Consumer Law Newsletter

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State Bar of Michigan Consumer Law Section

Lender Liability and the FTC Holder Rule

By Frederick L. Miller
Chairperson, Consumer Law Section

Lender or assignee liability for the actions of the seller is essential for the protection of consumers in many situations. Consumer issues frequently come up in defense of collection actions brought by finance companies and banks. While immediate sellers can be brought into the cases, many times they are out of business or uncollectible. Without lender liability for claims assertable against the seller, the consumer will be stuck.

If the financing company is an assignee of an installment sales contract entered into with the seller, there are many sources of law supporting the liability of the assignee for claims and defenses available against the seller. To begin with, the holder-in-due-course rule of UCC Article 3, MCLA 440.3302 and 440.3305(b), which is asserted to protect assignees, doesn't apply, since the transaction doesn't fit the definition of a negotiable instrument. MCLA 440.3104(a). As a result, holder-in-due-course protections shouldn't be available to the assignee.

In addition, various state consumer statutes enforce assignee liability for most consumer contracts. See, e.g. MCLA 445.865 (Retail Installment Sales Act); MCLA 492.114a (Motor Vehicle Sales Finance Act); MCLA 445.1207 (Home Improvement Finance Act).

Finally, the Federal Trade

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Annual Meeting Topics: Building a Practice and Legislative Developments

Nationally-recognized attorney, author and consultant Richard Feferman and State Rep. Elizabeth Brater will be the featured speakers at the Consumer Law Section annual meeting during the State Bar's annual conference in September. Feferman will speak on "Building a Consumer Law Practice," and Brater will review consumer legislative issues.

Feferman is the author of *Building Your Firm with Associates*, and contributing author and assistant editor for *The Quality Pursuit*. Both are published by the American Bar Association. Feferman is a member of the Publications Board of the ABA Section on Law Practice Management. He has an active consumer practice in Albuquerque, New Mexico, handling suits against car dealers, debt collectors and lenders. Feferman is a 1971 graduate of the University of Michigan Law School, and a member of the State Bar of Michigan.

Rep. Elizabeth Brater is the chair of the Michigan House of Representatives Consumer Protection Committee. Rep. Brater will review legislative developments during the past year, and the goals for her committee's work in the coming year.

The State Bar Annual Meeting will be held September 16-18 in Lansing. The Consumer Law Section will meet on Friday, September 18. The business meeting of the section will convene at 9:00 a.m., and will include the election of officers for the coming year, and elections to fill open Section Council seats. The program will begin at 9:45 a.m.

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In Search of the MCPA Attorney Fees Lodestar

By Gary M. Victor

While *Smolen v Dahlmann Apartments, Ltd*[1] was pending before the Court of Appeals, my first article on computing attorneys' fees under the Michigan Consumer Protection Act (MCPA) was published.[2] In both the article and my appellate briefs I argued that Michigan should adopt a lodestar-reasonable hours times a reasonable rate-approach in computing MCPA fees. It was my belief then, as now, that whatever merit there may be in the fee calculation criteria established in *Crawley v Schick*[3] and approved by the Supreme Court in *Wood v DAIIE,*[4] the lodestar approach provides a much more objective starting point from which to calculate attorneys' fees. Unfortunately, the Smolen Court did not agree. The Court specifically declined to hold that "the product of multiplying reasonable hours by a reasonable rate is presumed to provide a reasonable fee."[5] The purpose of this short article is to engage in a search for an MCPA lodestar after Smolen.

The Smolen Court having spoken quite dispositively, I assumed the search for the lodestar in calculating attorneys' fees under Michigan statutes was over, at least for the foreseeable future. Coming less than a year after Smolen, the Court of Appeals adoption of the lodestar in *Howard v Canteen Corp*[6] came as a surprise. The Howard Court was called upon to evaluate an attorney fee award made under the Michigan's Elliot-Larsen Civil Rights Act.[7] Even though the Court stated that trial courts must use the Wood criteria in computing attorneys' fees,[8] it went on to state:

> *"The most useful starting point for determining the amount of a reasonable attorney fee is the number of hours reasonably expended on the case multiplied by a reasonable rate."*

More confusing was the Court's pronouncement that "the 'lodestar' (reasonable hourly rate times reasonable hours expended) … is presumed to be a reasonable attorney fee."[10] This statement appears to be totally contradictory to the position taken by the Court in *Smolen*.

How can it be that one panel of the Court specifically rejects the proposition that the lodestar is presumed to be a reasonable fee while another adopts the same principle? Before being so bold as to suggest that one panel of the Court may have no idea of what another has held, or worse, that one panel may not care what another has held; it is politic to look for a viable legal reason for this apparent inconsistency. In fact, there is one avenue of analysis that can "legitimately" account for this disparity.

One can reasonably argue that the difference in approach in these two cases is permissible given the fact the *Howard* is a Civil Rights case while Smolen was brought under the MCPA. This argument is based on the proposition that in actions brought under Michigan's Civil Rights Act, "Michigan courts regard federal precedents . . .as highly persuasive."[11] The lodestar has long been the majority federal approach to attorney fee calculations.[12] Hence, it would not be

unexpected for Civil Rights cases in Michigan to utilize the federal lodestar approach in making fee calculations.

Howard itself confirms this analysis in that the citation for its holding that the lodestar figure is presumed to be a reasonable fee is a federal case rather than state case.[13] The author can find no Michigan cases stating the lodestar is presumed to be a reasonable attorney fee other than those brought under either Michigan or federal Civil Rights statutes.[14]

Although the presumption of the lodestar as a reasonable fee appears to apply only to civil rights cases, the use of the lodestar as a beginning point in attorney fee calculations is garnishing greater general acceptance. Two very recent cases bring the lodestar as a starting point beyond the civil rights arena. In *B & B Investment Group v Gitler*,[15] a statutory slander of title action,[16] the Court cited Wood but went on to hold:

"The most useful starting point for determining the *amount of a reasonable attorney fee is the number of hours reasonably expended on the case multiplied by a reasonable hourly rate.*[7]

In *Michigan DOT v Randolph*[18] the Court reviewed an attorney fee award under the Uniform Condemnation Procedures Act.[19] The trial court had calculated attorney fees using a lodestar approach. The Court of Appeals affirmed the award stating:

> *"In circumstances where a full one-third contingency is unreasonable, lodestar analysis provides a useful starting point for determining a reasonable fee.*[20]

There is one other case that can be thrown into the mix of our search for the lodestar and this case is MCPA specific. *Jordan v Trans-national Motors, Inc*[21] holds that in determining attorney fees under the MCPA trial courts must consider the goals of the act.[22] Those goals being to enable "consumers to protect their rights and obtain judgments where otherwise prohibited by monetary constraints."[23] The Court held that where the trial court had found plaintiff's counsel's time spent and hourly rate reasonable, it was an abuse of discretion to base its attorney fee award on the "low value of the case."[24] Thus, *Jordan* effectively removes certain monetary aspects of the Crawley factors from consideration in MCPA fee awards.

So where does this leave us in the search for the illusive lodestar in MCPA cases? Given Smolen's specific holding on the lodestar,[25] it is very difficult to argue that the lodestar should be presumed to be a reasonable fee in MCPA cases. Citing the recent cases discussed herein one can well argue, however, that the lodestar should be the starting point of the court's fee analysis. Furthermore, in the light of *Jordan*, a trial court's variance from the lodestar figure must be consistent with the goals of the MCPA. Hopefully, that constraint should go a long way to prevent trial courts from reducing MCPA attorney fee awards below the lodestar figure.

Endnotes

[1] 186 Mich App 292 (1990).

[2] *Victor*, Attorney Fees Under the Michigan Consumer Protection Act-Creating Consumer Power or Empty Promises, 6 Cooley L. Rev. 285 (1989). Another article on this topic was published after *Smolen* was decided: Victor, Attorney Fees Under the Michigan Consumer Protection Act, and Other Developments on Attorneys' Fees, 4 COLLEAGUE 8 (May, 1991).

[3] 48 Mich App 728 (1973).

[4] 413 Mich 573 (1982).

[5] Smolen, *supra* n 1 at 297.

[6] 192 Mich App 427 (1991).

[7] MCL 37.2802.

[8] *Howard*, *supra* n 6 at 437.

[9] *Id.*

[10] *Id* at 439.

[11] *Collister v Sunshine Foods, Inc,* 166 Mich App 272 (1988).

[12] See, *e.g.*, *Hensley v Eckerhart,* 461 US 425 (1983).

[13] *Howard* at f n 24 cites *Rode v Dellarcipete,* 892 F2d 1177, 1183(C A 3, 1990).

[14] See, *e.g.*, *Shellenberg v Elks Lodge* No. 2225, ____ Mich App_____ (1998) (Docket No 185598) and *Mitchell v Cole,* 196 Mich App 675 (1992).

[15] ___ Mich App ____ (1998) (Docket No. 189751).

[16] MCL 565.108.

[17] Gitler at ____.

[18] ____ Mich App ____ (1998) (Docket No. 191228).

[19] MCL 213.66.

[20] Randolph at ____.

[21] 212 Mich App 94 (1995).

[22] *Id* at 97-98.

[23] *Jordan* at 97-98.

[24] *Id* at 98.

[25] See, *supra* n 5.

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Winning Statutory Damages in Repossession Cases

By Carolyn Bernstein

When a creditor fails to properly notify a consumer debtor of the creditor's intent to sell a repossessed vehicle, Michigan courts have held that the creditor loses his right to collect any loan deficiency. But can the debtor also recover statutory damages from the creditor under the Uniform Commercial Code? The answer under current case law should be yes, though no such award has yet been made. Making the argument is worth a try and, at the least, provides terrific bargaining leverage for consumer attorneys.

A secured creditor facing a defaulted loan can choose his remedy. He can accelerate the loan balance and proceed as a judgment creditor, or he can enforce his security interest by repossessing the collateral. If the creditor chooses repossession as his remedy, Article 9 of the UCC imposes specific duties on him, among which is the often neglected duty to notify the debtor of the "time and place of any public sale or reasonable notification of the time after which a private sale or other intended disposition is to be made." MCLA 440.9504(3). Anyone with an interest in the collateral is considered a "debtor" under this section and must be sent notice, including co-signers, owners, sureties and bankruptcy trustees.

The Michigan Court of Appeals has ruled that failure to send notice of the intended disposition of repossessed collateral operates as an absolute bar to the recovery of a deficiency judgment. Honor *State Bank v Timber Wolf Const*, 151 Mich App 681 (1986); *Bank of Standish v Keysor,* 166 Mich App 93 (1988).

In *Timber Wolf*, the parties did not dispute that the creditor had failed to notify the debtor of its intent to resell the repossessed collateral. The issue for the court was which of three possible approaches to damages to adopt in the case:

- The creditor's right to a deficiency judgment is complete, subject only to setoff for the debtor's losses under Section 9-507(1);
- The creditor may recover a deficiency, but only to the extent that he can overcome the presumption that the value of the collateral equals the value of the debt; or
- The creditor is absolutely barred from recovering a deficiency since notice is a condition precedent to such recovery. *Id*, at 685.

In affording debtors the maximum protection available under the UCC, the Court of Appeals relied heavily on a Delaware case, *Wilmington Trust Co v Conner*, 415 A2d 773 (Del, 1980). Only the absolute bar approach serves the three purposes of the notice requirement:

- To give the debtor a chance to exercise his redemption rights,
- To bid or solicit others to bid at the sale, and
- To oversee every aspect of the disposition to maximize the sale price.

But why haven't Michigan debtors received any damages under Article 9 in addition to the absolute bar? Section 9-507(1) specifically states:

> *"If the disposition [of the collateral] has occurred the debtor or any person entitled to notification . . . has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus 10% of the principal amount of the debt or the time price differential plus 10% of the cash price."*

One reason debtors in published opinions have not been awarded damages may be because none of the repossessed collateral were consumer goods. Though any debtor can seek actual damages, the statutory formula applies only to consumer goods. Perhaps none of the non-consumer debtors even sought to recover damages.

Some jurisdictions do award both statutory damages and the absolute bar in consumer cases. Of particular note: Delaware. In *Wilmington Trust v Connor*, the case on which *Timber Wolf* is based, the Delaware court found that strict compliance with the UCC's notice provisions is a condition precedent to a deficiency judgment. Failure to comply warrants application of the absolute bar rule, but in no way diminishes a debtor's right to recover statutory damages under Section 9-507(1). There is simply nothing in the UCC which dictates that the bar should be an exclusive remedy. To the contrary, Section 1-106(1) provides that remedies shall be "liberally administered."

Furthermore, though it may seem a consumer windfall, public policy favors awarding damages in addition to the absolute bar. Statutory damages are intended not just to compensate consumers, but to deter creditor misconduct. There is an inherent power imbalance between the creditor and consumer debtor; the creditor retains primary control over contract provisions and the disposition process following repossession. Awarding statutory damages recognizes—and helps to balance—this power disparity.

The language in *Timber Wolf* clearly suggests that the absolute bar is a condition precedent to a deficiency judgment, and not the exclusive remedy for Michigan debtors. All that remains is for an actual award to be made in a published case. Given the artificially low sale prices accepted as standard in repossession cases, consumer attorneys have an opportunity here not just to provide a real benefit to consumers, but to effect lasting change in creditors' resale practices as well.

Disputes Over Motor Vehicle Repair Fees and the Consumer's Dilemma: Advising Consumers of Motor Vehicle Repairs.

By Ian Lyngklip

When disputes arise between a consumer and a mechanic over vehicle repair charges, the end result is often the assertion of a mechanic's lien. If the facility has overcharged or performed those repairs without authorization, then the consumer may be shocked to hear that the mechanic is now refusing to return the vehicle based on non-payment. In these situations, the consumer may feel that the vehicle is being held for ransom, and the only available way of getting it back is to pay the bill.

This familiar consumer dispute presents a dilemma for both the consumer and the practitioner. If the consumer pays the bill, then he must sue to regain any illegally charged portion of the repair bill. On the other hand, if he refuses to pay, then he must sue to recover the vehicle and any other damages, such as rental costs.[1] In either event, the consumer must bring an action to be made whole. The question then is which course of action to advise.

For the practitioner, this situation presents a dilemma of another kind. As attorneys we tend to want to plead as many theories as possible and take the best one to trial. But in this kind of case, advising any course of action at this early stage of the dispute means an irrevocable election of remedies for the client. Therefore, advising the client requires a clear understanding of the remedies available under the Motor Vehicle Service And Repair Act (MVSRA).[2]

The Possessory Lien—The Garage Keeper's Lien Act

The principal tool of the repair facility is the assertion of a garage keeper's lien. The Garage Keeper's Lien Act[3] provides this lien to repair facilities for any work or storage charges attributable to the vehicle. However, the statute provides rigorous deadlines if the garage keeper wishes to assert the lien.

The possessory lien by the facility can be asserted only within the first 90 days after the repair services were rendered. After that 90 days has expired, there is no statutory authority for the facility to retain the vehicle, so the facility must act quickly to execute upon this statutory lien.[4] While the facility may retain the car in their possession within this 90 days, it may not move to sell the vehicle until 45 days after it has delivered a claim of lien and final bill to consumer. The garage must move to sell the vehicle between 20 and 60 days after the expiration of that 45 day grace period. No less than 10 days before that sale, the facility must notify the Secretary of State and owner of its intent to dispose of the vehicle.

The overall effect of this statute is plain. The facility can retain possession of the vehicle for a period of 90 days during which it must move to execute on the lien. The consumer cannot regain possession of the vehicle unless the facility's bill has been satisfied, the lien is waived or a court orders otherwise.[5]

The Basics: Motor Vehicle Service & Repair Act

The election of remedies problem in this situation is raised by the MVSRA. This statute regulates repair facilities, mechanics, and the process of motor vehicle repairs. Additionally, the statute has two principal remedies for aggrieved consumers.[6] First, repair facilities are barred from bringing any action, asserting any lien, or collecting any fee if they have committed an unfair or deceptive practice.[7] Second, the consumer may bring action for unfair or deceptive acts and recover damages, costs and attorney fees, and[8] in the event of a willful violation, the consumer may recover double his damages.[9]

The first of these remedies under MCL §257.1331 provides the consumer with an absolute defense to the assertion of any claim or lien by the repair facility. In effect, this section is a shield which can be used against any legal action and bars any action by the facility at law or equity for the collection of a repair bill.

More importantly, this shield provision does not differentiate between portions of the bill that are legitimately charged and those that are unlawful. Rather, this affirmative defense effectively penalizes repair facilities for illegal acts by removing the ability to collect for legitimate repairs if there has been an unfair or deceptive act.

Thus, if the consumer waits for the facility to assert a claim for repairs, he may effectively seek to have the entire claim barred, and regain the vehicle without paying for any of the repairs. The consumer receives a statutory windfall and the facility is penalized for its actions in using a court process to collect an illegal bill.

The second remedy lies in MCL §257.1336. This section provides the consumer with a cause of action for unfair or deceptive acts by a repair facility. If a consumer has been damaged by an illegal act, he can bring an action to recover damages, costs, and attorney fees. Together, these sections represent a sword and a shield. The first section shields against suits by repair facilities, and the second provides a cause of action for unfair or deceptive acts. But, in examining how these sections function in a litigation setting, the practitioner must realize that they can't both be effectively asserted at the same time. There must be an election of remedies.

The Practitioner's Dilemma

Since MCL §257.1331 establishes an affirmative defense, it can only be used as a shield against a claim or lien asserted by the repair facility. If the facility has not asserted any such claim or lien, the consumer cannot use it as a cause of action.[10] Rather, if a facility has given an estimate of $100 for a repair and then performs an additional $900 in repairs, the client would be able to assert MCL §257.1331 as a defense to a collection action or lien for the $1,000. If the client prevails he may obtain the benefit of $1,000 in free repairs, which would effectively be a penalty against the facility.

On the other hand, if the client pays the entire bill, then this provision is of no use. Having paid the $900, the client could not use MCL §257.1331 as a claim. Instead, the client would have to bring an action under MCL §257.1336 for performing unauthorized

repairs. Consequently, the client would seek $900 as damages representing the amount that the client had not authorized. At the same time, there would be no defense to the $100 in charges which he had agreed to pay. Therefore, your client cannot effectively use the penalty provisions of this statute if he has already paid the bill.

The practitioner's dilemma is this, by refusing to pay the bill, the client loses the benefit of having his vehicle and will be greatly inconvenienced. The client retains the ability to use the shield portion of the MVSRA against any claim for recovery and may assert claims for rental car costs as a consequential damage for the illegal possession. And if the client has offered to pay the agreed amount, then the client also has a viable claim for conversion. Nonetheless, the leverage of having the penalty portion of the MVSRA available along with a conversion claim comes at the price of a serious inconvenience to the client.

On the other side of the dilemma, if the client pays for the repair, then he loses the ability to take advantage of the penalty provisions of the MVSRA's shield and gives up the leverage of a conversion. However, the client may benefit by having the continued use of the repaired vehicle and retains the right to sue for damages arising out of illegal conduct.

Advising The Client And Early Elections of Remedies

There are no hard and fast rules about which course of action to adopt for a particular client, but the practitioner must be able to understand the ramifications of each course of action and move decisively to pursue the appropriate remedies. In making that decision, the following factors are important decision point:

- ***How much money does the legal charge represent?*** If your client has authorized a relatively large amount of repairs and the facility has overcharged a substantial sum, you can gain considerable bargaining leverage by leaving the vehicle in the hands of the facility. If you are able to secure a finding that the facility has violated the MVSRA, then your client will be able to assert that violation as a defense to any claim for the repairs. Thus, if the amount of legal charges is large, the facility will not want to forego that amount, and instead may opt for a swift settlement rather than sustain the penalty of losing the ability to charge any fee.
- ***Can the client afford the bill?*** If the client cannot afford to pay the overcharges, then clearly you must tailor your claims to that fact. In short, if your client cannot pay, then your course of action must be to leave the vehicle with the repair facility until you can obtain a court order granting him possession. On the other hand, if the client does have the means to pay the bill, you must advise the client by paying the bill, he is electing to forego the penalty provision of MCL §257.1331. If the client does elect to wait for the court's order, the practitioner should make sure to assert the MVSRA violations as well as claim that no charges may be levied against the vehicle.
- ***How quickly can you obtain possession of the vehicle?*** In some courts, you may be able to obtain an order of possession within a week of filing the complaint. In other courts, the time may approach several months. Therefore, it is important to know in advance where your client's claims may be brought, as well as the local procedure for bringing a motion for possession. If you can obtain swift relief for your client, you may want to leave the vehicle in possession of the facility and bring your motion for possession. If the time frame for a hearing is short enough, there may be little difference between the time necessary to bring the motion and the time necessary to obtain funds and discharge the facility's lien. In so doing, you can forestall the election of remedies until trial.
- ***How much is the vehicle worth?*** If the vehicle is worth a substantial sum of money, then the assertion of an improper lien has behind it the specter of a conversion claim. Therefore, if the vehicle is worth a substantial sum, the treble damage provisions of the conversion statute represent a substantial incentive for settlement.
- ***Does the client have access to alternative transportation?*** If your client has no alternate means of transportation and must have access to the vehicle, you need to give that consideration first priority. While incidental damages are recoverable in a claim for conversion[11] and your client has no duty to mitigate[12], judges and juries may be hostile to what may be perceived as "manufactured" damages due to lost wages or employment termination. Simply put, it is imprudent to sacrifice a client's job to the vagaries of the judicial system. In the vast majority of cases, it behooves your client to keep their damages as low as possible, irrespective of any rules relating to mitigation.

Conclusion

In advising clients regarding MVSRA claims, practitioners must keep one eye peeled for an election of remedies, and the other on the client's particular circumstance. If the client redeems his vehicle prior to obtaining a court order, then he waives the ability to invoke the penalties provided by statute. On the other hand, if the client awaits a court order for possession, he may incur additional damages in alternate transportation costs. In either event, practitioners should be prepared to evaluate what kinds of claims and benefits will be forgone by choosing to between these two alternatives. And ultimately, clients should be advised as to these choices when they are presented.

Endnotes

1 Claim and delivery actions under MCL 600.2920 are subject to MCR 3.105 and, the consumer may bring a motion for possession pending the outcome of the case under MCR 3.105(e).

2 MCL 257.1301 *et seq.*

3 MCL 570.301 *et seq.*

4 While the statutory lien expires after 90 days, the Court of Appeals has held that the facility may retain a common law artisan's lien. *Nickell v Lambrecht*, 29 Mich App 191 (1970) This position, however has not been reviewed by the Supreme Court in any published opinion. This ruling appears to be inconsistent with the preemptive nature of a comprehensive statutory framework and the clear legislative intent to put in place time limitations and procecural safeguards for consumers who would not otherwise have any protections against unlawful or untimely assertions of a lien. *C.f.*, *Smith v. YMCA of Benton Harbor/Saint Joseph*, 216 Mich App 552 (1996), *c.f.* also *Jackson v. PKM Corp.*,430 Mich 262 (1988).

5 Under regulations promulgated under the MVSRA, it is an unfair or deceptive practice to refuse to return a vehicle if the owner has demanded its return and paid all the sums which he has agreed to pay, Rule 257.135(d). Reading the MVSRA together with the Garage Keepers Lien Act leads to the conclusion that the repair facility may attempt

to assert its lien on the vehicle for unauthorized repairs. However, the facility does so at the risk illegally converting the vehicle. If the consumer has offered to pay the agreed amount and a trier of fact concludes that remaining charges were not authorized, then the conclusion must be that the consumer was then entitled to possession, and the facility had no right to possession. Such illegal concealment of personal property violates MCL 600.2919a and is subject to treble damages for the value of the goods.

[6] The MVSRA provides several remedies in addition to those discussed in this article including administrative mediation, licencing sanctions, and corporate veil piercing.

[7] MCL 257.1331.

[8] MCL 257.1336.

[9] *Id.*

[10] See *Ballman v Borges*, CA No 193746.

[11] *Central Transport, Inc v Fruehauf Corp.*, 139 Mich App 536 (1984).

[12] *Rohe Scientific Corp v National Bank of Detroit*, 135 Mich App 777 (1984).

Lender Liability ....*Continued from page 1*

Commission (FTC) Rule on the Preservation of Claims and Defenses, 16 CFR 433, requires contract language in financed consumer sales which abrogates any protections available for the assignee. This language, when written into the installment sales contract as required, becomes enforceable as a contract term, making the assignee liable for claims and defenses that could be asserted against the seller that assigned the contract.

However, consumer finance arrangements are often written as direct loans from a bank or finance company rather than an installment sale assigned to the finance company after the sale. The seller may act as agent for the financing company, arranging the loan, or may send the buyer to the finance company office. With these arrangements, assignee liability provisions of Michigan consumer statutes may not apply to make the finance company liable for the actions of the seller. On paper, there is no installment sale, but a direct loan, usually secured, from the bank or finance company.

The buyer is left with two sources of law to keep the finance company from profiting at the expense of the bilked consumer: 1) the FTC Rule provisions on liability of related lenders, and 2) common law theories of joint action, agency, fraud or negligence.

The FTC Rule on Preservation of Claims and Defenses has a second notice requirement, in addition to the notice required in installment sales contracts, to be placed in certain loan agreements for purchase of consumer goods and services. This notice is required when there is a referral, affiliation or business arrangement between the seller and the lender. The notice subjects the lender to claims and defenses available against the seller, again as a matter of contract agreement.

Installment sales agreements entered into with sellers typically have the required FTC holder liability language. However, purchase money loans entered into directly with finance companies and banks often don't, even when the language is required due to the referral relationship between the lender and the seller. Two problems arise for the consumer attorney trying to enforce the FTC Rule requirements when the language is not in the loan agreement: 1) the FTC rules do not give rise to a private right of action; and 2) the Rule on Preservation of Claims and Defenses does not require the lender to put the appropriate language in the loan agreement, but only requires the seller not to accept proceeds of the loan if the language is not there.

Consumer attorneys have typically used state consumer statutes to enforce the FTC rules, in lieu of a private right of action directly under the Federal Trade Commission Act. Some state consumer laws directly incorporate FTC determinations of unfair and deceptive acts and practices. This is not true of the Michigan Consumer Protection Act.

However, several sections of the MCPA may be violated by the lender's failure to put the claims and defenses language in the loan agreement. These include:

- "Causing a probability of confusion or of misunderstanding as to the legal rights, obligations, or remedies of a party to a transaction," MCLA 445.903(1)(n).
- "Causing a probability of confusion or of misunderstanding as to the terms or conditions of credit...." MCLA 445.903(1)(o).
- "Failing to reveal a material fact, the omission of which tends to mislead or deceive the consumer, and which fact could not reasonably have been known by the consumer," MCLA 445.903(1)(s).

These sections impose a duty on the lender not to mislead the consumer. If there is a referral or other business arrangement between the seller and the lender, the lender is misleading the consumer if the consumer is not notified of the required FTC language. The existence of the referral or business arrangement, and its impact on the obligations and rights of the parties, are material facts that have not been disclosed to the consumer.No Michigan cases have yet addressed enforcement of FTC consumer rules through the Michigan Consumer Protection Act. There are a few useful cases from other jurisdictions. The Court in *Heastie* v *Community Bank of Greater Peoria*, 727 F Supp 1133 (ND Ill 1989), read the Illinois Consumer Fraud Act broadly to impose liability on a bank for using a form which contained language contradicting the FTC Claims and Defenses Rule. In *Brown* v *LaSalle Northwest National Bank*, 820 F Supp 1078 (ND Ill 1993), the Court held that a bank's practice of leaving the FTC language out of contracts involving car dealers with which it had a business or referral arrangement could form the basis for an action under the federal RICO statute. As the Court stated, "... the defendant can be part of a scheme to defraud consumers even if the regulation does not directly apply to lenders." *Brown*, at 1081.

The Brown case gives support for asserting common law fraud as well as Consumer Protection Act violations against a lender which ignores the FTC Rule in its contracts. Additional grounds for this claim, and for a negligence claim, may be found if the lender knew or had reason to know of unfair business practices of the seller. In *Estate of Sheradsky* v *West One Bank*, 817 F Supp 423 (SDNY 1993), the bank had information suggesting that the investment program that plaintiffs and others were borrowing money to invest in was a pyramid or "Ponzi" scheme. The Court held that the bank could be liable for the plaintiffs' losses. The Court cited "the perceptions underlying" the FTC Rule as support for this proposition, and stated, "If fraud is involved in a transaction, a financing entity which deliberately shuts its eyes to clues concerning the fraud may be unable to enforce promissory notes signed as a result of the fraud."

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Consumer Law Section ◆ Friday, September 18

the business meeting of the section will convene
at 9am with officer & council elections
the program will begin at 9:45am

Featured Speakers

Richard feferman–nationally recognized author and consultant

Topic: Building a consumer law practice

Elizabeth brater–state representative

Topic: Consumer Protection and the State Legislature