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Federal Statutes Allowing Consumers "Cooling Off" Periods to Rescind Contracts

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Summary

Contracts are generally governed by state law. Under state law, a contract takes effect and is enforceable upon being created -- that is, when an offer is accepted. Federal law, however, has several exceptions to this rule, which allow consumers a "cooling off" period during which they may rescind particular types of contracts, owe nothing, and not be subject to suit for breach of contract. These provisions are in the Truth in Lending Act, the Credit Repair Organizations Act, the Interstate Land Sales Full Disclosure Act, and a regulation promulgated under the Federal Trade Commission Act.

Truth in Lending Act: Second Mortgages

Section 125 of the Truth in Lending Act, 15 U.S.C. § 1635, provides that, in a consumer credit transaction in which a security interest is or will be retained or acquired in any property used as a principal dwelling of the borrower, the borrower shall have the right to rescind the transaction until midnight of the third business day following consummation of the transaction. The lender, furthermore, must clearly and conspicuously disclose to the borrower the right of rescission.

There are four situations, however, in which this right does *not* apply: (1) a *first* mortgage (a mortgage incurred when the dwelling was purchased), (2) a refinancing or consolidation loan (with no new advances), (3) a loan from a state agency, and (4) advances under a preexisting open end credit plan (a credit card or overdraft checking account) if a security interest has already been retained or acquired.

In addition, a 1995 amendment to the Act provides that, after the initiation of any judicial or nonjudicial foreclosure process on a borrower's primary dwelling, the borrower shall have a right to rescind the transaction if (A) a mortgage broker fee is not included in the finance charge in accordance with the laws and regulations in effect at the time the consumer credit transaction was consummated, or (B) the form of notice of rescission for the transaction does not comply with the requirements of the law. The right of rescission

following the initiation of a foreclosure process expires three years after the date of the consummation of the transaction, with specified exceptions.

The Credit Repair Organizations Act

This statute, enacted as § 2451 of Public Law 104-208 (1996), and codified at 15 U.S.C. §§ 1679-1679j, regulates credit repair organizations, which it defines as "any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform . . . any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of . . . improving any consumer's credit record, credit history, or credit rating." The definition, however, excludes any charitable (§ 501(c)(3)) organization, any creditor to the extent it is assisting the consumer to restructure any debt owed to the creditor, and any depository institutions or credit union.

Section 407 of the Act, 15 U.S.C. § 1679e, provides: "Any consumer may cancel any contract with any credit repair organization without penalty or obligation by notifying the credit repair organization . . . before midnight of the 3rd business day which begins after the date on which the contract . . . is executed"

Interstate Land Sales Full Disclosure Act

Section 1404(b) of the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1703(b), provides that any contract or agreement for the sale or lease of a lot covered by the Act may be revoked at the option of the purchaser or lessee until midnight of the seventh day following the signing of such contract or agreement, and such contract or agreement shall clearly provide this right.

The Act covers, in general, unimproved land divided or proposed to be divided into 25 or more lots for the purpose of sale or lease as part of a common promotional plan. In addition, § 1404(d) provides that, except when a warranty deed or its equivalent is provided, if a contract or agreement for the sale or lease of a lot covered by the Act does not contain specified provisions, then it may be revoked at the option of the purchaser or lessee for two years from the date of its signing.

Federal Trade Commission Act: Door-to-door Rule

Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, prohibits "unfair or deceptive acts or practices in or affecting commerce," and § 18, 15 U.S.C. § 57a, authorizes the Federal Trade Commission (FTC) to prescribe "rules which define with specificity acts or practices which are unfair or deceptive." One such FTC rule, published at 16 C.F.R. Part 429, provides for a three-day cooling off period for door-to-door sales and sales made at other than the seller's place of business. Specifically, it provides that, in connection with any

sale, lease, or rental of consumer goods or services with a purchase price of \$25 or more . . . , in which the seller or his representative personally solicits the sale, including those in response to or following an invitation by the buyer, and the buyer's agreement or offer to purchase is made at a place other than the place of business of the

seller (*e.g.*, sales at the buyer's residence or at facilities rented on a temporary or short-term basis, such as hotel or motel rooms, convention centers, fairgrounds and restaurants, or sales at the buyer's workplace or in dormitory lounges) . . .

the seller must furnish the buyer with a statement in bold face type of a minimum size of 10 points "in substantially the following form":

"You, the buyer, may cancel this transaction at any time prior to midnight of the third business day after the date of this transaction. See the attached notice of cancellation form for an explanation of this right."

The cooling off period does *not* apply for sellers of "automobiles, vans, trucks or other motor vehicles sold at auction, tent sales or other temporary places of business, provided that the seller is a seller of vehicles with a permanent place of business." It also does not apply "for sellers of arts or crafts sold at fairs or similar places."

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