

Complaint

98 F.T.C.

IN THE MATTER OF
HOUSEHOLD FINANCE CORPORATION

DISMISSAL ORDER, OPINION, ETC., IN REGARD TO ALLEGED
VIOLATION OF THE TRUTH IN LENDING ACT

Docket 9111. Complaint, June 13, 1978—Order, Aug. 6, 1981

This order dismisses the Commission's June 13, 1978 complaint charging one of the largest small-loan companies in the United States with violating the Truth in Lending Act (TILA). The Commission held that the company's practice of requiring customers to repay loans discharged in bankruptcy before receiving a new loan constituted "refinancing" under the TILA and therefore the amount of the discharged debt need not be disclosed as part of the "finance charge."

Appearances

For the Commission: *David G. Grimes, Jr., Rena Steinzor and Lawrence DeMille-Wagman.*

For the respondent: *J. Wallace Adair, Richard A. Kleine and R. Bruce Beckner, Howrey & Simon, Washington, D.C., and Richard P. McManus and Thomas M. Ryan, in-house counsel.*

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. 41 *et seq.*, the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and its implementing Regulation Z, 12 C.F.R. 226, duly promulgated by the Federal Reserve Board, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Household Finance Corporation, a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of said Acts and Regulation, and it appearing to the Commission that a proceeding by it in respect thereto would be in the public interest hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Household Finance Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware with its principal office and place of business located at Prudential Plaza, Chicago, Illinois.

PAR. 2. Respondent Household Finance Corporation is now and for some time past has been engaged in the extension of consumer loans to members of the public.

PAR. 3. In the ordinary course and conduct of its business as

aforesaid, respondent regularly extends consumer credit to consumers and is a creditor as "consumer credit" and "creditor" are defined in Sections 226.2(p) and 226.2(s), respectively, of Regulation Z.

PAR. 4. Respondent, in the ordinary course of its business, extends and for some time since July 1, 1969, has extended loans to consumers, some of whom subsequently file bankruptcy petitions prior to full repayment of their debt to respondent. Such consumers are duly adjudged as bankrupts pursuant to the Bankruptcy Act, 11 U.S.C. 1 *et seq.*, and are released from any legal obligation to repay discharged debts, including debts to respondent. [These consumers are hereinafter sometimes referred to as "discharged debtors".] [2]

PAR. 5. In many instances, respondent solicits discharged debtors offering them specific extensions of new credit on the condition that the discharged debtor reaffirm his or her discharged debt to respondent. When a discharged debtor, who has been solicited by respondent or who otherwise requests a specific subsequent extension of credit from respondent, enters into a subsequent transaction, respondent requires the debtor to sign a contract which reaffirms all or part of his or her discharged debt and obligates the discharged debtor to repay that amount plus any new loan advanced. Finance charges are imposed on the sum of the reaffirmed debt and the new loan. Respondent does not extend credit in the form of new loans to such consumers without their reaffirmation of discharged debt. The amount of debt reaffirmed therefore represents a charge which is payable directly or indirectly by the borrower as an incident to or a condition of the extension of credit and constitutes a cost of credit and is a finance charge as "finance charge" is defined in Sections 226.2(w) and 226.4(a) of Regulation Z.

PAR. 6. In its disclosures required by the Truth in Lending Act and Regulation Z for the loans described in Paragraph Five above, respondent treats the reaffirmed debt as part of the credit of which the consumer will have actual use and not as a "finance charge" on the new loan transaction. Respondent includes the reaffirmed debt in its disclosure of the "amount financed" on the new loans. Respondent, in connection with these loans thereby: (1) fails to accurately compute and disclose the finance charge, as required by Section 226.8(d)(3) of Regulation Z; (2) fails to compute and disclose the annual percentage rate, as "annual percentage rate" is defined in Sections 226.2(g) and 226.5 of Regulation Z, accurately to the nearest quarter of one percent as required by Sections 226.5(b) and 226.8(b)(2) of Regulation Z; and (3) fails to accurately compute and disclose the amount financed as required by Section 226.8(d)(1) of Regulation Z.

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PAR. 7. Pursuant to Section 103(s) of the Truth in Lending Act, respondent's aforesaid failure to comply with the provisions of Regulation Z constitutes a violation of that Act and, pursuant to Section 108 thereof, respondent has engaged in unfair or deceptive acts and practices in violation of the Federal Trade Commission Act, as amended.

INITIAL DECISION

BY DANIEL H. HANSCOM, ADMINISTRATIVE LAW JUDGE

MARCH 16, 1979

Allegations of Complaint

The complaint, which was served on respondent Household Finance Corporation (Household Finance) on July 10, 1978, charged respondent with having violated the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. 41, *et seq.*, the Truth in Lending Act, 15 U.S.C. 1601, *et seq.*, and its implementing Regulation Z, 12 C.F.R. 226. According to the allegations, Household Finance has been approached for new loans by persons who have had prior debts owed to it discharged in bankruptcy. In such cases, according to the complaint, where the discharged debtor was [2]otherwise eligible for a new loan, Household Finance would grant such a loan provided the discharged debtor would sign a contract which reaffirmed all or part of the discharged debt and obligated him or her to repay to Household Finance the amount of that debt plus the amount of the new loan advanced.

The complaint charged that Household Finance improperly treated the reaffirmed debt as part of the credit granted to the borrower and of which he or she would have actual use, rather than as a "finance charge" on the new loan transaction, in the disclosures required by the Truth in Lending Act and Regulation Z, promulgated by the Federal Reserve Board to implement the Act. In other words, it was alleged that Household Finance unlawfully included the reaffirmed debt, previously discharged in bankruptcy, in the disclosure to the borrower of the "amount financed" rather than in the "finance charge."

The complaint challenged this procedure alleging that the amount of the reaffirmed debt "represents a charge which is payable directly or indirectly by the borrower as an incident to or a condition of the extension of credit and constitutes a cost of credit and is a "finance

charge" as "finance charge" is defined in Regulation Z. The complaint further charged that Household Finance, in connection with such loans, by including the amount of the reaffirmed debt in the disclosure of the "amount financed" rather than in the disclosure of the "finance charge":

. . . (1) fails to accurately compute and disclose the finance charge, as required by Section 226.8(d)(3) of Regulation Z; (2) fails to compute and disclose the annual percentage rate, as "annual percentage rate" is defined in Sections 226.2(g) and 226.5 of Regulation Z, accurately to the nearest quarter of one percent as required by Sections 226.5(b) and 226.8(b)(2) of Regulation Z; and (3) fails to accurately compute and disclose the amount financed as required by Section 226.8(d)(1) of Regulation Z.

Procedural History

Respondent Household Finance's answer was filed August 7, 1978. A prehearing conference was scheduled for September 19 by Judge Teetor to whom this proceeding [3] was originally assigned. Judge Teetor, however, disqualified himself on September 7 and the prehearing conference of September 19 was cancelled. The undersigned was then assigned to this matter and rescheduled the conference for October 12.

At this conference an effort was made to secure from both sides a stipulation of facts inasmuch as this proceeding appeared to involve principally an issue of law relating to the application of Regulation Z and the Truth in Lending Act. The parties were directed to attempt to reach such a stipulation by November 10. In the meantime complaint counsel filed a request for admission of facts and genuineness of documents and, after receiving respondent Household Finance's response thereto, a motion that the sufficiency of such response be determined by the law judge. A second request for admission of facts and genuineness of documents was filed, but was withdrawn by complaint counsel on agreement by both sides to a "Statement of Stipulated Facts."

At a second prehearing conference held December 19 the stipulation of facts was taken up by the law judge and discussed with the parties. Neither side wishing to offer anything in evidence in addition to the stipulation, it was determined that no evidentiary hearings were required and that no further procedural steps were necessary other than the submission by both sides of proposed findings and supporting memoranda. On December 20 an order was issued based on the preceding day's conference accepting the stipulation, closing the record for the reception of evidence and establishing a briefing schedule. February 2, 1979 was established as a date for the submission of findings and briefs, and February 16,

1979, for the filing of any replies by each side to the filings of the other.

Complaint counsel and counsel for respondent Household Finance have agreed that the "Statement of Stipulated Facts" is to be the sole statement of the facts to be used by any party in this proceeding. Counsel for both sides have also agreed that nothing in the stipulation can be used or considered as an admission by respondent in any other proceeding, with the exception of a proceeding brought by the Commission pursuant to Section 19 of the Federal Trade Commission Act as a result of an administrative decision in this proceeding, Docket No. 9111, which is based on facts stated in the stipulation and found herein. Respondent, furthermore, does not agree or admit that the Commission has authority [4]to institute a proceeding under Section 19 of the Federal Trade Commission Act or otherwise obtain restitution against respondent in connection with this proceeding.

FINDINGS OF FACT

Except for a few grammatical changes, the joint "Statement of Stipulated Facts" is incorporated herein as the following "Findings of Fact," each numbered finding corresponding to the same numbered paragraph of the stipulation:

1. Respondent Household Finance Corporation is a corporation organized under the laws of the State of Delaware. Its principal office and place of business is located at 2700 Sanders Road, Prospect Heights, Illinois.

2. Respondent is now and for some time in the past has been engaged in the extension of consumer loans to members of the public.

3. In the ordinary course and conduct of its business as aforesaid, respondent regularly extends consumer credit to consumers and is a creditor as "consumer credit" and "creditor" are defined in Sections 226.2(p) and 226.2(s), respectively, of Regulation Z, 12 C.F.R. 226.

4. Since July 1, 1969, although not a substantial number of respondent's total customers, a substantial number of consumers to whom respondent has extended loans have, prior to full repayment of their indebtedness to respondent, filed petitions in bankruptcy.

5. Of those consumers who filed petitions in bankruptcy as described in Finding 4, a substantial number were subsequently adjudged bankrupts and granted discharges in bankruptcy in accordance with the provisions of the Bankruptcy Act, 11 U.S.C. 1, *et seq.*, with respect to indebtedness to respondent and others.

6. In a substantial number of cases after notification that the petition in bankruptcy had been filed, and in a substantial number of cases after a final discharge in bankruptcy had been granted, respondent has contacted consumers described in Findings 4 and 5 [5] and informed them that upon reaffirmation of a part or all of their discharged debts to respondent, and if otherwise eligible for credit, it would reestablish their credit with respondent and shortly thereafter grant them new loans.

7. In a substantial number of cases after notification that the petition in bankruptcy had been filed, and in a substantial number of cases after a discharge in bankruptcy had been granted, consumers described in Findings 4 and 5 have sought new loans from respondent.

8. During their negotiations concerning new loans, respondent and most of the consumers described in Findings 4, 5, 6 and 7 discussed one or more of the following: (a) the consumer's desire to retain property pledged as security by the consumer with respect to the indebtedness owed to the respondent; (b) the release of a co-maker's obligation to pay the consumer's indebtedness to respondent; (c) resolution of litigation pending in bankruptcy court concerning the indebtedness of the consumer; (d) reestablishment of the consumer's credit with respondent.

9. During their negotiations concerning new loans, respondent and the consumers described in Findings 4, 5, 6 and 7 discussed the reaffirmation of part or all of the consumer's debt to respondent which had either been discharged by the bankruptcy proceeding or was scheduled as a debt in the bankruptcy proceeding at the time of the negotiations.

10. In a substantial number of instances since July 1, 1969, respondent has obtained reaffirmations from the consumers described in Findings 4, 5, 6 and 7 of part or all of their indebtedness to respondent which had been discharged in bankruptcy or which was scheduled as a debt in the bankruptcy proceeding at the time of the reaffirmation. Most of those consumers have reaffirmed their debts to respondent for one or more of the following reasons: (a) to retain property pledged as security by the consumer in connection with the indebtedness owed to respondent; (b) to secure the release of a co-maker's obligation to repay the indebtedness of the consumer; (c) to settle bankruptcy court litigation concerning the indebtedness of the consumer; (d) to reestablish credit with respondent. Such consumers must reaffirm part or all of their debts to respondent before obtaining new loans from respondent. [6]

11. Since July 1, 1969, respondent's policy and usual and custom-

any practice has been that part of any new loan from respondent to the consumers described in Findings 4, 5, 6 and 7 must be used to repay part or all of their debts to respondent which had been discharged in bankruptcy or which were scheduled as a debt in a bankruptcy proceeding at the time of the new loan.

12. Since July 1, 1969, respondent's policy and usual and customary practice has been that during the negotiations concerning new loans and before consumers described in Findings 4, 5, 6 and 7 agree to reaffirm debts to respondent, its employees inform such consumers that such reaffirmation is necessary to reestablish their credit with respondent and that part of any new loan from respondent must be used to repay part or all of their debt to respondent which had been discharged in a bankruptcy proceeding or which was scheduled as a debt in a bankruptcy proceeding at the time of the negotiations.

13. Since July 1, 1969, whenever a consumer has agreed to pay all or a portion of a debt scheduled or discharged in a bankruptcy proceeding with part of the principal amount of the new indebtedness, respondent has imposed finance charges on those portions of the principal amount of the new indebtedness which are applied to repayment of part or all of the reaffirmed debt and the amount of new money paid to the consumer. The term "principal amount of the new indebtedness" shall mean the total amount of money the consumer agrees to pay respondent which includes (a) the amount of the new indebtedness which is applied to the payment of part or all of the reaffirmed debt; (b) the amount of new money paid to the consumer; and (c) the finance charge imposed on (a) and (b) above.

14. Since July 1, 1969, whenever a consumer has agreed to reaffirm and pay all or a portion of a debt scheduled or discharged in a bankruptcy proceeding with part of the principal amount of the new indebtedness, respondent's policy and usual and customary practice regarding the Truth in Lending disclosure statement furnished to the consumer in connection with the new indebtedness has been that: [7]

a. The amount of the reaffirmed debt paid from the principal amount of the new indebtedness is disclosed as part of the amount financed;

b. The amount of additional credit extended is disclosed as part of the amount financed;

c. The amount of the reaffirmed debt paid from the principal amount of the new indebtedness is not included in the finance charge disclosed; and

d. The annual percentage rate disclosed is computed by relating the disclosed finance charge to the disclosed amount financed.

15. With respect to the disclosure statements described in Finding 14, if the amount of the reaffirmed debt repaid from the principal amount of the new indebtedness were included in the finance charge disclosed, and removed from the amount financed disclosed, and if the annual percentage rate were recomputed on the basis of the amended finance charge and amount financed, the annual percentage rate would be increased by more than one-quarter of one percent, from what appeared in the disclosure statements described in Finding 14.

16. Prior to on or about July 1, 1977, respondent did not offer consumers the right to rescind contracts which reaffirmed debts previously discharged in bankruptcy. Respondent required those consumers to sign a loan agreement to repay the principal amount of the new indebtedness, part of which was used to settle their reaffirmed debt and part of which was new money paid to the consumers.

17. Beginning on or about July 1, 1977, to the present, respondent has, as a matter of usual and customary practice, presented consumers who reaffirmed debts previously discharged in bankruptcy and repaid them from the principal amount of the new indebtedness a *Statement of Rights, Agreement and Cancellation Notice*, a copy of which is Attachment B set out herein.

18. The two-page document set out herein as Attachment A is a true, correct copy of a genuine original memorandum which was prepared at respondent's home office on or about June 29, 1977. [8]

19. Attachment B is a true, correct copy of Form 3, referred to in Attachment A.

20. Attachments A and B were distributed by respondent to its employees identified in Attachment A as "U.S. Managers" on or about June 29, 1977.

21. Respondent's home office directed respondent's U.S. Managers, on or about June 29, 1977, that the procedures described in Attachment A were to be followed, as applicable, in dealings with consumers who had been discharged in bankruptcy from some indebtedness to respondent.

22. Respondent has not rescinded or modified Attachments A and B.

23. Since on or about June 29, 1977, as a matter of usual and customary practice, the procedures described in Attachment A have been followed, as applicable, in dealings with consumers who have

been discharged in bankruptcy from some indebtedness to respondent.

24. The policy and customary practices of respondent as set forth in Findings 4 through 7 and 11 through 15 are the policy and customary practices of many of respondent's competitors, including its competitors who are not within the jurisdiction of the Federal Trade Commission.

25. Since July 1, 1969, the policies and customary practices of respondent and its competitors, as described herein, have not been challenged by the Federal Trade Commission or the Federal Reserve Board in any formal proceeding. [9]

Initial Decision

HOME OFFICE MEMORANDUM

To: All U.S. Managers
 Subject: Bankruptcy Refinancing Agreements

Date: June 29, 1977

As a result of a recent occurrence in New York, it is desirable to more fully implement our policy with respect to bankruptcy refinancing agreements. We must make certain that all bankrupt customers fully understand and freely exercise their rights with respect to such agreements. Accordingly, a notice and cancellation procedure is established.

In the absence of a restraining order, bankrupt customers may be contacted to discuss collateral or to discuss reaffirmation. If the bankrupt asks about obtaining a new loan, this possibility may be discussed if the bankrupt is otherwise eligible for additional credit. In any discussion concerning reaffirmation or a new loan the bankrupt must be advised that there is no legal obligation to repay the bankrupt account balance, and that part of any new loan must be used to settle the discharged debt but the amount so used is negotiable.

At the closing of any loan in which part of the proceeds is used to settle a bankruptcy discharged debt, and before the loan papers are signed, the following procedures must be followed:

1. Complete Form 3 (example attached) to show the Amount Financed of the new loan, the amount applied to the discharged debt, and the amount actually disbursed, including the premium charge for any credit insurance elected;
2. Have the customer read the Form 3 and sign it;
3. Have the other loan documents signed and disburse the loan proceeds; and,
4. Give the Customer Copy of Form 3 to the borrower and retain HFC's File Copy with the legals.

DO NOT STAMP THE OLD PAPERS PAID OR CANCELLED OR RETURN THEM TO THE CUSTOMER. NOR RELEASE ANY SECURITY INTEREST AT THIS TIME.

If the discharged debt is an open account the new loan must be coded as a "NEW".

If the discharged debt is a Bad Debt account, the new loan must be coded as a "FOR". In both cases the amount applied to the discharged debt would be coded as a counter payment.

(Attachment A, page 1)

FEDERAL TRADE COMMISSION DECISIONS

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All U.S. Managers

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June 29, 1977

If the CANCELLATION NOTICE is not received within ten (10) calendar days plus three (3) business days after the new loan was closed, mark the previous account's papers in the normal way and return them to the customer.

If the CANCELLATION NOTICE is received within ten (10) calendar days plus three (3) business days, the amount applied to the discharged debt must be credited to the new loan as follows: Void the payment that was applied to the discharged balance and apply that amount as a counter payment to the new loan.

Retain the discharged account's documents as if the new loan had not been made. Payments on the new loan must continue to be made as scheduled, disregarding the credit to the new loan that was applied; i.e., the credit to the new loan must not be considered as paying it in advance.

Offices serving District of Columbia, Iowa, New Jersey and West Virginia must apply the special restrictions listed in Section 6-7 of the Collection GDM to bankruptcy refinancing agreements as well as reaffirmations. This instruction is sent to New York offices for information only and those branches should continue to follow the special instructions previously issued.

Section 6-7 of the Collection GDM will be expanded to include the notice and cancellation procedure at the time of its next reprinting. A supply of Form 3 will be shipped under separate cover. If you have any questions, please contact your District Manager.

W. J. D. Miller
Vice President
Administration - Operations

WJDM/kv
Attachment

(Attachment A, page 2)

Initial Decision

STATEMENT OF RIGHTS

1. To obtain a new loan you will be required to repay all or part of your outstanding debt to HFC that was discharged in bankruptcy.
2. Your discharge in bankruptcy has fully released you from any legal obligation to repay any part of your outstanding debt to HFC.
3. You may bargain with HFC on the amount of the new loan to be paid towards your old loan.
4. You may cancel within 10 days your agreement with HFC to apply an agreed amount to your old loan.
5. If you decide, within 10 days, to cancel your agreement with HFC to apply an agreed amount to your old loan, tear off, date, sign and mail the bottom of this notice, below the dotted line, to HFC at this branch office address.
6. If you do cancel, the amount applied to your old loan will be credited in full to your new loan, but you are required to meet your new loan payments as scheduled.
7. If you do not cancel within 10 days, the note representing your obligation under the old loan will be marked paid and cancelled and promptly returned to you by HFC.

AGREEMENT

HFC and I have agreed that HFC will:

1. Make me a new loan in the Amount Financed of \$ _____;
2. Apply to my old loan that was discharged in bankruptcy \$ _____; and,
3. Disburse to me or on my behalf from the new loan \$ _____.

By signing this agreement, I acknowledge that I have read and understood its terms and that I have received a copy. I understand I am under no legal obligation to enter into such an agreement.

Date _____ Signature _____
 Witness, HFC Representative _____

CANCELLATION NOTICE

TO: HOUSEHOLD FINANCE CORPORATION

Address: _____

City: _____ State: _____ Zip Code: _____

I hereby cancel my agreement with HFC to apply an agreed amount to my old loan.

Date _____ Signature _____

FORM 1

CUSTOMER COPY

(Attachment B)

[12] *Discussion*

The question presented in this proceeding is whether, under the stipulated facts including Attachments A and B, the amount of a reaffirmed debt previously discharged in bankruptcy is a cost of credit which must be disclosed to the borrower as part of the "finance charge" under the Truth in Lending Act and its implementing Regulation Z, rather than listed as part of the "amount financed," as has been the practice of respondent Household Finance. The Truth in Lending Act is the short title for Title 1 of the Consumer Credit Protection Act, legislated by Congress in 1968. 15 U.S.C. 1601, *et seq.* Pursuant to Section 1605(a) of the Act, as amended, the term "finance charge" is defined as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit . . ." Section 1604 provides that the Board of Governors of the Federal Reserve System shall prescribe regulations to carry out the purposes of the Truth in Lending Act. Pursuant to this mandate the Board issued Regulation Z, effective July 1, 1969, and amended October 28, 1975.

Regulation Z defines the term "finance charge" as "the cost of credit determined in accordance with Section 226.4" of the regulation. 12 C.F.R. 226.2(w). Section 226.4 provides that:

. . . the amount of the finance charge in connection with any transaction shall be determined as the sum of all charges, payable directly or indirectly by the customer, and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit, whether paid or payable by the customer, the seller, or any other person on behalf of the customer to the creditor or to a third party

Regulation Z enumerates several types of charges which must be included by the lender within the "finance charge," as well as certain charges excludable from the "finance charge." 12 C.F.R. 226.4(a)-(b). The import of this enumeration of charges to be included or excluded from the "finance charge" in the required disclosure statement is that if the payment is required by the lender as an incident to or a condition for granting the loan it must be listed as part of the "finance charge." [13]

Where insurance, for example, is required by the lender as a condition for the loan and the borrower must pay the premium, the latter must be included within the "finance charge." 12 C.F.R. 226.4(a)(5). On the other hand, if the borrower already owns a policy of insurance which the creditor requires to be assigned to him as a condition for the loan, the insurance is not written "in connection with" the loan transaction (provided the policy was not purchased

for use with the credit transaction), and premiums for such insurance are not "finance charges." 12 C.F.R. 226.4(a)(5) n. 3. Similarly, charges in connection with a checking account which involve credit extension must be included in the "finance charge" to the extent they exceed charges that a customer is required to pay "in connection with such an account where it is not being used to extend credit." 12 C.F.R. 226.4(a)(5) n. 2.

Appendix A of Regulation Z reiterates that the "finance charge" is "the total of all costs which . . . [a] . . . customer must pay, directly or indirectly, for obtaining credit." Appendix A further notes that some costs which would be paid by the borrower in any event "if credit were not employed" may be excluded. In sum, costs payable for obtaining a loan are part of the "finance charge," and costs which the borrower would have to pay regardless of whether or not a loan were obtained are not part of the "finance charge."

The purpose of the Truth in Lending Act is to assure that every consumer who has need for credit is given meaningful information of the true cost of that credit enabling the consumer to compare better the credit terms offered from various sources and thereby avoid the uninformed use of credit. 15 U.S.C. 1601(a); *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 363-65 (1972); *Joseph v. Norman's Health Club, Inc.*, 532 F.2d 86, 90 (8th Cir. 1975). This is to be accomplished by stating the cost of credit by items and in dollars in a disclosure of the "finance charge" to be provided every customer seeking consumer credit.

The discharge of a debt in bankruptcy releases a debtor from any legal compulsion to repay the debt. A discharge in bankruptcy enjoins all creditors whose credit extensions have been discharged from thereafter instituting or continuing any action or employing any process to collect such debts as personal liabilities of the bankrupt. 11 U.S.C. 32(f). The foregoing provides: [14]

(f) An order of discharge shall -

(1) declare that any judgment theretofore or thereafter obtained in any other court is null and void as a determination of the personal liability of the bankrupt with respect to any of the following [debts] . . . and

(2) enjoin all creditors whose debts are discharged from thereafter instituting or continuing any action or employing any process to collect such debts as personal liabilities of the bankrupt.

A debt discharged in bankruptcy, therefore, is uncollectable by legal process although it is not forgiven or cancelled. *Wagner v. United States*, 573 F.2d 447, 453 (7th Cir. 1978); *Binnick v. Avco Financial Services of Nebraska*, 435 F. Supp. 359, 363 (D. Neb. 1977). *Collier on*

Bankruptcy, Section 17.33 (14 Ed.), states "The general rule is that a discharge affects only the remedy of the creditor and the obligation itself is not cancelled."

Since neither forgiven nor cancelled, a discharged debt may be rendered legally enforceable again if reaffirmed by the discharged debtor. According to *Collier, supra*:

The law in the various states governs this matter, and it is generally agreed that the bar of a discharge may be waived by the making of a new promise. In reaching this decision, the courts have employed various theories; some courts have found consideration for the new promise in the form of a past legal obligation plus a present moral obligation, while other courts have declared that no new consideration is necessary to support the waiver.

Accordingly, when a debtor reaffirms, promising to pay to Household Finance a debt discharged in bankruptcy in order to obtain a new loan, a legally enforceable obligation against him or her is created which previously did not exist. Respondent has cited many state court cases to this effect (RPF, pp. 13-16 and Appendix to RPF Table of Authorities). [15]See also *Kessler v. Department of Public Safety*, 369 U.S. 153, 169-70 (1962); *Zavelo v. Reeves*, 227 U.S. 625, 629 (1913); *Girardier v. Webster College*, 563 F.2d 1267, 1272 (8th Cir. 1977); *Zabella v. Pakel*, 242 F.2d 452, 454 (7th Cir. 1957); *In re Innis*, 140 F.2d 479, 481, (7th Cir. 1944), *cert. denied*, 322 U.S. 736 (1943); *Shepherd v. McDonald*, 61 F. Supp. 948, 953 (D. Ore. 1945), *rev'd on other grounds*, 157 F.2d 467, 468 (9th Cir. 1946), *cert. denied*, 329 U.S. 802 (1947). The Supreme Court, in *Kessler*, stated, 369 U.S. at 170:

... a moral obligation to pay the debt survives discharge and is sufficient to permit a State to grant recovery to the creditor on the basis of a promise subsequent to discharge, even though the promise is not supported by new consideration . . .

A debtor, after reaffirmation, can thus be forced through legal process to pay money which, until reaffirmation, Household Finance could not collect through legal process. Under these circumstances, the additional legally enforceable liability of a borrower, arising from reaffirmation, to pay all or part of a previously discharged debt is clearly a "cost" of a new loan granted by Household Finance.

This "cost" of credit, furthermore, is exacted as an incident to or a condition for the grant of credit. Unless an applicant for a loan who has had a prior debt to Household Finance discharged in bankruptcy, in whole or in part, will reaffirm all or part of the prior discharged debt, Household Finance will not grant a new loan. See Finding 10. The "Statement of Rights, Agreement and Cancellation Notice" (Attachment B) leaves no doubt, telling borrowers clearly that "[t]o obtain a new loan you will be required to repay all or part

of your outstanding debt to HFC that was discharged in bankruptcy." See also Finding 11.

Although the Act itself is unambiguous on the point, it has been specifically held that a tying relationship between the imposition of a charge and the extension of credit renders the former a "finance charge." *Mondik v. DiSimo*, 386 F. Supp. 537 (W.D. Pa. 1974). It has been held that the assumption by a borrower of the preexisting debt of another as a condition for obtaining a loan results in a "cost" or "charge" which must be disclosed in the "finance charge." *Campbell v. Liberty Financial Planning, Inc.*, 422 F. Supp. 1386 (1976). No reason would seem to exist for [16] a different result when a borrower is required to reaffirm his own debt previously discharged in bankruptcy. In both cases the borrower is saddled with a legally enforceable monetary obligation which he or she did not previously have as a condition for being granted new credit. Further precedent can be found in cases involving other kinds of costs, for example, unearned non-rebated insurance premiums, *Ives v. W.T. Grant Company*, 522 F.2d 749, 760 (2nd Cir. 1975), *Welmaker v. W.T. Grant Company*, 365 F. Supp. 531, 538-39 (D. Ga. 1973), mandatory service contract, *Carney v. Worthmore Furniture, Inc.*, 561 F.2d 1100, 1103 (4th Cir. 1977), notary fees not mandatory under state law, *Buford v. American Finance Co.*, 333 F. Supp. 1243, 1247 (D. Ga. 1971), but see *George v. General Finance Corp of Louisiana*, 414 F. Supp. 33, 35 (E.D. La. 1976), delivery charges, *Mondik v. DiSimo*, *supra*, discounts on notes, *Joseph v. Norman's Health Club, Inc.*, *supra*. In the opinion of the undersigned, a discharged debt reaffirmed to obtain a new loan is a cost of credit and must be disclosed as such to the borrower as part of the "finance charge."

Respondent's Contentions

Household Finance denies that the amount of a discharged debt reaffirmed by a recipient of a new loan must be disclosed as part of the "finance charge." Respondent argues that because a discharge in bankruptcy does not wipe out the debt which continues to exist, and because reaffirmation is simply an agreement to pay an existing obligation which is enforceable without further consideration, reaffirmation cannot be a "charge" paid by a consumer to obtain a new loan (RPF, pp. 11-18; RRB, pp. 11-14).^{*} Household Finance further contends that because there is already an existing moral obligation, the agreement to reaffirm is sufficient to hold the consumer legally

^{*} Respondent's proposed findings are abbreviated "RPF" and respondent's reply brief is abbreviated "RRB."

liable to pay the reaffirmed debt without additional consideration or any new written instrument, and thus reaffirmation is wholly "independent" of a "subsequent extension of credit," *i.e.*, a new loan, and is not "imposed" on the consumer (RPF, p. 21; RRB, pp. 21-28). Since the borrower has the right to cancel within 10 calendar days, Household Finance argues that it has not "imposed [any] requirement on the consumer to pay the amount used to settle the reaffirmation" and that, for this reason also, there [17]has been no "charge" (RPF, p. 23). Adding to the argument that nothing has been "imposed" on the customer, respondent asserts that "most" borrowers reaffirm for reasons wholly unrelated to credit extensions or simply to "reestablish credit" and, therefore, reaffirmation is neither "imposed" nor "incident to the extension of credit" (RPF, p. 24).

As stated earlier, the purpose of the Truth in Lending Act is to ensure that consumers of credit receive meaningful disclosures of the costs or charges for credit. 15 U.S.C. 1601. The Act must be given a broad, liberal construction, not a technical, narrow one. *Sellers v. Wollman*, 510 F.2d 119 (5th Cir. 1975); *Eby v. Reb Realty, Inc.*, 495 F.2d 646 (8th Cir. 1974); *Pinkett v. Creditthrift of America, Inc.*, 430 F. Supp. 113 (D. Ga. 1977); *Gerasta v. Hibernia National Bank*, 411 F. Supp. 176 (D. La. 1976). The word charge means any pecuniary burden, expense or obligation. *Garza v. Chicago Health Clubs, Inc.*, 347 F. Supp. 955 (N.D. Ill. 1972); *Meyers v. Clearview Dodge Sales, Inc.*, 384 F. Supp. 722 (E.D. La. 1974). The assumption of a legally enforceable obligation to pay a discharged debt in order to secure new credit, where before such assumption there was at most a moral obligation unenforceable by legal process, is clearly a cost or charge. The borrower must now pay something which before reaffirmation he or she could not have been made to pay. Reaffirmation of a discharged debt is a cost or a charge within the meaning of the Truth in Lending Act notwithstanding the continued existence of the debt after discharge and a "moral obligation" to pay.

The fact that a borrower may have his or her own reasons for reaffirming a discharged debt does not mean that reaffirmation is not imposed by Household Finance. The statement of Household Finance to borrowers informing them that to obtain a new loan they are required to repay all or part of the debt discharged in bankruptcy refutes any contention that Household Finance does not impose reaffirmation. See Attachment B. See also Findings 10, 11 and 12. Even if, apart from Household Finance's requirement, debtors reaffirm their discharged debts to keep property pledged as security or to release co-makers, or the like, the plain fact is that they would not get a new loan if they refused to reaffirm. And, they are fully

advised of this condition by respondent when they apply for a new loan. Finding 12. The realities of the situation dictate that the prospect of a new loan must be a factor in motivating many borrowers to reaffirm discharged debts. [18]

Nor does the right of a borrower to rescind the reaffirmation of the discharged debt within 10 calendar days mean that there has been no imposition of a charge incident to the extension of credit. It should be noted, in connection with this argument, that prior to July 1, 1977, Household Finance did not offer borrowers the right to rescind an agreement to reaffirm debts previously discharged in bankruptcy. Respondent's argument on this point is not applicable to its failure to disclose the amount of the reaffirmed debt as part of the "finance charge" prior to that date. With respect to transactions subsequent to July 1, 1977, Section 1601 of the Truth in Lending Act requires that there be a full disclosure of credit terms to a borrower *before* the transaction is consummated so that there may be a comparison of the terms available from various sources and uninformed use of credit may be avoided. *White v. Arlen Realty & Development Corp.*, 540 F.2d 645 (4th Cir. 1974); *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257 (3rd Cir. 1975); *Philbeck v. Timmers Chevrolet, Inc.*, 499 F.2d 911, *rehearing denied*, 502 F.2d 1167 (5th Cir. 1974). At the time a new loan is negotiated reaffirmation has taken place, a cost or charge has been placed on the borrower and the disclosures required by the Truth in Lending Act are required to have been made.

Determinations that a reaffirmed debt is principal rather than interest in actions under state usury laws do not mean that the amount of the reaffirmed debt is not a cost of credit which must be disclosed under the Truth in Lending Act as a part of the "finance charge" (RPF, pp. 17-18). The term "finance charge" under Section 1605(a) of the Act includes not only interest but many other charges for credit. *H.R. Report* No. 1050, 90th Cong. 2nd Sess. (1967); *Joseph v. Norman's Health Club, Inc.*, 532 F.2d at 93. In *Campbell v. Liberty Financial Planning, Inc.*, 422 F. Supp. at 1391, the District Court held that the debt or another assumed by the borrower, although not interest, was a charge which had to be disclosed as a "finance charge" under the Truth in Lending Act.

Respondent argues, as already mentioned, that the requirement for reaffirmation of a discharged debt by an applicant for a new loan is not "incident to the extension of credit" because the reaffirmation transaction and the grant of a new loan are "wholly independent" (RPF, pp. 21, 24-25; RRB, pp. 21-28). In the instant setting this [19] argument is little more than the kind of "semantic posturing"

referred to by the court in *Campbell* in rejecting the claim that the borrower's assumption of the balance of his mother's discharged debt was a separate transaction not incident to the grant of the borrower's own loan. The contention that reaffirmation is a transaction wholly independent of the grant of a new loan is negated by respondent's straightforward advice to borrowers tying a new loan to the repayment of all or part of the outstanding debt to HFC that was discharged in bankruptcy. Attachment B; Findings 10-12.

Respondent contends (RPF, p. 22) that reaffirmed debts do not constitute a "finance charge" because they are not similar to the types of charges enumerated in Section 1605(a) of the Truth in Lending Act. That section, however, makes no pretense of being an exhaustive listing of finance charges. Nor is there any suggestion that every finance charge must be similar in nature to those listed. Additionally, it has been held that no charge other than those specifically listed in Section 1605(d) may be excluded from "finance charge" unless the exclusion "is approved by the [Federal Reserve Board] by regulation." 15 U.S.C. 1605(d)(4). In *Buford v. American Finance Company*, 333 F. Supp. 1243, 1247 (N.D. Ga. 1971), the court stated that "only those charges specifically exempted from inclusion in the 'finance charge' by statute or regulation may be excluded from it."

Respondent asserts that reaffirmation of a discharged debt as an incident to the grant of a new loan is governed by Section 226.8(j) of Regulation Z which relates to "Refinancing, consolidating or increasing" an existing extension of credit.* (RPF, pp. 25-26). Section 226.8(j) states: [20]

Refinancing, consolidating, or increasing. If any existing extension of credit is refinanced, or two or more existing extensions of credit are consolidated, or an existing obligation is increased, such transaction shall be considered a new transaction subject to the requirements of this part. . . .

Reaffirmation in whole or in part of a discharged debt in order to obtain a new loan does not constitute a "refinancing" of the old, discharged debt. Nor does it constitute the "consolidating" or "increasing" of a former extension of credit. It is not a financing "again or anew" or a "reorganization" of the debtor's finances. See *Webster's New International Dictionary*, 2nd Ed. Where no new loan is involved in the arrangement between a discharged debtor and his or her creditor, whereby a discharged debt is reaffirmed, the

* As already pointed out, a debt discharged in bankruptcy cannot be collected by legal process and any judgment respecting such debt is void as a determination of the personal liability of the bankrupt. 15 U.S.C. 32(f). A discharged debt, thus, has no enforceability by legal process. Following this reasoning, it can be argued that a discharged debt is not an "existing extension of credit" within the meaning of 12 C.F.R. 226.8(j).

disclosure requirements of the Truth in Lending Act and Regulation Z are irrelevant to this proceeding (RRB, pp. 14-18). As is clear from all that has been written hitherto, this proceeding concerns the disclosure requirements applicable in connection with a *new* loan to a discharged debtor who is required to repay all or part of the outstanding debt to Household Finance that was discharged in bankruptcy.

Respondent argues that requiring the inclusion of the amount of any reaffirmed debt in the disclosure of the "finance charge" would result in consumer confusion and would make comparison shopping between respondent and its competitors more, not less, difficult, contrary to the goals of the Truth in Lending Act. To prove this argument, Household Finance presents a hypothetical situation (RPF, pp. 30-32) involving a consumer who has borrowed money from respondent by pledging his automobile as security, and has thereafter gone through bankruptcy, having his or her debts discharged including \$500 owed to respondent. Subsequently, the discharged debtor wishes to keep his car upon being told by Household Finance that "it will repossess the automobile" and also desires to borrow "another \$600 to pay his bankruptcy attorney" (RPF, p. 31). Respondent then depicts the disclosures under the "finance charge" and "annual percentage rate" when the consumer borrows from Household Finance a new [21]\$600 to pay his lawyer and reaffirms the discharged \$500 (borrowing an additional \$500 to pay that also), and where the consumer borrows \$1100 from a rival loan company and no reaffirmation is involved. Respondent shows that the inclusion in its "finance charge" disclosure to the borrower of \$500 of discharged debt distorts the "annual percentage rate" so that the borrower appears to be receiving a better deal from Household Finance's competitor than from Household Finance, although the truth is to the contrary. This situation, of course, is only hypothetical, and may have little or no relation to reality. The fact that respondent can construct hypothetical cases where inclusion of a reaffirmed debt in the "finance charge" results in a distortion of the "annual percentage rate," when compared with an equivalent amount of a new loan by a competitor involving no reaffirmation, does not mean that the true cost of credit need not be disclosed by Household Finance as required by the Truth in Lending Act and Regulation Z. As emphasized earlier, reaffirmation of a discharged debt under the circumstances of this case is an incident to and a condition of the extension of credit. As such, the reaffirmation must be disclosed to the borrower as a cost of credit in the listing of such costs under the "finance charge."

Conclusions

By including the amount of the reaffirmed debt previously discharged in bankruptcy under the "amount financed" rather than under the "finance charge," in cases where discharged debtors apply for and are granted new loans by respondent provided that they reaffirm their discharged debts in whole or in part, Household Finance has failed to disclose accurately the "finance charge" and has thereby violated the Truth in Lending Act and Regulation Z. 15 U.S.C. 1605, 1639; 12 C.F.R. 226.4, 226.6, 226.8. Where the foregoing violation has occurred, it has resulted in other violations of the Truth in Lending Act and Regulation Z, as follows:

(1) Violation for failure to compute and disclose accurately the "annual percentage rate" on the new loan transaction to the nearest one quarter of one percent. 15 U.S.C. 1606, 1639; 12 C.F.R. 226.5(b), 226.6, 226.8. [22]

(2) Violation for failure to compute and disclose accurately the "amount financed" on the new loan transaction. 15 U.S.C. 1639; 12 C.F.R. 226.6, 226.8.

Respondent Household Finance Corporation does business nationwide (see Statement of Stipulated Facts including Attachments A and B) and its practices here involved are in or affect commerce as "commerce" is defined in the Federal Trade Commission Act and are subject to the jurisdiction of the Federal Trade Commission.

Remedy

Respondent Household Finance is a substantial firm engaged in the small loan business. The strong financial interest of Household Finance in obtaining reaffirmation of debts resulting from prior loans which have been discharged in bankruptcy is self-evident. The practice of encouraging reaffirmation of prior discharged loans, as such, is not an issue in this proceeding. But this proceeding is concerned with the right of borrowers to be adequately informed of the true cost of new loans when they do reaffirm debts discharged in bankruptcy as an incident to obtaining such new loans. Over a period of years small loan applicants who have had prior loans to Household Finance discharged in bankruptcy have been required to reaffirm such debts in whole or in part as an incident to obtaining new loans. Over such period, as stated earlier, respondent has violated the Truth in Lending Act and Regulation Z by failing to include the amount of the reaffirmed debt as part of the "finance charge," and by erroneously and improperly including it under "amount financed." Due to this practice borrowers who have reaffirmed their discharged debts to obtain new loans have not been

given the meaningful disclosure of the cost of such new loans that is required by law. Under the circumstances, an order is necessary.

The first sentence of the order issued herein prohibits Household Finance from failing to include in the disclosure of the "finance charge" the amount of any indebtedness by the borrower to Household Finance which was reaffirmed "as an incident to or condition of the extension of credit."

A basic dispute in this proceeding has been whether or not reaffirmation has been incident to or a condition for the granting of new loans to discharged debtors. [23]Household Finance has vigorously argued that reaffirmation has not been required by it as an incident to the grant of a new loan. The undersigned, however, has found the contrary to be the case. An order which simply prohibits failure to include the amount of a reaffirmed debt within the disclosure of the "finance charge" where reaffirmation is an incident to or condition of the extension of credit would be ineffective in this proceeding. The order must establish safeguards so that, where the amount of a reaffirmed debt is not listed as part of the "finance charge" disclosed in connection with a new loan, there will be a reasonable assurance that reaffirmation was not indirectly or implicitly exacted as an incident to or condition of the new loan.

Paragraph 1(a) provides that reaffirmation is not an incident to or condition of the extension of credit *only* if the reaffirmation is not required and is not a factor in the new extension of credit, the amount or the terms thereof. If the reaffirmation of a discharged debt is among the factors given consideration by Household Finance in making its decision to grant a new loan, then it is "incident to" the extension of credit as set out in Section 1605(a) of the Truth in Lending Act and Section 226.4 of Regulation Z.

Where reaffirmation is not specifically tied to a particular new loan but, rather, is allegedly required by Household Finance to restore a debtor to a "creditworthy" standing and, based on such standing, credit is later extended, reaffirmation must still be disclosed as a cost of credit under the "finance charge." Holding otherwise would open the door to evasion of the disclosure requirements of the Truth in Lending Act and Regulation Z in this case. If "fencing in" is necessary in this respect, that is within the authority of the Commission. *Federal Trade Commission v. National Lead Company*, 352 U.S. 419 (1957); *Federal Trade Commission v. Colgate Palmolive Co.*, 380 U.S. 374 (1957); *Jacob Siegel Co. v. Federal Trade Commission*, 327 U.S. 608 (1946).

If full compliance with the letter and intent of the Truth in Lending Act and Regulation Z is to be assured, the following must

also be provided. Before Household Finance may exclude the amount of a reaffirmed debt from the "finance charge," Household Finance must (1) make a clear and conspicuous written disclosure to the borrower of the amount of the debt to be reaffirmed, the fact that reaffirmation in whole or in part is not required by Household Finance and that reaffirmation is not a factor considered by Household Finance in granting the loan or in its terms or amount and (2) after the foregoing [24]disclosure has been made, Household Finance must receive from the borrower a separate written, signed and dated statement of the agreement to reaffirm.

Where Household Finance has excluded the amount of a reaffirmed debt from the "finance charge" in making a new credit extension, it must allow borrowers a "cooling off" period of 10 calendar days during which the reaffirmation may be rescinded by the borrower after he or she has received notification in writing of the right to rescind. Such an enforcement provision is reasonable, and is necessary to ensure that the requirements of the order herein are not evaded and that, where reaffirmation has occurred and the amount of the reaffirmed debt has not been listed under the "finance charge," reaffirmation has not been a motivating factor in the grant of the new credit. Bankrupt members of the public are likely to have a genuine need for credit and are likely to be in a poor bargaining position vis-a-vis respondent. In such cases, reaffirmation may be exacted tacitly as the price or part of the price of a new loan notwithstanding the provisions of the order. Respondent now provides a "cooling off" period of 10 calendar days to borrowers who have reaffirmed discharged debts (Attachments A and B), so no additional burden is placed upon respondent by incorporation in the instant order of the requirement for a "cooling off" period.

To reiterate, such a "cooling off" period would only apply where the amount of the reaffirmed debt has not been included in the disclosure of the "finance charge." In such cases where a borrower subsequently rescinds his or her reaffirmation, the obligations of the borrower should be no different from what they would have been had there been no reaffirmation and rescission thereof.

The purposes of Paragraphs 2, 3 and 4 of the order are self-evident. Paragraph 5 is a broad provision prohibiting Household Finance from failing to make any of the disclosures required by the Truth in Lending Act and Regulation Z. Once a violation has occurred the public should not have to undertake the high costs of investigation and adjudication to stop other and future violations. *Federal Trade Commission v. National Lead Co., supra; Zale Corporation*, 78 F.T.C.

1195 (1971), *aff'd* *Zale Corp. v. Federal Trade Commission*, 473 F.2d 1317 (5th Cir. 1973).

Respondent argues that the Bankruptcy Act of 1978 obviates the need for an order in this proceeding (RRB, pp. 40-42). On November 6, 1978, the foregoing became law. 15 U.S.C. 525. The new Act sharply curtails the legal enforceability of reaffirmed debts previously discharged in bankruptcy. Subsequent to [25]October 1, 1979, neither respondent nor any other consumer loan company will be able to obtain a legally enforceable claim merely by securing a written reaffirmation of a discharged debt as part of a new loan transaction. In order to enforce a reaffirmed discharged debt, specific procedures set out in the new Bankruptcy Act will have to be followed after October 1, 1979, including a hearing before the court which granted the discharge in bankruptcy. 11 U.S.C. 525(c) and (d).

However, these procedures do not render relief herein unnecessary. The new Act states that a case commenced under the prior Act shall be conducted as if the subsequent Act had not been enacted, and that the rights of the parties shall be governed by the prior Act. Complaint counsel point out that there are the following substantial categories of the public where reaffirmation would not be affected by the new Bankruptcy Act (Memorandum in Support, pp. 30-33):

(1) Members of the public who have had debts to Household Finance discharged in bankruptcy and who may seek new loans from Household Finance;

(2) Members of the public who are now presently in bankruptcy proceedings and whose debts to Household Finance will ultimately be discharged, and who may seek new loans from Household Finance;

(3) Members of the public who will file petitions in bankruptcy prior to October 1, 1979 and who will have debts to Household Finance discharged and who may seek new loans from Household Finance.

As to these categories of the public, an order is necessary to ensure that proper disclosure of the "finance charge" and the "amount financed" be made, and that there is a proper calculation and disclosure of the "annual percentage rate."

Furthermore, even after October 1, 1979, an order is necessary to ensure that Household Finance makes the proper disclosures. It may well be that substantial numbers of debtors will reaffirm debts discharged in bankruptcy after the hearing required by 11 U.S.C. 524(d). As to these debtors, disclosures of the "finance charge," "amount financed" and "annual percentage rate" must be properly

made as required by the Truth in Lending Act. The new Bankruptcy Act does not address the matter of disclosures to those obtaining credit. To ensure that the required disclosures are made, an order is required. [26]

ORDER

It is ordered, That respondent Household Finance Corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with any extension of consumer credit or advertisement to aid, promote or assist, directly or indirectly, any extension of consumer credit, as "consumer credit" and "advertisement" are defined in Regulation Z (12 C.F.R. 226) of the Truth in Lending Act (15 U.S.C. 1601, *et seq.*, as amended), do forthwith cease and desist from:

1. Failing to include and treat as part of the finance charge, as "finance charge" is defined by Sections 226.2(w) and 226.4(a) of Regulation Z, the amount of any indebtedness by the borrower to respondent, previously discharged in bankruptcy, which was reaffirmed as an incident to or a condition of the extension of credit.

In connection with this Order, a reaffirmation is not an incident to or a condition of the extension of credit *only* if:

(a) the reaffirmation is not required by respondent and is not a factor in or connected with respondent's approval of the extension of credit or its terms or the amount of credit extended; and

(b) any borrower who consummates a consumer credit transaction with respondent and who reaffirms a discharged debt to respondent, in whole or in part, executes a separately signed and dated written statement of the agreement to reaffirm after first receiving from respondent a clear and conspicuous written disclosure of (1) the amount of the reaffirmation and (2) that such reaffirmation is not required by respondent and is not a factor in or connected with respondent's approval of the extension of credit or its terms or the amount of credit extended. [27]

2. Failing to compute and disclose accurately the finance charge, as required by Sections 226.4(a) and 226.8(d)(3) of Regulation Z.

3. Failing to compute and disclose the annual percentage rate, as "annual percentage rate" is defined in Sections 226.2(g) and 226.5(b) of Regulation Z, accurately to the nearest quarter of one percent, as required by Sections 226.5(b) and 226.8(b)(2) of Regulation Z.

4. Failing to compute and disclose accurately the amount financed, as "amount financed" is defined by Sections 226.2(f) and 226.8(d)(1) of Regulation Z, as required by Section 226.8(d)(1) of Regulation Z.

5. Failing in any consumer credit transaction or advertisement, to make all the disclosures that are required by Sections 226.4, 226.5, 226.6, 226.7, 226.8, 226.9 and 226.10 of Regulation Z in the manner, form and amount specified therein.

6. Failing to maintain records of compliance with this Order for three years after the date of this agreement to cease and desist.

It is further ordered, That respondent shall grant to each borrower who consummates a consumer credit transaction with respondent and who reaffirms a discharged debt to respondent, in whole or in part, which is not disclosed as part of the "finance charge" on a new consumer credit transaction, 10 calendar days within which to cancel the reaffirmation by notifying the respondent in writing of the borrower's election to do so.

The foregoing period shall begin to run upon receipt by the borrower of the notices described in the next paragraph of this provision. The borrower's notification of cancellation of his or her reaffirmation, if done by mail, shall be deemed to have been made at the time mailed; if by telegram, mailgram or the like, notification shall be deemed to have been made at the time filed for transmission; and, if the writing is delivered by other means, notification shall be deemed to have been made at the time delivered to the respondent's place of business. [28]

Respondent shall mail to each such borrower the notices set forth in Attachments "1" and "2" to this Order no earlier than two (2) days and no later than fifteen (15) days following consummation of the consumer credit transaction.

If a borrower exercises his or her right to cancel the reaffirmation of a previously discharged debt, then such borrower shall not be obligated to repay the amount of the reaffirmation and any finance charges assessed thereon. Furthermore, the borrower's periodic payments on any debt to respondent remaining after cancellation of the reaffirmation shall be no larger than they were prior to the cancellation.

It is further ordered, That respondent shall forthwith deliver a copy of this Order to cease and desist to all present and future employees who are engaged in the solicitation or extension of consumer credit and shall secure from each such employee a signed

statement acknowledging receipt of this Order and stating the intention to be bound by the requirements hereof.

It is further ordered, That respondent shall notify the Commission within thirty (30) days prior to any 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 or any other change in the corporation which may affect compliance obligations arising out of this Order.

It is further ordered, That the respondent herein shall, within sixty (60) days after service upon it of this Order, file with the Commission a report in writing, setting forth in detail the manner and form in which it has complied with this Order and file such other reports as the Commission may require.

ATTACHMENT 1

NOTICE OF RIGHT TO CANCELLATION

Name of _____

(Respondent)

Address of _____

(Respondent)

Name of _____

(Customer)

Address of _____

(Customer)

Dear Customer:

You recently took out a loan with HFC. At that time, you also agreed to repay us an old debt of \$ _____. This old debt had been discharged when you went bankrupt.

You did not have to agree to repay the discharged debt in order to get a loan. We want to be sure you understood that, so we are giving you a chance to cancel *within ten days* your agreement to repay your discharged debt. If you cancel, the \$ _____ discharged debt and its finance charges will be dropped. But you will still have to repay the \$ _____ you actually got, plus \$ _____ in finance charges. Your monthly payments will be no larger than they are now.

You have *TEN DAYS* from the day you get this letter to cancel your agreement to repay your discharged debt. *If you want to cancel, you must notify us in writing within ten days.* Use the enclosed notice or send a letter or telegram to the address above.

Sincerely,

ATTACHMENT 2

NOTICE OF CANCELLATION

To _____
(Name of Respondent)

(Address of Respondent)

Please cancel my agreement to repay my old discharged debt of \$ _____.

(Date)

(Borrower)

OPINION OF THE COMMISSION

BY PERTSCHUK, *Commissioner*:

I. INTRODUCTION

The complaint in this case charges Household Finance Corporation (HFC) with violations of the Truth in Lending Act (TILA), 15 U.S.C. 1601, *et seq.*, and its implementing Regulation Z, 12 C.F.R. 226. The complaint alleges that HFC, a consumer loan company, has been violating the TILA and Regulation Z by not including the amount of reaffirmed debts in the "finance charge" of later loans. The complaint avers that a debt discharged in bankruptcy must be reaffirmed by the debtor in order to obtain new credit from HFC, and thus is a cost of credit which under the TILA and Regulation Z must be disclosed in the "finance charge." Complaint counsel seek an order which, *inter alia*, would require HFC to include the amount of the reaffirmed debt in the finance charge and to compute and disclose accurately the finance charge, annual percentage rate, and "amount financed" (amount of credit extended to the customer).

Following issuance of the complaint on July 10, 1978, complaint counsel and respondent HFC agreed in lieu of trial to a "Statement of Stipulated Facts" to serve as the sole factual record for this proceeding. On March 16, 1979, Administrative Law Judge Hanscom found HFC to be in violation of the TILA and Regulation Z as alleged in the complaint. The ALJ's order would require HFC to disclose, as part of the finance charge, the amount of discharged debt reaffirmed in connection with subsequent grants of credit to the debtor. It also defines when reaffirmation would not be a condition [2] of credit and thus would not have to be disclosed in the finance charge; provides

for a 10-day cooling-off period following consummation of the subsequent loan transaction where the amount of the reaffirmed debt has been excluded from the finance charge; and requires compliance with all disclosure provisions of Regulation Z.

On April 5, 1979, HFC served notice of its intention to appeal the ALJ's decision. On appeal complaint counsel argue in support of the conclusions and order issued below and do not cross-appeal on any issues.

For the reasons discussed below, the Initial Decision and Order are reversed and the complaint in this matter is dismissed.

II. STATEMENT OF THE FACTS

The ALJ's Findings of Fact repeat virtually verbatim the parties' "Statement of Stipulated Facts." They establish the following.

For the past several years, many borrowers of HFC have filed petitions for bankruptcy, been adjudged bankrupt, and obtained discharges of their indebtedness to HFC. I.D.F. 4-5.¹ In many instances HFC then has notified discharged debtors that upon reaffirmation of a part or all of their discharged debts, and if they are otherwise eligible for credit, it would reestablish their credit with HFC and shortly thereafter grant them new loans. I.D.F. 6. Many discharged debtors then have sought new loans from HFC. I.D.F. 7. [3]

During negotiations for new loans, discharged debtors and HFC discussed the question of reaffirmation of part or all of the consumer's debt to HFC. I.D.F. 9. Pursuant to HFC policy and practice, consumers in these negotiations were informed by HFC employees that reaffirmation was necessary to reestablish their

¹ The following abbreviations of citations are used herein:

- | | |
|--------|--|
| I.D.F. | - Initial Decision Finding of Fact No. |
| I.D. | - Initial Decision Page No. |
| CB | - Complaint Counsel's Memorandum of Law in Support of Proposed Findings of Fact, Conclusions of Law, and Order |
| RB | - Respondent's Memorandum of Law in Support of Proposed Findings of Fact, Conclusions of Law, and Order |
| CR | - Complaint Counsel's Reply Memorandum of Law and Objections to Respondent's Proposed Findings of Fact |
| RR | - Respondent's Reply to Complaint Counsel's Proposed Findings of Fact |
| CAB | - Complaint Counsel's Appeal Brief Page No. |
| RAB | - Respondent's Appeal Brief Page No. |
| RRAB | - Respondent's Reply Appeal Brief Page No. |

credit with HFC and that part of any new loan from HFC had to be used to repay part or all of their previously discharged debt to HFC. I.D.F. 12. On or around June 29, 1977, employees of HFC were instructed by a Home Office Memorandum that in any discussion of reaffirmation or a new loan, the bankrupt must be advised that there is no legal obligation to repay the discharged debt, but that part of any new loan must be used to settle the discharged debt. Attachment A (p. 1) to I.D.F.

From July 1, 1977 to the present, bankrupt consumers of HFC have received a "Statement of Rights, Agreement and Cancellation Notice" from HFC. I.D.F. 17. This Statement (Attachment B) appraises them, among other things, that they have no legal obligation to repay any part of their discharged debt to HFC but that to obtain a new loan they will be required to agree to repay all or part of their outstanding debt to HFC. The Statement also informs them that they may cancel within 10 days their agreement with HFC to use part of the new loan to repay the old but that if they do cancel, they are still required to pay off the new loan.

Discharged debtors of HFC thus know that they must reaffirm part or all of their debts to HFC before obtaining new loans. Many of them have reaffirmed and obtained new loans for one or more of the following reasons: (a) to retain collateral from the prior debt owed HFC; (b) to secure the release of a co-maker's obligation to repay the prior debt; (c) to settle bankruptcy court litigation over the prior debt; and (d) to reestablish credit with HFC. I.D.F. 10.²

Respondent HFC imposes a finance charge on the new loans made to reaffirming debtors. I.D.F. 13. This charge applies both to the part of the loan granted to repay the prior debt and to the part which represents new money paid to the consumer. I.D.F. 13. For these loans, HFC's truth-in-lending disclosure policy has been that the amount of the [4]reaffirmed debt to be paid from part of the new loan is disclosed in the amount financed rather than the finance charge. I.D.F. 14. It is acknowledged that if the amount of the reaffirmed debt were made part of the finance charge, the annual percentage rate for the loan would be increased. I.D.F. 15.

In addition to HFC, many of its competitors require reaffirmation before reextending credit to discharged debtors and disclose the amount of the reaffirmed debt in the amount financed rather than

² It should be noted that after the complaint in this case was issued, severe restrictions were placed on contractual reaffirmation of discharged debts by the Bankruptcy Reform Act of 1978, Pub. Law 95-598, 11 U.S.C. 525(c) and (d). Under this law, reaffirmation agreements are unenforceable absent approval, following a judicial hearing, by the court which granted the discharge in bankruptcy. *But see Marathon Pipeline Co. v. Northern Pipeline Construction Co.*, 49 U.S.L.W. 1173 (April 23, 1981) (jurisdictional provision of Act delegating new authority to bankruptcy court judges declared unconstitutional; order dismissing case stayed pending appeal).

the finance charge of the new loan. I.D.F. 24. Until this proceeding was initiated, neither the Commission nor the Federal Reserve Board had challenged this practice in any formal proceeding. I.D.F. 25.

III. DISCUSSION

The legal issue presented is whether a creditor must disclose in the finance charge the amount of debt reaffirmed with respect to a loan transaction in which a portion of the loan proceeds is used to pay off the reaffirmed debt. The Administrative Law Judge answered this question in the affirmative. I.D. at 21. HFC's appeal challenges the Initial Decision on the following grounds:

One, the Commission lacks jurisdiction in this case because the record fails to show that the challenged practices were in or affected interstate commerce. RAB at 7.

Two, the transactions in issue are "refinancings" under Regulation Z, in which the amount of a reaffirmed debt is disclosed in the "amount financed." RAB at 20-25.

Three, assuming the transactions in issue are found to be new loans rather than refinancings, mandatory reaffirmation is not a condition for receiving a specific loan from HFC, and thus is not a cost of credit within the definition of finance charge in the TILA and Regulation Z. RAB at 6.

Four, the order entered below is not in the public interest because it will create a result contrary to the purposes of the Truth-in-Lending Act. Id.

Five, the order entered by the ALJ exceeds the Commission's statutory authority and is overbroad. RAB at 7.

A. Jurisdiction

The Commission's jurisdiction in this matter rests on Section 108(c) of the TILA, 15 U.S.C. 1607, which states that violations of that Act shall also be violations of the requirements of the Federal Trade Commission Act, as amended, 15 U.S.C. 41 *et seq.* Section 108(c) specifically provides in part that: [5]

... All of the functions and powers of the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with the requirements imposed under this title *irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act.* (emphasis added)

By its terms, Section 108(c) does not require a showing that the

challenged practices are in or affect interstate commerce. Nevertheless, respondent HFC alleges that a relationship to interstate commerce is the test of jurisdiction here, and that the record does not permit such a finding. RAB at 24-37.³ Respondent's jurisdictional argument is without merit. The Commission explicitly has jurisdiction in this case.

B. *The Nature of the Transaction*

The answer to the TILA disclosure question presented depends on whether the transaction in issue is a new loan subject to the finance charge disclosure requirements of Section 226.4(a) of Regulation Z, 12 C.F.R. 226.4(a),⁴ or a refinancing within the meaning of Section 226.8(j) of Regulation Z, 12 C.F.R. 226.8(j).⁵ The Commission [6] believes it is a refinancing in which the amount of the reaffirmed debt should be disclosed in the "amount financed."⁶

HFC's loans to bankrupt customers involve reaffirmation of an existing but discharged obligation coupled with the advancement of new money.⁷ Although these "hybrid" transactions appear at first blush to be new loans, as the Commission had reason to believe when it issued the complaint and as the ALJ found, I.D. at 20, closer scrutiny, aided by the record and the arguments of the parties, reveals that they are more in the nature of refinancings.⁸

³ Respondent may be laboring under the false impression that this is a case brought under Section 5 of the FTC Act, which has an "in or affecting commerce" provision. Respondent may have formed this impression from the ALJ's conclusion that the alleged practices meet the "commerce" test of jurisdiction in the FTC Act. I.D. at 22. Since jurisdiction rests on Section 108(c) of the TILA, which explicitly overrides the jurisdictional requirements of the FTC Act, the ALJ need not have made this finding and the Commission need not examine the factual basis for it.

⁴ Section 106(a) of the TILA, as amended, 15 U.S.C. 1605(a), and Section 226.4(a) of Regulation Z combine to define "finance charge" as the "sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit."

⁵ Section 226.8(j) provides: "Refinancing, consolidating, or increasing. If any existing extension of credit is refinanced, or two or more existing extensions of credit are consolidated, or an existing obligation is increased, such transaction shall be considered a new transaction subject to the disclosure requirements of this Part. For the purpose of such disclosure, any unearned portion of the finance charge which is not credited to the existing obligation shall be added to the new finance charge and shall not be included in the new amount financed."

⁶ In a refinancing of this type, the prior debt is included in the "amount financed" while the unearned interest from, but not credited to, the prior obligation is added to the new finance charge. See Section 226.8(j) of Regulation Z.

⁷ Although a debt discharged in bankruptcy is unenforceable by an action *in personam* against the debtor, Section 14 of the Bankruptcy Act, as amended, 11 U.S.C. 32, it is a continuing obligation collectable by other legal means, such as a counterclaim, *Binnick v. Avco Financial Services of Nebraska*, 435 F. Supp. 359 (D. Neb. 1977), or retention of security, *In re Traham*, 283 F. Supp. 620, *aff'd*, 402 F. 2d 797, *cert. denied*, 394 U.S. 930 (1969). Legally, the debt survives the discharge and is neither forgiven nor cancelled. *Kessler v. Dept. of Public Safety*, 369 U.S. 153, 170 (1961), citing *Zavala v. Reeves*, 227 U.S. 625 (1913); W. Collier, 1A *Collier on Bankruptcy* Section 17.33 (14th Ed. J. Moore and L. King ed. 1971). Reaffirmation thus does not create a new debt; it simply reactivates an existing one. The ALJ's contrary assertion that a discharged debt is not an "existing extension of credit," within the meaning of Section 226.8(j) of Regulation Z, disregards the continuing nature and legal enforceability, in certain circumstances, of the obligation. See I.D. at 19.

⁸ It is noteworthy, although hardly dispositive, that HFC's instructions to employees on these transactions are contained in a memo entitled "Bankruptcy Refinancing Agreements." See Attachment A.

The fundamental nature and purpose of these transactions is the satisfaction of an existing obligation. Reaffirmation is the central element of a process whereby funds become available to the bankrupt consumer to pay back an existing loan. [7] It is directly related to the satisfaction of a continuing obligation and only indirectly related to "new" extensions of credit. If anything, the simultaneous advance of additional money creating a new obligation is an "incident to" the core transaction enabling repayment of the reaffirmed loan, and does not alter its fundamental character as a refinancing. The loan does not create a new obligation in the first instance; it merely resolves an existing one by being applied, at least in part, toward repayment of the reaffirmed debt.

HFC's purpose in providing these initial loans to bankrupt consumers also supports the conclusion that they are refinancings dedicated to satisfying existing obligations. The extension of credit in connection with an existing debt is designed principally to return HFC and the borrower to the *status quo* that existed before the debt was discharged in bankruptcy. The grant of money in connection with the reaffirmation enables, in fact requires, the borrower to use at least part of the loan to pay off the debt owed before bankruptcy, to the benefit of HFC. Thus, it is reasonable to assume that HFC's immediate interest in resuming a credit relationship with a discharged debtor, subject to a requirement to reaffirm, is to recover the proceeds of the existing loan plus interest accrued on it;⁹ otherwise, HFC would have little reason to require reaffirmation by discharged debtors seeking further extensions of credit.

From the borrower's standpoint, reaffirmation represents more than a price for an individual loan. It enables the consumer to reestablish credit with HFC, retain or recover collateral on the prior loan, secure the release of a co-maker's obligation to repay the earlier debt, and settle bankruptcy litigation. I.D.F. 10. Indeed, most bankrupt customers of HFC had one or more of these purposes in mind when they reaffirmed their debts. *Id.* Thus, while HFC's reaffirmation agreements are related to specific extensions of credit, their broader function is to ensure repayment of the earlier loan and enable HFC and the bankrupt consumer to pursue their respective interests in resolving the earlier transaction. This aspect of reaffirmation in connection with an advance of money distinguishes it from other charges, such as interest or loan fees, which are imposed and paid solely for the purpose of financing new loans. [8]

The views of the Federal Reserve Board are of course highly

⁹ This assumption is reinforced by the fact that HFC had the contractual right to enforce reaffirmation agreements whether or not the related loan transaction was consummated. See Attachment A, RAB at 18-20.

relevant to the Commission's determination about the nature of the credit transactions involved in this case.¹⁰ While no official opinion of the Board itself has directly addressed the issue in this case, the Board's staff has said formally that reaffirmations are refinancings under Section 226.8(j) of Regulation Z.¹¹ In FRB staff Opinion Letter No. 415, CCG ¶ 30,604 (October 29, 1970), reaffirmed in staff Opinion Letter No. 426, CCG ¶ 30,613 (November 24, 1970), the Board staff said:

It is our view that Section 226.8(j) which requires new disclosures whenever any existing extension of credit is refinanced would apply to any reaffirmation *except* those which involve no change in the credit terms . . . if any additional amounts were advanced . . . or any other material terms of the original obligation modified, we would view it as a 'refinancing' under Section 226.8(j) requiring new disclosures. (emphasis in original)

Five years later, the FRB staff published Opinion Letter No. 966 which is relied upon by complaint counsel because it suggests, by negative implication, that where reaffirmation of an existing debt is a condition of a specific extension of credit, it should be disclosed in the [9]finance charge.¹² This opinion expressly did not deal with such a situation, however, and the Board staff has had occasion in a specific case to look closely at the true character of a transaction like the one involved in this proceeding. Further, Letter No. 966 did not repudiate or otherwise limit the staff's previously stated position that any reaffirmation involving a change in credit terms, including one in which new money is advanced, is a refinancing.

Asserting serious ambiguity in the FRB staff's position, complaint counsel filed a motion on December 3, 1979, following oral argument, urging the Commission to ask the Board to file a statement of its views in this case.¹³ The Commission does not believe the Board

¹⁰ An important consideration in TILA matters before the Commission is the formal position of the Federal Reserve Board, which is recognized as the primary issuer of regulations and interpreter of the law in this area. Section 105 of the TILA, 15 U.S.C. 1604; *Ford Motor Credit v. Milhollin*, 100 S.Ct. 790, 794, citing *Mourning v. Family Publications Service Inc.*, 411 U.S. 356, 93 S.Ct. 1652 (1973). Indeed, good faith reliance upon a Board interpretation now constitutes a defense to any enforcement action brought by the Commission. Section 23(b) of the Federal Trade Commission Act, as amended by the FTC Improvements Act of 1980, 15 U.S.C. 57b-4.

¹¹ The official interpretations of the Board's staff are a reliable indicator of Board policy and are accorded substantial deference by the credit industry, Section 130(f) of TILA, 15 U.S.C. 1640(f), FRB Letter No. 444, CCG ¶ 30,640 (March 1, 1971), the courts, see, e.g., *Ford Motor Credit v. Milhollin*, *supra*, at 797, and by the Commission.

¹² FRB staff Opinion Letter No. 966, CCG ¶ 31,305 (December 4, 1975). This letter states, in pertinent part: Staff believes that the amount of the reaffirmed debt should not be included in the finance charge or reflected in the annual percentage rate on any future extensions of credit to the debtor. Although the reaffirmation is a prerequisite to the bank's consideration of future credit applications by the debtor, the reaffirmation is not related to any particular credit extension; it is simply one element in the bank's decision to make its credit services in general available to the debtor. Since the reaffirmation is not a condition of a specific credit extension, the amount of the reaffirmed debt would not, in staff's view, come within the definition of a finance charge under Section 226.4(a) of the Regulation.

¹³ Prior to this motion, complaint counsel also had filed a motion, dated November 21, 1979, requesting that the Commission disregard an October 18, 1979 FRB staff letter (Attachment A to the motion) on reaffirmations presented by respondent for the first time at the oral argument. Complaint counsel argue in their motion that this

(Continued)

staff's expressed views, taken together, leave significant room for dispute. Although Letter 966 may have created some ambiguity in the treatment of reaffirmations, there has been no significant modification of the Board staff's earlier opinion that reaffirmations coupled with advancements of new money are refinancings. The Commission's decision today is consistent with that position. [10]

In addition, since issuance of the complaint in this proceeding, Congress has amended the Truth-in-Lending Act¹⁴ and the Board has revised Regulation Z.¹⁵ The new regulation, which became effective on April 1, 1981 but does not become enforceable until March 31, 1982, significantly redefines a "refinancing."¹⁶ In explaining the revised definition, the Board said that it "most closely resembles the events intended to be covered by refinancing disclosures." 46 *Fed. Reg.* at 20882. By its terms, the new definition seems to encompass HFC's loans to bankrupt consumers, which involve repayment of an existing obligation and assumption of a new one (through the advancement of additional money) by the same person. Furthermore, the exemption from *refinancing* disclosures for agreements, *including reaffirmations*, that arise from a judicial proceeding,¹⁷ indicates that the Board agrees with its staff that loans involving reaffirmation are refinancings. These loans are subject to the redisclosure requirements of Section 226.20, as revised, and not to the finance charge provisions of Section 226.4(a) of the regulation (unchanged from the old).

The Commission thus does not believe the Board's position needs to be clarified. Accordingly, complaint counsels' motion for clarification is denied. [11]

C. The Relationship of the Proposed Order to the Purposes of the TILA.

The Commission holds today that the cost of reaffirmation should be included in the amount financed rather than the finance charge. This conclusion is corroborated not only by the position of the

letter had not been placed on the public record of this matter, was not an official interpretation of the FRB staff, and had not been made public by the Board. Complaint counsel thus contend that they had no reasonable opportunity to know about the letter or prepare a rebuttal to it. Because consideration of this letter is unessential to a proper decision of this case, complaint counsels' motion to disregard it is granted.

¹⁴ Truth-in-Lending Simplification and Reform Act (Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132).

¹⁵ Truth-in-Lending; Revised Regulation Z, 46 *Fed. Reg.* 20848 (April 7, 1981).

¹⁶ Section 226.20(a) of Regulation Z, as revised, states that a refinancing occurs "when an existing obligation that was subject to this subpart is satisfied and replaced by a new obligation undertaken by the same consumer The new finance charge shall include any unearned portion of the old finance charge that is not credited to the existing obligation."

¹⁷ See Section 226.20(a)(3) and 46 *Fed. Reg.* 20882 where the Board, amplifying upon Paragraph (a)(3), indicates that exempt agreements include reaffirmations of debts discharged in bankruptcy.

Federal Reserve Board, but by respondent's showing of the adverse effects that the proposed finance charge disclosure could have on credit comparisons.

Respondent argues that the proposed disclosure requirement would distort comparison-shopping for credit by bankrupt customers and foster the false impression that a competitor disclosing an amount equal to the prior debt in the amount financed was offering a better deal than HFC.¹⁸ Respondent purports to show that if the amount of the reaffirmed debt has to be disclosed in the finance charge by HFC, the "annual percentage rate" could be substantially distorted, thereby misleading consumers into making erroneous comparisons and economically irrational credit purchasing decisions. This result would [12]contravene Congress' stated intention in Section 102(a) of the TILA, 15 U.S.C. 1602, to promote well-informed comparison-shopping for credit.¹⁹

Neither the ALJ nor complaint counsel have refuted respondent's illustration of the proposed disclosure's potential for hindering credit comparisons; in fact, both concede there would be distortion. However, the ALJ rejects respondent's showing as:

only hypothetical, and may have little or no relation to reality. The fact that respondent can construct hypothetical cases where inclusion of a reaffirmed debt in the 'finance charge' results in a distortion of the "annual percentage rate" when compared with an equivalent amount of a new loan by a competitor involving no reaffirmation, does not mean that the true cost of credit need not be disclosed by Household Finance as required by the Truth in Lending Act and Regulation Z. I.D. at 21. [13]

¹⁸ In respondent's hypothetical example, the "annual percentage rate" of a \$1,100 loan by HFC to a reaffirming consumer would be 120% if the reaffirmed debt were treated as a finance charge, and the total obligation would be \$1,320. The "annual percentage rate" for a competing loan of \$1,100, which would not involve reaffirmation but would be used in part to pay the debt to HFC, would be 25%, with a total obligation of \$1,375. The \$55 difference results because the second lender's interest rate is 25% while HFC's is 20%. Respondent's point is that because of the "sky-high" "annual percentage rate" computed for the HFC loan using the proposed method of disclosure, the consumer may think that the other loan is the better deal, when in fact it is not. For the full example, see RAB at 32-33.

¹⁹ Section 102 of the TILA declares that the Act is designed to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him . . . (emphasis added).

While the proposed disclosure could violate this tenet of the Act by disabling bankrupt customers of HFC from making well-guided comparisons of credit, complaint counsel argue that Congress intended for all imposed costs of credit to be included in the finance charge unless specifically excluded by the TILA or Regulation Z. CR at 13-16. It asserts that since reaffirmation is not specifically excluded it is, by definition, a finance charge. The legislative history and case law cited by complaint counsel, however, do not establish that Congress intended such a mechanistic application of the finance charge provisions of the Act in the face of evidence that it could hinder informed comparison-shopping for credit. The basis for the holding in *Buford v. American Finance Co.*, 333 F. Supp. 1243, 1247 (D. Ga. 1971) that only those charges explicitly exempted from inclusion in the finance charge may be excluded from it, was the intent of Congress "to establish by statute and regulation a uniform method for such determination [of finance charge] so that consumers could 'comparison shop' by looking at a single 'price tag'—the 'annual percentage rate'." In that case, the finance charge (a \$1.00 notary fee) was unlikely to significantly affect total loan costs and credit comparisons. The district court was not confronting, as is the Commission here, a charge that could distort the "price tag" of the loan—the "annual percentage rate"—and induce a skewing of comparisons by consumers and economically unsound credit decisions.

The Commission agrees with respondent that this example is hypothetical only because the proposed disclosure has not yet gone into effect. RAB at 33. Moreover, the ALJ has given the Commission no reason to believe that the example will not occur in practice. In addition, respondent's position in opposition to the proposed disclosure is not inconsistent with the objectives of meaningful disclosure and credit comparisons established by the TILA and Regulation Z. If the cost of reaffirmation is included in the "amount financed," consistent with our determination that HFC's loans to bankrupt consumers are refinancings, the "annual percentage rate" for those loans will bear a much closer "relation to reality" than would the result dictated by the Initial Decision.

Complaint counsel attempt to mitigate the alleged impact of the proposed order on two grounds. First, they argue that respondent's example is not supported by any facts of record. In respondent's example, the consumer reaffirms his discharged debt to HFC in order to retain property in which HFC has a security interest. The record indicates that retention of property is one of the reasons consumers have reaffirmed their debts to HFC, I.D.F. 10, but complaint counsel point out that it does not show what portion of consumers have reaffirmed for this reason. Complaint counsel therefore argue that it is impossible to conclude from the record that respondent's example is representative of the impact the proposed order would have on actual consumer credit transactions. CR at 19.

This argument misses the mark. The proposed disclosure potentially could have the described impact whenever a bankrupt customer, *for whatever reason*, wants to pay off a discharged debt to HFC, considers HFC's terms for a loan (including the requirement to reaffirm) and then compares competing credit terms. Further, the record indicates that in many cases discharged debtors have sought loans from HFC, I.D.F. 7, subject to reaffirmation. I.D.F. 9-10. Although the number of discharged debtors who have sought loans from HFC is unknown, those who shop around for credit would be potentially exposed to the consequences of the proposed disclosure seen in respondent's example. Thus the Commission cannot agree with complaint counsel that the record provides no support for respondent's illustration, and a finding, that the proposed disclosure could adversely affect the ability of bankrupt customers of HFC to comparison-shop for credit.

Second, complaint counsel contend that similar distortions can

result from other finance charge disclosures, such as credit life insurance, which are required by the TILA or [14]Regulation Z.²⁰ Complaint counsel admit, however, that the difference in annual percentage rates shown in its example is of a lesser magnitude than that alleged here. CR at 20. Further, given the clear policy in opposition to lending disclosures that impede comparison-shopping for credit and thereby frustrate the purpose of the TILA, the Commission does not accept the proposition that “distortion” of credit comparisons in one context is necessarily precedent for mandating distortion in another.

Finally, an important consideration in today’s decision is that the Commission fails to see how HFC’s current practice of disclosing the reaffirmation in the amount financed itself misleads and harms consumers. Presumably consumers are aware from their bankruptcy proceedings of their discharged debts to HFC. They are told by HFC that reaffirmation is a precondition for receiving further credit from the company. Attachment B to I.D. Thus, consumers know they must reaffirm; they negotiate the amount that they reaffirm; and they know that a like percentage of any subsequent loan will be used to repay the amount reaffirmed. The Commission does not believe, therefore, that disclosure of the amount of reaffirmation in the finance charge would better in any significant way the bankrupt customer’s understanding of the terms and requirements of the transaction.

As this opinion has stated, the Commission views HFC’s loans to bankrupt consumers as refinancings under Regulation Z, and is dismissing the complaint on that ground. The reasons for this result, discussed *supra*, coupled with the apparent absence of consumer harm from the challenged practice and the possibility of adverse effects from the disclosure proposed by the ALJ, persuade the Commission that the amount of a reaffirmed debt should be included in the amount financed of the transactions in issue.

Because we are dismissing the complaint, the Commission does not reach or decide the specific remedial issues, such as the alleged overbreadth of the proposed order, presented by HFC’s appeal.

FINAL ORDER

This matter has been heard by the Commission upon the appeal of respondent from the initial decision and upon briefs and oral argument in support of and in opposition to the appeal. For the

²⁰ In an example of their own, complaint counsel show how the annual percentage rate would differ between a consumer loan in which the purchase of credit life insurance is required and one in which it is not. See CR at 20-21.

reasons stated in the accompanying Opinion, the Commission has determined to sustain respondent's appeal. Complaint Counsels' motions to disregard a letter presented by respondent at oral argument and to request a statement of views from the Federal Reserve Board are granted and denied, respectively. Accordingly,

It is ordered, That the complaint is dismissed.

IN THE MATTER OF
EXXON CORPORATION, ET AL.

Docket 9130. Interlocutory Order, Aug. 6, 1981.

ORDER

The Administrative Law Judge, pursuant to Section 3.23(b) of the Rules of Practice, has certified to the Commission complaint counsel's application for review of the ALJ's prehearing order of March 2, 1981, directing them to "exclude resort" to special reports under Section 6(b) of the FTC Act. The ALJ, in authorizing the appeal, stated that his ruling "involves in part Section 6 issues which lie without the Part 3 Rules of the Commission."

I. BACKGROUND

The adjudication in this case began on August 10, 1979, when the Commission issued a complaint charging that the proposed acquisition by respondent Exxon Corporation ("Exxon" or "respondent") of Reliance Electric Company would violate Section 7 of the Clayton Act, as well as Section 5 of the FTC Act. The Commission entered an order on that date directing that the case be tried on an expedited basis. On October 26, 1979, the United States District Court for the District of Columbia entered a hold-separate order pending the administrative proceeding. The first prehearing conference was held before the ALJ on October 24, 1979, and several conferences were subsequently held to map out a proper route for discovery.

During a prehearing conference on February 27, 1981, the ALJ requested counsel to describe the progress of their respective discovery efforts. This review led to a discussion of complaint counsel's plan to use Section 6(b) as a means of discovery. The ALJ then stated his intent to disallow the use of Section 6(b) and on March 2, 1981, he issued a pretrial order directing complaint counsel "to proceed forthwith by way of Part 3 discovery rules and exclude the Section 6 method."

In his March 18, 1981, order authorizing complaint counsel to file an application for review pursuant to Rule 3.23(b), the ALJ justified his decision to preclude the use of Section 6(b) as a means of discovery on two grounds: (1) the injection of Section 6 issues into the proceeding might result in needless and undue delay, in contravention of the Commission's order dated August 10, 1979; and (2) complaint counsel's use of Section 6(b), "a device not available to respondents, would be fundamentally unfair."