Missouri Law Review

Volume 42
Issue 4 *Fall 1977*

Article 13

Fall 1977

Truth-In-Lending Disclosure Requirements-Security Interest in After-Acquired Consumer Goods

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TRUTH-IN-LENDING DISCLOSURE REQUIREMENTS—SECURITY INTEREST IN AFTER-ACQUIRED CONSUMER GOODS

Tinsman v. Moline Beneficial Finance Co.[1]

Steve and Nancy Tinsman obtained a loan from Moline Beneficial Finance Co. in order to make a down payment on furniture. The Truth-in-Lending disclosure statement given to the Tinsmans stated that Beneficial retained a security interest in "[a]ll consumer goods of every kind now owned or hereafter acquired by Debtors in replacement of said consumer goods . . . and now owned or hereafter located on the debtors' place of residence."[2] The Tinsmans filed suit alleging that this disclosure violated the Truth-in-Lending Act.[3] Summary judgment was granted for the plaintiffs, and they were awarded the statutory recovery of twice the finance charge plus attorney's fees. On appeal the United States Court of Appeals for the Seventh Circuit affirmed.

The court of appeals held that Beneficial's disclosure of the security interest was worded so broadly that it included more after-acquired consumer goods than were allowed under Uniform Commercial Code [U.C.C.] section 9-204(2),[4] and therefore did not clearly set forth the security interest in an accurate manner, in violation of the Truth-in-Lending Act.

The *Tinsman* case illustrates some fundamental characteristics of the Truth-in-Lending Act. First, the consumer need not actually be harmed. Steve Tinsman was a former bank employee who had audited loan computations,[5] and he was familiar with the type of security agreement used in the transaction.[6] He was not "shopping for credit," so at least his initial credit decision was not affected by the disclosure. At any rate, since the disclosure made Beneficial's loan appear less attractive than it really was, it is unlikely

1. 531 F.2d 815 (7th Cir. 1976).

2. *Id.* at 818.

3. *Id.* at 816. The Tinsmans sued on three different theories, but the court of appeals decided only on the theory that the disclosure did not clearly set forth the security interest in an accurate manner. The other alleged violations were inadequate disclosure of the method of computing the unearned portion of the finance charge and failure to describe each item in the finance charge. *Id.* n.1.

4. ILL. REV. STAT. ch. 26, § 9-204(2) (1973). Illinois has adopted the revision of Article 9 of the U.C.C., but this amendment did not substantively alter the relevant provisions. Section 9-204(2) appeared in the previous version of the Code at § 9-204(4).

5. Brief for Appellant, Appendix at 39, Tinsman v. Moline Beneficial Fin. Co., 531 F.2d 815 (7th Cir. 1976).

6. *Id.* at 37, 38.

that Beneficial stood to gain by its breadth. It is possible, however, that such an overly broad disclosure statement might be used to dupe an unwary consumer into surrendering more goods upon default than the lender could lawfully obtain.[7]

Second, this case demonstrates the devices in the Truth-in-Lending Act which serve to make it self-executing. The amount loaned in *Tinsman* was approximately $300,[8] while the total award which Beneficial had to pay was over $3,000.[9] The strong economic incentive for the creditor to comply with the Act is obvious. In addition, there is an incentive for the debtor to enforce the Act. The Act allows recovery for actual damages,[10] or twice the finance charge with a maximum recovery of $1,000 and a minimum of $100[11] plus reasonable attorney's fees.[12] The $3,000 judgment in *Tinsman* is graphic evidence of what can occur when a faulty collateral clause is used in a consumer loan setting.

The most important aspect of *Tinsman*, however, is its holding that if a security interest purports to attach to more goods than is allowed under state law, a disclosure of that security interest must state those limits to comply with the Truth-in-Lending Act. This holding will be examined in light of statutory provisions, administrative regulations, judicial decisions, and other interpretations.

The Truth-in-Lending Act[13] was enacted in 1968 "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."[14] It utilizes "[o]ne of the oldest and most prevalent methods of regulating consumer transactions,"[15] that of requiring the seller to disclose information to his buyer. Pursuant to a broad grant of authority[16] the Federal Reserve Board promulgated Regulation Z[17] to supply the details of disclosure requirements. Section 1640 of the Act provides a civil remedy for a failure to disclose required information. Additional information *may* be disclosed, but only if it will not mislead or confuse.[18]

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7. Sneed v. Beneficial Fin. Co., 410 F. Supp. 1135 (D. Hawaii 1976); Evans v. Household Fin. Corp., CONS. CRED. GUIDE (CCH) ¶ 99,007 (1973).
8. Brief for Appellant, *supra* note 5, at 27.
9. *Id.* at 36.
10. 15 U.S.C. § 1640(a)(1) (Supp. V 1975).
11. 15 U.S.C.A. § 1640(a)(2)(A)(i) (West Supp. 1977).
12. 15 U.S.C. § 1640(a)(3) (Supp. V 1975).
13. 15 U.S.C. §§ 1601-1605 (1970).
14. 15 U.S.C. § 1601 (1970).
15. Whitford, *The Functions of Disclosure Regulations in Consumer Transactions*, 1973 WIS. L. REV. 400.
16. Mourning v. Family Publications Serv., Inc., 411 U.S. 356 (1973); 15 U.S.C. § 1604 (1970); 15 U.S.C.A. § 1602(s) (West Supp. 1977).
17. 12 C.F.R. §§ 226.1 *et seq.* (1977).
18. Regulation Z, 12 C.F.R. § 226.6(c) (1976); *cf.* 15 U.S.C. § 1632(b) (Supp. V 1975).

The general standard under the Truth-in-Lending Act is "clear and conspicuous" disclosure.[19] For example, one court held that since the disclosure form is for the borrower's benefit it must be presented in a conceptual framework that he can easily comprehend.[20] Other courts have noted that since the statute is remedial in nature, there must be strict compliance with its technical terms.[21] Similarly, all ambiguities in the disclosure statement should be construed against the creditor, it being both the drafter and the party upon whom the statute imposes the burden of compliance.[22]

In addition to dictating *how* disclosures must be made, the Truth-in-Lending Act and Regulation Z set out the specifics of *what* must be disclosed. The disclosure requirements differ depending on the type of transaction involved. The instant case involved security interests in connection with consumer loans. The specific disclosure requirements are set out in 15 U.S.C. section 1639(a)(8)[23] and Regulation Z section 226.8(b)(5).[24] As to security interests in general there are basically two requirements: (1) a description of any security interest retained, and (2) a clear identification of the property to which it relates. In applying the first requirement, courts have held that the disclosure statement must reveal the existence of a chattel mortgage,[25] and if a vendor's lien is retained, it too must be dis-

19. 15 U.S.C. § 1631 (Supp. V 1975); Regulation Z, 12 C.F.R. § 226.6(a) (1977).

20. Allen v. Beneficial Fin. Co., 531 F.2d 797 (7th Cir. 1976).

21. Powers v. Sims & Levins Realtors, 396 F. Supp. 12 (E.D. Va. 1975); Woods v. Beneficial Fin. Co., 395 F. Supp. 9 (D. Ore. 1975).

22. Sneed v. Beneficial Fin. Co., 410 F. Supp. 1135 (D. Hawaii 1976).

23. 15 U.S.C. § 1639(a) (1970) provides:

> Any creditor making a consumer loan [subject to this section] shall disclose . . . the following items, to the extent applicable:
>
> . . . .
>
> (8) A description of any security interest held . . . by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

24. Regulation Z, 12 C.F.R. § 226.8(b) (1977) provides:

> In any transaction subject to this section, the following items, as applicable, shall be disclosed:
>
> . . . .
>
> (5) A description or identification of the type of any security interest held . . . by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify . . . . If after-acquired property will be subject to the security interest . . . this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held . . . .

25. Wilson v. Shreveport Loan Corp., 404 F. Supp. 375 (W.D. La. 1975).

closed.[26] The second requirement, dealing with identification of the property, has been held not to require particularization of each article secured.[27] At least one court, however, has held that the description in the disclosure statement must use terms synonymous with those used in the security agreement.[28]

In addition to these disclosure requirements dealing with security interests in general, Regulation Z supplements the Act by adding a disclosure requirement dealing specifically with security interests in after-acquired property.[29] Regulation Z section 226.8(b)(5) states: "If after-acquired property will be subject to the security interest . . . this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired." The language seems clear. Nonetheless, the courts and the Federal Reserve Board have had considerable difficulty in applying this provision.

These problems in applying the disclosure requirements as to security interests in after-acquired property have arisen in connection with U.C.C. section 9-204(2),[30] although the result reached with respect to the Code should also apply to other state statutes restricting security interests in after-acquired goods.[31] U.C.C. section 9-204(4)(b) prohibits the attachment of security interests in after-acquired consumer goods, when given as additional security, unless the debtor acquires rights in the goods within ten days. If, contrary to the U.C.C., a creditor attempts to take a security interest in all after-acquired consumer goods, the question arises whether a failure to set out this ten day limitation in a disclosure statement violates the Truth-in-Lending Act. The courts considering this question have held that it does violate the Act, but they have done so on confused and conflicting theories.

Some courts have held that disclosure of a security interest which covers more after-acquired consumer goods than is permissible constitutes additional information stated so as to mislead or confuse in violation of Regulation Z section 226.6(c).[32] This conclusion seems strained. Section

26. Starks v. Orleans Motors, Inc., 372 F. Supp. 928 (E.D. La.), *aff'd mem.*, 500 F.2d 1182 (5th Cir. 1974).

27. Slatter v. Aetna Fin. Co., 5 CONS. CRED. GUIDE (CCH) ¶ 98,767 (N.D. Ga. 1974); Kenney v. Landis Financial Group, Inc., 349 F. Supp. 939 (N.D. Iowa 1972).

28. Woods v. Beneficial Fin. Co., 395 F. Supp. 9 (D. Ore. 1975).

29. 12 C.F.R. § 226.8(b)(5) (1977).

30. U.C.C. § 9-204(4)(b) (1972) provides:

> No security interests attaches under an after-acquired property clause to consumer goods . . . when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

31. *See, e.g.*, WIS. STAT. ANN. § 422.417(3)(a) (West 1974) (prohibits most security interests in household goods). *See also* U.C.C.C. § 3.301 (1974) (prohibits security interests in after-acquired goods in sale and lease transactions); NATIONAL CONSUMER LAW CENTER, NATIONAL CONSUMER ACT §§ 2.416(2), .416(6)(a), .416(6)(c) (1973) (prohibits security interests in consumer goods other than those worked on or sold, and in all after-acquired property).

32. Johnson v. Associates Fin., Inc., 369 F. Supp. 1121 (S.D. Ill. 1974); Kenney

226.6(c) provides that *additional information* may be disclosed, provided it is not misleading or confusing. One must distinguish between a disclosure which purports to cover property additional to that allowed under state law and a disclosure which states *information* additional to that which is required under the Truth-in-Lending Act. No additional information is disclosed in these cases. The creditor is simply disclosing those terms of the transaction which the Act requires him to disclose.[33] Section 226.6(c) by its terms does not apply to disclosure of required information. Therefore, a required disclosure of information that confuses or misleads the consumer does not violate the Truth-in-Lending Act.

Some courts have ignored the fact that section 226.6(c) applies only to "additional information" and have held that a disclosure of a security interest in after-acquired consumer goods which does not set out the ten day limitation in U.C.C. 9-204(2) is misleading and confusing and therefore violates the Act, without first finding it to be additional information.[34] One court attempted to justify this by stating that section 226.6(c) is a "catch-all" provision for violations not specifically fitting within a particular category.[35] The answer to this contention is that section 226.6(c) is clearly not a "catch-all" provision, but is expressly limited to additional information. It does not prohibit all misleading or confusing disclosures.

Other courts in dealing with this have concluded that a failure to disclose the ten day limitation violates the Truth-in-Lending Act and Regulation Z because it fails to define the extent of the security interest[36] or it fails to make a complete disclosure of the security interest retained.[37] These conclusions also fail to bear scrutiny. Regulation Z section 226.8(b)(5) requires only that the creditor disclose which type of security device is being employed, *i.e.*, whether a chattel mortgage or a vendor's lien or a U.C.C. "security interest"[38] is retained. The fact that after-acquired property will be subject to the security interest in no way affects the type of security interest involved.

One case held that a disclosure of a security interest in all after-

v. Landis Financial Group, Inc., 349 F. Supp. 939 (N.D. Iowa 1972). The lower court in *Tinsman* also based its decision upon this ground, *inter alia*, but the court of appeals declined to decide this question. 531 F.2d at 819.

33. FRB Letter No. 829 (August 22, 1974), 5 CONS. CRED. GUIDE (CCH) ¶ 31,151.

34. Woods v. Beneficial Fin. Co., 395 F. Supp. 9 (D. Ore. 1975); Evans v. Household Fin. Corp., CONS. CRED. GUIDE (CCH) ¶ 99,007 (S.D. Iowa 1973).

35. Houston v. Atlanta Fed. Sav. & Loan Ass'n, 414 F. Supp. 851 (N.D. Ga. 1976).

36. *In re* Dunne, 407 F. Supp. 308 (D.R.I. 1976); Johnson v. Associates Fin., Inc., 369 F. Supp. 1121 (S.D. Ill. 1974).

37. Pollock v. General Fin. Corp., 535 F.2d 295 (5th Cir. 1976); Willis v. Town Fin. Corp., 416 F. Supp. 10 (N.D. Ga. 1976).

38. Under the U.C.C. the single term "security interest" is used for all security devices. In non-Code jurisdictions, like Louisiana, various kinds of security devices still thrive.

acquired consumer goods violates Regulation Z section 226.8(b)(5) in that it fails to make a clear identification of the property to which the security interest relates.[39] Regulation Z does indeed require a clear identification of the property to which the security interest relates. However, the wording of this provision suggests that this "clear identification" requirement was not meant to apply to after-acquired property. The last sentence of section 226.8(b)(5) states that if after-acquired property will be subject to the security interest, this fact must be clearly set forth in conjunction with the description or identification of the type of security interest retained. There is no reference to "this fact" also being set out in conjunction with the clear identification of the property. Also, since stating that after-acquired property will be subject to the security interest is in fact a manner of identifying property to which the security interest relates, it would be redundant to require both. This strongly suggests that the "clear identification" requirement was not intended to apply to after-acquired property.

In addition to the case law on this question, there is also a series of unofficial Federal Reserve Board staff letters interpreting Regulation Z.[40] The degree to which courts are willing to accept these staff letters varies considerably. One court stated they were entitled to great weight,[41] while another castigated them as being the product of lobbying by the credit industry.[42] Despite these aspersions, the Federal Reserve Board has a central role in Truth-in-Lending matters, and to the extent these staff letters indicate the Board's thinking, they are of value.

One letter that has found considerable support in the cases is Federal Reserve Board (FRB) Letter No. 829. It states that each creditor must insure that all information disclosed is accurate according to the applicable state law. In particular it states that the description of the security interest must accurately reflect the type of security interest that may legally be acquired.[43] This conclusion has been seriously questioned in later letters. For example, FRB Letter No. 983 expressly modifies Letter No. 829 and states that upon further consideration the staff believed it would be sufficient, in disclosing an after-acquired property clause under section 226.8(b)(5), to state simply that the security interest covered such property.[44] Still another letter, No. 1053,[45] retreated from that statement. While it

39. Sneed v. Beneficial Fin. Co., 410 F. Supp. 1135 (D. Hawaii 1976).

40. These FRB letters are drafted by the staff in response to inquiries from interested persons. They are not binding on the courts and are intended to serve as an informal means of helping creditors comply with the technicalities of Regulation Z. They must be distinguished from the official interpretations which are given in accordance with Regulation Z, 12 C.F.R. § 226.1(d) (1977). Good faith reliance upon the latter is a defense. 15 U.S.C. § 1640(f) (Supp. V 1975).

41. Philbeck v. Timmers Chevrolet, Inc., 499 F.2d 971 (5th Cir. 1974).

42. Willis v. Town Fin. Corp., 416 F. Supp. 10 (N.D. Ga. 1976).

43. (August 22, 1974), 5 CONS. CRED. GUIDE (CCH) ¶ 31,151.

44. (December 30, 1975), 5 CONS. CRED. GUIDE (CCH) ¶ 31,323.

45. FRB Letter No. 1053 (May 28, 1976), 5 CONS. CRED. GUIDE (CCH) ¶ 31,393.

too stated that the clear language of section 226.8(b)(5) did not require more than a simple statement that after-acquired property may be subject to the security interest, it went on to say that the creditor may not affirmatively misstate the scope of the security interest. It would be an "inaccurate and misleading disclosure in violation of Regulation Z" to disclose an interest in all after-acquired property, when the interest would actually attach only to property acquired within a certain period of time.[46] It is noteworthy that no citation to the statute or the Regulation is given for this conclusion.

Apparently, then, the latest FRB staff interpretation would permit a disclosure that after-acquired property "may" be subject to the security interest, but would prohibit a disclosure that "all" after-acquired property would be subject to the security interest. At least one court has rejected precisely this distinction.[47] Yet even if this were the distinction the staff meant to draw, it is difficult to understand the rationale behind it. The remedy for a violation of the state law should be sought in that same law.[48] If the disclosure statement clearly and conspicuously sets forth the terms of the credit transaction[49] the fact that those terms do not conform to some state law does not make the *disclosure* inadequate.[50]

An overview of the various statutes, regulations, cases, and interpretations reveals that there is virtual unanimity of opinion that the Truth-in-Lending Act has been violated when a security interest is disclosed in terms which cover more than is permissible under the applicable state law, and *Tinsman v. Moline Beneficial Finance Co.* follows this consensus. However, the theories advanced to support these conclusions are confused and contradictory. Nor is this state of confusion surprising, since a close examination of the Truth-in-Lending Act and Regulation Z reveals little basis for finding a violation. There is no express requirement that the disclosures required under the Act be in conformity with the substantive limitations imposed by state law. If the Truth-in-Lending Act had been intended to supply a remedy for violations of other laws, a statement to that effect is conspicuously absent. The purpose of the Act is effectuated by a clear and conspicuous disclosure of the terms of the transaction, for if those terms are in conflict with state law, the disclosure will help bring this fact to the consumer's attention.

CRAIG S. BIESTERFELD

46. *Id.*

47. Pollock v. General Fin. Corp., 535 F.2d 295 (5th Cir. 1976).

48. *Compare* 15 U.S.C. § 1610(b) (1970) *with* U.C.C. § 9-203(4), which together strongly suggest that neither was intended to affect the other in any way.

49. *See* Mourning v. Family Publications Serv., 411 U.S. 356, 361 (1973), where Chief Justice Burger states that a typical disclosure provision in the Truth-in-Lending Act "requires merchants . . . to disclose certain *contract information*." (emphasis added).

50. Pennino v. Morris Kirschman & Co., 526 F.2d 367 (5th Cir. 1976); Kenney v. Landis Financial Group, Inc., 349 F. Supp. 939, 946 (N.D. Iowa 1972).