to disclose the sum of the cash price, all charges other than the cash price which are included in the amount financed but which are not part of the finance charge, and the finance charge, using the term "deferred payment price," as required by Section 226.8(c)(8)(ii) of Regulation Z.

5. Failing to identify respondent Charnita, Inc., as the creditor, as required by Section 226.8(a) of Regulation Z.

6. Failing, in connection with any offer of a discount for prompt payment, to make the separate disclosures required by Section 226.8(o), as amended, of Regulation Z, on the invoice or other evidence of sale, as required thereby.

7. Failing, in connection with any offer of a discount for prompt payment, to exclude from the amount of the cash price the greatest amount of discount for prompt payment of which the customer may avail himself under the terms of the offer, as required by Section 226.8(c)(1) of Regulation Z.

8. Failing, in connection with any offer of a discount for prompt payment, to itemize the amount of the discount as part

of the finance charge, as required by Section 226.8(c)(8)(i) and Section 226.8(o), as amended, of Regulation Z, and to include that amount in the finance charge as required by Section 226.8(c)(8)(i) of Regulation Z and when computing the annual percentage rate, as required by Section 226.8(b)(2) and Section 226.8(o), as amended, of Regulation Z.

9. Stating in any advertisement the period of repayment, without stating all of the following items, in the manner and form prescribed by Section 226.8 of Regulation Z, as required by Section 226.10(d)(2) of Regulation Z:

- (a) the cash price;
- (b) the amount of the downpayment required;
- (c) the number, amount and due dates or period of repayments scheduled to repay the indebtedness;
- (d) the amount of finance charge expressed as an annual percentage rate; and
- (e) the deferred payment price.

10. Failing, in any transaction arising in the future in which a customer has the right to rescind as provided in Section 226.9 of Regulation Z, to provide the customer with the notice of right to rescind, in the form and manner provided in that Section prior to consummation of the transaction and in connection therewith to provide a question seeking a statement in writing designating whether or not said customer expects to use the lot as his principal place of residence.

11. Failing, in any consumer credit transaction or advertisement, to make all disclosures, determined in accordance with Section 226.4 and Section 226.5 of Regulation Z, in the manner, form and amount required by Sections 226.6, 226.8, 226.9 and 226.10 of Regulation Z.

12. Failing to deliver a copy of this order to cease and desist to all present and future employees or other persons engaged in the sale of respondents' real property or in the creation of any advertisement therefor, and to secure from each such employee or other person a signed statement acknowledging receipt of said order.

It is further ordered That the corporate respondent herein shall cease to remain in violation of the Truth in Lending Act within sixty (60) days after service upon it of this order, by delivering notice of a right to rescind, in the manner and form set forth in Section 226.9(b) of Regulation Z, to each customer who purchased real property from it in any credit transaction consummated on or

Opinion of the Commission

80 F.T.C.

after July 1, 1969, in which the customer notified respondent that he expected to use that property as his principal place of residence and in which respondent has retained or acquired or will retain or acquire a security interest in that property. This portion of this order shall not apply to customers who have previously sold the property purchased.

It is further ordered, That respondent corporation shall forthwith distribute a copy of this order to each of its operating subsidiaries and divisions.

It is further ordered, That respondents notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries which may affect compliance obligations arising out of the order, or any other change in the corporation which may affect compliance obligations arising out of the order.

It is further ordered, That respondents herein shall, within sixty (60) days after service upon them of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they have complied with this order.

OPINION OF THE COMMISSION

JUNE 6, 1972

BY MACINTYRE, *Commissioner*:

This matter is before the Commission on appeal from an initial decision of a hearing examiner in which it was found that respondent Charnita, Inc., a firm engaged in the development and sale of residential and recreational real property, and its president, Charles G. Rist, had violated the Consumer Credit Protection Act (Truth in Lending title), 15 U.S.C. 1601 *et seq.*, the regulations issued thereunder by the Federal Reserve Board (Regulation Z, 12 CFR § 226), and thus the Federal Trade Commission Act, 15 U.S.C. 41, 45. Several violations of the disclosure provisions of the Truth in Lending Act were found by the hearing examiner, including failure to disclose, in its credit sales of real property, such information as the amount of the "cash price," the "cash downpayment," the "unpaid balance of cash price," the "deferred payment price," and the like. In addition, the hearing examiner found that respondents had failed to provide certain of its customers with notice of their right to rescind under Section 226.9 of Regulation Z.

The only serious issues in dispute in the matter before us relate to respondents' obligation to give certain purchasers an opportunity to

rescind the agreement between them and to provide them with notice of their right to do so.¹

Section 125(a) of the Consumer Credit Protection Act (hereinafter referred to as the Act) provides that:

* * * [I]n the case of any consumer credit transaction in which a security interest is retained or acquired in any real property which is used or is expected to be used as the residence of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the disclosure required under this section and all other material disclosures required under this chapter, whichever is later * * *.

It is apparent, therefore, that respondents' obligation to give notice of a right to rescind, depends, as a threshold matter, upon whether the confession of judgment clauses retained by respondents in their contracts of sale are security interests subject to the right of rescission.

Complaint counsel rely on the regulations promulgated by the Board of Governors (hereinafter referred to as the Board) and on the Interpretations issued by the Board which specifically include confessions of judgment among the class of interests giving rise to rescission rights under Section 125(a).² Respondents argue, however, that by thus defining or expanding upon the definition of security interests, the Board of Governors has exceeded its statutory authority and, therefore, that respondents' retention of confessions of judgment did not make them subject to the requirements of Section 125(a). Inasmuch as Regulation Z and the Interpretations of the regulations clearly make confessions of judgment subject to rescission re-

¹ The examiner, apparently through inadvertence, omitted in his order a provision correcting an additional disclosure violation, respondents failure "to identify Charnita, Inc. as a creditor as required by Section 226.8(a) of Regulation Z." Initial Decision, page 899, Finding 5(e). The order will be modified to include an appropriate prohibition of further such violations.

² Section 226.2(z) of Regulation Z defines security interest as: "any interest in property which secures payment or performance of an obligation. The terms include * * * consensual or confessed liens whether or not recorded, * * * Section 226.202 of the Federal Reserve Board's interpretations further define the interests referred to in the statutes:

"Under § 226.2(z) 'security interest' is defined to include confessed liens whether or not recorded and, in general, to include any interest in property which secures payment or performance of an obligation * * *.

"In some of the States, confession of judgment clauses or cognovit provisions are lawful and make it possible for the holder of an obligation containing such clause or provision to record a lien on property of the obligor simply by recordation entry of judgment; the obligor is afforded no opportunity to enter a defense against such action prior to entry of the judgment.

"Since confession of judgment clauses and cognovit provisions in such States have the effect of depriving the obligor of the right to be notified of a pending action and to enter a defense in a judicial proceeding *before* judgment may be entered or recorded against him, such clauses and provisions in those States are security interests under § 226.2(z) and for the purposes of § 226.7(a) 7, § 226.8(b) 5, and § 226.9. This is the case even if the judgment cannot be entered until after a default by the obligor."

quirements of the Act, we could dismiss this aspect of the complaint against respondents only upon a finding that the Board exceeded its authority.

Under Section 105 of the Act, the Board is authorized to promulgate regulations "to carry out the purposes of" the Act. We believe that Section 125(a) was intended to provide and guarantee a cooling off period to persons entering contracts carrying particularly high risks. Specifically, the purpose of the legislation was to insure that purchasers entering certain types of agreements under which they risked to lose their dwellings, should they default, would have a reasonable opportunity to consider the risks and to weigh the merits of subjecting themselves to them. Confession of judgment clauses, by depriving the obligor of an opportunity to enter a defense in an action against him, represent the type of risk which, under the statute, an obligor is entitled to consider for three days without being bound. It is the type of risk which, under the Act, gives rise to the right to rescind; and it is our view, therefore, that by including confession of judgment clauses in the category of interests subject to rescission rights, the Board was well within its statutory mandate to prescribe regulations which effectuate the purposes of the legislation.

Commissioner Dennison in his separate statement, and respondents in their argument before the Commission have taken the position, however, that the Board further exceeded its statutory authority by making rescindable transactions in which no present security interest is retained but which may result in the future creation of a security interest. It is argued that the respondents herein will obtain an interest in the property of the obligors only upon the happening of a future and uncertain event and, therefore, that the contract between respondents and the obligator is not a "transaction in which a security *is retained or acquired*." Commissioner Dennison further refers to *N. C. Freed Co., Inc. v. Board of Governors*, CCH Consumer Credit Guide, Par. 99,356 (W.D. N.Y. 1971), which found that the Board has exceeded its authority by including certain mechanic's liens among those which give rise to the right to rescind.

We note at the outset that confessions of judgment, which the Board has defined as security interests for the purposes of the Act, are retained at the time of and as part of the consideration for the transaction. While it is true that, as with other security interests, certain events may be necessary to perfect the interest and to reduce it to judgment—*i.e.*, recordation, default, a suit by the creditor, judgment confessed, etc.—the confession of judgment/security inter-

est exists at the time of the transaction and *without* the occurrence of these subsequent events.

Furthermore, we feel that the *Freed* decision is not dispositive of the issue presented herein. The confession of judgment which constitutes the security interest retained by respondents in its transactions is distinguished in several important respects from the mechanic's liens dealt with in *Freed*. There the court noted that if the Board was correct in making mechanic's liens subject to rescission requirements:

All of the plaintiff's contracts would be rescindable by the obligor without restriction because of the likelihood that a security interest *would be acquired in the future* by subcontractors, materialmen or others *not creditors under plaintiff's contracts*. *Even though plaintiffs might effectively waive all lien rights*, present or future, their contracts are still rescindable under [the Regulations] because there is a likelihood that a security interest will be acquired in the future by others not creditors under the contract. Such a result was not contemplated under the provisions of Section 125(a) of the Act. That much of the regulation pertaining to security interests that will be retained or acquired is beyond the Board's power and is an invalid implementation of § 125(a) * * *. That liens which may come into existence in the future by operation of law, such as materialmens and mechanics liens, were not intended to come within the scope of Section 125(a), seems clear from the language of the section which provides that the exercise of the right to rescind voids "any security interest given by the obligor." *An obligor does not give or assent to a mechanics or a materialmens lien. It arises by operation of law, even against the obligor's wishes* * * *. A mechanics or a materialmens lien is not one in existence nor is it created by mutual consent * * *.

In contrast, the security interests—confession of judgments here—are held by the creditor in the transaction, arise by mutual consent of the parties and, as previously discussed, do not arise in the future but exist at the time the transaction is consummated. These security interests, therefore, are not the type considered by the court in *Freed*; and they do trigger the rescission rights of Section 125(a).

Respondent claims that even if confessions of judgment are security interests subject to Section 125(a), the obligors' rescission rights have been extinguished by respondents' subsequent waiver of any security interest in residential property. Respondents further argue that if the Commission were to order them to provide a three-day rescission period and notice thereof to obligors, it would be creating and imposing upon respondents obligations which do not already exist under the law. We disagree.

The Act provides that a purchaser will have the right to rescind for three days from the time notice is received provided that in the underlying transaction a security interest is retained in his resi-

Opinion of the Commission

80 F.T.C.

dence. Such an interest was retained in this matter, and the purchaser's right to rescind and to notice arose at that time and could not subsequently be extinguished until three days after he had received notice of his Section 125 rights.

Our order, which will require respondents to give notice of that right and will enable purchasers entitled to such notice to rescind the transactions, is not based on a technical reading of the statute, as respondent would have us believe, but is based on our belief that this is the best method by which to restore to these obligors rights to which they were entitled under the statute and to correct the injury they may have sustained by being deprived of these rights. Although these obligors no longer are threatened with the possibility of foreclosure on their residential property, such a threat did exist for the period between the time they signed the agreement containing the confession of judgment and the time that respondents waived their security interest. During that time, an obligor advised of his right to rescind might have chosen to terminate the agreement. We must assume, however, that without notice, such an obligor was unaware of his rights; and in these circumstances it is possible that an obligor may have continued to meet his obligations under a contract he would have preferred to rescind in the fear that should he default, judgment would be executed upon his property. The potential for this type of injury is the result of respondents' failure to comply with the requirements of the Act, a failure which was not cured by their subsequent waiver of security interests in the residential property of purchasers; and, therefore, respondents will be required by our order to give notice of the right to rescind to those purchasers qualifying for such notice under the Act.

Respondent, Charnita, Inc., a Pennsylvania corporation with its principal office and place of business located at Fairfield, Pennsylvania, is engaged in the business of selling land for recreational and residential homesite purposes, its sales for fiscal 1970 amounting to \$4,280,747. A number of its sales are credit transactions, its contracts receivable amounting to \$1,723,474 in 1970.

Section 226.9 of Regulation Z, issued by the Federal Reserve Board pursuant to the Truth in Lending Act, provides that, with certain exceptions not applicable here, any purchaser of real estate shall have a three-day right to rescind the transaction where, first, it is a "credit transaction in which a security interest is or will be retained or acquired" by the seller and where, secondly, the property "is used

or is expected to be used as the principal residence" of the buyer.³ From July 1, 1969 (the effective date of Regulation Z) through March 20, 1970, approximately 470 customers purchased property from Charnita on credit.⁴ In all of these credit sales, and in others made since July 1969 except for those consummated between March 20 and November 1970, respondents retained a "security interest" in the property in the form of promissory notes containing confession of judgment clauses or retention of the deed until a specified number of installment payments had been made.⁵ Because respondent Charnita sells both *recreational* and residential homesites, however, not all of these 470 purchasers bought property which "is used or is expected to be used as the *principal residence* of the customer" (emphasis added) and which are thus entitled to rescind under Section 226.9 of Regulation Z. The record discloses only that "some" of those customers satisfy this "use" criteria of the regulation, *i.e.*, some but not all of Charnita's customers have purchased since July 1, 1969, and do purchase, lots on credit from respondents with the intention of building a principal place of residence thereon at some future date.⁶

As to those customers who bought lots from respondents on credit since July 1, 1969, and who, in addition, intended at some future time to erect their principal place of residence thereon, respondents have an unfulfilled and continuing duty to give notice, in accordance with Section 226.9 of Regulation Z, of the customers' right of rescission. Until such notice is given, respondents are thus in continuing violation of the statute. Before such notice can be given, however, the particular customers entitled to it—those that had the necessary "use" intent at the time of purchase—must be identified.

³ "Section 226.9—Right to Rescind Certain Transactions. (a) General rule. Except as otherwise provided in this section, in the case of any credit transaction in which a security interest is or will be retained or acquired in any real property which is used or is expected to be used as the principal residence of the customer, the customer shall have the right to rescind that transaction until midnight of the third business day [ftn. omitted] following the date of consummation of that transaction or the date of the delivery of the disclosures required under this section and all other material disclosures required under this Part, whichever is later, by notifying the creditor by mail, telegram, or other writing of his intention to do so. * * *

"(b) Notice of opportunity to rescind. Whenever a customer has the right to rescind a transaction under paragraph (a) of this section, the creditor shall give notice of that fact to the customer by furnishing the customer with two copies of the notice set out below, one of which may be used by the customer to cancel the transaction. * * *"

⁴ CX 1; Initial Decision of the hearing examiner (May 17, 1971), p. 7 [p. 900 herein].

⁵ See Finding 15 of the Commission's Findings as to the Facts, Conclusions and Order, *infra* 917.

⁶ CX 1, I(9), p. 4. Initial Decision of the hearing examiner (May 17, 1971), p. 7 [p. 900 herein].

The appropriate way to make such a determination in the first instance is of course simply to ask the purchaser, at the time of the initial transaction, whether he intends to use the property as his principal place of residence either then or at some time in the future. If he says no, then no right of rescission accrues to him; if, on the other hand, he says yes, then he is entitled, under Section 226.9 of Regulation Z, to notice of his right to rescind.

Here, however, except for a brief period in 1970,⁷ respondents failed to make any such inquiry of its customers at the time the land was initially purchased, the result being that, if respondents are not to remain in continuing violation of the law in this regard, a fair and workable method must be devised for distinguishing those of respondents' post-July 1969 customers that intended to use the property as their principal place of residence from those that did not so intend. Counsel supporting the complaint proposes, for example, that respondents should simply be directed to send *all* of their post-July 1969 customers a notice informing them that they (a) have a right to rescind *if* they intended to so use the property and that (b) they can claim that right by informing respondents, within fourteen (14) days, that they in fact had such an intent. The argument here is that unless the customers are told the legal significance of their answers to the inquiry—that is, unless they are told how their property rights will be affected—they may give either casually-considered or perhaps no answers at all when asked what use they intended to make of that property.

Respondents argue, on the other hand, that to inform all of its post-July 1969 customers that they can acquire a right to rescind by simply signing an affidavit that they had the intent in question at the time they bought the property would have the practical effect of giving a right of rescission to at least some customers that are not in fact entitled to it. The contention is that there are always a number of buyers of any commodity that, for reasons unrelated to the Truth in Lending Act or any other statute, would like to rescind the purchase transaction and get their money back. To prevent such an unfair enlargement of the number of customers entitled to rescind, therefore, respondents argue that a narrower form of notice must be devised.

We agree that the order provision proposed by complaint counsel is too broad in this regard. Only those customers who did in fact intend to use the purchased property as a principal place of residence are entitled to a right of rescission under Section 226.9 of Regu-

⁷ Finding 15, note 5, *supra*; CX 4.

lation Z and it would thus be contrary to that regulation to employ an enforcement provision that, in its practical operation, enabled others not entitled thereunder to receive that right as well. Our order will thus direct respondents to end their continuing violation of the statute by (a) first asking each post-July 1, 1969 customer, in writing and in a clear and unambiguous manner (Appendix A and B to our order), whether he did or did not purchase the property for use as his principal place of residence and (b) then, as to each such customer who answers in the affirmative, sending the notice of right to rescind that is prescribed by Section 226.9 of Regulation Z.

An appropriate order will be entered.

SEPARATE STATEMENT OF COMMISSIONER DENNISON, CONCURRING IN PART AND DISSENTING IN PART

Simply stated, the majority found that "the confession of judgment provisions in the promissory notes respondents caused their customers to execute * * * and respondents' retention of the deed to the real property purchased until the purchaser has made four scheduled payments under the contract * * * constitute a 'security interest' in the property within the meaning of that term as used in * * * [Regulation Z]."

The failure to give customers a 3-day notice of their right to rescind the transaction where a security interest is retained or acquired in property used or expected to be used as the residence constitutes a violation of Section 125 of the Truth in Lending Law (15 U.S.C. 1635). Such violation is also deemed a violation of Section 5 of the Federal Trade Commission Act.¹ As a remedy, the majority has ordered the respondents to cease and desist from violating Regulation Z and required them to send a notice to all post-July 1, 1969, customers ascertaining whether they intended to use the property purchased from respondents as their principal place of residence, and, should the customers' responses be in the affirmative, to give them the required notice and opportunity to rescind.

There exists considerable diversity in the cases being developed by the Federal courts in construing the meaning of "security interest" as that term is used in Section 125 of the Truth in Lending Law and Section 226.9 of Regulation Z (the term is defined at Section 226.2 of Regulation Z). While giving due emphasis to the Board of Governors of the Federal Reserve System (hereinafter referred to as

¹ By virtue of Section 108 of the Truth in Lending Act.

Separate Statement

80 F.T.C.

the FED), and being cognizant of the fact their regulations are entitled to great deference,² I am of the opinion the FED exceeded their authority in construing confession of judgment or cognovit provisions in promissory notes as being security interests.³

There are two cases bearing on this issue. In *Douglas v. Beneficial Finance Company of Anchorage*,⁴ the court upheld the FED's interpretation of security interest as applying to cognovit provisions. At approximately the same time, another District Court in New York ruled that the FED exceeded its authority in interpreting security interests to include consensual liens predicated upon mechanics' lien law.⁵ Notwithstanding the Alaska Court's natural desire to interpret the FED regulations to accomplish what it viewed as the indicated purpose of the Act, I am of the view that since Truth in Lending imposes penal sanctions, its provisions must be strictly construed. See *Mourning v. Family Publications Service, Inc.*, CCH Consumer Credit Guide ¶ 99,337 (5th Cir. 1971).

A cognovit provision in a note is nothing more than a warrant whereby the maker authorizes judgment to be confessed for him based upon the record. At the time of the consummation, the creditor does not have a lien or security interest in the property, nor is he entitled to one. It should be pointed out at this juncture that the lien, if any, which may be created by a cognovit provision is a judgment lien; *i.e.*, a lien predicated upon judgment made by a court of competent jurisdiction rendered in accordance with applicable state law.

Under most situations, in order to permit the creditor to obtain a judgment lien based upon a cognovit provision there must be a default by the maker, a suit brought, the warrant exercised, judgment confessed in court and entered prior to filing of the judgment lien. Regardless of one's opinion of the merits and social desirability of cognovit provisions, they are valid in many states, including Pennsylvania where the transactions involved herein took place, and form a part of the judicial system of those states. For the FED to single out judgment liens predicated on cognovit provisions and label them security interest is an unwarranted invasion into a state's internal judicial process.

As pointed out in the *Freed* case, the security interest subject to the notice and right to rescission is that "given by the obligor."⁶

² *Udall v. Tallman*, 380 U.S. 1 (1965).

³ The FED has ruled that a cognovit provision constitutes a confessed lien, ergo a security interest. FED interpretation dated May 26, 1969.

⁴ CCH Consumer Credit Guide ¶ 99,295 (D.C. Alaska 1971).

⁵ *N.C. Freed Company, Inc. v. Board of Governors*, CCH Consumer Credit Guide ¶ 99,356 (D.C.W.D. N.Y. 1971).

⁶ Section 125(b) of Truth in Lending Act.

The obligor, by signing a note containing a confession of judgment clause has not given a security interest, rather he has given an inchoate right to confess a judgment. Whether a lien arises therefrom is subject to the occurrence of certain conditions subsequent and much speculation.

Therefore, I am of the opinion that the FED exceeded the authority delegated in Section 105 of the Truth in Lending Law by including confessed liens in the definition of security interest. Consequently, respondents have not violated the Truth in Lending Law by failing to give a notice of rescission when it required its obligors to execute notes containing cognovit provisions.

The second branch of the majority's opinion deals with the respondents' practice of withholding delivery of the deed of conveyance until their customers had made four scheduled monthly payments. This practice is analogous to a land contract situation which the FED had interpreted as a security interest.⁷ A plain reading of the statutory provision creating the right of rescission would indicate that security interest must create an interest in the creditor which is paramount to that of the obligor. Expressing this another way, a security interest is an interest in real property which would effectively preclude a bona fide purchaser for value from acquiring an interest superior to that of the obligor. Certainly the withholding of the deed until four installments have been paid constitutes a retention of a security interest which would be as effective as duly filing a mortgage against the obligor's interest.

In conclusion, I find that respondents' use of "confession of judgment" provisions in their note forms does not constitute a security interest, as that term is defined in the Truth in Lending Law, and, consequently, they are not obligated to give notice of opportunity to rescind to customers acquiring lots by this method. I do find, as did the majority, that the retention of the deed for a period of four installments does constitute a security interest. Therefore, I am of the opinion that customers who purchased land under this method and who expected to use it as a residence are entitled to a notice of opportunity to rescind. The method adopted by the majority to determine which customers had such an expectation is appropriate.

FINDINGS AS TO THE FACTS, CONCLUSIONS AND ORDER

The Federal Trade Commission issued its complaint in this matter on January 11, 1971 (amended on April 7, 1971), charging that

⁷ FED letter of June 5, 1970, No. 347, by Frederick Solomon, Director, CCH, Consumer Credit Guide ¶ 30,402.

Findings

80 F.T.C.

respondent Charnita, Inc., a firm engaged in the development and sale of residential and recreational real property, and its president, Charles G. Rist, had violated the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and the regulations promulgated thereunder by the Federal Reserve Board (Regulation Z, 12 CFR § 226), in failing to make certain disclosures in its credit transactions with purchasers of its real property and in failing to give certain of its customers notice of their right to rescind as required by those implementing regulations. A prehearing conference was held on February 26, 1971, and hearings were held on March 16 and March 26, 1971, the evidence received consisting of a stipulation between the parties as to the facts (CX 1) and a number of documentary exhibits (CX 2-7; RX 1-2A). In an initial decision of May 17, 1971, the hearing examiner found that respondents had engaged in a number of violations of the disclosure requirements of Regulation Z and had failed to provide, as also required by that regulation, certain of its customers with notice of their right to rescind the purchase transactions involved. An order was entered by the examiner that would require respondents to cease these violations.

The Commission, having considered the appeal filed by respondents and counsel supporting the complaint and the entire record, and having determined that the examiner's findings of fact, conclusions, and order, as modified and supplemented herein, should be adopted as the findings, conclusions, and order of the Commission, now makes its findings as to the facts, its conclusions drawn therefrom, and its order.

FINDINGS AS TO THE FACTS

1. through 12. The Commission finds the facts to be, except as modified or supplemented herein, as set forth in findings 1 through 12 (pages 4 through 7) [pp. 897-900 herein] of the hearing examiner's initial decision of May 17, 1971, and adopts those findings as its own.

13. Respondent Charnita, Inc., is a Pennsylvania corporation with its principal office and place of business at Route 1, Fairfield, Pennsylvania. It is engaged in the development, advertising, and sale of real property, its sales of land for the fiscal year ended September 30, 1970, totaling \$4,280,747, at least 40 percent of which (\$1,723,474) represented contracts receivable. (CX 7.)

14. Respondent Charles G. Rist is the president of respondent Charnita, Inc., a member of its board of directors, and its principal stockholder. On July 1, 1969, he owned 97 percent of the firm's stock. The other four (4) of the company's five (5) board members were

employees of the corporation. On November 13, 1969, his stock ownership was reduced to 62 percent; on October 29, 1970, an independent board of directors was elected; and on November 27, 1970, 80 percent of Rist's stock was deposited in a trust. Prior to October 29, 1970, respondent Rist formulated, directed, and controlled the policies, acts and practices of respondent Charnita, Inc., including the acts and practices involved in the instant complaint. (CX 1, 7; RX 1.)

15. Since July 1, 1969, respondents, in the course of their advertising and sale of real property, have sold lots on credit, the purchasers executing sales agreements, installment payment contracts, and promissory notes. From July 1, 1969, through March 20, 1970, approximately 470 customers purchased property from respondent Charnita, Inc., on credit, some of whom purchased their lots with the intention of building their principal place of residence thereon at some future date. (CX 1.) In all such credit sales, and in all others since July 1969 except for those consummated between March 20 and November 1970, respondents retained a security interest in the property sold:

a. *Period 1.* From July 1, 1969, to March 20, 1970, respondents caused their credit customers to execute a promissory note containing a confession of judgment clause, as illustrated by CX 2. (CX 1.) No inquiry was made of these credit customers as to whether they intended to use the property as a principal place of residence.

b. *Period 2.* From March 20, 1970, to November 1970, respondents expressly exempted property sold as a principal place of residence from their confession of judgment clauses and included in some of their sales agreements an inquiry as to whether the purchaser intended to so use the property purchased. (CX 4.)

c. *Period 3.* Since November 1970, respondents have caused their credit customers to execute agreements of sale providing for respondents' retention of the deed to the real property purchased until the buyer has made four (4) scheduled monthly payments. (CX 1, 5.) No inquiry was made of these customers as to whether they intended to use the property as a principal place of residence.

16. While it is not known how many of the 470 customers who purchased lots from respondents on credit during Period 1 (and the presumably equal or larger number that have purchased lots from them on credit during Period 3) did so with the intention of using the purchased property as a principal place of residence, respondents have advertised their development as an ideal location for residential and retirement homesites. (CX 6.)

Findings

80 F.T.C.

17. On September 24, 1970, apparently in an effort to avoid the duty of giving a right-to-rescind notice to those of its credit customers that had previously purchased lots with the intent of building on them a principal place of residence, respondent Charnita, Inc., adopted a resolution waiving its security interest (confession of judgment liens) in those customers' notes. (CX1; RX 2.) The purchasers themselves were not notified of this resolution.

18. Respondents have not given any purchaser any rescission notice since the effective date of the Truth in Lending Act (CX 1; Respondents' Appeal from Initial Decision, p. 8.)

19. Since July 1, 1969, respondents, in connection with their credit sales, failed in a number of instances to identify Charnita, Inc., as the creditor as required by Section 226.8(a) of Regulation Z.

CONCLUSIONS

1. The Federal Trade Commission has jurisdiction over the respondents, and the subject matter of this proceeding.

2. Respondents have violated the provisions of Regulation Z and of the Truth in Lending Act title of the Consumer Protection Credit Reporting Act, 15 U.S.C. 1601 *et seq.*, in failing to make the required disclosures as found by the hearing examiner herein.

3. Respondents have violated the provisions of Regulation Z and of the Truth in Lending Act title of the Consumer Protection Credit Reporting Act, 15 U.S.C. 1601 *et seq.*, in failing to identify those credit customers that purchased real property in which respondents retained a security interest for use as a principal place of residence and in failing to give such customers notice of their right to rescind as required by said regulation and statute.

4. The confession of judgment provisions in the promissory notes respondents caused their customers to execute in Period 1 herein, and respondents' retention of the deed to the real property purchased until the purchaser has made four (4) scheduled payments under the contract (Period 3), constitute a "security interest" in the property within the meaning of that term as used in said regulation.

5. Respondents' adoption on September 24, 1970, of a resolution waiving their confession of judgment lien in the promissory notes as to those purchasers that had purchased property for use as a principal place of residence did not extinguish the right, created at the time the transaction was consummated by operation of Regulation Z, of those customers to receive notice of their right to rescind under that regulation.

6. Section 226.9 of Regulation Z, in providing that "in the case of any credit transaction in which a security interest is or will be retained or acquired in any real property which is used or is expected to be used as the principal residence of the customer, the customer *shall have the right to rescind* that transaction" for a specified period time (emphasis added), and in further providing that "Whenever a customer has the right to rescind a transaction under paragraph (a) of this section, the creditor *shall give notice of that fact* to the customer" by sending a specified form of notice (emphasis added), creates an absolute right on the part of such customer to receive notice of his right to rescind, a right that is not conditioned on the customer's affirmatively advising the creditor, without being asked, that the property is to be used as a principal residence. Accordingly, it is the creditor's duty under such regulation to affirmatively inquire of its credit customers, at the time of the transaction, whether they so intend to use the property.

ORDER

This matter having been heard by the Commission on the exceptions of respondents Charnita, Inc., and Charles G. Rist to the hearing examiner's initial decision finding respondents in violation of the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and implementing regulations, and on the exceptions of complaint counsel; and

The Commission having determined that the examiner's findings of fact, conclusions, and order, as modified and supplemented herein, should be adopted as the findings, conclusions, and order of the Commission.

It is ordered, That the third paragraph on page 15 [p. 905 herein] of the examiner's order be, and it hereby is, amended to read as follows:

It is further ordered, That respondent Charnita, Inc., shall within thirty (30) days from the date hereof make a clear and conspicuous inquiry in writing, in the manner and form shown on Appendix A and B attached hereto, via registered mail with return receipt required and with enclosed self-addressed and stamped envelope, to all customers who purchased property from respondent on or after July 1, 1969, and in which respondent has retained or acquired or will retain or acquire a security interest.

It is further ordered, That within sixty (60) days from the date hereof, in the event that all of the questionnaires (Appendix B) have not been completed and returned to respondent Charnita, Inc., respondent shall employ an independent contractor with interviewing

Findings

80 F.T.C.

capabilities which is acceptable to the Federal Trade Commission to telephone, and if necessary to meet in person, each customer who fails to return the questionnaire and to provide him with the information contained in the letter set forth in Appendix A in order to elicit his response to and signature on the questionnaire.

It is further ordered, That respondent Charnita, Inc., shall maintain adequate records, to be furnished upon the request of the Federal Trade Commission, which disclose the dates and manner in which customers were contacted pursuant to the above procedures and the dates and manner in which customers responded thereto.

It is further ordered, That respondent Charnita, Inc., shall cease to remain in violation of the Truth in Lending Act by delivering, within ten (10) days after receipt by it of notice from its customers (or from the independent contractor) regarding their expected use of the property in question, notice of the customer's right to rescind, in the manner and form set forth in Section 226.9(b) of Regulation Z, to each customer who purchased real property from it in any credit transaction consummated on or after July 1, 1969, and in which the customer has or shall notify respondent pursuant to the procedures set forth above that he expected to use that property as his principal place of residence and in which respondent has retained or acquired, or will retain or acquire, a security interest therein. *Provided, however*, That this portion of this order shall not apply to customers who have previously sold the property purchased from Charnita, Inc.

It is further ordered, That respondents Charnita, Inc., a corporation, and its officers, and Charles G. Rist, individually and as an officer of said corporation, and respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with any consumer credit sale of real property or in any advertisement to aid, promote, or assist directly or indirectly any extension of credit, as "credit sale" and "advertisement" are defined in Regulation Z (12 CFR § 226) of the Truth in Lending Act (Pub. L. 90-321, 15 U.S.C. 1601 *et seq.*), do forthwith cease and desist from failing to identify their security interest as required by Section 226.8(b)(5) of Regulation Z together with all other required disclosures, as required by Section 226.8(a) of Regulation Z.

It is further ordered, That the exceptions of respondents Charnita, Inc., and Charles G. Rist to the findings, conclusions, and order of the hearing examiner be, and they hereby are, denied, and that the exceptions of counsel supporting the complaint to said findings, conclusions, and order be, and they hereby are, granted in part and denied in part.

892

Findings

It is further ordered, That the examiner's findings, conclusions, and order, as modified and supplemented herein, be, and they are, adopted as the findings, conclusions, and order of the Commission.

It is further ordered, That respondents herein shall, within three (3) months after service upon them of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they are complying with this order and shall, within six (6) months thereafter, file a further report in writing setting forth in detail the manner and form in which they have complied therewith.

APPENDIX A

IMPORTANT NOTICE

To: (Customer)

By an order of the Federal Trade Commission entered on _____, we have been directed to determine from you whether at the time you purchased property from Charnita, Inc., you intended to use it as your principal place of residence, either currently or at any time in the future. The Commission has determined that the collection of this information is required under the Truth in Lending Act, and it is important, therefore, that you provide us with your response to the enclosed questionnaire as soon as possible so that we may comply with the Commission's order.

Please indicate your intended use for the property you purchased from Charnita by checking one of the boxes on the enclosed statement and returning it to us within fourteen (14) days. The copy is for your files.

(Signed)
CHARNITA, INC.

APPENDIX B

To: CHARNITA, INC.

☐ At the time I purchased property from Charnita, Inc., it was my intention to use that property either as my current or future principal place of residence.

☐ At the time I purchased property from Charnita, Inc., it was NOT my intention to use that property either as my current or future principal place of residence.

(Date)

(Signature)

(Signature)

Amended Complaint

80 F.T.C.

IN THE MATTER OF

LEHIGH PORTLAND CEMENT COMPANY

CONSENT ORDER, ETC., IN REGARD TO THE ALLEDGED VIOLATION OF SEC. 7
OF THE CLAYTON ACT AND THE FEDERAL TRADE COMMISSION ACTS

Docket 8680. Amended Complaint, April 24, 1967—Decision, June 7, 1972

Consent order requiring the third largest manufacturer of portland cement with headquarters in Allentown, Pa., to divest itself of 11 plants in Virginia, 6 plants in Florida, and 22 once acquired, but no longer owned, plants in Florida, Kentucky and Virginia, if respondent regains ownership or control. As for the ready-mixed concrete plants the order requires that they be kept in operating condition prior to divestiture, that respondent not add other ready-mixed concrete plants for two years in any county where acquired plants are to be divested. The order also prohibits acquisition of other ready-mixed concrete and concrete product industries for a period of 10 years without prior Federal Trade Commission approval.

AMENDED COMPLAINT

The Federal Trade Commission, having reason to believe that the above-named respondent has violated the provisions of Section 7 of the Clayton Act, as amended, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. §§ 18, 45, and that a proceeding in respect thereof would be in the public interest, issues this amended complaint, stating its charges as follows:

I DEFINITIONS

1. For the purpose of this complaint the following definitions shall apply:

a. "Portland cement" includes Types I through V of portland cement as specified by the American Society for Testing Materials. Neither masonry nor white cement is included.

b. "Ready-mixed concrete" includes all portland cement concrete which is manufactured and delivered to a purchaser in a plastic and unhardened state. Ready-mixed concrete includes central-mixed concrete, shrink-mixed concrete and transit-mixed concrete.

c. "The Miami Area" consists of Dade County, Broward County and Palm Beach County, Florida.

d. "The Orlando Area" consists of Orange, Brevard and Seminole Counties, Florida.

e. "The Jacksonville Area" consists of Duval County, Florida.

f. "The Louisville Area" consists of Jefferson County, Kentucky, and Clark and Floyd Counties, Indiana.