PART 2424—PROTECTION OF PRIVACY AND FREEDOM OF INFORMATION
Sec.
Subpart 2424.1—Protection of Individual Privacy Procedures
2424.103 Procedures.
Subpart 2424.2—Freedom of Information Act
2424.202 Policy.
Authority: Sec. 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).
Subpart 2424.1—Protection of Individual Privacy
2424.103 Procedures.
(b)(2) See 24 CFR Part 16 for the HUD regulations which implement the Privacy Act.
Subpart 2424.2—Freedom of Information Act
2424.202 Policy.

SUBCHAPTER E—GENERAL CONTRACTING REQUIREMENTS

PART 2429—TAXES
Subpart 2429.1—General
2429.101 Resolving of tax problems.
In order to have uniformity in HUD’s treatment of the tax aspects of contracting and ensure effective cooperation with other Government agencies on tax matters of mutual interest, the Office of General Counsel has the responsibility within HUD for handling all those tax problems. Therefore, the contracting activity will not engage in negotiation with any taxing authority for the purpose of determining the validity or applicability of, or obtaining exemptions from or refund of, any tax. When a problem exists, the Contracting Officer shall request in writing the Office of General Counsel’s assistance. The request shall detail the problem and be accompanied by appropriate backup data. The Office of General Counsel shall report to the Contracting Officer as to the necessary disposition of the tax problem. The Contracting Officer will notify the contractor of the outcome of the tax problem. The Office of General Counsel shall have the responsibility for communications with the Department of Justice for representation or intervention in proceedings concerning taxes.
Sec. 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).

PART 2432—CONTRACT FINANCING
Subpart 2432.4—Advance Payments
2432.410 Findings, determination and authorization.
(c) The Determination and findings required by FAR 32.402(c)(1)(iii) shall be made by the Head of the Contracting Activity only in those instances where specific delegation of authority has been issued in writing giving the HCA such authority to approve advances.
Sec. 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).

PART 2436—CONSTRUCTION AND ARCHITECT-ENGINEER CONTRACTS
Subpart 2436.6—Architect-Engineer Services
Sec.
2436.602 Selection of firms for architect-engineer contracts.
2436.602-2 Evaluation boards.
2436.602-4 Selection authority.
2436.602-5 Short selection processes for contracts not to exceed $10,000.
Authority: Sec. 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).
Subpart 2436.6—Architect-Engineer Services
2436.602 Selection of firms for architect-engineer contracts.
2436.602-2 Evaluation boards.
(a) Each architect-engineer evaluation board, whether permanent or ad hoc, shall consist of at least three voting members who are Federal employees from the appropriate program area or from Federal offices outside the program area as appropriate. One member of each board shall be appointed Chairperson. Three (3) alternate members who are Federal employees shall also be appointed, but at any given time the majority of voting members shall be from the program area concerned. The members of a permanent board shall be appointed for a period of two years. Appointment shall be made by the following authorities with copies of appointment memoranda furnished to the appropriate contracting activity:
(1) Assistant Secretary or equivalent for boards appointed at the Headquarters level;
(2) Field Office Manager for boards appointed at the Field Office level.
(c) Conflict of interest. Each board member, whether voting or nonvoting, shall become familiar with those provisions of 24 CFR, Subtitle A, Part O, Housing and Urban Development Act (42 U.S.C. 3535(d)).

PART 2437—SERVICE CONTRACTING
Subpart 2437.2—Consulting Services
2437.204 Policy.
All proposed consulting service awards in excess of the applicable small purchase limitation are subject to the review and approval of the Headquarters and Field Procurement Review Boards mandated by 2415.105.

Subchapter G—Contract Management
(See (d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).

PART 2449—TERMINATION OF CONTRACTS
Subpart 2449.1—General Principles
2449.111 Review of proposed settlements.
The Head of the Contracting Activity shall establish internal procedures to ensure the independent review of proposed termination settlements in excess of $100,000.
(See 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).
Donald J. Keuch Jr.
Deputy Assistant Secretary for Administration.

BILLING CODE 4210-01-M
Part III

Department of Health and Human Services

Office of Human Development Services

Administration for Children, Youth and Families; Runaway and Homeless Youth Program; Availability of Financial Assistance; Notice
DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Human Development Services

[Program Announcement No. 13623–841]

Administration for Children, Youth and Families; Runaway and Homeless Youth Program; Availability of Financial Assistance

AGENCY: Office of Human Development Services, Department of Health and Human Services.


This program announcement consists of three parts. Part I covers the scope of this announcement and generally describes the following: the purpose, goals and objectives of the Runaway and Homeless Youth Program; the two types of grants to be supported during FY 1984—Basic Center and Coordinated Networking Grants; and the application and review process attendant to the award of grants under Parts II and III of this announcement. Part II describes the Basic Center Grants component and provides detailed guidance on how to prepare and submit an application. Part III describes the Coordinated Networking Grants component and gives detailed guidance on how to prepare and submit an application for the separate part.

FOR FURTHER INFORMATION CONTACT: ACUF/Youth Development Bureau, Division of Runaway and Homeless Youth Programs, 400 Sixth Street, SW., Room 5754, Washington, D.C. 20201. Telephone: (202) 755–6208.

DATE: The closing date for receipt of all applications under Parts II and III of this announcement is April 16, 1984.

Part I: General Considerations

A. Scope of This Program Announcement

This program announcement solicits applications and describes the application process for the Basic Center Grants and the Coordinated Networking Grants Programs to be competitively awarded during the third and fourth quarters of fiscal year 1984. The grantees who are eligible for non-competitive basic center continuation grants will receive administrative guidance for the submission of their applications from their respective regional offices, listed at the end of this program announcement. They are, therefore, not covered under this announcement.

B. Program Purpose

The purpose of the National Runaway and Homeless Youth Program is to provide financial assistance to establish or strengthen community-based centers designed to address the needs (e.g., outreach, detached youth work, temporary shelter, counseling, family counseling and aftercare services) of runaway and homeless youth and their families. Additionally, Section 311(a) of the Act authorizes the Secretary “to make grants ... to coordinated networks ...”. These grants are to provide financial assistance to the coordinated service networks of runaway and homeless youth serving agencies to develop and strengthen the coordination of resources and services to runaway and homeless youth and their families between and among the public and private sectors.

Programs receiving Runaway and Homeless Youth Act funding under Parts II and III of this announcement are required to be knowledgeable of and to adhere to the requirements of 45 CFR Part 1351, Runaway and Homeless Youth Program, and other applicable Federal regulations. Applicants must develop their application in accordance with those regulations and the supplementary instructions which are included in this announcement.

C. Program Goals and Objectives

The program goals and objectives of the Runaway and Homeless Youth Act are to assist runaway and homeless youth centers to: (a) Alleviate the problems of runaway and homeless youth; (b) reunite youth and their families and to encourage the resolution of intrafamily problems through counseling and other services; (c) strengthen family relationships and to encourage stable living conditions for youth; and (d) help youth decide upon a future course of action.

The centers to be funded under Part II of this program announcement are required to provide outreach, temporary shelter, individual and group counseling, family counseling and aftercare services. These services must address the immediate needs of youth while they are away from home, and provide individual and family counseling and other assistance needed to resolve intrafamily problems, and to strengthen family relationships. Additionally, both directly and through linkages with other social service agencies, the centers are required to furnish other assistance such as health, education, legal, and employment services geared to the needs of the individual clients and families served.

For FY 1984, a special emphasis is being placed on strengthening the coordination of resources and services for runaway and homeless youth and their families by supporting, through one-time grants, coordinated networks of nonprofit, private service agencies at the State, local or regional levels. The applications for networking grants will be solicited and reviewed under three discrete priority areas. The networking priority areas are: Networking to develop effective community responses to the needs of older adolescents; networking to expand the State role in meeting the needs of runaway and homeless youth; and networking support for center-oriented problem solving. Part III of this announcement provides detailed guidance on the requirements and application procedures for this activity.

D. Application Process

Eligible organizations wishing to compete for Basic Center or Coordinated Networking Grants must submit a completed application by April 16, 1984. All applicants must clearly identify on the application form (SF 424, Box 7) whether they are applying for a Runaway and Homeless Youth Basic Center Grant or Coordinated Networking Grant. Applications received in response to this announcement will be reviewed by ACUF and other Federal staff and non-Federal experts.

Agencies and organizations interested in applying for funds may receive application information from the Youth Development Bureau, ACUF, 400 6th Street, SW., Washington, D.C. 20201—Attention ACUF—YDB—841. Telephone: (202) 755–6208.
1. Application Requirements

In order to be considered for a Runaway and Homeless Youth Basic Center or Coordinated Networking Grant, an application must be submitted on the forms and in the manner required by the Administration for Children, Youth and Families.

The application must be executed by an individual authorized to act for the applicant agency and to assume responsibility for the obligations imposed by the terms and conditions of the grant award. Applications must be prepared in accordance with the guidance provided in this announcement. All the information needed and the forms required to submit a complete application under this program are contained in this announcement.

2. Notification Under Executive Order 12372

This program is covered under Executive Order 12372, “Intergovernmental Review of Federal Programs”, and 45 CFR Part 100, “Intergovernmental Review of Department of Health and Human Services Programs and Activities”, previously the A-95 review process. In those States that have opted to review applications for financial assistance under the Runaway and Homeless Youth Act Program, State processes or directly affected State, areawide, regional and local officials and entities have sixty (60) days to comment on your application, starting from the deadline date for application submission.

Applicants are encouraged to submit material required by their State Single Point of Contact as early as possible and are encouraged to obtain comments prior to the submission of the application. Material should be submitted to the applicable State Single Point of Contact identified in the listing included at the end of this announcement. The applicant should forward any comments received by the State process to ACYF. ACYF will notify the State of any application received which has no indication that the State process had an opportunity to review it.

3. Priority for Funding

Section 313 of the Runaway and Homeless Youth Act requires that priority for funding be given to organizations with demonstrated experience in providing services to runaway and homeless youth, and their families, and to organizations requesting grants of less than $150,000. As specified in 45 CFR 1351.12—“Past experience means that a major activity or the agency has been the provision of temporary shelter, counseling, and referral services to runaway and otherwise homeless youth and their families, either directly or through linkages established with other community agencies.”

4. Availability of Forms

For your convenience, a copy of each form required to submit an application for a grant under the Runaway and Homeless Youth Program is included in the Appendices to this announcement. Title III of Pub. L. 96-509, the Runaway and Homeless Act, and the Code of Federal Regulations (CFR) Title 45, Part 1351—Runaway Youth Program may be available at the main branch of your local public library, university libraries, U.S. Government Printing Office bookstores, or from the ACYF regional offices listed at the end of this announcement. These materials may also be obtained by writing to: ACYF, Youth Development Bureau, Division of Runaway and Homeless Youth Programs, 400 Sixth Street, SW., Room 5754, Washington, D.C. 20201, Telephone: (202) 755-8208.

Additional copies of this announcement are also available from the above address or may be obtained from the regional offices listed at the end of this announcement.

5. Application Consideration

All applications which are complete and conform to the requirements of this program announcement will be subject to a competitive review and evaluation process against the specific criteria outlined in Sections II-D and III-G of this program announcement. This review will be conducted in Washington, D.C. Reviewers will include individuals knowledgeable in the areas of youth development and/or human service programs (from States other than the one being reviewed), Federal staff and other experts. The results of the competitive review will be taken into consideration by the Director of the Youth Development Bureau who, in consultation with the ACYF regional officials, will recommend projects to be funded. The ACYF Commissioner will make the final selection of applicants to be funded. The Commissioner may elect not to fund any applicants that have known management, fiscal or other problems or situations which make it unlikely that they would be able to provide effective services to runaway and homeless youth. For example, this might apply to an applicant which has failed to serve an adequate number of runaway and homeless youth in the past. Successful applicants will be notified through the issuance of a Notice of Financial Assistance Awarded which sets forth the amount of funds granted, the terms and conditions of the grant, the effective date of the grant, the budget period for which support is given, the non-Federal share to be provided, and the total project period for which support is provided.

Organizations whose applications have been disapproved will be notified in writing of that decision.

Part II: Basic Center Grants

A. Eligible Applicants

States, localities, private non-profit agencies and coordinated networks of such agencies are eligible to apply for a Runaway and Homeless Youth Basic Center Grant as long as they are not a part of the law enforcement structure or the juvenile justice system. States are defined to include any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Trust Territories of the Pacific Islands, the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands. (See 42 U.S.C. 5003(7) as amended by Sec. 5(c) of Pub. L. 96-509). Federally recognized Indian tribes are eligible to apply for grants as local units of government. Non-Federally recognized Indian tribes and Indian organizations are eligible to apply for grants as private nonprofit agencies.

B. Available Funds

The Administration for Children, Youth and Families expects to award a total amount of approximately $18,000,000 in Basic Center Grants to an estimated 240 programs for runaway and homeless youth in fiscal year 1984. Of that amount, an estimated $2,200,000 will be available for the non-competing continuations that were funded for the first time in fiscal year 1981 for a four year project period. It is anticipated that the balance of approximately $15,800,000 will be available under Part II of this announcement to fund an estimated 198 programs, including some new centers in currently unserved communities that did not receive funding under the Runaway and Homeless Youth Act (Title III, Pub. L. 96-509) during the previous center grants competition held in fiscal year 1983. It is also anticipated that the project and budget periods of grants, both competitive and non-competitive, will be for a period of 12 months.

The number of Basic Center Grants awarded within each State will depend upon the State’s allocation and the
number of acceptable applications. Also, all applicants under this announcement will compete with other applicants in the State in which their services will be provided. In the event that agencies within any State jurisdiction either submit applications which fail to meet the minimum criteria for funding, or do not submit applications, the Assistant Secretary for Human Development Services may reallocate any such unused funds.

Under Section 313 of this Act, as amended (42 U.S.C. 5713), DHHS, in considering both Basic Center and Coordinated Networking Grant applications, gives priority to organizations which have a demonstrated experience in the provision of services to runaway and homeless youth and their families and to organizations requesting grants of less than $150,000. In negotiating the final budgets for successful applicants, consideration will be given to the need expressed in the application which identifies the number of runaway or homeless youth in the community in which the center will be located; the existing availability of services designed to meet the immediate needs of runaway and homeless youth and their families; and the range and types of services to be provided under the proposed project within the requirements of the Act, as shown in criterion number 3, Section D of the announcement.

The following table indicates the total fiscal year 1984 allocations for each State.

<table>
<thead>
<tr>
<th>State</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>$324,809</td>
</tr>
<tr>
<td>Alaska</td>
<td>39,692</td>
</tr>
<tr>
<td>Arizona</td>
<td>234,581</td>
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<tr>
<td>Arkansas</td>
<td>180,460</td>
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<tr>
<td>California</td>
<td>1,823,502</td>
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<tr>
<td>Colorado</td>
<td>230,631</td>
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<tr>
<td>Connecticut</td>
<td>216,562</td>
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<tr>
<td>Delaware</td>
<td>45,110</td>
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<td>District of Columbia</td>
<td>37,986</td>
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<tr>
<td>Florida</td>
<td>881,620</td>
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<td>Georgia</td>
<td>456,707</td>
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<td>Hawaii</td>
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<td>Idaho</td>
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<td>Illinois</td>
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<tr>
<td>Indiana</td>
<td>433,107</td>
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<tr>
<td>Iowa</td>
<td>223,770</td>
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<tr>
<td>Kansas</td>
<td>180,463</td>
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<tr>
<td>Kentucky</td>
<td>292,126</td>
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<tr>
<td>Louisiana</td>
<td>376,945</td>
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<tr>
<td>Maine</td>
<td>86,821</td>
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<tr>
<td>Maryland</td>
<td>312,020</td>
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<tr>
<td>Massachusetts</td>
<td>397,014</td>
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<td>Michigan</td>
<td>723,648</td>
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<tr>
<td>Minnesota</td>
<td>315,417</td>
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<tr>
<td>Mississippi</td>
<td>233,772</td>
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<td>Missouri</td>
<td>369,947</td>
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<tr>
<td>Montana</td>
<td>63,185</td>
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<tr>
<td>Nebraska</td>
<td>122,582</td>
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<tr>
<td>Nevada</td>
<td>64,137</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>70,509</td>
</tr>
<tr>
<td>New Jersey</td>
<td>535,102</td>
</tr>
</tbody>
</table>

**RUNAWAY AND HOMELESS YOUTH CENTERS**

**ALLOCATIONS BY STATE**

**Continued (Total 57 States—Fiscal year 1984)**

<table>
<thead>
<tr>
<th>State</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Mexico</td>
<td>117,302</td>
</tr>
<tr>
<td>New York</td>
<td>1,295,861</td>
</tr>
<tr>
<td>North Carolina</td>
<td>452,958</td>
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<tr>
<td>North Dakota</td>
<td>54,128</td>
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<tr>
<td>Ohio</td>
<td>320,531</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>247,221</td>
</tr>
<tr>
<td>Oregon</td>
<td>198,509</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>839,143</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>64,967</td>
</tr>
<tr>
<td>South Carolina</td>
<td>259,983</td>
</tr>
<tr>
<td>South Dakota</td>
<td>55,944</td>
</tr>
<tr>
<td>Tennessee</td>
<td>353,704</td>
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<tr>
<td>Texas</td>
<td>1,271,125</td>
</tr>
<tr>
<td>Utah</td>
<td>162,415</td>
</tr>
<tr>
<td>Vermont</td>
<td>37,900</td>
</tr>
<tr>
<td>Virginia</td>
<td>404,221</td>
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<tr>
<td>Washington</td>
<td>306,817</td>
</tr>
<tr>
<td>West Virginia</td>
<td>151,588</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>388,124</td>
</tr>
<tr>
<td>Wyoming</td>
<td>43,311</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>250,093</td>
</tr>
<tr>
<td>Virgin Islands</td>
<td>12,631</td>
</tr>
<tr>
<td>American Samoa</td>
<td>2,611</td>
</tr>
<tr>
<td>Guam</td>
<td>12,631</td>
</tr>
<tr>
<td>Pacific Trust Territories</td>
<td>5,046</td>
</tr>
<tr>
<td>Northern Mariana Islands</td>
<td>1,906</td>
</tr>
</tbody>
</table>

Total: $18,000,000

**C. Grantee Share of the Project**

A ten percent match of the Federal dollars requested is required of all grantees funded under this announcement. The non-Federal portion may be for grantee incurred costs or in-kind contributions (including the facility, equipment or services) and must be project-related and allowable under the cost principles as provided in 45 CFR Part 74, the Department's regulation on the Administration of Grants.

**D. Review Criteria**

All competitive applications for financial assistance to support the operation of basic centers for runaway and homeless youth will be reviewed and evaluated against the following criteria:

1. The reasonableness of the proposed budget, including a justification for costs. (10 points)
2. The extent to which the applicant has demonstrated the ability to access other resources which can strengthen support for the existing or proposed center's activities and to remain a viable organization at the expiration of the Federal funding period. (15 points)
3. The extent to which the application documents the need for services to runaway and homeless youths in proposed service areas [e.g., specific communities, districts, neighborhoods] on the basis of a comprehensive community needs assessment, including the extent to which the selection of these areas is based on the incidence of runaway and homeless youth. (15 points)
4. The ability of the applicant to document the need and availability of services for runaway and homeless youth within the locality to be served by the Runaway and Homeless Youth Program. (Citation of data sources) (5 points)

b. The applicant appropriately describes the relationships between the location of the center to other existing availability services within the community and discusses the results or benefits anticipated in terms of both clients served and the community at large and the State (for example: youth reunification with the family, reduction in delinquency). (5 points)

Total: 20 points.

4. The ability of the applicant to design, establish and continue a center which can achieve the goals and requirements of this grant program as set forth in the Runaway and Homeless Youth Act, the Administrative Requirements (45 CFR Part 1351), and the Program Performance Standards. (15 points)

b. The applicant appropriately describes the relationships between the location of the center to other existing availability services within the community and discusses the results or benefits anticipated in terms of both clients served and the community at large and the State (for example: youth reunification with the family, reduction in delinquency). (5 points)

Total: 20 points.

4. The ability of the applicant to design, establish and continue a center which can achieve the goals and requirements of this grant program as set forth in the Runaway and Homeless Youth Act, the Administrative Requirements (45 CFR Part 1351), and the Program Performance Standards. (15 points)

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Total: 20 points.

4. The ability of the applicant to design, establish and continue a center which can achieve the goals and requirements of this grant program as set forth in the Runaway and Homeless Youth Act, the Administrative Requirements (45 CFR Part 1351), and the Program Performance Standards. (15 points)

b. The applicant appropriately describes the relationships between the location of the center to other existing availability services within the community and discusses the results or benefits anticipated in terms of both clients served and the community at large and the State (for example: youth reunification with the family, reduction in delinquency). (5 points)

Total: 20 points.

4. The ability of the applicant to design, establish and continue a center which can achieve the goals and requirements of this grant program as set forth in the Runaway and Homeless Youth Act, the Administrative Requirements (45 CFR Part 1351), and the Program Performance Standards. (15 points)

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Total: 20 points.

4. The ability of the applicant to design, establish and continue a center which can achieve the goals and requirements of this grant program as set forth in the Runaway and Homeless Youth Act, the Administrative Requirements (45 CFR Part 1351), and the Program Performance Standards. (15 points)

b. The applicant appropriately describes the relationships between the location of the center to other existing availability services within the community and discusses the results or benefits anticipated in terms of both clients served and the community at large and the State (for example: youth reunification with the family, reduction in delinquency). (5 points)

Total: 20 points.
E. Instructions for Completing the Application

1. Application Requirements. In order to be considered for a Basic Center Grant, an applicant must submit one signed original and two copies of the grant application, including all attachments. ACYF encourages the submission of an additional five copies for a total of eight copies in order to expedite the processing and to facilitate the panel review process. There is no penalty for not submitting these additional copies. One copy of the complete application should be sent to the appropriate Regional office listed at the end of this announcement. The remaining complete applications, including the original and all copies, must be sent to: HDS/Division of Grants and Contracts Management, 330 Independence Avenue, SW., Room 1740, Washington, D.C. 20201—Attention ACYF-YDB-841. The program announcement number (13623-841) must be clearly identified on the application (SF 424, box 6).

2. Content of Application. Each copy of the application must contain the following items in the order listed:
a. A Project Abstract Form  
b. A Standard Form 424, page 1  
c. Part II—Project Approval Information  
d. Part III—Budget Information  
e. Part IV—Project Narrative  
f. HHS—SF 441, Assurance of Compliance, Title VI, Civil Rights Act of 1964  
g. HHS—SF 641, Assurance of Compliance, Sec. 504, Rehabilitation Act of 1973, As Amended.

3. Instructions for Preparing Application. For your convenience, we have reprinted the forms and instructions for applying for Federal Assistance from HDS programs as appendices A and B to this announcement. We suggest that you reproduce the forms and use them to prepare your application. Prepare your application in accordance with the following instructions:
a. Project Abstract Form—Please complete the Project Abstract Form which is Appendix A of this announcement. The completed form should be used as a cover sheet for your application. In order to facilitate handling, do not use covers, binders, or tabs.
b. Standard Form 424, page 1—Complete Standard Form 424, page 1 in accordance with the instructions contained in Appendix B.

c. Part II—Project Approval Information. This form is self-explanatory.
d. Part III—Budget Information—Complete Part III in accordance with the instructions contained in Appendix B.
e. Part IV—Project Narrative—Describe the project you propose in response to this announcement. Your narrative (27 pages typed single-spaced maximum, on 8¼” × 11” plain white bond with 1” margins on both sides) should provide information on how application meets the review criteria. We strongly suggest that you follow this format and page limitations.

1. Table of Contents. Provide a Table of Contents including a listing of any appendices.

2. Geographic Location. Describe the precise location of the project. Maps or other graphic aids may be attached. (1 page).

3. Objectives and Need For This Assistance. (4 pages maximum, single spaced).

Provide a concise description documenting the need for services for runaway and homeless youth in the area to be served. These data must be documented by source and may be compiled from the most recent census, police, juvenile court, welfare, existing runaway services and other sources. (1) Information should include data on the incidence of runaway and homeless youth in the geographic area to be served including the demographics of males, females; ethnic origin; ages; State of origin; approximate distance that clients have run to the center; services needed by youth and families; and outcomes as well as an analysis of the existing services for runaway and homeless youth in the community. (2) Demonstrate the connection between the needs identified and the program of services planned or offered by the applicant agency.

4. Results or Benefits Expected. (2 pages maximum, single space).

This section should identify the results and benefits to be derived from the implementation of services to runaway and homeless youth and their families under this grant program. Specifically, the applicant should describe: the results or benefits anticipated in terms of clients served, the community-at-large, the State (for example: Youth reunification with the family, independent living situations, aftercare services, reduction in delinquency, etc.). In addition, explain the criteria to be used to evaluate the results of successes of the project and to determine if the results and benefits identified are being achieved.

5. Approach. (20 pages maximum, single spaced, excluding timetables,
networks or coalitions of youth serving agencies or other human services organizations.

b. Provide quantitative monthly or quarterly projections of the accomplishments to be achieved such as the number of runaway and homeless youth and their families to be served.

c. Identify the kinds of data to be collected and discuss how the project will maintain adequate statistical records profiling the youth and families served and the procedures that are or will be employed to ensure the confidentiality of this information.

6. Organizational Capability. (5 pages maximum, excluding position descriptions or résumés)

Provide an organizational chart and describe the following: How the program is staffed; how staff are selected, supervised and trained; how the organization ensures 24-hour accessibility to its services and an adequate youth/adult staff ratio at all times. Discuss the extent to which the program has defined specific roles for youth in planning, policy, decision making and service delivery.

a. Provide position descriptions and résumés for key positions in the program (e.g., the Executive Director, Counseling Supervisor), and a listing of board members, as applicable. Describe how the organization involves other members of the community and State in its program. Demonstrate that the organization has legal and fiscal viability in accordance with the provisions of the CFR, Title 45, Part 74.

b. Describe the recruitment, training and utilization efforts for volunteers in the organization, including the roles volunteers have in service delivery, outreach in the community, and as members of the Board of Directors or advisory group.

7. Plans and Assurances. Applicants should provide a statement evidencing that they will comply with the program requirements provided in the Code of Federal Regulations, Title 45, Part 1351.

Closing Date for Receipt of Applications

The closing date for receipt of applications under this announcement is April 16, 1984. Applications must be mailed or hand delivered to: HHS/ Division of Grants and Contracts Management, 330 Independence Avenue, S.W., Washington, D.C. 20201, Room 1740, Attention: ACYF/YDB 841.

Mailed applications. Applications mailed through the U.S. Postal Service shall be considered as meeting the deadline if they are either:

1. Received on or before the deadline date; or

2. Sent by first class mail, postmarked on or before the deadline date, and received in time for submission to the independent review group. (Applicants are cautioned to request a legible U.S. Postal Service postmark or to use express mail or certified or registered mail and obtain a legibly dated mailing receipt from the U.S. Postal Service. Private metered postmarks shall not be acceptable as proof of timely mailing.)

Applications submitted by other means. Applications submitted by any means except mailing first class through U.S. Postal Service shall be considered as meeting the deadline only if they are physically received before close of business on or before the deadline date.

Late applications. Applications which do not meet these criteria are considered late applications and will not be considered in the current competition.

Part III: Coordinated Networking Grants

A. Background Information

In FY 1984, a special emphasis is being placed on strengthening the coordination of resources and services to runaway and homeless youth and their families. Approximately, 30 to 44 grants will be awarded under the Coordinated Networking Grants activity. Applicants may be established networks or networks to be established in response to the requirements of this program announcement. All applications received in response to this section of the announcement will be competitively reviewed and evaluated on a national basis. Coordinated networks of agencies means an association of two or more nonprofit, private agencies whose purpose is to develop or strengthen services to runaway or otherwise homeless youth and their families. All grantees shall be required to document in program reports, through descriptive summaries, the specific outcomes of the networking activities supported by this grant.

Described below are the requirements and instructions for submitting grant applications under this section (Part III—Coordinated Networking Grants) of the FY 1984 Runaway and Homeless Youth Program Announcement.

Approximately $825,000 will be available to support grants under this section of the announcement. It is expected that grant awards will range from $10,000 to $55,000. However, the specific range for each priority area may vary. This is discussed in Section C.

The project periods for all networking grants funded under this announcement will be 12 months or less.
2.3 Aftercare Systems

2.1 Statewide Outreach Systems

The three program priority areas are:

1.2 Developing Family Support Networks. In terms of long-range solutions, the most often cited need by service providers is to strengthen family relationships. Weakening of the traditional family structure through separation, divorce, poverty and high mobility is a major contributing factor to, if not the cause of, runaway behavior and homeless youth. Family support networks have demonstrated effectiveness in helping families cope with the various stresses brought about by the weakening of the family structure. They have been particularly helpful in providing aftercare support services following the reunification of a youth with his or her family. Family support networks also appear to be an effective mechanism for the prevention of the runaway behavior and/or the homeless state of older adolescents.

ACFY will also support applications that address the issue of runaway and homeless youth who are currently unreported by their families and/or uncounted by any official system. This includes possibly one million youth. The magnitude of the problem within a State requires a more accurate assessment before effective prevention and outreach strategies can be developed.

Applications should address one or more of the following purposes:

2.1 Statewide Outreach. This area includes improving the various public and private State systems’ involvement in helping identify and alleviate
problems that contribute to runaway behavior or being homeless. These systems include but are not limited to schools, health and health education, recreation, welfare, social services, civic organizations, day care, juvenile justice, retail stores, churches, hotel associations, unions, and public media. Special emphasis should be placed on unserved areas in the State.

2.2 Employment Training/Job Placement. States support and manage different job programs for vulnerable youth. Training and job placement components are essential to the success of independent living models. ACYF will support grants that address the development of stronger linkages between State job training and placement programs and runaway and homeless youth service providers. Training and job placement slots should be linked to shelters for runaway and homeless youth, especially those with independent living models.

2.3 Aftercare Systems. Aftercare consists of counseling services to runaway and homeless youth and their parents or guardians following a youth’s return home or placement in alternative living arrangements. The purpose of aftercare is to assist in alleviating the problems that contribute to runaway behavior or being homeless. Different youth serving programs within a State service system such as foster care, residential care and treatment, and juvenile justice recognize the need for aftercare. About half of the runaway youth are estimated to have a realistic prospect for family reunification or long-term stable foster placement (e.g., independent living arrangements, group homes). In the opinion of experts in the field, the success of this reunification is largely dependent on the availability of strong aftercare services (e.g., independent living training, long-term counseling). Aftercare systems are expensive and hard to establish. They involve many different disciplines and cut across a number of different service delivery systems. ACYF/YDB will support grants that provide for State participation in developing and coordinating State-wide efforts to address this issue.

2.4 Counting and Reporting. Many runaway and homeless youth are uncounted by any official system or survey. It is difficult to track and count persons who have no permanent address, particularly youth with no work history or Social Security number, and who may be inclined to conceal their real names. Police and juvenile probation personnel consistently advise that only one in four or five runaway/homeless youth whom they see is ever arrested, detained or officially counted and that many runaways are not reported as missing by their parents. Other studies have found that only one in six runaways is reported as missing by parents or guardians. Again, state participation could play a vital role in developing and coordinating better reporting and counting of runaway and homeless youth in their States and region.

2.5 Structured Care Placement Options for the Older Adolescent. Many practitioners and experts agree that today’s runaway and homeless youth are a more complex and more troubled group than previously acknowledged. “Tougher,” “more severe,” “more long-term problems,” “more abuse,” and “more running from something instead of to something” are the most common descriptions used. Several New York City shelters recently participated in a study not yet published which found that about 80 percent of the runaway and homeless youth sampled were depressed or in poor mental health, as measured against an accepted medical standard. Respondents of another recently completed study indicate that about 25 percent of the clients are “street kids” in serious trouble, of which more than half engage in some type of criminal activity and half in prostitution. Many shelter staff particularly cite the lack of safe placement options. They see the changes in the status offense laws as leaving runaway and homeless youth in a position to “fall between the cracks of service provision.” Many runaway/status offenders are ignored, when what they need is to be stopped and placed in care for short-term stabilization while their needs can be investigated and options planned.

Problem factors in developing appropriate placement options for these youth include many of the following: difficulties in recruiting and licensing foster homes; the absence of special support systems (e.g., counseling) for difficult placements; the scarcity of alternative placements such as supervised transitional living arrangements; and education/training opportunities to prepare older youth for full emancipation. Leadership is needed to develop and coordinate efforts addressing the service gaps in safe placement options for older youth.

ACYF will award 10-12 grants under this priority area. It is expected that grants will range from $50,000 to $65,000. The estimated total funds available under this priority area is $525,000.

3.0 Networking for Center-Oriented Problem Solving Support—Long and Short-Term. Federally funded shelters and non-federally funded service providers experience periodic need for problem solving kinds of support in order to maintain and/or increase their capabilities to serve runaway and homeless youth and their families. These needs are not necessarily related to major trends or established significant issues but are more oriented to the fluctuations of individual center program growth and development. Coordinated networks are excellent sources of such support.

Some of the priorities to be addressed by networking in this area shall include but are not limited to:

3.1 Development of alternative funding sources.
3.2 Aftercare systems.
3.3 Case management and planning.
3.4 Program evaluation.
3.5 Crisis intervention techniques.
3.6 Fiscal management skills.
3.7 Recognizing and providing for learning disabled and handicapped youth.

Applications should address one or more such areas, and should describe the support to be provided, justify the need, indicate whether the support is long-term or short-term, list the recipients, document the recipients’ desire for such support, and describe how the cost-efficiency of the support provided will be measured.

It is anticipated that 10-20 grants will be awarded in this area with the range in size of grants being approximately $10,000–$25,000. The total amount available under this priority area is $200,000.

E. Available Funds

Approximately $825,000 will be available for Coordinated Networking Grants. ACYF expects to award between 30-44 such grants in FY 1984. Of the total amount, $100,000 will be available for 10-12 competing awards under Priority Area I—Networking Community Resources to meet the Needs of the Older Homeless Youth. Approximately $525,000 will be available for 10-20 competing grants under Priority Area II—Coordinated Networking to Expand the Role of the State in the Development of Services to Runaway and Homeless Youth. Approximately $200,000 will be available for 10-12 competing grants in Priority Area III—Networking for Center-Oriented Problem Solving Support—Short-Term, Long-Term.

Funds unexpended in one priority area will be reallocated to other priority areas and/or to the Basic Center Grant Program.
F. Grantee Share of the Project.

A ten percent match of the Federal dollars requested is required of all grants funded under this announcement. The non-Federal portion may be for grantee incurred costs or in-kind contributions (including the facility, equipment or services) and must be project-related and allowable under the cost principles as provided in 45 CFR Part 74, the Department's regulation on the Administration of Grants.

G. Review Criteria

All Coordinated Networking Grant applications must address a priority area. All applications must be complete and meet the deadline. They will be reviewed and evaluated against the following criteria:

Criterion 1: Responsiveness to Program Announcement

The applicant clearly identifies and addresses the priority area. The applicant documents the need for the proposed activities to be undertaken. (20 points)

Criterion 2: Soundness of Approach

A clear discussion of the feasibility of the proposed effort is provided. The ability of the applicant network to achieve the proposed objectives is described. The level of effort required is discussed and is adequate to conduct the proposed activities. A clearly stated workplan, staff loaded for task accomplishment is provided. (30 points)

Criterion 3: Budget Appropriateness and Reasonableness

The proposed budget is commensurate with the level of effort needed to accomplish the proposed objectives. The cost of the proposed activity is reasonable in relation to the value of the anticipated results. The contribution of the collaborative agencies or organizations is assured in writing and included with the application when it is submitted. The participation of an agency other than the applicant, if critical to the proposed effort, is evidenced by a letter indicating agreement to participate. (15 points)

Criterion 4: Staffing and Management

The proposed staff are well qualified to carry out the proposed activity. The division of responsibilities is appropriate to carry out workplan tasks. The applicant's facilities and/or staff available to achieve the proposed objectives are adequate. (15 points)

Criterion 5: Identified Outcomes

The identification of specific quantifiable outcomes (i.e., an increase in the number of placement options for older homeless youth; public education/public media; involvement in statewide outreach/prevention efforts; problem-solving support in case planning and management provided to "x" number of shelters; and family support networks developed serving "y" number of families). (20 points)

Total: 100 points.

H. Instructions for Completing Applications

1. Application Requirements. In order to expedite the processing of applications, applicants must follow the instructions provided explicitly. Each application package should include:

a. An original and a minimum of two additional copies of the application. While an original and two copies are required, five additional copies are requested in order to facilitate processing and review. No applicant will be penalized for submitting only the three required copies. Each copy should be stapled (back and front) in the upper left corner. The original copy of the application must have original signatures.

i. In addition, to facilitate the identification and review of these applications it is suggested that a special identifier be used on the front cover of the original and the copies. Mark the symbol "NET" in large letters with a red marker pen in the upper right hand corner. In order to facilitate handling, please do not use covers, binders, or tabs. Three extra copies of SF 424 and three copies of the cover sheet/abstract stapled together apart from the copies of the application are requested.

ii. The special identifier, "NET", should be applied to the three extra copies of the SF 424 and abstract form as well. All applicants will be automatically notified of receipt and of the identification number assigned to their application. This number and the priority area must be referred to on all subsequent communication with ACYF concerning the application. If acknowledgement is not received within six weeks after the deadline date, please notify ACYF by telephone (202) 755-8208.

2. Content of Application. Each copy of the application must contain each of the following items in the order listed:

a. A Project Abstract Form.


c. Part II—Project Approval Information.

d. Part III—Budget Information.

e. Part IV—Project Narrative which includes:

i. A table of contents, including a listing of any appendices.

ii. Project narrative, no more than twenty-five pages long, single spaced and typewritten on one side only, completed according to instruction listed below.

iii. Organizational capability statement or materials, no more than two double-spaced typewritten pages. [See instructions below.]

f. HHS-SF 441, Assurance of Compliance, Title VI, Civil Rights Act of 1964.

g. HHS-SF 641, Assurance of Compliance, Sec. 504, Rehabilitation Act of 1973, As Amended.

3. Instructions for Preparing the Application. For your convenience, we have reprinted the forms and instructions for applying for Federal assistance from HHS programs as appendices A and B to this announcement. We suggest that you reproduce the forms and use them to prepare your application.

Prepare your application in accordance with the following instructions:

a. Project Abstract Form.

b. Please Complete the Project Abstract Form at Appendix A of the announcement. The completed form should be used as a cover sheet for your application. In order to facilitate handling, do not use covers, binders, or tabs.

c. Standard Form (SF) 424, page 1:

Except for items 6b, the SF 424 should be completed in accordance with the instructions contained in Appendix B. Item 6b. should be completed as follows: Type: "Runaway and Homeless Youth FY 1984 Coordinated Networking Grant Program" and the number of the priority areas and topic under which the application is being submitted.

d. Instructions for Part II (self-explanatory).

e. Instructions for Part III—Budget Information.

Complete Part III in accordance with the instructions contained in Appendix B.

e. Part IV—Project Narrative.

Describe the activity you propose in response to this announcement. Your narrative (27 pages typed single-spaced maximum, on 9½" X 11" plain white bond with 1" margins on both sides) should provide information on how the application meets the review criteria. We strongly suggest that you follow these formats and page limitations:

1. Table of Contents. Provide a Table of Contents including a listing of all appendices.

2. Geographic Location. (1 page, single spaced)
Describe the precise location(s) of the projected activity. Maps or other graphic aids may be attached.

3. Priority Area, Objectives and Need for This Assistance. (4 pages maximum, single spaced)

Clearly identify the priority area and provide a brief description of the activity being proposed, documenting the need for such an effort. These data must be documented by source. (1) Information should include data on the incidence of runaway and homeless youth in the geographic area to be served, where applicable; (2) the gaps in services available; (3) how services will be developed or strengthened; and (4) how the shelters will benefit.

4. Results or Benefits Expected. (2 pages maximum, single spaced)

This section should identify the results and benefits to be derived from the implementation of services to runaway and homeless youth and their families under this grant program. Specifically, the applicant should describe: the results or benefits anticipated in terms of clients served, the community-at-large, the State (for example: youth reintegration with the family, independent living situations, aftercare services, reduction in delinquency, etc.). In addition, explain the criteria to be used to evaluate the results of successes of the project and to determine if the results and benefits identified are being achieved.

5. Approach. (20 pages maximum, single spaced, excluding timetables, charts, supporting documentation, position description, listings or resumes)

i. Outline a plan of action pertaining to the scope and detail of how the proposed work will be accomplished for this grant program. This section of the program narrative must describe the specific plan of action workplan. Specifically, the program narrative must address at a minimum the following: (1) The feasibility of the proposed effort; (2) the availability of the applicant to achieve the objectives proposed; (3) the level of effort required and person days loaded to task accomplishments; and (4) the criteria to be used to evaluate the results and successes of the project and to determine if the results and benefits identified in (e)(4) are being achieved.

ii. Provide an organizational chart and describe the following: the members of the network: The network governance; network staff or qualifications of staff to be hired for the proposed effort. Discuss how youth are involved in the network and the principle partners of the network in the proposed effort. Provide position descriptions and résumés for key persons. Describe how the network involves other members of the community and State in its program.

Demonstrate that the network has legal and fiscal viability in accordance with the provisions of the Code of Federal Regulations, Title 45, Part 74.

6. Plans and Assurances. Applicants should provide a statement of assurance that they will comply with the program requirements provided in the Code of Federal Regulations, Title 45, Part 1351.

7. Supporting Documentation. Applicants may attach any additional materials, such as letters of support or agreement, news clippings, or descriptions of the program’s participation in local, State or regional coalitions of youth service agencies, which would give further support to the application.

f. HHS-SF 441, Assurance of Compliance, Title VI, Civil Rights Act of 1964 (self-explanatory).

g. HHS-SF 841, Assurance of Compliance, Sec. 504, Rehabilitation Act of 1973, As Amended.

I. Closing Date for Receipt of Applications

The closing date for receipt of applications under this announcement is April 16, 1984. Applications must be mailed or hand delivered to: HHS/Division of Grants and Contracts Management, 330 Independence Avenue, SW., Washington, D.C. 20201, Room 1740. Attention: ACYF/YDB 841. Mailed applications. Applications mailed through the U.S. Postal Service shall be considered as meeting the deadline if they either:

1. Received on or before the deadline date; or
2. Sent by first class mail, postmarked on or before the deadline date, and received in time for submission to the independent review group. (Applicants are cautioned to request a legible U.S. Postal Service postmark or to use express mail or certified or registered mail and obtain a legibly dated mailing receipt from the U.S. Postal Service. Private metered postmarks shall not be accepted as proof of timely mailing. Applications submitted by other means. Applications submitted by any means except mailing first class through the U.S. Postal Service shall be considered as meeting the deadline only if they are physically received before close of business on or before the deadline date. Late applications. Applications which do not meet these criteria are considered late applications and will not be considered in the current competition.

Regional Program Directors, Administration for Children, Youth and Families

Region I. Mr. Richard Stirling, Regional Program Director, Office of Human Development Services, John F. Kennedy Federal Building, Room 2011, Boston Massachusetts 02203 (VT, CT, ME, NH, RI, MA). Attention: Ms. Susan Rosen (617-233-6450)

Region II. Mr. Dennis Doughlin, Acting Regional Program Director, Office of Human Development Services, 26 Federal Plaza, Room 4149, New York, New York 10278 (NY, NJ, FR, VI). Attention: Ms. Estelle Haferling (212-294-1329)

Region III. Mr. Alvin Pearis. Regional Program Director, Office of Human Development Services, 3355 Market Street, Post Office Box 101714, Philadelphia, Pennsylvania 19101 (DE, DC, MD, VA, WV, PA). Attention: Ms. Mary Williams (215-596-0319)

Region IV. Mr. John Jordan, Regional Program Director, Office of Human Development Services, 101 Metrotower Tower, Suite 503, Atlanta Georgia 30323 (AL, FL, GA, KY, MS, NC, SC, TN). Attention: Mr. James Shelton (404-221-2128)

Region V. Mr. German White, Regional Program Director, Office of Human Development Services, 300 South Wacker Drive, Chicago, Illinois 60606 (IL, IN, MN, OH, WI, MI). Attention: Mr. John M. Kelly (312-353-6514)

Region VI. Mr. Tommy Sullivan, Regional Program Director, Office of Human Development Services, 1200 Main Tower, 20th Floor, Dallas, Texas 75202 (LA, NM, OK, TX, AR). Attention: Mr. Jerry Mabe (214-767-6506)

Region VII. Mr. Hilton Baines, Regional Program Director, Office of Human Development Services, Federal Office Building, Room 304, 601 East 12th Street, Kansas City, Missouri 64106 (IA, KS, MO, NE). Attention: Mr. Robert Mead (816-374-7542)

Region VIII. Mr. David Chappa, Regional Program Director, Office of Human Development Services, 1961 Stout Street, Federal Office Building, 9th Floor, Denver, Colorado 80224 (CO, MT, ND, SD, UT, WY). Attention: Mr. Juan Cordova (303-837-3106)

Region IX. Mr. Roy Fleischer, Regional Program Director, Office of Human Development Services, 50 United Nations Plaza, San Francisco, California 94102 (AZ, CA, HI, NV, CU, AS, TT). Attention: Mr. Ray Myrick (415-550-6153)

Region X. Mr. William Hayden, Regional Program Director, Office of Human Development Services, 2801 Third Avenue, Mail Stop 503, Seattle, Washington 98121 (AK, ID, OR, WA). Attention: Mr. Lee Koenig (206-442-0838)

Executive Order 12373—State Single Points of Contact

Arizona
Arkansas  
State Clearinghouse, Office of Intergovernmental Services, Department of Finance and Administration, P.O. Box 3278, Little Rock, Arkansas 72203, Tel. (501) 371-2311.

California  
Office of Planning and Research, 1400 Tenth Street, Sacramento, California 95814, Tel. (916) 445-0262.

Colorado  
State Clearinghouse, Division of Local Government, 1313 Sherman Street, Room 520, Denver, Colorado 80203, Tel. (303) 666-2156.

Connecticut  
Gary E. King, Under Secretary, Comprehensive Planning Division, Office of Policy and Management, Hartford, Connecticut 06106-4459.  
Note.—Correspondence & questions concerning this state's E.O. 12372 process should be directed to: Intergovernmental Review Coordinator, Comprehensive Planning Division, Office of Policy and Management, 80 Washington Street, Hartford, Connecticut 06106-4459, Tel. (203) 566-4208.

Delaware  
Marna C. Whittington, Director of the Budget Office, P.O. Box 1401, Dover, Delaware 19903, Tel. (302) 736-4101.

Florida  
Ron Fays, Executive Office of the Governor, Office of Planning and Budgeting, The Capitol, Tallahassee, Florida 32301, Tel. (904) 488-8114.

Georgia  
Charles H. Badger, Administrator, Georgia State Clearinghouse, 270 Washington Street, S.W., Atlanta, Georgia 30334, Tel. (404) 656-3855.

Hawaii  
Mr. Kent M. Keith, Director, Department of Planning and Economic Development, P.O. Box 2359, Honolulu, Hawaii 96804. For Information Contact: Hawaii State Clearinghouse, Tel. (808) 548-3085.

Illinois  

Indiana  

Iowa  
Office for Planning and Programming, Capital Annex, 523 East 12th Street, Des Moines, Iowa 50319, Tel. (515) 281-6483.

Kansas  
Kansas Department of Human Resources, Office of The Secretary, Attention: Judy Krueger, 401 Topeka Avenue, Topeka, Kansas 66603, Tel. (913) 296-5075.

Kentucky  
Kentucky State Clearinghouse, 2nd Floor, Capital Plaza Tower, Frankfort, Kentucky 40601, Tel. (502) 564-2382.

Louisiana  
Wallace L. Walker, Executive Director, Louisiana State Planning Office of the Governor, P.O. Box 44426, Baton Rouge, Louisiana 70894, Tel. (504) 342-7410.

Maryland  
Guy W. Hager, Director, Maryland State Clearinghouse for Intergovernmental Assistance, Department of State Planning, 301 West Preston Street, Baltimore, Maryland 21201-2365, Tel. (301) 383-7875.

Massachusetts  
Executive Office of Communities and Development, 100 Cambridge Street, Room 1401, Boston, Massachusetts 02232, Tel. (617) 727-3264.

Michigan  
Carol Hoffman, Director, Office of Business and Community Development, Michigan Department of Commerce, P.O. Box 30004, Lansing, Michigan 48909, Tel. (517) 378-8363.

Mississippi  
Office of Federal State Programs, Department of Planning and Policy, 1504 Walter Sillers Bldg., 500 High Street, Jackson, Mississippi 39201. For Information Contact: Mr. Rich Haydel, Department of Planning and Policy, Tel. (601) 359-3069.

Minnesota  

Missouri  
Missouri Federal Assistance Clearinghouse, Office of Administration, Division of Budget and Planning, Room 129 Capitol Building, Jefferson City, Missouri 65102, Tel. (314) 751-4934 or 751-2345.

Montana  
Manager, Intergovernmental Review Clearinghouse, c/o Office of the Lieutenant Governor, Capitol Station, Helena, Montana 59620, Tel. (406) 449-3111, x53.

Nebraska  
Policy Research Office, P.O. Box 94601, Room 1221, State Capitol, Lincoln, Nebraska 68501, Tel. (402) 471-2414.

Nevada  
Ms. Linda A. Ryan, Director, Office of Community Services, Capitol Complex, Carson City, Nevada 89710, Tel. (702) 685-4420.

New Hampshire  
David G. Scott, Acting Director, New Hampshire Office of State Planning, 2½ Beacon Street, Concord, New Hampshire 03301, Tel. (603) 271-2155.

New Jersey  
Mr. Barry Skokowski, Director, Division of Local Government Services, Department of Community Affairs, CN 803, 363 West Street, Trenton, New Jersey 08625, Tel. (609) 292-6813.

New Mexico  
Peter C. Pence, Director, Department of Finance and Administration, State of New Mexico, 515 Don Gaspar, Santa Fe, New Mexico 87503, Tel. (505) 827-3865.

New York  
Director of the Budget, New York State.  
Note.—Correspondence & questions concerning the state's E.O. 12372 process should be directed to: New York State Clearinghouse, Division of the Budget, State Capitol, Albany, New York 12224, Tel. (518) 474-1605.

North Carolina  
Mrs. Chrys Baggett, Director, State Clearinghouse, Department of Administration, 116 West Jones Street, Raleigh, North Carolina 27611, Tel. (919) 733-4311.

Ohio  
State Clearinghouse, Office of Budget and Management, 30 East Broad Street, Columbus, Ohio 43215. For Information Contact: Mr. Leonard E. Roberts, Deputy Director, Tel. (614) 466-0699.

Oklahoma  
Office of Federal Assistance Management, 4545 North Lincoln Blvd., Oklahoma City, Oklahoma 73105, Tel. (405) 528-8300.

Oregon  
Intergovernmental Relations Division, State Clearinghouse, Executive Building, 155 Cottage Street, N.E., Salem, Oregon 97301, Tel. (503) 373-1958.

Pennsylvania  
Pennsylvania Intergovernmental Council, P.O. Box 1238, Harrisburg, Pennsylvania 17108. ATTN: Charles Griffis, Executive Director, Tel. (717) 783-3700.

Rhode Island  
Daniel W. Varin, Chief, Rhode Island Statewide Planning Program, 265 Melrose Street, Providence, Rhode Island 02907, Tel. (401) 277-2656.

South Carolina  
Danny L. Cromer, Grant Services, Office of the Governor, 1205 Pendleton Street, Room 477, Columbia, South Carolina 29201, Tel. (803) 758-2417.

South Dakota  
Jeff Stroup, Commissioner of the Bureau of Intergovernmental Relations, Second Floor, Capitol Building, Pierre, South Dakota 57501, Tel. (605) 773-3891.

Tennessee  
Tennessee State Planning Office, 1600 James K. Polk Building, 505 Deaderick Street, Nashville, Tennessee 37219, Tel. (615) 741-1876.

Texas  
Bob McPherson, State Planning Director, Office of the Governor, Office of the
Governor, Austin, Texas 78711, Tel. (512) 475-6150.

Utah
Michael B. Zuhl, Director, Office of Planning and Budget, State of Utah, 116 State Capitol Building, Salt Lake City, Utah 84114, Tel. (801) 539-5245.

Vermont
State Planning Office, Pavilion Office Building, 109 State Street, Montpelier, Vermont 05602, Tel. (802) 828-3326.

Virginia
Robert H. Kirby, Intergovernmental Review Officer, Department of Planning and Budget, Post Office Box 1422, Richmond, Virginia 23211, Tel. (804) 786-1921.

Washington

West Virginia
Mr. Fred Cutlip, Director, Community Development Division, Governor’s Office of Economic and Community Development, Building #6, Room 553, Charleston, West Virginia 25305, Tel. (304) 348-4010.

Wisconsin
Secretary Doris J. Hanson, Wisconsin Department of Administration, 101 South Webster Street—CEF 2, Madison, Wisconsin 53702, Tel. (608) 266-7121.

Wyoming
Wyoming State Clearinghouse, State Planning Coordinator’s Office, Capitol Building, Cheyenne, Wyoming 82002, Tel. (307) 777-7574.

Virgin Islands
Federal Programs Office, Office of the Governor, The Virgin Islands of the United States, Charlotte Amalie, St. Thomas 00801.

District of Columbia
Pauline Schneider, Director, Office of Intergovernmental Relations, Room 436, District Building, Washington, D.C. 20004, Tel. (202) 727-6206.

Puerto Rico
Nelson Soto, President, Puerto Rico Planning Board, P.O. Box 4119 Minilla Station, San Juan, Puerto Rico 00940, Tel. (202) 727-6265.

Northern Mariana Islands
Planning and Budget Office, Office of the Governor, Saipan, CM 96950.
(Catalog of Federal Domestic Assistance Program Number 19.23) Runaway and Homeless Youth Program)

Joseph A. Mottola,
Acting Commissioner, Administration for Children, Youth and Families.


Dorcas R. Hardy,
Assistant Secretary for Human Development Services.

BILLING CODE 4130-91-M
Runaway and Homeless Youth Grant

Project Abstract Form

Using this format, please provide the following information, not exceeding one page. Attach the original and two copies to the front of the application that contains the original signatures. Attach one copy to the front of the other sets of applications you submit.

a. Type of Grant: Basic Center Networking Priority Area

b. Name of Applicant:

c. Address:

d. City/State/Zip Code:

e. Phone Number: (  )

f. Congressional District(s) Served:

g. Estimated No. of Clients to be Served:

Youth

Families

h. Principal Population Area Served:

Urban

Suburban

Rural

i. Requested Funding Level: Federal Non-Federal Total


j. Proposal Summary: Provide a 200 word maximum synopsis of your (proposed) program, including objectives, special needs, approach, expected outcomes, or other pertinent information. In the Basic Center applications, this should highlight special program emphases beyond the services mandated by the Act (e.g., independent living, job training/placement, linkages with the schools, prevention and outreach). In the Networking applications, the summaries should highlight the priority area and subtopic being addressed, the activity proposed, the need for the proposed activity, the objectives and approach and outcomes to be achieved.
## FEDERAL ASSISTANCE

**1. TYPE OF APPLICATION:**
- [ ] PREAPPLICATION
- [ ] APPLICATION
- [ ] REPORT OF FEDERAL ACTION

**2. APPLICANT'S NUMBER:**
- [ ] Leave Blank

**3. STATE APPLICATION IDENTIFIER:**
- [ ] Leave Blank

**4. APPLICANT:**
- Applicant Name:
- Organization Unit:
- Street/P.O. Box:
- City:
- State:
- Contact Person (Name & telephone No.):

**5. FEDERAL EMPLOYER IDENTIFICATION NO.:**
- [ ] Leave Blank

**6. TYPE OF APPLICANT/RECIPIENT:**
- A-State
- B-Interstate
- C-Local
- D-District
- E-City
- F-School District
- G-Special Purpose District
- H-Community Action Agency
- I-Higher Educational Institution
- J-Indian Tribe
- K-Other

**7. TITLE AND DESCRIPTION OF APPLICANT'S PROJECT:**

**8. TYPE OF ASSISTANCE:**
- A-Basic Grant
- B-Supplemental Grant
- C-Loan
- D-Insurance
- E-Other

**9. AREA OF PROJECT IMPACT:**

**10. ESTIMATED NUMBER OF PERSONS BENEFITING:**

**11. TYPE OF APPLICATION:**
- A-New
- B-Renewal
- C-Continuation
- D-Amendment
- E-Other

**12. PROJECT START DATE:**
- Year month day

**13. PROJECT DURATION:**
- Months

**14. PROJECT ENDING DATE:**
- Year month day

**15. ESTIMATED DATE TO BE SUBMITTED TO FEDERAL AGENCY:**
- Year month day

**16. EXISTING FEDERAL IDENTIFICATION NUMBER:**
- [ ] Leave Blank

**17. FEDERAL AGENCY TO RECEIVE REQUEST:**
- Name, City, State, ZIP code

**18. REMARKS ADDED:**
- [ ] Leave Blank

**19. RESPONSIBLE PERSON:**
- To the best of my knowledge and belief, the data in this preapplication/application are true and correct. The document has been duly authorized by the governing body of the applicant and the applicant will comply with the attached assurances if the assistance is approved.

**20. CERTIFICATION:**
- [ ] Leave Blank

**21. CERTIFYING REPRESENTATIVE:**
- Type Name and Title
- Signature
- Date Signed

**22. FUNDING:**
- [ ] Leave Blank

**23. FEDERAL AGENCY A-95 ACTION:**
- [ ] Leave Blank
# PART II

## PROJECT APPROVAL INFORMATION

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Name of Governing Body</th>
<th>Priority Rating</th>
<th>Name of Agency or Board</th>
<th>Name of Approving Agency</th>
<th>Date</th>
<th>Check one:</th>
<th>Name of Federal Installation</th>
<th>Federal Population benefiting from Project</th>
<th>Name of Federal Installation</th>
<th>Location of Federal Land</th>
<th>Percent of Project</th>
<th>Number of:</th>
<th>See instructions for additional information to be provided.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Does this assistance request require State, local, regional, or other priority rating?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td>State</td>
<td>Local</td>
<td>Regional</td>
<td>Location of Plan</td>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>Does this assistance request require State, or local advisory, educational or health clearances?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>3</td>
<td>Does this assistance request require clearinghouse review in accordance with OMB Circular A-95?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>4</td>
<td>Does this assistance request require State, local, regional or other planning approval?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>5</td>
<td>Is the proposed project covered by an approved comprehensive plan?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Will the assistance requested serve a Federal installation?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Will the assistance requested be on Federal land or installation?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Will the assistance requested have an impact or effect on the environment?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
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<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
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<tr>
<td>9</td>
<td>Will the assistance requested cause the displacement of individuals, families, businesses, or farms?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
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<td>Yes</td>
<td>No</td>
<td></td>
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<tr>
<td>10</td>
<td>Is there other related assistance on this project previous, pending, or anticipated?</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
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<td></td>
<td>Yes</td>
<td>No</td>
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B-2
### PART III - BUDGET INFORMATION

### SECTION A - BUDGET SUMMARY

<table>
<thead>
<tr>
<th>Grant Program, Function or Activity</th>
<th>Federal Catalog No.</th>
<th>Estimated Unobligated Funds</th>
<th>New or Revised Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>(b)</td>
<td>(c)</td>
<td>(d)</td>
</tr>
<tr>
<td>1.</td>
<td></td>
<td>$</td>
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</tr>
<tr>
<td>2.</td>
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<tr>
<td>3.</td>
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<tr>
<td>4.</td>
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<tr>
<td>5. TOTALS</td>
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### SECTION B - BUDGET CATEGORIES

<table>
<thead>
<tr>
<th>Object Class Categories</th>
<th>Grant Program, Function or Activity</th>
<th>Total</th>
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<tr>
<td>(1)</td>
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<td>a. Personnel</td>
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<td>b. Fringe Benefits</td>
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<tr>
<td>c. Travel</td>
<td>$</td>
<td>$</td>
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<tr>
<td>d. Equipment</td>
<td>$</td>
<td>$</td>
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<tr>
<td>e. Supplies</td>
<td>$</td>
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<tr>
<td>f. Contractual</td>
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<tr>
<td>g. Construction</td>
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<td>$</td>
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<tr>
<td>h. Other</td>
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<tr>
<td>i. Total Direct Charges</td>
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<td>j. Indirect Charges</td>
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<td>k. TOTALS</td>
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<td>7. Program Income</td>
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### SECTION C - NON-FEDERAL RESOURCES

<table>
<thead>
<tr>
<th>(a) Grant Program</th>
<th>(b) APPLICANT</th>
<th>(c) STATE</th>
<th>(d) OTHER SOURCES</th>
<th>(e) TOTALS</th>
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<tr>
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<td>12. TOTALS</td>
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### SECTION D - FORECASTED CASH NEEDS

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<thead>
<tr>
<th></th>
<th>Total for 1st Year</th>
<th>1st Quarter</th>
<th>2nd Quarter</th>
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<td>14. Non-Federal</td>
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<td>15. TOTAL</td>
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### SECTION E - BUDGET ESTIMATES OF FEDERAL FUNDS NEEDED FOR BALANCE OF THE PROJECT

<table>
<thead>
<tr>
<th>(a) Grant Program</th>
<th>FUTURE FUNDING PERIODS (YEARS)</th>
<th>(b) FIRST</th>
<th>(c) SECOND</th>
<th>(d) THIRD</th>
<th>(e) FOURTH</th>
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<tr>
<td>20. TOTALS</td>
<td></td>
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</tbody>
</table>

### SECTION F - OTHER BUDGET INFORMATION

(Attach additional sheets if necessary)

21. Direct Charges:

22. Indirect Charges:

23. Remarks:

### PART IV PROGRAM NARRATIVE (Attach per instruction)
PART V
ASSURANCES

The Applicant hereby assures and certifies that he will comply with the regulations, policies, guidelines and requirements, including OMB Circulars No. A—95, A—102 and FMC 74—4, as they relate to the application, acceptance and use of Federal funds for this federally-assisted project. Also the Applicant assures and certifies to the grant that:

1. It possesses legal authority to apply for the grant; that a resolution, motion or similar action has been duly adopted or passed as an official act of the applicant’s governing body, authorizing the filing of the application, including all understandings and assurances contained therein, and directing and authorizing the person identified as the official representative of the applicant to act in connection with the application and to provide such additional information as may be required.

2. It will comply with Title VI of the Civil Rights Act of 1964 (P.L. 88-352) and in accordance with Title VI of that Act, no person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under any program or activity for which the applicant receives Federal financial assistance and will immediately take any measures necessary to effectuate this agreement.

3. It will comply with Title VI of the Civil Rights Act of 1964 (42 USC 2000d) prohibiting employment discrimination where (1) the primary purpose of a grant is to provide employment or (2) discriminatory employment practices will result in unequal treatment of persons who are or should be benefiting from the grant-aided activity.

4. It will comply with requirements of the provisions of the Uniform Relocation Assistance and Real Property Acquisitions Act of 1970 (P.L. 91-646) which provides for fair and equitable treatment of persons displaced as a result of Federal and federally assisted programs.

5. It will comply with the provisions of the Hatch Act which limit the political activity of employees.

6. It will comply with the minimum wage and maximum hours provisions of the Federal Fair Labor Standards Act, as they apply to hospital and educational institution employees of State and local governments.

7. It will establish safeguards to prohibit employees from using their positions for a purpose that is or gives the appearance of being motivated by a desire for private gain for themselves or others, particularly those with whom they have family, business, or other ties.

8. It will give the sponsoring agency or the Comptroller General through any authorized representative the access to and the right to examine all records, books, papers, or documents related to the grant.

9. It will comply with all requirements imposed by the Federal sponsoring agency concerning special requirements of law, program requirements, and other administrative requirements.

10. It will insure that the facilities under its ownership, lease or supervision which shall be utilized in the accomplishment of the project are not listed on the Environmental Protection Agency’s (EPA) list of Violating Facilities and that it will notify the Federal grantor agency of the receipt of any communication from the Director of the EPA Office of Federal Activities indicating that a facility to be used in the project is under consideration for listing by the EPA.
The phrase "Federal financial assistance" includes any form of loan, grant, guaranty, insurance payment, rebate, subsidy, disaster assistance loan or grant, or any other form of direct or indirect Federal assistance.

11. It will comply with the flood insurance purchase requirements of Section 102(a) of the Flood Disaster Protection Act of 1973, Public Law 93-234, 87 Stat. 975, approved December 31, 1976. Section 102(a) requires, on and after March 2, 1975, the purchase of flood insurance in communities where such insurance is available as a condition for the receipt of any Federal financial assistance for construction or acquisition purposes for use in any area that has been identified by the Secretary of the Department of Housing and Urban Development as an area having special flood hazards.

12. It will assist the Federal grantor agency in its compliance with Section 106 of the National Historic Preservation Act of 1966 as amended (16 U.S.C. 470), Executive Order 11593, and the Archeological and Historic Preservation Act of 1966 (16 U.S.C. 469a-1 et seq.) by (a) consulting with the State Historic Preservation Officer on the conduct of investigations, as necessary, to identify properties listed in or eligible for inclusion in the National Register of Historic Places that are subject to adverse effects (see 36 CFR Part 800.8) by the activity, and notifying the Federal grantor agency of the existence of any such properties, and by (b) complying with all requirements established by the Federal grantor agency to avoid or mitigate adverse effects upon such properties.
Instructions for Applying for Federal Assistance from HDS Programs

Introduction

Use of Forms

The forms included in this "kit" shall be used to apply for all new discretionary grants and cooperative agreements awarded by the Office of Human Development Services. They shall also be used to request supplemental assistance, proposed changes or amendments, and request continuation or refunding for previously approved grants or cooperative agreements from the Office of Human Development Services. An original and two copies of the forms should be submitted to the responsible grants management office. If an item cannot be answered or does not appear to be related or relevant to the assistance required, write "NA" for not applicable.

Applications

Applicants for new awards and competing continuations are required to submit a complete application which consists of Parts I (SF-424) through Part V. Applicants for new projects must include completed Standard Forms 441, Civil Rights Assurance and HHS—641 Rehabilitation Act Assurance. Applicants for additional funding (such as a continuation or supplemental grant) or amendments to a previously submitted application should include only affected pages. Previously submitted pages whose information is still current need not be resubmitted. Additionally, applicants for certain HDS programs may be subject to the EO 12372 clearance process. Therefore, applicants must follow the instructions provided relative to EO 12372 coverage where appropriate.

Submission of Applications

(1) Continuation Grants—Applicants for continuation grants must submit these forms not later than 90 days prior to the budget period end date.

(2) New Projects and Competing Continuations—Applicants for Assistance to support new projects or for competing extensions should refer to program announcements for information regarding deadline dates for submission of forms.
INSTRUCTIONS FOR COMPLETION OF PART I (SF-424)

Section I

Applicants shall complete all items in Section I. If an item is not applicable, write "NA". If additional space is needed, insert an asterisk (*) and use the remarks section.

Item

1. Mark "Application Box" when used as a grant application. The applicant, unless otherwise advised by the State Point of Contact, shall use the SF-424 as a notification of intent to apply for Federal Assistance in accordance with procedures established by these offices. When used for this purpose, mark "Notification of Intent".

2a. Applicant's own control number if desired.

2b. Date Section I is prepared.

3a. For a program covered by Executive Order 12372, enter the number assigned, if any, by the State Point of Contact Office. Applications submitted to OHDS must contain this identifier, if provided by the State Point of Contact, and must also include a certification statement that the application was submitted to the State Point of Contact. A certification form is provided in this application package.

3b. Date applicant notified of clearinghouse identifier.

4a.-4h. Enter legal name of applicant/recipient, name of primary organizational unit which will undertake the assistance activity, complete address of applicant, name and telephone number of person who can provide further information about this request.

5. Enter employer identification number of applicant as assigned by Internal Revenue Service. If the applicant organization has been assigned a DHHS entity number consisting of the IRS employer identification number prefixed by "1" and suffixed by a two-digit number, enter the full entity number. If applicant has other grants with DHHS and has been assigned a payee identification number, enter PIN in parenthesis () beside employer identification number.

6a. Enter the Catalogue of Federal Domestic Assistance number assigned to program under which assistance is requested. If more than one person (e.g., joint funding) enter "multiple" and explain in remarks. If unknown, cite Public Law or U.S. Code.

HDS Application Instructions
6b. Enter the program title from Catalog of Federal Domestic Assistance. Abbreviate if necessary.

7. Enter a title and appropriate description of project. For notification of intent, continue in Remarks Section if necessary to convey proper description.

8. Enter appropriate letter to designate grantee type—"City" includes town, township or other municipality. If the grantee is other than that listed, specify type on "Other" line e.g., Council of Government. Note: Nonprofit organizations which have not previously received HDS program support must submit proof of nonprofit status.

9. All applicants for HDS discretionary grant funds should enter the letter "A".

10. Enter Governmental unit where significant and meaningful impact could be observed. List only largest unit or units affected, such as State, county, or city. If entire unit affected, list it rather than subunits.

11. Identify estimated number of persons directly benefiting from project, as described in the program narrative.

12. Enter appropriate letter. Definitions are:
   a. New. A submittal for the first time for a new project or project period (includes competing continuations).
   b. Renewal. Not applicable to HDS grant programs.
   c. Revision. A modification to project after the initial funding/budget period and within the approved project period.
   d. Continuation. Support for a project after the initial funding/budget period and within the approved project period.
   e. Augmentation. (Referred to elsewhere in these instructions and in other HDS publications as a "supplement"). An application for additional funds for a period previously awarded funds in the same funding/budget period.

13. Enter amount requested or to be contributed during the initial funding/budget period by each contributor. Where allowable the value of in-kind contributions will be included. If the action is a change in dollar amount of existing grant (a revision or augmentation), indicate only the amount of change. For decreases, enclose the amount in parentheses. For multiple program funding use totals and show program breakdowns in remarks. Item definitions: 13a, amount requested from Federal Government; 13b, amount applicant will contribute; 13c, amount from State, if applicant is not a State; 13d, amount from local government, if applicant is not a local government; 13e, amount from any other sources, explain in remarks. Note: Applicants for research grant should complete 13a and 13f only.

14a. Self explanatory.

14b. Enter the district(s) where most of actual work will be accomplished. If city-wide or State-wide covering several districts, write "City-wide" or "State-wide".
15. Complete only for revisions (item 12c), or augmentations (Supplements) (Item 12e).

16. Enter approximate date project is expected to begin. If initial budget period is other than 12 months, check item 21 and explain in Part IV.

17. Enter estimated number of months to complete project after Federal funds are available.

18. Estimated date application will be submitted to Federal agency (HDS program office) if this project requires clearinghouse review. If review is not required, this date would usually be same as date in item 2b.

19. Enter existing Federal grant number if this is not a new request and directly relates to a previous Federal action. Otherwise write "NA".

20. Indicate Federal agency to which this request is addressed. Street address not required, but do use ZIP.

21. Check appropriate box as to whether Section IV of form contains remarks and/or additional remarks are attached.

Section II
Applicants shall always complete items 23a, 23b, and 23c. An explanation follows for each item.

23a. Name and title of authorized representative of legal applicant.

23b. Self explanatory. Note: Authorized representative signature cannot be signed by designee.

23c. Self explanatory.

Note: APPLICANT COMPLETES ONLY SECTIONS I AND II. SECTION III IS COMPLETED BY FEDERAL AGENCIES.
Instructions for Completion of Part III

This form is designed so that application can be made for funds to support one or more functions or activities. Generally, HDS funded programs do not require a breakdown by function or activity. Therefore, only Line 1 need be completed. However, Head Start, funded by the Administration for Children, Youth and Families requires that activities commonly identified by program accounts be displayed separately on individual lines (Lines 1-4 under Section A and Columns 1-4 under Section B).

Since HDS programs award funds to support activities for budget periods which are generally 12 months in duration, Section A, B, C, and D must provide budget information for the requested budget period. Section E should present the need for Federal assistance in subsequent budget periods.

Applicants for research grants are not required to complete information items related to non-Federal share. Rather, research cost sharing shall be negotiated separately with the funding office.

Section A—Budget Summary

Lines 1-4

Col. (a): For applications pertaining to a single grant program and not requiring a functional, activity or program account breakout enter on Line 1 under Column (a) the Federal Domestic assistance Catalog program title (See attached listing). For “Head Start”, enter the activities (program accounts) name and number for which funds are being requested on separate lines.

Col. (b): Enter appropriate Catalog of Federal Domestic Assistance number. For “Head Start”, enter the activities (program accounts) name and number for which funds are being requested on separate lines.

Col. (c)-(g): For new applications, leave Columns (c) and (d) blank. For each line entry, enter in Columns (e), (f), and (g) the appropriate amounts needed to support the project for the first budget period. Applicants for research grant should make no entries in Column (f).

For continuation applications, or competing continuations, enter in Columns (c) and (d) the estimated amounts for funds which will remain unobligated at the end of the current budget period. Enter in columns (e), (f), and (g) the appropriate amounts needed to support the project for the new budget period. (Applicants for research grants should make no entries in Columns (d) or (f). Column (g) should equal the total of Column (e) and Column (f).

For augmentation (supplements) and changes to existing grants, leave Columns (c) and (d) blank and enter in Columns (e) and (f) the amount of increase or decrease of Federal and non-Federal funds, as appropriate. Enter in Column (g) the new total budgeted amount (Federal and non-Federal) which includes the previously authorized total budgeted amounts for the current budget period plus or minus, as appropriate, the amounts shown in Columns (e) and (f). The amount(s) in Columns (g) should not equal the sum of the amounts in Columns (e) and (f). Applicants for research grants should make no entries in columns (d) or (f).
Enter the totals for all columns completed.

**Section B - Budget Categories**

**Column 1-5**

In the Column heading (1) through (4), enter the same titles of the grant programs and/or program accounts shown on Lines 1 through 4, Column (a), Section A. For each grant program or activity (program account) entered in Columns (1) through (4) enter the total requirements for Federal funds by object class categories and enter total in Column 5.

Allowability of costs are governed by applicable cost principles set forth in Subpart Q of 45 CFR Part 74 and the HDS Grants Administration Manual.

**Personnel—Line 6a:** Enter the total costs of salaries and wages of applicant/grantee staff. Do not include costs of consultants or personnel costs of delegate agencies. (See Section F, Line 21, for additional requirements).

**Fringe Benefits—Line 6b:** Enter the total costs of fringe benefits unless treated as part of an approved indirect cost rate. Provide a break-down of amounts and percentages that comprise fringe benefit costs.

**Travel—Line 6c:** Enter total costs of out-of-town travel for employees of the project. Do not enter costs for consultant’s travel or local transportation. Provide justification for requested travel costs. (See Line 6h and Section F, Line 21, for additional instructions).

**Equipment—Line 6d:** Enter the total costs of all non-expendable personal property to be acquired by the project. “Non-expendable personal property” means tangible personal property having a useful life of more than two years and an acquisition cost of $500 or more per unit. An applicant may use its own definition of non-expendable personal property, provided that such a definition would at least include all tangible personal property as defined in the preceding sentence. (See Section F, Line 21 for additional requirements).

**Supplies—Line 6e:** Enter the total costs of all tangible personal property (supplies) other than that included on line 6d.

**Contractual—Line 6f:** Enter the total costs of all contracts, including (1) procurement contracts (except those which belong on other lines such as equipment, supplies, etc.), and, (2) contracts with secondary recipient organizations including delegate agencies. Also include any contracts with organizations for the provision of technical assistance. Do not include payments to individuals on this line. Attach a list of contractors indicating the name of the organization, the purpose of the contract and the estimated dollar amount of the award. If the Name of Contractor, Scope of work and estimated total is not available or has not been negotiated, include in Line h, “Other”. (Note: Whenever the applicant/grantee intends to delegate part or all of the program to another agency, the applicant/grantee must submit sections A and B of Part III, Budget Section, completed for each delegate agency by agency title, along with the required supporting information referenced in the applicable instructions. The total cost of all such agencies will be part of the amount shown on Line 6(f). Provide back-up documentation identifying Name of contractor, purpose of contract and major cost elements.)
Construction—Line 6g: Enter the costs of renovation or repair. Provide narrative justification and break-down or costs. New construction is unallowable.

Other—Line 6h: Enter the total of all other costs. Such cost, where applicable, may include, but are not limited to, insurance, food, medical and dental costs, (noncontractual), fees and travel paid directly to individual consultants, local transportation (all travel which does not require per diem is considered local travel), space and equipment rentals, printing and publication, computer use, training costs including tuition and stipends, training service costs including wage payments to individuals and supportive service payments, and staff development costs.

Total Direct Charges—Line 6i: Show the totals of Lines 6(a) through 6(h).

Indirect Charges—Line 6j: Enter the total amount of indirect costs. If no indirect costs are requested enter “none”. This line should be used only when the applicant (except local governments) has an indirect cost rate approved by the Department of Health and Human Services. If rate has recently been approved, please enclose a copy of current rate. Local governments shall enter the amount of indirect costs determined in accordance with HHS requirements. In the case of training grants to other than State or local governments, (as defined in 45 CFR Part 74), the reimbursement of indirect costs will be limited to the lesser of actual indirect costs or 8 percent of the amount allowed for direct costs exclusive of any equipment charges, rental of space, tuition and fees, post-doctoral training allowances, contractual items, and alteration and renovations. It should be noted that when an indirect cost rate is requested, these costs included in the indirect cost pool should not be also charged as direct costs to the grant.

Total—Line 6k: Enter the total amounts of Lines 6(i) and 6(j). For all new, continuation, and competing extension applications and total amount shown in Column (5), Line 6(k), should be the same as the amount shown in Section A, Column (e), Line 5.

For all supplements or changes, the total of the amount shown in Columns (1) through (4) should equal the amount shown in Section A, Line 5(e). The amount shown in Column (5) should include the cumulative total of the previously approved Federal share for the current budget period plus or minus, as appropriate, the increase or decrease of Federal funds.

Program Income—Line 7: Enter the estimated amount of income, if any, expected to be generated from this project. Do not add or subtract this amount from the total project amount. Show, in the program narrative statement, the nature and source of income.
Section C—Non-Federal Resources

Line 8-11: Enter amounts of non-Federal resources that will be used to support the project. (Applicants for research grants should not complete this Section but will negotiate appropriate cost sharing arrangements with the funding office). Provide a brief explanation, on a separate sheet, showing the type of contribution, and whether it is in cash or inkind. If inkind, is allowable and included, show the basis for computation including:

1. Numbers and types of volunteers and rates at which their services are valued;
2. Valuation of donated space (use only) including number of square feet and value assigned per square foot; and
3. Determination of depreciation and use allowance for grantee-owned space; [Include statement whether space was purchased or constructed, totally or in part with federal funds for item (2) and (3)].
4. Type and value of other inkind contributions expected.

Column (a): Enter the program title or activities (program accounts) as in Column (a) Section A.

Column (b): Enter the amount of cash and inkind contributions to be made by the applicant.

Column (c): Enter the State contribution. If the applicant is a State agency, enter the non-Federal funds to be contributed by the State other than the applicant State agency.

Column (d): Enter the amount of cash and inkind contributions to be made from all other sources.

Column (e): Enter the totals of Columns (b), (c), and (d).

Line 12—Enter total of each of Columns (b) through (e). The amount in Column (e) should be equal to the amount on Line 5, Column (f), Section A.

Section D—Forecasted Cash Needs

Line 13—Enter the amount of Federal cash needed for this grant, by quarter, during the budget period.

Line 14—Enter the amount of cash from all other sources needed by quarter during the budget period. (Applicants for research grants should not complete this line).

Line 15—Enter the totals of amounts on Lines 13 and 14.
ASSURANCE OF COMPLIANCE WITH THE DEPARTMENT OF HEALTH AND HUMAN SERVICES REGULATION UNDER TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

(Name of Applicant)

HEREBY AGREES THAT it will comply with title VI of the Civil Rights Act of 1964 (P.L. 88-352) and all requirements imposed by or pursuant to the Regulation of the Department of Health and Human Services (45 CFR Part 80) issued pursuant to that title, to the end that, in accordance with title VI of that Act and the Regulation, no person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under any program or activity for which the Applicant receives Federal financial assistance from the Department; and HEREBY GIVES ASSURANCE THAT it will immediately take any measures necessary to effectuate this agreement.

If any real property or structure thereon is provided or improved with the aid of Federal financial assistance extended to the Applicant by the Department, this assurance shall obligate the Applicant, or in the case of any transfer of such property, any transferee, for the period during which the real property or structure is used for a purpose for which the Federal financial assistance is extended or for another purpose involving the provision of similar services or benefits. If any personal property is so provided, this assurance shall obligate the Applicant for the period during which it retains ownership or possession of the property. In all other cases, this assurance shall obligate the Applicant for the period during which the Federal financial assistance is extended to it by the Department.

THIS ASSURANCE is given in consideration of and for the purpose of obtaining any and all Federal grants, loans, contracts, property, discounts or other Federal financial assistance extended after the date hereof to the Applicant by the Department, including installment payments after such date on account of applications for Federal financial assistance which were approved before such date. The Applicant recognizes and agrees that such Federal financial assistance will be extended in reliance on the representations and agreements made in this assurance, and that the United States shall have the right to seek judicial enforcement of this assurance. This assurance is binding on the Applicant, its successors, transferees, and assignees, and the person or persons whose signatures appear below are authorized to sign this assurance on behalf of the Applicant.

Dated

(Applicant)

By

(President, Chairman of Board, or comparable authorized official)

(Applicant's mailing address)

HDS GRANTS MANAGEMENT

Return Original To: Office of Civil Rights, Room 5627/B North Building 330 Independence Ave. S.W. Washington, D.C. 20201

Send Copy to Grants Management
DEPARTMENT OF HEALTH AND HUMAN SERVICES
ASSURANCE OF COMPLIANCE WITH SECTION 504 OF THE
REHABILITATION ACT OF 1973, AS AMENDED

The undersigned (hereinafter called the "recipient") HEREBY AGREES THAT it will comply with section 504 of the Rehabilitation Act of 1973, as amended (29 U.S.C. 794), all requirements imposed by the applicable HHS regulation (45 C.F.R. Part 84), and all guidelines and interpretations issued pursuant thereto.

Pursuant to § 84.5(a) of the regulation (45 C.F.R. 84.5(a)), the recipient gives this Assurance in consideration of and for the purpose of obtaining any and all federal grants, loans, contracts (except procurement contracts and contracts of insurance or guaranty), property, discounts, or other federal financial assistance extended by the Department of Health and Human Services after the date of this Assurance, including payments or other assistance made after such date on applications for federal financial assistance that were approved before such date. The recipient recognizes and agrees that such federal financial assistance will be extended in reliance on the representations and agreements made in this Assurance and that the United States will have the right to enforce this Assurance through lawful means. This Assurance is binding on the recipient, its successors, transferees, and assignees, and the person or persons whose signatures appear below are authorized to sign this Assurance on behalf of the recipient.

This Assurance obligates the recipient for the period during which federal financial assistance is extended to it by the Department of Health and Human Services or, where the assistance is in the form of real or personal property, for the period provided for in § 84.5(b) of the regulation (45 C.F.R. 84.5(b)).

The recipient: [Check (a) or (b)]
   a. ( ) employs fewer than fifteen persons;
   b. ( ) employs fifteen or more persons and, pursuant to § 84.7(a) of the regulation (45 C.F.R. 84.7(a)), has designated the following person(s) to coordinate its efforts to comply with the HHS regulation:

   Name of Designee(s) — Type or Print
   C12

   Name of Recipient — Type or Print
   A12

   (IRS) Employer Identification Number
   A1
   B1
   C1

   Street Address or P.O. Box
   A42

   City
   B12

   State
   B42

   Zip
   B71

I certify that the above information is complete and correct to the best of my knowledge.

Date
B72

Signature and Title of Authorized Official
B78

If there has been a change in name or ownership within the last year, please PRINT the former name below:

NOTE: The 'A', 'B', and 'C' followed by numbers are for computer use. Please disregard.

PLEASE RETURN ORIGINAL TO: Office for Civil Rights, Room 5627/B North Building
Send Copy to Grants Management
330 Independence Ave. S.W.
Washington, D.C. 20201
HHS GRANTS MANAGEMENT
EXECUTIVE ORDER 12372

STATE POINT OF CONTACT PROJECT NOTIFICATION CERTIFICATION

Legal Organization Name

Has _____ or Has Not _____ Submitted This Application to the State Point of Contact Office.

Date Submitted to the State Office __________________________________

Signature of Authorized Official ________ Date ________
Part IV

Federal Trade Commission

16 CFR Part 444
Trade Regulation; Credit Practices; Final Rule
FEDERAL TRADE COMMISSION

16 CFR Part 444

Trade Regulation Rule; Credit Practices

AGENCY: Federal Trade Commission.

ACTION: Final trade regulations rule.

SUMMARY: The Federal Trade Commission issues a final rule, the purpose of which is to restrict certain remedies used by lenders and retail installment sellers in consumer credit contracts. The remedies affected by this rule are: Confessions of judgment, waivers of exemption, wage assignments, security interests in household goods, and certain late charges. The rule further prohibits misrepresentations of cosigner liability and provides that potential cosigners be furnished a "Notice to Cosigner" which explains in general terms their obligations and liabilities.

This notice contains the rule's Statement of Basis and Purpose, incorporating a Regulatory Analysis, and the text of the final rule.

EFFECTIVE DATE: March 1, 1985.

ADDRESS: Requests for copies of the rule, the Statement of Basis and Purpose and Regulatory Analysis should be sent to Public Reference Branch, Room 130, Federal Trade Commission, 6th Street and Pennsylvania Avenue, NW., Washington, D.C. 20580.


SUPPLEMENTARY INFORMATION:

List of Subjects in 16 CFR Part 444

Consumer credit contracts, Cosigner disclosures, Trade practices, Truth in lending.

By direction of the Commission, Commissioner Calvani did not participate.


Benjamin I. Berman,
Acting Secretary.

CREDIT PRACTICES RULE;
STATEMENT OF BASIS AND PURPOSE AND REGULATORY ANALYSIS

I. History of the Proceeding

A. Introduction

This proceeding focuses on the relationship between consumers and the institutions from whom they seek and obtain credit for purposes other than the purchase of real estate. It originated as a result of: (1) An extensive survey conducted by the National Commission on Consumer Finance which examined the consumer credit market and reached a variety of conclusions based upon empirical data and econometric analysis; and (2) an investigation of the consumer finance industry conducted by the Bureau of Consumer Protection from the Fall of 1972 until the Spring of 1974, to determine whether the use of certain collection remedies was an unfair practice under Section 5 of the FTC Act. The Commission published an Initial Notice of Rulemaking in the Federal Register on April 11, 1975. Written comments were received through August 5, 1977. Comments were received from industry, consumers, legal services, state attorneys general, labor unions, consumer organizations and other interested parties. A Final Notice of Rulemaking was published on June 24, 1977, setting forth the time and places for public hearings on the proposed rule and enumerating 14 issues which the Presiding Officer designated under §1.13(d)(1) of the Commission's Rules of Practice. Hearings were conducted in Dallas, Texas; Chicago, Illinois; San Francisco, California; and Washington, D.C., from September 12, 1977, to January 30, 1978. Rebuttal submissions were received until May 1, 1978.

The written comments, the materials placed on the record by the Presiding Officer and the Commission staff, the hearing transcripts and exhibits, and the rebuttal statements comprise the principal evidentiary record of this proceeding. After the receipt of rebuttal statements, reports to the Commission based on the rulemaking record were prepared by the Presiding Officer, who made findings on designated issues, and by the Commission staff, who summarized and analyzed the record evidence and made recommendations to the Commission for a revised Trade Regulation Rule. The Bureau of Economics also submitted comments and recommendations to the Commission for a revised rule.

Pursuant to §1.13(h) of the Commission's Rules of Practice, publication of the Final Staff Report initiated a sixty-day comment period which afforded the public an opportunity to comment on the reports of the Presiding Officer and the staff. This comment period was extended and closed on January 16, 1981. A summary of post-record comments was placed on the public record.

On April 14, 1983, the rulemaking staff's memorandum recommending a final modified proposed rule, and memoranda from the staff of the Bureau of Economics, and the Directors of the Bureaus of Consumer Protection and Economics were placed on the public record. On June 6 and 7, 1983, the Commission heard oral presentations from prior rulemaking participants who had been invited to present their views directly to the Commission as provided in §1.13(i) of the Commission's Rules, 16 CFR 1.13(i). On June 13, 1983, the Commission met to consider whether to adopt a final rule, and if so, what form the rule should take. Although as to the rule as a whole no final determination was made during that meeting, the Commission deleted the provisions of the staff proposed rule concerning attorneys' fees and deficiency balances and directed the staff to draft proposed disclosures for the remaining provisions of the rule. The Commission further directed the staff to draft alternative proposals for a limitation on household goods security interests and third party contacts. The staff was instructed to draft a modified disclosure for cosigners. The Commission indicated tentative support for a ban on confessions of judgment and wage assignments. The Commission further indicated support for the late
charges provision subject to clarification of the language to focus more clearly on the "pyramiding" problem.

On July 20, 1983, the Commission tentatively adopted the portions of staff's revised proposed rule banning "pyramiding" and clarifying the FTC's interpretation of statutory property exemptions, wage assignments, pyramiding late charges, and blanket security interests in household goods. The Commission also tentatively adopted staff's revised proposal requiring that potential co-signers be furnished with a "Notice to Co-signer" which explains their obligations and liability.

The Commission rejected the provisions of the proposed rule pertaining to third party contacts and cross collateralization. The Commission determined that the effective date of the rule is to be one year from the date of promulgation.

B. Nature of Evidence on the Record

Publication of the proposed Credit Practices Trade Regulation Rule was preceded by a two-year investigation which culminated in subpoena returns from 12 large national consumer finance companies. The subpoenaed material consists of over 7,000 individual files on delinquent debtors and official company operating manuals and training materials.

In response to the invitation to comment on the proposed rule 11 the Commission received over 1,300 written comments. The comments are divided as follows by source: Banks (475); bank trade associations (19); finance companies (189); finance company trade associations (46); retailers (108); retail trade associations (8); credit unions (96); credit union trade associations (9); savings and loan associations (11); savings and loan trade associations (8); legal aid attorneys (117); consumer groups (23); governmental entities (36); other organized groups (18); and miscellaneous, including individual consumers (207). An additional 356 post-

record comments were received during the 1980-81 reopening for comments on the Presiding Officer and Staff Reports.

Three hundred and nineteen witnesses appeared in ten weeks of hearings held in Chicago, Dallas, San Francisco, and Washington from September 1977 through January 1978. The interests they represented were: Finance companies and their trade associations (95); banks and bank associations (25); retailers and their associations (12); credit unions and their associations (8); legal services attorneys (67); governmental entities (49); consumers and consumer groups (14); and miscellaneous (15). In all, 508 hearing exhibits were placed on the record.

C. Consumer Credit Market

Approximately 70 percent of household indebtedness is in the form of home mortgages; about 23 percent is in the form of installment consumer credit.12 About 5 percent of consumer debt is noninstallment consumer credit, that is, 30 day charge credit held by retailers, travel and entertainment companies and single-payment loans at commercial banks for consumer purposes.13 At the end of December 1981 total consumer noninstallment credit amounted to $78.4 billion.14

At the end of 1981, consumer installment credit totaled $333.4 billion.15 Of that amount, 44.8 percent was held by commercial banks, 26.9 percent by finance companies, 13.8 percent by credit unions, 8.9 percent by retailers, 3.5 percent by savings and loan associations, 1.3 percent by gasoline companies, and 0.8 percent by mutual savings banks.16

By types of credit, $126.4 billion, or 37.9 percent of installment credit outstanding at end of 1981, was for the purchase of automobiles.17 Revolving credit outstanding amounted to $63.0 billion at the end of 1981 (18.9 percent of the total). Commercial banks held $33.1 billion, retailers $25.5 billion and gasoline companies $4.4 billion.18

All other consumer installment financing of $125.4 billion comprised 37.6 percent of the total outstanding at the end of 1981. Commercial banks held $46.7 billion, finance companies $40.0 billion, and credit unions $23.5 billion. Retailers (including the wholly owned finance subsidiaries of chain stores) held $4.0 billion, savings and loan associations $8.4 billion, and mutual savings banks $2.8 billion. This "other" category includes installment contract financing of household goods such as appliances and furniture, as well as all personal loans.19

II. Legal Basis for the Rule

This proceeding focuses on certain of the terms and conditions that appear in the written contracts that consumers sign when they obtain credit for reasons other than the acquisition of real estate.1 Its purpose is the evaluation of certain collection remedies and related practices in light of the requirements of Section 5 of the FTC Act. This Chapter of the Statement discusses the Commission's mandate to enforce unfair or deceptive acts or practices and will serve to place in perspective subsequent discussions of the specific provisions of the rule.

The Commission's authority to promulgate this Trade Regulation Rule is derived from two sections of the FTC Act: Section 18(a)(1)(B) and Section 5(a)(1).2

A. Rulemaking Authority

Section 18(a)(1)(B) of the Federal Trade Commission Act states, in pertinent part, that the Commission may prescribe:

[Rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce * * * [within the meaning of section 5(a)(1) of the FTC Act] * * * Rules under this subparagraph may include requirements for the purchase of automobiles. Finance companies held $45.3 billion, most of which consisted of contracts purchased by the subsidiaries of manufacturers—that is, by General Motors Acceptance Corporation (GMAC), Ford Motor Credit and Chrysler Financial Corporation. Credit unions held $22.0 billion in loans made for the purchase of automobiles. 3

12 "Consumer credit" is defined by the Federal Reserve as "most short and intermediate-term credit extended to individuals through regular business channels, usually to finance the purchase of consumer goods and services or to refinance debts incurred for such purposes, and scheduled to be repaid (or with the option of repaying) in two or more installments." Board of Governors of the Federal Reserve System. Federal Reserve Statistical Release G.10 (Feb. 10, 1978).

13 NCFA 1982 Finance Facts Yearbook at 41.

14 Id.

15 During the 1970's the increases varied between $4.8 billion in 1970 and $43.1 billion in 1978. The increase in 1980 was only $1.5 billion.

16 Id.

17 Generally the automobile serves as security for installment contracts which are written by dealers and sold to banks or finance companies, or as security for auto loans made directly to consumers by banks and credit unions. Predominant in financing these purchases were commercial banks, with $40.2 billion outstanding of which $55.1 billion was purchased paper and $24.1 billion direct loans

18 NCFA 1982 Finance Facts Yearbook at 41.


prescribed for the purpose of preventing such acts or practices. 5

The Commission believes that the record should contain a preponderance of substantial reliable evidence in support of a proposed rule before that rule is promulgated. This belief is based partly on the Commission’s perception of its function and partly on statutory and judicial authority. Any rule promulgated by the FTC may be challenged in court and may be set aside if “the court finds that the Commission’s action is not supported by substantial evidence in the rulemaking record * * * taken as a whole.” FTC Act section 16(e)(3)(A). 15 U.S.C. 57(e)(3)(A) (West Supp. 1983). Congress imposed this high standard as a “greater procedural safeguard [ ]” because of the “potentially pervasive and deep effect” of FTC rules. American Optometric Ass’n v FTC, 626 F.2d 896, 905 (D.C. Cir. 1980) (quoting H.R. Rept. No. 1107, 93d Cong., 2d Sess. 45–46, 1974 United States Code Cong. and Ad. News 7702, 7715.) Therefore, the Commission takes seriously its responsibility to determine if there is a preponderance of substantial reliable evidence to support a proposed rule, and to see that any supporting evidence is clearly recorded.

Initially, the Commission requires substantial evidence for the factual propositions underlying a determination that an existing act or practice is legally unfair or deceptive. When substantial evidence both supports and contradicts such a finding, the Commission bases its decisions on the preponderance of the evidence. Before promulgating a rule, however, rather than bringing individual cases, the Commission believes the public interest requires answers to the following additional questions: (1) Is the act or practice prevalent? (2) Does a significant harm exist? (3) Will the proposed rule reduce that harm? and (4) Will the benefits of the rule exceed its costs? 6 In analyzing each of these questions, three types of evidence are frequently brought to bear: Quantitative studies, expert testimony, and anecdotes. The Commission has the flexibility to marshal evidence for a rulemaking record that combines the best mix of these three. However, it has a responsibility to see that the best evidence reasonably available is included. 7

The best evidence will often be surveys or other methodologically sound quantitative studies. Carefully prepared studies can often give a reliable answer to each of the four questions. First, reliable estimates of the incidence of a practice are an integral part of an assessment of prevalence and are frequently well-suited to quantitative methods. Second, the overall harm caused by a problem is best measured by determining both the magnitude of consumer injury when it occurs and the frequency of such an injury. This issue is also well-suited to quantitative analysis. Third, the effectiveness of a proposed remedy can often be shown only by quantitative studies since informally observed changes may be influenced by other, uncontrolled factors, or may be the result of chance (i.e., not statistically significant). Finally, quantitative studies are most helpful when comparing costs with benefits.

In many instances, of course, precise quantitative answers to these questions are not possible, or could be obtained only at a prohibitive cost. In such cases, the Commission will seek alternative ways to conduct a systematic assessment of the benefits and costs of its regulatory proposals. As in considering the merits of a rule, the Commission will balance the benefits and costs of obtaining additional information. Although carefully structured quantitative studies are generally preferred as evidence in a rulemaking record, the Commission believes that it is possible in some instances to support a rule without such studies.

The second type of evidence is expert testimony. The primary use of expert testimony is in providing underlying technical details, such as medical or engineering facts or information concerning state law and procedures. Expert testimony is also useful to address the methodology of quantitative studies, and its possible effects on the results. Finally, experts can give their own opinions regarding the issue facing the Commission. These opinions are usually predictions of what quantitative studies would show. As such, they are less satisfactory than an actual study. When an expert’s opinion conflicts with the conclusions of a study, the study itself is generally more reliable, unless deficiencies in the methodology or execution of the study have been established and a better study would, in all likelihood, support the expert’s opinion.

A third type of evidence is anecdotes. Narratives of specific consumer injuries are helpful in certain ways. They call attention to a possible problem; they illustrate the contours of a known problem; and they may suggest areas for further inquiry. By themselves, anecdotes are generally good evidence that some harm exists. Without thorough exploration of the details of individual examples, however, anecdotes cannot establish the cause of a problem. Moreover, anecdotes give little evidence of the frequency of the harm, they provide limited evidence for the effectiveness of a proposed rule and virtually no evidence of the balance of benefits and costs. Therefore, anecdotal evidence is rarely sufficient to provide the “substantial evidence” which the Commission requires in the rulemaking record.

B. The Criteria for Unfairness Under Section Five

Section 5(a)(1) of the FTC Act, in turn, states:

Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful. 8

The Commission’s authority to prohibit unfair acts or practices in the marketplace is well established. 9 The Commission and the courts have developed an extensive body of law concerning unfair practices.

- When Congress created the Commission’s unfairness authority, it deliberately framed that authority in general terms. Congress felt that any attempt to list all “unfair * * * acts or practices” could leave loopholes for evasion of the law. Also, Congress did not intend the meaning of “unfair” to be static. It was expected that the underlying criteria would evolve and develop over time. For a comprehensive discussion of the generality of Section 5, see Statement of Facts and Purpose, Advertising of Ophthalmic Goods and Services, 43 FR 23992, 24000 (1987).
- Although a majority of the adopted rule provisions are based on the Commission’s authority to regulate unfair acts or practices, 15 U.S.C. 57(a)(1), which concerns misrepresentations of the nature or extent of cosigner liability, is premised on the FTC’s jurisdiction over deceptive acts or practices. A discussion of the Commission’s authority to identify and control consumer deception is set forth in Chapter IX, infra.

* * *

8 The concept of “reasonably available” takes into account the practical resource constraints on the ability of the Commission or parties to a rulemaking to marshal evidence bearing on a particular problem.
The Wheeler-Lea amendment of 1938, the 1975 and 1980 FTC Improvements Acts, and pending legislation in the Congress constitute legislative recognition that, in an imperfect system, certain commercial practices may impose undue costs and risks on individuals, depriving them of the benefits normally associated with free and vigorous competition. In this proceeding, the Commission is exercising its unfairness jurisdiction to determine whether in the consumer credit market there is a market imperfection that is preventing a balancing of costs and benefits to individuals. This proceeding examines the market to determine whether it ensures an efficient allocation of costs and risk between consumers and those who extend credit to them. It is our conclusion that the practices addressed by this rule, as discussed individually in Chapters IV—IX, are within the parameters of unfairness under Section 5.

In December 1980, the Commission prepared a formal statement analyzing the legal basis for the exercise of its Section 5 consumer unfairness jurisdiction. That document reviewed the Commission's prior exercise of its unfairness jurisdiction and clarified the criteria for its future use of this authority.

Consumer injury is the central focus of any inquiry regarding unfairness. Not every instance of consumer injury is unfair, however, because virtually any commercial practice involves a complex mix of benefits and costs. In its statement, the Commission observed that:

To justify a finding of unfairness the injury must satisfy three tests. It must be substantial; it must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided.

Pending legislative proposals would give Congressional recognition to this unfairness standard:

An act or practice in or affecting commerce shall be considered to be an unfair act or practice * * * if:

(i) Such act or practice causes or is likely to cause substantial injury to consumers and
(ii) Such substantial injury (I) is not reasonably avoidable by consumers; and (II) is not outweighed by countervailing benefits to consumers or to competition which result from such practice.

Any determination under the preceding sentence regarding whether an act or practice is an unfair act or practice shall take into account, in addition to other relevant factors, whether such act or practice violates any public policy as established by Federal or State statutes, common law, practices in business or industry, or otherwise. The Commission's unfairness authority does not extend to trivial or speculative harm. "An injury may be sufficiently substantial, however, if it does a small harm to a large number of people, or if it raises a significant risk of concrete harm." Furthermore, except in aggravated cases where tangible injury can be clearly demonstrated, subjective types of harm—embarrassment, emotional distress, etc.—will not be enough to warrant a finding of unfairness. Rather, economic or other tangible harm must also be present. Earlier articulations of the consumer unfairness doctrine have also focused on whether "public policy" condemned the practice in question. In its December 1980 statement, the Commission stated that it relies on public policy to help it assess whether a particular form of conduct does in fact tend to harm consumers.

We have thus considered established public policy "as a means of providing additional evidence on the degree of consumer injury caused by specific practices." By "established" public policy, we mean that: (i) The policy is embodied in "formal sources" such as constitutions, statutes, or judicial decisions, and (ii) it is widely shared by a number of states. This is especially true concerning court decisions involving constitutional rights, such as due process guarantees. Where public policy appears to be in conflict, the Commission will "reconsider its assessment of whether the practice is actually injurious in its net effects."

The Commission has applied this standard to the creditor practices prescribed by this rule.

In short, consumer injury is the central element in a finding of unfairness. But not every instance of consumer injury will lead to a determination of unfairness. The injury must be found to be substantial, not reasonably avoidable by the consumer, and not outweighed by countervailing benefits to consumers or competition. The record as it relates these criteria to each rule provision will be reviewed in the respective chapters of this statement addressing each rule provision. Chapter III of this Statement contains an examination of the record as it relates to the general question of reasonable avoidance by consumers of creditor remedies. The balance of this Chapter has an overview of the remaining unfairness criteria as they relate to the rule.

C. Unfairness in Creditors' Contractual Remedia

1. Substantial Injury

The rulemaking record documents substantial consumer economic or monetary injuries from the use of these creditor remedies. For example, confessions of judgment cause injury by depriving consumers of notice of a suit or hearing and the opportunity to appear and present any meritorious claims or defenses. Once obtained, the confessed judgment can be turned into a lien on the consumer's real and personal property. If the contract also contains...
a waiver of exemption clause, the consumer can lose the basic necessities of life. This would require that the debtor replace these items or face destitution, and the possibility of becoming a public charge. Blanket security interests in household goods also present this possibility.

A wage assignment also occurs without the due process safeguards of a hearing and an opportunity to assert defenses or counterclaims. For consumers who may have valid reasons for nonpayment, the injury inherent in the denial of due process protections can be severe. It can lead to job loss, or severely reduced income, either one of which could prevent the consumer from providing for his or her family or cause default on other obligations.

Pyramiding of late charges results in the consumer being unknowingly assessed multiple late charges for a single late payment, even though subsequent payments are timely made. The multiple late charges can add up to 60 percent annual percentage rate in many cases.

The rulemaking record establishes by a preponderance of the evidence that consumers suffer substantial economic or monetary injury from creditors' use of these practices. This is the primary focus of our unfairness analysis. Although our unfairness standard makes it a subsidiary consideration, the record shows that consumers often suffer substantial emotional or subjective harm as well. For example, wage assignments invade the consumer's right of privacy, causing embarrassment and humiliation, without a judicial determination of the validity of the creditor's claim. Although such subjective harm is not easily quantifiable, it is clear that consumers value measures to protect them from such injury.

In assessing particular remedies, our focus has been on the consequences of this remedy for consumers in those cases when the remedy is invoked or threatened. Nonetheless, all consumers will benefit from the rule to the extent that it reduces the adverse consequences of default because it serves, in that capacity, as a form of insurance. At the time a consumer enters into a loan agreement, the likelihood of default is both remote and difficult to assess. Thus, all consumers face some risk of default and will value insurance which reduces the most injurious consequences of default, even if they never need the insurance. In this sense, all consumer debtors will benefit.

2. Not Reasonably Avoidable

A violation of the Section 5 unfairness standard will almost always reflect a market failure or market imperfection that prevents the forces of supply and demand from maximizing benefits and minimizing costs. Normally, we can rely on consumer choice to govern the market. In considering whether an act or practice is unfair, we look to whether free market decisions are unjustifiably hindered.

In consumer credit transactions, the rights and duties of the parties are defined by standard-form contracts, over most of which there is no bargaining. The economic exigencies of extending credit to large numbers of consumers each day make standardization a necessity. The issue, however, is whether the contents of these standard form contracts are a product of market forces.

Although market forces undoubtedly influence the remedies included in standard form contracts, several factors indicate that competition will not necessarily produce optimal contracts. Consumers have limited incentives to search out better remedial provisions in credit contracts. The substantive similarities of contracts from different creditors mean that search is less likely to reveal a different alternative. Because remedies are relevant only in the event of default, and default is infrequent, consumers reasonably concentrate their search on such factors as interest rates and payment terms. Searching for credit contracts is also difficult, because contracts are written in obscure technical language, do not use standardized terminology, and may not be provided before the transaction is consummated. Individual creditors have little incentive to provide better terms and explain their benefits to consumers, because a costly education effort would be required with all creditors sharing the benefits. Moreover, such a campaign might differentially attract relatively high risk borrowers.

For these reasons, the Commission concludes that consumers cannot reasonably avoid the remedial provisions themselves. Nor can consumers, having signed a contract, avoid the harsh consequences of remedies by avoiding default. When default occurs, it is most often a response to events such as unemployment or illness that are not within the borrower's control. Thus, consumers cannot reasonably avoid the substantial injury these creditor remedies may inflict.

3. Countervailing Benefits

These creditor practices involve a mixture of costs and benefits, both economic and social. An individual creditor practice will not be considered to be unfair unless it is injurious in its net effects. The potential costs include burdens such as "increased paperwork, increased regulatory burdens on the flow of information, reduced incentives to innovation and capital formation, and similar matters."

The potential costs of most significance in this proceeding include increased collection costs, increased screening costs, larger legal costs, and increases in bad debt losses or reserves. Increased creditor costs generally would be reflected in higher interest rates to borrowers, reduced credit availability, or other restrictions such as increased collateral or longer down payment requirements.

The possible magnitude of these costs is diminished by the fact that the rule leaves untouched a wide variety of more valuable creditor remedies. Remedies such as repossession, suit, garnishment, acceleration and direct contacts, which are highly valued by creditors, are not affected by this rule. Thus, for example, the impact of restrictions on wage assignments is limited, given the availability of other remedies to allow creditors to reach a debtor's income. The remedies subject to the rule must be evaluated in light of their more limited incremental contribution to deterring

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See infra Chapter III, Section B

See Pfizer, Inc., 81 F.T.C. 23, 62-63 n.13 (1972); Statement of Basis and Purpose, Disclosure Requirements and Prohibitions Concerning Franchising the Business Opportunity Ventures, 43 FR 50614, 50636 n.95 (1978). When making this determination, the Commission may refer to existing public policies for help in ascertaining the existence of consumer injury and the relative weights that should be assigned to various costs and benefits. The role of public policy in unfairness determinations will be discussed more generally below.

The insurance thus provided is not costless, of course, and some consumers may prefer not to purchase it. The costs are discussed in this Chapter. See infra Section II, Countervailing Benefits; infra note 11, at 7.

E.g., Walter E. Huizenga, National Automobile Dealers Association, R-II [g]-419; Helmut Schmidt, Transamerica Finance Association, Tr. 6187-89.

default or reducing other creditor costs, given remedies that remain available. The action we take today based on this record is premised on our finding that the cost of each rule provision is lower than the costs, to consumers and competition, of the specific practices at which the rule is aimed. For the provisions we adopt, record evidence establishes that the action we take will provide benefits to consumer in excess of any costs. In other cases, the record does not justify the action originally proposed.32

2 To the extent that the remedies that the rule prohibits reduce the cost of business for creditors, borrowers as a group benefit from those remedies through greater availability of credit and lower interest rates. However, the Commission believes the overall costs to consumers are greater than these benefits.33

D. Legal Format of the Rule

We have adopted certain text changes to bring this rule into accord with the decision in Katherine Gibbs School v. FTC 34 (hereinafter Gibbs), which requires a rational connection between the practice found to be violative of Section 5 and the prescribed remedy. In order to make this connection clear, the Second Circuit held that the Magnuson-Moss Act requires the Commission to set forth in the actual text of a rule a description of the underlying unfair or deceptive acts or practices which serve as its basis. Most of the provisions of this rule require the elimination or restriction of specified contractual terms and conditions,35 or of identified accounting procedures.36 The rule defines the use of such clauses or procedures, in se, to be an unfair practice. Because in these instances the direct relationship between the unfair practice and the proscription of that practice is apparent on the face of each such provision, there is no reason to set out the two separately. The only provision to which this analysis does not apply is the requirement of a cosigner disclosure notice in § 444.3. In order to comply with the Gibbs ruling, we have modified this section to, first, define the unfair or deceptive practices (misrepresentation of and failure to disclose the nature or extent of cosigner liability) and, second, prescribe the remedy (furnishing the required notice). We believe this language meets both the statutory requirement that the unfair practice be described with specificity and the Gibbs imperative that the identified prescription be rationally related to the defined unfair practice.

E. Regulatory Analysis

Based on unfairness, the legal theory for this rule requires the Commission to examine the benefits and costs of each rule provision to conclude that the practice at issue violates Section 5. This analysis is no different than that embodied in the statutory requirement to conduct a regulatory analysis.37 For this reason, the Commission has integrated the regulatory analysis with the Statement of Basis and Purpose for the rule. A regulatory analysis for the sections of the original proposal that the Commission decided not to promulgate is included in Chapter XIII.

III. Evidentiary Basis for the Rule as a Whole

As discussed in the preceding chapter, there are three elements in the Commission's consideration of whether the consumer injury associated with a practice reaches the level of legal unfairness. To justify a finding of unfairness, the injury must be substantial, not outweighed by countervailing benefits to consumers or competition, and not reasonably avoidable by consumers. This chapter discusses our rationale and the evidence relating to the third element—the degree to which injury is reasonably avoidable by consumers. The ability to avoid injury depends on the existence of appropriate market forces. If there have access to loan contracts without the provisions in question, and in part on whether, having signed a contract containing these provisions, consumers can avoid their implementation. Our analysis deals with the rule as a whole. Discussion of record evidence pertaining to specific provisions is reserved for subsequent chapters.

A. The Market for Creditors' Remedies

In part, consumers' ability to avoid certain remedies depends on their ability to shop and compare the language of different credit contracts. To the degree consumers cannot reasonably obtain contracts without certain

32 We have deleted, therefore, the provisions concerning deficiency balances, attorneys' fees, cosigners (other than the disclosure notice to cosigners of third party contacts, and cross collateralization.

33 See infra Chapter X.

34 412 F.2d 658 (2d Cir. 1970).

35 See 444.2(a) (1) through (4).

36 See 444.4.

In and of itself, standardization is not an indictment of the consumer loan market. The use of standardized forms is an efficient, low cost method of conducting transactions. The costs of negotiating with each customer would surely outweigh the benefits that would result from individually tailored contracts. As the Presiding Officer found, "it is simply not feasible to conduct the transaction any other way." In addition, testimony indicates that the complex regulatory environment in which most lenders do business makes precise contract wording important, and thereby necessitates the use of standardized contracts.

In a well-functioning market, competition among sellers would tend to produce the mix of standardized contract terms that would best satisfy borrower preferences. Despite the use of standardized contracts, individual creditors have incentives to compete with each other by offering different standard form contracts, provided that a sufficient number of consumers know about the differences and prefer one contract to another. In such circumstances, consumers could reasonably avoid undesirable contracts, and there would be no basis for Commission intervention. It is therefore necessary to examine the factors that limit consumer search for more desirable credit contracts.

Record evidence indicates that differences exist in the kinds of contracts offered by different creditors. Finance companies in particular are more likely to use the remedies subject to this rule than are other creditors. Among finance companies, use of some contract terms is relatively low when examined nationally. In particular states, however, where certain remedies are more widely used, the incidence is considerably greater. Moreover, within a local area, contracts offered by creditors of a given class may be substantially identical.


In general, the National Consumer Law Center Survey of Credit Contract Practices (1977), HI-467; NCCF Technical Studies, Vol. V (1972). The incidence of use of wage assignments is most prevalent in Illinois and New York, see infra Chapter IV; use of cognovits is substantially limited to one state—Pennsylvania, see infra Chapter IV.

Since, e.g., use of wage assignments is most prevalent in Illinois and New York, see infra Chapter IV; use of cognovits is substantially limited to one state—Pennsylvania, see infra Chapter IV.

Geoff Stigler, in a pioneering article on the subject of search, shows that "if the dispersion of price quotations among sellers is at all large (as is the case in many markets), the costs and difficulties of searching for additional quotations will be so great that average, to canvas several sellers." In contrast, when price dispersion is small and the cost of information acquisition is relatively low, consumers will be willing to search for additional quotations. The Economics of Information," 89 Journal of Political Economy, 171 at 173 (1981). This argument applies, in general, to any information, not just price quotations. If additional search is unlikely to discover a better alternative, it will not pay to engage in additional search.

If 80 percent of creditors chosen at random use a particular term, then the chance that 3 creditors chosen at random all use the terms is .8 x .8 x .8 or 516 percent.

See infra Section B.

E.g., Professor John Spanogle, Tr. 917; Dr. Paul E. Smith, Wharton School, on behalf of the National Consumer Finance Association, Tr. 8798; William S. Ballenger, Director, Michigan Department of Licensing and Regulation, Tr. 1814.

The strong similarity of consumer credit contracts among creditors of a given kind within a local area limits consumers' incentives to search elsewhere for a better contract. If 80 percent of creditors include a certain clause in their contracts, for example, even the consumer who examines a contract from three different sellers has a less than even chance of finding a contract without the clause. In such circumstances relatively few consumers are likely to find the effort worthwhile, particularly given the difficulties of searching for contract terms discussed below.

A second factor also limits the incentives of consumers to search for better credit contracts. Default is a relatively infrequent occurrence, and most often occurs for reasons that are beyond the control of the borrower. Unlike terms such as interest rates or fees, which are relevant in every transaction, the chances are good that the remedial provisions in any particular transaction will never be relevant. Thus, consumers would quite reasonably concentrate their search for credit on terms such as interest rates and payments, rather than alternative remedial provisions.

Consumers' limited incentives to seek out better contracts are compounded by the costs and difficulties of searching for contract language. Borrowers usually cannot understand the technical language used in credit contracts.
Some witnesses stated that many provisions are phrased in terms that are virtually impossible for the non-lawyer to understand. As the Presiding Officer noted:

Consumer credit contracts are not drafted with a view of making the provisions understandable to the consumer generally and do not contain an adequate explanation of either the consumer's rights or the creditor's obligations.

Nor can consumers seek explanations from lenders, because inquiries by prospective customers regarding remedies may tend to make a creditor wary and hesitant to grant the loan. The Presiding Officer concluded "that consumers do not have a complete understanding of consumer credit contracts." We concur.

Comparing contracts is also complicated by the lack of standardized terminology among various creditors. Different creditors may use different language to achieve essentially the same results. For example, some contracts may use "waiver of exemption," which other contracts might describe as a confession of judgment. Particularly given the complex legal terminology often employed, many consumers may find it difficult even to identify substantive differences in contracts. In some cases, comparison is impossible because the creditor refuses to give out the loan contract until the borrower seems ready to sign it.

In many other markets when comparing products is difficult for shoppers, companies attempt to make such comparisons more readily accessible. Companies with more favorable remedial terms have an incentive to advertise that fact, and thereby attract a larger share of the loan market. No such advertising is reflected in the record, however. Nor does the rulemaking record have specific information on why such advertising fails to occur. Nevertheless, the Commission sees several possible explanations, including those discussed above: the complexity of the legal process surrounding remedies and the fact that the average consumer does not focus on elements of a transaction that are distant in time and probability.

Consumer ignorance with regard to the meaning of contractual language is one factor that may inhibit such advertising. For example, the company that claims that its contract contains no waiver of exemption will have to explain what a waiver is, and why consumers should prefer a contract without it. Such an educational campaign might and will tend to benefit other creditors who "free ride" on the company's efforts. If consumers prefer contracts without waivers, then other companies can eliminate their waivers (and advertise the fact) without bearing the costs of education.

Adverse selection by borrowers also limits the incentives of creditors to promote remedies that are relatively lenient. Within any group of borrowers that appear identical to the creditor, the true default risk for some is greater than others. If a creditor were to introduce a loan contract with less onerous remedies than those of its competitors, then its contract would become especially attractive to relatively high risk borrowers, because these borrowers have the most to gain from the more lenient remedy terms. Therefore, a disproportionately greater share of the borrowers attracted to this company would be those with a relatively high risk of default. Thus, a company that promoted more lenient remedy terms might experience a higher rate of borrower default than its competition. Unless its higher rate of interest could fully compensate for this higher rate of default, the company would find these remedy provisions unprofitable, even if consumers would prefer the provisions.

Ultimately, similar considerations led the Commission to reject an alternative rule that would have required plain English disclosure of contractual remedies. Such a rule would make information more easily accessible to borrowers. However, in so doing it would tend to exacerbate the adverse selection problem. Moreover, disclosure alternatives would deal only partially with limited seller incentives to promote alternative remedies due to the free rider problem, and would not address at all consumers' limited incentives to search for information about remedies.

Although some options exist, and some consumers may search for contract provisions they prefer, the record indicates that in consumer credit markets, comparison of competing contracts is difficult and costly. Moreover, remedies intended to reduce the costs of identifying better contracts are unlikely to succeed. Therefore, the Commission has concluded that consumers cannot reasonably avoid the contract clauses at issue in this proceeding.

B. Default and its Causes

Even if a contract contains undesirable remedies, borrowers could reasonably avoid injury if they could avoid implementation of remedies. Addressing this possibility requires an examination of the causes of default.

There are two leading studies of the causes of default, one by the National Commission on Consumer Finance and the other by sociologist David Caplovitz. The studies complement each other—the NCCF relied on survey data from creditors but Caplovitz surveyed debtors. Both reach similar conclusions.

"Loss of income" stands out as the leading cause of default in the Caplovitz study. The primary causes of loss of income are "adverse employment change" (including unemployment, loss of overtime, etc.) and "illness or death of the wage earner." Findings of the NCCF are similar. Unemployment is ranked as the most important cause of default by all classes of creditors. Overextension is found to be the second most important cause by banks and finance companies, and the third most important cause by retailers.

These categorizations are necessarily somewhat imprecise. Nevertheless, the results indicate that the precipitating cause of default is usually a circumstance or event beyond the debtor's immediate control. When such events occur, default is generally an involuntary response.

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22 For a fuller discussion of the disclosure alternative see Chapter XIII.
Nonetheless, among a minority of debtors, default might have been prevented. Caplovitz found voluntary overextension was given as either a major or contributing cause of default by 25 percent of the debtors surveyed and debtor irresponsibility by 5 percent. The NCCF found overextension to be the second or third most important cause of default (no distinction was made between voluntary and involuntary overextension) and lack of intention to repay as the last or next to the last most important cause of the 8 causes studied. Moreover, some debtors can engage in precautionary behavior that will soften the impact of unfortunate events, and to this end, they may increase their chances of weathering adversity without defaulting on their obligations. One study on the record provides some insight in this regard. It examines the incidence of seven economically traumatic events in a representative sample of American families over a five-year period. Events studied were firings, unemployment, underemployment, evictions, unplanned emergency expenditures, unplanned children, and illness resulting in two or more weeks absence from work. The study found that over a five-year period almost all households experience at least one of the listed events. A majority experience four or more.

Default, however, is a far less common experience. Data on automobile loans, for example, indicates a yearly default rate which fluctuates between 3 and 6 percent. The primary reason for about half of the income loss of individuals in study, while illness accounted for another third. More complete results can be found in the following table:

<table>
<thead>
<tr>
<th>Major Reasons Creditors Report Have Caused Debtors to Fail to Meet Contractual Obligations</th>
<th>Banks (708 responses)</th>
<th>Finance companies (218 responses)</th>
<th>Retailers (461 responses)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Overextension</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Illness of debtor</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Separation</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Illness in family of debtor</td>
<td>5</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Divorce</td>
<td>6</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Lack of intention to repay—&quot;deadbeat&quot;</td>
<td>7</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Family relocation</td>
<td>8</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>


For example, Caplovitz interviewed debtors in default and asked: "What were the main reasons why you stopped making payments on the ("merchandise/loan")? A typical response was: "I got sick and didn't work for a while and there were too many bills to keep up." Is the cause of this default involuntary overextension or illness? Such distinctions are difficult to make and Caplovitz acknowledges that his coding decisions "were to some extent arbitrary." D. Caplovitz, supra note 28, at 60-61. In addition, there may be response bias as debtors may tend to underestimate their own responsibility in causing default.

Section 444.2(a)(1) of the rule provides that it is an unfair act or practice for a lender or retail installment seller to take or receive from a consumer an obligation that constitutes or contains a cognovit, confession of judgment (for purposes other than executory process in the state of Louisiana), a warrant of attorney, or other waiver of the right to notice and the opportunity to be heard in the event of suit or process thereon.

### Nature of the Practice

The cognovit is a legal device whereby the debtor, by means of a provision included in the contract, consents, in advance to the creditor obtaining a judgment without prior notice or hearing. The debtor either confesses judgment in advance of default or authorizes the creditor or an

This discussion of statutory safeguards reflects the law governing confessions of judgment in Pennsylvania, see infra notes 33-45 and accompanying text. In other states, procedural safeguards governing the use of cognovits are similar but variations exist. See, e.g., discussion of statutory safeguards in Delaware and Virginia infra notes 29-32 and accompanying text.

Absent a defense, however, judgment will not be reopened merely because the debtor has a counterclaim or set-off that he could have joined with his defense. J.M. Korn & Son, Inc. v. Float Air Corp., 305 Pa. Super. 458, 440 A.2d 945, 947 (1982). Additional limits on the debtor's right to a trial de novo are discussed infra at notes 43-47 and accompanying text.

The lien of the judgment or of any levy or attachment is preserved while these proceedings are pending. Although such statutory safeguards provide debtors with some means of protecting their property interests, they fail to provide the full due process protection required by the fourteenth amendment to the Constitution. The essence of the due process clause as it relates to property is to protect the individual from wrongful deprivation by, or through the offices of, the government. Such protection is achieved by giving individuals notice of the claim against them, and the opportunity to contest those claims at a hearing. If the hearing is to achieve its purpose, then, in anything other than an emergency situation it must precede the property deprivation.

Judgment debtors whose property is encumbered through the existence of a creditor's lien lose the full use and enjoyment of their property. Debtors are unlikely to be able to sell, or to use it as collateral while it is subject to a lien. Although the debtor may eventually prevail on the merits and dissolve the lien, the post-judgment rights provided by statute cannot cure the deprivation experienced while the action is pending. Even a temporary and non-final deprivation of the use of one's property is a matter of constitutional significance and invokes the protection of the due process clause. Because state statutory protections governing cognovits arise only after debtors are deprived of the full use of their property, they cannot guarantee full due process protection. The right to a hearing before deprivation occurs is essential.

The contractual waiver of one's right to due process is constitutionally permissible, provided that the waiver is made voluntarily, knowingly, and intelligently. Thus, in a commercial context, the use of confessions of judgment has been upheld where the facts demonstrated that this standard had been met. A consumer who is unaware of the existence or meaning of a cognovit clause, however, cannot be said to have waived due process rights voluntarily, knowingly, and intelligently by signing a contract that includes such a clause.

Of the creditor remedies addressed by the rule, confessions of judgment are least likely to be understood by consumers. In many cases, consumers, especially low-income consumers, are not aware that cognovit clauses are in their contracts. To the extent that they are aware, consumers rarely understand the significance of these clauses because they are worded in legal language and because the concept of judgment by confession conflicts with the common understanding of basic due process rights. The record shows that, for these and other reasons (discussed in Chapters II and III above), consumers do not bargain over this provision or shop for contracts without it. The Commission finds, therefore, that consumers cannot reasonably avoid the injury caused by cognovits.

B. State Law

Virtually all states currently impose some statutory restrictions on the use of cognovit clauses. The protection that such statutes provide is far from uniform, however. A number of states either bar the use of confessions of judgment altogether or prohibit their use in connection with any claims arising out of a consumer credit transaction. Other state restrictions their use in specified classes of transactions, such as retail installment sales contracts, but do not impose a general prohibition on

374 Pa. 1, 4-5, 97 A.2d 234, 236 (1953).


4 See infra notes 33-45 and accompanying text.

5 The lien could have been used in the debtor's defense in a trial on the merits. The lien provides, default is not a necessary condition precedent to the entry of judgment. The judgment may be taken by any person holding the note. At common law it operates to cut off the opportunity to contest jurisdiction or venue or to present any claims or defenses that the debtor may have. Judgment is rendered for the amount due shown on the face of the note plus any other charges authorized, such as back interest fees and any court costs. It can be converted into a lien on the debtor's property, which subjects debtor's property to seizure and sale to satisfy the judgment.

6 See Swarb v. Lennox, 405 U.S. 191, 197 (1972) (Id. at 196 (citing a 1968 study conducted by David Caplovitz of 245 confessed-judgment debtors in Philadelphia, only 14 percent of whom knew that the contracts they had signed contained cognovit clauses). 17 E.g., Carolyn C. Maguire, Legal Aid Society of Cleveland, R-I(c)-38, 36 J. S. Litman, Middlesex County Legal Services Corporation, R-I(c)-28 at 3; Eugene Thirlow, Land of Lincoln Legal Assistance Foundation, Tr. 3356.

their use with respect to all consumer transactions. In addition, a significant number of states prohibit small loan licenses from utilizing confessions of judgment in loan agreements with consumers. The statutory definition of a small loan licensee varies from state to state, however. Thus, the protection such provisions afford consumers varies accordingly.

Other states authorize confessions of judgment, but only if they are executed after action on the underlying obligation has been instituted. The hallmark of the common law cognovit is the waiver of due process rights before the time that the debtor needs their protection. Because a statute prohibits waiver of these rights before commencement of an action against the debtor, in effect they bar the common law cognovit and the illus traditionally associated with it. Before an action can be commenced the debtor must receive notice, and the right to a hearing necessarily follows. If at this point the debtor chooses to confess judgment, the waiver of the right to a trial on the merits may be assumed to have been executed voluntarily. A few other states restrict confessions of judgment by requiring that they be entered into after default, rather than after institution of suit, or by requiring that the debtor appear personally in court to confess judgment if he or she chooses.

Another group of states restricts confessions of judgment by authorizing their use but requiring that the debtor sign a verified statement under oath attesting to the existence of the obligation due or to become due. Such confessions of judgment may help to focus the debtor's attention upon the existence of the cognovit clause at the time due process rights are waived. They do not ensure that the waiver is made intelligently, however, or at a time that the waiver has meaning for the debtor.

A few states provide for the entry of a judgment by confession only after requiring verification of the confession under oath and also without providing the debtor with notice and a hearing at the time of entry. Instead, these states rely on post-judgment procedures to alleviate wrongful deprivation that the debtor may have suffered. The required procedures provide varying degrees of protection to the debtor. Delaware, for example, provides for a hearing on the question of whether the debtor understood the constitutional rights waived at the time the judgment was confessed. Before judgment becomes final the court clerk must send notice to the debtor by certified mail of the opportunity for such a hearing. In addition, the debtor may seek to vacate or reopen the judgment and may present any defenses not deemed to have been waived, i.e., any defenses of which the debtor had no knowledge at the time of the confession of judgment or that arose subsequently.

Virginia law provides that any confessed judgment may be reduced or set aside within twenty-one days following notice to the debtor of its entry on any ground that would have constituted an adequate defense or set-off to the underlying claim. It also requires the creditor to notify the debtor of the right to contest judgment on these grounds. Unlike Delaware, however, Virginia does not specifically provide for a hearing on the preliminary question of intelligent or understanding waiver. Pennsylvania also authorizes the entry of judgment by confession against a debtor without advance notice and hearing. Although some statutory restrictions apply, it appears that some provisions may help to focus the debtor's attention upon the existence of the cognovit clause at the time due process rights are waived. They do not ensure that the waiver is made intelligently, however, or at a time that the waiver has meaning for the debtor. 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Virginia law provides that any confessed judgment may be reduced or set aside within twenty-one days following notice to the debtor of its entry on any ground that would have constituted an adequate defense or set-off to the underlying claim. It also requires the creditor to notify the debtor of the right to contest judgment on these grounds. Unlike Delaware, however, Virginia does not specifically provide for a hearing on the preliminary question of intelligent or understanding waiver. Pennsylvania also authorizes the entry of judgment by confession against a debtor without advance notice and hearing. Although some statutory restrictions apply, it appears that some provisions may help to focus the debtor's attention upon the existence of the cognovit clause at the time due process rights are waived. They do not ensure that the waiver is made intelligently, however, or at a time that the waiver has meaning for the debtor. A few states provide for the entry of a judgment by confession only after requiring verification of the confession under oath and also without providing the debtor with notice and a hearing at the time of entry. Instead, these states rely on post-judgment procedures to alleviate wrongful deprivation that the debtor may have suffered. The required procedures provide varying degrees of protection to the debtor. Delaware, for example, provides for a hearing on the question of whether the debtor understood the constitutional rights waived at the time the judgment was confessed. Before judgment becomes final the court clerk must send notice to the debtor by certified mail of the opportunity for such a hearing. In addition, the debtor may seek to vacate or reopen the judgment and may present any defenses not deemed to have been waived, i.e., any defenses of which the debtor had no knowledge at the time of the confession of judgment or that arose subsequently. Virginia law provides that any confessed judgment may be reduced or set aside within twenty-one days following notice to the debtor of its entry on any ground that would have constituted an adequate defense or set-off to the underlying claim. It also requires the creditor to notify the debtor of the right to contest judgment on these grounds. Unlike Delaware, however, Virginia does not specifically provide for a hearing on the preliminary question of intelligent or understanding waiver. Pennsylvania also authorizes the entry of judgment by confession against a debtor without advance notice and hearing. Although some statutory restrictions apply, it appears that
confessions of judgment are used relatively frequently in this state. Pennsylvania's procedural protections are more limited than those of Delaware and Virginia. In Pennsylvania, judgment is entered by the filing of a instrument confessing judgment or authorizing a third party to confess judgment against the debtor. Default is not a necessary condition precedent to the entry of judgment. The court clerk must notify the defendant debtor of the entry of judgment and enclose copies of the documents filed in support of judgment. Such notice is sent by ordinary mail rather than certified mail, however, and no return receipt is required. Thus, the court has no assurance that the debtor has, in fact, received notice. Failure to mail the notice and documents does not affect the lien against the debtor’s property imposed by the judgment. As a result, debtors may be wholly unaware that their property is subject to a lien.

Pennsylvania law provides for striking off or reopening of a judgment entered by confession. To strike a judgment the defendant’s petition must assert defects appearing on the record. To reopen a judgment the defendant’s petition first must assert prima facie grounds for relief. The existence of offsetting claims or counterclaims that the debtor has against the creditor does not constitute grounds for reopening. All defenses that are not included in the petition are waived. The court determines whether to reopen the judgment on the basis of the defendant’s petition, the plaintiff’s answer, and on any documents, depositions, and admissions. There is no statutory provision for a hearing on the petition to reopen. Only if the pleading produce evidence that would require submission of the issues to a jury will the court reopen the judgment. Thus, the reopening of a judgment entered by confession involves a preliminary pleading contest in which the debtor has the burden of persuasion.

In the event that the court does reopen the judgment, the lien of the judgment or of any execution issued on it is unimpaired, although the court may stay execution pending final disposition of the proceeding. This is a discretionary matter, however; the court is not required to stay execution. No further pleadings are permitted after reopening.

Although these statutory provisions afford some means of contesting a judgment that has been improperly entered, they fail to ensure that debtors’ rights will be protected adequately. This is true because, as noted above, there is no assurance that debtors will receive notice of the entry of judgment. Even when debtors do receive notice of the entry of judgment, the law does not require that they be notified of the right to contest the judgment or the grounds upon which they may so do. Evidence in the rulemaking record shows that debtors may fail to recognize the implication of judgments entered by confession against them, as well as the means that they have to contest such judgments. Moreover, ignorance of the rights that were waived at the time of confession is not a statutory defense in Pennsylvania. Finally, debtors’ due process rights are inadequately protected by Pennsylvania statute because the law permits encumbrance of their property before, rather than after, a hearing on the merits of the creditors’ claims.

The procedure is simple, straightforward, and expeditious. It ensures service of process upon the debtor. It provides full notice of the debtor’s right to defend, the time and place for doing so, and the consequences of failure to appear. Because depositions and interrogatories are not permitted, the burden and expense of presenting a defense are negligible. The reopening of a confessed judgment involves a preliminary pleading contest in which the debtor has the burden of persuasion. By contrast, to defend against a creditor’s claim in a trial de novo under the procedures outlined above, the debtor may simply appear and present any defenses to the district justice. No lien may be levied upon the debtor’s property until after the debtor has had this opportunity. Notwithstanding a meritorious defense, the procedural burden of reopening a judgment under Pennsylvania law requires a greater sophistication and expenditure of resources.
resources by the debtor than would be required in a trial on the merits in the first instance. For these reasons, Pennsylvania's post-judgment remedies provide an inadequate substitute for a trial de novo and fail to guarantee that debtors' rights will be protected to the degree that due process requires.

C. Prevalence

There is limited record evidence with respect to the prevalence of cognovit clauses in consumer credit contracts on a nationwide basis. Both legal aid attorneys and members of the finance industry testified to the use of confessions of judgments in Pennsylvania, Illinois, and Ohio.49 Other evidence points to frequent use in Pennsylvania, Illinois, and Ohio.51 There was also testimony that in Maryland, although confessions of judgment are prohibited in many consumer credit transactions, their use in other kinds of consumer contracts remains common.52

Survey evidence exists concerning the prevalence of cognovit clauses but does not break down the results by state. A survey of its members conducted by the Consumer Bankers Association, for example, shows that approximately 20 percent of banks responding to the survey included cognovit clauses in the majority of their contracts where permitted by law.53 A survey of legal aid attorneys indicates that, where permitted by law, cognovit clauses were utilized in 20 percent of loan agreements by credit unions, 21 percent by finance companies, 16 percent by banks, and 30 percent by creditors generally.54 A National Consumer Finance Association (NCFA) survey of over 13,000 consumer accounts indicates that cognovit clauses were used in 3.7 percent of consumer credit contracts used by its responding members and that all but one of the contracts came from Illinois or Louisiana.55 A Commission staff survey of 1,001 consumer account files subpoenaed from twelve large consumer finance companies in thirty-five states found cognovit provisions in seventy-four contracts (7.3 percent).56 This figure was thought to underestimate the true incidence of cognovit provisions in the sample, however.57 A more reliable survey from Social Science Research (BSSR) survey of 1,001 consumer account files drawn from the same group, but including only nine consumer finance companies in nineteen states, found cognovit provisions in ninety-six contracts or 9.5 percent of the sample.58 The results of the example legal aid survey that cognovits appeared in contracts from Colorado, Illinois, Indiana, Louisiana, New Jersey, Michigan, Ohio, Tennessee, and Virginia.59 Although Louisiana, Illinois, and Ohio account for the majority of the cognovit provisions in the sample,60 consumer account files from these states are over-represented in the sample. Eleven percent of the consumer account files were from Ohio, for example.61 Because the consumer files upon which these surveys were based were not drawn from all states and because not all states were disproportionately represented in the file samples, the results do not necessarily reflect those states in which cognovits were used most frequently nor the frequency of their use in a given state. They do suggest, however, that the use of cognovits may be somewhat more widespread geographically than the NCFA survey would indicate.62

Finally, a 1970 industry survey conducted by the National Commission on Consumer Protection found that 17 percent of large bank respondents and 17 percent of large finance companies stated cognovits to be a highly valuable provision in contracts for unsecured cash loans. This suggests that, among these respondents, confessions of judgment are employed on a regular basis.63

No precise quantification of the extent to which cognovits are used in consumer credit contracts can be made on the basis of record evidence. Evidence demonstrates their use in Pennsylvania, as well as in Louisiana, Ohio, Illinois and, at least to a limited extent, in several other states. There also is evidence to show that in states where their use is permissible, they are used with some frequency.64 Beyond this, there exists the issue of full faith and credit that must be paid by the courts of one state to the judgments of the courts of another state.65 To the extent that confessions of judgment are entered on the basis of the laws of a state in which they are permissible, they may be

49 Carol Knutson, Neighborhood Legal Services Association, Pittsburgh, Tr. 11121 [100 cases in 3 years]; Bernard A. Podcasy, Legal Services of Northwestern Pennsylvania, Tr. 9935 (3 current cases, perhaps 50 others); William T. Gwennap, Pittsburgh National Bank, Tr. 22322-34 (PNB uses cognovits in home improvement loans; other banks in Pennsylvania also use them); Leslie R. Butler, Consumer Bankers Association, HX-488, Tr. 11507 (in Pennsylvania many consumer contracts contain cognovits).

50 See Hopson, Cognovit Judgments: An Ignored Problem of Due Process and Full Faith and Credit, 29 U. CH. L. Rev. 111, 115 (1961) (these states produce the "overwhelming bulk" of cognovit judgments). Ohio, like Illinois, now prohibits the use of a warrant of attorney to confess judgment in instruments arising out of a consumer loan or transaction.

51 See H. Robert Erwin, Consumer Law Center, Legal Aid Bureau, Baltimore, Tr. 10004 (e.g., home improvement contracts).

52 Richard C. Slater, Consumer Bankers Association, HX-490, Tr. 11890. Mr. Slater, indicated that the banks responding to the survey held over 15 percent of all consumer credit outstandings in the types of credit extension that the survey addressed and a much larger market share overall. Thus, he believed that the survey responses were representative of the overall marketplace, Tr. 11816-17. Although Mr. Slater was unable to present the results on a state-by-state basis, he indicated that the number of respondents was too great to reflect banking practice only in Pennsylvania. Tr. 11837. He noted that a number of the respondents did business in Michigan, Illinois, and New York. Tr. 11832.

53 National Consumer Law Center (NCLC) Survey of Credit Contract Practices (1977), HX-467 at 44. Although 105 consumer law specialists responded to this survey, confessions of judgment were not lawful in many of the respondents' states. The estimate of prevalence reflects the opinions of the 22 respondents in whose states the practice was permitted, but results were not tabulated by state. Thus, the 20 percent estimate of prevalence may reflect the practice of creditors in a relatively small number of states. See President's Office Report at 302-04 for an evaluation of this survey as a whole.

54 Robert P. Shay, National Consumer Finance Association, HX-494 at 33, Tr. 12053.

55 For an explanation of the methodology employed and the results of this and the BSSR survey see R-XI-153 at 9-3, 9-10. For criticism of the underlying sampling methodology, see Robert P. Shay, National Consumer Finance Association, HX-494 at 4-10.

56 See R-XII-153 at 4-5. Because many of the files surveyed by the Commission staff were incomplete, it was not possible to determine in all cases whether a given contract provision was included. In addition, if a provision was found in all contracts from a given office, staff did not attempt to code each instance. In 80 percent of the BSSR survey, in contrast, used complete files and followed a formal coding procedures.

57 Id. at 9.

58 Id. printout A at 14-21, printout B at 1-6.

59 See id.

60 Id. at 3. n.4

61 Alternatively, the differences in survey results may reflect changes in state law or creditor use of cognovits that took place between 1973, when the Commission gathered its survey data, and 1977, when the NCFA conducted its survey.


63 See, e.g., NCLC survey, supra note 64 and accompanying text; Thomas E. Raleigh, Administrator, Collection Agency Act, Illinois, HX-96, Tr. 2453; Jerroid Oppenheim, Legal Assistance Foundation of Chicago, Tr. 2147; Herschel C. Adcock, Louisiana Consumer Finance Association, Tr. 1211; William T. Gwennap, Pittsburgh National Bank, Tr. 12322-34.

64 For a discussion of the applicability of the full faith and credit clause to cognovits, see Hopson, supra note 51 at 143-56; Note, Poverty Law Judgments by Confession, 49 Tex. L. Rev. 169, 171 (1970).
enforceable in other states where they would not otherwise be permissible. On balance it appears that cognovits are prevalent in Pennsylvania and may be used in other states as well, such as Virginia, where they are permitted.66 Despite the fact that their use has been prohibited by the legally restricted in most states, the Commission finds that there is sufficient evidence of continuing use of cognovits to warrant a rule addressing that use.

D. Consumer Injury

Although procedures for reopening confessions of judgment exist, the absence of notice and a hearing prior to the entry of the judgment carries significant consumer injury. Cognovit clauses typically are worded in arcane language and may appear in small print.67 Record evidence supports the conclusion that debtors are unaware that they have agreed to such clauses and that they waive due process rights by doing so.68 When debtors receive notice of a judgment entered against them, they may not understand its import or that they must act affirmatively to raise any defenses against it.69 This problem is exacerbated by the fact that many states, including Pennsylvania, do not require notice informing the debtor of the right to contest the judgment or the grounds for doing so.70 As a result the debtor may fail to respond despite having valid defenses to the judgment.71 The rulemaking record shows that judgments entered by confession frequently are invalid on their face.72 It also shows that debtors frequently have some defense to the judgment.73 When debtors are not apprised of their rights and therefore fail to challenge facially invalid judgments or fail to assert valid defenses, the consumer injury is clear. The judgment debtor's property may be taken in satisfaction of a claim that would not survive judicial scrutiny at a hearing on its merits. Loss of this property causes economic hardship, since the debtor loses both its use and any equity in it. Moreover, consumers must replace any essential items that are seized, usually at a greater cost than they were credited with for the seized property. The economic injury, therefore, is substantial.74

Alternatively, if they have the resources to do so, consumers may simply pay judgment debts when threatened with execution or garnishment although they dispute the underlying claim.75 Legal aid attorneys estimate that actual (or threatened) invocation of cognovits results in payment of disputed debts in a significant number of cases.76

Even when debtors understand their right to challenge the entry of judgment, post-judgment remedies of the sort provided by Pennsylvania statute do not make them whole. The procedure for reopening a judgment is complex and debtors are unlikely to succeed without incurring the cost of hiring an attorney.77

In addition to legal fees, sheriff's costs and deposition and transcript costs are ordinarily required in a proceeding to strike or reopen.78 Such costs are not necessarily incurred in a trial de novo.

In a proceeding to reopen, the debtor may assert the same affirmative defenses that could have been used in defending against an action on the underlying claim. However, in a proceeding to reopen the burden and expense of instituting litigation shift from the creditor, where they would lie absent the confession of judgment, to the debtor.79 Because of the relative ease with which confessions of judgment may be entered, creditors may be tempted to use them indiscriminately.80 To the extent that consumers must institute legal action to defend against unwarranted claims, they suffer considerable economic injury through the costs that they must incur.

Although consumers with meritorious defenses may ultimately succeed in vacating judgments against them, they are deprived of the full use of their property during the process. Under Pennsylvania law the entry of judgment creates a lien on the consumer's property and thus encumbers the right to use it.81 Until such a lien is dissolved, the consumer's ability to use the property for collateral or to dispose of it is significantly impeded.82 Moreover, because the lien is effective whether or not notice is mailed to or reaches the debtor,83 debtors may learn of its entry, judgment debtors suffer significant economic injury as a result. There is no statutory provision for an award of damages to a consumer

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66 Record evidence also demonstrates their prevalence in Illinois and Ohio. Cognovits are no longer permitted in these states in consumer transactions, however. Although they are also prevalent in Louisiana, the rule will not prohibit their use in that state. See infra notes 103-105 and accompanying text.

67 Carolyn C. McNichol, Legal Aid Society of Cleveland, R-[i]-38; Henry J. Sommer, Community Legal Services of Philadelphia, Tr. 10690.

68 Henry J. Sommer, Community Legal Services of Philadelphia, Tr. 10690, 10699; James D. Morris, Legal Services of Northeastern Pennsylvania, Tr. 9926; Herschel T. Elkins, Office of the Attorney General of California, Tr. 3589; Bernard A. Podcaster, Legal Services of Northeastern Pennsylvania, Tr. 9928; Eugene Thirkill, Land of Lincoln Legal Assistance Foundation, Tr. 3355.

69 Carol Knutson, Neighborhood Legal Services Association, Pittsburgh, Tr. 11104; Carolyn C. McNichol, Legal Aid Society of Cleveland, R-[i]-38.

70 Carol Knutson, Neighborhood Legal Services Association, Pittsburgh, Tr. 11104; Pennsylvania notice requirements, supra note 43 and accompanying text, with those of Delaware and Virginia, supra notes 30-32 and accompanying text.

71 Henry J. Sommer, Community Legal Services of Philadelphia, Tr. 10690.

72 In an investigative study of Chicago, Illinois, courts, 377 of 1274 confessed judgments filed during a two-week period in 1960 were invalid. See Hopson, supra note 51 at 122. Confessions of judgment are no longer permitted in Illinois, but this study demonstrates the potential for abuse that exists in states where they are permitted.

73 Carol Knutson, Neighborhood Legal Services Association, Pittsburgh, Tr. 11104; Jane Johnson, New Orleans Legal Assistance Corp., Tr. 473. See generally Karl R. Friedman, Alabama Consumer Finance Association, Tr. 61; William Bollinger, Michigan Department of Licensing and Regulation, Tr. 6776; Tom D. McIvor, Director, Idaho Department of Finance, Tr. 6566; Andrew Eiler, Consumer Affairs Department, United Auto Workers, R-[i]-92.

74 Henry J. Sommer, Community Legal Services of Philadelphia, Tr. 10690.

75 Confessions of judgment are more commonly used in unsecured loans. See Robert P. Shy, National Consumer Finance Association, 44 at 34, where consumer defenses may be less likely. Nonetheless, 22 consumer law specialists estimated that payment of disputed debts occurred in 23 percent of cases, based on their experiences in serving mainly low-income consumers. NCLC survey, supra note 54, HX-487 at 44-45.

76 See discussion of Pennsylvania procedures for reopening supra notes 35-42 and accompanying text. Because the procedure for reopening depends essentially on depositions, see supra 35. Confessions of judgment do not provide a procedure. In a proceeding to reopen the debtor must prove the invalidity of the judgment and therefore no notice is required.

77 See discussion of Pennsylvania procedures for reopening supra notes 35-42 and accompanying text. Because the procedure for reopening depends essentially on depositions, see supra 35. Confessions of judgment do not provide a procedure. In a proceeding to reopen the debtor must prove the invalidity of the judgment and therefore no notice is required.

78 See infra notes 103-105 and accompanying text.
whose property has been improperly encumbered.

The record demonstrates that economic loss of several different sorts is experienced by debtors against whom confessions of judgment are entered. Injury occurs even when consumers ultimately succeed in overturning a confessed judgment. Accordingly, we find that the use of cognovits causes substantial consumer injury.

**E. Offsetting Benefits**

Conflicting evidence appears in the rulemaking record with respect to the benefits derived from the use of cognovits. There is testimony indicating that confessions of judgment are considered a particularly useful collection device in Pennsylvania and Illinois. Other evidence suggests that some creditors do not consider them to be of great utility, however.

Those who supported the importance of cognovit clauses suggested that the abolition of confessions of judgment might decrease credit supply or increase credit cost. One commenter suggested that large finance companies and commercial banks might require security for loans more frequently than they currently do if cognovits were abolished.

In contrast, the National Commission on Consumer Finance found that where states had prohibited or restricted confessions of judgment, there had been, in fact, no significant effect on the cost or availability of consumer credit. Other commenters agreed with this finding with respect to the extension of credit in their states.

The principal reason that the abolition of cognovits might increase the cost of credit is that creditors would be required to file suit against defaulting debtors rather than merely filing a confession and obtaining judgment. Suit was described as a more time-consuming and costly procedure by one commenter from Illinois. Another stated, however, that although instituting suit might impose a thirty or forty day delay in carrying out collection activities, the abolition of confessions of judgment would have no practical significance for creditors.

In fact, it appears that many as 91 percent of debtors fail to appear to defend when creditors institute suit against them. To the extent that debtors do not answer and defend, creditors do not incur the legal expenses of preparing for and litigating their claims. Thus, although creditors may experience a slight delay in collection activities, it is unlikely that any significant additional costs will be incurred in the vast majority of cases.

Other testimony suggested that creditors might respond to the abolition of confessions by increasing the use of other more costly remedies that remain available, so that additional costs will be transferred to the debtor. On the other hand, commenters note that the use of cognovits imposes additional costs upon debtors who seek to reopen judgments against them, and may force debtors in marginal financial circumstances into bankruptcy. Thus, the costs associated with the prohibition of cognovits appear to balance the costs inherent in their use.

Without cognovits, creditors will be required to litigate their claims against those consumers who choose to appear and defend. In these cases creditors may ultimately incur greater expense than they would have through the simple entry of judgment. Presumably, at least some of these same consumers would have petitioned for reopening of the judgment, however. In such cases, the creditor would have incurred the expense of litigation in any event. Thus, except to the extent that debtors who would otherwise have done so are encouraged to contest creditors' claims when served with a complaint as opposed to notice of judgment, this provision of the rule will have little economic impact on creditors.

Viewed as a whole, the record demonstrates that confessions of judgment do not produce significant benefits to creditors or, by extension, to consumers. Because the injury associated with their use can be substantial, the Commission finds that any benefits produced by their continued use do not outweigh the injury that they cause to consumers.

**F. Alternatives Considered and Modifications Adopted**

This rule provision is intended merely to ensure that, before any deprivation of property occurs, debtors will be afforded the basic due process rights of notice and an opportunity to be heard. The proposed rule addressing confessions of judgment originally prohibited the taking or receiving from a consumer an obligation constituting "inter alia, a 'power of attorney.'" In response to the concerns expressed by many commenters, the phrase "warrant of attorney" has been substituted instead in the final version of the rule. This revision is designed to ensure that real estate first mortgages and deeds of trust are not affected by this rule.
provision. Such agreements typically contain powers of attorney for purposes of foreclosure, subject to various state restrictions governing, for example, mortgagees' rights to cure, equitable rights of redemption, and permissible notice and sale procedures. This rule provision is intended to bar the use of confessions of judgment in real estate-secured second mortgage loan obligations, however, to the extent that the proceeds of such secured loans are used for consumer purchases.100

Similarly, powers of attorney given to expedite the transfer of pledged securities of the disposition of repossessed chattels are not within the scope of this provision. For example, an automobile installment sale contract may include a power of attorney authorizing transfer of title in the event of repossession and sale of the vehicle. A power of attorney for this purpose would not constitute a "waiver of the right to notice and the opportunity to be heard in the event of suit or process" as contemplated by § 444.2(a)(1). This applies as well to a power of attorney to transfer ownership of pledged stocks, bonds, or similar instruments.

A power of attorney in an insurance premium finance contract enables prompt cancellation of an underlying third-party insurance agreement in the event of default.101 Such provisions likewise do not fall within the ambit of the rule because they do not entail loss of notice and hearing rights "in the event of suit or process." Comparable powers of attorney in two-party insurance agreements will be unaffected as well.102

This section of the rule was also revised, in response to testimony and written comments, so as not to apply to the Louisiana Via Executiva process. The state of Louisiana prohibits confessions of judgment except for purposes of executory process.103 This civil law executory procedure enables a creditor, when making a loan, to take a mortgage on property that is specifically identified in the mortgage. The mortgage may contain a confession of judgment, which has the effect of creating a security interest in the specified property.104 Thus, the Louisiana confession of judgment operates in rem; it is used only to execute upon property that the debtor has selected to serve as collateral. Unlike confessions of judgment in common law jurisdictions, it does not operate in personam and, therefore, it does not create a general lien on other property of the debtor.105 In sum, the property that may be encumbered or sold under Louisiana's executory process appears to be consciously chosen with that possibility in mind by the debtor. To the extent that Louisiana executory process may involve the loss of any due process rights, the Commission lacks sufficient evidence to find that these rights are waived involuntarily or unknowingly.

Finally, confessions of judgment prohibited by this rule provision should be distinguished from the cognovit actionem, or confession acknowledging liability following institution of suit and service of process. Unlike the latter, which is executed in conjunction with negotiated settlements, the prohibited confessions of judgment involve anticipatory waiveries of procedural due process protections in the context of credit obligations.106

V. Wage Assignments

Section 444.2(a)(3) of the rule provides that it is an unfair act or practice for a lender or retail installment seller to take or receive from a consumer an obligation that constitutes or contains a clause that makes and assignment of wages unless the assignment by its terms is revocable at the will of the debtor, constitutes a payroll deduction or preauthorized payment plan, or is an assignment of wages already earned.

A. Nature of the Practice

A wage assignment is a contractual transfer by a debtor to a creditor of the right to receive wages directly from the debtor's employer. To activate the assignment, the creditor simply submits it to the debtor's employer, who then pays all or a percentage of debtor's wages to the creditor.1 The debtor releases the employer from any liability arising out of the employer's compliance with the wage assignment, and may waive any requirement that the creditor first establish or allege a default.2 Absent a statutory restriction, it is not necessary to obtain the debtor's consent to enter into a wage assignment.3

Wage assignment and wage garnishment are both methods by which a creditor can obtain the debtor's wages to apply to or satisfy a debt. Procedurally, however, the two remedies are very different. Garnishment requires that the creditor obtain a court judgment before wages can be garnished to collect the debt. The Supreme Court has held that prejudgment garnishment deprives the debtor of constitutional due process rights.4 Wage assignment, on the other hand, does not require a judgment. A creditor can file a wage assignment without any judicial review of the creditor's claim. The assignment does not have a hearing with an opportunity to assert any defenses. Unlike prejudgment garnishment, prejudgment wage assignment has usually survived constitutional challenge.5 There is no meaningful distinction between the effects of the two remedies, but when

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100 See rule definitions, § 444.1 (a), (b), and (d).
102 See Jeffrey Yates, National Association of Insurance Agents, R-fa(581).
104 Herschel C. Adcock, Louisiana Consumer Finance Association, Tr. 1215-16, 1224.
105 Id. at Tr. 1215.
106 Numerous comments on the record urged that confessions of judgment obtained in the settlement or disposition of a pending action should not be prohibited, as they are entered into after the debtor has had notice and an opportunity to be heard. See, e.g., George H. Brassach, American Bar Association Committee on Consumer Credit, R-fa(76); F.T. Weisser, Sears, Roebuck and Co., R-fa(427). Due process implications of the cognovit actionem are discussed more fully supra at notes 22-23 and accompanying text.

1 Presiding Officer's Report at 115. For an example of a typical wage assignment, see Gwyneth D. Gillingham, Legal Aid Society of Kent County, R-fa(68) at Exh. B.

2 But see, e.g., Foster's Application, 23 Pa. D. 553-554 (1914), aff'd 60 Pa. Super. 6 (1915) (Pennsylvania wage assignment statute held to violate state constitution).

3 The Presiding Officer referred to wage assignment as the "contractual equivalent of garnishment." "Presiding Officer's Report at 124.
presented with challenges to wage assignments. Courts generally have not found sufficient state action in the assignment to trigger the due process protections of the fourteenth amendment; thus courts have not reached the merits of challenges based on constitutional claims.8

Some wage assignments are essentially voluntary payroll deductions, and are used most frequently by credit unions and other creditors closely associated with the employer.9 This record does not indicate that payroll deduction wage assignments cause consumer injury.10 We have therefore exempted such assignments from the rule. Similarly, preauthorized electronic fund transfers to accounts from wages may be considered to be wage assignments,12 but they are used as methods of payment rather than as a collection remedy.13 Thus, they are exempted from the rule because this rulemaking record does not show that they cause consumer injury.14

B. State Law

Wage assignments are prohibited in the Uniform Consumer Credit Code States,15 several other states,16 and in

17 The District of Columbia.17 A substantial majority of the remaining states have imposed restrictions on the use of wage assignments. Some of the more common restrictions are: a time limit for the assignment,18 a requirement that the employer file or spouse consent to the assignment, and an absolute prohibition of assignment in certain kinds of transactions.21 In addition, some states require that the wage assignment be on a separate document,22 and some allow the debtor to contest a wage assignment by informing the employer that he or she has a defense.23 Some states have enacted a limitation (generally 15 percent to 25 percent) on the amount of weekly or monthly wages that may be assigned.24 State provisions are inconsistent, however, and do not always offer adequate protection.25

1. Provisions for Wage Assignment

The Due Process Clause of the Fourteenth Amendment; Idaho Code section 28-43-304 (Supp. 1983); we have therefore exempted such assignments to trigger the due process protections ofassignment.8


All of the U.C.C. states except Colorado permit an employer to authorize deductions from his or her wages as long as the authorization is revocable. Idaho and Iowa also require that the debtor receive a complete copy of the authorizing the authority, and that the document contain the conspicuous notice of the right to revoke.

In addition, South Carolina and Wisconsin have enacted consumer protection codes that are substantially similar to the U.C.C.C., and incorporate the U.C.C.C. wage assignment prohibition. See S.C. Code Ann. sections 37-2-410, 37-4-305 (Law Coop. 1987); Wis. Stat. Ann. section 422.404 (West 1974).


In Pennsylvania, a statute regulating the assignment of future wages was held to be unconstitutional in Foster's Application, 35 Pa. D. 533 (1914), aff'd, 60 Pa. Sup. 8 (1915).


Not all states limit the amount of pay that can be taken with a wage assignment, e.g., Ark. Stat. Ann. sections 81-315, 81-317 (1976); Mass. Gen. Laws Ann. section 71-1-47 (1972); Wash. Rev. Code sections 48.46.090, 48.46.100 (1972) (statutory provisions governing wage assignments do not include any limit on the amount that can be assigned). See also Commerce Clearing House Consumer Guide at § 650.

Even in states with limits, creditors have sometimes taken more than the state limit and more than the 25 percent permitted under the federal Consumer Credit Protection Act, 15 U.S.C. 1671-1671j (1982). See Robert Atkinson, Legal Aid Service of Portland, Tr. (April 1983) (debtors take entire paycheck when employers' employment terminates); Daniel Hughes, Eq. Tr. 11361 (company stores 70-80 percent of consumers' wages despite prohibition).
Federal statutory limitations on wage garnishment do not apply to wage assignments. Thus, unless there is a state statutory limitation, creditors are restricted only by the terms of the wage assignment.

C. Prevalence

The rulemaking record shows that wage assignments are used primarily by small loan and finance companies, and most heavily in California, Illinois, Michigan, and New York. The National Consumer Finance Association (NCFA) reported that wage assignments were included in approximately 13 percent of the small loan contracts surveyed by member banks, see HX-490, HX-491. Members of the CBA are, in general, larger banks that do a high volume of consumer lending business. Richard Slater, Consumer Bankers Association, Tr. 1125-26. The CBA requested responses only from banks in states that permit wage assignments. HX-491, question 14. The CBA survey found that 26 percent of banks responded indicate use of wage assignments in the majority of personal loan contracts, compared to 7 percent for both automobile direct loans and automobile indirect paper, HX-493.


The rulemaking record shows that wage assignments have also been used in, among other states, New Jersey, Florida, and Virginia. XI-153 at 35-40. The record also indicates that wage assignments are used, albeit to a lesser extent, by creditors other than small loan and finance companies. Eugene Thirolf, Land of Lincoln Legal Assistance Foundation, Tr. 508 (company stores use wage assignments).

Wage assignments may be obtained from co-signers and spouses as well as from the principal debtor, and are commonly used with other forms of security. In states that permit wage assignments, consumers cannot reasonably shop around for a contract of wage assignments are actually filed with employers.

Wage assignments in the form of payroll deduction plans are used frequently by state and federal credit unions. As discussed below, payroll deductions are excused from the wage assignment prohibition in the rule.

In sum, the use of and restrictions on wage assignments vary considerably from state to state. Overall, the record shows that wage assignments are used in a significant number of consumer transactions, and they are prevalent in states where they are permitted.

D. Consumer Injury

The preponderance of record evidence establishes that consumers suffer substantial injury when wage assignments are used as a collection device. Wage assignment, unlike garnishment, occurs without the procedural safeguards of a hearing and an opportunity to assert defenses or counterclaims. The use of wage assignments causes interference with employment relationships, pressure from threats to file wage assignments with employers, and disruption of family finances. Wage assignments are particularly harmful because they cause injury to consumers who may have valid reasons for nonpayment.

<table>
<thead>
<tr>
<th>State</th>
<th>Percent (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>50</td>
</tr>
<tr>
<td>Illinois</td>
<td>86</td>
</tr>
<tr>
<td>New York</td>
<td>68</td>
</tr>
<tr>
<td>Michigan</td>
<td>53</td>
</tr>
</tbody>
</table>

California permits only the assignment of wages already earned, so that statistics for California are not comparable to figures for other states.


The NCFC reported results on a national basis without providing a state by state breakdown. In addition, the personal loan area, firms were directed to answer "yes" to the relevant question only if they included wage assignments in "essentially all of your personal loans." Id. at 217. The results of the NCFC survey were as follows:

Finance companies .... 13 percent (personal loans).

Id. at 59-60.

2. A 1977 Consumer Bankers Association (CBA) study that included unsecured and secured personal loans, see HX-491, HX-492. The CBA study treated loans secured by only one wage assignment as unsecured. HX-494, Exh. 5 (questionnaire). Illinois finance companies reported only 131 unsecured and 199 loans with wage assignments. Thus, even if we assume that all unsecured loans are subject to wage assignments, a substantial number of reported wage assignment loans were actually secured by other property. The same was true in Michigan, where finance companies reported 111 unsecured loans and 289 wage assignment loans, and in New York, where
Additionally and importantly, the record shows that debtors are not aware of the rights provided to them by state law. 44 In Illinois, for example, upon default the creditor must inform the debtor of the right to verify the employer and the creditor of any defense. 46 The debtor can then contest the wage assignment by serving a notarized "notice of defense" to the creditor by registered or certified mail. 47 Although designed to be protective, the statutory scheme does not accomplish its purpose because debtors do not understand what a defense is and therefore do not know if they have one. 48 As a consequence, despite the existence of state statutes, many wage assignments result in collection by creditors even when there have been a breach of warranty, fraud, or other violation of law that may constitute a defense to payment. 49

The rulemaking record establishes that wage assignments cause serious and detrimental interference with employment relationships. Employers are hostile to wage assignments, and loss of employment for the debtor is possible. 50 Promotions, pay raises, job assignments, and other employment factors may be adversely affected. Employers resent the added administrative expense of wage assignments. When an employee's job motivation will be affected, and view the failure to repay debts as a sign of irresponsibility. 52 The Consumer Credit Protection Act 53 prohibits an employer from dismissing an employee whose wages are garnished for any one indebtedness, but the Act does not apply to wage assignments. During the proceeding, some creditors argued that the rulemaking record establishes that wage assignments reduce job loss to some extent, 54 the protection offered by state law is limited and the record shows that a number of factors reduce the effectiveness of state protections. For example, in New York reinstatement is discretionary with the court; 55 in Illinois no statutory damages are provided. 56

Wage assignments also cause serious consumer injury when used as a threat to obtain payment. 57 The pressure from these threats may cause consumers to abandon legitimate defenses to prevent the creditors from contacting the employers. 58 Consumers fear that the wage assignment will result in job loss, 59 and the record indicates that creditors exploit that fear 60 despite the fact that job loss would be economically counterproductive to the creditor. State wage assignments do not offer protection from this type of injury. Most threats are made before the wage assignment is filed, but state statutes usually govern only procedural and post-filing rights. Wage assignments also cause disruption of the family's finances and make it difficult for the debtor to purchase necessities. 61 This disruption can result in costly refinancing or the impossibility of discharging other obligations in a timely fashion. 62

Fortescue, Wage Assignments in Chicago, 42 Yale L.J. 531, 537 (1932).

44 The Presiding Officer found that "wage assignment is the contractual equivalent of garnishment except that it permits the seizure of wages without the opportunity for a hearing or an impartial determination of whether or not, under the circumstances, the creditor is entitled to receive payment of those wages." Presiding Officer's Report at 124, citing James H. Hsiatt, Legal Aid Society, Oklahoma County, R—I(c)—14 at 2. See also George J. Wallace, University of Iowa Law School, HX—469 at 25; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—79 at 14—15.

Garnishment may also cause interference with employment opportunities by giving creditors pressure from threats to file the garnishment, and a disruption of family finances. The key distinction is that the potential injury to garnishment results only after the creditor has obtained a judgment and the debtor has had the opportunity to assert defenses and counterclaims. What renders wage assignments unfair is that, without a hearing, they may cause injury even to those who legitimately owe nothing to the creditor.

46 See Presiding Officer's Report at 126; Eugene Throf, Land of Lincoln Legal Assistance Foundation, Tr. 4649—54; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—13 at 46—52; Ralph R. Fledstrom, Family Counseling Service of Aurora, HX—547; James Baker, Onondaga Neighborhood Legal Service, HX—548.


48 See, e.g., Donald Oppenheim, Legal Assistance Foundation of Chicago, HX—214; George Corsetti, Michigan Association for Consumer Protection, Tr. 9495—96; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—79 at 14—15.

49 Fortescue, Wage Assignments in Chicago, 42 Yale L.J. 531, 537 (1932).

50 George Corsetti, Michigan Association for Consumer Protection, Tr. 1986—89; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—214; Eugene Throf, Land of Lincoln Legal Assistance Foundation, R—I(d)—128. Other files also contain employers that wage assignments will lead to job loss. E.g., R—XI—AVCO—144 (Ledger entry for 10/24 "Tel [telephone] B/A [business address] akp to Mr. [name], they deducted about $300 from his pay, he is getting tired of handling the wage will definitely let them go if they have another wage."); R—XI—AVCO—582 (Ledger entries 12/16 "WA sent"; 12/23 "TBA [telephoned business address] S/W [spoke with] Pers. [personnel department] Mr. [name] customer was warned has 30 days to clear up or be fired."); R—XI—HFC—216 (Ledger entry 1/12 "Job Pho Mr. [name] says must make arrangements to release W/A or O/C [our customer] to lose time & job. Advise OK we release but if O/C late 1 time we to resent & job loss would be economically counterproductive to the creditor. Another ledger notation states [employer] won't pay filed wages on both [debtor and wife], she was fired because of wage assignment."); R—XI—AVCO—150 (Ledger entry for 7/21/71 says that, according to neighbor who was also personnel manager for debtor's former employer, "the [debtor's] wife lost her job because of W/A's and garnishments."); and R—I—CT—208 (Ledger entries 9/1/71... said he will lose job if we don't lift wage."); 10/10/71 "T.I. [telephoned home] Spoke to wife she said he get laid off."); 11/17/71 "T.B. [telephoned business] Verifed he laid off for 8 wks."). See also William Bellenger, Tr. 8786; Ray Andrus, Tr. 8052.

51 E.g., Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—214; George Corsetti, Michigan Association for Consumer Protection, Tr. 10499—501; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—79 at 14—15; Ray Andrus, Tr. 8783.

52 Jerrold Oppenheim, Legal Assistance Foundation of Chicago, Tr. 5335—57; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—14 at 15—16; Robert J. Abrahams, Tr. 9819—20; Ray Andrus, Tr. 8783.

53 George Corsetti, Michigan Association for Consumer Protection, Tr. 1986—89; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—214; Eugene Throf, Land of Lincoln Legal Assistance Foundation, R—I(d)—128. Other files also contain employers that wage assignments will lead to job loss. E.g., R—XI—AVCO—144 (Ledger entry for 10/24 "Tel [telephone] B/A [business address] akp to Mr. [name], they deducted about $300 from his pay, he is getting tired of handling the wage will definitely let them go if they have another wage."); R—XI—AVCO—582 (Ledger entries 12/16 "WA sent"; 12/23 "TBA [telephoned business address] S/W [spoke with] Pers. [personnel department] Mr. [name] customer was warned has 30 days to clear up or be fired."); R—XI—HFC—216 (Ledger entry 1/12 "Job Pho Mr. [name] says must make arrangements to release W/A or O/C [our customer] to lose time & job. Advise OK we release but if O/C late 1 time we to resent & job loss would be economically counterproductive to the creditor. Another ledger notation states [employer] won't pay filed wages on both [debtor and wife], she was fired because of wage assignment."); R—XI—AVCO—150 (Ledger entry for 7/21/71 says that, according to neighbor who was also personnel manager for debtor's former employer, "the [debtor's] wife lost her job because of W/A's and garnishments."); and R—I—CT—208 (Ledger entries 9/1/71... said he will lose job if we don't lift wage."); 10/10/71 "T.I. [telephoned home] Spoke to wife she said he get laid off."); 11/17/71 "T.B. [telephoned business] Verifed he laid off for 8 wks."). See also William Bellenger, Tr. 8786; Ray Andrus, Tr. 8052.

54 See, e.g., Donald Oppenheim, Legal Assistance Foundation of Chicago, HX—214; George Corsetti, Michigan Association for Consumer Protection, Tr. 10499—501; Jerrold Oppenheim, Legal Assistance Foundation of Chicago, HX—79 at 14—15; Ray Andrus, Tr. 8783.


56 Jerrold Oppenheim, Legal Assistance Foundation of Chicago, Tr. 2143—45; Karl R. Fledstrom, Family Counseling Service of Aurora, Tr. 4547; James Baker, Onondaga Neighborhood Legal Service, Tr. 4548.

57 See, e.g., William Bellenger, Michigan Department of Licensing and Regulation, Tr. 8178; Legal Assistance Foundation of Chicago, Post—Record Comments XV—252 at 5—7; James Baker, Onondaga Legal Services, Tr. 10702—63.

In an early study of wage assignments in Chicago, the author concluded that over 40 percent of the 423 wage assignments investigated by the Legal Aid Bureau of Chicago were legally unenforceable.

58 See, e.g., William Bellenger, Michigan Department of Licensing and Regulation, Tr. 8178; Legal Assistance Foundation of Chicago, Post—Record Comments XV—252 at 5—7; James Baker, Onondaga Legal Services, Tr. 10702—63.

59 In an early study of wage assignments in Chicago, the author concluded that over 40 percent of the 423 wage assignments investigated by the Legal Aid Bureau of Chicago were legally unenforceable.
In the absence of procedural safeguards, the potential for severe, substantial disruption of employment, the coercion, or threats to file wage assignments, and the disruption of family finances constitute significant consumer injury. State law is inconsistent and does not offer sufficient protection to prevent this consumer injury.

E. Offsetting Benefits

Commenters who opposed the wage assignment prohibition submitted that wage assignments are important for borrowers who are bad credit risks or who have no other type of security, and that wage assignments keep collection costs down. Other commenters, usually credit unions, maintained that payoff deduction wage assignment Alinea Pilots and retail trade associations used for the convenience of borrowers and that they reduce handling costs. A few commenters emphasized that instead of a prohibition against wage assignments, the prohibition should be against employers who discharge employees because of wage assignments.

The Presiding Officer discussed the importance of wage assignments to borrowers who have bad credit risks or whose paycheck is their only asset. Creditors frequently consider wage assignments to be a form of security analogous to collateral. In states that statutorily limit the amount of an unsecured loan that can be made by a creditor, a wage assignment may be sufficient security to avoid such limitations. A wage assignment may allow consumers with no other collateral to obtain a secured loan. Record evidence indicates, however, that in a substantial number of loans secured by wage assignments, other security was also provided. Furthermore, in almost every state, garnishment is available as an alternative method of collection.

Considering that garnishment includes procedural protections not required in wage assignments, the benefit of wage assignments is considerably diminished.

Creditors favoring wage assignments argued that they save the cost of going to court. That argument does not, however, justify irrevocable wage assignments. In an undisputed case, court costs will be moderate. Although costs are greater in a disputed case, the costs are justified because it is precisely when the debtor has a defense that a court hearing is most valuable. With a wage assignment that is revocable at the will of the debtor, the debtor can choose either to set aside the contract by allowing the assignment or to revoke the assignment and raise defenses. Even if the debtor does not prevail, he or she will still have the statutory garnishment protections that apply to collection of a judgment.

Credit unions maintained that wage assignments benefit consumers because they are an important method of keeping transaction costs down. If a wage assignment is essentially a payroll deduction payment plan, the benefits outweigh the costs because the potential for the type of injury that this rule seeks to prevent is nonexistent.

The evidence, therefore, supports our finding that consumers and competition do not receive countervailing benefits sufficient to offset consumer injury caused by the use of wage assignments unless the wage assignment is revocable at the will of the debtor or is a payroll deduction plan. Commenters considered that the loss, or fear of loss, of job and the deprivation of procedural protections do not justify the limited usefulness of this remedy.

Furthermore, existing patterns and practices make clear that banning wage assignments will have little impact on the business of creditors other than finance companies. Banks and retail trade associations submitted that the rule provision on wage assignments would have little impact on their businesses.

There is evidence that a ban on wage assignments will have no effect on the aggregate volume of credit extended, but that a ban may lead to an increase in the rejection rate of finance company applications. A study of the cost effects of wage assignment restrictions found no statistically significant effects from the restrictions, but there is evidence predicting that a prohibition would affect consumers from whom a wage assignment can be made.

77 E.g., Betty Gregg, Credit Union National Association, Post—Debtor Contributions, 1033; William S. Ballenger, III, Director, Michigan State Department of Licensing and Regulation, Tr. 8778; and Thomas Crandall, Associate Professor of Law, Gonzaga University School of Law, Tr. 10666.

78 James Goldberg, American Retail Federation, Tr. 6155-18 (rule provision "will have absolutely no effect on the vast majority of retailers."). K. E. Buhmaster, New York State Bankers Association, R—(a)—200 at 2 ("The prohibition against wage assignments, while contrary to specific New York statutes, is not repugnant to banks since they generally do not use wage assignments."). An American Bankers Association spokesperson discussed peripheral issues concerning wage assignments but did not argue that they are important to banks as a collection device. William Owens, American Bankers Association, Tr. 5900-100.

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wage assignment is required to secure a loan. In addition to formal studies, there is some anecdotal evidence that restrictions on wage assignments have been of limited importance. With minor exceptions, the record does not show that finance companies or other creditors do business in a different way, or serve a different clientele, in states that do and do not permit wage assignments. Thus, prohibiting wage assignments will not significantly affect the credit markets.

The Presiding Officer found that "so long as the manner of garnishment is available, creditors could extend credit to the class of consumers from whom a wage assignment is ordinarily required without suffering an undue increase in costs." In fact, there is evidence that wage assignments do not provide a significant savings in legal costs. The record also shows cases where creditors had wage assignments but chose not to use them and paid off the debtor's wages. The fact that creditors voluntarily elect to forego use of wage assignments even when they have them is a strong indication of limited utility.

The Presiding Officer concluded that prohibiting wage assignments "would be of economic benefit to low-income or poor consumers, since it would no longer be possible to use this device as a means for interjecting the creditor into the employer-employee relationship without court action." The preponderance of evidence establishes that the marginal benefit of irrevocable wage assignments to creditors is limited,

especially with the availability of garnishment as an alternative remedy, and that any effect of banning wage assignments on overall credit availability will be small.

F. Alternatives Considered and Modifications Adopted

The initial proposed rule would have banned wage assignments entirely. Based on the record, we have made four modifications to the promulgated rule. First, the rule will not apply to wage assignments that by their terms are revocable at the will of the debtor. Second, the rule does not prohibit payroll deduction plans or similar preauthorized payment plans commencing at the time of the transaction in which the consumer authorizes wage assignments as a method of making each payment. Third, the rule will not apply to wages already earned at the time of the assignment. Fourth, a definition of the term "earnings" was taken from the Uniform Consumer Credit Code and added to the proposed rule to clarify its coverage.

The first change is designed to allow consumers to enter into noninjurious revocable wage assignments to minimize transaction costs. To fit within this exception the wage assignment must be revocable by its terms; therefore the wage assignment itself must include language that establishes revocability. The wage assignment also must be revocable at the will of the debtor. This will allow the debtor to stop the wage assignment before injury occurs.

The second change is designed to permit credit unions and other creditors to continue to use voluntary payroll deduction plans as a repayment device, and to clarify that the rule does not prohibit preauthorized electronic fund transfers. The exception for payroll deduction plans is consistent with the intent of the rule and with the record evidence. The rule is intended to address collection remedies, but a payroll deduction plan is a method of making payments on an obligation. Thus, consumer injury does not result from its use. The record contains substantial support for an exception to the rule for payroll deductions. Some commenters recommended that a definition of wage assignment be included in the rule to clarify that payroll deductions are not affected; we accomplish the same result by the exception we promulgate.

The third change is intended to eliminate a problem in California where certain creditors must take assignments of earned wages or a security interest in personal property to qualify for higher loan interest rates. Small loan companies take assignments of earned wages to qualify for property brokers under the state law. Some legal aid agencies opposed this exemption on the grounds that (1) Earned wages are part of a low income debtor's subsistence, and (2) debtors have no bargaining power over the terms of wage assignments. We find


For a description of a credit union payroll deduction plan, see Merle B. Jewell, Boeing Employees Credit Union, Tr. 1009.

See supra note 78 and discussion of consumer injury, supra Section D.

See supra note 67. Some credit union policies require a wage assignment to be irrevocable if the assignment is to constitute security for a loan. Merle B. Jewell, Boeing Employees Credit Union, Tr. 1009.

We adopt the definition of wage assignment from the Uniform Consumer Credit Code.

The Constitution of California establishes an interest ceiling of 10 percent but excepts from that ceiling...
that the record demonstrates that consumer injury from assignment of earned wages is minimal, and outweighed by offsetting benefits to consumers or competition.

We have also added the U.C.C.C.'s definition of "earnings" to the initial proposed rule to clarify the types of income to which the provision applies. This responds to industry suggestions that such a definition will facilitate compliance and add certainty to the rule.100

The National Commission on Consumer Finance recommended a ban on wage assignments for credit transactions involving over $300. It advised allowing assignments for transactions of $300 or less, but only for otherwise unsecured loans, and only on the condition that the assignment not exceed the lesser of: (1) 25 percent of the debtor's available earnings for any workweek, or (2) the amount by which his or her disposable earnings for the workweek exceed 40 times the federal minimum hourly wage prescribed by section 6(a)(1) of the Fair Labor Standards Act of 1938 in effect at the time.101 The Commission considered this approach, but we rejected it because the record shows that the injury caused by the use of wage assignments bears no relation to the size of the loan.102

Use of ceiling every significant class of consumer lenders, including personal property brokers. Cal. Const. Article XX section 22. At the time the Constitution was adopted, personal property brokers were defined by statute as those engaged in the business of lending money and taking as security for such loans either a contract involving the forfeiture of rights in or to personal property, the use and possession of which is retained by other than the lender, or alien on, assignment of, or a power of possession that creditors regard as valuable collateral.103

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ommission on Consumer Finance was apparently out of touch with reality today. See Professor Robert P. Shay, NCFRA, HK-404 at 39-40.104

A. Introduction

In return for the credit they receive consumers are often required to give their creditors a security interest in the property they own at the time credit is extended or may obtain after the credit transaction is consummated. Although creditors have made secured loans since the beginning of recorded history, the use of non-possessory liens on personal property is a comparatively recent development. Non-possessory security interests were not recognized at common law. Since the beginning of this century, loans secured by non-possessory liens on debtors' personal property have become increasingly common.2

Specifically addressed by this rule provision is a lien on a consumer's household goods taken in connection with a loan. The security interest in household goods gives rise to a right to seize property from a consumer, with the potential of inflicting a substantial forfeiture on the consumer. The rule at Section 6(a) may limit the use of security interests in household goods, as defined, in non-purchase money transactions,3 while permitting the pledge of certain possessions that creditors regard as valuable collateral.

B. State Law

Security interests are creatures of statute, inasmuch as non-possessory liens were not recognized at common law.4 Prior to the adoption of the Uniform Commercial Code (U.C.C.), a variety of different "security interests" were created by a variety of different statutes.5 The U.C.C. eliminated all the distinctions between security devices that preexisted it, distinguishing only between purchase money security interests and other interests. It cumulated all remedies available to secured creditors and reduced to a minimum the procedural formalities necessary to create a security interest.

Today, Article 9 of the U.C.C. is the predominant law governing use of security interests in consumer transactions. Article 9 of the U.C.C. affords creditors with maximum flexibility as to the terms contained in security interests, including coverage, description of property, and circumstances under which seizure may take place. The description of property required is minimal.6 Creditors can often retain a security interest in all of a debtor's "household goods" by simply checking a box on a standard form.7 Statutory limitations on a creditor's capacity to secure a consumer obligation fall into three categories. The first consists of statutes regulating installment sale transactions where seller and initial creditor are the same entity. Most states have enacted statutes restricting installment sellers to a lien on goods sold.8 In a few states additional limitations have been imposed on direct lenders.9 Thus, most

We address the question of what happens to an existing purchase money security interest when the loan is refinanced or consolidated infra at note 97.

Twine's Case, 76 Eng. Rep. 809 (Star Chambers 180).


The sole exception is Louisiana, a civil law jurisdiction. Louisiana debtors are required to execute a notarized mortgage of chattels which gives rise to a right to proceed in summary process in the event of a default. La. Civ. Code art. 2334. The debtor is held to confess his obligation in the notarial instrument and the creditor may foreclose his lien in accordance with a two step confession of judgment theory. La. Civ Code art. 230. Louisiana also permits installment sellers to retain a "privilege" in the goods which is analogous to a purchase money lien. La. Civ Code art 2166. There are no limitations on the use of security devices a creditor may take as security, and blanket security interests are common in Louisiana.


Retail installment sales acts reflect "conditional sale" concepts. E.g., Arizona, Ariz. Rev. Stat. tit. 12, ch. 16, art. 1544. The Uniform Consumer Credit Code (U.C.C.C.) at § 2-407 also limits installment sellers to a lien on the goods sold. The U.C.C.C. has been adopted in nine states (Colorado, Indiana, Iowa, Continued
statutory limitations do not address the problem of non-purchase money security interests in household goods in consumer loan transactions, despite a predisposition to limit purchase money creditors to a lien on the goods in credit sales.

C. Prevalence

Based on the rulemaking record, we find that the practice of securing consumer loans with a non purchase money security interest in household goods (HHG) is widespread. Finance companies are the predominant users, and HHG security interests are found in a majority of finance company loan contracts. However, banks also allow themselves of such security as do credit unions and even, occasionally, savings and loan associations.

Although retail installment sales acts tend to restrict retailers to a purchase money lien on the goods sold, the record also reveals that certain retailers rely on HHG security interests as additional collateral in credit sale transactions.

An HHG security interest may be created by checking a box appearing in the text of a standard form agreement. In such cases the description of covered property is cast only in general terms giving consumers little notice of the nature and extent of the collateral. They are pledged to secure the loan.

Consumers may thus be unaware, in a given instance, of what is subject to a security interest. Under current interpretations of Article Nine of the U.C.C., the simple inclusion of the term "household goods" is sufficient to encumber all of the personal property owned by the consumer.

On the other hand, there is evidence on the record that many finance companies do list security by preparing an inventory of all of a consumer's household property, sometimes by asking consumers to give a list of the covered items either orally or in writing when the loan papers are filled out. In these cases, and certainly where the consumer gives the inventory, there should be little question either that a security interest has been given or as to the scope of its coverage.

The majority of HHG security interests are taken in connection with extensions of credit made under small loan acts where the amount financed is limited, with the limit generally being between 1200 and 1500 dollars, but HHG security interests are frequently taken to secure smaller extensions of credit. In this connection, HHG security is employed by finance companies which are licensed to lend no more than 300 dollars.

The record reflects instances where cosigners as well as the primary debtor pledge all of their household goods when they guarantee the loan of another.

State regulators and officials generally confirmed the widespread use of blanket HHG security interests in consumer transactions, as did legal services attorneys who appeared in the hearings. Thus, the record strongly supports our finding that the use of HHG security interests is frequent and widespread.

D. Consumer Injury

This record reflects the fact that household goods typically have little economic value in the resale market. The value of security in the second hand market in most cases is much less than the consumer owes. It would be the exceptional loan where the furniture would be worth even one-half of the principal.

434 at 77; see also Post-Record Comments XV-263, 283, 301 and 842 at 89.

E.g., George W. Prentiss, Citizens Budget Co., Tr. 4214; Joseph C. Park, Michigan Consumer Finance Association, Tr. 3518; John R. Shuman, Tr. 3550.

The median extension of credit reflected in the NCFA survey for all of the consumer loans surveyed was $1,631.00 for precomputed loans and $5,686.00 for per diem loans. HX-494.

E.g., all of the debtors' household goods secure the loan in R-IB-154 ($375.00 loan); R-GFC-32 ($332.00 loan); R-IB-62 ($240.00 loan); R-LIB-268 ($166.00 loan); R-CIT-307 ($600.00 loan); R-GFC-146 ($240.00 loan); R-GFC-154 ($346.00 loan); R-GFC-156 ($277.00 loan); R-LIB-133 ($236.00 loan) and R-GFC-59 ($212.00 loan).

E. g., James White, Council of State Credit Institutes (trade association for lenders of amounts less than $500.00). Tr. 11152.

E.g., Hyman Weiner, Atlanta Finance Co., Tr. 6483.

E.g., Mervyn Dymally, Lieutenant Governor of California, Tr. 6515; Thomas Huston, Superintendent of Banking, Iowa, HX-89 p. 48; Irvin Parker, Administrator, Department of Consumer Affairs, South Carolina, Tr. 9303; Senator Alan Salmon, West Virginia, Tr. 8778-77.

E.g., Kahlile Keast, Black Hawk County Legal Aid, Council Bluffs, Iowa, Tr. 4941; Kathleen Keest, Black Hawk County Legal Aid, Council Bluffs, Iowa, Tr. 4941; Kathleen Keest, Black Hawk County Legal Aid, Council Bluffs, Iowa, Tr. 4941.
We lend more than the furniture is worth.31 In this proceeding, a large majority of industry witnesses confirmed that household goods have little, if any, economic value to creditors.32 Their value to creditors is psychological, as noted in the testimony of Helmut Schmidt, Vice Chairman of Transamerica Financial Corporation: There are two very, very important values to the furniture. One is the replacement value, the other is psychological, that may enhance sentimental values in heirlooms being provided and the negative of price, the loss thereof if a repossession takes place, etc. I couldn’t possibly say whether replacement value or pride is the more important.33

The record reflects the fact that creditors rarely engage in actual repossession of household goods.34 When it does occur, the furniture and other items seized frequently have little or no economic value; 35 occasionally, the act of seizure appears to be undertaken for punitive or psychological deterrent effect.36

Although seizure of household goods is rare, when it occurs it can have severe economic consequences. It may occur in various contexts, such as divorce, where a wife finds herself financially devastated and deprived of her personal belongings,37 or without baby furniture,38 or a refrigerator.39 Repossessed furniture may be taken to the dump 40 or auctioned for a tiny fraction of its replacement value.41 For the debtor, the replacement value is a true measure of the cost of the repossession.42 Thus seizure often imposes a cost on the consumer which is seriously disproportionate to any benefit the creditor obtains.

In the context of seizure the disproportionate economic impact of non-purchase money security interests is most apparent. Debtors lose property which is of great value to them and little value to the creditor.43 The value to debtors consists primarily of the replacement cost of the goods seized, together with psychological and emotional value. The debtor is, in an economic sense, willing to pay more for the household goods than they are ever worth to the creditor on the resale market. Although creditors are entitled to payment, such security interests offer little economic return to creditors at great cost to the debtor.44

We consider the context of divorce, where a wife finds herself financially devastated and deprived of her personal belongings, or without baby furniture, or a refrigerator. Repossessed furniture may be taken to the dump or auctioned for a tiny fraction of its replacement value. For the debtor, the replacement value is a true measure of the cost of the repossession. Thus seizure often imposes a cost on the consumer which is seriously disproportionate to any benefit the creditor obtains.

When consumers run into difficulty, the non-purchase money security interest in household goods also enables a creditor to threaten the loss of all personal property located in the home. This psychological lever, referred to over and over again in this proceeding, together with the cost to the consumer of replacing the security, gives this remedy its value to the creditor.

The preponderance of evidence on the record supports our finding that despite the limited economic value of household goods, creditors rely on the psychological lever to seek payment and to persuade consumers to take other actions the creditors may deem appropriate, such as refinancing or obtaining a cosigner.

If in your discussion with the applicant you find that certain articles have a sentimental value because of the fact that they are family heirlooms or gifts, make a note of this on your appraisal for future use.45

In this connection, the National Consumer Law Center found that legal aid attorneys considered non-purchase money security interests the single most common basis for threats and harassment of consumers of all of the creditors remedies surveyed.46 The findings of the NCLC survey are borne out by the testimony received in this proceeding.47

The consumer files on this record drawn from the offices of major consumer finance companies contain further examples of threats to seize household goods. Such use of psychological security is recorded on the backs of ledger cards which detail the collection contacts engaged in by the creditor, and in correspondence appearing in the consumer files.48 Threats may be direct or indirect; they may be made to third parties as well as the principal debtor.49

* * *
Certain witnesses testified that such threats were never made. Although the Commission recognizes that certain individual creditors may refrain from threatening to seize household goods, the preponderance of evidence supports a conclusion that such threats are considerable.

A threat to seize family possessions from the home of a consumer is psychologically debilitating and disruptive. This record demonstrates that such threats are made frequently, and that they are harmful in themselves. In recommending that household goods security interests be prohibited, the National Commission on Consumer Finance (NCCF), based on its first-hand experience of the harmful impact of creditor threats to seize furniture and personal possessions, found as follows:

A creditor should not be allowed to take other than a purchase money security interest in household goods.

A creditor should be able to take a security interest in goods which form the basis of the transaction, but security interests in household goods should not be allowed in any loan or consolidation transaction if the goods were not acquired by the use of that credit. In the event of default, such security interest in household goods and the accompanying right to repossess or threaten to repossess such goods have far too disruptive an impact on the family life of the debtor to be in the public interest.

Our view of the record supports our similar finding on the disruptive and harmful impact of threats to seize household goods. Because the economic loss to the consumer inherent in the seizure of these survey goods is so large, the threat to seize is correspondingly substantial. Legal services witnesses and others who appeared and commented in the proceeding offered first-hand experience of the harmful impact of creditor threats to seize furniture and personal possessions.

However, the psychological impact of such threats does not define or exhaust the injury they occasion. It is important to acknowledge, as a general proposition, the position in which consumers find themselves when creditors have a lien on personal possessions. Debtors who are in default and on the verge of having their personal possessions seized are under considerable pressure to make repayment arrangements acceptable to the lender who is threatening repossession. To avoid the greater loss of repossession, such consumers are likely willing to take other steps they would not willingly take but for the security interest. Accordingly, such creditors are in a prime position to urge debtors to take steps which may worsen their financial circumstances.

Such steps may include agreements to refinance debts, and diversion of funds needed for other obligations to pay the creditor holding the security interest. Because of the perceived imminence of repossession, debtors may also forego the assertion of valid or meritorious defenses in their rush to complete acceptable repayment agreements.

Actions such as these are not necessarily harmful in and of themselves, nor are they harmful to consumers in all instances. In other situations, the Commission believes consumers will take such actions only if they are in the consumer's self interest. Faced with the greater loss of a threatened repossession, however, consumers will willingly take steps that avoid immediate repossession, but otherwise worsen the consumer's situation. For debtors who are in need of a postponement of their financial circumstances, consumers may endure lesser injuries to avoid the greater injury of repossession. Because of the security interest, these injuries cannot reasonably be avoided.

The rulemaking record reflects the fact that threats to seize household goods frequently accompany efforts to compel debtors to agree to refinancings of overdue obligations. A refinancing

Chase and recheck is a psychological device in which the Dial office representative visits the uncooperative customer's home specifically for the purpose of rechecking the security interest. This will arouse concern on the part of the customer as to the reason for the rechecking. You are not to threaten that your branch is ready to repossess the security, merely advise the customer that you do not know the reason for the rechecking, that you are just carrying out an assignment, and that if you were in similar circumstances you would contact the office immediately. R-DPI-27. (Dial Finance Company manual)

The record shows that consumer and industry witnesses acknowledge that security interests in household goods are used in a way which is uniquely threatening and disruptive to consumers and their families. Ledger card entries in consumer files include directives such as "work HHG on wife" and similar instructions to apply pressure to family members by threatening destitution. In some cases threats are directed to children and family members.

In others, the creditor will appear at the home and terrify the whole family, threatened to seize his parents' household goods unless he assumed payment.

Eg., Eugene Throll, Land of Lincoln legal Assistance Foundation, R-L(c)-20; Drew Johnson, Lane County Legal Aid, Tr. 6325 (threat to seize HHG in clear majority of cases of default); Royal White, White Systems of Jackson, Tr. 213 (term used was "advise" consumers); James Boyle, Texas Consumer Association, Tr. 10; Harvey Miller, Gateway Loan Co., Tr. 2545 (implied threat); Robert Lohert, Chapter 13 Trustee (retired), Tr. 5743; Carol Knutson, Neighborhood Legal Services Association, Pittsburgh, Tr. 1127; Kenneth Levin, Atlanta Legal Aid Society, Tr. 8276; Mervyn Dynally, Lieutenant Governor of California, Tr. 6527; Robert Cagle, Legal Aid of Mecklenburg County, HX-44 at 2 (threat made to debtor's wife: Kathleen Keest, Black Hawk County Legal Aid, HX-158 at 2; Lawrence Mealer, Dallas Legal Services, Tr. 371; Daniel Hedges, Appalachian Research and Defense Fund, Tr. 1078-1171; Michael Nelson, Legal Aid Society of Kent County, Tr. 4622; Tom McEldowney, Department of Finance, State of Idaho, Tr. 5074; Roberta Ranstrom, Legal Aid Society of Sacramento, R-I(c)-23; Senator Ellis Bodron, Mississippi Consumer Finance Association, Tr. 295.

R-BEN-68; See also R-DIAL-160. (ledger card entry reveals a pressure on wife of debtor). R-XI-DIAL-24. (pressure was applied to wife after husband had a stroke).

Eg., R-DIAL-24; R-AVCO-68; R-XI-GFC-190 ($154 owed); R-XI-GFC-497; R-XI-HPC-184, 187, 188; R-XI-TA-6.

Eg., Lois Wood, Land of Lincoln Legal Assistance Foundation, R-I(c)-19 (loan company employee threatened to repossess debtor's home and describes furniture while wife is present); Robert Cagle, Legal Aid of Mecklenburg County, Tr. 1256; James Kocher, Lane County Legal Aid, Tr. 8578 (debtor with six children, the threat itself is injurious). See also R-XI-DIAL-183.

Michael Nelson, Legal Aid Society of Kent County, Tr. 681 (creditor appears with a moving van and threatens to empty the house); Roberta Ranstrom, Legal Aid Society of Sacramento County, R-I(c)-205 ("Give me $50 today or I'll have a truck at your door in the morning and take everything out of your house.") Lois Wood, Land of Lincoln Legal Assistance Foundation, R-I(c)-19; Martha Eller, Poet Sound Legal Assistance, Tr. 6538 ("the sheriff will come with us tonight to get the goods.").

Eg., Clare Rollwagen, Minnesota Consumer Finance Conference, Tr. 3952; Clarence Blezer, Wisconsin Finance Corporation, Tr. 3745; Don Prutt, Hometown Finance Company, Tr. 3103; Kenneth Davis, Kentucky Finance Company, Tr. 1547.

Eg., Martha Eller, Poet Sound Legal Assistance Foundation, Tr. 6535-60; Drew Johnson, Lane County Legal Aid Service, Inc., Tr. 8314-17; Mary Ellen Sloan, Utah Legal Services, Inc., Tr. 7144-45; Land of Lincoln Legal Assistance Foundation, R-I(c)-19; Case Histories A-C; Legal Aid Society of Metropolitan Denver, R-I(c)-5; Case History: Mildred F. and Laurie F., Beaver County Legal Aid Association, R-I(c)-78 at 2; Robert Gage, Legal Aid Society of Mecklenburg County, HX-44, Case History: Glenda Josepha.

Consumer Credit in the United States, Report of the National Commission on Credit, 277. (See also R-XI-DIAL-183).

Eg., Tucker Trustman, Colorado Department of Law, Tr. 8477; John F. Robert, Louisiana Consumers League, Tr. 10707; George Wallace, University of Iowa Law School, Tr. 11888; Robert Lohert, Land of Lincoln Legal Assistance Foundation, R-II(c)-19; Kathleen Keest, Black Hawk County Legal Aid, Tr. 4205; Lawrence Mealer, Dallas Legal Services, Tr. 371.

Eg., R-XI-DIAL-308; Martha Eller, Poet Sound Legal Assistance, Tr. 6645; John Faust, Legal Aid of Hawaii, Tr. 5394; James Boyle, Texas Consumer Protection Association, Tr. 28; Gerald Cope, Chapter 13 Trustee, Chapter 13, Southern District of Maine, Tr. 10523, 10645; Kathleen Keest, Black Hawk County Legal Aid, Tr. 4205; Thomas Baltus Legal Services of Eastern Michigan, Tr. 1007; James L. Brown, Center for Consumer Affairs, University of Wisconsin, 1 Dix-153 at 8; Eugene Throll, Land of Lincoln Legal Assistance Foundation, R-I(c)-19; Kathleen Keest, Black Hawk County Legal Aid, Tr. 4205; Lawrence Mealer, Dallas Legal Services, Tr. 371.

Chapters 13 Trustee (retired), Tr. 5743; Martha Eller, Poet Sound Legal Assistance, Tr. 6538; Robert Gage, Legal Aid of Mecklenburg County, Tr. 1256; Kathleen Keest, Black Hawk County Legal Aid, Tr. 4205; Lawrence Mealer, Dallas Legal Services, Tr. 371.

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may reduce or defer scheduled monthly payments, but it does so by increasing the overall amount a debtor owes. Although refinancing is appropriate in some instances, it is against the debtor's economic interest in others.61

Threats to enforce HHG provisions can also lead to payment of the secured creditor's loan in preference to other, perhaps more immediate needs or obligations.62 Fear that creditors will make good their threats to seize personal possessions if debtors do not promptly enter into new repayment agreements may also lead consumers to withhold assertion of legitimate counterclaims or set-offs.63

In the Commission's opinion, the use of blanket security interests to exhort an overextended or unemployed consumer to make a decision which may lead to increased financial difficulties has many of the attributes of economic duress.64 Threats to seize the personal possessions of a consumer and his or her family clearly meet many of the criteria for economic duress, especially given the dire financial circumstances in which the consumer finds himself.65 Although the Commission has premised its findings regarding the unfairness of threats to seize household goods on the resulting psychological and economic injury to consumers, as demonstrated by information contained in the rulemaking.

Assistant Foundation, Tr. 3304; Carl Woxman, North Carolina Consumer Finance Association, Tr. 1020-357.

64 See also, e.g., Drew Johnson, Lane County Legal Aid, Tr. 6549-57; Lois Wood, Land of Lincoln Legal Assistance Foundation, R-I(c)-19; Terrance Yerachchi, San Mateo Legal Aid, Tr. 7906; Kenneth Levitas, San Francisco, HX-5-56 at 11; David Dubon, North Louisiana Legal Assistance, Tr. 1680-J; Stephen Hewitt, Lane County Legal Aid, R-I(II)-281; James Kocher, Lane County Legal Aid, Tr. 1027.

65 See, e.g., Stephen Hewitt, Lane County Legal Aid, R-I(II)-281 (debtors will give up food and clothing to keep household necessities).

66 James Boyle, Texas Consumer Association, Tr. 28; John Peir, Legal Aid of Hawaii, Tr. 5344; Allison Steinew, Central Mississippi Legal Services, Tr. 1790; Charles DuMars, New Mexico Law School, Tr. 472.

67 In this connection, the common law has long recognized that agreements should be set aside where a weaker party acquiesces to a contract in the face of a threatened wrong. Such a contract has no effect because the assent of the weaker party is lacking. Goldstein v. Enoch, 248 Cal. App. 2d 801, 5 Cal. Rptr. 19 (1967); Sun Maid Raisin Growers v. Peapaz, 74 Cal. App. 231, 240 (1925).

68 People ex rel. Buell v. Buell, 20 Ill. 2d 62; 155 N.E.2d 104 (1959); Nixon v. Leitman, 32 Misc. 2d 448 (1962). The use of unequal bargaining power to force a person in an unusually distressing situation, it is evident, to a harsh contract that has been held to constitute duress at common law. Oswald v. City of El Centro, 211 Cal. 45, 292 P. 1073 (1930). Undue influence has been defined as the "taking of grossly oppressive and unfair advantage of another's necessity and distress." Cal. Civ. Code § 3375. See also Campbell Soup v. Wente, 172 F.2d 80, 82 (3d Cir. 1949).

record, these common law doctrines provide evidence of public policy supporting the Commission's findings. Since default most frequently occurs for reasons that are not within the control of the debtor,66 the threat to seize household possessions causes "great emotional suffering, humiliation, anxiety, and deep feelings of guilt, and this distress is but a conduit to physical breakdowns or illness, the disruption of the family, and undue strain on family relationships."67

For these reasons, the Commission concludes that non-purchase money security interests in household goods cause substantial consumer injury. D. Offsetting Benefits

Although the industry acknowledged that household goods generally have limited value and expressed disapproval of threats and harassment associated with their use, the industry maintained that blanket security interests were essential. "This is the edge" that makes the debtor pay.68 Creditors stated that borrowers are much better disciplined if they pledge their household goods69 and that the psychological value is essential.70 Such security interests were felt to enhance a debtor's sense of moral obligation71 and to encourage prompt payment.72 It was further argued that the security interest in household goods is evidence of a debtor's good faith effort to repay.73 In addition, it was stated that many consumers have nothing else to offer as security.74 Overall, the industry argued that in the absence of household goods security interests costs would increase and debtors will not obtain credit.75 It should be noted, however, that according to a survey of legal aid attorneys, their experience with legal aid clients indicated that 40 percent of

finance company loans containing security interests (principally but not only in household goods) were for home improvements, suggesting that the borrowers were homeowners and therefore may have had other assets to pledge as security.76

It was maintained that low-income consumers who have the most problems with collection practices would be denied credit in the event that blanket security interests could not be taken.77 Individual finance company operators stated that many loans would not be made absent household goods lien.78

One finance company officer estimated that for his company the charge-off rate for unsecured loans is nearly two-thirds higher than for secured loans, and concluded that "if security was forbidden" and a similar charge-off rate applied to all accounts, bad debt losses would mount and credit restriction would result.79 Certain industry witnesses considered threats to seize household goods to be a valuable remedy.

Q. What is there about security interests in household goods that seems to qualify an otherwise marginal debtor for credit? A. Well, there are several things. First of all, I do believe and have experience that household goods do provide some monetary security on

Number two, there is a psychological disadvantage to the consumer, in a sense (I hate to use the word "disadvantage"); in fact that we eventually back that truck up, tote his stuff out. His neighbors see it; his friends see it. It is embarrassing. It shows up on his credit record as a repossession. Man, next to a charge-off, that about as bad as you can do.80

The industry thus maintained, to a varying extent, that the household goods security interest was "a difference between in and out of this business."81

80 See supra Chapter III.

81 Presiding Officer's Report at 136, citing Martha Eller, Puget Sound Legal Assistance, Tr. 6040-42.

82 James White, Council of State Credit Institutes, Tr. 4487; George Perri, Citizens Budget Co., Tr. 4230-31.

83 E.g., Robert Abraham, Walter E. Heller Company, Tr. 6798; Kenneth Davis, Kentucky Credit Finance Co., Tr. 1523.

84 Leslie Sodowick, New Jersey Consumer Finance Association, HX-494 at 43, 45. See also, E.g., John Mosley, Mosley Finance Company, Tr. 910; Lester Sodowick, New Jersey Consumer Finance Association, Tr. 8392-93; Burton Coleman, Pennsylvania Consumer Finance Association, Tr. 9436; Richard Van Winkle, Lockhart Company, Tr. 7607.

85 William E. Wehner, Household Finance Corp., Tr. 9098. Mr. Wehner acknowledged that recoveries are made on charged-off accounts in some cases, Tr. 9014-15.

86 John Mosley, Mosley Finance Company, Tr. 945. See also, Helmut Schmidt, TransAmerica Financial Corporation, Tr. 8214. See also, Summary of Post-Record Comments XV-357 at 72, notes 35-36.
The rule provision we here adopt meets many of the objections of industry by incorporating substantial modifications (discussed in Section G, below) to the original, more sweeping 1975 proposal which was the prime focus of industry testimony and comment. By enacting a provision which leaves purchase money loans untouched and permits consumers to pledge many valuable possessions as security, we believe we satisfy most of the industry apprehensions that this provision would act to "forbid" security. Moreover, although the consumer finance industry generally took the position that blanket security interests are essential, individual firms from different states testified as to their capacity to operate successfully without such security. In some cases, firms operated in states which prohibit the household goods secured loan.85 In other cases, firms simply decided not to avail themselves of a blanket security interest, and indicated that they did not perceive any major increase in delinquency or collection problems.86 Non-consumer finance companies testified to their lack of confidence in household goods security interests.87

To evaluate the argument that a prohibition of household goods security interests would result in increased default and delinquency and/or a substantial narrowing of the scope of the HHG provision we enact today, as compared to the 1975 proposal addressed by the Presiding Officer. The Presiding Officer also based his conclusion in part on a finding that HHG security interests had "usefulness" in causing the consumer to reaffirm a debt following bankruptcy.88 Presiding Officer's Report at 311. Given the changes to the Bankruptcy Code under the Bankruptcy Reform Act of 1978 (after the Presiding Officer's findings), this benefit to creditors would be substantially eroded, if not eliminated entirely.

83 E.g., William Lehye, Consumer Loan Company, Tr. 4367, et seq. Fernando Negron, Island Finance Company, Tr. 8536. In these cases, however, there is no evidence that the creditor publicized or otherwise made known the determination not to employ HHG security interests.89 From a creditor's standpoint, the facts about the causes of consumer default in credit obligations suggest that the benefits of blanket security interests as a collection device are limited. Given that the majority of defaults occur for reasons beyond the borrower's control,88 a threat to seize furniture and personal possessions is of marginal value in cases of serious delinquency. Unemployed debtors, or debtors with sudden and substantial emergency expenses are hardly more able to remit monthly payments because they receive a threat to seize the furniture. E. The California Situation

A special problem was raised by industry witnesses in the State of California. It was argued that the prohibition on blanket security interests in household goods would make it impossible for the consumer finance industry to remain in business, because legal interest rates are tied to the taking of security.89 The industry maintained that the proposed rule would make it impossible for finance companies to lend under the Personal Property Broker's Law.90 The industry maintained that prohibiting security interests in household goods and prohibiting wage assignments would amount to a prohibition against small loan companies doing business in California because the applicable statute defines such lenders as those who take such security and/or wage assignments.

We find that the apprehension expressed by the California finance industry is unwarranted. The record indicates that, in practice, any personal property of any kind will suffice as security for the purpose of the statute.91 Lenders comply with the California law by taking a nominal security interest in a fountain pen or a ring.92 They can continue to take similar nominal security interests under the rule we promulgate here.93 The rule does not require any changes in California statutory law to permit consumer finance companies to remain in business.

90 George Richter, California Loan and Finance Association, Tr. 5885. See also Staff Report at 238, note 129.
91 "A close examination of these two forms of security will quickly show that they are largely a fiction device to permit this category of lender to function outside the 10 percent interest limitation." Mervyn Dymally, Lieutenant Governor of California Tr. 6514.
92 Earle Nelson, California Department of Corporations, Tr. 5043, 5045-46; George Richter, California Loan and Finance Association, Tr. 5909.
93 Wage assignments are prohibited in California, which also qualify a lender as a personal property broker, may only apply to income already earned at the time credit is extended. Such wage assignments are not prohibited by the rule.

Moreover, the rule does not prohibit all security interests in personal property. Purchase money security interests in such property are permitted, as are non-purchase money security interests in other than household goods, as defined, such as jewelry. Finally, there are other statutory alternatives in existence in California, which permit lenders to charge rates in excess of the constitutional usury limitation, and which consumer finance companies use. An example is the Industrial Loan Law under which finance companies may operate that affords a rate structure that is slightly lower than that under the Personal Property Brokers Law. See, e.g., Earle Nelson, California Department of Corporations, Tr. 5043.
collateral other than the automobile itself. The industry maintained that this approach was too restrictive, especially in the second mortgage area, and the rulemaking staff concurred. The purpose of this rule is to prevent the use of non-purchase money security interests in household goods (as defined) while permitting consumers to agree to second mortgages where it is in their interest to do so. It permits the use of non-household goods collateral, in any appropriate credit transaction, but limits household goods security interests to transactions where the credit received was applied to their acquisition.

In reviewing this rule provision the staff noted an ambiguity as to whether the rule applied to possessory security interests, i.e., property held in the possession of the secured party such as a pawnbroker. Under the U.C.C. a pawn or pledge is a "security interest" but were not intended to be covered by the rule. Thus Section a(4) has been revised to make it clear that it only applies to non-possessory security interests. This will eliminate any uncertainty as to whether a consumer can pawn or pledge household items. The record furnishes no evidence that such possessory security interests cause any injury.

The rule does not apply to purchase money security interests. When a purchase money loan is refinanced or consolidated, we intend that, for purposes of this rule, the security collateralizing the prior loan can continue to secure the new loan, even if the new loan is for a larger amount or is in other respects a non-purchase money loan. In enunciating our intent for purposes of this rule, we intimate no opinion with respect to different approaches taken by various approaches in analogous questions raised under the Bankruptcy Code.97

Staff Report at 244, note 140.

The issue arises in the context of bankruptcy proceedings because the 1976 bankruptcy reforms provided an exception to the old rule that secured loans survived bankruptcy, for those loans secured by blanket security interests in household goods, 11 U.S.C. §522(f)(2)(A). This has resulted in litigation over the question of whether a consolidated or refinanced loan, secured in part by previous purchase money collateral, can be avoided in bankruptcy, i.e., whether they are purchase money loans or HGIC-secured loans. Different courts have reached different results. Compare, e.g., In re Manuel, 507 F.2d 960 (5th Cir. 1975) with In re Conn, 18 B.R. 454 (Brkty., D. Ky. 1984) and In re

We adopt a further modification to this section of the rule narrowing the definition of "household goods" to more nearly limit coverage to necessities and to permit the pledge of certain possessions which have significant economic value. This modification has been undertaken in response to comment and to narrow the prohibition to the class of goods for which the injury to consumers from a security interest exceeds offsetting benefits.

Specifically, we define "household goods" in terms of a list of common household necessities, together with some items of uniquely personal value, excluding these categories:

1. Works of art;
2. Electronic entertainment equipment (except for one television and one radio);
3. Items acquired as antiques; and
4. Jewelry (except wedding rings).

We define "antique" as

Any item over one hundred years of age, including such articles which have been

Russell, 29 B.R. 270 (Brkty., W.D. Okla. 1983). We intend that, for purposes of this rule, when a loan is consolidated or refinanced, a creditor can retain an existing purchase money security interest in collateral which would otherwise come within the rule's definition of household goods. Thus, analogous "transformation" rules in bankruptcy decisions will have no bearing in determining, for purposes of the rule, the basic character of the collateral at the time of the refinancing or consolidation.

Those jurisdictions that do not follow the automatic transformation rule generally adopt a method of determining the extent of the purchase money interest in the refinanced loan; most often some variant on the first-in-first-out payment method specified in the U.C.C. section 2-409. To the extent that this issue is in conflict with our rule, state law should govern the determination of the extent of the security interest. For purposes of determining compliance with the rule, however, we intend that courts should look to the validity of the contract under the rule at the time the contract is made. Thus, if under applicable state law an interest is in part a purchase money security interest at the time a contract is signed, the contract does not violate the rule, even if the purchase money portion of the interest is extinguished before the end of the contract.

E.g., Thomas Huston, Superintendent of Banking, Iowa, Tr. 2285-86; W.C. Evans, Texas Finance Association, Tr. 966; Clarence Bleser, Wisconsin Finance Corporation, Tr. 3467 ("luxury household goods"), 3472 ("boats, snowmobiles, television sets, pianos"); Harold T. Welah, Illinois Credit Union League, Tr. 4068-69 (piano); Robert Mallock, Beneficial Management Corporation, Tr. 9577 ("multiple TV's, stereo's, home workshops * * *"); Betty Greggs, Credit Union National Association, Inc., Tr. 9665 (jewelry). See also Post-Record Comments XV-338 at 56 (finance company); XV-274 (credit union concerned about jewelry); XV-123 (credit union—should exclude things that for investment purposes); XV-213 (credit union—"piano could retain most of its value for the term of a five year loan while a room full of furniture depreciated to next to nothing").
“Personal effects” is not defined in the rules. We intend it to have its commonly accepted meaning as “Articles associated with a person, as property having more or less intimate relation to the person of the possessor.”

We specifically include wedding rings within the term “personal effects.” Other items clearly within the ambit of the term include those which an individual would ordinarily carry about on his or her person and possessions of uniquely personal nature, such as family photographs. Thus, the definition of household goods does not cover items such as boats, snowmobiles, cameras and camera equipment (including darkroom equipment), pianos, multiple television sets, home workshops and the like.

We exclude one television and one radio from the term “electronic entertainment equipment” because, in contemporary society, these items have become virtual necessities. For families in rural or isolated areas, a radio is an absolute necessity. For many—especially disabled or infirm persons, or shut-ins—a television may be an equal necessity. We intend that the term “radio” apply to a conventional, self-contained unit (such as a table model radio, or a transistorized portable radio) with its primary function as a radio. The term does not encompass multi-component audio systems, even though one element of such a system is a radio receiver. Nor does it apply to portable, self-contained, multi-function units (tape recorder/player, amplifier, clock), only one element of which is a radio receiver.

We have provided that wedding rings be included within the term “household goods.” This permits consumers to pledge as collateral for non-purchase money loans any items of jewelry, with the exception only of wedding rings, which should be protected because of their unique psychological and emotional value.

To the extent that individual states provide protections substantially equivalent to, or more protective than, this rule provision but do so by specifying a definition of “household goods” that differs in content from that employed in the rule, the exemption provision (§ 444.3) is available to allow any such state to petition for exemption.

VII. Waivers of Exemption

Section 444.2(a)(2) of the Rule provides that it is an unfair act or practice for a lender or retail installment seller to take or receive from a consumer an obligation that constitutes or contains a waiver provision of exemption from attachment, execution or other process on real or personal property held, owned by, or due to the consumer.

A. State Law

At common law, all property of a judgment debtor was subject to execution in order to satisfy the judgment debt. Beginning in the nineteenth century, however, most states and the District of Columbia enacted laws that exempted certain property from judicial seizure and sale. The property exempted usually consisted of a homestead and other necessary items, such as furniture, clothing, family Bible, tools of the trade, animals used in farming, etc. Today, many states retain laws containing lists of exempt personal property, while other states simply exempt personal property of a specified amount. Several current statutes contain approaches of both approaches.

The basic reason for exemption laws is to afford minimal protection to debtors and their families by allowing them to retain the prime necessities of life, with a view to preserving the family unit and furnishing the insolvent with nucleus to begin life anew.

Under general principles of contract law, it has been considered that the right to claim an exemption is a personal right to be claimed or waived at the discretion of the debtor, unless state law specifically prohibits such waiver. In a number of states, there appears to be no such legal impediment to waiver of statutory exemptions of personality. A number of jurisdictions prohibit waivers of exemption based on the strong public interest in protecting improvement debtors and their families.

See, e.g., Parsons v. Evans, 44 Okla. 715, 145 P. 1122 (1915).

See also Roberts v. U.S., 332 F.2d 892, 898 (8th Cir. 1964); In re Weisweiller, 40 B.R. 1, 94 B.R. 695 (S.D. Ind. 1984); and In re Zucker, Case No. 83-844 (9th Cir. 1982).

The definition is suggested by U.S. Customs descriptions (Tariff Schedules of the United States Annotated (1976) at §2 B. Schedule 7. Part II, Subparagraph 7.760.20).

Weaver v. Lynch, 79 Colo. 156, 157, 118 P. 576 (1911).

Weaver v. Lynch, 79 Colo. 156, 118 P. 576 (1911).
In most states, the homestead exemption that protects real property may be waived by granting a specific interest in the property by way of mortgage. The Uniform Consumer Credit Code, as well as the laws of some of the other states, however, prohibits the taking of a security interest in real property as security for loans below a stated amount and by certain types of lenders.

Non-purchase money waivers of personal property exemptions are treated more stringently by the states, particularly where the personal property consists of necessary household goods. Some states prohibit the taking of non-purchase money security interests in all or listed personal property that is the subject of exemptions. In those states where general executory waivers of exemption are prohibited, it is generally done on the basis of the legislative intent in creating exemptions, that is, to protect the debtor and the debtor's family from thoughtlessness, extravagance, and improvidence.

State action regarding waivers of exemption reveals the costs and benefits associated with the practice and its restriction, as viewed by the various jurisdictions. The fact that a relatively large number of states have acted in this area is not, in itself, determinative of the unfairness of a practice. Rather, examining state action aids the Commission in identifying the relevant issues in its own assessment of the unfairness of waivers.

**B. Prevalence**

The rulemaking record establishes that creditors frequently include clauses in their consumer credit contracts that require consumers to waive statutory protections. Although the rulemaking record does not permit a precise determination as to the frequency with which creditors include waivers in consumer contracts, the preponderance of the evidence does support a finding that the use of general waivers of exemption is prevalent, even in jurisdictions in which such provisions would not be given effect. This permits the use of such clauses as in terrorem collection devices, illustrating the gap in those states that may prohibit execution on waivers of exemption clauses, but not their inclusion in consumer credit contracts.

**Consumer Injury**

Waivers of state statutory exemptions permit creditors to seize, or threaten to seize, security that, by statutory definition, are necessities. Although in contrast to security interests execution on exempt property requires court action, waivers are essentially an alternate means to the same end as non-purchase money security interests in household goods. Thus, the consumer injury is essentially the same as that noted above in our discussion of household goods security interests (Chapter VI).

The record shows that much exempt property has little economic value as collateral, but great economic, psychological, and sentimental value to consumers. Generally, waivers are coupled with a blanket security interest in household goods; in other cases such a waiver, standing alone, is used to reach property that would be otherwise exempt.

Because of its low economic value, exempt property is rarely seized. The record, however, reflects indications of actual seizures. The record also shows that threats of seizure, in the context of collection, are frequent. The common inclusion of waivers of exemption clauses in consumer credit contracts, especially in jurisdictions where they are not enforceable, suggests their primary use as in terrorem collection devices.

The record also shows that, in some instances, threats to seize exempt property force debtors to pay disputed debts or to waive legitimate claims or defenses that would otherwise reduce or eliminate their debts. Such threats can also disrupt household finances, leading to

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11 E.g., Philip A. Lehman, Legal Aid Society of Mecklenburg County, R-(cc)-77, Case History; Mack.

12 E.g., Daniel W. Molloy, Mobile County Legal Aid Society, HX-72 at Exh. 5, federally home owner waived a homestead exemption in a $485 note to pay for a chain link fence) and Exh. 8. See also, Kenneth C. Davis, Georgia Legal Services Program, R-(cc)-44; Leonard Green, Wake County Legal Aid, R-(cc)-78, Case History Il.

13 E.g., Karl Friedman, Alabama Consumer Affairs, HX-494 at 35. HX-494 at 32-33; Jonathan Epstein, Essex-Newark Legal Services, HX-378, Tr. 8948.

14 John F. Robbott, Louisiana Consumer League, Tr. 1079; Richard F. Halliburton, Legal Aid of Kansas City, R-(cc)-102.

15 See also prepared statement of Robert P. Pickell, Supervisor of the Consumer Finance Section, Ohio Department of Commerce, HX-155. Mr. Pickell stated that in Ohio in 1976, "most loans that we have benefited" from this rule provision. (Although Mr. Pickell opposed the provision, his opposition was based, as was the opposition of other creditors, on a misapprehension that the provision would be a waiver of exempt rights through the grant of a security interest in otherwise exempt property at the time a loan is executed)

16 See, e.g., Jonathan Epstein, Essex-Newark Legal Services, Tr. 8949; Herbert Beakin, Charlottesville-Albemarle Legal Aid Society, TX-377 at 5-6; John M. Sears, Rhode Island Legal Services, Tr. 9970. Although waivers of exemption are not given legal effect until the creditor reduces a claim to judgment, that technical reality does not necessarily stand in the way of creditors' in terrorem use of waivers. Such use is abetted by most consumers' unfamiliarity with the technicalities of the legal process in general and, specifically, their unawareness of the significance of waivers (see supra note 10-11).

17 Note 10, supra. See also, R-XIII-36 (NFCA state-by-state printed report) worst-recorded event XV-228, Pentagon Federal Credit Union, Virginia ("It is a fast tactic and not normally enforceable.").

18 See NCLC survey, HX-407 at 34, indicating that legal aid attorneys believe threatened use of waivers results in unreasonable settlement of claims at a 20-21 percent frequency. See also, Daniel Molloy, Mobile County Legal Aid, HX-72; John M. Sears, Rhode Island Legal Services, Tr. 8970.

19 See infra note 10.
to delinquency on other obligations or resulting in costly refinancing.19

Creditors contended that current state law provides adequate consumer protection.20 Such laws, however, generally do not address either the inclusion of waiver clauses in form contracts or their use for in terrorem purposes. The rule provision is aimed squarely at these gaps in state consumer protection schemes.

The preponderance of record evidence causes us to conclude that consumers suffer economic injury, as well as more subjective harms, as a result of practices which flow from the inclusion of this provision in consumer credit contracts.

The rulemaking record shows that most consumers are neither aware of the rights they have under exemption statutes nor of the presence or significance of waiver clauses in their contracts.21 Creditors do not explain these rights or the contract clause to their customers.22 Consumers would thus be ill-advised to bargain over this provision or shop around for contracts without one.23 Thus, consumers cannot reasonably avoid the injury caused by waivers of exemption clauses.

D. Offsetfing Benefits

Some opponents of this provision contended that some exempt property has economic value as collateral, and that waivers of exemption are necessary to threaten debtors with seizure of the property as a means of inducing payment.24 This contention assumes that debtors fail to pay on time because they are unwilling to do so. The assumption is contradicted by the finding that most debtor default is the result of factors beyond the debtor's control.25 To the extent that the clause has any value as a collection device, creditors still have a large number of remedies at their disposal.26 A few witnesses predicted that the effect of prohibiting waivers of exemption would be to increase the cost of credit or restrict its availability.27 In those states that permit waivers, however, the record shows that they result in actual seizures relatively infrequently,28 this strongly suggests that creditors themselves consider waivers to be of little value.29 The Presiding Officer found that creditors are generally reluctant to effectuate executory waivers even where both the opportunity and statutory authorization to do so exist.30

Based on the evidence, we conclude that the benefits outweigh the costs for this provision. This is consistent with the Presiding Officer's finding that "taken as a whole, the record supports a conclusion that the prohibition on executory general waivers of all homestead and other exempt property in consumer credit contracts would prevent consumer abuses without doing undue harm to creditors."31

E. Alternatives Considered and Modifications Adopted

This provision of the proposed rule received widespread support throughout the proceedings. Creditor objections focused on a possible ambiguity which could lead to misinterpretation of the rule. Creditors were concerned that this prohibition, as originally proposed, would outlaw security interests in exempt property as well as waivers of the statutory exemptions, because in some jurisdictions a security interest was styled as a waiver of an exemption for the covered property. The provision we adopt has been revised to make it clear that § 444.2(a)(2) does not apply to security interests in such property if otherwise permitted by the rule and by state law.

As enacted, § 444.2(a)(2) prohibits the use of "executory" or "advance" waivers where there is no security interest in the affected property. Many creditors agree with, or at least have no objection to, this provision as modified.32 The provision will not affect existing state law which prohibits enforcement of executory waivers of exemption. But it will prevent creditors from employing executory waiver clauses in all jurisdictions regardless of their enforceability under state law.

VIII. Late Charges

Section 444.4 of the Rule provides that it is an unfair act or practice for a lender or retail installment seller to use any accounting or other method that results in the assessment of multiple late charges based on a single late payment that is subsequently paid.

A. Nature of the Practice

Late or delinquency charges are those the creditor assesses against the borrower when a payment is not made by the due date, although there is usually a grace period of five or ten days before the late charge is imposed. Deferral or extension charges are made by the creditor for extending the period of time within which the debtor may make one or more payments. Late and deferral charges both have a dual purpose. The first is to encourage the debtor to make timely payments; the second is to compensate the creditor for additional costs resulting from a failure.
on the part of the debtor to make payments in accord with the terms of the loan agreement.

The importance of the incentive effect of late charges was emphasized by creditors. Late charges prevent a debtor from converting a precomputed installment contract or a loan into open-end credit. When a consumer is late in making a payment under a precomputed credit contract, the creditor may receive no income for the period of delay; and the delinquent debtor can effectively pay a greater rate of interest than charged consumers who pay on time.

The rulemaking record demonstrates that creditor efforts to collect delinquent payments result in costs significantly greater than those associated with the maintenance of current accounts. These costs include those attributable to additional notices, letters, telephone calls, and personal contacts. The salaries of personnel engaged in such activities are also substantial. To help recover these costs, almost every consumer credit contract contains a provision for the assessment of late charges.

**Pyramiding**

The practice addressed by revised § 444.4 is known as the “creeping” or “pyramiding” late charge. It comes about by application of an accounting method which results in the assessment of multiple delinquency charges due to a single late payment. The general accounting principle is that payment is first applied to any outstanding late charge, then to the interest charge, and finally to the principal amount of that payment. In “pyramiding” the accounting method works in this fashion: If a consumer’s payment is due on the first day of January, for example, and the payment is not made until the 20th day of that month, the creditor assesses a late charge, for example, $5. The February payment and all subsequent payments are made on time. However, by allocating $5 of the February payment to the January late charge and only the remainder to the February payment, the creditor causes the February payment to be $5 “short”, hence delinquent. Timely payments in succeeding months are given the same treatment, so that there is a delinquency or late charge for each month. The cumulative impact of repetitive late charges can be substantial.

The staff of the Federal Reserve Board provided another example of late charges:

In some instances when a consumer makes one late payment, the creditor will treat every subsequent payment as being late. For example, where a consumer makes the third monthly payment one month late under an obligation which is to be repaid in six monthly installments, the creditor may then treat the fourth, fifth and sixth monthly payments as each one being one month late and collect a late payment charge for each of those payments.

The Rule provision is aimed at only the first example, or “pyramiding.” In the FRB example where the monthly payment is late but never made current, the effect may be to allow the creditor unilaterally to extend the term of the loan. The missed payment on the third month may not be made up until the seventh month, one month after the termination period of the contract. There are mechanisms in most state laws for deferring payments, subject to the creditor’s right to assess and collect a deferral—as opposed to a delinquency or default charge.

**B. State Law**

States have imposed limitations on the amount that creditors may assess consumers for late charges and deferral fees. The most frequently used state method is to put a “cap” on late charges equal to 5% of each installment more than ten days late or $5, whichever is less. Some states also put a “floor” of 5% or $5 on these charges to partially compensate the creditor for its added expense of collecting the late payment. States that have adopted the Uniform Consumer Credit Code expressly prohibit pyramiding of late charges.

**C. Prevalence**

The record establishes that consumer credit contracts almost uniformly provide for the assessment of late charges and extension charges, although they may not always be assessed. Such charges can be waived to assist debtors in financial distress or to facilitate settlement of delinquent accounts. Although the precise extent of pyramiding of late charges cannot be ascertained from the record, there is evidence that it occurs in most of the

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1. See, e.g., Wis. Stat. § 422.203, 204 (1973); UCC § 2-204, 3-204 (1960), and § 2-503 (1974); see generally CCH Consumer Credit Guide at 1401 et seq.
4. Many witnesses reported that late charges are frequently waived, e.g., Richard E. Edwards, Pennsylvania Consumer Finance Association, Tr. 8509; David White, National Association of Federal Credit Unions, Tr. 11095; John R. Shuman, Florida Consumer Finance Association, Tr. 3579; Joseph C. Park, Michigan Consumer Finance Association, Tr. 3162; Harvey R. Miller, Gateway Loan Corporation, Tr. 2530; Bernard J. Cunningham, Windsor Locks Finance, Inc., Tr. 8662; James M. Hassinger, Iowa Consumer and Industrial Loan Association, Tr. 3630.
5. See Robert A. Patrick, General Counsel, Wisconsin Office of Commissioner of Banking, who noted that the large corporations generally operate in a systematic fashion, and the taking of late charges would not likely be left to the discretion of local offices. Tr. 4095.
6. Id. See also, Presiding Officer’s Report at 203.
D. Consumer Injury

The record contains evidence that pyramiding of late charges results in the assessment of charges far in excess of the amounts, if any, actually expended by creditors to collect the account. Indeed the evidence indicates that, where the only delinquency on an account is attributable to a prior late charge, creditors do not persist in collection attempts.

The problem of pyramiding—where a payment is late but is paid in full on or before the next timely payment—is compounded by the fact that the debtor is usually unaware that the late charges are "pyramiding" until the final payment is made. If payments are accompanied by a coupon from a book of coupons given to the consumer at the time the credit is extended, the debtor may not receive any periodic statement indicating the amount of late charges as they accrue.

Furthermore, because pyramiding is based on an accounting method, not a contract provision, consumers cannot shop around for credit contracts that do not involve this practice, or otherwise reasonably avoid the injury which flows from its application. This provision will benefit borrowers by reducing late charges assessed for a single late payment.

E. Offsetting Benefits

Only one participant in this proceeding defended the use of pyramiding late charges, arguing that the creditor, seeking to make the account current, incurs collection costs during each period the installment remains unpaid. Because of this continuing effort, the creditor should be permitted to impose a late fee in each period that even a small amount remains unpaid to partially cover the cost of collection efforts during that period.

The evidence, however, establishes that creditors do not persist in collection efforts after a tardy payment is received and the only deficiency is a prior late charge. Where a payment is late but subsequently received, creditors make no further efforts to collect. Therefore, they do not need to be reimbursed for collection expenses after the late payment is received.

Pyramiding of late charges is basically the result of an accounting method. It is thus unknown to consumers and could not therefore serve as a useful deterrent to late payments. Because little or no collection effort occurs after a tardy payment is made, the creditor incurs little or no added collection expense. Prohibiting the use of pyramiding will have little, if any, impact on either the cost or availability of credit. Therefore, benefits to consumers or competition are insufficient to offset demonstrated consumer injury from pyramiding of late charges.

F. Alternatives Considered and Modifications Adopted

Some creditors argued that, because the initial proposal did not address the precise issue of pyramiding, no notice was given of this practice. This is incorrect, because the proposed rule clearly focused on late charges.

As initially proposed, the late charge provision would have prohibited the inclusion of provisions in consumer credit contracts permitting charges for late or extended payments that exceeded the amount derived from application of the annual percentage rate governing the transaction to any payment which was late or extended. The evidence adduced in the proceeding does not support a finding that late charges in excess of the APR are unfair. However, the Commission is adopting a revised provision to eliminate "pyramiding" of late charges.

Lenders generally demonstrated that permitted late charges do not always compensate them for the added costs of collecting delinquent payments. Because of this, it is not an unfair practice for creditors to assess a late charge for each payment period that the delinquent principal or interest payment remains unpaid. However, where a tardy payment is paid, and the only deficiency is a late charge imposed on that payment, the late charge itself should not be a basis for imposing further late charges.

Pyramided late charges do not compensate creditors for any costs incurred in collection. Such charges simply permit collection of sums over and above principal and interest due; pyramiding constitutes a windfall to the creditor that inflicts substantial injury on consumers that is not reasonably avoidable, without countervailing benefits to consumers or competition. Pyramiding of late charges, therefore, is an unfair practice.

Retailers suggested that open-end credit be exempted from this provision of the rule because no late charge provision is used in such contracts. We adopt a revised proposal which would not affect open-end creditors or any other creditors who do not employ this accounting method.

Several parties argued that late charges should not apply where a partial payment is made. There is inadequate record evidence to justify prohibiting late charges on partial payments. A partial payment, unless it is only partial because of previously due late charges that were "late," is a late payment.

Finally, we have determined that a straight-forward prohibition on the practice of pyramiding is sufficient remedy. Earlier proposals incorporated a requirement that creditors include in each consumer credit contract a clause prohibiting pyramided late charges. We find insufficient record evidence to support such a requirement. Our approach will result in no paperwork burden on creditors and will obviate the need for an unnecessary contract provision as to that substantial body of creditors which does not engage in the practice.
IX. Cosigners

Consumers who do not meet a creditor's standards for creditworthiness are often required to obtain one or more "cosigners" who agree to be liable for the debt. A cosigner is required to pay if the debtor defaults, but the cosigner receives no monetary consideration for undertaking the obligation, which can become onerous.

A. State Law

The term "cosigner" has no precise legal meaning. The rights and obligations of cosigners are defined by reference to the contracts they sign. The status of a cosigner is that of an accommodation party and surety. The cosigner's obligation is generally the same as that of the principal because cosigners waive traditional rights of sureties.

Except for a few reform statutes, the status of consumer cosigners has not been the subject of legislative or judicial consideration. Most reported cases involve commercial interests. Consequently, the law in this area does not reflect the special problems of cosigners in consumer transactions. In most jurisdictions, the creditor has no obligation to give the cosigner a copy of the contract or advise the cosigner of the extent of his or her liability.

In its report the National Commission, on Consumer Finance (NCCF) recommended that:

No person other than the spouse of the principal obligor on a consumer credit obligation should be liable as surety, co-signer, co-maker, endorser, guarantor, or otherwise assume personal liability for its payment unless that person, in addition to signing the note, contract, or other evidence of debt, signs and receives a copy of the separate co-signer agreement which explains the obligations of a co-signer.

Section 3.206 of the 1974 version of the Uniform Consumer Credit Code (U.C.C.C.) followed the NCCF's lead with a similar recommendation. Several states require written notice to cosigners.

B. Use of Cosigners

Cosigners were employed in 2 percent of the cases sampled by the National Consumer Finance Association. Individual small loan companies indicated that they use cosigners from 10 percent to 95 percent of the time. A survey by the Consumer Bankers Association showed that 7 percent of respondents always, 27 percent usually, or "often" encourage cosigners. A survey by the National Consumer Law Center which focused on low-income consumers, reported that legal aid attorneys estimated that finance company creditors use cosigners other than

1 Presiding Officer's Report at 205-267.
2 The U.C.C.C. also requires that cosigners be given a copy of the debtor's contract, as well as the co-signer agreement. For full text, see section 3.208.
3 Wisconsin, Illinois, California, West Virginia, Iowa, Colorado and South Carolina. NCFA Rebuttal Submission, RXII-31 at C-28. See also Staff Report at 425-426, notes 17-23.

The Dial Financial Corporation Surety Agreement states: "It being the intention hereof that the undersigned shall remain liable as principal[s] until said obligation with charges, if any, has been paid, notwithstanding any act or thing which might operate as a discharge or surety." Dial Form No. 1008 (surety agreement). R-XI-Dial-302.

The reason for the penalty of case law in this area is that the contract is signed by others, are not construed according to their terms. The agreement which a co-signer executes is a standard form contract drafted by the creditor to create equal liability between the debtor and co-signer and to waive any defenses which a surety would otherwise have. Such contracts leave little for the courts to construe in the cosigner's favor, and parole evidence is not admissible in suretyship cases. Peters, Suretyship Under Article Three of the Uniform Commercial Code, 77 Yale L.J. 833, 855 (1968).

spouses 41 percent of the time, banks use non-spouse cosigners 31 percent of the time, and credit unions use them 20 percent of the time. The Finance company files on the record also reflect the use of cosigners.

The record establishes that creditors seek and obtain cosigners at the time of initial extensions of credit and to secure delinquent accounts in a significant number of cases. Some witnesses testified that parents are the most frequent non-spouse cosigners. Other relatives, friends and employers are also used.

C. The Unfairness of Failure To Disclose Cosigner Liability

The consumer injury addressed by § 444.3 of the rule is occasioned in some cases by the failure of creditors to inform potential cosigners of their obligations and liability (an unfair

1 Mark Leymaster, National Consumer Law Center, IX-467 at 35. One finance company stated that none of its loans require as many as six cosigners, so the number of cosigned loans may underestimate the number of consumers affected by this practice. Jackson W. Guyton, Mutual Savings Credit Union, Fairfield, Iowa, Statement, RXII-109 at 3.
3 E.g., cosigners were obtained at the time of the initial extension of credit in:

R-XI-DIAL - 107, 99, 112, 123, 128, 37, 40, 44, 58, 63, 130, 146, 153, 154, 156, 159, 174, 178, 193, 204, 210, 216.
5 Cosigners were obtained after the initial extension of credit and after a default had occurred in:

R-XI-DIAL - 31, 42, 43, 45, 40, 48, 57, 64, 128, 134, 145, 153, 154, 156, 159, 174, 178, 193, 204, 210, 216.
6 R-XI-CIT - 189, 208, 246. See also testimony of Clare A. Rollwagon, Maryland Consumer Finance Conference, Community Credit Company, Tr. 390B.
7 Cosigners were solicited after serious delinquency on the part of the principal debtor in:

R-XI-DIAL - 8, 9, 10, 11, 12, 13, 14, 15, 16, 19, 20, 21, 33, 38, 41, 56, 61, 102, 111, 113, 115, 127, 136, 137, 158, 172, 213, 214.
9 E.g., Joe Martin, 1st United Bancorporation, Tr. 1165.
10 E.g., Ronald L. Polk, Arizona Consumer Loan and Finance Association stated that their practice is to take only immediate family members as additional cosigners, R-(a)-460 at 3. Robert E. Ericson, DNA Legal Services, Window Rock Reservation, stated that parents, relatives, and friends are obtained as cosigners in his experience, Tr. 1975. Charles L. Childers, Tyler Bank and Trust Company and Texas Bankers Association, stated that employers are also used
11 Richard K. Slater, Consumer Bankers Association, Tr. 11618.
12 Estimates that more than half of its non-spouse cosigners are parents or other relatives, R-(a)-816.
practice and, in other cases, by affirmative creditor misrepresentations concerning such obligations and liability (the misrepresentation practice). Section 444.3(a)(2) of the rule provides that it is an unfair practice to fail to disclose to a potential cosigner the nature of the liability undertaken by becoming a cosigner.

The record establishes that creditors fail to disclose the nature and extent of cosigner obligations. Although some creditors stated that they explain the implications of cosigning a loan, and may do so quite colorfully, the preponderance of evidence causes us to conclude that a large number of creditors are not so enlightened. Finance company operating manuals included in the record do not instruct their employees to provide an explanation. Creditors testified that they do not provide cosigners with explanations of the obligation undertaken, and that they often never see the cosigner, but direct the principal debtor to obtain the signature of a friend or relative on the contract. Thus, failure to disclose the nature and extent of cosigner liability is prevalent.

1. Consumer Injury

As might be expected, creditors seek to collect from cosigners when the principal debtor defaults. In the NCFA sample, creditors demanded payment from cosigners in 74.7% of the precomputed loans and 72.5 percent of per diem loans upon default. A banker stated that his bank collects from cosigners in 75 percent of all defaults.

The evidence shows that cosigners are relied upon for repayment by creditors, and are subject to the full range of collection tactics, including those addressed by other sections of this rule. The sudden liability that can result from cosigner status can cause over-extension when a consumer is confronted with a debt, the timing of which cannot be controlled by the cosigner because it is due to nonpayment by the principal debtor. A study by David Caplovitz indicates that 6 percent of all consumer default is due to cosigner liability. Because of the range of potential liabilities, many consumers might not become cosigners had they known the likely costs of doing so. When cosigner obligations are explained:

A whole bunch of them have said "never looked at it that way * * * ain't no way I'm going to do this." (Henry Goodman, Arizona Finance Co., Tr. 7785).

Cosigners thus undertake obligations which they might not have undertaken had they understood them, and suffer economic and other hardship as a result when called upon to repay.

2. Reasonable Avoidance

Despite the high likelihood that they will be asked to pay in the event of default, many cosigners are unaware of the nature of the obligation they undertake absent a disclosure. Some believe that they are merely acting as a reference.

Legal aid attorneys estimate that only 20 percent of cosigners understand the nature and extent of their obligation. Although some cosigners are aware of the basic fact of liability, many cosigners who realize that they are not merely references are often not fully aware of the extent of their obligation.

At common law, creditors had an obligation to exhaust their remedies against the principal before seeking payment from a cosigner. This requirement was consistent both with the economic role of the cosigner in the transaction and with cosigners' expectations. Many current cosigner contracts, however, contain a waiver of the requirement that the creditor first pursue the principal. Thus, upon default, the cosigner may be required to pay even if the principal has assets from which the creditor could be paid. Some finance company training manuals instruct employees to make cosigners the focus of collection efforts once the principal debtor has become more than minimally delinquent.

NCLC Survey, HX-457 at 36.

E.g., Leslie R. Butler, Consumer Bankers Association, HX-488 at 18; Gayle C. Williams, Legal Aid Society of St. Louis, Tr. 4620. See, e.g., Craig L. Williams, Idaho Legal Aid Society, Tr. 7071-72; David R. Duhon, North Louisiana Legal Assistance Corporation, Tr. 1430 U-V, Fernando Acevedo, Esq., Tr. 8856.

E.g., Agnes C. Ryan, Legal Aid Bureau of Chicago, Tr. 2235-56; Kayla Vaughn, Missouri Public Research Group, Tr. 6550; Gayle C. Williams, Legal Aid Society of St. Louis, Tr. 4000-12; Jonathan Epstein, Essex-Newark Legal Service, Tr. 8690; Sidney Margolius, columnist, New York, Tr. 11208.

E.g., L. Johnson, Lane County Legal Aid Service, Inc., Tr. 8519; Judge Arthur L. Dunn, Cook County, Illinois, Tr. 2738. Some industry members agreed that cosigners do not fully understand their liabilities; see, e.g., ACA, HX-494 at 59-60; Bryce A. Baggett, Oklahoma Consumer Finance Association, Tr. 655-96. See also Presiding Officer's Report at 277.

The common law background of cosigners' liability is reviewed in detail at pp. 421-424 of the Staff Report.

See generally, Gayle C. Williams, Legal Aid Society of St. Louis, Tr. 4602; Royal White, White Systems, of Jackson, Mississippi Consumer Finance Association, Tr. 206; FTC New York Regional Office Study, R-XI-49; Lois J. Wood, Land of Lincoln Legal Assistance Foundation, East St. Louis, Illinois, R-lf-2; consumer complaint letter, R-XI-106; Thomas J. Tahsou, Supervisor, Minnesota Office of Consumer Services, Tr. 2901.


See also, R-XI-DC-12; Mary K. Gillespie, San Francisco Neighborhood Legal Assistance Foundation, HX-224.

Of course, the contract a cosigner signs sets forth the basic fact that the cosigner is liable. Thus, potential cosigners consider the injury that stems from the creditor's failure to disclose by carefully reading the contract document itself. The question is whether, in the circumstances, consumers can reasonably avoid injury by reading and understanding the contract.

The record reveals in these circumstances they cannot. As noted earlier, consumer credit contracts are written in technical language that is difficult for consumer to understand. The record also indicates that cosigners are no more likely than other consumer borrowers to comprehend contract language. Moreover, most cosigners are not provided with copies of the documents they sign or of documents received by the primary debtor. In any event, the entire transaction is often conducted very quickly, leaving little opportunity for the potential cosigner to consider the contract carefully.

In addition, the circumstances under which cosigners are solicited make it unreasonable to expect the potential cosigner to read and consider the contract. Cosigners who might otherwise be attentive to the nature of agreements they enter into may be more cautious when they agree to be cosigners. Cosigners are often sought under circumstances that may make it impossible for a decision in the cosigner's best interest. Many loans in which the credit

creditor seeks a cosigner would not be made if a cosigner is not obtained. Thus, cosigners may be subject to pressure from both the borrower, who may urge urgently the need for a cosigner, and the creditor, who may question the cosigner's loyalty to the borrower if he or she hesitates to cosign. In such circumstances, cosigners may be reluctant to explore fully the legal ramifications of their actions.

Thus, the record establishes that cosigners often incur liability but are seldom informed of their liability. Because they are frequently not aware of the nature and extent of their obligation, cosigners cannot reasonably rely on their general understanding of the transaction to avoid injury. Because the contract itself is difficult to understand and may be available only briefly, consumers cannot reasonably avoid injury by relying on the contract itself. For these reasons, the Commission concludes that cosigners cannot reasonably avoid the injury that stems from the creditor's failure to disclose.

3. Offsetting Benefits.

This record contains substantial evidence that creditors do not now provide cosigners with the information they need to make informed decisions, and that considerable pressure attends the solicitation of cosigners in connection with the collection of delinquent debts. The detriment to cosigners from the lack of information is not offset by benefits to consumers or competition.

Certain benefits may flow to the consumer who is the principal debtor for a cosigned loan, and there may be benefits to competition from the greater number or size of loans which can be extended when a cosigner shares liability for the debt. The rule, by leaving the use of cosigners unaffected, will have no effect on any such benefits. The rule will insure that an informed decision is made prior to consummation of a cosigner agreement.

The primary offsetting benefit of failing to disclose liability is that creditors thereby avoid the cost of making the disclosure. Testimony based on creditor experience, however, suggests that the cost of providing the cosigner with the required disclosure will not be great. Moreover, some creditors testified that they now provide such notices to cosigners or conduct interviews with them.

4. Summary Concerning Unfairness

Failure to disclose produces injury because the extent of liability is a material fact that would likely affect the cosigner's willingness to undertake the

See supra notes 21–22, 43. 45.

E.g., Mel Neusteleode, National Association of Federal Credit Unions, to the Director, CCI Marquardt Federal Credit Union. Tr. 7219–20.

The following creditors stated that they presently interview or counsel cosigners concerning their liability: Mel Neusteleode, National Association of Federal Credit Unions. CCI Marquardt Federal Credit Union. Los Angeles, Tr. 7220–7221; Bernard J. Cunningham, Connecticut Consumer Finance Association and Windsor Locks Finance, Inc., Windsor Locks, Connecticut, Tr. 8564. The following creditors stated that they now give a notice similar to that required by the rule: Merced School Employees Federal Credit Union, Merced, California, R-II(1)–9; The West Bend Co., Wisconsin, R-II(1)–402; Hyman Weimer, Atlantic Finance Co. and California Loan and Finance Association, Tr. 6407; Marcus A. Trewen, Island Finance Corp. of Puerto Rico, Tr. 1359.

E.g., J. M. Tapley, The Harter Bank and Trust Company, Ohio, R-II(1)–236. One creditor suggested that providing the notice would ultimately decrease creditor cost:

"If a cosigner does not have a clear understanding of his obligations and a full and complete acceptance of his obligations, then it makes collection much more difficult and consequently increases collection costs to the creditor. According to a creditor, who does not have a clear understanding of his obligations and a full and complete acceptance of his obligations, then it makes collection much more difficult and consequently increases collection costs to the creditor.

Accordingly, we commend the language in the proposed notice and suggest that even if it is not adopted in the rule that it would be well for creditors to use it voluntarily." Vernon Lemmon, Jr., Texas Finance Institute, Tr. 1021–1022.
obligation. Consumers cannot reasonably avoid injury because lenders do not explain or disclose liability and there are no low cost alternative sources of information. Many potential cosigners might choose differently if they had full information on the extent of their obligation. Consumers cannot understand the nature of cosigner liability is unfair.

D. Deceptive Representations Concerning Cosigner Liability

The record shows that in some instances creditors misrepresent the nature of cosigner liability. A legal services representative described the nature of cosigner liability. Of course, the business is no longer a party and the salesman is most likely gone, and (so then is the cosigner’s money). Similar practices are apparent in the following case history offered by a consumer:

My husband was asked by his brother to sign some papers. I said I didn’t want to get involved with any cosigning. But Dial Manager and [the debtor] said it wasn’t cosigning. It was just a note of agreement to [the debtor’s] character. So my husband signed it. But I still refused to sign. Now Dial is trying to make us pay Dial for the [debtor’s] bill because they claim my husband signed a cosigner note. And can take him to court if he doesn’t pay. They never did give him a copy of what he signed.

The nature of such deceptive practices makes detection difficult, and the rulemaking record does not permit a precise measure of the prevalence of outright deception. Nonetheless, the clear evidence of affirmative misrepresentations which do appear on this record convinces us that deceptive practices in connection with obtaining cosigners are sufficiently prevalent to warrant application of our remedial authority.

The Commission’s authority to prohibit consumer deception in the marketplace is well established. The Commission and the courts have developed an extensive body of law concerning deceptive practices that proscribes misleading conduct. According to these well established principles, Section 5 is violated whenever a creditor misrepresents to a consumer facts that are material to the consumer’s decision.

In evaluating the meaning of a representation and its likely impact on a consumer, the Commission takes into account all of the circumstances surrounding the transaction. Of course, the contract document itself contradicts misrepresentations concerning cosigner liability. As discussed above in the context of our finding that the failure to disclose liability is unfair, however, consumers quite reasonably do not understand the contract document.


See e.g., H. Robert Erwin, Jr., Legal Aid Bureau, Inc., Tr. 10035–37; Vincent Alfara, Summit County Legal Aid Society, Tr. 6038; Lloyd B. Snyder, Legal Aid Society of Cleveland, Tr. 2058; Ben T. Reyes, State Representative, Texas, Tr. 1600BB; Herbert L. Beskin, Charlotteville-Albemarle Legal Aid Society, Tr. 9007–08; John F. Robbert, Louisiana Consumers’ League, Tr. 1956; Alston Steiner, Central Mississippi Legal Services, Tr. 1756.


In Peacock Buick, the Commission disagreed with respondent’s arguments that disclosure obviated the possibility of deception. The Commission noted, “It is clear from consumer testimony that oral deception was employed in some instances to cause consumers to ignore the warning in their sales agreement.” Peacock Buick, 86 F.T.C. 1352, 1558–59 (1974).


86 The Supreme Court has recognized this principle in commercial speech cases. Central Hudson Gas & Electric Co. v. PSC, 447 U.S. 557, 507 (1980).
The rule declares misrepresentation of the nature or extent of cosigners' liability to be a deceptive practice, and the failure to disclose cosigner liability to be an unfair practice. To remedy the unfair practices shown on this record, we adopt a requirement that cosigners be informed, prior to becoming obligated on a loan, of the nature of their liability (§ 444.3(a)(2) of the rule). To stem the deceptive practices demonstrated by the record, we impose a direct prohibition on misrepresentations of the nature or extent of cosigner liability (§ 444.3(a)(1) of the rule), and provide that compliance with the preventive requirement is sufficient to avoid charges that a creditor has engaged in misrepresentations in violation of the rule. To prevent both the unfair and deceptive cosigner practices, we require that the disclosure notice, the text of which is set out in § 444.3(b), be given to potential cosigners.

This scheme of remedial provisions is clearly within the Commission's authority. Section 18(a)(1)(B) provides that Commission rules "may include requirements prescribed for the purpose of preventing" acts or practices declared unfair or deceptive. It is well established that the remedies selected by the Commission to cure the unfair or deceptive cosigner practices must bear a "reasonable relationship" to the practices demonstrated on the record. In Jacob Siegel Co. v. FTC, 66 the Supreme Court set forth the standard for review of remedial provisions of Commission adjudicative orders: "[T]he courts will not interfere except where the remedy selected has no reasonable relationship to the unlawful practices found to exist." The Supreme Court has reaffirmed the Commission's remedial discretion in adjudicative proceedings. 67

The disclosure notice mandated by rule § 444.3(b) is intended to remedy the unfair and deceptive practices shown on the record by providing the potential cosigner with basic information about the nature and extent of cosigner liability. The notice is couched in general terms sufficient to alert potential cosigners of the potential consequences of entering into cosigner status. Language such as "same collection methods" and "your credit record" will alert the consumer to some of the additional potential consequences of cosigning a loan. Thus, this simple summary of the nature and extent of a cosigner's potential liability addresses the unfair practices of failing to disclose such information, as well as the deceptive practice of misrepresentation of the role of a cosigner.

Indeed, commenters endorsed the disclosure notice as necessary to remedy cosigners' lack of awareness of their liability and creditor misrepresentation of the nature of cosigner obligations. 68

F. Alternatives Considered and Modifications Adopted

Because cosigners can be important in making credit available to consumers without a well established credit record, the rule as proposed did not ban their use. Instead, the rule originally proposed by the Commission would have imposed the following requirements:

1. Potential cosigners must be given a plain language explanation of their obligation.
2. Potential cosigners must be given a three day cooling-off period before they obligate themselves.
3. Cosigners must be given copies of all documents they sign or that are given to the principal debtor.
4. The contract obligating the cosigner must provide that:
   a. The creditor must employ "due diligence" in attempting to collect from the principal debtor before seeking payment from the cosigner.
   b. The cosigner's liability is limited to the total of payments owed by the principal debtor at the time the cosigner becomes obligated.
   c. The cosigner must be promptly notified of any default by the principal debtor.

During the proceeding, creditors emphasized the importance of cosigners in making credit available to inexperienced borrowers. 69 They argued that the rule provision would reduce the availability of credit to such borrowers if it made the use of cosigners costly or inconvenient. There was relatively little opposition to the concept of informing cosigners of their obligation. 70 There was strong opposition to the three day cooling-off period, even among cosigner advocates, that it would cause serious inconvenience in making cosigner loans. 71 Creditors also objected to the "due diligence" requirement, primarily on the ground that the term was ambiguous. 72

Various objections were registered to the cosigner provision's application to open-end credit. 73 These concerns are addressed by providing that in open end transactions the disclosure notice be supplied only at the time of the initial extension of credit. 74 We have adopted modifications in that portion of the cosigner rule that we promulgate today to reach other concerns raised during the proceeding, such as paperwork burden.

The Final Rule

Although the record before us documents certain problems in connection with the use of cosigners, and although the Staff Report

70 Post-record comment summary at 198–193.
71 Notes 44–45.
72 Post-record comment summary at 190–193.
recommended a number of modifications in the rule provision initially proposed by the Commission, we are not persuaded that the benefits of those proposals offset their probable costs. The rule we adopt today, providing a cosigner disclosure, will go a long way toward remedying not only the major problem reflected on the record—lack of consumer awareness of the full significance of becoming a cosigner—but also some of the ancillary problems that are, to a large degree, also a function of cosigner awareness.

The rule corrects the problems of cosigner lack of information by requiring that a notice be provided alerting the consumer to the obligations and consequences of cosigning. A disclosure requirement received support from creditors as well as consumer representatives. Robert P. Shay stated that: "...the high incidence of payment being demanded (from cosigners) lends support to those who would urge some form of disclosure ..." (HX-494 at 60).

It is also supported by the Presiding Officer who concluded: "The record of this proceeding supports a requirement that cosigners in consumer credit transactions should be provided by the creditor with a clear and succinct statement of their potential liability." 78

Compliance

This rule does not require that the creditor personally give the notice to the cosigner, but only that it "be given" to the cosigner. Therefore, if the creditor would not otherwise have personal contact with the cosigner, the rule will not require such contact. The creditor can provide the notice through the borrower or by other means such as the mail. However, the creditor is obligated by the rule to assure that the cosigner does in fact receive the notice prior to becoming obligated. If the creditor asks the borrower to give the notice to the cosigner and the borrower does not do so, the creditor will be in violation of the rule. Each creditor may adopt procedures of its own choosing for assuring that the notice is actually received.

The rule specifically requires that the notice be provided in a separate document. The purpose of this requirement is to assure that the cosigner will actually be aware of the notice before becoming obligated. Thus, the notice document cannot be affixed to other documents unless the notice document appears before any other document in a package, and it may not include any other statements, with one exception. Several states already require special notices to cosigners. Those states may apply for an exemption under § 444.5 of the rule. However, if a state does not apply, or if an exemption is not granted, a creditor can still avoid having to provide two separate documents by putting both notices in one, unless the state law forbids it.

Although this is not specifically addressed in the text of the rule, the Commission intends that the notice document may also contain the creditor's letterhead. The information on the letterhead would not distract the cosigner from the notice and, because the notice may very often be the only document retained by the cosigner, such information might prove helpful at a later time. Similarly, if a creditor chooses to assure cosigners obtain the disclosure documents by requesting a signed acknowledgement, the notice document may include a signature line.

We also note that the cosigner disclosure should be provided in the same language as that in which the underlying loan contract is written. Although this is not specifically addressed by the rule itself, failure to provide such same-language disclosures could constitute a separate violation of Section 5.

Open End Credit

Witnesses objected to the cosigner provision in open end credit transactions. They argued that the rule would create confusion upon each extension of credit pursuant to an open end account, making overdraft checking impossible and other forms of open end accounts complicated to administer. 80 The rule we promulgate today has been revised to make it clear that a notice need not be used every time a consumer draws on an open end line of credit.

For open end accounts, the cosigner need only be given a single notice when the account is first opened. The specific language required by § 444.3(b) of the rule has been modified so that it applies when the cosigner guarantees an open end account and may be liable for an amount less than or equal to the line of credit extended.

Definition of Cosigner

Several creditors stated the rule can be evaded by requiring potential cosigners to become co-applicants for credit. 81 We incorporate in the final rule a revision which defines as a cosigner any person whose signature is obtained after the initial applicant is told that the signature of another person is necessary. Creditors should not seek to evade the rule by designating cosigners as co-applicants.

It was thought by some that the definition of cosigner was so broad as to include the principal debtor or an authorized user of a credit card. 82 Recommendations were also made that "compensation" be defined, 83 or that consideration 84 or some other term 85 be used in the definition. Substitution of the term "accommodation party" for cosigner was recommended, as was revising the definition to make it explicit that one who signs in order that another may receive the benefit of the goods or money is a cosigner. 86 It was also suggested that the definition does not make clear whether a person who hypothecates security of a passbook on a loan but does not personally guarantee the loan is a cosigner for the purposes of

**Footnotes**

77 See discussion of rejected provisions in Chapter XII.

78 E.g., Leslie R. Butler, Consumer Bankers Association and First Pennsylvania Bank, Tr. 11582; Vernon Leona, Jr., Texas Finance Institute, Tr. 1023; Carl W. Berg, American Marine Bank, Wa., R-II(d)-8; Mary Caldwell, Ferro Nashville Employees Credit Union, R-II(d)-25; Eva E. Wolf, York Bank and Trust Co., Pennsylvania, R-II(b)-104; T. J. Ryan, Albuquerque Bell Federal Credit Union, R-II(d)-5.

79 E.g., Robert H. Erwin, Legal Aid of Baltimore, Tr. 10228; Gayle C. Williams, Legal Aid Society of St. Louis, Tr. 4512; Pamela Piering, C.A.M.P. Consumer Action Project, Wa., Tr. 6077; Charles Hammond, Arlington County Dept. of Consumer Affairs, Virginia, R-II(h)-12; Lewis Taffler, Alliance for Consumer Progress, Pennsylvania, R-II(h)-4; Ronald A. Gall, Wisconsin Consumers League, Tr. 3578; James L. Sullivan, Director, Department of Consumer Affairs, Missouri, Tr. 4561.

80 See supra note 74.

81 Paul H. Camerlengo, First City National Bank of Houston, R-II(d)-326; Michael Brown, United Auto Dealers Association, Chicago, Tr. 2768-2769.

82 Technical comments by the staff of the Board of Governors of the Federal Reserve Board, HX 451 at 18, 25; William B. Johnson, Sun Oil Company, R-II(b)-496; Russell A. Freeman, Security Pacific Corp., Los Angeles, R-II(d)-335; James Goldberg, American Retail Finance, Tr. 6123.

83 Technical comments by the staff of the Board of Governors of the Federal Reserve Bank, HX 451 at 18; Frederick T. Berkenhe, Administrator Colorado U.C.C.C., HX 251 at 7; Thomas Chandall, Gonzague University Law School, Wa., Tr. 10872-73; Bryce A. Beggett, Oklahoma Consumer Finance Association, Tr. 850.

84 George H. Braasch, Chairman, Subcommittee of the Committee on the Regulation of Consumer Credit—Section of Corporation, Banking and Business Law of the American Bar Association, R-II(1)-328; David H. Pohl, Capital Financial Services, Ohio, R-II(a)-541.

85 T. McLean Griffin, First National Bank of Boston, R-II(d)-54 would define cosigner as "a natural person who without compensation and without an opportunity to obtain credit under the obligation." 86

86 John P. Winston and Walter E. Huizenga, National Automobile Dealers Association, R-II(a)- 501; Lois J. Wood, Land of Lincoln Legal Assistance Foundation, R-I(c)-361.
the rule." One commentator thought that the definition should be modified by the addition of the phrase "whether or not that person was specifically designated on the contract as being a cosigner."

Another felt that cosigner should be redefined as one who enables a consumer to receive goods, services, or money, but does not receive such goods, services or money himself. We reject the recommendation that "consideration" be substituted for "compensation" since applicable cases hold that cosigner agreements are supported by consideration. The use of the term consideration thus would not serve the purpose intended.

We have added language which makes it clear that a person is a "cosigner" under this rule, whatever he or she is called by a creditor, if he or she meets the definition in the rule.

**Modifications to Required Notice**

The proposed rule requires use of a notice advising cosigners of their liability. The industry asserted that the originally proposed notice was too long, unclear, inconsistent with state and federal law, inconsistent with cosigner's rights under other parts of the rule, inapplicable to openend credit, and unnecessarily time consuming because of all the blanks to be filled in. Some commenters felt that other information, especially the fact that the cosigner is being asked to take a risk which the creditor is unwilling to take, should be included in the notice. We have adopted revisions as set out below to meet some of these concerns.

The notice as originally proposed had eight blanks which the creditor would be required to complete. The revised form has none. It is substantially shorter. The detailed recitation of remedies which a creditor could employ against the cosigner has been eliminated since some remedies are not available in all states.

The reference to the contract evidencing the obligation in the final paragraph has been amended to make it clear that it is the contract, and not the notice, which defines the cosigner's obligation.

Finally, Commission action in deleting the non-disclosure portions of the rule removes the possibility of a direct, albeit minor, conflict with certain state laws. A number of states already require informational notices to cosigners whose wording differs from the cosigner notice required by the rule. Because the state notices describe cosigners' obligations under existing law, they might no longer have been strictly accurate if the Commission adopted the parts of the proposed rule which would have substantively altered cosigner obligations.

X. Analysis or Projected Costs, Benefits, and Effects of the Rule

As set forth earlier, the Rule comprises six major components—contract clauses that are prohibited, one accounting practice that is prohibited, and an affirmative disclosure requirement. Each of these elements is, to a certain extent, separagable from the whole for the purposes of analyzing projected costs, benefits, and effects of the rule.

However, many of the projected costs and, to a lesser extent, benefits of the rule may not be readily separagable, and therefore are more appropriately attributable to the rule as a whole, rather than to any particular element of the rule. These benefits and costs are likely to arise from the impact on the market of the entire rule, rather than from the impact of any one element.

The costs and benefits attributable to the individual provisions of the rule are discussed in Chapters IV-IX, supra. The costs and benefits of the interrelated parts of the rule as a whole are discussed here.

A. Costs

Most commenters who opposed the rule argued that it would increase credit costs by either increasing the price of credit (because consumers would demand more of a more attractive product and creditors would supply less of it) and/or decreasing the availability of credit, especially for the marginal risks (because of stricter screening of the applicant). These commenters stated that such increases in costs to creditors would outweigh whatever benefits consumers and competition might obtain from the rule. The record for the proceeding establishes, however, that the rule will not have a major impact on either the price or availability of credit.

1. Econometric Studies

Comprehensive econometric analyses of creditor remedies, interest rates, and amount of credit extended were prepared for the rulemaking record. The results of these studies were consistent with the experience in the states, described below.

The first study was a detailed and thorough examination of the theoretical economic implications of the rule and the empirical work done by the National Commission on Consumer Finance that evaluated these implications with reference to the existing consumer credit market. This study defined the economic issues raised by the rule, evaluated the empirical work that predated it, defined a microeconomic model of the consumer credit market, and suggested further empirical work in the area to answer the fundamental questions about the effects of restrictions on creditors' remedies on credit cost and availability.

The report contains a variety of important conclusions based on an examination of the data bases compiled by the technical staff of the National Commission on Consumer Finance. It found, for example, that there is no significant relationship between interest rate ceilings and rejection rates. It also found no significant relationship between prohibition of creditor remedies and rejection rates. In short,
there appeared to be no significant correlation between permissible creditor remedies and creditor willingness to extend credit to consumers.

In a second study, Professors Barth and Yezer developed a simultaneous econometric model for the consumer credit market. This model relies on individual, discreet loan transactions. Having developed the model, Barth and Yezer ran three series of regressions using data obtained from FTC investigations and data obtained from the National Consumer Finance Association.

Early problems with compiling an accurate table of state laws were eliminated in later versions of the study, which were presented in hearings on the rule. Using different data bases after problems with the state law data were eliminated, Barth and Yezer achieved consistent results. During the hearings, the NCFA introduced a large data base covering thousands of recent consumer loan transactions. Barth and Yezer ran a final version of their study using this data base.

In their final study, Professors Barth and Yezer concluded that the percentage point estimate for the rule’s effect is a 19/100’s of 1 percent (0.192%) increase in credit costs. Even this estimate may be too high because it compares a hypothetical laissez-faire state having no remedy restrictions with the same state having nearly all of the originally proposed restrictions. As noted, we have determined not to adopt several of the original staff recommendations, and we have significantly modified and refined several of those which we do adopt. Although the specific point estimates with respect to the impact of the rule on credit cost should be viewed as indicative of range or order of magnitude and not a precise estimate, the Barth-Yezer studies demonstrate that the impact of the rule on credit cost will be "clearly negligible."

During the course of this proceeding, the econometric studies—in particular the Barth-Yezer studies—which were the subject of considerable scrutiny and critical analysis, The Commission looked closely at the overall economic evidence, and focused on the Barth-Yezer work, during our final deliberations on the rule. We are cognizant of the limitations of the econometric studies. The studies represent, however, the most sophisticated analyses available on the record.

We have given careful consideration to the econometric evidence assembled on this record, particularly the latter studies of Professors Barth and Yezer. Our review has led us to consider that the econometric evidence does not, of itself, permit a definitive finding concerning the net costs or benefits of the rule as a whole. The relatively small magnitude of effects indicated by the econometric evidence does permit us to be reasonably certain that the effect of the rule will not be unduly large in either direction. Our conclusion in this regard has led us to look more closely at the other available evidence on the rule as a whole and as to each provision.

2. Experience in the States

There exists a large body of experience with restrictions on creditor remedies in consumer transactions. Most states already have laws similar to one or more of the provisions of the rule. During the rulemaking proceeding, three states were identified that have legal remedies in consumer transactions. These states were identified that have legal remedies in consumer transactions. These remedies are not legislative waivers of exemption and cosigner provisions. Thus, the study demonstrates that individual remedies cannot be evaluated except as a group.

The Barth-Yezer regressions using FTC and NCFA data reveal that the impact of individual provisions of the rule on credit cost is not significantly different from zero. Barth and Yezer consider that all the remedy variables must be viewed together, and that the study demonstrates that individual remedies cannot be evaluated except as a group.

State experience was examined intensely during the rulemaking proceedings. Statistics on credit markets in different states were collected by FTC, state regulators, and other sources. Comparisons were made between market conditions in states with laws similar to the proposed rule and other states. Although there is some state to state variation, these comparisons reveal no systematic differences between states that have restricted remedies and the other states. Interest rates in reform states tend to be lower than in representative states that do not restrict remedies covered by the rule. Borrower income and default rates were lower in reform states than in non-reform states, while borrower debt levels tend to be higher. Overall, there are no apparent negative impacts on cost where credit reform laws have been enacted.

Another source of information on state experience is comments and testimony by state regulators, creditors, and other persons from states that have adopted laws similar to the rule. In some instances these individuals accompanied their testimony with statistics, for example, on market conditions before and after a credit reform law took effect. Although occasional negative effects were noted, the consensus was that the state reform laws had not interfered with creditors’ business. No significant

10. See especially Staff Report at 525. See also Staff Report at 540 note 177, and 517; R-XIII-30 (state by state breakdown of NCFA survey data). Most of these comparisons used NCFA data on finance company loans and not retail credit. The market conditions in states with NCFA data are the market segment where adverse effects of the rule would be most apparent because finance companies deal with higher risk borrowers and make greater use of these remedies than do other creditors.


12. Testimony by these witnesses is summarized in detail in the Staff Report at 501-522.

13. E.g., Clarence P. Bleier, Wisconsin Finance Corp., Tr. 3481-83 (but see Robert P. Shay, HX-494 at 24); Thomas H. Huston, Iowa Banking Dept., Tr. 2289-91 (reports small increase in collection cost primarily attributable to an Iowa law provision not contained in rule). See also discussion of Credit Research Center Studies of Wisconsin Consumer Act in Staff Report at 544-546.

14. E.g., Richard A. Victor, Wisconsin Department of Justice, Tr. 4018-17; Robert A. Patrick, Office of Wisconsin Commissioner of Banking, Tr. 4037-38, 4044, R-[E]-109 at 1; Tucker K. Trautman, Colorado Dept. of Law, HX-502 at 3, Edward J. Heiser, Jr., Wisconsin Consumer Finance, HX-252 at 6; Robert C. Focht, Connecticut Banking Dept., Tr. 11525; Diane Cadrain, Connecticut Citizen Research Group, Tr. 10809; Kathleen Keest, Blackburn County Legal Aid Society, Tr. 4207. See also President’s Office Report at 340. 

15. See supra notes 5-6.

16. See, e.g., FTC Comments, R-XV-343 at 54-56; see also memorandum of April 4, 1983 from Timothy J. Maris, Director, Bureau of Consumer Protection, at 18-24; memorandum of the Bureau of Economics, April 5 and 7, 1983.

17. Professors Barth and Yezer made oral presentations before the Commission and were questioned by the Commissioners. See "Oral Presentations by Public Representatives", June 6, 1983, Tr. 51-123.

18. See, e.g., Murius memorandum, supra note 9 at 24, citing Staff Report at 527-39.

19. Wisconsin, Iowa and Connecticut. Because the final rule has detailed a significant number of the initial proposals, a larger number of states could now be said to have existing restrictions similar to the final rule.

20. Testimony by these witnesses is summarized in detail in the Staff Report at 501-522.

21. E.g., Clarence P. Bleier, Wisconsin Finance Corp., Tr. 3481-83 (but see Robert P. Shay, HX-494 at 24); Thomas H. Huston, Iowa Banking Dept., Tr. 2289-91 (reports small increase in collection cost primarily attributable to an Iowa law provision not contained in rule). See also discussion of Credit Research Center Studies of Wisconsin Consumer Act in Staff Report at 544-546.

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benefits received by consumers from restricting one or more of these remedies would offset any decrease in credit availability or increase in credit costs that may result. Although many of the benefits of the rule are properly addressed in the context of the individual provisions, a general overview can be made.

Because defaults are likely beyond the debtor’s control, the benefits of the proposed restrictions would be potentially available to any consumer. No one is so free from the possibility of loss of employment, large medical expenses, marital discord, etc., that the rule might never provide benefit. The benefits to all consumers can thus be analogized to insurance, in some respects.

Many of the rule’s benefits are difficult to evaluate monetarily, such as: procedural due process protections; the opportunity to assert valid claims and defenses; less economic distress and disruption of family finances; less embarrassment, humiliation, and anxiety; less interference in employment relations; retaining personal possessions and household goods; protection against coerced settlements; and well informed cosigners. Nevertheless, consumers place a value on such benefits (e.g., less emotional distress). Their willingness to pay for contracts that reduce these possibilities is the measure of these benefits.

Other benefits are more susceptible to an estimate of monetary value for individual consumers. These benefits include: fewer costly refinancings; less loss of equity in property; goods remaining in the hands of the party who values them more highly; and fewer additional delinquencies “triggered” by one creditor filing a wage assignment.

C. Summary

In assessing the costs and benefits of this rule, the Commission must be guided by ranges and magnitudes and not precise dollar estimates. There is no means available to prepare precise, dollar point estimates of the costs and benefits of curtailment of creditors’ remedies. This is because these costs and benefits are small, when factored into any precise empirical model that endeavors to define the array of factors which influence credit extension decisions. Moreover, the rule does not affect the most valuable creditor remedies, including garnishment, self-help repossession, direct debtor contacts and the like. Nor does our final rule address several creditor remedies encompassed in the original proposal (and upon which all aggregate impact assessments are based), e.g., deficiencies, attorneys’ fees, etc.

Although any restrictions on creditor remedies have cost implications, factors other than these six remedies predominantly determine costs and availability. The most important factors are: (1) The cost of money to the creditor, (2) the consumer’s present income, existing debt level, and capacity to incur further debt, (3) the possibility of the consumer being a repeat customer, (4) the creditor’s opportunity costs, (5) the applicable interest rate ceilings, (6) the availability of other fees and charges, (7) the availability of the most useful creditor remedies, (8) the principal amount of the loan, etc. Aggregate economic conditions have an effect as well. Thus, any assessment of the rule’s potential effects on credit costs or availability must start from a position that the remedies involved have little effect relative to the major determinants of cost and supply. Although this is not, in itself, evidence of the net effect of the rule, it does provide a context for assessing the expected impact of individual rule provisions, discussed in relevant chapters above.

The benefits of this rule also cannot be quantified precisely. At issue is the treatment of borrowers and their families when serious financial problems occur. The record contains extensive evidence that the specific remedies at issue here are a direct cause of substantial consumer injury, that consumers cannot reasonably avoid such injury, and that the injury is not offset by other benefits, either to consumers or to competition. The record contains evidence of the use of challenged remedies and the effect of such use on consumers and their families. Much of this evidence is quantitative in nature.

XI. Impact on Small Business

In the course of this proceeding certain creditors argued that the rule will injure small businesses.2 Our review


Throughout this proceeding, the rule has been revised, modified, and otherwise narrowed to leave intact those remedies demonstrated to be of greatest value to creditors. The original April 19, 1974, staff memorandum recommending the rule excluded self-help repossession from the proposal in part because of its importance to creditors. During the proceeding the staff recommended revisions in the rule so as to not interfere with non-household goods security interests and non-claimed late fees and extension charges. See Staff Report at 244-245 and 364-366. We have further narrowed the household goods proviso. Finally, we deleted provisions covering third-party contacts, deficiencies, attorneys fees, cross-collateral clauses, and substantive qualification of cosigners.

See supra Chapter II.

In their second economic study for this proceeding, Proffers Burh and Yezer assessed the rule’s potential benefits by calculating consumers’ willingness to pay higher rates for contracts with fewer creditor remedies. The study concluded that consumers were willing to pay up to an additional 7.18 percent APR for more favorable contract terms. This study was based on FTC-subsidized data, an admittedly unbiased data base. The last study, using NCPA supplied data, did not estimate consumers’ willingness to pay. No other evidence measured this factor.
More specifically, with respect to this rule the record contains evidence that many small creditors need to rely less on the contractual provisions and non-contractual practices addressed by the rule than large multi-office firms. Several operators of one and two office finance companies testified on their strong community ties, histories of courteous personal service to successive customers, and effective "notice and phone call" collection programs. Thus, small finance companies tend to rely less on the practices addressed in the final rule.

On the other hand, major national finance chains have high turnover rates in office personnel, uniform procedures for handling minor delinquencies and serious defaults, and generally deal with their customers on a less personal basis than small independents. The more personalized approach to collections that is possible with smaller creditors in many cases can serve as an effective substitute for formal remedies.

The National Commission on Consumer Finance survey results suggest that smaller banks and single-store retailers tend to rely less upon many of the contractual provisions and practices affected by the rule than larger firms. While there has been a long-term declining trend in the role of small finance companies this trend is attributable to causes other than regulations on creditor remedies. The record, taken as a whole, does not indicate that the rule will have a disproportionate effect on smaller creditors.

### XII. Relation Between The Rule and State Law

The rule has been drafted to be as consistent with existing state laws as possible. Indeed, state laws served as the model for several rule provisions. The rule prohibits practices that are authorized by statute or common law in at least some states. However, none of the rule provisions preempt state law by creating an irreconcilable conflict. That is, creditors will be able to comply with both state law and this rule.

Under the law governing preemption, state legislation that imposes requirements not inconsistent with the rule will remain in effect, whether or not states seek exemption. Therefore, where state regulation is more stringent than the rule, compliance with the rule will not immunize creditors from state enforcement.

Two remedies prohibited by the rule, wage assignments and confessions of judgment, tend to be included more frequently in the form contracts of single-state (compared to multi-state) finance companies and retailers. At 53-55, 65-66. This result may be explained in part by the widespread state restrictions imposed upon these remedies which necessarily limit their importance to any company operating on a national scale. The frequency of inclusion of these two remedies in bank contracts did not differ significantly between large and small banks in the NCFR survey. At 51, 94. Another reason for this phenomenon may be that the larger credit operations afford more expensive, formal collection methods. A.

Paul Smith, Vice Dean of the Wharton School, identified low commercial loan interest rates as "the most important" source of difficulty for small finance companies. Tr. 8494. By the same token, Dr. Smith pointed out that large finance companies are able to obtain capital at lower rates than small firms. Tr. 8495. He also stated that increasing competition from banks and credit unions and economies-of-scale in large, multi-branch operations have contributed to decreases in the number of independent firms. Tr. 8494-95. In his testimony, Dr. Smith did not allege that regulatory restraints have undermined the competitiveness of large, independent firms.

The rule has been drafted to be as consistent with existing state laws as possible. In a direct conflict. See, e.g., Statement by the Commission in Hearings on S. 986, 92d Cong., 1st Sess. 45 (1971) at 15; Florida Lime & Avocado Growers, Inc. v. Paul, 573 U.S. 132, 141 (1963). Florida Lime held that for Federal law to preempt there must be "such actual conflict between the two sets of regulations that one set will prevail in the same area," or "evidence of a congressional design to preempt the field." No evidence of a design to preempt the field of creditor remedy regulations is present in either the Federal Trade Commission Act or the rule.

### Table: Number of Finance Companies by Size

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requirements. We have, however, adopted a provision (Section 444.5) that affords an exemption in favor of states whose laws are substantially equivalent to, or more protective than, the rule to apply for specific exemption from the rule. This provision can be invoked with respect to any provision of the rule, but we are particularly mindful of the states’ role in defining what items are considered necessities, in the context of the state’s household goods definition.

Under §444.5, the rule will not be in effect in a state to the extent specified by the Commission only if: (1) Application for an exemption is made by a state; (2) there is a state requirement or prohibition in effect that applies to any transaction to which a rule provision applies; and (3) the state shows that its provision provides a level of protection that is as great as, or greater than, the protection afforded by the rule provision. If an exemption is granted, it shall be in effect only for as long as the state administers and enforces the state provision effectively.

As set forth in §444.5, the Commission will determine the appropriate relationship between the rule provisions and state provision on a case-by-case basis in the context of an exemption proceeding conducted pursuant to §1.16 of the Commission’s Rule of Practice. The Commission will evaluate appropriate petitions for exemption made by state governmental agencies to determine the level of protection to consumers and whether the state regulation is administered and enforced effectively.

The requirement in §444.5 that a comparable state requirement be “substantially equivalent” to the Commission rule provision does not, in our view, require that the state requirement mirror exactly the Commission provision. Any differences that exist, however, should be minor so as not to deprive consumers of the level of protection guaranteed by the Commission rule nor to complicate significantly compliance by interstate creditors.

Other factors that will be considered by the Commission in determining whether an exemption is warranted include the resources committed by the state to enforce its provision and the extent of any private rights of action available to aggrieved consumers.

Only state governmental entities may request exemptions from provisions of the Commission’s rule under §444.5. The grant of an exemption based on state requirement will necessarily place on the state the primary burden to enforce its provision. Therefore, a decision to seek exemption should be made solely by the state entity involved.

In a number of instances, participants in the proceeding indicated that the rule might conflict with state law, or interact with state law in a confusing or unforeseen way. We have adopted modifications in the rule to eliminate these problems.

In response to concerns expressed by state officials and others, the Commission takes this opportunity to make clear that the rule is not intended to occupy the field of credit regulation or to preempt state law in the absence of

For example, we have excluded certain wage assignments from Section (a)(3) of the rule because of possible problems with the California Personal Property Brokers law. clarified Section (a)(2) on waivers of exemption to avoid problems with mortgage laws in certain states, and significantly scaled back §444.5 on late fees in such a way as to avoid conflict with state laws on late fees. See generally the sections of this Statement on individual rule provisions.

E.g., Tucker Trautman, Colorado Assistant Attorney General, HS-252 at 5-12; Richard Gross, Massachusetts Assistant Attorney General, Tr. 10628; Richard Assistant Attorney General, HS-151; Robert Patrick, General Counsel, Wisconsin Office of Commissioner of Banking, HS-152 at 8.

E.g., National Consumer Law Center, R-I(a)-103 at 10-11; Jonathan Epstain, Essex-Newark Legal Services, Tr. 8647; Michael Burns, Legal Aid Society of Minnesota, HS-48 at 13; Terry Friedman, Western Center on Law and Poverty, Tr. 6537; Ronald Cull, Wisconsin Consumer League, Tr. 3976-77; Mary Gillespie, San Francisco Neighborhood Legal Assistance Foundation, Tr. 5589-89.

For purposes of this rule, a state requirement or prohibition could include statutes and formal state regulations. It would not include informal enforcement policy statements.

For purposes of this rule, a state requirement or prohibition could include statutes and formal state regulations. It would not include informal enforcement policy statements.

XII. Empirical Evidence on the Benefits and Costs of Provisions Considered by the Commission But Not Adopted.

This section discusses the benefits and costs of provisions of the 1975 proposed rule that the Commission considered but did not accept, together with analysis of a disclosure alternative considered by the Commission during its final deliberations on the rule.

A. Deficiencies

A deficiency arises when repossessed collateral is sold for less than the amount owing on a debt. The Commission has considered but rejected a provision that would have required valuing collateral other than household goods at its retail price for purposes of calculating deficiencies. The provision would have required an election of remedies in the case of household goods collateral, requiring creditors to choose between repossession or suit.

1. Prevalence

Sizeable deficiencies occur in the majority of transactions involving automobile repossessions; average automobile deficiencies range from 25 to 50 percent of the balance owing at the time of default. Little evidence addresses deficiencies for other types of collateral. Creditors apparently pursue a deficiency only infrequently, and on average creditors recover no more than 5 to 15 percent of the deficiency. As the Presiding Officer noted, under these circumstances creditors have an incentive to obtain the best possible price, net of sales costs, for collateral. Therefore, there is, therefore, insufficient evidence that problems in the valuation of collateral are prevalent.


E.g., Schmidt, Tr. 6194; GMAC, R-I(a)-812 at 10; Brown, Tr. 2777; Martin, Tr. 1143, 1154-55; Marsh, Tr. 2519-20.

Presiding Officer’s Report at 250.
2. Benefits

The benefits of an election of remedies requirement in repossession of household goods would be similar in nature if not magnitude to those that would result from the provision to prohibit non-purchase money security interests in household goods. When a deficiency is pursued, a requirement for valuation at the retail price would benefit borrowers, because normally resale would take place at the lower wholesale value. In the event of abuse, resale may take place below wholesale value.

Retail valuation thus raises two issues. The first is the requirement to credit consumers with the retail rather than the wholesale value of repossessed collateral before pursuing a deficiency. The second involves any remaining problems in cases where consumers are credited with less than the wholesale value of the goods. These issues will be addressed before considering the benefits and costs of the provision.

The difference between retail and wholesale prices is a result of the costs of retailing. The Commission concluded that it is not unreasonable for defaulters to bear the costs of retailing repossessed collateral and that sales at wholesale prices are therefore not inherently unfair. When retailers sell repossessed collateral themselves, they normally do sell it on the retail market.4

The fact that repossessed cars are sold for prices below wholesale book value 5 can often be explained by differences in the condition of repossessed cars and the average “good” used car, and hence there is little basis for concluding that undervaluation of collateral is prevalent.

The record does, nevertheless, reveal some problems in valuation of collateral when the creditor and the buyer are closely related. When the creditor sells the car to itself or in a “sweetheart” deal, there is an incentive to undervalue it to the extent that recovery on a deficiency is possible. However, the evidence does not indicate that such undervaluations are prevalent, and they frequently violate existing state law. The U.C.C. requires that collateral be disposed of in a “commercially reasonable” manner. As the Presiding Officer noted, a valuation requirement “is not a self-executing remedy. To secure benefits, consumers must resort to the courts just as they must do to insist that sales of collateral under current laws are made in a commercially reasonable manner. In view of reluctance or inability to take this action shown by the record, the provision will be largely ineffective.” 8

We therefore conclude that a case-by-case approach to enforce existing standards of valuation in the event of abuse is preferable to a rule that would restrict the legitimate use of deficiencies.

3. Costs

To the extent that these provisions would reduce recovery on deficiencies, or restrict repossession of household goods used as collateral for installment credit or purchase money loans, they would reduce the value of collateral to creditors and hence increase creditors’ costs and losses due to defaults. In addition, the determination of retail value and the allocation of selling costs would increase such costs for creditors as well as enforcement agencies.9 These costs would be especially great if a vehicle required extensive repairs or was resold several times before its eventual retail disposition.

Furthermore, the retail value provision could create perverse incentives. Some debtors might intentionally default on their loans in order to obtain free retailing services, the costs of which would be imposed on creditors.10 The rule would also create incentives for creditors to enter retailing even though costs might be lower if more efficient retailers were used.11

4. Commission Decision

A majority of the Commission decided that this provision would impose costs, and could limit credit or reduce the availability of credit, in excess of offsetting benefits. Creditoring debtors with the wholesale value is not unfair when a higher price is not obtained, there is little evidence of prevalence concerning valuation below the wholesale value, and such valuations are already illegal under current standards. Our decision is consistent with the Presiding Officer’s findings concerning the retail value provision.12

B. Attorney’s Fees

The Commission considered but rejected a provision prohibiting credit

contract clauses requiring that debtors pay attorneys’ fees incurred by creditor in debt collection.13 This provision would not have restricted the power of the courts to impose such fees on defaulters under state law, however. Consequently, the provision might have had little effect in some states.14

1. Prevalence

A large majority of the states permit attorneys’ fees clauses, although some ban them on small loans and/or place limits on the size of the fees.15 Record evidence indicates that such clauses are included in the great majority of contracts when they are permitted by state law.16 Attorneys’ fees represent a significant share of the average judgment.17

2. Benefits

The rationales offered for this provision were that attorneys’ fees exceed actual costs, that consumer liability for attorneys’ fees discourages the assertion of valid defenses, and that consumer liability reduces creditors’ incentives to minimize their legal costs.

The evidence shows that the attorneys’ fees assessed against defaulters generally reflect what attorneys charge creditors for their services.18 The evidence also shows that in some specific instances, what attorneys charge creditors for their services bears little relation to the amount of work performed and may appear excessive. However, this is explained by the way attorneys are paid, e.g., a percentage of the unpaid obligation,19 and does not imply that

One version of the provision would have allowed exceptions where attorneys’ fees are payable to the prevailing party or require a judicial determination that they are reasonable based on the value of services performed. The Commission rejected this version because it was not supported by the record. A provision that attorneys’ fees are to be paid by the losing party would have little impact, because debtors have default judgments entered against them in the vast majority of cases. Nothing would be gained from a requirement of judicial determination of reasonableness, because the evidence discussed below suggests that attorneys’ fees assessed against defaulters are already subject to state requirements of judicial review for reasonableness.

10 Presiding Officer’s Report at 322.
13 The NCLC survey indicates legal aid attorneys believe the average is 20 percent. H-X-467, H-X-469. The record contains references to figures of 5 to 23 percent in individual cases; e.g., Baker, H-X-443 at 1-2; Baker, H-X-444 at 5-11; Peer, H-X-5434; Presiding Officer’s Report at 180.
14 E.g., Hollister, Th. 7001-02; Webman, Th. 9091; Kushal, H-X-388 at 13-18; Goldberg, Th. 8119, 8139-37; Levenstein, Th. 8353; Nestlerode, Th. 7207.
15 Presiding Officer’s Report at 180.
debtor's overcompensation to creditors. As
the Presiding Officer found, on average,
"attorneys' fees, as limited by state
laws, do not fully reimburse creditors
for the amounts they actually expend for
such fees." 20

This provision would benefit
borrowers to the extent that, in the
event of default, it would increase their
bargaining power with creditors and
reduce the size of the judgments against
them.

Because this provision would reduce
the expected cost of defending a
lawsuit, under some circumstances it
would provide benefits by encouraging
the successful assertion of valid
defenses. The record contains evidence
of instances in which a debtor agreed
not to assert a defense in return for the
creditor's agreement to waive attorney's
fees. 21 The decision to reach a
settlement reflects a mutual interest in
minimizing legal costs. Although an
attorney's fees clause could affect the
terms of settlement, it would not
necessarily affect the probability of a
settlement. In any event, the
Commission shares the Presiding
Officer's conclusion that the "use of
attorneys' fees clauses to persuade
consumers to pay debts they do not owe
or to forego valid defenses is simply not
supported by the evidence in this
record."22

The suggestion that this provision
would provide benefits by encouraging
creditors to limit their legal costs is not
sufficiently supported by the record. As
with deficiencies, creditors have an
incentive to minimize attorneys' fees and
other collection costs, because
generally they are not fully reimbursed by
defaulters.23

3. Costs

As is the case with any measure that
reduces the costs of default to the
borrower, the attorneys' fees provision
might increase creditors' collection and
other costs. In the event of default and a
judgment, what borrowers would gain in
reduced judgments as a result of this
provision, creditors would lose in
reduced recoveries. In addition, if the
provision did encourage the assertion of
defenses, total legal costs would rise.

4. Commission Decision

After weighing the record evidence, the
Commission determined that the
costs of this provision outweigh the
benefits. This is consistent with the
conclusion of the Presiding Officer that

"...the record does not permit an
objective determination that the degree
of consumer injury is sufficient to justify
prohibiting the inclusion of attorneys' fees
clauses in consumer credit contracts." 24

C. Third Party Contacts

The Commission considered but
rejected a provision to prohibit creditor
contacts with third parties except to
locate the debtor, to determine the
nature and extent of the debtor's income
or property, or as a court permits.

1. Prevalence

Record evidence indicates that many
consumer credit contracts contain
provisions expressly waiving the
debtor's right to privacy or otherwise
permitting third party contacts. At the
time credit is extended creditors often
obtain names of employers, relatives,
friends, and neighbors. 25 Fifteen states
limit third party contacts, and two
prohibit them. 26

The NCFA survey of finance company
contracts indicates that third party
contacts with employers in the case of
delinquency occur in 1.5 percent of
personal loans and 0.23 percent of sale
finance contracts. 27 The percentage
increases to 5 percent for loans
delinquent 60 days or longer. Some of
these contacts are incident to wage
assignments and garnishments. 28

The NCFA survey shows that contacts with
third parties other than employers are
more frequent, occurring in 12
percent of personal loans and 6 percent of
sales finance contracts, and
increasing to 55 percent of personal
loans which have been delinquent for 60
days or longer. 29 Almost half of these
contacts are with relatives of the debtor.
The vast majority are to locate or leave
a message for the debtor. Nonetheless,
the survey reveals that about 5 percent
of these contacts are to seek collection
from a third party. 30

The record does not contain evidence of
widespread abusive third party
contacts. In the case of creditor contacts
with a debtor's employer, it is in the
creditor's interest refrain from abusive
conduct because to do otherwise might
jeopardize the debtor's earnings. 31

2. Benefits

This provision would benefit
borrowers to the extent that it would
reduce the ability of creditors to apply
pressure to them in the event of default,
reduce contacts with employers that
might endanger debtors' jobs, reduce
loss of privacy, or otherwise reduce
abusive contracts. Examples of such
abuses shown on the record include
threats to reveal information to third
parties, disclosures of information to
third parties that amount to gross
invasions of privacy, threats against
third parties, or threats against debtors
conveyed to third parties.

The provision requiring a contract
clause ruling out third party contacts
would produce few benefits because of
enforcement problems. In the event of a
prohibited third party contact, the
debtor would have to sue for breach of
contract, and the remedy would be
limited to actual damages. It is unlikely
that much litigation of this type would
occur, because the large majority of
judgments against debtors are taken by
default. 32

3. Costs

In some cases, the restriction on third
party contacts could work to the
detriment of debtors because these
contacts may currently prevent the use
of more onerous collection methods. 33

This provision would increase
creditors' collection costs and perhaps
losses due to default. Many contacts are
efficient, legitimate business procedures,
.e.g., contacts with third parties who
might posses the collateral or contacts
with other creditors for purposes of
instituting bankruptcy proceedings. 34

A general prohibition on the third party
contacts of the type contemplated by
this provision as proposed would
inevitably prevent some useful contacts
because of problems in drawing a clear
line between abusive and legitimate
contacts.

4. Commission Decision

The majority of the Commission
decided that the costs of this provision
outweigh its benefits. We consider that
a case-by-case approach is more
appropriate to stem abusive third party
contacts.

20 Caplovitz, Consumers in Trouble: A Study of
Defaulting Debtors, at 100. and Warner, reporting
results of 6 U. Comm. L. Rev. 412 study, Tr. 8363-04.
Because of this problem, we also considered a
direct prohibition on third party contacts. Even with
this change, the provision was rejected because of
its other costs, particularly interference with
legitimate contacts.

21 E. G. Schmit, Tr. 6199-6200; Tanner, HX-174 at
15; Thomas, Tr. 9193-95.

22 E. G. Childers, Tr. 1188-87.
contacts without restricting legitimate contacts. In this decision, we departed from the findings of the Presiding Officer, who concluded that any potential benefit from third party contacts was “completely outweighed” by the potential for consumer injury.37

However, the Presiding Officer did find “a clear necessity for redrafting this provision of the rule so as to permit the creditor use of third party contacts that have a genuine business purpose.”38 We concluded that because of the difficulties of distinguishing contacts that are injurious from those that are beneficial, case-by-case enforcement against contacts that cause injury to consumers is a more cost-effective approach.

D. Late Charges

Another proposed rule provision that we rejected would have prohibited late charges, that is, fees assessed for late payments above and beyond interest on the late payments.

1. Prevalence

Consumer credit contracts almost universally provide for the assessment of late charges, and such charges are usually levied when payments are late.39 The amounts of these charges are limited by federal and state laws.40

2. Benefits

Borrowers would be better off in the event of delinquency if late charges could not be assessed. However, in the absence of pyramid ing there is no evidence of creditor abuse in imposing late charges.41 In general the charges assessed do not fully compensate creditors for the extra costs of handling delinquent accounts.42

3. Costs

Late charges serve a dual purpose. They provide an incentive to the debtor to make payments on time, and they partially compensate the creditor for the additional costs involved in collecting delinquent payments. Creditors receive a significant amount of income from late charges.43 Without late charges a debtor could effectively convert a precomputed installment contract or loan into open-ended credit. This could create serious portfolio problems for a creditor, and in particular would increase the risks related to changes in interest rates and matching of the terms of assets and liabilities. To prevent this problem, a creditor would have to declare a default and accelerate the due date of the entire balance. Such a choice would injure consumers rather than help them.

4. Commission Decision

The Commission concluded that the costs of the proposed provision outweigh the benefits. The benefits to borrowers would not be sufficient to offset the adverse effects on the cost and availability of credit. This is consistent with the findings of the Presiding Officer: “there does not appear to be any economic justification for [this provision of] the rule, at least from the standpoint of the consumer.”44

E. Cross-Collateralization

Cross-collateralization occur when goods purchased from a retailer on credit are used to secure credit extended for subsequent purchases until the account is cleared. A provision of the proposed rule which we decided not to promulgate would have restricted cross-collateral clauses in installment sales contracts. Essentially, the provision would have required first-in, first-out accounting for credit contracts covering multiple purchases.

1. Prevalence

Cross-collateral clauses are allowed in all but two states; however, another 18 states mandate a first-in, first-out accounting principle similar to the one specified by the proposed provision. Another 18 states mandate an accounting principle, based on proration of payments, which would have been prohibited by the proposed provision.45

The NCLC survey of legal aid attorneys and other evidence suggests that cross-collateral clauses are often used by retailers, particularly by sellers of furniture and appliances, in states where they are permitted.46 However, this evidence is not systematic, and there is insufficient evidence in the record to permit an estimate of the frequency with which such clauses appear.

Also, a majority of the Commission found that there is insufficient evidence that cross-collateral clauses cause any notable degree of consumer injury. There is some evidence that use of such

provisions by major retailers has not posed problems for consumers.47

2. Benefits

Borrowers would probably be better off in the event of default if cross-collateral clauses were restricted, because the amount of collateral subject to repossess would be reduced. However, little is known about the accounting schemes that would be used by creditors if cross-collateral clauses were prohibited or about their implications for consumer debtors.

3. Costs

This provision could significantly reduce the value of purchase money security interests. No payments would be allocated to reducing the principal owed on the most recent purchase until all earlier purchases are paid off. If preceding purchases were not paid off until a year after the most recent one, for example, the only security for the entire amount of the credit extended for the most recent purchase would then be a year-old appliance or piece of furniture.48

4. Commission Decision

In light of the fact that the record does not permit a finding regarding the prevalence of cross-collateral clauses or the prevalence of consumer injury, and because the record does suggest important costs that would result from restriction of security for retail credit sales, a majority of the Commission concludes that the benefits of this provision would not outweigh its costs.49

F. Other Cosigner Provisions

One provision of the originally proposed rule that a majority of the Commission decided not to accept would have required a three-day waiting period before cosigners could obligate themselves;43 another would have limited cosigner liability; another would have required that the creditor provide the cosigner with copies of all documents signed by the cosigner and all documents furnished to the debtors; another would have required the creditor to notify the cosigner whenever the debtor became delinquent;50 and

44 E.g., Tarpley, Tr. 3783-85; Halliburton, R-I(c)-29 at 8-7.

45 Korten, R-I(a)-240.

46 In this decision, the Commission departed from the conclusion of the Presiding Officer. Presiding Officer’s Report at 316-317.

47 In the latest version, this was restricted to cases where the debtor was already in default. See Staff Report at Appendix A, p. 5.

48 In the latest version, this was restricted to delinquencies of 30 or more days. Id. at 5-6.
another would have required that the creditor reduce a claim to judgment before seeking payment from the cosigner.

1. Waiting Period

The rationale for the waiting period was primarily the possibility that creditors might use high pressure tactics to secure cosigners, especially in situations where the loan is already in default. The record contains some evidence that such tactics are used, 51 but there is insufficient indication that their incidence is significant. 52 None of the states appear to require such a waiting period. 53

The provisions would impose two costs every time a cosigner is used: the credit could be delayed, which could be a serious problem in emergency situations, and a second meeting between the creditor and cosigner would be required. Creditors uniformly and vociferously objected that the three-day waiting period was unreasonable and unnecessary. 54

The Presiding Officer found that "in view of the evidence of delay, inconvenience, and costs accompanying a required three-day cooling-off period for cosigners, it is concluded that the record does not support a requirement for so drastic a remedy." 55 We concur in this determination.

2. Cosigner Liability

It was proposed that the cosigner's liability be limited to the total amount of payments for which the debtor is obligated at the time the cosigner signs. 56 This provision would impose a cost on creditors, who would be unable to seek compensation from cosigners for late charges, attorneys' fees, and court costs.

The Commission shares the Presiding Officer's conclusion that "there is insufficient justification for the rule's limitation on cosigner liability." 57

3. Documents

In most states, creditors are not required to give cosigners copies of the documents they sign or other documents, and in most cases these documents are not given. 58 Such documents would assist cosigners in presenting defenses when a creditor demands payment from them. The record contains a few references to instances in which cosigners tried unsuccessfully to obtain copies of the documents they signed, 59 but no systematic evidence addresses the incidence of this problem. This requirement would increase creditors' costs because many documents, including such things as warranties, are involved.

The Presiding Officer believed that cosigners should be furnished with such documents. 60 The Commission concluded that the record provides insufficient evidence to conclude that unavailability of documents when needed is sufficiently common to offset the costs of providing documents in all instances.

4. Notice of Delinquency

The rationale for requiring notice to the cosigner of delinquency by the debtor is that lack of notice deprives the cosigner of an opportunity to bring pressure to bear on the debtor or otherwise work to forestall more serious delinquency. Cosigners routinely sign waivers of their rights to notice of nonpayment. 61 However, there is little evidence in the record indicating that cosigners are not presently notified of delinquency. On the contrary, there is evidence that they are notified about serious delinquencies, because creditors often seek payment from cosigners. 62 The provision would have required creditors to contact cosigners even in cases of minor delinquency. When minor delinquencies are corrected, an additional notice would be necessary to inform the cosigner of this fact. These repeated contacts would increase creditors' costs. In addition, the required contacts might lead to unnecessary embarrassment for debtors and cosigners alike.

The Presiding Officer concluded that this provision was unnecessary, 63 and we concur.

5. Remedies Applied First to Debtor

The Commission's conclusion that the majority of defaults occur because the debtor cannot pay suggests that pursuing the cosigner when the debtor can pay is unlikely to constitute a significant problem. Despite isolated indications, no reliable evidence contradicts this proposition.

The proposed provision would increase creditors' collection costs in cases where the debtor cannot pay, because it would require an unnecessary court action. One reason that cosigners are used is that they usually pay without court action when the creditor asks them to do so. 64

6. Commission Decision

The Commission decided that these proposed provisions would impose substantial costs and that the evidence does not indicate that they would provide benefits in a significant share of cases.

G. Empirical Evidence on the Benefits and Costs of the Disclosure Alternative

An alternative to the rule that we promulgated here was considered but rejected during our final consideration of this proceeding. It would have required disclosure of information to borrowers concerning the contractual remedies available to creditors. The creditor would have been required to give the borrower a one-page, plain English disclosure containing a brief description of various remedies and checkoff boxes to indicate those that were included in the contract.

The disclosure alternative was proposed to the Commission late in the proceedings; consequently, little empirical evidence in the record directly addresses the benefits and costs of such an alternative.

The case for a disclosure rule would be persuasive if one could establish: (1) There is inefficiently high use of creditor remedies due to a market failure caused by consumer ignorance about the

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51 "CIT Financial Services, R-XI-CIT-E, Section L, 418 at 1-22; Piering, Tr. 6877; McCabe, Tr. 8739-8740; Gall, Tr. 3676; Elder, Tr. 3271; Williams, Tr. 4612.
52 Presiding Officer's Report at 278.
53 Presiding Officer's Report at 267.
54 "Vilches, Tr. 6506; Baggett, Tr. 693; Cohen, Tr. 3468; Montgomery, Tr. 2374-76; Walsh, Tr. 4127; Schmidt, Tr. 6200; Cwennap, HX-500 at 21; Wehner, HX-36 at 19; Pleiksticker, Tr. 2347.
55 Presiding Officer's Report at 268.
56 Because this could virtually prevent creditors on open-end accounts, in the latest version the provision was not applied to such accounts. However, the Commission rejected this restricted version of the provision, because we concluded that the costs of limiting cosigner liability would outweigh the benefits even for closed-end credit.
57 Presiding Officer's Report at 260.
58 Butler, HX-466 at 13; His, Tr. 1934; Rothachiel, Tr. 6604; Consumer Complaint Letters, R-XI—189, R—II[b]-414, R— II[l]-314; Erwin, Tr. 10028; Reisman, Tr. 7145; Williams, R—XI-V15; Consetti, Tr. 10503.
59 R-XI-DLAL-174; R-XI-CIT-36; R-XI-CIT-A—32.
60 Presiding Officer's Report at 266.
62 R—XI-GFC-468; R—XI-CTA-190; R-XI-ASSOC-92; R-XI-CIT—A—962; R-XI-LIB—85.
63 See supra Chapter III.
64 Presiding Officer's Report at 294.
65 Although disclosure was not a central focus, a few commenters did suggest disclosure remedies. See Bankruptcy Judge T. Sam Plowden, HX—458; James Barr, National Association of Federal Credit Unions, R—II[a]-404 at 4; Dan Griffin, R—[a]-897 at 2—3; John Roberts, Louisiana Consumers League, HX—073, Tr. 1968; Taylor, Fasherty, McCutcheon, 235-42-1—18—1; Brown, HX—153 at 1—3. Others opposed disclosure remedies. See Sidney Margolius, Tr. 11214; Sten, Tr. 5051.
remedies included in loan contracts and their meanings; (2) the disclosure would substantially reduce this ignorance; (3) that the cost of the disclosure would not be high; and (4) there are no other important sources of market failure in the market for creditor remedies.

The discussion of benefits and costs presented below focuses on whether these conditions exist. The Commission found that there are in fact other important sources of market failure in the market for creditor remedies, and that consequently the disclosure alternative would not adequately deal with the problems raised by use of certain creditor remedies.

1. Benefits

Although it does not explicitly address a disclosure alternative, the rulemaking record does contain evidence of the extent to which consumers “understand the meaning, legal effect and possible consequences of the provisions included in contracts used in consumer credit transactions.” 67 After reviewing the evidence, the Presiding Officer found that “consumers do not have a complete understanding of consumer credit contracts.” 68 He noted that “Consumer credit contracts are not drafted with a view to making the provisions understandable to the consumer generally and do not contain an adequate explanation of either the consumer’s rights or the creditor’s obligations.” 69 In discussing the individual provisions of the proposed rule, the Presiding Officer’s Report often infers evidence of consumer ignorance about contractual creditor remedies as a problem relating to the use of these remedies.

The fact that a significant share of borrowers have incomplete information about available creditor remedies suggests that there is a potential market failure that might be remedied by a disclosure rule. Although there is no direct information on the extent to which a disclosure would reduce consumer ignorance of specific creditor remedies, such a disclosure may well increase general consumer awareness.

If no other market failures restricted consumer choice, improved awareness would increase the ability of consumers to make credit decisions in their best interest and to comparison shop on the basis of creditor remedies. If an increased number of consumers made decisions and comparison shopped on the basis of remedies, creditors would have more incentive to compete with each other by offering those remedies that best satisfy consumer preferences.

Although it does not bear directly on disclosure of remedies, reliable record evidence of interest rate disclosures under the Truth in Lending (TIL) Act conducted for the National Commission on Consumer Finance (NCCF) indicates the potential effectiveness of disclosure of credit terms. Based on surveys of consumers conducted approximately 15 months after the effective date of the Act, the studies examined consumer awareness of annual percentage rates as well as the extent to which consumers actually shopped for interest rates. Prior to the TIL Act, a relatively small percentage of borrowers had an accurate perception of prevailing interest rates for installment credit. The Act significantly increased awareness of prevailing interest rates. 70

However, awareness of disclosed information is not sufficient to establish that disclosures are useful. An additional issue is the extent to which consumers actually use the disclosed information to shop for credit. Day and Brandt conducted a survey addressing consumer shopping behavior after TIL became effective. They found that over one-fifth of consumers claimed to have compared rates or postponed purchases based on TIL information. 71 This raises the question whether the level of awareness and the extent of shopping revealed by these studies are sufficient to assure competitive markets. The NCCF concluded:

In terms of fostering viable rate competition among credit grantees, these levels of awareness produced by TIL are probably adequate. Not all consumers need be aware of the APR or shop for credit to bring about effective price competition. A significant majority group of consumers who are aware and do shop is sufficient to “police” the market. As Senator Douglas pointed out in the House hearings on HR 11601, * * * it is the undecided minority that influences the sellers. So you need only have, in my judgment, about 10 percent cost conscious and they will get the firms competing for that 10 percent.” 72

The NCCF found: “In summary then, it appears that 15 months after TIL’s effective date a large enough body of consumers in the general market had enough information to enforce price competition in that market.” 73

However, this conclusion is subject to two important qualifications which limit its relevance to the current rulemaking. First, the NCCF’s discussion is concerned with the adequacy of information about interest rate options that are now available to consumers. It does not follow that in other credit areas efficient options will be made available, since there may be other market failures which prevent suppliers from offering them. Indeed, the Commission has concluded that this is the case for restrictions on certain creditor remedies. 74 Second, the NCCF results relate to shopping for interest rates. Consumers are less likely to consider creditor remedies than interest rates when they shop. 75

We also considered a 1977 survey of consumer awareness of APRs conducted by the Federal Reserve Board. 76 The 1977 Federal Reserve Board survey addressed changes in consumer awareness of APRs since the Truth in Lending Act, thus updating the earlier NCCF studies. The survey also addressed consumer shopping behavior when considering credit transactions. The survey found substantial increases in awareness of APRs between 1970 and 1977, and suggested that disclosures had provided enough information to influence the competitiveness of the credit market for all consumers, including lower income and less educated individuals. The survey, although it showed significant awareness of APRs by consumers, does not establish that levels of knowledge and shopping as a result of disclosure will necessarily be great enough to assure that disclosure of creditor remedies will work. 77 Again, we are most cognizant of the fact that the elements which influence consumer consideration of contract terms such as interest rates and those which influence consideration of creditor remedies are so fundamentally different as to make

68 Presiding Officer’s Report at 77.
69 Id.
72 Id. at 177, emphasis in original.
73 See supra Chapter III, which discusses impediments to competition in the market for creditor remedies.
74 Id., which discusses limitations on consumer shopping for creditor remedies.
76 Evidence of the effectiveness of disclosure in other contexts (e.g., corrective advertising) is inconclusive and of only marginal relevance to our consideration of creditor remedy disclosures. See, e.g., sources cited to the Commission from Carol Crawford, Director, Bureau of Consumer Protection, and Wendy L. Gramm, Director, Bureau of Economics, July 1, 1983, at 9-12, nn. 27-33.
generalizations about the efficacy of disclosures somewhat speculative.

Thus, even though the disclosure alternative might have produced some benefits, we concluded that disclosure would provide a less adequate remedy for existing market failures than would the prohibitory rule promulgated by the Commission. Inefficiently high use of certain creditor remedies results not only from lack of consumer awareness, but from other problems as well. Moreover, lack of consumer awareness of other relevant issues would not be addressed by the disclosure of creditor remedies. For example, some consumers may underestimate the risk of default, and some consumers may not understand legal procedure well enough to grasp the implications of some remedies (e.g., confessions of judgment) even if they are told that such provisions are in the contract.28

2. Costs

The principal cost of a disclosure rule would be the resources needed to provide the forms, individualize them for various consumer contracts, and explain them to borrowers, together with the resources needed to enforce the rule. Unlike the accepted rule, which restricts the use of collateral and collection procedures, the disclosure alternative would not prohibit the use of contract terms between informed borrowers and creditors. As a result, a disclosure alternative would avoid most of the costs of the accepted rule and any resulting effects on the cost and availability of credit.

3. Commission Decision

The Commission concluded that the benefits of the promulgated rule would exceed those of the disclosure alternative. Although the Commission also found that the costs of the promulgated rule would exceed those of the disclosure alternative, it concluded that the net benefits of the promulgated rule would exceed the net benefits that would result from a rule based on disclosures. In particular, a disclosure alternative would not address other impediments to shopping that prevent creditors from competing to supply the creditor remedies which informed borrowers would most prefer.

Accordingly, Title 16 of the Code of Federal Regulations is amended by the addition of new Part 444.

PART 444—CREDIT PRACTICES

Sec. 444.1 Definitions. 444.2 Unfair credit practices. 444.3 Unfair or deceptive cosigner practices. 444.4 Late charges. 444.5 State exemptions.


§ 444.1 Definitions.

(a) Lender. A person who engages in the business of lending money to consumers within the jurisdiction of the Federal Trade Commission.

(b) Retail installment seller. A person who sells goods or services to consumers on a deferred payment basis pursuant to a lease-purchase arrangement within the jurisdiction of the Federal Trade Commission.

(c) Person. An individual, corporation, or other business organization.

(d) Consumer. A natural person who seeks or acquires goods, services, or money for personal, family, or household use.

(e) Obligation. An agreement between a consumer and a lender or retail installment seller.

(f) Creditor. A lender or a retail installment seller.

(g) Debt. Money that is due or alleged to be due from one to another.

(h) Earnings. Compensation paid or payable to an individual or for his or her account for personal services rendered or to be rendered by him or her, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

(i) Household goods. Clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects (including wedding rings) of the consumer and his or her dependents, provided that the following are not included within the scope of the term "household goods":

(1) Works of art;

(2) Electronic entertainment equipment (except one television and one radio);

(3) Items acquired as antiques; and

(4) Jewelry (except wedding rings).

(j) Antique. Any item over one hundred years of age, including such items that have been repaired or renovated without changing their original form or character.

(k) Cosigner. A natural person who renders himself or herself liable for the obligation of another person without compensation. The term shall include any person whose signature is requested as a condition to granting credit to another person, or as a condition for forbearance on collection of another person's obligation that is in default. The term shall not include a spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law. A person who does not receive goods, services, or money in return for a credit obligation does not receive compensation within the meaning of this definition. A person is a cosigner within the meaning of this definition whether or not he or she is designated as such on a credit obligation.

§ 444.2 Unfair credit practices.

(a) In connection with the extension of credit to consumers in or affecting commerce, as consumer is defined in the Federal Trade Commission Act, it is an unfair act or practice within the meaning of Section 5 of that Act for a lender or retail installment seller directly or indirectly to take or receive from a consumer an obligation that:

(1) Constitutes or contains a cognovit or confession of judgment (for purposes other than executory process in the State of Louisiana), warrant of attorney, or other waiver of the right to notice and the opportunity to be heard in the event of suit or process thereon.

(2) Constitutes or contains an executory waiver or a limitation of exemption from attachment, execution, or other process on real or personal property held, owned by, or due to the consumer, unless the waiver applies solely to property subject to a security interest executed in connection with the obligation.

(3) Constitutes or contains an assignment of wages or other earnings unless:

(i) The assignment by its terms is revocable at the will of the debtor, or

(ii) The assignment is a payroll deduction plan or preauthorized payment plan, commenced at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment, or

(iii) The assignment applies only to wages or other earnings already earned at the time of the assignment.

(4) Constitutes or contains a nonpossessory security interest in household goods other than a purchase money security interest.
§ 444.3 Unfair or deceptive cosigner practices.

(a) In connection with the extension of credit to consumers in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, it is:

(1) A deceptive act or practice within the meaning of Section 5 of that Act for a lender or retail installment seller, directly or indirectly, to misrepresent the nature or extent of cosigner liability to any person.

(2) An unfair act or practice within the meaning of Section 5 of that Act for a lender or retail installment seller, directly or indirectly, to obligate a cosigner unless the cosigner is informed prior to becoming obligated, which in the case of open end credit shall mean prior to the time that the agreement creating the cosigner's liability for future charges is executed, of the nature of his or her liability as cosigner.

(b) Any lender or retail installment seller who complies with the preventive requirements in paragraph (c) of this section does not violate paragraph (a) of this section.

(c) To prevent these unfair or deceptive acts or practices, a disclosure, consisting of a separate document that shall contain the following statement and no other, shall be given to the cosigner prior to becoming obligated, which in the case of open end credit shall mean prior to the time that the agreement creating the cosigner's liability for future charges is executed:

Notice to Cosigner

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility. You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.

The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of your credit record.

This notice is not the contract that makes you liable for the debt.

§ 444.4 Late charges.

(a) In connection with collecting a debt arising out of an extension of credit to a consumer in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, it is an unfair act or practice within the meaning of Section 5 of that Act for a creditor, directly or indirectly, to levy or collect any delinquency charge on a payment, which payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, when the only delinquency is attributable to late fee(s) or delinquency charge(s) assessed on earlier installment(s).

(b) For purposes of this section, “collecting a debt” means any activity other than the use of judicial process that is intended to bring about or does bring about repayment of all or part of a consumer debt.

§ 444.5 State exemptions.

(a) If, upon application to the Federal Trade Commission by an appropriate state agency, the Federal Trade Commission determines that:

(1) There is a state requirement or prohibition in effect that applies to any transaction to which a provision of this rule applies; and

(2) The state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this rule;

Then that provision of the rule will not be in effect in that state to the extent specified by the Federal Trade Commission in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively.

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Part V

Department of Justice

28 CFR Part 39

Enforcement of Nondiscrimination on the Basis of Handicap in Department of Justice Programs; Supplemental Notice
DEPARTMENT OF JUSTICE

28 CFR PART 39
[Order No. 1051-84]

Enforcement of Nondiscrimination on the Basis of Handicap in Department of Justice Programs

AGENCY: Department of Justice.

ACTION: Supplemental Notice.

SUMMARY: On December 16, 1983, the Department of Justice published a Notice of Proposed Rulemaking for the enforcement of section 504 of the Rehabilitation Act of 1973, as amended, which prohibits discrimination on the basis of handicap, as it applies to programs and activities conducted by the Department of Justice. The Department has received certain preliminary comments on the NPRM that contain suggestions that the Department is inclined to accept. Therefore, during the remainder of the comment period, the Department solicits comments on the NPRM as well as comments on the suggested modifications to the NPRM set forth in this Supplemental Notice.

DATE: To be assured of consideration, comments must be in writing and must be received on or before April 16, 1984.

ADDRESSES: Comments should refer to specific sections in the regulation.

Address: Comments should be sent to: Stewart B. Oneglia, Chief, Coordination and Review Section, Civil Rights Division, U.S. Department of Justice, Rulemaking Docket 004, P.O. Box 1019, Washington, D.C. 20013.

Comments received will be available for public inspection in Room 654 of the HolC Building, 320 First Street NW., Washington, D.C., from 9:00 a.m. to 5:00 p.m., Monday through Friday, except legal holidays. Copies of this notice are available on tape for those with impaired vision. They may be obtained at the above address.

FOR FURTHER INFORMATION CONTACT: John L. Wodatch, Deputy Chief, Coordination and Review Section, Civil Rights Division, U.S. Department of Justice, Washington, D.C. 20530; (202) 724-2227 (Voice) or 724-7678 (TDD); or L. Irene Bowen, Supervisory Attorney, Handicap Unit, Coordination and Review Section, Civil Rights Division, U.S. Department of Justice, Washington, D.C. 20530; (202) 724-2245 (Voice) or 724-7678 (TDD). These are not toll free numbers.

SUPPLEMENTARY INFORMATION: The Department of Justice has received preliminary comments on Notice of Proposed Rulemaking to implement section 504 of the Rehabilitation Act of 1973, as amended (29 U.S.C. 794), with respect to programs and activities conducted by the Department, that was published on December 16, 1983 (48 FR 55996). Because those comments indicate that some portions of that proposal may be misunderstood, the Department seeks comments on suggested clarifications of its proposals.

1. We wish to clarify our reason for deleting the phrase "or interest in such property" from the definition of "facility." As used in this regulation, the term "facility" refers to structures, and does not include intangible property rights. It should, however, be noted that the regulation applies to all programs and activities conducted by the agency regardless of whether the facility in which they are conducted is owned, leased, or used on some other basis by the agency.

2. In its proposed rule, the department omitted the list of physical or mental impairments included in the definition of "handicapped person" in the coordination regulation for federally assisted programs (28 CFR 41.31). The Department wishes to make clear that the term "physical or mental impairment," as used in that definition, includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech, and hearing impairments, cerebral palsy, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, mental retardation, emotional illness, and drug addiction and alcoholism.

3. In response to the concern that the proposed rule has no specific criteria for conducting a self-evaluation, we request comment on the following alternative language for § 39.110:

Alternative § 39.110

(a) The agency shall, within one year of the effective date of this part, evaluate, with the assistance of interested persons, including handicapped persons or organizations representing handicapped persons, its current policies and practices, and the effects thereof, that do not or may not meet the requirements of this part, and to the extent modification of any such policies and practices is required, the agency shall proceed to make the necessary modifications.

(b) The agency shall, for at least three years following completion of the evaluation required under paragraph (a) of this section, maintain on file and make available for public inspection:

(1) A list of the interested persons consulted.

(2) A description of areas examined and any problems identified, and

(3) A description of any modifications made.

In connection with this provision, the Department is considering whether the Federal Advisory Committee Act (5 U.S.C. App.) is applicable to a self-evaluation group comprised of private individuals with which a Federal agency would consult in implementing its self-evaluation responsibilities.

4. The Department also seeks comments on the following proposed new requirement that the Department make available to employees, participants, beneficiaries, and other interested persons information regarding section 504 requirements and their applicability to the programs and activities the Department conducts.

Notice. The agency shall make available to employees, applicants, participants, beneficiaries, and other interested persons information regarding the provisions of this part and their applicability to the programs or activities conducted by the agency, and make such information available to them in such manner, as the Attorney General finds necessary to apprise such persons of the protections against discrimination assured them by section 504 and this part.

5. The proposed regulation does not contain a general statement of the program accessibility requirement similar to that appearing in the section 504 coordination regulation for federally assisted programs (28 CFR 41.50). The decision not to include this language in the proposed regulation has created the misperception that a change in substance was intended. In order to remedy this misunderstanding, we are inclined to add the following language to the regulation as the first sentence of § 39.150(a):

Except as otherwise provided in this section, no qualified handicapped person shall, become the agency's facilities are inaccessible to or unusable by handicapped persons, be denied the benefits of, be excluded from participation in, or otherwise be subjected to discrimination under any program or activity conducted by the agency.

6. We are inclined to believe that the following alternative language for §§ 39.150 and 39.160 would clarify our intentions regarding the meaning of the "undue financial and administrative burdens" language contained in the proposed regulation. It is our view that, because of the extensive resources and capabilities of the agency, compliance with § 39.150(a) or § 39.160 would in
most cases not result in undue financial and administrative burdens on the agency. In determining whether financial and administrative burdens are undue, all agency resources available for use in the funding and operation of the conducted program should be considered. The burden of providing that compliance with § 39.150(a) or § 39.160 would fundamentally alter the nature of a program or would result in undue financial and administrative burdens rests with the agency. The decision that compliance would result in such alteration or burdens must be made by the Attorney General personally and must be accompanied by a written statement of the reasons for reaching that conclusion. The Attorney General’s decision may be appealed through the procedures established by § 39.170.

7. We would appreciate comment on the following alternative language for the program accessibility (§ 39.150) and communications (§ 39.160) sections of the regulation:
Alternative § 39.150

Insert the following before the last sentence of § 39.150(a)(2):

In those circumstances where agency personnel believe that the proposed action would fundamentally alter the program or would result in undue financial and administrative burdens, the agency has the burden of proving that compliance with § 39.150(a) would result in such alterations or burdens. The decision that compliance would result in such alteration or burdens must be made by the Attorney General personally, after considering all agency resources available for use in the funding and operation of the conducted program, and must be accompanied by a written statement of the reasons for reaching that conclusion.

Alternative § 39.160

Insert the following before the last sentence of § 39.160(e):

In those circumstances where agency personnel believe that the proposed action would fundamentally alter the program or would result in undue financial and administrative burdens, the agency has the burden of proving that compliance with §39.160 would result in such alteration or burdens. The decision that compliance would result in such alteration or burdens must be made by the Attorney General personally, after considering all agency resources available for use in the funding and operation of the conducted program, and must be accompanied by a written statement of the reasons for reaching that conclusion.

8. Questions were also raised about paragraph (1) of the definition of “qualified handicapped person.” Some comments have taken exception to the reference in paragraph (1) to fundamental program alternations as part of the definition. The language we have proposed, however, comes directly from the Supreme Court’s interpretation of section 504. So long as the definition of “qualified handicapped person” remains faithful to the statute and current case law we are receptive to alternative language. While suggestions in this regard have been received and are under review, we believe additional comment in this area on possible alternative definitional language would be helpful.

William French Smith,
Attorney General.
[FR Doc. 84-5576 Filed 2-26-84 8:45 am]
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