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ATTORNEY GENERAL OPINION NO. 82- 143

Donald O. Phelps
Consumer Credit Commissioner
535 Kansas Avenue, Suite 1114
Topeka, Kansas 66603

Re: Consumer Credit Code -- Limitations on Consumer's
Liability -- Balloon Payments; Denial of Right to
Refinance

Synopsis: K.S.A. 16a-3-308 of the Consumer Credit Code gives a consumer certain protections against the use of a balloon payment, i.e., a scheduled payment that is more than twice as large as the average of earlier scheduled payments. The consumer has the right to refinance the balloon payment at the time it is due without penalty and at terms that are no less favorable to him or her than those of the original transaction. In that this section is clearly designed for the protection of consumers, a consumer is not obligated to affirmatively exercise this right, and a seller, lender or lessor may not, merely by the failure of a consumer to request the same terms, proceed to extend more onerous terms than those in the original agreement. Such conduct would result in an impermissible waiver by the consumer of rights given by the Code (K.S.A. 16a-1-107) and additionally could be found unconscionable (K.S.A. 16a-5-108). Cited herein: K.S.A. 16a-1-101, 16a-1-102, 16a-1-107, 16a-3-308, 16a-5-108, 16a-6-111.

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Dear Commissioner Phelps:

As Consumer Credit Commissioner for Kansas, you request our opinion on the interpretation to be given to a section of the Consumer Credit Code ("Code"), K.S.A. 16a-1-101 et seq.

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Specifically, you inquire concerning K.S.A. 16a-3-308, which relates to the rights of a consumer in the refinancing of a so-called balloon payment.

As amended by the 1981 Legislature, K.S.A. 16a-3-308 states:

"With respect to a consumer credit transaction, other than one pursuant to open end credit, if any scheduled payment is more than twice as large as the average of earlier scheduled payments, the consumer has the right to refinance the amount of that payment at the time it is due without penalty. The terms of the refinancing shall be no less favorable to the consumer than the terms of the original transaction. These provisions do not apply to the extent that the payment schedule is adjusted to the seasonal or irregular income of the consumer."

While fairly plain on its face, the statute has been interpreted by some so as to have a different result than that taken by your office. While you read the statute to leave a seller, lender or lessor no option but to refinance a balloon payment at terms that are as favorable as those initially agreed to by the consumer, this alternate reading would require a consumer to affirmatively exercise this right. In the absence of such action, a seller, lender or lessor would be free to offer refinancing terms different than in the original agreement.

Initially, we would note that nowhere in K.S.A. 16a-3-308 is an express notice requirement set out, as is the case in at least one other state which has also adopted the Code. See, e.g. Colorado Revised Statutes §5-3-402. However, in our opinion the absence of such a clause in the Kansas statute does not require the adoption of the latter interpretation noted above. Rather, it would be our conclusion that, if the purpose of the statute is considered, as well as that of other sections of the Code, the controlling legislative intent behind K.S.A. 16a-3-308 gives support to the interpretation reached by your office.

A useful background to the purpose of the statute is provided by the 1973 Kansas Comment written by Professor Barkley Clark. Therein, Professor Clark notes:

"Balloon payments can be used to induce a buyer or borrower to enter into a burdensome contract by offering him invitingly small installment payments until the end of the contract when

the buyer or borrower is confronted with a balloon payment too large to pay. This section meets that threat by giving the buyer or borrower the right to have the amount of the balloon payment refinanced under terms no less favorable than those of the original sale or loan. Under the refinancing, the size of the installment payments may not exceed the average scheduled payments excluding the balloon payment and the rate of finance charge may not exceed that under the original agreement. If the balloon payment was agreed to by the parties to accommodate the buyer or borrower because of his seasonal or irregular income expectations, the abuse at which the section is aimed is not present and the section does not apply. Agricultural notes and contracts are also excluded. Prior Kansas law contained no limits on balloon notes."

Additional help is provided by the Official Comment to this section adopted by the National Conference of Commissioners on Uniform Laws, which notes that the section's purpose "is to protect consumers against deceptive or unfair use of irregular payments." These comments indicate an interpretation of the section by the authors, as well as of the statute itself by a well-known commentator, that looks to a broad, and not a narrow, protection for consumers. Such a reading would be inconsistent with an implied requirement that a consumer must affirmatively ask for the same terms before a seller, lender or lessor would have to supply them.

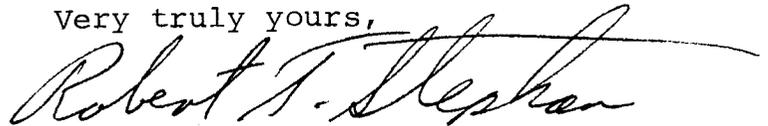
Such a narrow interpretation would also conflict with other sections of the Code. At K.S.A. 16a-1-102(1), it is stated that the Code should be liberally construed to promote its underlying purposes and policies. One such purpose, set out at subsection (2)(d) of the same statute, is "to protect consumer buyers, lessees and borrowers against unfair practices by some suppliers of consumer credit." Additionally, as provided by K.S.A. 16a-1-107(1), a consumer may not waive rights or benefits under the Code. By declining to inform a consumer of her or his rights under K.S.A. 16a-3-308, a seller, lender or lessor would be permitting just such a waiver.

Finally, although the facts of such situations could vary widely, we should also note that K.S.A. 16a-5-108, which prohibits unconscionable agreements, might also apply. The unconscionable agreement would not be the initial transaction, but would instead be the new agreement by which the balloon is refinanced at, for example, a higher rate of interest. The latter agreement could be found to have been induced by

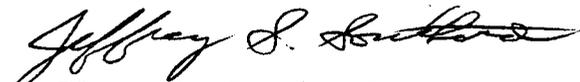
unconscionable conduct where it is made possible, for example, through the silence of the seller, lender or lessor as to K.S.A. 16a-3-308's existence. Such a finding by your office could trigger action under K.S.A. 16a-6-111 to restrain a creditor from so acting.

In conclusion, K.S.A. 16a-3-308 of the Consumer Credit Code gives a consumer certain protections against the use of a balloon payment, i.e., a scheduled payment that is more than twice as large as the average of earlier scheduled payments. The consumer has the right to refinance the balloon payment at the time it is due without penalty and at terms that are no less favorable to him or her than those of the original transaction. In that this section is clearly designed for the protection of consumers, a consumer is not obligated to affirmatively exercise this right, and a seller, lender or lessor may not, merely by the failure of a consumer to request the same terms, proceed to extend more onerous terms than those in the original agreement. Such conduct would result in an impermissible waiver by the consumer of rights given by the Code (K.S.A. 16a-1-107) and additionally could be found unconscionable (K.S.A. 16a-5-108).

Very truly yours,



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RTS:BJJ:JSS:hle