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Limitations on Agreements and Practices

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LIMITATIONS ON AGREEMENTS AND PRACTICES

Holder In Due Course

Of all creditor practices currently being criticized by consumer advocates, the one which has elicted the greatest outcry is the time-honored doctrine of holder in due course.[1] Under Louisiana negotiable instrument law, when a third party in good faith acquires a promissory note, which is in proper form, for value and without notice of any infirmity or defect, he becomes a holder in due course.[2] Such a status permits the assignee to enforce the obligation free from any personal defenses and equitites which may have existed between the original parties.[3] This doctrine developed in commercial settings in which both parties were aware that, normally, the instrument would be transferred into credit channels. In this context, holder in due course is a valid means of obtaining the commercially desirable goal of maximum negotiability of commercial paper.[4]

Unfortunately, what began as an incentive to generate confidence in negotiable paper has become an end in itself when used in consumer transactions. Retailers found that by taking negotiable notes in consumer installment sales, they would be able to discount the paper to finance companies who would then become holders in due course. Thus, if the goods were defective or even never delivered,[5] the consumer would still be liable for the full amount of the note thereby denying consumers their only viable remedy short of a law suit—refusing to pay until the contract is fulfilled. In this context, the holder in due course status has been called an "aberration"[6] and "statistically unnecessary."[7]

1. Hartmann and Walker, *The Holder in Due Course Doctrine and the Consumer*, 77 COM. L.J. 116 (1972); Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445 (1968); Littlefield, *Preserving Consumer Defenses: Plugging the Loophole in the New UCCC*, 44 N.Y.U.L. REV. 272 (1969); W. MAGNUSON AND J. CARPER, THE DARK SIDE OF THE MARKETPLACE 1118 (1968): "The single factor most responsible for consumer injustices is the holder in due course doctrine."; Comment, 52 MARQ. L. REV. 285 (1968). REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES (1972) [hereinafter cited as NCCF].

2. LA. R.S. 7:52 (1950).

3. *Id.* 7:57 (1950).

4. Hartmann and Walker, *The Holder in Due Course Doctrine and the Consumer*, 77 COM. L.J. 116 (1972).

5. NCCF at 34; Comment, 52 MARQ. L. REV. 285 (1968).

6. Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954).

7. Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 473 (1968).

The Uniform Consumer Credit Code (UCCC)[8] and the National Consumer Act (NCA)[9] both took positions aimed at limiting the negotiability of consumer paper. The NCA offers the greater protection for consumers by not only prohibiting the use of negotiable instruments in consumer transactions,[10] but also by providing that assignees would be subject to "all defenses and claims of the consumer."[11] The UCCC does not make such an assault on the holder in due course doctrine. While it does forbid the taking of negotiable instruments in consumer credit sales or leases, it does not abolish holder in due course status if the assignee acquires the instrument without notice that it was executed in connection with a consumer transaction.[12]

The UCCC reduces its protection even further by offering two alternatives regarding a consumer's ability to raise claims or defenses against an assignee if there are waiver of defenses clauses in the contract. The first alternative would limit an assignee's liability to the amount outstanding, and such defenses or claims as the consumer has could only be raised as a defense or set-off.[13] The second alternative provides even less protection for the consumer. It requires the consumer to raise any defenses he has within three months after notice of an assignment has been delivered to him. If he does not assert his defenses within this period, the assignee can enforce the obligation free from any defenses, thereby effectively becoming a holder in due course.[14]

The Louisiana Consumer Credit Act[15] is much more creditor-oriented than even the weakest alternative possible under the UCCC[16] and makes little substantive change in existing negotiable

8. The Uniform Consumer Credit Code was drafted by the National Conference of Commissioners on Uniform State Laws. It was approved at the National Conference of Commissioners' annual conference in 1968 and by the American Bar Association in August, 1968.

9. The National Consumer Act was prepared by the National Consumer Law Center, Boston College Law School and was adopted in 1969.

10. National Consumer Act § 2.405 (1969) [hereinafter cited as NCA].

11. *Id.* § 2.406.

12. UNIFORM CONSUMER CREDIT CODE § 2.403 [hereinafter cited as UCCC]. *But see* UCCC WORKING REDRAFT NO. 5, TENTATIVE FINAL DRAFT (Nov. 1973). This proposed revision would ban the use of negotiable instruments in a consumer credit sale or lease (section 3.307), and would be enforced by making the assignee who takes a negotiable instrument in violation of section 3.307 subject to all claims and defenses that the consumer would have against the seller.

13. UCCC § 2.404(A).

14. *Id.* § 2.404(B).

15. LA. R.S. 9:3510-68 (Supp. 1972).

16. See the Opinion of Attorney General of May 29, 1973, to Lieutenant Governor Fitzmorris wherein it is noted that "these statutes constitute the Louisiana version of

instrument law.[17] Even so, several provisions do provide some protection for the consumer. One change adds a new "form" requirement for an instrument to be negotiable.[18] Under the Act, if an instrument involved in any consumer credit transaction, except home solicitation sales[19] or those involving seller or lender credit cards, is to be negotiable, it must have the words "Negotiable Paper" printed on its face.[20] Failure to do so renders the instrument non-negotiable.[21] Seemingly, this additional form requirement is intended to inform consumers that the note being signed is likely to be assigned and that thereafter the obligation will be to a finance company. However, this "awareness" is basically illusory as the words "negotiable paper" have meaning only to persons acquainted with the practices and laws affecting the concept of negotiability. Also, there is no requirement as to size, color or placement of the wording; consequently, it is likely to be included in fine print.

One new limitation is placed on holders in due course: a requirement that notice be given to the consumer that his note is being assigned, and that he has 30 days in which to raise any complaints, claims or defenses arising out of the original transaction.[22] If the consumer does not notify the assignee within the 30-day period, the defenses are considered to have been "waived" and the assignee becomes a holder in due course.[23] The statute requires that the notice of assignment contain a specified warning[24] and inform the consumer as to the consequences of a failure to raise available defenses within the period.[25] The 30-day period between giving of notice and becoming a holder in due course should also be applied to any subsequent

a model Uniform Commercial Credit Code suggested for enactment by the American Law Institute."

17. LA. R.S. 7:1-195 (1950).

18. The Louisiana form requirements under existing Negotiable Instrument Law are found in R.S. 7:1.

19. LA. R.S. 9:3532 B (Supp. 1972). This could be a potentially important exclusion from negotiability. For a discussion see notes 78-82 and accompanying text *infra*.

20. LA. R.S. 9:3532 A (Supp. 1972).

21. *Id.*

22. LA. R.S. 9:3534 (Supp. 1972).

23. *Id.* 9:3533, 3534(3) (Supp. 1972).

24. *Id.* 9:3534(2) (Supp. 1972). "Are the terms of the contract described above correct? Are the goods or services contracted correct? Are the goods or services contracted for as they were represented to you? If not, you should notify us giving specific details within 30 days from the date the above notice was mailed." This warning is required to be in no less than the equivalent of tenpoint bold face type.

25. *Id.* 9:3534(3) (Supp. 1972).

transferees who acquire either before notice has been given or before the period has passed.

The statutory warning does not offer much protection from unscrupulous businessmen. The wording of the warning would not seem to adequately inform most consumers as to its true meaning and scope; not only because of the legalistic terminology used, but also because of the almost universal lack of understanding among consumers as to the legal ramifications of wording such as

> the assignee or transferee or any subsequent assignee or transferee will have the right to enforce the contract free of any claims or defenses you may have against the extender of credit.[26]

Furthermore, the thirty-day period is too short to protect consumers who are sold defective goods as most defects in even the poorest quality merchandise usually are not discovered so quickly. A complete failure to perform would seem to be the only claim which would normally arise during this period.[27] In the event the assignee[27.1] fails to give the 30-day notice, or should the notice fail to contain the required notice, the intent of the warning requirement should preclude an assignee from becoming a holder in due course until the proper notice is given.[28]

The Act does make one very major change in Louisiana's law of negotiability by redefining the "good faith" required for assignees of consumer paper to attain holder in due course status. Under this provision, the assignee does not acquire in "good faith" if he has

> knowledge of substantial complaints by other consumers of the extender of credit's failure or refusal to perform his contracts with them and the extender of credit's failure to remedy his defaults . . . .[29]

26. *Id.*

27. In many transactions where the seller's obligation is not expected to be immediately performed, as where a later delivery is promised, the 30-day period may have been long past before the consumer has even a suspicion that there will be total nonperformance. *See also* NCCF at 36.

27.1. LA. R.S. 9:3534 (Supp. 1972). "An instrument taken pursuant to a consumer credit sale may be assigned or transferred to a third person provided that the *original assignee or transferree gives written notice* that the instrument has been assigned or transferred." (Emphasis added.)

28. This could be analogized to the consumer's right to cancel a home solicitation sale until the seller has given the statutorily required notice. *See also* UCCC WORKING REDRAFT No. 5 § 3.404 (Nov., 1973) (which would make the assignee liable to consumer claims and defenses if the assignee took a negotiable instrument in violation of section 3.307 which restricts negotiability of consumer paper.)

29. LA. R.S. 9:3534(3)(a) (Supp. 1972).

Because the Louisiana negotiable instruments law requires "actual knowledge" to constitute notice of an infirmity or defect in the note,[30] Louisiana courts may insist that the "knowledge" contemplated in section 3534 of the Act be "actual." However, such a judicial interpretation would not be in keeping with the basic purposes of the Act. It would seem that this provision is an attempt abrogate the "empty head"[31] view of holders in due course and should at least be given enough scope to include Better Business Bureau and Credit Bureau reports or even what could be said to be common knowledge of the business community.[32] This interpretation would deny protection to finance companies who buy paper from known unscrupulous companies yet not affect the ability of honest retailers to assign credit instruments.

Ordinarily, finance companies are in a much better position than consumers to determine retailers' business practices and reputation because the lending agencies are constantly involved with retail credit transactions and because of the availability of investigative staff personnel. The finance companies are also able to bring far more concerted pressure on retailers to stop shoddy practices than are organized consumers, and are much more able to absorb, and thereby spread out over all consumers, the losses caused by defaulting sellers. Not only are finance companies able to protect themselves by investigating the merchants from whom they buy notes, but they can also protect themselves by requiring that endorsors be liable should consumers raise defenses within the thirty-day period (so-called "thirty day recourse paper") and by establishing bad debt reserves to protect against defaults by sellers.

One additional consumer protection device which could be derived from the Louisiana Consumer Law would have to be judicially created. The doctrine of "close connexity" has never been adopted in Louisiana,[33] although it has received much favorable comment. The basic idea of "close connexity" was well expressed in *Unico v. Owens*[34] where the court stated:

> The more the holder knows about the underlying transactions

30. *Id.* 7:56.

31. Note, 53 HARV. L. REV. 1200 (1939); Note, 16 LOYOLA L. REV. 457, 461 (1970).

32. This reasoning could be extended to include constructive knowledge of the public records as they apply to retail sales establishments (for example, several lawsuits against one seller for failure to live up to his obligations).

33. *See* Comment, 18 LA. L. REV. 322 (1958); Note, 16 LOYOLA L. REV. 457 (1970). *See also* note 36 *infra*.

34. 50 N.J. 101, 232 A.2d 405 (1967).

and particularly the more he controls or participates or becomes involved in it, the less he fits the role of a good faith purchaser for value; the closer his relationship to the underlying agreement which is the source of the note, the less need there is for giving him the tension-free rights considered necessary in a fast moving, credit-extending commercial world.[35]

Louisiana courts have consistently[36] refused to recognize close association as a grounds for denying holder in due course status, principally because the courts have felt it was the duty of the legislature, not the courts, to change the "clear provisions" of Title VII of the Revised Statutes.[37] However, the Louisiana Consumer Credit Law provides the courts with enough of a change in legislative policy to permit the development of a long needed,[38] close connexity doctrine. By seeing the Act as a step toward a more equitable balancing of the rights and protections offered consumers and finance companies; by noting the changes made in requirements for holder in due course status—especially the change in the definition of good faith; by examining the vastly changed social and credit system in the United States since the adoption of the Negotiable Instruments Law; by reviewing the equitable considerations which went into the reasoning of the many cases in other states establishing such a doctrine; and by using sound civilian methodology in examining all the social, legislative, doctrinal and jurisprudential changes; Louisiana courts could, and should, make close connexity available as a viable legal protection for consumers.

Home Solicitation Sales

In the past decade, there has been much consumer activity di-

35. 50 N.J. at 109-10, 232 A.2d at 410.

36. The Second Circuit Court of Appeal did adopt the close connexity doctrine in *Citizens Loan Corp. v. Robbins*, 40 So. 2d 503 (La. App. 2d Cir. 1949), *rehearing denied*, April 29, 1949. However, the supreme court specifically overruled this case in *White System v. Hall*, 219 La. 444, 53 So. 2d 227 (1951). *White System* has been followed since that time.

37. Note, 16 LOYOLA L. REV. 457, 465 (1970).

38. The concept of "close connexity" was first established in 1940 in the Arkansas case of *Commercial Credit Co. v. Childs*, 199 Ark. 1073, 137 S.W.2d 260 (1940). In this case, the court said the finance company was "so closely connected with the entire transaction that it cannot be heard to say that it, in good faith, was an innocent purchaser. . . ." *Id.* at 1077, 137 S.W.2d at 262. For an early assault on closely associated finance companies and retailers claiming the benefits of holder in due course, see Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954).

rected toward legislative protection from questionable door-to-door sales practices.[39] The most popular method urged is to allow the consumer a "cooling off period"[40] in which to cancel purchase agreements signed at his home.[41] Theoretically, this period gives the consumer an opportunity to reconsider the wisdom of the commitment he has made without the adverse influence of the "high-pressure" salesmen "fast-talking" him into "signing his name on the dotted line."[42] This premise is based on the idea that the consumer is less able to resist high-pressure sales tactics when at home, because, unlike at a store, he cannot simply walk out, nor is he likely to be so inhospitable as to throw the overly forceful salesmen out.[43] In response to these consumer pressures, statutes providing for a short cooling off period have been adopted in several countries and in most states,[44] including Louisiana.

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39. COMMITTEE ON CONSUMER PROTECTION, FINAL REPORT, CMND. NO. 1781, (1962) [hereinafter cited as MOLONY REPORT]. The recommendations of the English committee on Consumer Protection (The Molony Committee) are generally cited as the origin of governmental studies directed toward door-to-door sales practices. According to this report, the activities of door-to-door salesmen "have provoked a greater wrath and indignation . . . than any other single subject" discussed by witnesses at Committee hearings. MOLONY REPORT ¶ 741.

40. *See generally* Sher, *The "Cooling-Off" Period in Door-to-Door Sales*, U.C.L.A.L. REV. 717 (1968) [hereinafter cited as *Sher*]; Project, *The Direct Selling Industry: An Empirical Study*, 16 U.C.L.A.L. REV. 883 (1969) [hereinafter cited as *Project*]; Comment, 12 ARIZ. L. REV. 802 (1971); Note, 2 VAL. L. REV. 338 (1968). Other proposals include industry controls through "chargeback" systems, better recruiting of salesmen, and trade associations; government controls through licensing and injunctive suits; post-sale remedies such as higher warranty requirements, suits for fraudulent practices, stricter applications of unconscionability and more available legal services to implement individual consumer protections. Some of the items sold most frequently by means of a home solicitation sale include encyclopedias, cosmetics, magazine subscriptions, small home applicances (vacuum cleaners, sewing machines, etc.), roofing and siding installation and/or repairs, food freezer plans, cooking utensils and wearing apparel.

See Meserve, *The Proposed Federal Door-to-Door Sales Act: An Examination of Its Effectiveness as a Consumer Remedy and the Constitutional Validity of Its Enforcement Provisions*, 37 GEO. WASH. L. REV. 1171, 1173 (1969) [hereinafter cited as *Federal Door-to-Door Sales Act*], for another excellent overview of the problems associated with door-to-door sales and the effectiveness of a cooling-off period.

41. *See generally Sher* at 721-37 (for the direct selling industry's arguments against such a regulatory plan).

42. *See* Comment, 12 ARIZ. L. REV. 803, 804 n.7 (1971); *Sher* at 721; *Project* at 895-922, 1008; *Federal Door-to-Door Sales Act* at 1177.

43. *Federal Door-to-Door Sales Act* at 1174; W. MAGNUSON AND J. CARPER, DARK SIDE OF THE MARKETPLACE 105 (1968); *Sher* at 721-22, 725-30.

44. Only seven states (Kansas, Mississippi, Nebraska, New Mexico, South Carolina, Tennessee and West Virginia) do not have statutes regulating home solicitation sales.

The Louisiana definition of a home solicitation sale[45] is nearly identical to that of the UCCC,[46] with one important difference. The phrase defining a home solicitation sale as one solicited at "any place other than the business establishment of the seller"[47] considerably broadens the scope of protection offered by the Louisiana provision and closes an important loophole in the UCCC definition.[48] The Louisiana wording effectively includes sales which take place not only at the consumer's home, but also at his neighbor's home, at sales "parties" or at trade fairs. This seems to be a better approach and offers greater protection for the consumer.

A potential problem created by the definition may arise because of the exclusion of sales that have been "initiated by the consumer by communication with the seller at his business establishment."[49] Many direct sellers make use of advertising as a means of finding potential customers. Honest department stores and other retailers whose main business takes place at a fixed location but who also send out salesmen to customers' homes to sell such items as carpeting and central air conditioning will probably be benefited by this exclusion.[50] However, the exclusion, which is not part of the UCCC definition,

45. LA. R.S. 9:3517(17) (Supp. 1972): "A 'home solicitation sale' is a consumer credit sale of goods or services or both, other than motor vehicles, farm equipment or services, in which the seller or a person acting for him engages in a personal solicitation of the sale at any place other than the business establishment of the seller and the consumer's agreement or offer to purchase is there given to the seller or a person acting for him. It does not include a sale made pursuant to a pre-existing revolving charge account, a pre-existing consumer credit sale agreement providing for a series of sales, or a sale made pursuant to prior negotiations between the parties at a business establishment at a fixed location where goods or services are offered or exhibited for sale, or a sale that may have been initiated by the consumer by communication with the seller at his business establishment."

46. UCCC § 2.501: "'Home solicitation sale' means a consumer credit sale of goods, other than farm equipment, or services in which the seller or a person acting for him engages in a personal solicitation of the sale at a residence of the buyer and the buyer's agreement or offer to purchase is there given to the seller or a person acting for him. It does not include a sale made pursuant to a preexisting revolving charge account, or a sale made pursuant to prior negotiations between the parties at a business establishment at a fixed location where goods or sercices are offered or exhibited for sale."

47. LA. R.S. 9:3516(17) (Supp. 1972). Apparently, this wording was taken from earlier working drafts of the UCCC. The wording is nearly identical to that of section 2.501 of working draft No. 6, 1967. This approach is also very similar to that of the NCA § 2.501(2), which defines an "outside consumer approved transaction" as one "initiated or consumated personally by a merchant at a place other than the merchant's place of business."

48. *Sher* at 751 n.148.

49. LA. R.S. 9:3516(17) (Supp. 1972).

50. *See Sher* at 752-54.

will undoubtedly be used by unscrupulous businessmen as a means of escaping the coverage of the Act. One of the most misleading sales techniques, "bait advertising and switch selling"[51] depends upon consumers responding to advertised "specials." In such situations the consumer could be seen as initiating the transaction by "communicating with the seller at his business establishment" thereby freeing the "switch-seller" from the possibility of rescission. One way to limit the exclusion would be to equate "business establishment" with "retail outlet," not a mere office. In any event, if the basic intent behind the restrictions on home solicitation sales is to protect consumers in their own homes from poor business practices and pressure tactics, then the restrictions should be applicable no matter how the seller came to be there.[52]

Both the Louisiana Act and the UCCC allow the consumer to cancel a home solicitation sale until midnight of the third business day after the agreement is signed.[53] The consumer is not given the

51. "Bait and switch" selling tactics have been described as follows: "The first step is to issue an advertisement purporting to offer a domestic article such as a sewing machine at a remarkable low price, and inviting interested persons to write in for details. Anyone who does so is soon confronted by a salesman on his doorstep, announcing that he has called in response to the householder's inquiry for a demonstration. In a typical case, the advertised article is then produced, but the salesman makes no effort to sell it, on the contrary, he is only too ready to point out and demonstrate its defects, or to explain that because of a long waiting list delivery cannot be made for several months. The customer, having thus been induced to say this is of no use to him—and, incidentally to view the visitor as an honest and reasonable caller—the 'switch' is made. It so happens that the salesman has another model in his car, which might possibly interest his victim, might he be allowed to bring it in and to demonstrate it? The customer having so far seen only Dr. Jekyll and having a slightly uneasy conscience about having brought this pleasant man so far on a fruitless errand, readily agrees; whereupon a far more expensive article is produced and Mr. Hyde takes over." MOLONY REPORT ¶ 743.

52. MOLONY REPORT ¶ 528.

53. LA. R.S. 9:3538(1) (Supp. 1972): "[I]n addition to any right otherwise to revoke an offer, the consumer has the right to cancel a home solicitation sale until midnight of the third business day after the day on which the consumer signs an agreement or offer to purchase." *See* UCCC § 2.502. Regulation Z of the Federal Consumer Credit Protection Act (PL 90-321) also provides for a similar rescission period in any credit transaction in which a security interest in the consumer's principal residence is acquired. Thus, in home solicitation sales in which a security interest is acquired (such as many siding or roofing contracts), the consumer has a dual right to rescind during the cooling-off period.

Regulation Z also provides that "a business day is any calendar day except Sunday and those legal holidays specified in section 6103(a) of title 5 of the United States Code." Section 2269(a), footnote 14, effective October 1, 1971. These holidays include New Year's Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day and Christmas Day. (*See also* right to cancel if "the consumer requests the seller to provide goods or services without delay because of an emergency"[54] and (a) the seller makes a substantial beginning of performance,[55] and (b) in the case of goods, they cannot be returned in as good condition as when delivered to the consumer.[56] This waiver of the right to cancel does not make much sense in the context of a home solicitation sale. There is some question as to what kind of goods or services could be offered by an unsolicited door-to-door salesman that a consumer would need in an emergency. While there definitely are times when a consumer will need to enter into credit transactions in legitimate emergency situations (after hurricanes, fires, floods, etc.), in most such cases he would make the first contact, thus taking such a sale out of the heading of "home solicitation" anyway.[57] Also, as the emergency waiver is not required to be in writing, this provision may give unscrupulous companies a loophole through the protection afforded the consumer.

In non-emergency situations, the seller must obtain the consumer's signature on a written contract which contains notice of the consumer's right to cancel.[58] This notice cannot be hidden in fine print but must be "conspicuously captioned" "CONSUMER'S RIGHT TO CANCEL."[59] This type notice has been criticized by direct sellers as "an invitation to cancel,"[60] but it does improve the consumer's chances of knowing such a remedy is available. If the seller does not provide the consumer with such a written agreement containing the required notice, then the consumer may cancel the sale at any time, in any manner and by any means.[61]

The statutorily required wording, however, is somewhat mislead-

NCA § 2.105.) This seems to be a very workable definition and should probably be adopted in Louisiana in order to maintain uniformity with the federal act. Of course, some variation as to which days are to be considered legal holidays is expectable in order to reflect local practices.

See also LA. R.S. 9:2711 (Supp. 1970) (which permits "any person" signing a purchase agreement with an "itinerant door-to-door salesman" to withdraw his consent to the agreement providing he does so within a three-day period commencing on the day following the making of the agreement).

54. LA. R.S. 9:3538(E) (Supp. 1972). Apparently, the "emergency" exclusion to the right of rescission does not affect the non-negotiability of any notes taken in such a transaction. *See* text at notes 78-82 *infra*.

55. LA. R.S. 9:3538 E (1) (Supp. 1972).

56. *Id.* 9:3538 E (2) (Supp. 1972).

57. *See* the definition of "home solicitation sale" at note 45 *supra*.

58. LA. R.S. 9:3539 A (Supp. 1972).

59. *Id.* 9:3539 B (1) (Supp. 1972).

60. *Sher* at 730.

61. LA. R.S. 9:3539 C (Supp. 1972).

ing. The sentence warning the consumer that if he cancels, "the seller may keep all or part of your cash down payment,"[62] does not seem to adequately inform the buyer that the maximum amount the seller can retain is limited to five percent of the purchase price.[63] In some situations a buyer who puts down a large percentage of the purchase price may not want to cancel because of the fear of losing the whole sum, even though he is entitled to a substantial refund.

In normal situations where the proper required notice is given, the consumer can cancel by giving written notice of cancellation at the seller's address.[64] The cancellation can also take effect when deposited in a mailbox, properly addressed and stamped.[65] The notice of cancellation does not have to be in any particular form as long as it indicates the consumer's intention not to be bound by the agreement,[66] nor does the consumer have to give, or have, any reason to cancel; he may do so for any reason whatsoever.[67]

If the consumer does cancel, the seller has ten days in which to return any notes or other evidence of indebtedness as well as any trade-ins or payments given.[68] This requirement is given subject to the seller's right to retain a cancellation fee of five percent of the cash price or the amount of the cash down payment (whichever is smaller) as long as the seller complies with his obligations.[69] If the seller takes goods as a trade-in, while they are in his possesion the risk of loss of those goods remain with him if the consumer should cancel.[70] In addition, the consumer can retain possession of any goods delivered with

62. *Id.* 9:3539 B (2) (Supp. 1972).

63. *Id.* 9:3540 C (Supp. 1972).

64. *Id.* 9:3538 B (Supp. 1972).

65. *Id.* 9:3538 C (Supp. 1972).

66. *Id.* 9:3538 D (Supp. 1972).

67. Any interpretation of this act which would require a consumer to have a "reason" to cancel would vitiate the protection afforded, The intent seems to be to allow consumers an opportunity to overcome the effects of a high pressure salesman. Thus to require a reason would mean that a consumer who felt that something was wrong with the "deal" he just signed, yet is unable to articulate the feeling, could be denied the possibility of cancelling. Yet it would seem that he is the very person the Act is trying to protect.

68. LA. R.S. 9:3540 A, B (Supp. 1972). A consumer who signs a promissory note in connection with a home solicitation sale can be fairly certain that the seller will be able to return the note if the contract is cancelled, as R.S. 9:3532(2) declares that notes taken in connection with a home solicitation sale shall be non-negotiable.

69. *Id.* 9:3540 C (Supp. 1972).

70. *Id.* 9:3540 B (Supp. 1972).

a privilege for the amount due until the seller complies with his obligation to refund the down payments.[71]

After the consumer has cancelled, he has a reasonable time (presumed to be 40 days) in which to tender to the seller any goods delivered.[72] He is not obliged to tender them at any place other than at his home.[73] If the seller does not demand possession within that 40 day period, the goods become the consumer's with no obligation to pay for them.[74] The consumer who has possession of goods not yet repossessed by the seller has only a duty of reasonable care and any other risk of loss is on the seller.[75] Thus, the consumer is not obligated to return the goods; it is up to the seller who delivered them.

Home solicitation sales are not treated lightly by the Louisiana Act.[76] Not only are consumers given the right to rescind during the cooling off period, but any notes taken in connection with such a sale are deemed non-negotiable,[77] thereby precluding transferees from gaining holder in due course status. A problem in this regard is created by the lack of a requirement that such evidences of indebtedness be labelled so as to identify the paper as one taken in a home solicitation sale.[78] It is therefore probable that some door-to-door sales companies will try to negotiate notes taken in a home solicitation sale. Because of the likelihood of such an event, finance companies will have to make it part of their normal business practices to determine if home solicitation sales are part of the attempted assignor's marketing scheme.[79] Finance companies should be held to a "red flag" test: if there is any reason for them to believe the note came from a home solicitation sale, they must make a bona fide effort to determine how it was acquired.[80] It is reasonably argued that even in the event that

71. *Id.* 9:3540 D (Supp. 1972).

72. *Id.* 9:3541 A (Supp. 1972).

73. *Id.*

74, *Id.*

75. *Id.* 9:3541 B (Supp. 1972).

76. *See also* GOVERNOR'S CONSUMER PROTECTION DIVISION RULES AND REGULATIONS, Tit. 3, Ch. II, § 5002, which prohibits certain magazine and periodical subscription sales practices.

77. LA. R.S. 9:3532 B (Supp. 1972).

78. Such a labeling is required by Arizona law. ARIZ. REV. STAT. § 44-5004 (Supp. 1970-71).

79. Such will undoubtedly be the practice in order that the assignee can protect himself from buying paper which could be subject to cancellation and over which they would not be able to gain holder in due course status.

80. It would seem reasonable to assume that courts could analogize section 3534 (3)(a) of the Act to this situation and require that assignee "should have asked" if the instrument was taken in connection with a home solicitation sale.

a transferee should acquire without any reason to believe the note is non-negotiable, he should not be given holder in due course status. Here again is the clash between two "innocents," but in such a situation, because of the strict language of section 3532(2), the consumer should prevail.[81]

Referral Sales

"One of the most vicious and fastest growing"[82] misleading sales practices today is referral selling. Typically a salesman using this scheme will propose to reduce the price of the goods by offering rebates (or "commissions") if the consumer supplies the seller with names of friends or other prospects who will also agree to buy the seller's product. By offering "commissions," the seller hopes to entice the consumer into agreeing to purchase, on time, a generally much over-priced item which may seem cheap because of the promised rebates. However, the consumer frequently finds that his friends do not want the same merchandise, or the company does not use the leads provided at all, preferring to negotiate the notes taken to a third party holder in due course. Thus the consumer would be obligated to pay off the entire debt without the benefit of any of the promised reductions.[83]

The Louisiana Act treats such schemes very harshly. It not only forbids the offering of rebates or discounts to consumers in return for the consumer's supplying names of other prospective customers if the rebate is contingent on a future event (the referee's agreeing to buy the product);[84] it also prohibits the seller from enforcing the contract and allows the purchaser to either rescind the agreement or keep the goods without any obligation to pay for them.[85] Referral agreements are not forbidden if the rebate is not based on some future occurrence, but merely requires, for example, providing a list of prospective purchasers.[86]

This is one of the strongest sections of the Act because of the remedies available to the consumer. However, it does raise some

81. This would be the effect of the Arizona Home Solicitation and Referral Sales Act. *See* Comment, 12 ARIZ. L. REV. 819 (1970-71).

82. W. MAGNUSON AND J. CARPER, THE DARK SIDE OF THE MARKETPLACE 13 (1968).

83. LA. R.S. 9:3536 (Supp. 1972).

84. *Id.*

85. *Id.*

86. In some cases, such an agreement could be considered an unfair trade practice if the seller is involved in a multi-level distribution (pyramid sales marketing) scheme. GOVERNOR'S CONSUMER PROTECTION DIVISION, RULES AND REGULATIONS, Title 3, Ch. II, § 5001.

questions. The first is the problem of proof as the written contracts would not evidence the verbal, side agreements promising the rebates. Another area of uncertainty would be the effect of the rights of holders in due course of notes taken in connection with such a scheme. Is such a sale a newly created, valid defense against a holder in due course, or does the consumer's alternative of not paying for the goods apply only to obligations owed the seller? Seemingly, for the protection offered by this section to be effective, it should do away with the buyer's obligation entirely, even as to holders in due course, for otherwise the consumer would still be bound to pay the price.[86.1]

Right To Prepay With A Guaranteed Rebate Of Unearned Interest

Another limitation on what may be "agreed" to in a consumer credit transaction is the section permitting the consumer to prepay in full the unpaid balance at any time, even if a contrary provision is included in the contract.[87] This prohibits extenders of credit from hiding such a provision in fine print in an attempt to prevent a consumer who wants to prepay from doing so.

Upon prepayment in full,[88] or in case maturity is accelerated and a suit is filed,[89] the creditor is required to refund any unearned service or loan finance charges.[90] The rebate is computed by using the "Rule of 78's" or "Sum of the Digits" method.[91] If less than half the install-

86.1. In analogous situations, the courts have declared certain instruments void as a matter of public policy. *See* McLean v. Elliot, 26 La. Ann. 385 (1874); Wainwright v. Bridges, 19 La. Ann. 234 (1867); Coburn Fin. Corp. v. Bennett, 241 So. 2d 802 (La. App. 3d Cir. 1970); Williamson v. Humphries, 201 So. 2d 697 (La. App. 2d Cir. 1962); Soileau v. Pitre, 79 So. 2d 628 (La. App. 1st Cir. 1955); W.T. Rawleigh Co. v. Coen, 195 So. 660 (La. App. 2d Cir. 1940).

87. LA. R.S. 9:3527 (Supp. 1972).

88. *Id.* 9:3528 (Supp. 1972).

89. *Id.* 9:3529 (Supp. 1972).

90. *Id.* 9:3528 (Supp. 1972).

91. *Id.* The Louisiana Act defines the "Rule of 78" method of rebate as the "refund [of] unearned loan finance charges or credit service charges" representing "at least as great a proportion of the loan finance charge or credit service charge . . . as the sum of the monthly time balances beginning one month after the month in which prepayment is made, bears to the sum of all the monthly time balances under the schedule of payments in the contract."

The term "monthly time balances" refers to the amount of money outstanding during the month or "unit" of debt. Thus, given a twelve month loan, the first month can be conceptualized as being represented by the numeral 12 because the outstanding balance is 12 times as large during the first month as during the last. The second month would be represented by the numeral 11, the third by 10 and so on to 1. The portion of the interest considered earned by the creditor is 12/78 for the first month, 11/78 for the second, 10/78 for the third, and so on (12+11+10+ . . . . +1=78 which represents the whole of the precomputed interest; hence the name "Rule of 78's"). Therefore, to ment term has passed, a prepayment charge of not more than $25.00 may be first deducted from the total outstanding precomputed service or finance charge before determining the rebate.[92] This "prepayment charge" is a direct holdover from the charge permitted in the Motor Vehicle Sales Finance Act,[93] and would be forbidden under both the UCCC and the NCA.[94]

The Louisiana Act does not provide for partial prepayments—it only permits prepayments in full. Therefore, partial prepayments would only be allowed if agreed to by the creditor. Also, the rebate provisions would not apply to such prepayments. While the UCCC also only permits prepayments in full,[95] the NCA would allow both,[96] and would require rebates for the partial prepayments.[97]

Balloon Payments

Another scheme, known as "balloon payments," has been effective in inducing unwary buyers into signing very burdensome contracts. This plan works by offering small installment payments, until the last payment, when suddenly a much larger amount is due. The frequent result is that the consumer defaults and the goods are repossessed. The Louisiana Act deals with this abusive tactic by giving consumers the right to refinance the amount of the final payment at

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determine the amount of rebate, add the total percentage of interest earned (12/78+11/78+10/78 etc.) and multiply times the total precomputed interest. Thus if the debtor prepays at the end of the fourth month, the interest earned would be 12/78+11/78+10/78+9/78=42/78 and the rebate due would be 78/78-42/78=36/78 of the total finance charge.

However, the computations are somewhat more complicated in practice because of the great variety in the amounts and prepayment periods of credit transactions. Therefore, many lenders use published rebate tables rather than computing each transaction as needed.

92. LA. R.S. 9:3528 (Supp. 1972).

93. *Id.* 6:958A (Supp. 1972). This Act allows not only the prepayment charge, but also allows the creditor to compute his rebate on the basis of 90 percent of the "Rule of 78's."

94. Section 2.209 of the UCCC specifically permits prepayment at any time without penalty, subject to the rebate provisions of section 2.210. Section 2.210(2) allows the creditor to retain the minimum credit service charge as determined by section 2.201(6) ($5.00 if the amount financed is less than $75.00 or $7.50 when the amount financed exceeds $75.00) if the credit service charge earned subsequent to prepayment is less than the minimum charge contracted. NCA section 2.209 guarantees the right to repay without penalty and section 2.210 does not provide for retention by the creditor of any other fees than earned finance charges as computed by the actuarial method.

95. UCCC § 2.209.

96. NCA § 2.209.

97. *Id.* § 2.210(1).

terms which are no less favorable than those of the original contract.[98] Under this provision, the size of the installment payments cannot be larger, nor can the credit service charge rate be greater. This right seems to effectively prevent the worst abuse of such a scheme—that of "reaching a compromise" with the defaulting consumer by allowing him to refinance the amount due at a much higher interest rate.[99] However, some commentators have questioned permitting balloon payments at all.[100] By prohibiting them altogether, except in special situations when needed to reflect the consumer's irregular income, the abuses would be prevented and creditors would not be unduly prevailed upon.[101]

The section does not apply to payment schedules which are arranged to fit a consumer's irregular or seasonal income.[102] In such a situation, the problem of overwhelmingly large payments is not as likely to arise. Also, specifically excluded are credit transactions which are primarily for agricultural purposes or are part of a revolving charge or loan account.[103] The reason for excluding agricultural purposes is somewhat unclear,[104] the major factor seemingly being the seasonality of the income. However, such situations seem well within the contemplation of the "seasonal or irregular income" clause.

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98. LA. R.S. 9:3535 (Supp. 1972). This section is almost identical to UCCC section 2.405 which applies to consumer credit sales and section 3.402 which applies to consumer loans.

99. In *Time Finance Co. v. Louis*, 152 So. 2d 248 (La. App. 4th Cir. 1963), the defendants purchased a car, agreeing to pay 23 installments of $75.00 each and a final balloon payment of $1,975. Defendants paid all 23 regular installments but were unable to make the last "impossible" payment. They then signed another note for $2,952 to re-finance the amount due on the first note. After paying off over $1,800 on the second note, defendant defaulted, the finance company seized the car, sued for the remaining debt, and was awarded a judgment.

100. Kass, *S.2589 and the Uniform Consumer Credit Code: A Comparison of Consumer Protections*, 37 GEO. WASH. L. REV. 1131, 1145 (1969).

101. This is basically the approach taken by the NCA in section 2.402. This Act allows the consumer with an irregular income to revise the schedule of payments at any time (section 2.402(3)). *See also* NCCF at 39.

102. LA. R.S. 9:3535 (Supp. 1972).

103. *Id.*

104. Kass, *S.2589 and the Uniform Consumer Credit Code: A Comparison of Consumer Protections*, 37 GEO. WASH. L. REV. 1131, 1146 (1969). Agricultural credit transactions are normally excluded from coverage by the various consumer credit acts because they are considered to be a "business" rather than a "consumer" transaction.