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CONSUMER LENDING LAW

Welcome Relief for Lenders

Federal Truth in Lending Act
trumps New Jersey law

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A recent appellate decision affords some welcome relief to lenders and other assignees of retail installment contracts. These assignees are regularly haled into the New Jersey courts to answer for the wrongs of unscrupulous retail businesses alleged to have deceived consumers prior to assigning the underlying contracts. Victimized consumers contend that the assignees, as “holders” of the underlying contracts, are derivatively liable for the conduct of the assignors even if the assignees had no involvement whatsoever in the allegedly deceptive transactions. In *Psenky v. American Honda Finance Corp.*, 378 N.J. Super. 221 (App. Div. 2005), the Appellate Division for the first time squarely held that the federal Truth in Lending Act’s (TILA) substantial limitation on assignee liability trumps inconsistent state laws and shields assignees from claims brought under the New Jersey Consumer Fraud Act (CFA) for an assignor’s failure to adequately disclose

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the terms of a consumer credit transaction.

TILA’s pre-emptive effect has been a settled issue in the majority of courts that have considered the issue. The situation has been less clear, however, in the New Jersey state courts. The problem for counsel defending against these claims in the New Jersey state courts has been two-fold: the absence of any clear-cut appellate authority on the TILA preemption question and the existence of an adverse trial court decision reflecting a less than cogent analysis of the issue. Specifically, in *Scott v. Mayflower Home Improvement Corp.*, 363 N.J. Super. 145 (Law Div. 2001), the court held that TILA’s express limitation on liability applied only to claims brought under TILA and did not preclude plaintiffs from attempting to peg derivative liability claims to the CFA or other state law. Seizing upon the Scott court’s dubious analysis, savvy plaintiffs’ lawyers have attempted to side-step the federal pre-emption issue by asserting disclosure violation claims against assignees under various state law theories while studiously avoiding any claim under TILA itself. Given the dearth of appellate authority, the Scott case has given this strategy a surprising degree of viability. The result for assignees has been that, of all the venues in which they might be sued on these types of claims, the state courts of New Jersey have been among the least attractive of all. *Psenky* stands to change that to some degree.

Psenky is one in a long line of cases in which purchasers of automobiles have accused dealerships of failing to disclose the

true terms of their deals. The primary target in many of these cases, however, is the deep-pocket institution to which a dealership typically assigns the retail installment contract it entered into with the consumer. In these cases, the plaintiff contends that the assignee should be made to answer for the dealership’s misdeeds due to its status as a subsequent “holder” of the contract. Under the so-called Holder Rule incorporated as part of the New Jersey Retail Installment Sales Act (RISA), these plaintiffs argue, assignees are as liable for nondisclosures as the unscrupulous dealerships themselves.

The Conflict

The New Jersey Holder Rule was intended to strip assignees of the defenses they otherwise would have as holders in due course. It provides that any subsequent holder of a consumer note relating to a retail installment contract “shall be subject to all claims and defenses of the retail buyer against the retail seller arising out of the transaction...” N.J.S.A. 17:16C-38.2. A similar Holder Rule is found in the Federal Trade Commission’s regulations. See 16 C.F.R. § 433.2.

In contrast to the Holder Rules, the scope of assignee liability under TILA is extremely narrow. Within a decade of TILA’s enactment in 1968, regulators concluded that creditors were finding it difficult to comply with the statutory scheme. Accordingly, Congress made a critical revision to TILA in 1980. Specifically, through Section 1641(a) of TILA, Congress imposed a substantial limitation on assignee liability by providing that an assignee may be held liable for a disclosure violation only

if the "violation for which such action or proceeding is brought is apparent on the face of the disclosure statement...." 15 U.S.C. § 1641(a).

Section 1641(a) has been interpreted to reflect Congress's intent not to impose liability on assignees who are not responsible for and who had no notice of any disclosure violations at the time of the assignment. Under Section 1641(a), an assignee's sole duty is to examine the assigned documents to determine if they comply with TILA's disclosure requirements. There is no obligation to inquire beyond the face of the assigned documents into, for example, the potentially wrongful conduct of the assignor.

The Psensky Decision

In *Psensky*, plaintiff entered into a retail installment contract with Island Honda, Inc. (Island Honda) for the purchase of a used automobile. The dealership then assigned the contract to American Honda Finance Corp. (American Honda). Plaintiff alleged that Island Honda violated the CFA by failing to adequately disclose the terms of the deal. Further, plaintiff alleged that as Island Honda's assignee, American Honda, was derivatively liable for the dealership's disclosure violations.

American Honda moved for summary judgment, arguing that it was shielded from liability because TILA's express limitation on assignee liability trumped the conflicting Holder Rules. The trial court denied the motion. Taking its lead from *Scott*, the court narrowly construed TILA's limitation on liability as applying only to claims brought under TILA. The court concluded that because plaintiff's claims were tied to the CFA rather than TILA, TILA's limitation on the liability was of no moment and the Holder Rules controlled.

The Appellate Division reversed, holding that state laws that are inconsistent with TILA are pre-empted. Tracking the analysis in the closely analogous decision in *Alexiou v. Brad Benson Mitsubishi*, 127 F. Supp. 2d 557 (D.N.J. 2000), the Appellate Division observed that "New Jersey's holder law broadly subjects assignees to any liability claim that can be asserted against the [assignor]." *Psensky*, 378 N.J. Super. at 226. The Appellate Division reasoned that such "broad potential liability conflicts with the

congressional purpose of the TILA 1980 amendment to restrict assignee liability and erects a barrier to Congress's purpose to hold assignees responsible only for disclosure failures that can be observed on the face of the loan document." *Id.* To hold an assignee liable on a state law claim relating to a retail installment contract that appears on its face to comply with TILA's disclosure requirements, the court concluded, "would be contrary to the goals of the TILA...." *Id.* The FTC Holder Rule, the court concluded, also was pre-empted because, as a mere federal regulation, it plainly is superseded by TILA. *Id.* at 226-27.

The Appellate Division found that permitting the Holder Rules to defeat TILA's limitation on liability would undermine the objective of the 1980 amendment to the federal statute. Were it not for pre-emption of the Holder Rules, the court reasoned, "an assignee who conducts business nationally 'would be compelled to research the laws of all of the states to ensure that it is abiding by each and every law promulgated by the states.'" *Id.* The court concluded that this was precisely the type of "substantial burden that Congress intended to avoid through enactment of the 1980 Amendment." *Id.*

Relying upon *Scott*, plaintiff maintained that absent a TILA claim, his state law claims were "unaffected by the TILA preemption." *Id.* at 227. The court, however, declined to elevate form over substance. Studious avoidance of a TILA claim, the court observed, "does not preclude application" of the federal pre-emption doctrine. *Id.* Regardless of whether the claims were asserted under state law or TILA, the court concluded, in essence what was being alleged was that Island Honda had failed to make the requisite consumer credit disclosures. The court reasoned:

In failure to disclose situations, should an assignee, though exempt from liability under the TILA, be liable under state law such as the Consumer Fraud Act, "it would impose disclosure requirements on assignees beyond those mandated by federal law. This would frustrate the overarching reasons put forth by Congress in enacting the assignee exemption...." *Id.* at 231 (citation omitted).

A Pragmatic Resolution

Psensky reflects a highly pragmatic resolution of the important pre-emption issue. If all a plaintiff had to do to sidestep TILA's liability limitation was to peg his disclosure violation claim to some law other than TILA, the protections Congress put in place in 1980 would be gutted. Congress was concerned with exposing lenders to liability for disclosure violations they could not reasonably have discovered without engaging in burdensome due diligence into each and every consumer credit transaction. This protection would be rendered meaningless if plaintiffs could, through state law claims, make an end-run around Section 1641(a) and impose a greater burden upon lenders than Congress deemed prudent. As the Appellate Division correctly concluded, Congress cannot possibly have intended for artful pleading to so easily eviscerate TILA's 1980 amendment.

Assignees can be forgiven for reveling in both the result in *Psensky* and the fact that it unequivocally overruled *Scott*. It would be imprudent, however, for assignees to conclude they now are in the clear. The Appellate Division was careful to limit its holding in *Psensky* to derivative claims arising out of disclosure violations relating to the terms of consumer credit transactions. It made clear that TILA "does not provide complete immunization for assignees from Consumer Fraud or other state law claims." *Id.* The court instructed that TILA will not deflect consumer fraud claims pegged to allegations, for example, that the assignee participated actively and directly in the disclosure violations.

Against this backdrop, assignees reasonably can expect the nature of claims asserted against them in this context to shift toward allegations that, given the nature and extent of the business relationship between assignor and assignee, the assignee was complicit in the assignor's fraudulent or deceptive practices. The fact-sensitive nature of such a core allegation may shield many of these claims from pretrial dismissal. The number of cases brought against lenders in this area may very well decline, thanks to *Psensky*. The difficulty and expense of defending against those fewer claims that are brought, however, likely will not. ■