



The Holder Rule: When You Take Out a Loan, and the Product is Defective or Fraudulent

From the Office of Minnesota Attorney General Lori Swanson

Consumers often purchase items or services through financing arrangements offered or arranged by sellers. Sometimes the item turns out to be defective, or it is never delivered. Other times, services are shoddy, incomplete, or not performed at all. For consumers who find themselves in this position, a federal regulation known as the Holder Rule may help.

If the Holder Rule applies, a consumer may be able to stop making payments on a loan and may even be able to get a refund of payments already made. Whether the Holder Rule applies requires a careful analysis of the relationship between the seller and the lender.

What Is the Holder Rule?

The Holder Rule is a federal regulation intended to help consumers when a defective or fraudulent product or service is purchased with credit extended directly by the seller or arranged by the seller. If the seller (1) provided your financing directly or (2) has a certain type of relationship with the provider of your financing, you may be able to stop paying on the loan and possibly obtain a refund of any payments you made on the loan if a product or service is defective or not provided.

When a credit agreement is entered into as part of the sale, it is supposed to include a statement like this:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

(Absence of this language in your contract, however, does not necessarily mean the Holder Rule is unavailable to help you.)

Does the Holder Rule Apply to My Contract?

Several facts must exist for the Holder Rule to apply to your loan. Some of those factors include:

- The credit was granted in connection with the sale of the fraudulent/defective goods or services;
- The credit was extended to a consumer, not a business;
- The sale amount is less than \$55,800 (which may change annually); and
- The seller of the fraudulent/defective goods or services (1) is the creditor, or (2) referred the customer to the creditor, or (3) is affiliated with the original creditor.
 - o Examples of a referral may include the seller routinely sending customers to a specific lender, contacting lenders on behalf of buyers, or helping buyers to prepare the loan application. A referral may exist where the seller channels buyers to particular lenders, but does not exist if the seller makes an occasional referral or merely passes along information about where buyers may obtain credit.
 - o An affiliation may exist if the seller and the lender have some sort of common ownership – perhaps one is a subsidiary of the other, or they are owned by the same company or individuals. An agreement, contract, or other arrangement between the seller and the lender can also be an affiliation. Examples of such arrangements include:

- The seller keeps the lender's loan application forms in its office.
- The seller pays the lender for sales leads.
- The seller and lender jointly process loan documents.
- The seller and lender advertise together.

The Holder Rule does not apply to loans you obtain on your own without the help of or referral by the seller.

When May I Stop Paying on My Contract?

Generally speaking, if the Holder Rule applies you should be able to answer "yes" to the following:

- (1) Was the credit agreement entered into as part of your purchase?
- (2) Is the seller the creditor, or does the seller regularly refer customers to the creditor, or is the seller affiliated with the creditor?
- (3) Do you have a valid reason to stop paying on your loan and/or request a refund of payments you have made (for example: the seller misrepresented the product/service; the product was defective; the service was not performed)? And do you have evidence to show why you should not have to repay the loan or receive a reimbursement?

If the Holder Rule applies, you may be able to stop making payments on your loan and even recoup previously paid amounts. You may even be able to assert claims that are otherwise barred by the statute of limitations if state law permits those claims to be raised as defenses to payment. Be cautious about stopping payment to a creditor! If your claim is unsuccessful, collection proceedings and negative credit reporting may result. You should consult an attorney before taking such an action. Please note that the Minnesota Attorney General's Office cannot provide legal advice to individuals in private legal matters. Our Office cannot tell you whether the Holder Rule may apply to your situation. You may wish to consult this Office's publication, *Hiring an Attorney*, for guidance in looking for an attorney.

What If the Holder Rule Language Does Not Appear in My Contract?

If the Holder Rule applies and the Holder Rule statement is not in the contract, the creditor has violated federal law. If your credit contract does not include the statement and you have reason to believe it should, you should consult an attorney to explore your legal options. You may still have legal rights under the Holder Rule even if the Holder Rule statement is not in your contract.

Where Can I Go for Help?

The Consumer Financial Protection Bureau (CFPB) is the federal agency that has authority to enforce the Holder Rule. If you believe the creditor has violated federal law, you may contact the CFPB as follows:

Consumer Financial Protection Bureau

Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220
(855) 411-2372
www.consumerfinance.gov

You may also wish to contact the FTC to report the possible violation:

Federal Trade Commission

Consumer Response Center
600 Pennsylvania Avenue NW
Washington, DC 20580
(877) 382-4357
www.ftccomplaintassistant.gov

Does the Holder Rule Apply to My Student Loans?

The FTC has stated that student loans are within the scope of the Holder Rule. The Department of Education also has regulations applying principles similar to the Holder Rule to many federal student loans. For private loans, the borrower may be able to cancel existing debt if a school fraudulently induced the student to enroll and had some relationship with the lender. For federal direct loans, the promissory notes include a statement about your rights and will tell you to contact your direct loan servicer if you believe you should not have to repay the loan.

Please also note that, following enforcement actions by the federal government and other authorities against a particular school, the Department of Education announced in 2016 that it would implement rules that would more easily allow student-borrowers who experienced fraud or other misconduct in enrolling in a school to have their federal student loans forgiven. The Department of Education announced in 2017, however, that it was placing these rules on hold while it engages in new rulemaking to alter them. Despite the Department's actions to delay these new rules, the "borrower defense" regulation allowing the Secretary of Education to forgive loans taken out subject to fraud still exists in federal law and students may still submit claims for borrower defense to repayment

More information about the Department of Education's process is available at <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/borrower-defense>. If you believe you have a valid reason to not repay your federal student loans, you may submit materials by email to FSAOperations@ed.gov or by mail to:

U.S. Department of Education
P.O. Box 194407
San Francisco, CA 94119

Information about what to include in your submission is available at the following address: <https://studentaid.ed.gov/sa/about/announcements/Corinthian>. Please note this Office has no authority over the Department of Education's review of the borrower defense claims it receives, the timeliness of its review of such claims, or its decision to grant or deny such claims.

More Information

Further information about the Holder Rule is published by the FTC at the following address: www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/holder-due-course-rule. You may also contact the Attorney General's Office for more information:

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