Consumer Protection: Judicial Approaches to Rescission and Restoration Under the Truth in Lending Act

Janis K. Stanich
CONSUMER PROTECTION: JUDICIAL APPROACHES TO RESCISSION AND RESTORATION UNDER THE TRUTH IN LENDING ACT

In 1968, Congress enacted the Truth in Lending Act\(^1\) to protect consumers by requiring creditors\(^2\) to disclose certain credit terms\(^3\) to borrowers\(^4\) in a consistent and uniform manner.\(^5\) The Federal Reserve Board has implemented the Act by promulgating Regulation Z, which prescribes both the substance and form of credit disclosures.\(^6\) The Act


2. The Act requires disclosure by those "who regularly extend, or arrange for the extension of, credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, whether in connection with loans, sales of property or services, or otherwise." 15 U.S.C. § 1602(f) (Supp. V 1975). In general, courts have broadly interpreted the term "creditor," making the requirements of the Act widely applicable. See, e.g., Eby v. Reb Realty, Inc., 495 F.2d 646, 650 (9th Cir. 1974) (realtor extending credit to customers in nearly half its sales is "creditor" within meaning of Act); Lauletta v. Valley Buick, Inc., 421 F. Supp. 1036 (W.D. Pa. 1976) (automobile dealer providing credit to automobile buyer is "creditor" subject to the Act's disclosure requirements).


5. Congress summarized this general purpose of the Act as follows:

The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit. 15 U.S.C. § 1601 (1970).

6. The Act specifies what information shall be disclosed, and Regulation Z details the form to be followed in making disclosures. 12 C.F.R. §§ 226.1–1002 (1977); see, e.g., LaGrone v. Johnson, 534 F.2d 1360, 1362 (9th Cir. 1976) (creditor violated the Act by failing to clearly delineate required disclosures from other information provided which was not required).
was intended to alleviate public confusion resulting from inconsistent creditor disclosure practices. This goal was to be accomplished by providing consumers with the credit information necessary to make reasoned decisions. Moreover, Congress envisioned that competition among creditors would be strengthened by enabling consumers to make comparisons and shop for favorable credit terms.

Now, a decade later, both consumer protection advocates and creditors believe that the Act, as written and implemented, is not achieving its stated objectives. Proponents are concerned that the disclosures required are so complex that their impact on consumer credit decisions is negligible. Creditors find it difficult to comply with the regulations and complain of being subjected to needless litigation for harmless violations of the Act.

Because of the intricacy of the statutory provisions and administrative regulations, courts have had to struggle, first, to define what constitutes a violation, and then to apply the appropriate remedial provisions of the Act. One remedial provision presenting particular

---

7. Prior to adoption of the Act, creditors calculated finance charges by a variety of methods. Some used a monthly rate, and others based the charge on the original rather than the declining balance of the obligation. Still others added incidental fees and charges to the basic finance charge, and some informed the consumer of only the dollar cost of credit without reference to rate. [1968] U.S. CODE CONG. & AD. NEWS 1962. 1970.


9. Senator Proxmire, original sponsor of the Act, remarked: "I doubt that many consumers take the time to wade through all the information provided. The essential items . . . are lost amid dozens of other numbers, computations and notices." Truth in Lending Act Needs Comprehensive Overhauling, Says Proxmire, 31 PERSONAL FINANCE L.Q. REP. 16, 16 (1976) [hereinafter cited as Proxmire Remarks]. See Warren, Consumer Credit Law: Rates, Costs, and Benefits, 27 STAN. L. REV. 951, 962-63 & n.72 (1975) (there is no compelling evidence borrowers do more comparative shopping for credit than they did before adoption of the Act).


11. A good example of the protracted litigation that has ensued under some provisions is the question of when and how acceleration clauses should be disclosed. For a summary of the judicial approaches to this problem, see 46 CIN. L. REV. 284, 285-87 (1977).

interpretive difficulties is section 1635, which enables the borrower to rescind certain loan transactions in which his home has been encumbered. Some courts do not require the borrower to restore the creditor following rescission; others find mutual restoration to be a statutory requisite. This comment will describe the statutory scheme for rescission and restoration, identify where and why interpretive problems arise, summarize the judicial approaches to these problems, and analyze those approaches in relation to the stated purposes of the Act.

I. STATUTORY RESCISSION AND RESTORATION

A. The Rescission Provision: Subsection 1635(a)

Subsection 1635(a) applies to loan transactions in which the creditor retains a security interest other than a first lien on the borrower's principal residence. It gives an absolute right to rescind for three business days following finalization of the transaction; the right continues thereafter for three years if the creditor fails to make any material disclosure, including disclosure of the right of rescission.

Rescission under subsection 1635(a) should not be confused with

14. Courts taking this position are herein referred to as the literalists. See Part II-A infra.
15. These courts are herein referred to as the discretionists. See Part II-B infra.
16. 12 C.F.R. § 226.2(gg) (1977) defines "security" and "security interest" as "any interest in property which secures payment or performance of an obligation." But see Meyers v. Clearview Dodge Sales, Inc., 539 F.2d 511 (5th Cir. 1976) (creditor does not obtain a security interest when a confession of judgment is contained in a chattel mortgage); Mims v. Dixie Fin. Corp., 426 F. Supp. 627 (N.D. Ga. 1976) (assignment and waiver of homestead does not create a security interest).
18. For a discussion of when rescissionary relief is available under the Act, see Griffith, Truth-In-Lending and Real Estate Transactions: Some Aspects, 2 Ohio N. L. REV. 1 (1974).
19. The courts have rarely questioned whether a creditor's violation is "material" because ordinarily borrowers rescind when creditors have made multiple violations of the Act. Nonetheless, there is a largely undefined area of "inmaterial" violations which will not justify an act of rescission. See, e.g., Ivey v. United States Dept. of Hous. & Urban Dev., 428 F. Supp. 1337 (N.D. Ga. 1977), in which the creditor miscalculated the total amount financed by $11.30. The court held that the violation "was not a 'material' non-disclosure," establishing the test that a violation which would not be of significance to a reasonable consumer comparison shopping for credit will not justify an act of rescission. Id. at 1343.
nonstatutory rescission, which requires as a condition that the rescinding party tender restitution.\textsuperscript{20} By the terms of the Act, the borrower may rescind merely by giving notice to the creditor,\textsuperscript{21} whereupon he is absolved of further obligation under the transaction and "is not liable for any finance or other charge."\textsuperscript{22} Thus, termination of the borrower's contractual obligations through rescission is both a remedy and a method for privately enforcing the disclosure requirements of the Act. The noncomplying creditor risks losing his expected return on the loan and having to bear the administrative costs of the transaction. In the event of court action to enforce rescission, the creditor also will incur litigation expenses. In addition, the creditor may concurrently be liable for civil damages.\textsuperscript{23} If he should lose the civil suit, the statute requires him to pay the borrower's reasonable attorney's fees. Courts have also awarded attorney's fees to borrowers who successfully sue to enforce rescission.\textsuperscript{24}

\textsuperscript{20} Nonstatutory abrogation of an agreement may take the form of legal rescission or equitable discharge, but either theory requires the rescinding party to make restitution. 12 S. WILLISTON, CONTRACTS § 1454, at 10 (3d ed. 1970). The mechanics of completing rescission and restitution vary, however, with the theory of relief. At law, rescission is accomplished by act of the parties upon notice and tender of restitution by the rescinding party, whereas, in equity, the court determines whether to discharge the contract and ensures restitution for both parties as a condition of its order. See Dobbs, Pressing Problems for the Plaintiff's Lawyer in Rescission: Election of Remedies and Restoration of Consideration, 26 ARK. L. REV. 322, 341-46 (1972).

\textsuperscript{21} 15 U.S.C. § 1635(a) (Supp. V 1975). The Board requires the creditor to provide the obligor written notice of the right to rescind. 12 C.F.R. § 226.9(b) (1977). Thereafter, an obligor electing to rescind must give written notice to the creditor, but need not state grounds for election. 12 C.F.R. § 226.9(a) (1977). But see Powers v. Sims & Levin, 542 F.2d 1216, 1220 (4th Cir. 1976) (plaintiff's notice of rescission held to be invalid when accompanied by indication of unwillingness to make restitution).

\textsuperscript{22} The effect of rescission under § 1635(a) is stated in 15 U.S.C. § 1635(b) (Supp. V 1975).

\textsuperscript{23} There has been controversy over whether a civil award under § 1640 and rescission under § 1635 present independent or mutually exclusive remedies. Some courts have held that the sections are inconsistent remedial provisions requiring the borrower to elect his remedy. See Bostwick v. Cohen, 319 F. Supp. 875 (N.D. Ohio 1970), in which a creditor acquired a security interest as part of an agreement to install a swimming pool. When the borrower sought both to rescind and to recover civil damages, the court held the election of remedies doctrine to be applicable. The Supreme Court has, however, referred to § 1640 as a penal provision. Mourning v. Family Publications Serv., Inc., 411 U.S. 356, 375 (1973) (dictum) (the Act should not be narrowly construed simply because it contains provisions for civil and criminal penalties). Lower courts have relied on the Court's dictum to hold that since the civil liability provision is penal, the election of remedies doctrine is inapplicable and borrowers may seek to rescind and recover civil damages. See Eby v. Reb Realty, Inc., 495 F.2d 646, 651 (9th Cir. 1974) (both remedies are available for admitted creditor violations of the Act). See also Note, Truth In Lending Act Litigation: Concurrent Recourse to Rescission and the Civil Penalty, 43 GEO. WASH. L. REV. 840, 846-69 (1975).

B. Restoration Following Rescission: Subsection 1635(b)

Subsection 1635(b) details the performances necessary to complete restoration after the borrower has rescinded. Upon rescission, restitution for the borrower is partially accomplished because the creditor’s security interest becomes void. Following rescission, the creditor must return any money or property received from the borrower, and take the steps necessary to reflect termination of his security interest. When the creditor’s security interest has been recorded, these further steps are necessary to restore the borrower completely; title to the borrower’s property may remain clouded until the public record reflects termination of the security interest. Once the creditor has cleared title, the borrower is then required to tender back the consideration received—whether money or property—or its reasonable value. The creditor must then take possession of the tendered con-

damages to reasonable attorney’s fees; however, the Act makes no corresponding provision for consumers seeking to enforce the right of rescission. Nonetheless, most courts have awarded attorney’s fees to rescinding plaintiffs on the theory that § 1640(a)(3), which authorizes attorney’s fees “in the case of any successful action to enforce the foregoing liability,” refers to actions for nondisclosure violations, and is therefore broad enough to encompass rescissionary actions. See, e.g., James v. Ragin, 432 F. Supp. 887, 894 (W.D.N.C. 1977); Burley v. Bastrop Loan Co., 407 F. Supp. 773, 778–79 (W.D. La. 1975).

25. 15 U.S.C. § 1635(b) (Supp. V 1975) is entitled “Return of money or property following rescission,” and requires each party to tender back consideration according to the procedure specified therein.

26. Id.

27. Id.

28. Technically, as regards the creditor’s security interest, restitution for the borrower occurs when the security becomes void upon rescission. Still, the documents that created the interest remain, and the statute requires the creditor to make the public records reflect termination of that security interest. Until the documents are terminated, the borrower’s title to the property may remain clouded. See, e.g., Ljepava v. M.L.S.C. Properties, Inc., 511 F.2d 935 (9th Cir. 1975) (rescinding borrowers had difficulty selling property subject to lender’s void security interest). The term “restoration,” as distinct from restitution, will be used herein to refer generally to whatever steps are necessary to put the parties in the position each would have occupied had the original transaction never occurred.


30. Id. The rescission provision of the Act applies to two general types of consumer credit transactions. The borrower may obtain a second mortgage loan and use the proceeds for investment or other purposes, in which case the Act would require the borrower to tender back the money advanced by the creditor. See, e.g., Palmer v. Wilson, 502 F.2d 860, 862–63 (9th Cir. 1974) (the court remanded, directing the lower court to devise a repayment plan whereby the borrower could return the proceeds of the second mortgage loan). A requirement that the borrower tender back consideration given may, however, be impractical or inequitable when the borrower has entered into a home improvement type loan. In such case, tender back of the reasonable value of the property purchased would be permissible.
sideration within ten days or forfeit it to the borrower.\textsuperscript{31} By this statutory process, both parties are ultimately returned to the status quo ante.

C. Interpretation of Subsections 1635(a) and (b)

Interpretation and enforcement of subsections 1635(a) and (b) present difficulties because the courts must define and assume a judicial role for which Congress did not provide.\textsuperscript{32} Subsection 1635(b) directs each party to restore the other following rescission, suggesting that the provision will be self-enforcing. Examination of the typical fact patterns prompting subsection 1635(b) litigation, however, illustrates why judicial enforcement is often necessary. Although statutorily obligated to clear title to the borrower's property following rescission, creditors are often reluctant to do so. The creditor who asserts a good faith defense to the borrower's act of rescission will claim that she is by reason of that defense under no obligation to make restoration as required by subsection 1635(b).\textsuperscript{33} More generally, the creditor will not clear title because the rescinding borrower ordinarily is unable to make full and immediate repayment of the loan proceeds.\textsuperscript{34} The creditor may even have specific indications of the borrower's lia-

\begin{itemize}
\item \textsuperscript{31} 15 U.S.C. § 1635(b) (Supp. V 1975).
\item \textsuperscript{32} Subsection 1635(b) "contemplates an orderly progression of specific events" whereby the parties exchange consideration received. Sosa v. Fite, 498 F.2d 114, 118 (5th Cir. 1974). It does not provide for judicial intervention. Presumably, had Congress expected § 1635(b) to produce court actions, it would have included provision for a judicial role. See Burley v. Bastrop Loan Co., 407 F. Supp. 773, 779 (W.D. La. 1975) (the court noted that there is no convincing evidence that Congress contemplated litigation under the provision). The attempt to extrapolate congressional intent is a particularly imprecise endeavor here where the Act as initially proposed did not mention rescission. An amendment provided for a three day notice before execution period, see 114 Cong. Rec. 1611 (1968) (remarks of Rep. Cahill), and a conference committee appointed to reconcile House and Senate differences included in its report a rescission provision requiring contemporaneous acts of restoration by both parties. [1968] U.S. Code Cong. & Ad. News 2021, 2023. As finally enacted, the borrower's obligation to make restitution does not arise until the creditor's concomitant obligation has been fulfilled. 15 U.S.C. § 1635(b) (Supp. V 1975). For a thorough discussion of the interpretive difficulties surrounding the rescission provision arising from the scant indicators of congressional intent, see Note, supra note 23, at 842–43.
\item \textsuperscript{33} The borrower may rescind by notifying the creditor, and need not state grounds justifying that act. See note 21 supra. Unless the act of rescission is valid, the creditor is not correspondingly bound to make restitution. This is the position of creditors asserting defenses to alleged violations of the Act. See, e.g., LaGrone v. Johnson, 534 F.2d 1360 (9th Cir. 1976) (creditor claimed that disclosures of an acceleration clause and the amount financed were adequate).
\item \textsuperscript{34} A recent survey of plaintiffs' attorneys showed that about one-half of the borrowers bringing claims under the Act sought legal assistance simply because they were
\end{itemize}
bility or unwillingness to tender back consideration.\textsuperscript{35} Fearing that the loan proceeds will be unrecoverable, the creditor attempts to ensure recovery by retaining her security interest despite the borrower's act of rescission.

If the creditor fails to clear title to the borrower's property, the rescinding borrower may request the court to make the public record reflect termination of the security interest voided by the rescission.\textsuperscript{36} This result can be accomplished judicially through issuance of a termination order that has the effect of cancelling the operative documents.\textsuperscript{37}

If the court does no more than issue a termination order, the borrower is fully restored, but the creditor may well be left without practical means of obtaining restitution of money or property transferred.\textsuperscript{38} If the court refuses to issue such an order,\textsuperscript{39} the creditor's

\begin{itemize}
\end{itemize}

Courts have also noted that rescinding borrowers are often unable to make full restoration immediately. See, \textit{e.g.}, Palmer v. Wilson, 502 F.2d 860, 862–63 (9th Cir. 1974) (the court remanded, stating that a repayment plan consistent with the borrower's current financial situation might be devised). In dissent, Judge Wright also indicated that borrowers will commonly be unable to make immediate restoration. \textit{Id.} at 864. One explanation for the borrower's inability to make repayment is that in the cases reported, rescission occurred long after the borrower had expended or transformed the loan proceeds. See, \textit{e.g.}, Sosa v. Fite, 498 F.2d 114, 116–17 (5th Cir. 1974) (rescission occurred approximately two years after the parties entered into the transaction); cf. Strader v. Beneficial Fin. Co., 551 P.2d 720, 722 (Colo. 1976) (rescission permitted under state Uniform Consumer Credit Code when borrower rescinded eleven months after consumation of the transaction).

\textsuperscript{35} See Powers v. Sims & Levin, 542 F.2d 1216, 1220 (4th Cir. 1976) (bulk of the loan proceeds were used to discharge existing indebtedness, and the court found that the rescinding plaintiff specifically expressed unwillingness to tender back consideration); LaGrone v. Johnson, 534 F.2d 1360 (9th Cir. 1976) (creditor instigated foreclosure proceedings because borrower had defaulted on two identical loan agreements; borrower rescinded, and the court found that the rescission was an attempt to extricate herself from her obligations).

\textsuperscript{36} The courts uniformly refer to the cases arising under § 1635(b) as actions for rescission. See, \textit{e.g.}, Palmer v. Wilson, 502 F.2d 860 (9th Cir. 1974). As provided in § 1635(a), however, rescission occurs upon notice by the borrower before the court is consulted. See note 21 \textit{supra}. All contractual obligations are terminated upon notice, and the court is petitioned only for full restoration following rescission.

\textsuperscript{37} The court will issue whatever order is necessary to reflect termination of the voided security interest and fully restore the borrower to the status quo ante. The court may issue a termination order which also requires the borrower to restore the creditor.

\textsuperscript{38} Restitution may be unavailable simply because borrowers are unable to repay the debt immediately. See note 34 and accompanying text \textit{supra}. If the court does not enter judgment for the creditor in the amount of the loan proceeds, she cannot attach any assets the borrower might have.

In addition, if the federal court does not ensure restoration for the creditor, she may not have a state forum in which to assert her claim. The creditor's interest in
voided security interest is effectively reinstated and the lender may then attempt to enforce it to obtain immediate restoration. In that case, however, the borrower has not been restored, because the security interest taken incident to the rescinded transaction has been given renewed validity. Thus, the court cannot ensure immediate restoration for both parties by issuing or denying a termination order.

When litigation occurs, courts must recognize that immediate restoration of both the creditor and the borrower may be mutually exclusive objectives. Some courts, interpreting the statute literally, order termination, but do not require the borrower then to restore the creditor. Other courts invoke discretion to achieve a result consonant with nonstatutory rules governing rescission by ensuring some measure of deferred restoration for both parties following rescission. The remainder of this comment examines these two lines of judicial reasoning, and concludes that the discretionary approach better fulfills congressional purposes.

restitution may be characterized as a compulsory counterclaim under Federal Rule of Civil Procedure 13(a). Palmer v. Wilson, 502 F.2d 860, 864 (9th Cir. 1974) (Wright, J., concurring in part and dissenting in part). If so, the creditor will later be barred from raising the issue. See 17 HUGHES FEDERAL PRACTICE JURISDICTION & PROCEDURE § 20572 (1940).

State court relief has also been denied the creditor on the theory that since the contract has been rescinded, the creditor cannot recover on a "void, annulled obligation." Burley v. Bastrop Loan Co., 407 F. Supp. 773, 778 (W.D. La. 1975). There is little support for the court's reasoning in Burley because a creditor's interest in restitution is quasi-contractual or equitable, but not contractual, therefore the creditor was not attempting to recover on the original obligation.

39. No court has refused to issue a termination order, but the discretionist courts, most notably in the Ninth Circuit, have issued termination orders contingent upon repayment of the loan proceeds. See Part II–B infra.

40. If the documents reflecting the security interest remain intact, it is for all practical purposes reinstated, because title to the borrower's property remains clouded and all parties dealing with respect to that property will act as if the interest remained valid. Palmer v. Wilson, 502 F.2d 860, 863 (9th Cir. 1974) (Wright, J., concurring in part and dissenting in part).

41. The phrase "immediate restoration" for the creditor refers to any means whereby the creditor may be able to recover the entire amount of the loan proceeds at one time following rescission. A reinstated security interest may allow the creditor to do this. See note 40 supra. Immediate restoration for the borrower refers to the unconditional termination of all evidence of the lender's security interest following rescission. See note 28 & 37 supra.

42. See Part II–A infra.

43. See Part II–B infra.

44. See note 20 supra.

45. Deferred restoration results when a party may ultimately be fully restored, but restoration is contingent or completed over time. When the borrower repays the loan proceeds over a period of time, the creditor receives deferred rather than immediate restoration. Similarly, the borrower receives only deferred restoration when the lender's security interest is reinstated until the full amount has been repaid.
II. THE LITERALIST AND DISCRETIONIST INTERPRETATIONS OF SUBSECTION 1635(b)

A. The Literalist Approach

When the creditor fails to clear title following rescission, subsection 1635(b), read literally, seems to require the court to order termination and leave the borrower's obligation to make restoration unenforced.\(^{46}\) Issuing the order is necessary to restore the borrower immediately.\(^{47}\) The statute, however, requires the creditor to provide restoration as a condition precedent to the borrower's reciprocal obligation.\(^{48}\) Technically, the condition is not fulfilled by the court's order of termination. Thus, unless the creditor clears title, literalist reasoning dictates that the borrower's obligation to repay is excused.\(^{49}\)

Literalist reasoning differs somewhat when the borrower offers restoration upon giving notice of rescission, or indicates a willingness to do so.\(^{50}\) Here, the borrower's offer of restoration is considered equivalent to actual statutory tender. When the borrower has made statutory tender, ordinarily after the creditor has cleared title, subsection 1635(b) directs the creditor to take possession of the proffered consideration within ten days or forfeit it to the borrower. The literalist court considers the borrower's willingness to make restoration sufficient in itself to activate this forfeiture clause, leaving the creditor


\(^{47}\) See notes 26–28 and accompanying text supra.

\(^{48}\) Subsection 1635(b) reads in pertinent part: "Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor." 15 U.S.C. § 1635(b) (1970) (emphasis added).

\(^{49}\) In Gerasta v. Hibernia Nat'l Bank, 411 F. Supp. 176 (E.D. La. 1975), the court ordered termination, but did not require the borrower to make restitution. The court stated: "Because [the creditor] chose not to respond within ten days of the date upon which the plaintiffs rescinded the transaction, tender by the plaintiffs of the loan proceeds . . . was, therefore, not required." Id. at 191. See also Powers v. Sims & Levin Realtors, 396 F. Supp. 12, 25–26 (E.D. Va. 1975) (creditor must clear title as a condition precedent to borrower's obligation to make restitution, and the borrower is excused from tendering back when the condition is not met), rev'd, 542 F.2d 1216 (4th Cir. 1976) (there is no condition precedent to clear title when it is clear that the borrower does not intend to repay).

\(^{50}\) See, e.g., Sosa v. Fite, 498 F.2d 114 (5th Cir. 1974) (borrower's notice of rescission was accompanied by an express offer of restoration, and the court construed the offer as equivalent to statutory tender, concluding that, as a result, the forfeiture clause of § 1635(b) was activated).
with no statutorily enforceable right to restoration after the ten days have expired.\textsuperscript{51}

Literalists concede that either the excuse or forfeiture analysis generally renders the creditor unable to recover the loan proceeds.\textsuperscript{52} These courts reason that this result is harmonious with the broad congressional goals of providing debtor protection and encouraging creditor compliance with the terms of the Act.\textsuperscript{53} In their view, when the parties fail to comply with subsection 1635(b) directives, an unconditional termination order is proper because it fully protects the borrower's property from the threat of foreclosure by a creditor who acquired a security interest without making full disclosures.\textsuperscript{54} If the creditor is then faced with a potential loss of consideration, she will have an incentive to clear title to the borrower's property as required by subsection 1635(b). In this way, the literalist interpretation encourages creditor compliance with the terms of the Act and thereby promotes the informed use of consumer credit.\textsuperscript{55}

Courts adopting the literalist approach recognize that the result is incongruous with traditional rules of rescission and restitution, and also with one objective of subsection 1635(b)—ultimately to return both parties to the status quo ante. These courts reason, however, that this result occurs only when the creditor has frustrated the statutory

\textsuperscript{51} Some courts have adopted the forfeiture theory when there was no evidence of the borrower's willingness to tender back. See Gerasta v. Hibernia Nat'l Bank, 411 F. Supp. 176, 191 (E.D. La. 1975); Powers v. Sims & Levin Realtors, 396 F. Supp. 12, 25-26 (E.D. Va. 1975) (the court explicated both the excuse and forfeiture theories), rev'd, 542 F.2d 1216 (4th Cir. 1976).


\textsuperscript{53} Although the courts split as to whether a literalist or discretionist approach to the statute is proper, substantially all commentators support the literalist reading and contend that the use of discretion contravenes the protective intent of the legislation. See, e.g., Note, supra note 23, at 846; Note, Truth-In-Lending: Judicial Modification of the Right of Rescission, 1974 Duke L.J. 1227; 48 Colo. L. Rev. 437 (1977).

\textsuperscript{54} Judge Wright has best explicated the literalist interpretation. He reasoned that any termination order which does not entirely unburden the borrower of the effect of the security interest contravenes the purpose of the provision. Palmer v. Wilson, 502 F.2d 860, 863-64 (9th Cir. 1974) (Wright, J., concurring in part and dissenting in part). See generally 114 Cong. Rec. 1611 (1968) (remarks of Rep. Cahill).

\textsuperscript{55} One court wrote:
We hold that this statutory provision is intended as an impetus for the creditor to take immediate action to clear title and to fulfill its obligations. If not interpreted in this way, there is no stimulus for the creditor to comply with the statutory provisions requiring him to release the security interests within the ten day period.

scheme by failing to perform as required by subsection 1635(b). They would conclude that this result is not unduly harsh because the creditor can avoid the loss of consideration by clearing title as required.

B. The Discretionist Approach

Some courts find the literalist result unpalatable. They enforce subsection 1635(b) by invoking discretion to balance the equities of the case in view of the legislative policy concerns underlying the Act and the general restorative aim of subsection 1635(b). In the context of this provision, the most important legislative policy concern is to protect the borrower's property from foreclosure by a creditor who gained a security interest without making the required disclosures.


57. Although the discretionist approach has garnered some support, courts exercising discretion have evoked judicial dissent and critical commentary. See, e.g., Powers v. Sims & Levin, 542 F.2d 1216, 1222 (4th Cir. 1976) (Winter, J., concurring in part and dissenting in part); Palmer v. Wilson, 502 F.2d 860, 863–64 (9th Cir. 1974) (Wright, J., concurring in part and dissenting in part); Note, Truth-In-Lending: Judicial Modification of the Right of Rescission, 1974 DUKE LJ. 1227, 1241; Note, supra note 23, at 846. The criticism is largely deserved, not because the discretionist position is unsound, but because judicial articulation of the discretionist approach has been incomplete, conceptually confusing, and consequently susceptible to attack. The courts use the phrase “conditional rescission” when “conditional termination” apparently is intended. For example, in LaGrone v. Johnson, 534 F.2d 1360 (9th Cir. 1976), the court properly referred to the district court's failure to “condition cancellation,” but then stated that the issue on appeal was whether to “condition rescission.” The distinction is vital, because rescission occurs upon notice under §1635(a), and if the court determines that the creditor has indeed violated the Act, the borrower was entitled to rescind. Thereafter, the use of discretion is relevant only to the issue of how to enforce the restitutionary provisions of §1635(b) following rescission.

58. The propriety of the court's order “of course will depend on the equities present in a particular case, as well as consideration of the legislative policy of full disclosure ... and the remedial-penal nature of the private enforcement provisions of the Act.” Palmer v. Wilson, 502 F.2d 860, 862 (9th Cir. 1974).

59. The Court of Appeals for the Fourth Circuit reasons that the effect of rescission is to absolve the borrower of the obligation to pay finance or other charges, but that it does not relieve him of the duty to make restoration. Rather, §1635(b) requires the borrower to fulfill that obligation. Thus, §1635(b) and traditional equitable concepts both result in the restoration of each party, and thereby require judicial enforcement of the borrower's obligation to make restoration. Powers v. Sims & Levin, 542 F.2d 1216, 1220–22 (4th Cir. 1976).

60. Congress expressed particular concern for the potentially grave eventuality of home foreclosure that can result when the creditor takes a security interest and the borrower does not perform as contractually obligated. 114 Cong. Rec. 1611 (1968) (remarks of Rep. Cahill). Under the statute, if the borrower was not informed of essential credit terms, especially the taking of the security interest, she could resort to
discretionist court, after finding that a material violation of the Act validates the borrower's rescission, would consider the following factual variables before ordering restoration for either party: (1) whether the creditor asserted a good faith defense to the borrower's act of rescission;\(^6\) (2) of what significance the creditor's violation would be to a reasonable consumer, comparison-shopping for credit;\(^6\) (3) whether the borrower indicated either willingness or ability to repay the loan proceeds;\(^6\) and (4) whether other means of enforcing creditor compliance are available.\(^6\)

Under this balancing approach,\(^6\) a court can order unconditional-

---

61. A good faith defense will not invalidate the borrower's act of rescission if a material violation by the creditor is found. See note 19 and accompanying text supra. Nevertheless, the defense would be an equitable consideration in the discretionist balancing. See notes 34–35 and accompanying text supra for an explanation of why a creditor might fail to clear title under § 1635(b) following the borrower's rescission.

62. The importance of this factor is that it indicates the relative significance of the policy concern for protecting the uninformed borrower. See note 60 supra. Additionally, this factor, in conjunction with evidence of the borrower's willingness or ability to tender back, see note 63 infra, can help to expose the borrower who, unharmed by the creditor's violation, is attempting to escape both his contractual and restorative obligations.

63. Like the assertion of a good faith defense, this factor can help to explain whether the creditor had any justification for refusing to clear title. See Powers v. Sims & Levin, 542 F.2d 1216 (4th Cir. 1976), in which the court stated that "surely the Congress did not intend to require a lender to relinquish its security interest when it is now known that the borrowers did not intend and were not prepared to tender restitution." Id. at 1221.

64. The lender should not escape without liability for his violation. Powers v. Sims & Levin, 542 F.2d 1216, 1222 (4th Cir. 1976). The concern, however, is that the loss of consideration in addition to other sanctions such as civil liability may work a penalty that is "too harsh" and therefore presumably unintended by Congress. Palmer v. Wilson, 502 F.2d 860, 862 (9th Cir. 1974); Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974).

65. Two examples illustrate application of the balancing approach. Assume B contracts with C for home improvements, and C takes a security interest in B's home. C does not make full credit term disclosures and B, unversed in the English language, is unaware that the creditor has acquired a security interest in her home. B makes timely repayments until she becomes dissatisfied with C's faulty workmanship. B gives notice of rescission accompanied by an offer to return the home improvements. C asserts no defense to violations of the Act, but refuses to clear title to B's property. See Sosa v. Fite, 498 F.2d 114 (5th Cir. 1974). Here, C's refusal to clear title seems unjustified. He asserted no good faith defense, and he was not attempting to retain necessary insurance of restoration, because B offered to make restoration. B, unaware that a security interest had been taken in her home, could not have made an informed credit decision. See note 60 supra. Thus, the need to protect B's property is great, and the creditor's interests slight. Under these circumstances, an unconditional termination order could be appropriate.

Now assume C takes a security interest in B's home to secure repayment of a
Truth in Lending

al termination without provision for creditor restoration and thereby achieve the same result as a literalist court. Generally, however, the court's order will reflect the restorative obligations of both parties. It is usually necessary to order deferred restoration, because the borrower cannot immediately repay the full amount of the loan proceeds. Deferred restoration can be accomplished by either conditioning termination upon the borrower's compliance with a realistic repayment plan, or granting termination unconditionally and entering judgment for the creditor in the amount of the loan proceeds.

$12,000 loan. The first monthly installment is $60, and all others are $50. makes full disclosures, except that he uses the $50 per month to compute the total of payments and thereby understates the total by $10. See Ivey v. United States Dept of Hous. & Urban Dev., 428 F. Supp. 1337 (N.D. Ga. 1977). B defaults. B and agree to avoid foreclosure by signing a new loan agreement identical to the first. B again defaults. See LaGrone v. Johnson, 534 F.2d 1360 (9th Cir. 1976). C instigates foreclosure proceedings, whereupon B rescinds, indicating that she will not repay the loan. See Powers v. Sims & Levin, 542 F.2d 1216 (4th Cir. 1976). When C fails to clear title, B initiates an action to enforce § 1635(b) and also seeks civil damages under § 1640. C defends, claiming his violation was "technical." Here, it does not appear that C's violation would be of special significance to a reasonable consumer comparison-shopping for credit. This, combined with the fact that B rescinded only after C instigated proceedings for B's failure to meet her contractual obligations, and B's indication to C that she did not intend to make restoration, would support a finding that B was not an uninformed borrower, but was merely attempting to extricate herself from an unwanted transaction. In addition, C's failure to clear title does not mitigate against fulfilling the restorative purpose of § 1635(b). His defense appears to have been made in good faith, and his fear that B would not make restitution seems legitimate. Finally, the availability of civil liability seems an adequate sanction for C's violation, and a reasonable means to further the general goal of encouraging creditor compliance. Here, an order of deferred restoration would be proper.

Courts employing the discretionist approach have great flexibility to shape termination orders. In Ljepava v. M.L.S.C. Properties, Inc., 511 F.2d 935 (9th Cir. 1975), the district court conditioned termination upon repayment of the loan proceeds. The borrower was unable to tender fully because the cloud on title to his property remained and he was unable to deal with the property to procure the funds to tender restoration. The court of appeals remanded, directing the lower court to fashion a more equitable order reflecting the rights and obligations of both parties. at 944–45.

See notes 34–35 and accompanying text supra.

See, e.g., Palmer v. Wilson, 502 F.2d 860 (9th Cir. 1974).

See, e.g., Rachbach v. Cogswell, 547 F.2d 502, 505 (10th Cir. 1976) (rescission relieves the borrower of the obligation to pay finance charges, but the creditor deserves judgment for the amount of the outstanding loan proceeds); James v. Ragin, 432 F. Supp. 887, 894 (W.D.N.C. 1977). To enter judgment produces deferred restoration for the creditor because he must find an attachable asset to enforce the judgment. If the borrower has no assets other than her interest in the subject property, restoration may be unavailable because homestead exemptions, available in many states, will probably prevent the judgment from attaching to the property. See, e.g., Wash. Rev. Code § 6.12.040 (1976) (declaration of homestead); id. § 6.12.090 (homestead exempt from execution); id. § 6.12.100 (homestead subject to execution). For a discussion of the protection afforded the borrower by homestead laws similar to the Washington statute, see 1975 Wis. L. Rev. 192, 198–99.
Discretionist courts reason that deferred restoration for each party following rescission is consonant with the language and purpose of subsections 1635(a) and (b). Subsection 1635(a) is viewed as a substantive provision granting relief in the form of rescission; subsection 1635(b) is characterized as a procedural provision detailing the mechanics of restoration, first for the borrower and then for the creditor.\textsuperscript{70} The combined effect of these two provisions is to abrogate contractual obligations and then to restore both parties, a result consistent with traditional principles of rescission.\textsuperscript{71} Thus, the role developed by the discretionist court is to restore both parties to the extent possible following rescission by fashioning a remedy that parallels the subsection 1635(b) requirements left unfulfilled by the parties. Unlike the literalists, the discretionist court would reach a different result only when, under the facts presented, legislative policy concerns outweigh the mutual restorative aim of the provision.\textsuperscript{72}

III. RECOMMENDING THE DISCRETIONIST APPROACH

Subsection 1635(a) allows a borrower to rescind a credit transaction on grounds of material nondisclosure.\textsuperscript{73} Thereafter, subsection 1635(b) is aimed at achieving equity between the parties by returning each to the status quo ante.\textsuperscript{74} The discretionist thesis advances both of these objectives by ordering deferred restoration when full and immediate restoration for both parties is not possible.\textsuperscript{75} A borrower unable to make full repayment has an effective remedy of rescission, because the discretionist court can protect his property from foreclosure by ordering repayment of the loan proceeds according to terms consistent with his ability to repay.\textsuperscript{76} The discretionist approach is also consis-

\textsuperscript{70} For example, the court in Powers v. Sims & Levin, 542 F.2d 1216, 1221 (4th Cir. 1976), characterized § 1635(b) as a procedural provision.

\textsuperscript{71} See note 20 and accompanying text supra.

\textsuperscript{72} See Burley v. Bastrop Loan Co., 407 F. Supp. 773 (W.D. La. 1975) (the court refused to enforce restoration for the creditor, but stated that such a result might be appropriate but for the creditor's unwillingness to refinance the money owing).

\textsuperscript{73} See note 19 and accompanying text supra.

\textsuperscript{74} See Part I-B supra.

\textsuperscript{75} See note 45 and accompanying text supra.

\textsuperscript{76} The court's order can take any appropriate form. The court will consider the borrower's finances in fashioning a termination order requiring repayment, see Palmer v. Wilson, 502 F.2d 860, 862-63 (9th Cir. 1974), and the borrower need only comply with the court's order to avoid enforcement of the security interest. If judgment is
tent with the judicial approach taken to enforce any statute when the plaintiff seeks other than money or judgment relief and Congress has not denied the courts discretion to determine the rights of the parties.\textsuperscript{77}

Extensive reform of the Act has been widely urged.\textsuperscript{78} The need to amend subsections 1635(a) and (b) is demonstrated by the necessity of judicial enforcement\textsuperscript{79} and the chasm between the literalist and discretionist interpretations. Pending reform, the assumption of a broad discretionary judicial role allows a court to consider the circumstances surrounding the creditor's failure to clear title which result in the breakdown of the subsection 1635(b) scheme for restoration.

Creditors may reasonably be expected to assert good faith defenses to the borrower's act of rescission in many cases.\textsuperscript{80} A creditor with a good faith defense should not forfeit his interest in restoration by asserting a right to judicial validation of the borrower's act.\textsuperscript{81} To so enforce the provision does not promote the congressional goal of strengthening competition among creditors to lower the costs of consumer credit.\textsuperscript{82} On the contrary, creditors may react to what they believe is an unfair penalty by making credit more difficult to obtain.

\textsuperscript{77} Although they rarely say so explicitly, discretionist courts rely on the proposition that a court may always exercise discretion when it is requested to grant equitable relief. In the context of § 1635(b) cases, the equitable relief sought is the termination order which determines the restorative rights and obligations of the parties following rescission. See Powers v. Sims & Levin, 542 F.2d 1216, 1221 (4th Cir. 1976), wherein the court characterized the relief sought by the rescinding borrower as equitable, and found nothing in the statutory provisions to prevent the court from exercising its discretion to grant such equitable relief. \textit{But see id.} at 1223 n.2 (Winter, J., concurring in part and dissenting in part) (suggesting that, in enforcing a statutory remedy, discretion should not be invoked if it is not expressly authorized by Congress).

\textsuperscript{78} See notes 8–10 and accompanying text supra.

\textsuperscript{79} Judicial enforcement is required only when the parties do not meet the restorative mandates of § 1635(b). See Part I–C supra.

\textsuperscript{80} When creditors are uncertain whether their disclosures are adequate, they may later defend against allegations of noncompliance. The problem has been succinctly stated: "In short, the requirement of selective term disclosure and the all-is-relevant philosophy has made compliance extremely difficult and the chance of a violation extremely high." Landers, \textit{supra} note 34, at 676. See also notes 9–11 and accompanying text supra.

\textsuperscript{81} Forfeiture would occur under the literalist approach, because its reasoning is absolute and contains no device for measuring the fact of a good faith defense. See Part II–A supra.

\textsuperscript{82} Senator Proxmire reasons that the net effect of the prodigious amount of litigation generated by unintentional and harmless violations is to increase creditors' costs, and that those costs are then passed on to the consumer. \textit{Proxmire Remarks, supra} note 9. See also 48 COLO. L. REV. 437, 449 (1977).
and increasing consumer credit charges to reflect their increased costs. The discretionist court can consider the creditor's good faith defense in determining how to enforce restoration for the parties.

Commonly, however, creditors try to retain their security interest because they believe the borrower will not otherwise make restoration. This belief may be based on the assumption that the borrower is unable to repay, or on specific indications that the borrower is hoping to free himself from an undesirable transaction without making repayment. Under these circumstances, the discretionist court can consider the equities of the case and discourage any unwarranted litigation by requiring the borrower to make restoration when the creditor's violations cannot reasonably have been expected to bear on the borrower's ability to make an informed credit decision and the borrower seeks only to extricate himself from the contract without making restoration.

IV. CONCLUSION

Reform of the Act should include amendment of subsection 1635(b) to provide for judicial enforcement of this restorative provision. Congress should clarify the rights and obligations of the parties following rescission and sanction the judicial use of discretion to fashion an equitable restorative order. If Congress finds, however, that the literalist result best advances the purpose of subsection 1635(b) and the legislative goal of promoting the informed use of consumer credit, it should expressly preclude the use of judicial discretion by providing that a court shall issue an unconditional termination order following rescission. In choosing between the literalist and discretionist approaches, Congress should remain mindful that, as written, subsection 1635(b) ostensibly is aimed at assuring mutual restoration. Denial of judicial discretion will rob the provision of its seemingly equitable nature and transform it into merely an enforcement device

Proxmire Remarks, supra note 9.
See note 61 and accompanying text supra.
See notes 34-35 and accompanying text supra.
86. The court in LaGrone v. Johnson, 534 F.2d 1360 (9th Cir. 1976), apparently so reasoned when the borrower twice defaulted and rescinded after the creditor began foreclosure proceedings. See also Sosa v. Fite, 498 F.2d 114, 119 (5th Cir. 1974) (dictum) (the court stated that when the borrower has shown no willingness to make restitution, and wants only to be freed of his obligations, the court should enforce the borrower's obligation to make repayment).
Truth in Lending

whereby a borrower may rescind and obtain restoration without being required to tender back consideration received.

Janis K. Stanich