Chicago-Kent Law Review

Volume 52 | Issue 1 Article 6

April 1975

The Holder in Due Course Doctrine in the Aftermath of the Truth in Lending Act

James B. Currie

James B. Currie

THE HOLDER IN DUE COURSE DOCTRINE IN THE AFTERMATH OF THE TRUTH IN LENDING ACT

Negotiable instrument law historically has contained a provision for a holder in due course, a very special character who curiously enough was never afflicted with all of the infirmities of the ordinary holder of a negotiable instrument. The obviously superior quality of this holder has prompted courts and scholars to describe him as the "emperor of the bona fide purchasers"[1] and even as the "super plaintiff."[2] Today, however, this extraordinary creature of the law is being disfigured—and possibly faces eventual extinction—in the area of consumer installment credit transactions.

The purpose behind the creation of such a superior character as a holder in due course was to encourage the free negotiability of commercial paper. By removing certain anxieties of the innocent purchaser of negotiable instruments, negotiation was facilitated.[3] Under the *Uniform Commercial Code,* four requirements must be met before a holder in due course status can arise: the transferee of the negotiable instrument has to be (1) a holder, (2) for value, (3) in good faith, and (4) without notice that the instrument was overdue or had been dishonored, or of any defense against or claim to it on the part of any person.[4] Once all of these requirements have been met, the holder in due course is totally immune to all personal defenses, and subject to only a few real defenses.[5]

Although only real defenses are available against a holder in due course under the *Uniform Commercial Code*, the courts have judicially expanded the list of acceptable defenses.[6] The development of additional defenses emphasized judicial concern for the inequitable result to a consumer where the seller and his transferee (a holder in due course) have maintained a close relationship. In the aftermath of the enactment of the Federal Truth in Lending Act,[7] the courts are now manufacturing still more defenses to avoid

1. J. White & R. Summers, Uniform Commercial Code 456 (1972) [hereinafter cited as White & Summers].
2. Illinois Valley Acceptance Corp. v. Woodard, 304 N.E. 2d 859, 863 (Ind. Ct. App. 1974).
3. Unico v. Owen, 50 N.J. 101, 109, 232 A.2d 405, 410 (1967); *see also* Calvert Credit Corp. v. Williams, 244 A.2d 494, 496 (D.C. 1968).
4. Uniform Commercial Code § 3-302 [hereinafter cited as UCC]. For the Illinois court's application of the code *see* Atlanta National Bank v. Johnson Tractor Sales, 130 Ill. App. 2d 793, 796, 267 N.E.2d 358, 361 (1971).
5. UCC § 3-305. The real defenses include infancy, incapacity, duress, illegality, insolvency and fraud in the factum.
6. *See* Calvert Credit Corp. v. Williams, 244 A.2d 494 (D.C. 1968), and Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967). Today *see* Kriger v. European Health Spa, Inc., 363 F. Supp. 334 (E.D. Wis. 1973), and Garza v. Chicago Health Clubs, Inc., 347 F. Supp. 955 (N.D. Ill. 1972).
7. 15 U.S.C. §§ 1601-65 (1974).

the effect of an assertion of holder in due course. The reason for this recent judicial manipulation appears to be that the need for a holder in due course defense is outweighed by other more important considerations affecting a consumer in his installment credit transactions. Although many state legislatures have taken cognizance of this judicial concern and have enacted appropriate legislation, there is an urgent need for a comprehensive regulation restricting the holder in due course doctrine in the area of consumer installment credit transactions—regulation which only Congress can adequately provide. The patchwork-type law resulting from various court decisions and individual state legislation has become oppressive to consumers because of its failure to deal uniformly with the holder in due course defense in all jurisdictions.

The following discussion will outline present attitudes regarding the holder in due course doctrine in the aftermath of the Federal Truth in Lending Act, and then will analyze the usefulness of the existence of such a doctrine for consumer installment credit transactions by reviewing past and recent judicial decisions, current state statutes and present criticisms.

The Holder in Due Course Under the Truth in Lending Act

The Effect of Being a "Creditor"

Prior to the enactment of the Federal Truth in Lending Act (TLA), the courts relied on theories of agency-principal,[8] oneness,[9] or close connectedness[10] in order to avoid "hard cases"[11] involving the defense of holder in due course (HDC) in consumer installment credit transactions. An additional opportunity to mitigate the harshness of the HDC doctrine was given the courts by the TLA, which provided a means—the broad definition of creditor[12]—to pierce the HDC shield. That broad definition has encouraged the courts to be liberal in their application of it. A "creditor" refers only to persons who regularly extend or arrange for the extension of credit to consumers[13] for which the payment of a finance charge is required, whether it be in connection with loans, sales of property or services, or otherwise.[14] Regulation Z of the TLA adds little additional insight as to the definitional

8. Calvert Credit Corp. v. Williams, 244 A.2d 494, 496 (D.C. 1968).

9. WHITE & SUMMERS, *supra* note 1, at 480.

10. Unico v. Owen, 50 N.J. 101, 110, 116, 232 A.2d 405, 410, 413 (1967); *see also* Illinois Valley Acceptance Corp. v. Woodard, 304 N.E.2d 859, 863 (Ind. Ct. App. 1974).

11. Johnston, *Unico v. Owen—Judicial Mastery of the "Hard Case,"* 24 RUTGERS L. REV. 500 (1970). "Hard case" is a term used by the author in referring to a case with difficult factual and legal problems which may result in bad law. "Hard case" was taken from the dissenting opinion of Northern Sec. Co. v. U.S., 193 U.S. 197 (1904).

12. 15 U.S.C. §§ 1601-65 (1974), Truth in Lending Act; and *see* § 1602(f).

13. The Truth in Lending Act covers only that credit which is extended to natural persons and specifically excludes credit arranged between corporations, *see* F.R.S. Reg. Z, 12 C.F.R. § 226.2(k) (1974); *see also* a court's acceptance of this limitation in Joseph v. Norman's Health Club, Inc., 336 F. Supp. 307, 317 (E.D. Mo. 1971).

14. 15 U.S.C. § 1602(f) (1974).

limits of a creditor.[15] Under the broad TLA definition of creditor, a holder seemingly may be drawn into the original transaction as a creditor, subject to the TLA, instead of remaining a holder who is at least once removed from the original credit transaction. There is thus a direct impact on the "good faith" and "notice" elements of the HDC doctrine by implying knowlege of the original credit agreement to a holder who qualifies as a TLA creditor.

The courts[16] have construed the statutory definition as an invitation to liberally interpret the term "creditor," and have even extended it to include others who are closely involved in the financial arrangements. For example, in *Kriger v. European Health Spa, Inc.*,[17] the court held that the bank was a creditor under the TLA definition on the basis that it had extended or arranged for the extension of credit to Spa's members through the "conduit"[18] of Spa. The "conduit" characterization was developed because Spa had tendered 100% of the obligations of its members to the same bank, and the bank in turn had accepted 88% for discounting, only after checking the credit references of each one tendered. The bank had retained the final choice of accepting or rejecting a particular member's note. In addition, at least sixty notes were repurchased by Spa upon default pursuant to an agreement with the bank. The court, citing an analogous case,[19] said that lenders may not escape the TLA status of creditors by using sales companies as "front men."[20] The court's opinion in *Kriger* made it clear that there was no reason to protect a holder, as an HDC, by excluding him from the definition of creditor under the TLA, when the front man (Spa) had merely carried out all the arrangements dictated by the bank (holder). Hence, the bank was not a *UCC* 3-302 "holder" under the TLA, since it was deemed to be a "creditor" with notice and knowledge of the original credit transaction.

In *Garza v. Chicago Health Clubs, Inc.*,[21] the court dealt with the creditor issue in a similar manner. In a class action for violation of the TLA, the court concluded that assignees of consumer installment credit contracts, who regularly extend or arrange for the extension of credit to consumers through the assignors of such contracts, may themselves be creditors under the TLA. In support of its holding, the court noted that the assignee had underwritten all of the health clinic's consumer finance programs for almost ten years and had regularly loaned money to the clinic. Although the assignee did not supply the clinic with form contracts or have direct contact with its contract debtors, their long relationship and the regular extension of credit to

15. 12 C.F.R. §§ 226.2(m), 226.1(a) (1974), explaining that a creditor is one who in the ordinary course of business regularly extends or arranges for the extension of consumer credit.

16. To date, only the federal district courts have construed the effect of the TLA on the HDC doctrine.

17. 363 F. Supp. 334 (E.D. Wis. 1973).

18. *Id.* at 336.

19. Garza v. Chicago Health Clubs, Inc., 347 F. Supp. 955, 964 (N.D. Ill. 1972).

20. 363 F. Supp. 334 (E.D. Wis. 1973).

21. 347 F. Supp. 955, 964 (N.D. Ill. 1972).

assignor's contract debtors prompted the court to find that the assignee was the "prime mover"[22] in each transaction by arranging the extension of credit to consumers through the conduit of the health clinic.

The *Garza* court had therefore recognized the significance of the conduit test in determining the creditor responsible under the TLA. The assignee consequently was unable to assert the defense of HDC as against the consumer. Under the TLA he was deemed a creditor, and thus subject to the penalties for any violations of the TLA. The once iron-clad defense of HDC had apparently softened in the face of the broad TLA definition of creditor, and the disfiguration of the HDC creature continued.

In *Philbeck v. Timmers Chevrolet*,[23] the court recognized the consumer credit transaction as one which involved the front man situation confronted in *Kriger.* Holding the finace company to be a creditor and therefore violating the credit disclosure requirements of the TLA, the court reasoned that where a finance company works closely with a seller and actually prepares the consumer credit contracts and the seller merely executes and assigns them back to the finance company, then the finance company must be considered a TLA creditor.[24] In *Philbeck*, the court was confronted with GMAC as the finance company for a GM dealer (Timmers Chevrolet); it held that GMAC was a creditor under the TLA, since GMAC supplied the forms and regularly used Timmers as a conduit through which to place its installment sales contracts with consumers.

In addition to providing a broad definition of creditor, which prompted courts to develop theories such as "conduit," the TLA also expresses an intent that *each* creditor (if more than one is involved) must disclose all finance charges in accordance with the general requirements of the TLA.[25] Regulation Z also stresses the importance of disclosure by each creditor.[26] Therefore, in absence of clear proof of key factors necessary to establish the conduit theory, such as exclusive dealing, preparation of contract forms, or review of the actual credit applications, today's practitioner might be able to advance an alternative argument based upon a co-creditor rationale.

The Defense of Illegality

Although judicial interpretations of the term "creditor" under the Truth in Lending Act provided the consumer with one means of piercing the HDC shield to guard against the deceptive practices of the cunning salesman and a closely related finance company, the consumer may also have received the key for a backdoor attack on the validity of the HDC defense. Under the

22. *Id.* at 965.
23. 361 F. Supp. 1255, 1261 (N.D. Ga. 1973), *rev'd on other grounds*, 499 F.2d 971 (5th Cir. 1974).
24. 361 F. Supp. at 1261, 1262.
25. 15 U.S.C. § 1631 (1974).
26. 12 C.F.R. § 226.6(d) (1974).

Uniform Commercial Code, it is clear that an HDC is subject only to the real defenses, such as illegality.[27] By arguing that a violation of the TLA is an illegal business practice subject to civil[28] and criminal[29] sanctions, the consumer may be able to successfully avoid the effects of the defense of the HDC doctrine. Although there are no cases on this point, the *Uniform Commercial Code* comments do not rule out violation of a consumer protection statute as a basis of asserting illegality. The drafters, in the comments, state that the illegality must be one which renders the agreement null.[30] Nullity exists when a person is allowed to treat an act as though it had absolutely no legal effect or force.[31] In the case of the TLA, the apparent Congressional purpose for providing non-disclosure sanctions was to render ineffective all agreements which did not make proper disclosures, at least as to the finance charges imposed. To ensure this result, Congress provided for damages based upon the actual finance charges sought.[32] Thus, under the TLA a creditor could become liable to the consumer for an amount equal to or greater than the finance charges bargained for under the contract, leaving a contract consisting of a straight loan of the principal at best. Recent amendments to the TLA would provide further compensation beyond the "finance charge" damages for any actual damages incurred by a consumer.[33] Hence, a creditor conceivably could become liable to the consumer for an amount which exceeds the total value of the contract. However, where such excess liability does arise, it is uncertain whether courts will treat the contract as null for illegality or whether recovery under the TLA will act merely as a set-off. If a court is persuaded to accept the nullity conclusion, then the consumer will be entitled both to recovery under the TLA and also to a valid defense against the HDC. On the other hand, where the court concludes that it is merely a set-off, then the consumer will be left only with his remedy of recovery under the TLA and without a valid defense against an HDC. The illegality argument under the TLA consequently would be ineffective as a deterrent to holders in due course if the set-off conclusion is reached, as actual damages may be difficult to establish.

State statutes,[34] such as the Illinois Retail Installment Sales Act

27. UCC § 3-305(2)(b).
28. 15 U.S.C. § 1640(a) (1974).
29. *Id.* at § 1611.
30. UCC § 3-305, comment 6.
31. BLACK'S LAW DICTIONARY 1216 (Revised 4th ed. 1968); and *see* BALLENTINE'S LAW DICTIONARY 871 (3rd ed. 1969), which explains that a nullity is a proceeding of no effect whatsoever because of a defect therein.
32. 15 U.S.C. §§ 1640, 1611 (1974). Section 1640(a) permits civil liability based upon finance charges as follows: liability equal to twice the finance charges but not less than $100 nor greater than $1,000. Section 1611 provides for criminal penalties of $5,000 or imprisonment or both. *See also* U.S. CODE CONG. & AD. NEWS 5706, § 408(a)(1) (Dec. 15, 1974), which would allow an additional recovery to cover *actual* damages.
33. U.S. CODE CONG. & AD. NEWS 5706, § 408(a)(1) (Dec. 15, 1974).
34. For a complete review of state statutes affecting the holder in due course doctrine in other jurisdictions, *see generally* Willier, *Need for Preservation of Buyers' Defenses—State Statutes Reviewed*, 5 UCCLJ 132 (1972) [hereinafter cited as Willier].

(RISA),[35] have taken a similar position against violations of disclosure requirements by providing that one who fails to make the requisite state disclosures shall not be able to recover finance or other charges. The Illinois courts have construed the term "recover" to include voluntary collection as well as collection by legal action.[36] The distinction between the TLA and RISA is that the latter makes a "knowing" violation of the state disclosure act a class A misdemeanor.[37] Thus, the defense of illegality may be asserted more easily by an Illinois consumer who establishes that the assignee (holder) is accountable under Chapter 38.[38]

Congressional Intent

The stated pupose of the Truth in Lending Act is to assure a complete disclosure of credit terms to allow the consumer an opportunity to compare all credit terms available to him.[39] Disclosure in accordance with the TLA is enforced under the threat of civil and criminal sanctions.[40] A conflict arises because the act affords protection of the consumer at the expense of the merchant, while the holder in due course doctrine, as enunciated in the *Uniform Commercial Code*, affords protection to a "qualified" holder at the expense of the consumer. The TLA is thus an apparent about-face in general policy. Not only has the TLA denied immunity to an HDC who is a creditor, but it also has provided for criminal and civil sanctions against a qualified HDC. The net result is an HDC doctrine which is eroded with each liberal judicial construction of the broad definition of creditor under the TLA. The TLA also provides that an assignee of the original creditor may be liable under the act where a violation is apparent on the face of the instrument assigned.[41] Although this provision may be interpreted as merely affecting the "good faith" element of an HDC, it may also be a significant indicator of Congressional intent to restrict the HDC defense when construed in light of the stated purpose of the TLA.

As additional evidence of Congressional intent to restrict the HDC doctrine, the Senate Committee on Banking, Housing and Urban Affairs,[42] in

35. ILL. REV. STAT. ch. 121½, § 531(b) (1971).
36. Garza v. Chicago Health Clubs, Inc., 347 F. Supp. 955, 963 (N.D. Ill. 1972).
37. ILL. REV. STAT. ch. 121½, §531(a) (1971).
38. ILL. REV. STAT. ch. 38, §§ 5-1, 5-2 (1972). Accountability through "common design" was accepted in People v. Smith, 8 Ill. App. 3d 729, 281 N.E.2d 767 (1972). Legislative intent apparent in ILL. REV. STAT. ch. 121½, § 517(c) seems to be in accord with this illegality argument since it provides that even an express agreement not to assert any defense against an HDC is invalid if the holder has knowledge or notice (from its course of dealings) that the seller has failed to lawfully disclose.
39. 15 U.S.C. § 1601 (1974).
40. *Id.* at §§ 1640, 1611.
41. *Id* at § 1640(d); *see also* U.S. CODE CONG. & AD. NEWS 5708, § 115 (Dec. 15, 1974).
42. Although this Senate Committee was concerned with the issue of bank credit card procedures and limitations (i.e. HDC doctrine), the underlying fact pattern involved a similar three-party consumer credit transaction as discussed in *Kriger, Garza*, and *Philbeck*.

its 1972 report, rejected by one vote a proposal to partially abolish the HDC doctrine as it applies to bank credit card systems.[43] The report indicated that thirty-two states had already imposed limitations on the HDC with success.[44] Although not favoring the HDC defense, the Committee concluded that state legislation to limit the HDC doctrine was preferable to federal action.[45] One senator, in voicing his dissent, noted that an unlimited HDC concept has and will continue to produce serious abuses for consumers, and would only provide a temptation to sellers to supply poor quality merchandise.[46] In urging abolition of the HDC doctrine, the senator stressed that although thirty-two states[47] had acted on their own to repeal or modify the HDC doctrine in installment credit sales, the free flow of credit had not been impeded, despite dire credit industry predictions to the contrary.[48]

THE FUTURE OF THE HDC DOCTRINE

Past Indicators

The courts had attempted to restrict the HDC doctrine prior to the enactment of the TLA. By means of employing theories of agency-principle,[49] oneness,[50] or close connectedness,[51] the courts sought to avoid the "hard case" result.[52] Although substantially agreeing in the ultimate result, the courts were split as to whether their theories left unsatisfied the elements of "notice" or "good faith."[53] Nevertheless, there was apparently general agreement as to the underlying rationale:

43. *S. Rep. No. 652, 92nd Cong., 2d Sess.*, CCH 1972 CONSUMER CREDIT GUIDE 15 [hereinafter cited as *Senate Report*].

44. Willier, *supra* note 34, at 133-38. The following comprise the thirty-two states which have limited the HDC doctrine: Alaska, Alabama, Arizona, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Indiana, Louisiana, Maine, Massachusetts, Maryland, Michigan, Minnesota, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Utah, Vermont, Washington, Wisconsin, and Wyoming. Also, Puerto Rico and the District of Columbia have enacted statutory provisions restricting the HDC defense.

45. *Senate Report*, *supra* note 43, at 16.

46. *Id.* at 31, Individual Views of Mr. Proxmire: As Senator Proxmire pointed out in his dissent, "The committee report argues that consumers themselves must bear some of the responsibility for shoddy merchandise. These views exhibit an almost shocking disregard of the main thrust of consumer protection legislation over the last twenty years. While consumers undoubtedly have some responsibilities, they also have rights. The old legal concept of 'buyer beware' has no place in modern society."

47. Willier, *supra* note 44.

48. *Senate Report*, *supra* note 46, at 29.

49. Calvert Credit Corp. v. Williams, 244 A.2d 494, 496 (D.C. 1968).

50. WHITE & SUMMERS, *supra* note 1, at 480; and *see* Unico v. Owen, 50 N.J. 101, 115, 232 A.2d 405, 413 (1967).

51. Unico v. Owen, 50 N.J. 101, 110, 116, 232 A.2d 405, 410, 413 (1967).

52. For a further discussion of the pre-TLA cases dealing with the holder in due course defense, *see* WHITE & SUMMERS, *supra* note 1 at § 14-8; *see also* Note, *Erosion of Ohio's Holder in Due Course Doctrine*, 1 OHIO NORTH. L. REV. 111, 111-113 (1973) [hereinafter cited as *Erosion*].

53. *See generally*, Comment, *Unico v. Owen: Consumer Finance Companies as Holders in Due Course Under the UCC*, 54 VA. L. REV. 279 (1968); *see also* WHITE & SUMMERS, *supra* note 1, at § 14-8; and *see* Johnston, *Unico v. Owen—Judicial Mastery of the "Hard Case,"* 24 RUTGERS L. REV. 500 (1970).

> . . . the more the holder knows about the underlying transaction and particularly the more he controls or participates or becomes involved in it, the less he fits the role of good faith purchaser for value; the closer the relationship to the underlying agreement which is the source of the note, the less need there is for giving him the tension-free rights [as HDC] considered necessary in a fast moving credit-extending commercial world.[54]

Notwithstanding the specific theory adopted by the court to avoid the "hard case" result, the intent was usually the same—not to allow a holder the opportunity to insulate himself from responsibilities for fraudulent sales practices, which he knew were being used, by feigning ignorance and seeking the status of holder in due course.[55]

In apparent response to the trend in court decisions involving the HDC in consumer installment credit transactions, thirty-two states have passed statutes to modify or repeal the HDC doctrine, and further action is under consideration in several others.[56] Although a number of these bills are being proposed, many are weakened by compromise because the users of the HDC defense have great lobbying strength to preserve the doctrine for their special interests.[57] A number of state statutes dealing either directly or indirectly with the HDC defense have felt the effects of lobbying pressures for compromise. An example of legislative compromise which weakened a direct-approach statute to the point of ineffectiveness was an Ohio statute which purported to restrict the HDC doctrine.[58] The most important party to a consumer installment credit transaction—the financial institution—had been excluded from the effect of the statute through legislative compromise.[59] The statute consequently was unable to effectively regulate the operation of the HDC doctrine, since finance companies represent a large majority of the users of the HDC defense.

In addition to the direct-approach statutes, other states have enacted indirect-approach statutes which impose only minor limitations on the HDC doctrine. Such a statute has been categorized as the "non-insulation period" type.[60] Although the "non-insulation period" statute does nothing more than protect the consumer by disallowing a holder the HDC defense for a fixed period,[61] it also represents a legislative compromise—a compromise between what the legislature has recognized as potential harm to an unsuspecting consumer, and strong lobbying pressure exerted to resist further restriction of

54. Unico v. Owen, 50 N.J. 101, 109, 232 A.2d 405, 410 (1967).
55. Calvert Credit Corp. v. Williams, 244 A.2d 494, 496 (D.C. 1968).
56. Willier, *supra* note 44; *see also* Senate Report, *supra* note 43, at 16, 29.
57. *Erosion, supra* note 52, at 114, 115; and *see* Willier, *supra* note 34, at 141.
58. *Erosion, supra* note 52, at 115.
59. *Id.* at 117.
60. Willier, *supra* note 34, at 138. Willier categorized this type of statute as a "non-insulation period" statute.
61. Willier, *supra* note 34. According to Willier, these "fixed periods" could vary from five days (in Illinois) to ninety days (in Arizona).

the HDC doctrine. The ultimate result of such a compromise is apparent in the Illinois statutes.[62] An Illinois statute provides that where a negotiable instrument is given before the merchandise is delivered, an assignment to a holder will not preclude the buyer from asserting any defense or right of action, *unless* the original sales contract contains the requisite five-day notification provision. This notice provision allows the buyer five days (from the date of delivery of the merchandise) in which to give written notice of an existing right or defense to the holder.[63] Although this statute fails to adequately protect the consumer from the harsh results of the HDC defense because of the short time in which to act, it clearly exhibits an intent by the legislature to temporarily curb the effects of the HDC doctrine in order to avoid potential harm to an unsuspecting consumer.

Present Criticisms

Legal scholars have for years criticized the HDC doctrine. They uniformly advocate that it be severly restricted or abolished in consumer installment credit transactions, but offer differing rationales as to why it must be done. For instance, some are dissatisfied with watching each court struggle to overcome factual and legal obstacles involved with the HDC doctrine in order to render an equitable solution.[64] Others resent the patchwork-type law which results from each jurisdiction relying on a different theory to defeat the HDC defense.[65] Still another group accuses the federal government of "passing the buck" and "shirking their duties" by neglecting to enact a statute which demands nationwide uniformity of decision.[66]

Which one represents the best reason for doing away with the HDC doctrine in consumer installment credit transactions? The answer is that they all do. There is no valid reason to uphold the age-old theory of HDC when its purpose goes against present-day policies underlying consumer installment credit transactions.[67] In addition to being contrary to present-day policies, the HDC doctrine has become an instrument of oppression to consumers for several reasons. A citizen who is highly protected under one state statute becomes vulnerable if he moves or transacts business in another state.

62. ILL. REV. STAT. ch. 121½, § 262D (1974); *see also* Household Finance Company v. Mowdy, 13 Ill. App. 3d 822, 827, 300 N.E.2d 863, 867 (1973), where the court held that even a waiver of defense clause which was implied in an installment contract was nullified by section 262D.

63. For a comprehensive treatment of *all* state statutes dealing with the HDC doctrine, *see* Willier, *supra* note 34; *see also* Fairfax, *Timely Demise of Holder in Due Course Doctrine*, 5 UCCLJ 117 (1972) [hereinafter cited as Fairfax].

64. Comment, *Unico v. Owen: Consumer Finance Companies as Holders in Due Course Under the UCC*, 54 VA. L. REV. 279 (1968); *see also* Johnston, *Unico v. Owen—Judicial Mastery of the "Hard Case,"* 24 RUTGERS L. REV. 500 (1970).

65. *See, e.g.*, Willier, *supra* note 34.

66. *See, e.g.*, Fairfax, *supra* note 63; and *see* Willier, *supra* note 34.

67. Fairfax, *supra* note 63, at 119: ". . . when you find courts using silly distinctions to avoid the application of a rule of law, the reason may be that the rule has outlived its usefulness."

Individual consumers who cannot afford the cost of litigation are constantly forced into court. Another means of consumer recourse, class action suits, has been discouraged in this area by recent amendments to the TLA.[68] Finally, a "statute which leaves the enforcement to private litigation" rather than to federal regulation "gives the consumer-bilking swindler a license to operate."[69] There is thus an urgent need for a federal statute to restrict or abolish the HDC doctrine as it applies to consumer installment credit transactions.

After a decision has been made in favor of federal legislation, restricting the HDC doctrine in consumer installment credit transactions, the remaining issue centers on the probable consequences of such action. Federal legislation restricting the HDC doctrine would not be unduly burdensome to holders and creditors since other avenues, such as recourse financing, are available to an HDC. Although some advocates maintain that the HDC doctrine is the "oil in the wheels of commerce,"[70] a study in Massachusetts has shown that without it, the consumer credit business would continue with little effect.[71] That study indicated that subsequent to the abolition of the HDC doctrine, the amount of consumer credit increased. Further, there was no evidence that sellers had difficulty in transferring negotiable paper.[72] The net result of abolishing the HDC doctrine amounted to only an increase in recourse financing.[73] For instance where if a dispute existed between the consumer and the seller, the holder could (1) require the seller to remedy the problem; or (2) require the seller to take back the paper; or (3) refuse to take any more of the seller's paper by virtue of his conduct.[74]

The truth remains that consumer installment credit is profitable and that even if the enactment of a statute abolishing the HDC defense in consumer installment credit transactions results in an increase in the number of losses, the banks would not give up the business.[75] The ultimate impact, however, may force all holders to impose an implied rule of "know your customer."[76]

Conclusion

By analyzing the trend in judicial decisions, in state statutes enacted, and in recent interpretations of the scope of the TLA, it is clear that the HDC doctrine should not continue to be a dominant force in consumer installment credit transactions. As indicated by the study in Massachusetts, the existence

68. U.S. Code Cong. & Ad. News 5706, § 408(a)(2)(B) (Dec. 15, 1974).
69. Fairfax, *supra* note 63, at 119.
70. White & Summers, *supra* note 1, at 457.
71. Willier, *supra* note 34, at 143.
72. *Id.* at 144; *see also* Fairfax, *supra* note 63, at 120.
73. The term "recourse financing" refers to the alternatives available to a financial institution (one who buys credit contracts from merchants) when a dispute arises between a merchant and a consumer which could preclude further performance on the contract.
74. *Erosion*, *supra* note 52, at 117; *see also* Willier, *supra* note 34, at 144.
75. Fairfax, *supra* note 63, at 122.
76. *Id.* at 124.

of the HDC doctrine is not necessary to maintain the health of the consumer credit industry or even to provide the "oil in the wheels of commerce" since the credit industry will continue to reap profits while incurring some minor losses. The enactment of a state statute abolishing the HDC doctrine neither increased the cost of credit nor impaired the transferability of the notes. The continued existence of the HDC doctrine for consumer installment credit transactions also produces harsh results for the consumer and "hard cases" for the courts.

Although Congress is willing to defer to state enactments dealing with the HDC doctrine, a comprehensive federal statute is much preferred for several reasons. Through federal regulation of the HDC doctrine, uniformity of court decisions necessary to ensure fairness and justice to all consumers ideally would be guaranteed regardless of the state in which they live or transact business. The yoke that Congress has placed on the courts to determine the method to avoid the "hard case" would be removed by providing federal regulation of the HDC doctrine. No longer would the courts be forced to conjure up various theories, such as creditor/conduit under the TLA or close-connectedness, to overcome harsh results which could have easily been avoided at the outset by a comprehensive federal statute. Congress appears content to bypass its responsibilities in this regard, however, forcing the courts and the state legislatures to carry the burden.[77] Finally, Congress should be the body responsible for enacting comprehensive legislation since only Congress possesses the capability to study the entire problem in all jurisdictions and to enact pervasive legislation.

Admittedly, the solution to this difficult issue is not easily found, but there are numerous alternatives that could be explored, including a few that already have been successful as state statutes. Prior to searching for the ultimate solution, however, Congress must decide between total and partial abolition of the HDC doctrine for consumer installment credit transactions. Although the former, in this author's opinion, is the best choice available, lobbying pressures will weigh heavily in favor of the latter. While the ultimate solution to the consumer installment credit issue remains uncertain, one point is quite clear to today's consumer: Congress must stop shifting its burden to the courts and to the state legislatures and must enact a comprehensive federal regulation restricting the availability of the HDC defense in consumer installment credit transactions.

JAMES B. CURRIE

77. Curiously enough, members of Congress have failed to recognize the double benefit to be derived by enacting such a statute: they would gain votes through consumer appeal, while incurring little additional cost to the federal government—a combination that is rarely experienced in modern politics. *See* Comment, *Unico v. Owen: Consumer Finance Companies as Holders in Due Course Under the UCC*, 54 VA. L. REV. 279, 294 (1968).