THOMAS J. MILLER
ATTORNEY GENERAL

Department of Justice

CONSUMER PROTECTION DIVISION
HOOVER BUILDING
DES MOINES, IOWA 50319
TELEPHONE: 515-281-5926
TELEFAX: 515-281-6771

May 22, 2001

David J. Kuebelbeck
Senior Counsel
US Bancorp
U.S. Bank Place
601 Second Avenue South
Minneapolis, MN 55402-4302

BY FAX: 612 . 973 . 3257
RE: Diane Rickers / Omaha Prime Meats / US Bank

Dear Mr. Kuebelbeck:

Susan Bulver has asked me to respond to your letter of April 16, 2001, regarding the relationship of US Bank's purchase money contract to the actions of Omaha Prime Meats. In that letter, you indicated that you were recommending US Bank take no action until the earlier of May 31 or resolution of the complaint.

You asked for an explanation of our position if we disagreed with US Bank that its rights under the financing loan are completely independent of any complaint against Omaha Prime Meats, and asked that we advise you if any refunds are made to the complainant, "in order that her obligations to the Bank can be satisfied."

Ms. Bulver indicates that there are on-going conversations with Omaha Prime Meats about resolution of this matter. However, we did wish to respond to your letter prior to May 31.

In sum, we do not believe that US Bank's rights in this matter are independent of Omaha Prime Meats. Your letter indicates that you may not be fully aware of how the loan between Ms. Rickers and US Bank came to be, as it has been described to us. Based on our understanding of the origin of that loan, it is our position that US Bank has no greater rights in connection with this note than would Omaha Prime Meat as creditor. If either US Bank or Omaha Prime Meat incur any losses as a result of Ms. Rickers exercising her rights under the law, the allocation of those losses is a matter for US Bank and Omaha Prime Meats to sort out between themselves: they are not for Ms. Rickers to bear.

I. The Origin of the US Bank loan

As it has been explained to us, Ms. Rickers did not go independently to US Bank to apply for a loan. In fact, she did not go to US Bank at all. This direct loan was arranged by the seller, Omaha Prime Meats, and consummated in the consumer's home, with Omaha Prime Meats closing the loan for US Bank. (The seller thus appears to have acted as US Bank's agent, though for purposes of this complaint, it is not necessary that actual agency be involved.) Omaha Prime Meats appears to have taken the application for financing -- the application was among documents supplied to us by the seller, not by the bank. The seller obtained the US Bank loan documents, and took those loan papers to the buyer's home, where it, on behalf of US Bank, obtained her signature on the loan documents and delivered to the buyer the completed contract and the required Truth in Lending disclosures.

The seller, Omaha Prime Meats, was in the consumer's home twice. The first time was to make the sales pitch for the food plan. The retail installment contract to purchase the food was signed on that date, January 18, 2001. The second time the seller the seller came was on January 26, when it did two things: it delivered the food and brought the financing papers to pay for the sale on credit -- the US Bank loan documents -- to the home for Ms. Rickers to sign.

Thus the seller acted an arranger for this loan, at a minimum, and may have acted as an agent for US Bank in taking the financing application and obtaining the signatures on the documents, and delivering required documents on US Bank's behalf to the consumer.

II. The Bases for US Bank's Liability for Omaha Prime Meats' Violation(s) of the Law

A. ICCC

Iowa Code §537.3405(1) provides that lenders[1] are subject to defenses arising from sales and leases.

> A lender, other than the issuer of a lender credit card, who, with respect to a particular transaction, makes a consumer loan for the purpose of enabling a consumer to buy or lease from a particular seller or lessor property or services, is subject to all claims and defenses of the consumer against the seller or lessor arising from that sale or lease of the property or services if any of the following are applicable:....

In this instance, US Bank furnished Omaha Prime Meats with the loan documents, and

[1] A "lender" is defined as a person who makes a loan or who takes assignment. Iowa Code § 537.1301(23).

Omaha Prime Meats closed the loan for US Bank, thus making at least § 537.3405(1)(d) applicable, and triggering the application of the ICCC lender-liability provision. (Note that the lender liability provision is distinct from the ICCC's assignee liability provision in Iowa Code § 537.3404.)

B. The FTC anti-holder rule

1. General

Apart from any common law principles this situation would trigger regarding agency, the US Bank loan is a "purchase money loan" within the meaning of 16 C.F.R. 433, the FTC Rule Concerning Preservation of Consumers' Claims and Defenses, (the "anti-holder" rule). For a transaction to be covered under the FTC anti-holder rule, it need not be an assigned contract. Direct loans in which the seller either refers the consumer to a lender or arranges the financing are also subject to the anti-holder rule.

Omaha Prime Meats at a minimum referred Ms. Rickers to the lender or, more aptly, arranged for the financing pursuant to a business arrangement or contract with US Bank as defined in 16 C.F.R. 433.1. The resulting loan was a "purchase money loan," in that the cash advance was applied "in whole or substantial part" to the purchase of goods from a seller who "(1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, *or business arrangement.*" 16 C.F.R. 433.1(d). "Business arrangement" is broadly defined to include, *inter alia,* any understanding or informal arrangement between the seller and a creditor in connection with the sale of goods or the financing. 16 C.F.R. 433.1(g). "Contract" is also broadly defined to include any "oral or written, formal or informal" agreement between a seller and a creditor which contemplates or provides for cooperative or concerted activity in connection with the sale or goods or services or the financing thereof. 16 C.F.R. 433.1(f).

In this case, there was at least an informal agreement from US Bank that the seller could refer its customers. Given that the seller took the buyer's credit application in the home, and brought the US Bank loan papers (with US Bank's terms filled in) back to the consumer's home, obtaining the buyer's signatures, and delivering the required copy of the loan papers and TIL disclosures to the buyer on US Bank's behalf, it would certainly appear that the seller also is "affiliated" with U.S. Bank by a business arrangement as the regulation broadly defines that term, or has at least an informal agreement contemplating cooperative activity. Consequently, US Bank's purchase money loan should, by law, have had the following clause in it:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER FOR GOODS OR SERVICES

OBTAINED WITH THE PROCEEDS THEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

(Emphasis added.) By this contract clause, US Bank would contractually agree to derivative liability for "all claims and defenses" which the obligor has against the seller of the goods or services purchased with the proceeds of the loan.

2. The bases for direct lender liability (derivative or otherwise) in the event of non-compliant contracts under the FTC anti-holder rule

The seller, Omaha Prime Meats, in this case, is the entity directly covered by the FTC rule. That means it can neither take a retail installment contract which excludes the anti-holder clause mandated by 16 C.F.R. 433.2(a), nor can it accept as payment for the sale the proceeds of a purchase money loan (such as the loan at issue) in which the loan document does not include the above-quoted anti-holder clause mandated by 16 C.F.R. 433.2(b). It violated the FTC holder rule when it accepted payment from US Bank pursuant to a contract which did not comply with 16 C.F.R. 433.2(b).

Banks, though not directly subject to FTC TRRs, nevertheless may not necessarily take advantage of non-compliance by the seller in order to deprive the consumers of their rights under the FTC holder rule.

* Some courts read the anti-holder language into a contract as an implied term. (Under standard contract doctrine, applicable law is an implied term in every contract.)

* Lenders whose contracts should have included the clause, but do not, may be held independently liable themselves under state unfair and deceptive acts and practices law for their own failure to include the clause in their own contracts where required. (In many states, including Iowa, the UDAP law is one of general applicability. See Iowa Code § 714.16). Because the FTC anti-holder rule has been a staple of consumer protection laws for over a quarter of a century, this should be a staple of compliance by now for related lenders engaging in the financing of sales of goods and services, whether indirectly, by purchasing paper, or engaging in direct, purchase money lending resulting from seller referrals or arrangements.

* Depending upon the nature of the relationship between a direct lender and a seller, the lender also might be held independently liable under aiding and abetting theories for its joint effort with the seller to try to deprive consumers of their rights under the FTC rule. See, e.g. *Brown v. LaSalle National Bank,* 820 F. Supp. 1078 (N.D. Ill. 1993). In that case, one of the things LaSalle National Bank was alleged to have done was to furnish the seller with non-compliant notes for its joint customers to sign. (Since this case involved the seller taking the documents to the consumers' home, US Bank presumably furnished the seller with the non-

compliant loan papers.)

Consequently, we do not believe that US Bank can cooperate with door-to-door sellers, accept their referrals or engage with sellers who arrange purchase money loans to finance the sellers' goods, provide the sellers with non-compliant purchase money loan documents to facilitate that arranged financing, and then try to invoke the same rhetoric distancing itself from the seller's conduct which was the original impetus for the enactment of the anti-holder rules in the UCCC and the FTC TRRs a quarter of a century ago. The purpose of these rules was to assure that the seller's obligation to comply with all applicable laws was not severed from the buyer's obligation to pay. US Bank's position here simply harkens back to the pre-1975 law.

These are the bases for our position that US Bank's purchase money loan is subject to the claims and defenses that the buyer, Ms. Rickers, has against the seller, Omaha Prime Meats.

III. Violation(s) of the Right to Cancel

Apart from any other alleged violations which either the sales or the loan itself may present, there are violations of Chapter 555A which result in voiding the sale and any related evidence of indebtedness. There are, in fact, two separate ways in which just the date on the notice of right to cancel does not comply with the law.

Assuming that the trigger date for the three-day right to cancel was January 18, the January 21 date is incorrect. It is that "clear-on-its-face" violation which was the basis for Ms. Bulver's letter of April 2 to both Omaha Prime Meats and US Bank requesting that arrangements be made to pick up that food already delivered within 20 days, or Ms. Rickers is entitled to keep the food without obligation.

In the event US Bank continues to finance Omaha Prime Meats -- or any other door-to-door seller -- however, please note that January 18 was not the true trigger date for the right to cancel this date in any event: January 26 was. This transaction is an example of the "two-contract dodge," by which sellers (sometimes with the cooperation of their financers) try to circumvent the buyers' right to make an informed decision about whether to exercise their opportunity to cancel by telling the buyer how much the whole deal will cost only after the 3-days to cancel the purchase appears to have passed. When, as here, it was understood from the beginning that this was to be a financed sale -- with the seller arranging the financing -- the time which triggers the three-day right to cancel is the time at which the consumer knows what the full, financed cost will be. The trigger date for the 3-day cancellation right on a combined sale/credit transaction is when the financing contract is completed and accompanying Truth in Lending disclosures are given to the buyer.

> If this were not the case, a consumer unable to pay cash might be forced to sign a credit contract she had never seen simply because her right to cancel the sales

> contract had expired. This would eliminate the protection of the state and federal cooling off periods.....
>
> This is the rule for all "combined sales/credit transactions," whether they involve (a) retail installment obligations, where the seller is the initial credit and may assign the contract to a financial institution, or (b) loans directly from a financial institution to whom the consumer has been referred by the seller. The determining factor is that the seller offers to assist the buyer in arranging the financing.

Opinion of the Kentucky Attorney General, 1992 WL 540962 (March 17, 1992).

This timing rule is consistent with court decisions involving purportedly separate sales/ financing contracts in door-to-door sales of home improvements, which have been litigated in a number of cases in the context of the TIL rescission rights. See, e.g *Taylor v. Domestic Remodeling*, 97 F.3d 96 (5th Cir. 1996; *In re Lombardi*, 195 B.R. 569 (Bankr. D.R.I. 1996).

The effect of the violation is to void the financing contract, as well as the sales contract.

> **555A.5 EFFECT ON INDEBTEDNESS**
>
> Rescission of any contract pursuant to this chapter or the failure to provide a copy of the contract to the buyer [e.g. one with a compliant notice of right to cancel] shall void any contract, *note or other evidence of indebtedness executed or entered into* <u>*in connection with the contract*</u> ...

As explained in the first section, this was a purchase money loan which, by law, should have included a contract provision making the holder of the financing contract (US Bank) liable for all claims and defenses which the buyer has against the seller. It is our position that US Bank cannot now evade that obligation by furnishing the related seller with non-compliant forms to have the buyer sign, and then raise that very non-compliance to insulate itself from the conduct of the seller. Moreover, ICCC § 537.3405 makes the claims and defenses available against US Bank, as well.

I hope this explains our position that US Bank, through its purchase money loan, is subject to all claims and defenses which Ms. Rickers has against Omaha Prime Meats, including

the violation of Iowa Code 555A which in turn triggers 555A.5. If you have any questions, please feel free to contact me directly by phone, 515 . 281 . 6386, or email, at kkeest@ag.state.ia.us. Ms. Bulver is the contact person for questions regarding the status of discussions with Omaha Prime Meats.

Sincerely,

Kathleen E. Keest

Kathleen E. Keest
Assistant Attorney General
Deputy Administrator,
Iowa Consumer Credit Code