

# THE UNIFORM COMMERCIAL CODE DRAFTING PROCESS: WILL ARTICLES 2, 2B AND 9 BE FAIR TO CONSUMERS?

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Ms. Hillebrand's publications include: *The Redrafting of UCC Articles 2 and 9: Model Codes or Model Dinosaurs?*, 28 LOY. L.A. L. REV. 191 (1994); *The Revision of UCC Article 9: Issues for Consumers*, 27 UCC L.J. 179 (1994); *UCC Articles 3 and 4 in the California Legislature: A New Focus on Consumer Protection in Uniform Law Proposals*, 47 CONSUMER FIN. L.Q. REP. 123 (1993); *Revised Articles 3 and 4 of the Uniform Commercial Code: A Consumer Perspective*, 42 ALA. L. REV. 679 (1991). The author wishes to disclose that she is not a disinterested observer of the uniform law process. As an attorney for Consumers Union, she has participated as an observer to the Article 2 and 9 drafting committees, has submitted comments on Article 2B, and has responded to invitations by legislative staff for analyses on how the revised UCC Articles 3, 4 and 8 could affect consumers.

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### SUMMARY

The Uniform Commercial Code (“UCC” or the “Code”) revisions now underway will have a significant and long lasting impact on consumers. Part I of this piece summarizes the key issues for consumers which have developed in the drafting of Articles 2, 2B, and 9. Part II examines the structural barriers to full and effective consideration of the impact of revisions to the UCC on consumers. The barriers arise in part from the limitations of adequate numbers of staff and expertise on these very specialized topics within the consumer movement. The barriers are exacerbated, however, by the drawn-out nature of the drafting process; the tradition of openness to observers, most of whom represent affected industries; and to some degree, by the nature of the pool from which Uniform Law Commissioners are drawn.

Part III identifies some of the changes in law being made in the drafts of Articles 2, 2B, and 9 and the possible impacts on consumers because of those changes. Part IV describes the types of nonuniform amendments state

legislatures have made to Articles 3 and 4. That experience suggests the questions that uniform law drafters should ask themselves—and should expect from legislators—about any new UCC draft. Part V offers some suggestions for making the UCC drafting process more amenable to considering the impacts of changes to the Uniform Commercial Code on consumers and other underrepresented groups.

How Articles 2, 2B, and 9 treat consumers will reflect on the integrity of the uniform law drafting process and on the credibility of the National Conference of Commissioners on Uniform State Laws (“NCCUSL” or the “Conference”) and the American Law Institute (“ALI”) as law reform bodies. In light of the extreme difficulty for consumers or their advocates to participate fully in the process of the drafting of the UCC, both the Conference and the ALI have a special responsibility to weigh the fairness of uniform law drafts on consumers and to refuse to promulgate any draft which does not provide fair and workable provisions for consumer commerce. The Conference and the ALI should shoulder the responsibility of protecting the interests of consumers and small businesses who are not fully represented in the uniform law drafting process, reject proposed UCC provisions in Articles 2 and 2B which would limit consumers’ rights against unscrupulous sellers of goods or software, and avoid conferring broad new rights on creditors in the revision of Article 9. If they fail to do so, state legislators’ concerns about the impact of UCC changes on their consumer constituents may impede uniform adoption of these drafts.

#### I. INTRODUCTION AND SCOPE OF CHANGES TO THE UCC AFFECTING CONSUMERS ARISING IN ARTICLES 2, 2B, AND 9

Over the next two years, NCCUSL and the ALI will make decisions affecting nearly every American consumer. These decisions will be made in evaluating the proposed revisions to Articles 2 and 9 of the UCC and in evaluating the text of the new Article 2B, which will cover information licensing. The revisions to Articles 2 and 9, and the new Article 2B, will affect the scope of warranties and the enforceability of clauses in standard form contracts for every kind of good sold to U.S. consumers, the enforceability of terms in software licenses and contracts for on-line services, and the rights and obligations of the parties to a loan secured by personal property. The decisions made by the Conference and the ALI on these broad revisions will affect consumers in their everyday commerce, from toasters to automobiles, children’s software to home and business accounting software,

and car loans to margin loans.

The impact of the UCC on consumers would be difficult to overstate.<sup>1</sup> The National Association of Consumer Agency Administrators has recognized the UCC's importance to consumers by adopting a resolution urging the Conference to address consumer issues in Articles 2, 3, 4, and 9.<sup>2</sup> UCC Article 2 provides the basic contract law for the sale of goods to consumers and businesses in all fifty states.<sup>3</sup> This includes the annual sale of twelve to fifteen million new automobiles and light trucks, and a similar number of used cars.<sup>4</sup> Many of these sales are to consumers. Electronic goods sold to U.S. consumers in 1994 totaled \$55.9 million.<sup>5</sup> Non-automobile consumer goods sold in the U.S. recently totaled in excess of \$1.7 trillion.<sup>6</sup> Revised Article 2 will provide the basic rules of contract formation for all of these transactions.

Article 2B is a proposed new statute dealing with computer software and on-line services.<sup>7</sup> It would provide contract law and default rules for all software and on-line information services sold in the U.S. In 1995, according to industry sources, sales of personal computer application software in the United States and Canada reached \$7.53 billion.<sup>8</sup> The version of Article 2B presented to the Conference in the summer of 1996 would have dramatically altered the balance of rights and responsibilities between software makers and users, depriving licensees of remedies available to them under current law for the purchase of goods. The Conference as a whole asked the drafting committee to re-examine its decisions and to seek a better balance in the draft between provisions favoring licensees and those favoring licensors. The

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1. See Nat'l Ass'n of Consumer Agency Adm'rs, Resolution: Uniform Commercial Code (19th Annual Mtg. June 7, 1994).

2. *Id.*

3. U.C.C. § 2-101 cmt. (1995).

4. TELEPHONE INQUIRY TO RETAIL SALES DIV., U.S. DEP'T OF COMMERCE, WASHINGTON, D.C. (1994).

5. *Id.*

6. *Id.*

7. Draft, Uniform Commercial Code Article 2B-Licenses (Nat'l Conference of Comm'rs on Unif. State Laws, July 12-19, 1996) [hereinafter July 1996 Annual Meeting Draft, Art. 2B], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited on Jan. 20, 1997). Citations will be to the January 24, 1997 Article 2 draft and the March 21, 1997 Article 2B draft except where otherwise noted. More recent drafts may be cited where the text of the noted section has been substantially changed.

8. Software Publishers Association, *Personal Computer Application Software Sales Reach \$7.53 Billion in North America in 1995* (Mar. 25, 1996) (press release) (visited Oct. 10, 1996) <<http://www.spa.org/research/releases/4q95namr.htm>>.

expectation that the draft will change dramatically is based on the statements made by numerous members of NCCUSL at its 1996 annual meeting. In substance, these comments by members of the Conference questioned the strong pro-industry tone of the draft being presented to them and expressed concern about a series of decisions made in that draft which selected the licensee rather than the licensor to bear an identified risk. The decisions that committee makes on those issues, and the response of the ALI and the Conference to those decisions, will determine how Article 2B affects consumers.

Finally, UCC Article 9 governs security interests in personal property collateral, ranging from cars and furniture to uncertificated stock.<sup>9</sup> Article 9 gives a creditor the right to repossess goods without a court order and sets the standards for how creditors must treat property after they repossess it. Proposed changes to Article 9 will affect what collateral a creditor can take under the UCC, when a creditor may seek to collect a deficiency, and what the consequences are if a creditor fails to meet the basic standard of commercial reasonableness in disposing of collateral.<sup>10</sup>

*A. Proposed Changes to Basic Contract Law for the Sale of Goods Would Both Help and Harm Consumers*

Most of the proposed revisions to existing UCC Article 2 will help consumers. The new Article 2 will help consumers by protecting them from unreasonable terms when signing standard form contracts. The UCC currently protects businesses which exchange standard forms from certain unexpected clauses in those forms. The proposed revisions to Article 2 include a new rule in draft section 2-206 that would prohibit a seller from enforcing terms in a form contract against a consumer if those terms could not reasonably have been expected unless the consumer expressly agreed to the terms.<sup>11</sup> For example, a term that says that a new car will not run would be

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9. U.C.C. § 9-101 cmt. (1995).

10. Draft, Uniform Commercial Code Article 9—Secured Transactions; Sales of Accounts and Chattel Paper (199\_) (Nat'l Conference of Comm'rs on Unif. State Laws, July 12-19, 1996) [hereinafter July 1996 Annual Meeting Draft, Art. 9], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited on Jan. 20, 1997).

11. Draft, Uniform Commercial Code Article 2—Sales (199\_) § 2-206 (Nat'l Conference of Comm'rs on Unif. State Laws, July 12-19, 1996) [hereinafter July 1996 Annual Meeting Draft, Art. 2], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited Jan. 20, 1997). The draft has since been extensively renumbered. Citations will be to the renumbered January 1997 Article 2 Draft except where otherwise noted. Draft, Uniform Commercial Code Revised Article 2 Sales (Nat'l

unenforceable under this new legal rule even if the consumer had signed a preprinted contract with that term in it, except where the seller proves that the consumer really did agree to buy a car that did not run.<sup>12</sup> This section presents the single most important improvement for consumers to emerge from the lengthy revision process. Unfortunately, however, it is still under attack from industry and changes to weaken it are under consideration.

Another useful change will also help consumers by simplifying enforcement of advertised promises made by a manufacturer about goods, even though the consumer buys the goods from a third-party retailer and not directly from the manufacturer.<sup>13</sup> In the modern, national economy, advertised promises about goods are often made by the manufacturer instead of the retailer. Advertising can have a great influence on consumers, regardless of whether the ads are offered by the retailer or the manufacturer.

One proposed change to Article 2 which could harm consumers is the expansion in the right of a seller to cure a defect or breach. Under current law, there is a post-purchase period when a consumer has an absolute right to reject the goods and cancel the contract if the goods do not completely comply with the contract.<sup>14</sup> These changes are discussed in Part III.A.

#### *B. New Law on Software Licensing and On-Line Services Favors Licensors*

New UCC Article 2B would create new legal rules for the licensing of both computer software and information services, such as on-line services. The draft of Article 2B was presented to the Conference for discussion at its

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Conference of Comm'rs on Unif. State Laws, Jan. 24, 1997) [hereinafter Jan. 1997 Draft, Art. 2], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited Mar. 28, 1997). After the renumbering scheme, current Part 5 provisions are now in Part 6 and Part 7 provisions are now in Part 8.

12. Whether the new provision would also invalidate a term in a used car contract stating that the car would not run would depend on whether, under all the circumstances of the transaction, the consumer could have reasonably expected that term. *Id.* The answer might be yes for a transaction conducted at a junkyard. The answer might be no for a sale at a used car lot which included a test drive of a working car and a price that reflects an expectation that the car would be usable for transportation rather than parts.

13. The advertising industry has hotly criticized this proposal. *See, e.g.*, Memorandum from Advertising Group to National Conference of Commissioners on Uniform State Laws, Section 2-313 (July 2, 1996) (on file with author) (prepared by Hall Dickler Kent Friedman & Wood, L.L.P.); Memorandum from NIMA International to National Conference of Commissioners on Uniform State Laws (July 3, 1996) (on file with author). NIMA is the name of the entity formerly known as the National Infomercial Marketing Association.

14. U.C.C. § 2-601 (1995).

summer 1996 annual meeting.<sup>15</sup> Many members of the Conference severely criticized it as being too favorable to the software industry and substantial revisions are expected. Some aspects of that draft will be discussed, both to illustrate flaws in the uniform law drafting process and because many of its harmful provisions have survived. However, persons interested in the impact of the draft on software users should take care to obtain the most current draft, as it continues to change rapidly.<sup>16</sup>

The Article 2B draft presented to the Conference in the summer of 1996 would have harmed consumers in five key ways.<sup>17</sup> Two of those harms have been removed in subsequent drafts, but three remain. First, the Summer 1996 draft would have authorized *any* term in a standard form contract so long as the term was consistent with customary industry practices, even if the term could not have been expected by the consumer or the term was the type of term that would cause a reasonable consumer to reject the contract if he or she had understood that term.<sup>18</sup> For example, suppose most software contracts had a term stating that the software maker is not responsible for any damage that the software does to the consumer's computer files, even if the software maker knows that certain types of files are damaged by the program. If this contract term were commonly used in the industry, the Summer 1996 Article 2B draft would have validated the term even if it was otherwise unreasonable and unexpected. After the broad criticism of the Article 2B draft by the Conference in the summer of 1996, this section was revised to eliminate this objectionable safe harbor. However, it still measures the enforceability of a standard form contract from the perspective of the expectations of the drafter of the contract, rather than the expectations of the consumer or licensee upon whom the contract is imposed.

Second, the draft would make it easy for software makers and on-line services to eliminate responsibility for viruses.<sup>19</sup> This has been the subject of additional discussion at several meetings since the summer conference. Third,

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15. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7.

16. Copies of the draft are available on the Internet and can be downloaded from <<http://www.kentlaw.edu/ulc>> and from the Article 2B homepage at <<http://www.law.un.edu.ucc2b>>. Useful information on the impact of the draft on consumers can be found at <<http://www.cptech.org/ucc/ucc.html>>.

17. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7.

18. *Id.* § 2B-308(b)(1).

19. *Id.* § 2B-320 (renumbered in Draft, Uniform Commercial Code Article 2B—Licenses § 2B-319 (Nat'l Conference of Comm'rs on Unif. State Laws Nov. 10, 1996) [hereinafter Nov. 1996 Draft, Art. 2B], available in <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited Jan. 24, 1997).

the Article 2B draft would give a software maker a qualified right to reach into a user's computer and remove its programs if the user has failed to pay or has otherwise materially breached the contract.<sup>20</sup> It would authorize a software maker to seize software out of the consumer's computer, leaving the consumer to later prove damages. Although this provision has received extensive criticism, it remains in the draft.

Fourth, the Summer 1996 Article 2B draft would have set an unrealistically low dividing line between those consumers who would be treated as if they had the power to bargain with large software makers and other consumers who would be treated as so-called mass-market licensees. The draft gave somewhat broader rights to consumers, small businesses, and others who fall into the category of mass-market licensee, but then restricted that category to only those persons paying less than \$1,000 per year for a software program or an on-line service.<sup>21</sup> All licensees who spend more than this amount per program or service were generally treated as if they could bargain over the terms of the license with a software maker or on-line service.

The unrealistic dividing line of \$1000 per year, has been removed from subsequent drafts for consumer software users, but an even cut off of \$500 has been selected for nonconsumer users.<sup>22</sup> Anyone who has ever tried to change the terms of the prepared software license agreement that comes in the box or appears on the monitor on the first use of the software knows that it is highly unlikely that consumers or many businesses will be able to bargain over these terms, even if the software they are licensing is expensive.

The fifth area of serious weakness in the Article 2B draft presented to the Conference for discussion in the summer of 1996 was its lack of meaningful remedies. The perfect tender rule would be eliminated, so that the right to reject without a dispute about the degree of the non-conformance would be lost.<sup>23</sup> The right to reject would be narrowed so that it would be triggered only by "material" breaches, potentially forcing the consumer to retain bad

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20. *Id.* § 2B-712 (renumbered as Section 2-313 in Draft, Uniform Commercial Code Revised Article 2 Sales (Nat'l Conference of Comm'rs on Unif. State Laws, Mar. 21, 1997) [hereinafter Mar. 1997 Draft, Art. 2], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited on Apr. 8, 1997).

21. *Id.* § 2B-102(26)(i)(C).

22. Nov. 1996 Draft, Art. 2B, *supra* note 19, § 2B-102(25) alt.A & B. Draft, Uniform Commercial Code Article 2B, Licenses § 2B-102(25) & Notes (Nat'l Conference of Comm'rs on Unif. State Laws, Mar. 21, 1997) [hereinafter Mar. 1997 Draft, Art. 2B], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited Apr. 16, 1997).

23. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7, §§ 2B-601 & rpt'r.'s note 6, § 2B-602.

software and decide if it is economical to sue for damages.<sup>24</sup> Incidental damages could be limited by contract to a refund of the price paid, regardless of the amount of damage which the software caused to the user's computer or files.<sup>25</sup> The rule against consequential damages has since been removed and some limited progress has been made in preserving the perfect tender rule. The other weaknesses, however, remain.<sup>26</sup>

### C. *The Draft Revisions to Article 9 Favor Creditors*

The proposed revisions to UCC Article 9 favor creditors in several ways. The revisions make it easier to create and enforce a security interest by expanding the types of tangible and intangible personal property collateral creditors can take and codifying new legal obligations for creditors who repossess property.<sup>27</sup> The revisions are likely to expand the types of assets that can be taken as collateral from a business, and perhaps also from a consumer. The proposed revisions would expand the collateral that a creditor can take under Article 9 to include a security interest in the bank accounts of small and other businesses, including business checking and savings accounts.<sup>28</sup>

Other draft revisions to Article 9 would deprive courts of the ability to deny a deficiency as a result of a creditor's proven violation of Article 9 in the disposition of collateral.<sup>29</sup> This would be the rule in commercial transactions and an option in consumer transactions. For example, the draft would eliminate the absolute bar rule for commercial debtors. Under that rule, thirteen states have held that a creditor who violates obligations to a debtor under Article 9 loses its right to pursue a deficiency against that debtor.<sup>30</sup> The

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24. *Id.* § 2B-702.

25. *Id.* § 2B-706(a).

26. *Id.* § 2A-701(a) (position changed in Nov. 1996 Draft, Art. 2B, *supra* note 19).

27. *See infra* Part III.C.1.

28. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-107 (renumbered in Draft, Uniform Commercial Code Article 9—Secured Transactions; Sales of Accounts and Chattel Paper § 9-104 (Nat'l Conference of Comm'rs on Unif. State Laws Oct. 1996) [hereinafter Oct. 1996 Draft, Art. 9], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited on Jan. 24, 1997)). Deposit accounts are expected to remain exempt in consumer loans. *Id.* § 9-104(13) (renumbered in Oct. 1996 Draft, Art. 9, *supra*, § 9-113(13)).

29. *Id.* § 9-507 (renumbered in Oct. 1996 Draft, Art. 9, *supra* note 28, § 9-625 alt.B).

30. Jurisdictions using the rule are Arkansas, California, Delaware, the District of Columbia, Iowa, Kansas, Kentucky, Maryland, Montana, Nebraska, Texas, Vermont, and Wyoming. One of those states applies the rule only in consumer transactions while another applies it to consumer transactions below \$100,000 and commercial transactions below \$50,000. A few jurisdictions use the rule for notice violations only.

drafting committee has voted to leave open the applicability of the absolute bar doctrine in consumer transactions, so that states in which it has been developed through case law could retain it.<sup>31</sup> The draft comments also eliminate the doctrine of constructive strict foreclosure.<sup>32</sup> Under this doctrine, a court may find that a creditor who has waited an undue length of time to sell repossessed property is deemed to have decided to keep the property in lieu of selling it and seeking a deficiency.<sup>33</sup>

One of the most harmful changes for consumers in the proposed revisions to Article 9 would provide a new defense to creditors who break the law when they sell collateral repossessed from consumers. This new defense could prevent consumers from obtaining the simple, easy-to-calculate remedy of statutory damages for some types of Article 9 violations.<sup>34</sup> Creditors will not be punished or deterred for some legal violations to the same extent that they are under current law.<sup>35</sup>

Other proposed revisions to Article 9 authorize creditors to file a financing statement in state or local records showing that the creditor has a security interest in the property of a consumer or a business, without obtaining the signature of the debtor, as required by current law.<sup>36</sup> The policy issues raised by these and other changes to Article 9 are further discussed in Part III.C.

*D. The Article 2B and 9 Drafts Reveal Serious Unanswered Questions About Whether the Uniform Law Drafting Process Will Produce UCC Revisions Which Are Fair to Consumers*

The Article 2 draft appears likely to be workable for consumers, although some troublesome issues remain unresolved. In particular, the draft revisions to Article 2 take a key step forward in the manner in which the new Article 2 treats standard form contracts. The draft recognizes that these transactions involve a pattern of behavior very different from the traditional Code paradigm of mutual agreement. It applies the basic contract law idea of the

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31. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-507 rptr's cmt. 3.

32. *Id.* § 9-505 rptr.'s cmt. 6.

33. *See* U.C.C. § 9-507 (1995).

34. *See infra* Part III.C.4.

35. The Consumer Issues Subcommittee has recommended that any new defenses be so narrowed to notice violations, but it is not clear whether it will be so modified. *See* Memorandum from the Article 9 Drafting Committee, Consumer Issues Subcommittee to the Consumer Task Force Members 12 (Oct. 7, 1996) [hereinafter Consumer Issues Subcommittee Preliminary Report] (on file with author).

36. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-402 & rptr.'s cmt. 2.

reasonable expectations of the parties to terms that were not bargained for, but present in preprinted contract language prepared by one party.<sup>37</sup> The Article 2 draft recognizes that the reasonable expectations of *both* parties, not just the drafting party, should influence what becomes part of a contract when a standard form is used.

The drafts of Articles 2B and 9 differ sharply from the Article 2 draft in their impact on consumers. The draft of new Article 2B was roundly criticized by Conference members as being skewed in favor of software makers and on-line services at the expense of consumers and other users. The committee which produced this unbalanced draft has begun to reexamine it. Until that work is completed, it is impossible to say whether Article 2B will be fair and equitable for U.S. consumers.

Many commentators have suggested that the new Article 9 draft tips the balance of the law too far in favor of creditors.<sup>38</sup> The draft exempts consumers from some but not all of those changes. At the same time, the draft contains an unnecessary new defense for creditors to the statutory damages currently available under Article 9, codifies an expansive definition of purchase money security interests which may harm consumers in bankruptcy, and creates the possibility of interference with statutory and judicially developed remedies available to a consumer when his or her creditor breaks the law in disposing of the consumer's collateral.<sup>39</sup> The draft also contains several provisions that would be helpful to consumers. Whether the revisions to Article 9 will ultimately be fair to consumers depends in large part on how the committee drafts those new provisions and how other open issues are eventually resolved.

## II. STRUCTURAL BARRIERS TO DEVELOPMENT OF SOUND POLICY AFFECTING CONSUMERS IN THE UNIFORM LAW PROCESS

The uniform law process has been the subject of much debate in recent years.<sup>40</sup> It has been suggested that, because of their membership and

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37. July 1996 Annual Meeting Draft, Art. 2, *supra* note 11, § 2-206(b) & Note 1.

38. See discussion *infra* Part III.C.1.

39. See *infra* Part III.C.4-6.

40. For a description of the life of a uniform law draft from inception to adoption, see Marianne B. Culhane, *The UCC Revision Process: Legislation You Should See in The Making*, 26 CREIGHTON L. REV. 29 (1992); Donald J. Rapson, *Who is Looking Out for the Public Interest? Thoughts About the UCC Revision Process in the Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249, 259-265 (1994); and Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory*

procedures, groups such as the NCCUSL and the ALI “will have a strong status quo bias and sometimes will be captured by powerful interests.”<sup>41</sup> This piece identifies a host of structural barriers in the uniform law process to complete evaluation of the effects of UCC changes on consumers.

*A. Expense of Advocating the Consumer Interest in a Multiyear, Multistate Process*

There are very high structural barriers to effective participation by consumers and consumer groups in the Uniform Commercial Code process. The first and most obvious structural barrier is the staff time needed to effectively participate in the work of a drafting committee. Nationwide, consumer protection agencies are short of resources to serve the pressing existing needs of consumers in their immediate jurisdictions. Many have simply no time or staff to devote to legislative or law-reform efforts. In 1993, *Consumer Reports* documented the closing or downsizing of consumer protection agencies from Alaska to Tennessee.<sup>42</sup> A 1996 *Money* magazine investigation found that seventeen states and the District of Columbia are “losing ground when it comes to protecting consumers.”<sup>43</sup> *Money* stated that forty-four of the consumer offices it looked at had “seen their funding or staffing slashed or eliminated altogether during the past decade.”<sup>44</sup>

The second structural barrier to consumer participation in the drafting process is the three- to five-year time period for drafting revisions to a UCC article.<sup>45</sup> There is usually a study group process that precedes appointment of a drafting committee. After a drafting committee is formed, it meets for about three years. Both state consumer agencies and non-profit consumer groups frequently experience levels of funding uncertainty that makes it extremely difficult to commit to such a long process.

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*Rulemaking Process of Private Legislators*, 29 GA. L. REV. 909, 915-916 (1995).

41. Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595, 651 (1995); see also Corrine Cooper, *The Madonnas Play Tug of War with the Whores or Who Is Saving the UCC?*, 26 LOY. L.A. L. REV. 563 (1993); Kathleen Pachtel, *Interest Group Politics, Federalism, and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993).

42. *Dark Days for Consumer Agencies*, CONSUMER REP., May 1993, at 312-14, available in Westlaw, CONSUMER Database.

43. Ruth Simon, *Losing Your Consumer Rights*, MONEY, Mar. 1996, at 100, available in 1996 WL 8792785.

44. *Id.*

45. Schwarcz, *supra* note 40, at 918.

The fact that meetings rotate throughout the country is a third barrier. If meetings were consistently held in one location, it might be possible for a local consumer advocate, law professor, household economics professor, legal services attorney, or pro bono counsel to regularly attend meetings held in his or her own city and present a consumer viewpoint.<sup>46</sup> Because meetings move about the country, this opportunity to develop a committed volunteer consumer advocate is lost. Spreading the meetings throughout the country might at first blush appear to be a way to maximize input. However, it does not maximize input because the personal credibility that is developed over time with continued participation is essential to effective advocacy in the uniform law process. A single appearance has little effect in a three-year process.

A fourth barrier to effective consumer participation in the uniform law drafting process is the relatively specialized nature of UCC articles. The substantive expertise necessary to advocate effectively in the Code revision process is not widespread in the consumer movement. Many effective state and local consumer agencies are staffed by non-lawyers, who are unlikely to have training in the Commercial Code. Changes in highly technical Code sections can have serious impacts on consumers, but those impacts can be hard to see unless one has litigated or worked with the sections being altered. Legal services attorneys can be invaluable sources of information about how UCC sections work for consumer clients in practice, but many legal services programs are no longer able to accept consumer cases.<sup>47</sup>

#### *B. Lack of Practice Background in Consumer Issues by Decisionmakers*

A key structural weakness in the UCC revision process is that the practices of many of the NCCUSL members who serve on the drafting committees do not provide those members with a full understanding of the kind of conduct that is engaged in by companies dealing with consumers. The ten- to fourteen-person drafting committees are composed primarily of NCCUSL members, plus two or three ALI members. Unlike the ALI, the

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46. When the Article 2 Consumer Issues Subcommittee met in Dallas, Texas, a representative from the Better Business Bureau and a former attorney from the consumer unit of the Attorney General's office joined them. Both enriched the debate but were unable to attend subsequent meetings of the drafting committee held in far-away cities. Similarly, an attorney from Land of Lincoln Legal Assistance attended an Article 9 drafting committee meeting which was held in Chicago.

47. David Barringer, *Downsized Justice*, A.B.A. J., July 1996, at 60.

NCCUSL does not select its own membership. Instead, members are selected by a political process in each state. NCCUSL members tend to be attorneys with a commercial law practice, state legislators or legislative staff, plus some academics and judges.

The UCC is a specialized topic. It should not be surprising therefore that many of the nonlegislators who seek and secure appointments as Uniform Law Commissioners have practices specializing in interpreting and applying the Code for commercial clients. However, this concentration of practice backgrounds among NCCUSL's nongovernmental employee members could create a lack of perspective on how changes in the Code will affect consumers. This is not to suggest that individuals volunteering their time to the uniform law process are driven by their client's agendas. Rather, a person's practice background, no less than life experiences, can affect how he or she approaches a problem. Familiarity with the practices of a particular industry can heighten sensitivity to the needs or arguments of that industry.

Members of the Conference also may be less likely than the average consumer to have personal or practice experience with the segment of an industry that most needs legal attention. Because of their social stratum, Uniform Law Commissioners are probably less likely than the average consumer to borrow from finance companies or buy from shady used car dealers.<sup>48</sup> The assumptions and experiences of decisionmakers can affect policy choices by creating differing levels of receptivity to various arguments. Here is an illustration. One issue that has arisen in connection with Articles 2, 2B, and 9 is the degree to which consumers should be expected to read and understand all the terms in a standard form sales contract, license, or loan note. A lawyer who regularly reads everything before signing may have a different view on this topic than an ordinary consumer.<sup>49</sup> A consumer whose experience of the marketplace is that several entities are competing for his or

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48. The Reporter for the Article 8 drafting committee has described the uniform law commissioners as "an elite group," and as "prominent lawyers" chosen at least in part for "intellectual interest in uniform law." James J. White, *Ex Proprio Vigore*, 89 MICH. L. REV. 2096, 2096-97 (1991). Professor Jean Braucher has pointed out that an attorney with the reputation and abilities to be selected as a Uniform Law Commissioner might be treated differently in his or her life as a consumer than a middle class or working class consumer. Jean Braucher, *The UCC Gets Another Rewrite*, A.B.A. J., Oct. 1996, at 66.

49. Ninety million of the 191 million adults in the United States have literacy levels on a literacy scale of one or two, meaning that they "were much less likely to respond correctly to the more challenging literacy tasks in the assessment . . . [such as] integrat[ing] or synthesiz[ing] information from complex or lengthy texts." NATIONAL CTR. FOR EDUC. STATISTICS, ADULT LITERACY IN AMERICA, at xiv-xv (1993).

her business may place a higher value on reading the contract than a consumer who faces "take it or leave it" treatment from merchants and lenders. In addition, some consumers have few alternatives because there are no other stores in the neighborhood offering the product, there is no direct bus service to the suburban mall, or there are no salespeople who speak the consumer's language at other locations where the product is sold.

The Article 2 drafting committee seems to have avoided the weakness of a narrow perspective in part through strong representation from academics and in part because, as discussed below, Article 2 covers the kind of transactions where there is some similarity in the marketplace for consumers from differing economic classes. The thirteen-person Article 2 drafting committee includes seven law professors, one state legislator, and five private attorneys.<sup>50</sup> One of the private attorneys is a retired in-house counsel, one is a trial lawyer with a varied commercial and individual practice, and the remaining three are from large- and medium-sized firms, practicing in the areas of banking, consumer credit, commercial, corporate and insurance.<sup>51</sup>

Two of the academic members of the Article 2 drafting committee also serve on the Article 2B drafting committee, but the balance of the membership of that committee differs sharply from that of the Article 2 committee. Slightly more than sixty percent (eight of thirteen) of the Article 2B drafting committee members are private attorneys with commercial practices.<sup>52</sup> Of these eight, six are with large- or medium-sized firms, one is with a small-sized firm and one is a solo practitioner.<sup>53</sup> These attorneys practice in the areas of banking, commercial finance, bankruptcy, venture capital, real estate, intellectual property, insurance defense and tax.<sup>54</sup> The remaining members of the Article 2B drafting committee are three law professors and two attorneys employed by governmental entities.<sup>55</sup> As discussed above, and further in Part III, these two sharply differing committees have developed very different drafts.

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50. July 1996 Annual Meeting Draft, Art. 2, *supra* note 11, preface. These statistics do not include the committee reporters.

51. Representative clients of these attorneys' firms include Coopers & Lybrand, General Motors, United Parcel Service, venture capitalists, and real estate developers. MARTINDALE-HUBBELL LAW DIRECTORY (1996).

52. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7, preface. These statistics do not include the committee reporter.

53. MARTINDALE-HUBBELL LAW DIRECTORY (1996).

54. Representative clients of their firms include Pacific Bank, FDIC, Travelers Insurance, Honda, AT&T, Anheuser-Busch, DuPont, Exxon, and General Motors. *Id.*

55. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7, preface.

The Article 9 drafting committee also lacks members who bring to the drafting process a familiarity with the consumer perspective. Nine of its twelve members are private attorneys or corporate counsel.<sup>56</sup> The majority of these attorneys practice with large or medium-sized firms, one is with a small firm, one is a solo practitioner, and one is corporate counsel to a financial group.<sup>57</sup> The remaining three members of the drafting committee are two law professors and one bankruptcy judge.<sup>58</sup> At its inception, the Article 9 drafting committee did have a member who was a former consumer regulator, however she resigned from the Conference.<sup>59</sup>

There has been an ongoing public discussion in recent years about whether members of law reform bodies can and do “check their clients at the door.” In four years of attending approximately twenty such drafting committee meetings, this author has never seen a member of a UCC drafting committee advocate a position for an individual client, but she has seen committee members on at least one committee speak from experience with a particular type of client. At the 1996 annual meeting, on the full floor of the Conference, several Commissioners gave examples of how a provision would affect a type of client. The flaw in the uniform law process perceived by this author is *not* the use of the process to promote clients’ interests. The problem, instead, is both more subtle and more difficult to remedy. The problem is the lack of sufficient practice exposure to, and understanding of, the problems experienced by consumers under the Code.

The existence and severity of the problem of lack of familiarity with the impact of the Code on consumers varies among the articles. This is partly

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56. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, preface. These statistics do not include the committee co-reporters. An analysis by practice background should not prove too much, however. American Law Institute representative Donald Rapson, who is employed as a senior vice president and associate general counsel of The CIT Group, Inc., a major creditor, has been an outspoken proponent of solving one of the key failures of current Article 9: that it permits deficiencies to be calculated based upon very low prices at disposition sales. *See, e.g.*, Donald J. Rapson, *Repurchase (of Collateral?) Agreements and the Larger Issue of Deficiency Actions: What Does Section 9-504(5) Mean?*, 29 IDAHO L. REV. 649 (1992-93).

57. MARTINDALE-HUBBELL LAW DIRECTORY (1996).

58. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, preface.

59. Other drafting committees for recently completed UCC revisions have also had many corporate attorneys in their membership. Of the eight members of the Article 3 & 4 drafting committee, five were private attorneys who represent corporate interests in their practices. They included a corporate counsel for a financial group, plus four attorneys from large- and medium-sized firms with practice areas in commercial law, banking, tax, real estate, antitrust, creditors’ rights, bankruptcy, insurance, and mergers and acquisitions. The remaining members included one judge and two law professors.

because different articles cover differing degrees of market segmentation in markets serving consumers. For example, although the Article 2 drafting committee does not contain any professionals who specialize in representing consumers in their purchase of goods,<sup>60</sup> the members of that committee, as individual consumers, probably deal with a broad range of the spectrum of sellers of goods.<sup>61</sup> There is a risk in assuming that the combined experiences of Uniform Law Commissioners and other drafters as consumers reflect the broad experience of U.S. consumers. Having an attorney or any other articulate, persistent advocate in the family can be of great assistance in resolving difficulties with a merchant or a manufacturer. The relatively affluent economic group from which Uniform Law Commissioners are drawn may have very different experiences as consumers than the average full-time U.S. worker, whose annual household income is \$47,012 for a family of four.<sup>62</sup> However, the members of the Article 2 drafting committee probably get their groceries from the same chain supermarkets which serve all but the poorest Americans.<sup>63</sup>

The Article 9 drafting committee members, by contrast, probably have no personal experience in the credit market faced by poor and working class Americans. Segmentation of the credit market means that the personal experiences of the Article 9 drafting committee members as consumers are likely to differ sharply from the experiences of other credit consumers. Low income and working-class consumers frequently participate in a different segment of the credit market than middle and upper-middle income consumers. Consumers with the highest incomes are often served by private bankers,<sup>64</sup> whose economic incentive to maintain the entire business relationship with the client may create a tendency to offer favorable terms and conditions on a personal loan. Upper income and upper-middle income consumers not at the private banking level are served by banks and frequently many banks compete for their business. Lower income consumers, including

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60. One Commissioner's practice, however, includes this as part of a general practice.

61. They may be unlikely to have personally experienced the lower end of the distribution system, however.

62. U.S. Census Bureau, *The Official Statistics, 1994 U.S. Median Income for 4-Person Families, by State* (visited Aug. 13, 1996) <<http://www.census.gov/hhes/income/4person.html>>.

63. For a discussion of the degree to which poorer neighborhoods may lack basic retail services such as chain grocery stores, see DAVID DANTE TROUT, *THE THIN RED LINE: HOW THE POOR STILL PAY MORE* (W. Coast Reg. Office, Consumers Union of U.S., Inc. 1993).

64. Peter Sinton, *Banking on the Rich*, S.F. CHRON., July 24, 1996, at C1, available in 1996 WL 3224300.

families trying to survive on one or two full-time, minimum-wage salaries, face a different credit market. Finance companies are a more common source of credit for lower income consumers. The business practices of some of these entities are quite different than those of banks. To a much larger extent, credit is "sold, not bought."<sup>65</sup> If the members of a drafting committee have not been exposed to the practices in a subpart of the market, either through their law practices or as individual consumers, this creates a special challenge to the development of sound policy affecting this subpart of the market.

*C. Heavy Participation by Industry Observers Can Affect the Dynamics of a UCC Drafting Committee's Discussion*

A key structural barrier to development of UCC articles which fully and fairly consider and address consumer transactions is the likelihood that there will be an industry or group of industries which has much more at stake than other affected parties. This barrier is greater in connection with those articles that centrally affect one or a small group of industries. It can also occur when two types of commercial parties would be affected, but only one of those types of parties is organized. Finally, this barrier is found where an issue is central to the business of a party on one side of a transaction while peripheral to the business of the other. Article 9 is an example. Both commercial borrowers and commercial creditors will be affected by the changes to Article 9 to a degree at least as great as the impact of the draft on consumer borrowers. The commercial credit industry is built around the function of providing credit, and Article 9 is a central statute affecting that activity. By contrast, commercial borrowers' businesses are built around their specific industries, not around their role as credit-seeking entities.

This type of imbalance in the degree of attention paid to drafting of legal changes by different parties to affected transactions can lead to different levels of participation, which can skew the process. The centrally affected industry may send many participants to the drafting process, with a shared viewpoint on key issues. The many other groups which are less directly impacted by the changes may be less completely represented. The most directly affected industry may also exert pressure through express or implied threats that revisions unacceptable to it will not be enacted.

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65. See *infra* Part III.C.10 (discussing the degree to which assumptions made by the Article 9 drafting committee grounded in the markets for commercial credit and middle- and upper-income consumer credit are not true in the credit market faced by lower-income consumers).

The impact of strong interest in uniform law changes by a particular industry can be magnified by the role which observers play in the UCC drafting process. Observers attend drafting committee meetings, usually receiving full speaking privileges. In many of the drafting committee meetings this author has attended, observers were regularly invited to participate in a "sense of the room" straw vote before the drafting committee voted on a particular provision.

The observers to the Articles 2, 2B and 9 drafting committees are overwhelmingly representatives of or outside counsel to affected industries. Almost sixty percent (forty-nine of eighty-two) of the Article 9 observers on its July 1994 observer list have practices representing corporate interests.<sup>66</sup> This group includes ten observers from business and industry (including Ford Motor Credit, General Motors Acceptance Corporation, Household International, and Associates Financial); six from financial institutions or their trade groups (including the American Bankers Association, the California Bankers Association, Citicorp Mortgage, and the Bank of Oklahoma); twenty-three corporate attorneys from large- or medium-sized firms (with firm practice areas including secured transactions, bankruptcy, real estate, creditors' rights, municipal financing, taxation and banking);<sup>67</sup> and ten attorneys from small-sized firms (with practice areas such as bankruptcy, corporate finance, creditors' rights, securities, real estate, banking and taxation).<sup>68</sup> Only twenty-three percent (nineteen of eighty-two) of the observers on the July 1994 Article 9 observers list were employed by entities that could be classified as neutral.<sup>69</sup> Twelve are law professors, two are from

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66. 1994 Article 9 Observers List (on file with author). The list of observers tends to expand as a drafting effort proceeds. Lists from relatively early periods in the life of both the Article 2 and 9 drafting committees have been analyzed, in part because of the author's observation that early and sustained participation is the most effective way to participate in the drafting process.

67. Representative firm clients include Bank of America, Boeing, Coca Cola, Continental Airlines, General Motors, Lloyds of London, Merrill Lynch, AMC Entertainment, Brown & Williamson Tobacco, Johnson & Johnson, Phillip Morris, Texaco, Clorox, Bristol Myers Squibb, Digital Equipment Corp., E. and J. Gallo Winery, Marriott International, MCI, Safeway and Westinghouse. MARTINDALE-HUBBELL LAW DIRECTORY (1996).

68. Representative firm clients include Bank of Jackson Hole, Nimrod Natural Gas, Fireman's Fund, Dun & Bradstreet, New England Mutual Life Insurance, Maryland Lumber, Resolution Trust Corp., National Auto Auction Association, United Services Automobile Association, Wal-Mart, AT&T Capital and General Electric Capital. *Id.*

69. In this analysis, attorneys were characterized as having corporate practices if they had practice areas of antitrust, bankruptcy, commercial, creditors' rights, finance, insurance, mergers and acquisitions, real estate, securities, taxation, and venture capital. One is classified as neutral if he or she represents a quasi-governmental law reform organization, bar association, government agency, or is a

the American Law Institute, two are from the Federal Reserve Bank of New York, and three are from state law revision commissions.

Less than ten percent (seven of eighty-two) of the observers on that Article 9 observers list could be classified as "consumer-friendly."<sup>70</sup> One observer is from the consumer/antitrust division of a state attorney general's office; two are attorneys with a small-sized firm or solo practice (practice areas include class action, consumer protection, shareholder litigation, and debt collection abuse); and four are with public interest organizations.<sup>71</sup> The remaining nine percent of observers (seven of eighty-two) include two drafting committee chairs from other UCC articles, three reporters from other UCC articles or restatements, and two observers for whom there was no available information.<sup>72</sup>

The observers to the Article 2 process also are primarily from affected industries, with the important distinction that those industries are affected in their roles as both buyers and sellers. Of the thirty-five individuals on the Article 2 observer list as of September 30, 1992, approximately sixty-six percent (twenty-three of thirty-five) represented commercial interests in their practices, twenty percent (seven of thirty-five) fell in the neutral category, eleven percent (four of thirty-five) could be categorized as consumer-friendly, and one could not be categorized.<sup>73</sup>

Of the Article 2 observers representing corporate interests, the overwhelming majority (nineteen of twenty-three) represented business and industry (e.g., National Association of Manufacturers, IBM, Chrysler, Mobile Oil, Microsoft, National Electrical Manufacturers Association).<sup>74</sup> One observer represented a financial institution (American Bankers Association) and three were attorneys with corporate practices.<sup>75</sup> The seven neutral

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law professor, judge or ALI representative with no other known affiliation. The term "consumer-friendly" is used to describe attorneys with practice areas of consumer protection, shareholder litigation, debt collection abuse, legal services, and employees of consumer rights organizations.

70. See *supra* note 66.

71. MARTINDALE-HUBBELL LAW DIRECTORY (1996).

72. These observers had no Martindale-Hubbell listing or the listing stated the address only.

73. See Sept. 30, 1992 Article 2 Observers List (on file with author); MARTINDALE-HUBBELL LAW DIRECTORY (1996).

74. MARTINDALE-HUBBELL LAW DIRECTORY (1996).

75. Listed practice areas of these attorneys include corporate, high technology and commercial. *Id.* Representative clients of the firms of these attorneys included Aetna Life & Casualty, Black & Decker, Citizens Bank of Maryland, Lloyds of London, Royal Globe Insurance, Bank One of Columbus, Physicians Health Plan, Honda Federal Credit Union and John Hancock Mutual Life Insurance. *Id.*

observers included three law professors, three from quasi-governmental law reform organizations, and one from the American Law Institute. Of the four observers representing consumer interests, three represented consumer organizations (two from Consumers Union and one from National Consumer Law Center), and one represented a union legal services plan. Not all of these persons, however, were able to attend even one drafting committee meeting.

The observers to the Article 2B drafting committee's work also are dominated by industry. According to a mailing list provided by the Conference at one point in the process, two-thirds of the observers (twenty-six of thirty-six) represent industry or corporate interests. Nine observers represented business and industry (e.g., the Software Industry Coalition, Business Software Alliance, Software Publishers Association, Hewlett-Packard, E.I. du Pont de Nemours & Company, Recreation Vehicle Industry Association, Caterpillar Incorporated, and Siemens Corporation) and fifteen were private attorneys representing corporate interests (practice areas include banking, antitrust, bankruptcy, copyright, trademark, telecommunications, and technology transfers).<sup>76</sup>

This imbalance of participation can create a climate in which a persistent consumer advocate raising issues at each point where the draft affects consumers will appear to be a nuisance to the process, merely because the comments all come from one person. An industry represented by multiple observers can divide its issues among its advocates so that no one advocate appears to be seeking too many changes to the draft. One participant who attempted to interject consumer issues into the debate about Articles 3 and 4 has written eloquently of the difficulties of raising consumer issues in a forum in which the participants are not familiar with or receptive to the issues.<sup>77</sup>

An imbalance in the level of participation between commercial and consumer representatives could also lead a drafting committee or the full Conference and the ALI to the mistaken impression that the impact of changes in law on commercial parties will be of more importance in the enactment process in state legislatures than any harm that might be done to

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76. Representative clients of these attorneys include Microsoft, the American Council of Life Insurance, General Motors, Dime Savings Bank, Banks-Baldwin Law Publishing, Proctor & Gamble, Foundation Press, West Publishing, General Electric Capital, Merrill Lynch, and USX). Two observers are corporate counsel for a financial group. MARTINDALE-HUBBELL LAW DIRECTORY (1996). The pool of observers is constantly shifting making any analysis of these lists necessarily of the snapshot variety.

77. Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993).

consumers.<sup>78</sup> The recent experience with uniform law proposals such as UCC Articles 3 and 4 contradicts this assumption. As discussed in more detail in Part IV, several state legislatures and the highly respected New York Law Revision Commission found Articles 3 and 4 to be inadequate with respect to consumers and made or recommended nonuniform changes. UCC Articles 2B and 9 could face a similar fate in the state legislatures if care is not taken now to evaluate how they will affect consumers.

*D. Policy Implications of the Structural Barriers to Consumer Participation in the UCC Revision Process*

Because of the intractability of the structural barriers, the Conference and the ALI have an increased obligation to evaluate the impact of proposed UCC changes on consumers. It is not yet clear how well these bodies will rise to that responsibility. In the summer of 1995, the scope and program committee of the Conference recommended removing from the jurisdiction of the

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78. Concerns about undue influence of affected industries are as old as the Code itself. The issue of whether the Code is a fair and balanced product for consumers is not new. The original Article 4 was criticized as "a deliberate sell-out of the American Law Institute and the Commission of Uniform Laws to the bank lobby." Fredrick K. Beutel, *The Proposed Uniform [?] Commercial Code Should Not be Adopted*, 61 YALE L.J. 335, 362 (1952). Grant Gilmore reported in 1951 that critics of the original Article 9 asserted that it "removes most of the restrictions and limitations on lender's operations which have grown up over a century of common law and under statute." Grant Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 LAW & CONTEMP. PROBS. 27, 34 (1951). Participants in the original Article 9 process suggested that the interests of the credit industry in that drafting process resulted in a draft which was skewed in favor of the industry. *Id.* at 34-37. Robert E. Scott stated that the desires of the financial community strongly influenced the original Article 9. Schwartz & Scott, *supra* note 41, at 638. Scott described the original Article 9 as the creation of an "interest-group-dominated study group." *Id.* at 639.

The early drafts of existing Article 9 contained far more extensive consumer transaction provisions than the final draft. Grant Gilmore's writings suggest that the scaling back was partly because of political reality. He stated in 1951:

By its nature Article 9 cannot become a matter of any great public interest—although there is a certain amount of fun in imagining the Governor of Connecticut or of North Carolina running for re-election on the issues of the after-acquired property clause and the floating charge. It is a technical statute for specialists. Unfortunately all the specialists are on the same team and there is no opposition. Financing operations in this field have become so complex that no one, except the operating men and their counsel, any longer understands them. It is a fair guess that at legislative hearings, apart from the local Commissioners on Uniform Laws, no one will show up except bank and finance company counsel, appearing either in that capacity or as representatives of local, state and national bar associations. To the extent that the passage or defeat of legislation depends on rational grounds, Article 9 will pass or fail depending on the attitude to be taken by the representatives of the financing industry.

Gilmore, *supra*, at 48.

Articles 2, 2B and 9 drafting committees any consideration of the impact of their actions on consumer transactions. The Executive Committee of the Conference rejected that recommendation and instead directed each drafting committee to create a Consumer Issues Subcommittee that would make a recommendation to the drafting committee and to the NCCUSL's Executive Committee the following summer on whether and how consumer issues should be treated in the Code.

Those subcommittees met extensively. They provided a forum for discussion of important issues, but they also constituted an additional hurdle to those trying to improve the Code in ways that might benefit consumers. Although the subcommittees worked hard to understand the issues and ultimately make sound recommendations, additional meeting days, including additional staff time and travel expense, were required of consumer and industry representatives to participate effectively in the process. The Consumer Issues Subcommittee process also created an additional hurdle for proposals simply to retain current law for consumers in the face of a change being made for commercial transactions. Ultimately, both the Article 2 and the Article 9 subcommittees recommended that their respective acts include provisions addressing consumer issues.<sup>79</sup> The Conference's scope and program committees also recommended that Articles 2 and 9 address consumer issues and its Executive Committee adopted resolutions to that effect.<sup>80</sup> As the discussion of the substantive decisions made by the drafting committees to date shows, however, it remains to be seen whether the uniform law drafting process will result in a fair and workable UCC Article 9 for consumer secured transactions.

### III. POLICY ISSUES FOR CONSUMERS IN ARTICLES 2, 2B, AND 9

#### A. Article 2

##### 1. *Reasons Why Articles 2 and 9 Should Address Consumer Issues*

Some of those who have opposed improvements in Article 2 for consumers have argued that Article 2 need not be concerned with providing

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79. The Article 2B drafting committee did not form a Consumer Issues Subcommittee, apparently because of its decision to draw a line not between consumer and nonconsumer transactions, but instead between small and large transactions. *See infra* Part III.B.

80. Executive Committee Resolution, July 1996 (on file with author).

rules that work in consumer sales because other state and federal laws address the sale of goods to consumers. Those other laws, however, do not eliminate the need for Article 2 to address consumer contracts for the sale of goods. As described by an American Bar Association (“ABA”) Task Force on Article 2, the Federal Magnuson-Moss Act is “in most respects a disclosure statute.”<sup>81</sup> The state lemon laws also are not comprehensive laws for the sale of consumer goods.<sup>82</sup> Lemon laws are limited to vehicles, usually new vehicles.<sup>83</sup> They address remedies after breach of warranty, not other basic Article 2 issues such as contract formation.<sup>84</sup> As the ABA Task Force concluded, “There is not available a viable package of non-U.C.C. law to resolve consumer sales law problems.”<sup>85</sup>

While Article 2 will not address all the issues in the sale of goods to consumers, it can and should address basic contract formation issues such as when terms in a standard form contract are effective, what promises become part of the bargain, and how the basic warranty of merchantability can be disclaimed. Indeed, if Article 2 does not address these issues directly, courts are likely to bend the statutory language which it does contain to do so indirectly. The American Bar Association’s Task Force has pointed out that a failure to include rules for consumer sales in Article 2 would be likely to lead courts to reinterpret the general rules for consumer transactions, undermining uniformity and certainty for commercial transactions.<sup>86</sup>

Similarly, the existence of other laws does not eliminate the need for Article 9 to be designed to work properly in those consumer transactions which it reaches. There is no body of federal law which governs repossession and post-repossession conduct of creditors. The Fair Debt Collection Practices Act, for example, governs only collection activity of third-party collectors, not the conduct of parties acting to collect debts owed to them.<sup>87</sup> The Federal Truth in Lending Act is mainly a disclosure statute, not one which restricts the substantive conduct of the creditor with respect to a debt

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81. Task Force of the A.B.A., Committee on the Uniform Commercial Code, *An Appraisal of the March 1, 1990, Preliminary Report of the Uniform Commercial Code Article 2 Study Group*, 16 DEL. J. CORP. L. 981, 1003 (1991) [hereinafter ABA, *Appraisal*].

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* at 1002-03.

87. 15 U.S.C. §§ 1692(e), 1692a(6) (1994).

secured by personal property.<sup>88</sup> Some states have adopted the Uniform Consumer Credit Code ("UCCC"), but many have not.<sup>89</sup> The Federal Trade Commission's Credit Practices Rule does contain certain restrictions on conduct, but it was expressly intended not to occupy the field.<sup>90</sup> Instead, it was written with the backdrop of state laws, including the Uniform Commercial Code, as a fundamental assumption.<sup>91</sup>

It is worthwhile to observe that the UCC already recognizes that consumer transactions can call for different rules than commercial transactions. Existing section 2-719(3) dealing with the limitation of consequential damages for personal injury, applies only to consumer goods.<sup>92</sup> Section 2-318 extends warranties by referring to the family or household of a buyer who is a natural person.<sup>93</sup> Section 9-109(1) defines consumer goods as those "used or bought for use primarily for personal, family or household purposes."<sup>94</sup> Section 9-204(2) limits the effectiveness of an after-acquired property clause in consumer goods, but not in other types of goods.<sup>95</sup> Section 9-307(2) provides that a consumer buyer of consumer goods takes the goods free of certain security interests of which he or she was unaware.<sup>96</sup> Section 9-505(1) prohibits strict foreclosure of consumer goods collateral where sixty percent has been paid and recognizes potential conversion liability for failure to dispose of these goods promptly.<sup>97</sup> Section 9-507(1) creates damages where the collateral is consumer goods amounting to the credit service charge plus ten percent of the cash price.<sup>98</sup>

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88. *Id.* § 1601(a).

89. Seven states have adopted some form of the 1968 draft of the UCCC. These states are Colorado, Indiana, Oklahoma, South Carolina, Utah, Wisconsin and Wyoming. KEVIN W. BROWN & KATHLEEN E. KEEST, *USURY AND CONSUMER CREDIT REGULATION* § 2.3.3.9 (1987). Four states have adopted a form of the 1974 draft. These states are Idaho, Iowa, Kansas and Maine. *Id.*

90. 49 Fed. Reg. 7740, 7783 (1984).

91. *Id.*

92. U.C.C. § 2-719(3) (1995).

93. *Id.* § 2-318.

94. *Id.* § 9-109(1).

95. *Id.* § 9-204(2).

96. *Id.* § 9-307(2).

97. *Id.* § 9-505(1).

98. *Id.* § 9-507(1). Some creditors have argued that because they are not asking for changes to current Article 9, no new provisions beneficial to consumers should be added. While it is interesting that some creditors are satisfied with current Article 9, what is under discussion by the drafting committee is very different than current Article 9. The new Article 9 draft moves quite far toward making the legal rules even more friendly to creditors than current Article 9. For example, it adds new safe harbors, permits partial strict foreclosure, and codifies a definition of purchase money security interest as continuing after a refinance. That definition is now left to the courts. Those very changes in

## 2. *Improvements for Consumers in the Article 2 Draft*

### a. *Treatment of Standard Form Contracts, Section 2-206*

The Article 2 draft takes a critically important step forward by proposing language to address standard form contracts. This is an appropriate subject for the UCC. The basic design of the Uniform Commercial Code assumes that contract language reflects the mutual desires of the parties. A primary role of the Code has been to honor the choices of the parties, filling in with default rules where the parties have not made a mutual choice of a term.<sup>99</sup> The Code paradigm of the bargained-for transaction, however, does not reflect actual contracting practices in consumer transactions or in many other types of transactions where standard form contracts are widely used. For this reason, the ABA Task Force on Article 2 recommended in 1991 that the Article 2 drafting process “try to deal in a statutory way with the adhesion contract.”<sup>100</sup>

Existing Article 2 recognizes that preprinted documents prepared by one party may not truly reflect the actual bargain of the parties. Current section 2-207 addresses the effect of preprinted forms when they are exchanged between parties.<sup>101</sup> The Article 2 draft extends this concept by adding section 2-206 on the effect of preprinted forms prepared by a single party.<sup>102</sup> This section recognizes the widespread use of standard form contracts and provides a straightforward rule for determining when unagreed-to terms that contained in a standard form and become part of a contract.<sup>103</sup>

Article 2 already recognizes that terms drafted by one party will not necessarily reflect a mutual agreement of the parties. Comment 1 to section 2-207 states in part “because the forms are oriented to the thinking of the respective drafting parties, the terms contained in them often do not correspond.”<sup>104</sup> Comment 5 to section 2-207 further explains that the types of clauses that should be treated as part of the contract of the parties, unless notice of objection is given, are clauses which “involve no element of

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the new Article 9 draft make the inclusion of separate consumer rules essential to preserve some elements of current law for consumers, and to rebalance the statute for consumers in light of the many other changes being made to it.

99. U.C.C. § 1-102 & cmt. (1995).

100. ABA, *Appraisal*, *supra* note 81, at 1005.

101. U.C.C. § 2-207 & cmts. (1995).

102. July 1996 Annual Meeting Draft, Art. 2, *supra* note 11, § 2-206 & notes.

103. *Id.* This draft section is discussed at length in a piece in this symposium. Michael M. Greenfield, *The Role of Assent in Article 2 and Article 9*, 75 WASH. U. L.Q. 289 (1997).

104. U.C.C. § 2-207 cmt. 1 (1995).

unreasonable surprise.”<sup>105</sup>

Draft section 2-206 takes the concept of unfair surprise which underlies existing section 2-207 and adapts it for use in standard form contracts, including consumer contracts.<sup>106</sup> This essential section provides some protection against unexpected terms without prohibiting standard form contracts and without specifying or limiting the types of terms that can be included in those forms.

It is essential that Article 2 treat the effect of terms in a standard form contract. A consumer does not draft the terms of the standard form and cannot change them. Even the person with whom the consumer deals usually lacks the authority to vary the terms of the printed contract. In transactions where the price is subject to bargaining, such as in a car sale, the consumer still has no ability to bargain over other contractual language. Indeed, bargaining over price could create the impression that the deal has been concluded when the price is settled and that the standard form contract is merely implementing “paperwork,” rather than the true bargain of the parties.

Draft section 2-206 addresses these contracting realities in a manner which is consistent with the principles of the Code. It fully honors any actual agreement of the parties because terms which the consumer could not reasonably have expected can also become part of the contract upon express agreement.<sup>107</sup> The section also implements all terms of a standard form contract which were never discussed by the parties, as long as those terms could reasonably have been expected by the consumer.

The approach of draft section 2-206 is fully consistent with the purpose of existing Code section 2-207 which is to prevent unreasonable surprise.<sup>108</sup> The draft is also consistent with international legal principles. The draft is in part based on Article 2.20 of the UNIDROIT Principles of International Commercial Contracts.<sup>109</sup> That international principle of contract law validates standard terms only if they could reasonably have been expected.<sup>110</sup>

Draft section 2-206 will not introduce a new source of uncertainty in ascertaining the terms of the parties’ agreement. The Code already recognizes

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105. U.C.C § 2-207 cmt. 5 (1995).

106. July 1996 Annual Meeting Draft, Art. 2, *supra* note 11, § 2-206 note 1.

107. Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-206.

108. *See supra* note 105 and accompanying text.

109. July 1996 Annual Meeting Draft, Art. 2, *supra* note 11, § 2-206 Note 4.

110. UNIDROIT Principles of International Commercial Contracts art. 2.20 (1994)(visited Oct. 23, 1996) <[http://itl.irv.uit.no/trade\\_law/documents...xt/unidroit-principles.complete.html#NR34](http://itl.irv.uit.no/trade_law/documents...xt/unidroit-principles.complete.html#NR34)>.

that the question of what the parties have agreed to is a question of fact. Article 1 defines agreement to be the bargain in fact of the parties as found in their language or by implication from other circumstances.<sup>111</sup> Comment 3 to section 1-201 states that the definition of agreement is intended to include not only course of dealing, course of performance and usage of trade, but also “the surrounding circumstances.”<sup>112</sup>

Draft section 2-206 would place no limits on the types of proof that a seller may offer to show that a term reasonably could have been expected. The nature of the transaction, the price of the product, oral or written disclosures, and the custom and practice in the industry might all be sources of evidence tending to show that a term could reasonably have been expected. The section also directs the courts to examine the content, language and presentation of the standard form and the term.

One of the key differences between the Article 2 and 2B drafts has been Article 2’s selection of the expectations of *the reasonable consumer* in the position of this consumer. The Article 2B draft chooses a different standard. Article 2B selects the standard of what a reasonable *seller* would have thought that a reasonable consumer expected. The reasonable objective consumer standard of the Article 2 draft is more appropriate than the reasonable objective seller standard of the Article 2B draft. A standard which relies upon what a seller or licensor expected consumers to think is subject to manipulation. One can easily imagine a seller or licensor who might, for example, fund a biased study on what consumers expect, and then argue that it relied upon that study in including terms in a standard form contract. If a seller cannot prove that a reasonable consumer would have expected the term, it should not be enough to prove that the seller *thought* that a consumer would have expected a term.

Draft section 2-206 will validate the use of many terms found in standard forms for the sale of goods. At the same time, it will prevent the perversion of contract theory by refusing to permit standard forms to impose surprising terms on a consumer when those terms were never part of the bargain in fact. It is a critical step forward for Article 2. Its presence in the draft contradicts, at least for the Article 2 process, worries about potential “capture” of the drafting process by powerful commercial interests.

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111. U.C.C. § 1-201(3) (1995).

112. U.C.C. § 1-201 cmt. 3 (1995).

*b. Treatment of Express Warranties by Remote Sellers, Section 2-405*

Draft section 2-404 (formerly section 2-313) addresses express warranties made to the public by remote sellers.<sup>113</sup> This section recognizes that the realities of modern commerce often do not fit the UCC paradigm of a two-party, face-to-face transaction. Affirmations of fact and promises by sellers which are not puffing frequently create express warranties under current Article 2 if they are made by a direct seller.<sup>114</sup> However, remote and intermediate sellers distribute many consumer goods. A manufacturer or other remote seller may make affirmations of fact or promises about the goods in order to induce consumers to buy those goods from an intermediate seller. For this reason, the ABA Task Force recommended that “the drafting should be broad enough to encompass representations in advertising which are broadly addressed to the public.”<sup>115</sup> Draft section 2-405 addresses that goal.

Draft section 2-405 permits consumers and other buyers to enforce advertised affirmations of fact or promises about the goods when certain conditions are met. First, the advertising must contain an affirmation of fact, promise, description, or sample or model which became part of the agreement.<sup>116</sup> The advertisement is not enforced if a reasonable person in the buyer’s position would believe that the affirmation of fact or promise did not become part of the agreement.<sup>117</sup> Even if a reasonable person in the buyer’s position would believed concluded that the affirmation of fact or promise became part of the agreement, the remote seller may still escape responsibility for its promise by establishing that it was puffing.<sup>118</sup>

Draft section 2-404 recognizes that advertising by remote sellers can create legitimate consumer expectations. Manufacturers make affirmations of fact or promises in their advertising in order to influence consumers to purchase their goods. When the advertising succeeds and the consumer buys the product, that buyer should be able to enforce those affirmations which

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113. Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-404.

114. U.C.C. § 313 (1995).

115. ABA, *Appraisal*, *supra* note 81, at 1104.

116. Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-404(b).

117. *Id.* § 2-404(a).

118. Draft, Uniform Commercial Code Article 2—Sales (199\_) § 2-405(c) & note 4 (Nat’l Conference of Comm’rs on Unif. State laws, Nov. 1, 1996) [hereinafter Nov. 1996 Draft, Art. 2], available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited on Jan. 10, 1997).

exceed puffing against the party who made them. As one commentator has stated:

There is clearly something incongruous about a manufacturer or other remote seller advertising or otherwise promoting his products in language that rises to the level of an affirmation of the quality of the goods, and then taking the position that claimants who relied on those affirmations, at least in part, in selecting those goods cannot assert a warranty claim because of a lack of privity.<sup>119</sup>

Draft section 2-404 should not deter truthful advertising. A manufacturer will not incur liability under the section if its product lives up to advertised promises and affirmations of fact. If the advertising is truthful, the only effect of section 2-404 should be to allocate the risk to the remote seller of an occasional unit which does not live up to the remote seller's advertised affirmations or promises, rather than to the consumer who bought the bad unit. Untruthful advertising may be deterred, to the benefit of both consumers and of more responsible sellers and advertisers.

Section 2-404 was significantly narrowed after its initial debut in the draft. As previously stated, the section clearly preserves puffing as a defense. It restricts the express warranty to those buyers influenced by the advertisement, rather than to all persons to whom the ad was directed.<sup>120</sup> Finally, the draft restricts the express warranty solely to those for whom it has become part of the bargain. The draft excludes statements from the bargain if a reasonable buyer would not have believed that those statements were part of the bargain.<sup>121</sup> Although more limited than earlier versions, this section takes a useful step by eliminating the need to litigate privity when enforcing promises a remote seller makes to the public about its own goods.<sup>122</sup>

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119. GEORGE I. WALLACH, *THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE*, ¶ 11.15[1][b] (1981).

120. There are sound theoretical reasons why this restriction should not have been included. Consumers who buy mass-marketed goods generally pay the same price whether or not they were aware of a particular advertised promise. If the cost of compliance with the promise is built into the cost of the product, why should only those who learned of the promise be able to enforce it? For a discussion of some of these issues, see Donald F. Clifford, *Issues, Answers and Some Questions Relating to Revised 2-313, 2-316, and 2-318*, in *COM. L. ANN.* 89, 109 (Louis F. Del Duca & Patrick Del Duca eds., 1995) (citing Robert S. Adler, *The Last Best Argument for Eliminating Reliance from Express Warranties: "Real-World" Consumers Don't Read Warranties*, 45 *S.C. L. REV.* 429, 468-470 (1994)).

121. Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-404(c).

122. *Id.* § 2-404.

c. *Disclaimer of the Implied Warranty of Merchantability, Section 2-408(c)*

The Article 2 draft also contains an important provision in section 2-407(c).<sup>123</sup> The draft section recognizes that a sale of goods to a consumer which lacks the basic implied warranty that the goods are merchantable is, and should be, an unusual transaction.<sup>124</sup> The implied warranty of merchantability is the fundamental warranty that the product will do what products of that type, appearance, age and condition should do.<sup>125</sup> A disclaimer of this warranty is an extraordinary disclaimer—it means that the consumer is buying goods that need not work at all. Doubts about whether there was an agreement to eliminate merchantability should be resolved against the disclaimer because consumers are unlikely to want or expect unmerchantable goods.

As Professor Donald Clifford has pointed out, disclaimers seriously impair reasonable consumer expectations:

Consumers generally do not perceive that they have the power to bargain over disclaimers, especially when printed standard forms are used. Where the warranties and disclaimers come from a remote seller, there is not even anyone the consumer may bargain with since the remote seller provides [that] the immediate seller has no power to alter the terms of the remote seller warranty.<sup>126</sup>

Many states have addressed the surprising nature of disclaimers of the implied warranty of merchantability directly by making these disclaimers inoperable.<sup>127</sup> The Article 2 draft takes a less complete but also less effective approach. The draft does not prohibit disclaimer of the implied warranty of merchantability. It does not render all disclaimers inoperable. Instead, draft section 2-407(c) permits the parties to agree on a disclaimer of this most fundamental warranty.<sup>128</sup> At the same time, the provision attempts to reduce the likelihood of unfair surprise by requiring that the agreement to the

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123. *Id.* § 2-407(c).

124. *Id.* § 2-407(c) & note 3.

125. U.C.C. § 2-314(2)(a)-(f) (1995).

126. Memorandum from Donald F. Clifford to Subcommittee on Consumers Issues of the Article 2 Drafting Committee 6 (Jan. 1, 1996) (on file with the author).

127. Donald F. Clifford, Jr., *Non-UCC Statutory Provisions Affecting Warranty Disclaimers and Remedies in Sales of Goods*, 71 N.C. L. REV. 1011, 1021 (1993).

128. Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-407(c).

disclaimer be a real, "express" agreement.<sup>129</sup> It does so by recognizing disclaimers in consumer contracts only where the disclaimer was expressly agreed. Unfortunately, however, the drafting committee at its March 1997 meeting voted to further weaken this standard. The final text remains unknown.

Draft section 2-407(c) would replace the portion of existing section 2-316 which permits disclaimer of the implied warranty of merchantability by the use of conspicuous terms such as "as is" or "with all faults."<sup>130</sup> This change is needed because terms such as "as is" cannot ensure that a disclaimer accurately reflects the actual bargain of the parties. A simple disclaimer does not communicate how completely a product may fail to meet its description if there is no implied warranty of merchantability.

As long ago as the late 1970s it was known that a significant number of consumers do not comprehend the full implications of "as is." A 1978 Staff Report to the Federal Trade Commission describes three studies that tested consumer understanding of the term "as is."<sup>131</sup> Data from two surveys covering used car buyers in twenty-three states revealed that as many as twenty-five percent of the respondents could not identify a correct description of an "as is" sale.<sup>132</sup> Many used car buyers also did not understand that "as is" meant that the buyer would bear all repair costs.<sup>133</sup> Between thirty-six percent and fifty-nine percent of consumers in another study mistakenly believed that the seller would bear all or part of any repair costs incurred within twenty-five days after an "as is" sale.<sup>134</sup>

Evidence in the same record showed that consumers attributed specific, but incorrect, meanings to the term "as is." Some consumers equated "as is" in a car sale with the description "as the car appears to be."<sup>135</sup> These consumers applied "as is" only to visible or known defects (e.g., body rust or dents).<sup>136</sup> Other buyers believed that "as is" referred to the accessories already installed in the vehicle, such as the radio, air conditioning, power steering or

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129. *Id.* This section, however, is still under discussion by the drafting committee and further changes may be made.

130. *Id.* § 2-407(b)(1).

131. BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMM'N, SALE OF USED MOTOR VEHICLES: FINAL STAFF REPORT TO THE FEDERAL TRADE COMMISSION AND PROPOSED TRADE REGULATION RULE (16 CFR PART 455) 262-63 (1978).

132. *Id.* at 262.

133. *Id.*

134. *Id.* at 263.

135. *Id.*

136. *Id.*

power brakes.<sup>137</sup> A third set of buyers perceived “as is” to mean that the goods would not be conditioned or prepared before delivery.<sup>138</sup> Consumers may understand terms such as “as is” to mean that goods are less than perfect, but not necessarily that the goods are altogether unmerchantable.

Another reason why a pure disclaimer approach is not adequate under Article 2 is that requiring a disclaimer without an actual agreement permits the seller to provide the disclaimer at a time in the transaction where it has little meaning. Disclosures are not likely to be effective when made after the true deal has been completed by the parties.<sup>139</sup> One scholar, discussing the need for timeliness in disclosures, has stated: “This notion casts doubt on the effectiveness of any disclosure requirement in which the information is only presented after the effective agreement—the oral agreement—is concluded.”<sup>140</sup> This is directly relevant to disclaimers of the implied warranty of merchantability. It can be difficult, if not impossible, for a consumer to determine the precise terms of the warranty prior to purchase.<sup>141</sup> A warranty document is often sealed in a package designed to protect against damage and pilferage. Sales clerks are unlikely to agree to open a package to produce the warranty before the sale.<sup>142</sup> An “express agreement” standard such as that found in section 2-407(c) of the January 1997 Article 2 draft could encourage sellers to make warranty limits known at a time when it is meaningful—prior to the consumer expressly agreeing to the disclaimer.

The disclaimer of the implied warranty of merchantability provision in current Article 2 is inadequate to assure that disclaimers actually reflect the bargain in fact of the parties. The “express agreement” standard of draft

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137. *Id.*

138. *Id.* at 264-65.

139. Griffith L. Garwood et al., *Consumer Disclosure in the 1990s*, 9 GA. ST. U. L. REV. 777, 781-83 (1993) (discussing prerequisites for effective disclosure in consumer financial services).

140. George S. Day, *Assessing the Effects of Information Disclosure Requirements*, J. MKTG., Apr. 1976, at 42, 47 (citing William C. Whitford, *Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400, 443).

141. Laurence P. Feldman, *New Legislation and the Prospects for Real Warranty Reform*, J. MKTG., July 1976, at 41, 42.

142. *Id.* Feldman states:

Two researchers, who spent a month shopping in an attempt to compare written warranties for various products, were frequently told by salesclerks that they could not see the warranty in advance of purchase because the opened package would suggest to subsequent buyers that the item had been purchased and returned.

*Id.* (citing *Consumer Warranty Protection: Hearings on H.R. 20 and H.R. 5021 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 93rd Cong. 101 (1973)).

section 2-408(c) attempts to accomplish that goal. Some have asserted that section 2-408(c) will make it hard to eliminate an implied warranty of merchantability.<sup>143</sup> It would be more accurate to say that it will make it hard to eliminate the warranty without the knowledge or consent of the consumer. However, the draft also permits a seller broad leeway to prove and enforce an actual agreement that the sale is to proceed without the warranty.

### *3. The Article 2 Draft Still Needs Strong Restrictions on Variation by Agreement of Its Pro-Consumer Provisions*

The Article 2 draft has a number of provisions that will be helpful to consumers, but are unlikely to have any impact if they can be waived by standard form contracts. These provisions include section 2-105 on unconscionability; section 2-206 on standard form contracts; sections 2-403 through 2-405 concerning warranties; section 2-408(c) on disclaimer of warranties; section 2-810 on minimum adequate remedies and failure of essential purpose; and section 2-809 (formerly 2-709) on liquidated damages.

Earlier versions of the Article 2 draft provided that certain provisions could not be varied by agreement. The style committee recommended deleting the list of nonvariable provisions from section 2-110. The section was deleted. Not all of the needed restrictions on waiver were redistributed throughout the draft, and it is not clear what further restrictions on waiver are contemplated. In particular, section 2-206 on standard form contracts does not yet contain a prohibition on waiver. That section and others which benefit consumers will have little meaning if they can be varied by agreement.

It has been suggested that restrictions on waiver are unnecessary because of existence of section 1-102. However, section 1-102 does not prevent waiver of remedies, but only waivers of good faith, reasonableness, diligence, and care. Relying solely on section 1-102 could mean that the carefully crafted minimum remedies, unconscionability, new section 2-206(b) on standard form contracts, the limits on disclaimers, and the extension of warranties might be lost via waiver language in form contract.

Another weakness of relying on section 1-102 rather than upon specific Article 2 restrictions on waiver and on variation by agreement is that section 1-102 permits parties to define the standards by which performance will be

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143. These assertions were made by some industry representatives attending Article 2 drafting committee meetings.

measured if the standards are “not manifestly unreasonable.” A party seeking to change the provisions of Article 2 might, for example, define in its contract as a minimum adequate remedy, a remedy which in fact is unreasonably low. Although that remedy could fail under the relevant substantive section, it might survive under section 1-102 unless it provided so such a small quantum of remedy that it would be manifestly unreasonable to define that limited remedy as a minimum adequate remedy. For these reasons, section 1-102 does not substitute for more specific restrictions in Article 2 on waiver or variation by agreement of certain provisions.

#### 4. *Areas Where the Article 2 Draft May Harm Consumers*

In some areas, the Article 2 draft appears to be worse for consumers than current Article 2. In addition to making liquidated damage clauses somewhat easier to enforce,<sup>144</sup> it expands the right of cure, interfering with the operation of the perfect tender rule. The perfect tender rule is a simple consumer remedy.<sup>145</sup> If a consumer can stop payment on a check or dispute a credit card charge near the time of the rejection, the consumer can use rejection for an imperfect tender to achieve a complete refund, without any need for litigation. The draft continues to permit rejection for lack of a perfect tender, but then creates a new right of cure for a seller *after* a timely rejection.<sup>146</sup> Expanding the time for a seller’s right to cure could undermine the simple refund mechanism available under the current perfect tender rule.

An expanded right to cure may change the relative negotiating positions of the consumer and seller in those situations where there is a dispute about the adequacy of an actual or proposed cure. The reason given for expanding a seller’s right to cure has been to encourage negotiation between parties. Consumers are unlikely to have ongoing or repeat contractual relationships for the purchase of goods with a single seller. Moreover, moving away from simple, bright line rules will interfere with the ability of consumers to resolve disputes with sellers without litigation.

Current Article 2 permits a seller to cure in a non-installment contract, but only if the time for performance has not yet passed at the time of a rejection,

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144. Compare Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-710, with U.C.C. § 2-809(1995). The draft deletes the requirement of section 2-718 that liquidated damages be reasonable in light of the difficulties of proof of loss and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

145. U.C.C. §§ 2-601 & cmts., 2-606(1)(a) (1995).

146. Jan. 1997 Draft, Art. 2, *supra* note 11, 2-709.

or if the seller had reason to believe that the first tender would have been acceptable and it makes a fully conforming tender.<sup>147</sup> Draft section 2-709(2)<sup>148</sup> extends the time for the seller's absolute right to cure beyond the time for performance. This expansion of cure could interfere with the practical ability of a consumer to unwind an unsatisfactory transaction. Under the new draft, after a consumer rejects or revokes acceptance, a seller could frustrate the consumer's ability to cancel the contract by offering a cure which the seller claims is conforming, leaving the consumer to accept or sue, two unsatisfactory choices.

Under current Article 2, if a consumer rejects or revokes acceptance, that action is a basis to cancel the contract. The seller cannot cure after revocation of acceptance. The seller can only cure after rejection if time remains for performance, or if both of these conditions are met: 1) the seller had a reasonable basis to believe that the original nonconforming product would be acceptable; and 2) the cure offered was in fact conforming.<sup>149</sup> Draft section 2-709 offers cure after rejection beyond the time for performance, and offers a new right of cure after revocation of acceptance.<sup>150</sup> Expanded cure will as a practical matter deprive consumers of the ability to cancel the contract where the consumer and the seller have a disagreement of fact over whether the cure is appropriate, timely, and of conforming goods.

It has been suggested that an expansion of seller's cure will induce parties to negotiate over minor breaches. Unfortunately, however, in consumer transactions, an expanded right for the seller to cure is likely to change the balance of power between the parties after negotiation has failed. Consumers already have every incentive to negotiate with sellers in order to secure replacement goods rather than having to stop payment on a check, request a charge back on a credit card, seek a refund or sue the seller. A seller whose business practice is to provide a voluntary cure which is satisfactory to the customer can do so without an expanded statutory right to cure.

The statutory right will become important in those instances when the seller insists on a cure which the consumer believes is not sufficient. Under current law, a consumer who has rejected or revoked acceptance and who wants to insist on unwinding the transaction usually may do so. Under the expanded right to cure, the seller may insist on a cure and perhaps force the

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147. U.C.C. §§ 2-508(1), (2) (1995).

148. Jan. 1997 Draft, Art. 2, *supra* note 11.

149. U.C.C. § 2-508 (1995).

150. Jan. 1997 Draft, Art. 2, *supra* note 11, § 2-709.

buyer who believes that the cure is inadequate to accept it or to litigate over the adequacy of the offered cure. When there is a disagreement over the offered cure consumers could lose the simple remedy of rejection or revocation of acceptance, followed by cancellation and stop payment or a credit card charge-back which a non-installment buyer now has under Article 2. Under current Article 2, the consumer simply rejects or revokes acceptance, returns the goods, and stops payment on the check or applies for a charge-back of a credit card payment. Under the expanded right to cure, the seller may oppose the charge-back attempt by asserting that it offered to cure the defect in an allegedly “appropriate and timely” cure, even if it knows that the offered cure was unsatisfactory to the consumer.

For example, if a consumer purchases an infant car seat which cannot be properly affixed to the car, the consumer might want to cancel the contract, get a refund, and try another brand of car seat. Under current law, the consumer does this by revoking acceptance and disputing the credit card charge or asking for a refund. Because the time for performance has passed (under current section 2-508(1)) and the seller had no basis to believe that a car seat that would not properly affix to the car would have been acceptable in the first place (under current section 2-508(2)), the seller has no right to cure. The consumer returns the car seat and cancels the contract. The seller now owes the consumer a refund and has no defense for the credit card billing dispute over the charge for the car seat.

Those same facts could lead to a different result—or to the same result after years of litigation—under new section 2-709. Now, the consumer revokes acceptance and the seller says, “I will give you a new car seat.” The consumer does not want to accept the new car seat, having lost confidence in the quality of the company’s products and not wanting to expose his or her child to further risk of injury. The consumer says, “I want a refund.” The seller refuses to give the refund, asserting that the offer of cure is conforming and does not substantially impair the value of the contract to the buyer. The consumer is now stalemated. The price of the car seat is not worth litigating over. If the consumer paid by credit card, he or she might still try to dispute the credit card charge. If the consumer paid by cash or debit card, or with a check which has already cleared, the change in law leaves the consumer with no practical remedy.

Theoretically, the requirement that the cure not substantially impair the value of the contract to the buyer could protect consumers. In practice, however, it is unlikely to do so because the consumer will not be in a position to disagree with a seller’s assertion that a particular cure meets the standard,

because litigation would be necessary to do so. The current perfect tender rule combined with the limited cure permitted under current section 2-508 is preferable in consumer transactions because it avoids these kinds of factual questions.

### *B. Impact of Article 2B on Consumers as Licensees*

The relatively balanced Article 2 draft stands in sharp contrast to the 1996 annual meeting draft of new Article 2B and the subsequent drafts of Article 2B. The summer 1996 Article 2B draft tilted very strongly toward the interests of software and information providers. Although some of that tilt has been removed, proposed Article 2B still poses grave concerns for consumers and for other small licensees of software and of on-line information services. Many jurisdictions have already applied Article 2 to computer software.<sup>151</sup> In those jurisdictions, both consumer and business licensees have the rights of an Article 2 buyer of goods. The draft of Article 2B creates a new and less favorable legal structure for consumers and other licensees than would be available under current Article 2, whether it is applied directly or by analogy.

The draft of Article 2B is changing rapidly. The drafting committee reviewed its first draft in January 1996.<sup>152</sup> Final votes on the draft by the Conference and the American Law Institute are currently scheduled for July 1997 and May 1998, respectively.

Because the substance of the Article 2B draft is still being modified substantially, not all of the issues it presents for consumers may be analyzed

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151. The December 1995 Article 2B draft cited 19 cases from various jurisdictions which it stated applied Article 2 to the sale or license of computer software. Some of the cases which have held that a purchase or license of software is treated as a sale under current Uniform Commercial Code Article 2 include: *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 939 F.2d 91 (3d Cir. 1991); *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991); *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 635 F.2d 1081 (3d Cir. 1980); *Triangle Underwriters, Inc. v. Honeywell Inc.*, 604 F.2d 737 (2d Cir. 1979); *Hospital Computer Sys., Inc. v. Staten Island Hosp.*, 788 F. Supp. 1351 (D.N.J. 1992); *Carl Beasley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325 (E.D. Pa. 1973); *Neilson Bus. Equip. Ctr., Inc. v. Italo Monteleone*, 524 A.2d 1172 (Del. 1987); *Photo Copy, Inc. v. Software Inc.*, 510 So. 2d 1337 (La. Ct. App. 1987); and *Schroders, Inc. v. Hogan Sys., Inc.*, 522 N.Y.S.2d 404 (N.Y. Sup. Ct. 1987).

152. The Article 2 drafting committee had studied these issues before the Article 2B drafting committee was formed, and the Article 2B reporter served as a co-reporter to the Article 2 drafting committee before the two committees were split. For a history of the work which preceded formation of the Article 2B drafting committee, see Raymond T. Nimmer, *Article 2B Issues: Meeting the Information Age* (on file with author); and *Preface to Draft, Uniform Commercial Code Article 2B—Licenses* (Nat'l Conference of Comm'rs on Unif. State Laws, Dec. 12, 1996), available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited Jan. 24, 1997).

here. The draft also presents serious issues for home-office software users and small business users, which will not be discussed.

*1. Improvements for Consumers Needed in Article 2B*

Improvements are needed in the Article 2B draft in a host of areas. These include:

- 1) Eliminate the automatic safe harbors for defining conspicuousness by type size, use of contrasting type, and use of capital letters found in section 2B-102(a)(6)(A) and (B). The Article 2 draft now omits such safe harbors.
- 2) Eliminate the partial trumping of state consumer protection statutes in section 2B-104(b).
- 3) Follow Article 2A and draft Article 2 to permit unconscionability in the inducement to contract as a basis for a finding of unconscionability. This would require modification of section 2B-109.
- 4) Modify section 2B-303(b) to retain the policy of current Article 2 that a no-oral modification clause in a consumer transaction must be separately signed to be effective against the consumer.
- 5) Modify the standard form contract section, 2B-308, to:
  - a) Tie the expectations standard to the objective licensee in the shoes of this licensee, not to the expectations of the licensor about what a licensee would have thought; and
  - b) Tie the expectations standard to terms which could not reasonably have been expected, without limiting it only to terms which would have caused the consumer to refuse to enter into the contract; and
  - c) Change the standard under which unexpected terms become part of the contract. This section now authorizes any unexpected term if there was a manifestation of assent to the term. This is a far less protective standard than the parallel provision of draft Article 2.
- 6) Eliminate the ability for a mass-market licensor to disclaim liability for failure to take reasonable care to attempt to prevent viruses in software delivered over the Internet or intellectual property infringement, as permitted in section 2B-313(b). A similar issue arises with respect to disclaimers of intellectual property infringement permitted in section 2B-401(e).

- 7) Expand the right of refusal, which takes the place of rejection, beyond software which is delivered to a consumer on "a physical medium," i.e., on a diskette. Consumers need this right for software purchased over the internet as well, section 2B-601(b).
- 8) Eliminate the authorization to extend specific performance in section 2B-711 to the obligation to make future payments.
- 9) Provide in Part 7 for meaningful remedies for mass-market licensees, and for persons harmed by licensed software. As part of these changes, section 2B-703, authorizing contractual modification of remedy, should be amended to require that a limited remedy be at least a minimum adequate remedy. The exclusion of incidental and consequential damages in favor of a limited remedy such as repair or replace should fail if the limited remedy fails of its essential purpose.
- 10) Eliminate the self-help remedy in section 2B-716 or restrict it to non-mass-market licenses. The purported safeguards on the self-help remedy depend on the possibility that the wronged party will later sue and will be able to prove that the self-help removal was improper. Consumers engaged in lower dollar-value licenses will not, as a practical matter, be able to sue for wrongful self-help.

## *2. Areas Where Article 2B Reduces the Rights of Licensees and Increases the Rights of Licensors*

### *a. Possible Interference with the Pure Self-Help Rejection Remedy for Consumers*

The Summer 1996 Article 2B draft eliminated the perfect tender rule, thus depriving consumers of the simple remedy of rejection, cancellation, and a demand for a refund which is available to the non-installment buyer under existing Article 2.<sup>153</sup> This remedy is important for consumers because it is often enforceable without litigation. The consumer simply rejects, returns the goods or software, and stops payment on the check or applies for a charge-back of a credit card payment. Under Summer 1996 draft, consumers would have been forced to retain software which did not fulfill the contract description, as long as the software did not constitute a material breach of the

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153. U.C.C. § 2-601 (1995). There have been numerous drafts since that time. As of this writing, the current draft is dated March 21, 1997. All citations will be to the March 21, 1997 draft, except where otherwise noted.

contract.<sup>154</sup> The licensee would be, in effect, forced to continue in a contract with an entity that has already failed to completely fulfill its contractual promises.

The drafting committee voted at its September 1996 meeting to reinstate the perfect tender rule for mass-market transactions. The redraft recharacterizes rejection as “refused.” However, the draft then limits the right of refusal to software delivered “on a physical medium,” section 2B-601(b).

*b. Disclaimer of Warranties Against Viruses*

Article 2B also permits broad disclaimers of basic elements of the expected contract such as delivery of software which infringes on the intellectual property rights of others or contains viruses. Section 2B-319 of the November 1996 draft permitted a licensor to disclaim liability even for those viruses which could have been prevented through the exercise of reasonable care.<sup>155</sup> The December 1996 draft was an improvement, setting forth a general reasonable care standard. However, the disclaimer may still be an open issue.<sup>156</sup> The March 1997 draft permits a simple, broadly worded disclaimer to eliminate all responsibility for viruses (even if reasonable care has not been taken to exclude them), except for software delivered on a physical medium to a mass-market licensee. This means that licensors who license software to be downloaded over the Internet will have no effective obligation of reasonable care to avoid viruses. Ease of disclaiming the obligation to use reasonable care to prevent viruses is unlikely to encourage the marketing of high-quality software.

The Article 2B draft maintains the basic merchantability warranty for consumers and other mass-market licensees, but replaces the implied warranty of merchantability for non-mass-marketed software with a warranty given by merchant licensors that only the media is merchantable and that the program “will perform in substantial conformance with any promises or affirmation of facts contained in the documentation with specification provided with or before program delivery.”<sup>157</sup>

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154. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7, § 2B-608.

155. Nov. 1996 Draft, Art. 2B, *supra* note 19, § 2B-319.

156. Draft, Uniform Commercial Code Article 2B—Licenses § 2B-318(b) & rptr.’s notes (Nat’l Conference of Comm’rs on Unif. State Laws, Dec. 12, 1996) [hereinafter Dec. 1996 Draft, Art. 2B] (section was renumbered in the March 1997 Draft, Mar. 1997 Draft, Art. 2B, *supra* note 22, § 2B-313), available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited Jan. 24, 1997).

157. Mar. 1997 Draft, Art. 2B, *supra* note 20, § 2B-403(b).

The Article 2B Reporter, Professor Ray Nimmer, has expressed to the author his view that a substantial “conformance with specifications” standard is more protective of licensees than the implied warranty of merchantability.<sup>158</sup> The author is skeptical that this will be the case in practice because of the likelihood that in many transactions the licensor will either draft the specifications itself or will have a clearer understanding of the nuances of the specifications than the licensee has.

A small business purchasing or licensing a \$5000 accounting system is an example of where the changed standard could authorize licensing of unmerchantable products. The specifications might say, in highly technical language, that only ninety percent of the checks input into the accounting system will print. Such a defect might make an accounting product unmerchantable because printing checks is probably an expected feature of a small business accounting system. Under the new standard, that business would have no claim for breach of any implied warranty because the specifications have not been violated. If a “substantial conformance with specifications” standard is intended to raise, rather than lower, the licensor’s obligation under the implied warranty of merchantability, then it should simply be added as an additional aspect of the implied warranty for all Article 2B transactions, rather than displacing that warranty for non-mass-market licensees.

*c. Article 2B Creates a Statutory Right to Invade the Home or Business Computer of a Software User and Remove Software*

Article 2B permits a licensor to “take possession of” software or other licensed computer information by requiring return of the licensed information and by preventing the licensee’s continued exercise of rights in the information.<sup>159</sup> This right to remove or disable software on the user’s system is available only if it can be accomplished “without a foreseeable breach of the peace, risk of injury to persons, or significant damage to or destruction of information or property of the licensee.”<sup>160</sup> The statute contains no penalty beyond suit for damages for removal or disablement exceeding the allowable bounds, although that conduct might also be a common law tort.<sup>161</sup>

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158. Meeting with Professor Ray Nimmer in San Francisco, Cal. (May 1996).

159. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7, § 2B-712 (referring to § 2B-711).

160. *Id.* § 2B-712(a).

161. *Id.* § 2B-712(b).

The apparent safeguards placed in the self-help remedy section—no breach of the peace, no significant damage—cannot work if people who are wrongfully subjected to self-help software removal or disablement cannot afford to challenge the removal in court. It is highly unlikely that mass-market licensees will bring such challenges. The amount of injury consumers will suffer from the removal or disablement is unlikely to warrant litigation unless it includes personal injury. Thus, statutory safeguards will have little meaning for the average consumer-licensee who finds the software gone and who has lost the ability to use files created under that software.

*d. The Article 2B Draft Would Authorize Most Unexpected Terms in Standard Form Licenses*

One of the sharpest contrasts between the drafts of Articles 2 and 2B is in the treatment of terms in standard form contracts. As discussed in Part II.A, the Article 2 draft generally would enforce standard form contract terms which were either reasonably expected by the buyer or expressly agreed to by the buyer. The Article 2B draft would enforce terms that were neither expected nor agreed to if the licensee manifested assent, or if the drafter of the standard form license would not have known that the term would cause a reasonable person in the position of the licensee to refuse the license if that term were brought to his or her attention.

The standard form contract provision of the Article 2B draft, section 2B-308, addresses the use of standard form licenses.<sup>162</sup> However, it fails to fully serve the goal of protecting the reasonable expectations of the parties or of promoting behavior to prevent unfair surprise in three ways. First, it authorizes any term that a licensor would have thought that a user would reasonably expect. Its focus is on the licensor's perspective, instead of the licensee's. This will reduce the incentive of the licensor to try to communicate the nature of the term to the consumer because the licensor need only show that it *thought* that a licensee would have expected a term, not that a reasonable licensee in the position of this user would have expected the term.

Second, section 2B-308 does not fully serve the goal of protecting the reasonable expectations of the non-drafting party because it permits and authorizes unexpected terms to be inserted in a contract by the drafting party if the drafter knew that the licensee would have to accept the contract in spite

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162. *Id.* § 2B-308.

of any objection to the unexpected term. The Article 2B formulation is much more favorable to unexpected terms than the formulation in the Article 2 revision. Under Article 2B, a term not only must be unexpected, but also must be of the type that would cause a reasonable person in the position of the licensee to refuse the license if that term were brought to the party's attention. Does this mean that any time there is only one maker of the needed software, it can put any term it likes into its license? That maker might argue that a reasonable consumer would not reject its terms no matter how onerous or unexpected because there is no other supplier of the product. Software makers also might argue that a consumer would not have refused a contract containing unexpected terms if consumers who buy the software need it immediately, such as software to monitor a medical condition.

Third, section 2B-308 permits any term, even if it conflicts with the agreement's negotiated terms and even if it would cause a reasonable person in the position of the party receiving the forms to refuse the license, to nevertheless become part of the contract if the licensee manifests assent to the term.<sup>163</sup> Manifest assent to a term occurs under section 2B-112 if there is an opportunity to review the term and conduct or an authentication relating specifically to the term.<sup>164</sup> Although not entirely clear, it appears that a screen which says, "Check here if you want to read our terms" and presents two boxes: "Check here to receive screens of gobbledygook," or "Check here to agree to skip the boring legal jargon and agree to the license" would meet this standard.

A key purpose of a standard form contract section should be to promote conduct which encourages contracts to reflect the reasonable expectations of nondrafting parties, either by the use of contract terms consistent with their actual expectations or by modifying expectations through express agreement for unexpected terms. Section 2B-308 is too weak to meet this goal.

*e. The Draft Permits Easy Elimination of the Implied Warranty of Merchantability*

Section 2B-406 makes it too easy to disclaim the implied warranty of merchantability.<sup>165</sup> Consumers pay for software because they need it to work. A transaction in which a consumer contracts for and pays for software which

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163. *Id.* § 2B-308(c).

164. *Id.* § 2B-112.

165. *Id.* § 2B-406.

is not merchantable should be an unusual transaction. The implied warranty of merchantability is the fundamental warranty that the product will do what products of that type, appearance, and condition should do. A disclaimer of this warranty should be an extraordinary disclaimer—it means that the consumer is licensing a product that need not work at all. Doubts about whether there was an agreement to eliminate merchantability should be resolved against the disclaimer because consumers are unlikely to want or expect an unmerchantable product.

The Article 2B draft retains the concept from current Article 2 that “as is” or other brief preprinted language is adequate to disclaim the implied warranty of merchantability. The literature cited in the Part III.A shows that consumers do not understand the term “as is” to mean that a product could be so deficient that it is legally unmerchantable. That literature generally shows that consumers understand “as is” to mean that something minor may be wrong or missing from the product, but not that it may not work at all for its intended purpose.

*f. The Article 2B Draft Does Not Provide Meaningful Remedies for Mass-Market Licensees*

At the 1996 annual meeting floor session on Article 2B, many Conference members questioned the remedy structure of the Article 2B draft and the allocation of risks between licensee and licensor. The chairperson of the drafting committee stated that these issues would be revisited over the next year, with revision to the draft likely. Any such revision should provide for all of the following:

- 1) A simple, non-litigation mechanism for a refund in the event of a nonconforming licensed product. This could be achieved under the current draft if the right of refusal were broad and to permit return of a licensed product after discovery of the nonconformity even if the product had been delivered online.
- 2) A minimum adequate remedy standard similar to draft section 2-810(a)(2) should be included in section 2B-703.
- 3) A failure of the essential purpose of a limited remedy standard of the type found in draft section 2-810(b) should be included in section 2B-703.
- 5) Incidental damages in mass-market transactions should not be waivable.

- 6) The costs of recovery from a breach which crashes a user's system should be clearly included in the definition of incidental damages. This could be clarified in the definition of incidental damages in section 2B-102(17) so that small users need not litigate over it.
- 7) Reasonably expected persons should be included as third-party beneficiaries of a warranty. Third parties who are served by the entity using a software program could be harmed by it. For example, a hospital's use of defective patient-tracking software could harm a patient who is not contacted for timely follow-up visits.
- 8) The licensor's ability to avoid personal injury liability caused by licensed products should be limited as it is in current Article 2 and draft revised Article 2. For example, a licensor who offers software marketed to manage potential conflicts between prescription drugs should not be able to eliminate its responsibility for personal injury caused by flaws in that program to persons whose side-effects could have been avoided if the program had worked as marketed.

*g. Section 2B-703 on Contractual Modification of Remedies Exemplifies Article 2B's Remedial Imbalance*

Section 2B-703 provides an example of the continuing imbalance in Article 2B's remedy sections.<sup>166</sup> It codifies a rule that clauses excluding consequential and incidental damages are not affected by failure or even unconscionability of an agreed remedy. This is precisely the opposite result from the developing case law under Article 2 which recognizes that the failure of a limited remedy in a consumer contract can resurrect otherwise available Code remedies in a consumer contract.

Section 2B-703 also is missing a minimum adequate remedy standard similar to draft Article 2 section 2-810(a)(2). Instead, section 2B-703(a) expressly authorizes a limited remedy such as repair or replacement without any requirement that the limited remedy meet a standard of minimum adequacy. In many circumstances, a repair, replace or refund test would undoubtedly satisfy a minimum adequate remedy test. Where such a remedy

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166. *Id.* § 2B-706.

would not be minimally adequate, however, it should not be authorized by Article 2B. Here are two examples. A mass-market licensee who purchases word processing software might reasonably be limited in its remedy to a new copy of the software if the new copy does not have the same nonconformity as the original (and, as not yet provided by Article 2B, if the licensee could recover incidental damages for the cost of restoring a system crashed by the software). However, another mass-market licensee who has licensed software to remind a family member to take medication at specific times could incur significant medical costs, lost work time, and other fully foreseeable consequential losses if the software fails to properly provide the medication reminder. In this case, the court should remain able to hold that the limited remedy of replacing the software fails of its essential purpose, making consequential damages available.

*h. The Article 2B Draft Expands the Availability of Specific Performance to Enforce a Licensee's Obligation to Make Future Payments*

Section 2B-711 appears to permit a licensor to receive specific performance for the payment of future license fees if the agreement calls for specific performance, but the usual standards for specific performance are not met. An order to pay money (future license fees) should not be an appropriate subject for specific performance unless the usual judicial requirement that other remedies are inadequate is met. A court order to pay money raises questions of enforcement by the contempt power for payment of a debt, a concept generally discredited in our legal system. There is, in this author's view, no reason why any part of the Code should expand the availability of specific performance against a natural person for an obligation to pay money.

*i. Other Issues*

The Article 2B draft also tilts the law against consumers who license software in other ways. It expands the enforceability of no oral modification clauses against consumers.<sup>167</sup> The Article 2B draft also attempts to override

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167. *Id.* § 2B-303(b). These sections increase the enforceability of no-oral modification clauses against consumers by substituting a requirement of manifest assent for one of separate signature. This will be harmful to consumers because an enforceable no-oral modification clause can reward a commercial party that permits its salespersons or its support line personnel to make post-license oral promises. Such oral promises could induce the consumer not to exercise contract remedies for breach.

state consumer protection statutes under which a state might decide that some aspects of a license must meet higher requirements than those imposed by Article 2B for proof of agreement, conspicuousness, or which might require signature rather than just authentication. For example, this could prevent application of an existing state statute requiring that certain disclaimers be effective only if they were made before a sale or license transaction, rather than after the sale and in connection with the initial preparation for use.<sup>168</sup> Finally, the draft defines assent to be manifested to a form if the licensee does not return the software.

The Summer 1996 Article 2B draft had two improvements in the law for consumers which have since been deleted. First, it recognized the need for attorneys' fees for a licensee attempting to enforce a warranty.<sup>169</sup> Second, it recognized that a licensee has a privacy interest in information it provides in connection with a licensing transaction.<sup>170</sup> Both of those sections have been deleted. The draft continues to provide some protections with respect to choice of forum for consumer licensees.<sup>171</sup>

The Article 2B draft misses an opportunity in its failure to follow both Article 2A and the draft of Article 2 to add "unconscionable inducement" to the basic prohibition on unconscionable contracts and terms. Unconscionable inducement permits a court to examine and to remedy gross unfairness in the circumstances leading to a contract without examining the intent of the participating parties. It is very difficult for a consumer or other small party to prove intent. Also, consumers need protection from unintended unconscionable inducement just as they do from intentional conduct. When a transaction is conducted electronically rather than in person, intent may well

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If the licensor can invoke a no-oral modification clause when the consumer attempts to enforce such oral promises, then it has a reduced incentive to try to control the number and type of promises made by its representatives. To track current Article 2, a no-oral modification clause in a consumer license should become enforceable against a consumer only if the consumer signed the clause or provided an electronic authentication in lieu of signature for that clause. This would implement the policy of current section 2-209(2) which permits a clause prohibiting oral modification to be effective against a consumer only if it is separately signed. The Article 2B draft adopts only the lesser standard of manifest assent. The substitution of "manifest assent" in Article 2B for the signature required under existing Article 2 will have the effect of increasing the enforceability against consumers of no-oral modification clauses when the consumer attempts to enforce oral promises made by sales or support personnel of the licensor.

168. *Id.* § 2B-104(b). A state could, of course, enact legislation imposing such requirements after adopting Article 2B.

169. July 1996 Annual Meeting Draft, Art. 2B, *supra* note 7, § 2B-706(d)(2).

170. *Id.* § 2B-317(c).

171. Mar. 1997 Draft, Art. 2B, *supra* note 22, § 2B-107(b).

be an impossible burden. The remedies for unconscionable inducement would not include damages.<sup>172</sup> Instead, the key remedy would be non-enforceability of the offending clause or of the contract as a whole.

The Article 2B draft is expected to continue to change. Some important areas where Article 2B should be improved are better treatment of standard terms not expected by a reasonable consumer in the position of the licensee; elimination of the partial preemption of state consumer statutes; elimination of disclaimer of the duty to try to prevent viruses; improved remedies for licensees; a clear and complete preservation of the perfect tender rule's outcome of a nonlitigation-based-refund right for consumers; and changes in the allocation of risk between licensor and licensee on a host of issues. If the draft presented to the Conference in the Summer of 1997 does not make substantial changes of this type, this may show that the uniform law drafting process is not capable of delivering a balanced and useful uniform law in the face of the sustained pressure by an affected industry.

*C. The Proposed Revisions to Existing Article 9 Solve Key Problems for Creditors While Making More Modest Improvements, and Some Harmful Changes, for Consumers*

*1. The Changes to Article 9 Will Facilitate the Taking of New Types of Article 9 Collateral and Provide Other New Rights to Secured Creditors*

The draft revisions to Article 9 would expand the rights of secured creditors by:

1. Sweeping more types of collateral into Article 9 and permitting creation of an interest in collateral using broad descriptive categories;
2. Giving secured creditors a safe harbor method for providing a notice of sale and creating a safe harbor time period for commercial secured transactions;
3. Adding a new defense to statutory damages in consumer secured transactions;
4. Codifying a broad definition of purchase money security interests,

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172. See U.C.C. § 2A-108 (1995).

resulting in the nondischargability of some interests in household goods which are presently dischargeable under the Bankruptcy Code;

5. Eliminating the absolute bar doctrine altogether in commercial secured transactions;
6. Depriving courts of the equitable doctrine of constructive strict foreclosure when a secured creditor has waited an unreasonably long time to dispose of collateral;
7. Permitting secured parties to engage in partial, rather than full, strict foreclosure in commercial secured transactions;
8. Expanding the definition of proceeds;
9. Reversing case law in some states holding that a secured party may not proceed against personal property before real property;
10. Permitting filing of a financing statement without the signature of the borrower;
11. Expanding the time period from ten to twenty days for temporary perfection of a purchase money security interest before possession;
12. Extending successor liability for successor debtors; and
13. Streamlining the filing system and requiring filing offices to respond within two business days to requests for information.<sup>173</sup>

In short, the draft revisions to Article 9 seem to resolve by codification a large number of problems which secured creditors currently face under Article 9. At the same time, they leave unsolved the most fundamental problem that consumers have faced under Article 9—the problem of low values on the disposition of consumer goods collateral. The drafting

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173. See July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-102 (renumbered in Oct. 1996, Draft, Art. 9, *supra* note 28, § 9-112) (scope); § 9-110 (renumbered § 9-111) (all assets clause); § 9-504 (renumbered § 9-611) (safe harbor for notice); § 9-107 (renumbered § 9-104) (PMSI definition); § 9-507 (renumbered § 9-625) (elimination of the absolute bar rule in commercial secured transactions); § 9-505 (renumbered § 9-618) (addition of partial strict foreclosure, loss of constructive strict foreclosure); § 9-306 (renumbered § 9-313) (proceeds definition); § 9-318(b) (renumbered § 9-406) (qualifying the claims available against an assignee to those in recoupment); § 9-501(f) (renumbered § 9-604) (eliminates the one form of action rule); § 9-304(e) (renumbered § 9-310(e)) (expanded time period); § 9-402(m) (renumbered § 9-502(m)) (eliminates borrower's signature on financing statement); § 9-105(23) (renumbered § 9-102(23)) (successor liability); § 9-405(e) (renumbered § 9-520(d)) (time for filing office to respond to requests).

committee has voted to address a portion of that problem relating to sales to the secured party or to affiliated parties, but how it will do so and whether the approach will be effective remained unknown in January of 1997.<sup>174</sup> The revisions also affirmatively harm consumers in the area of statutory damages and purchase money security interests.<sup>175</sup> However, the draft revisions also contain a useful new provision entitling consumers who prove a violation of Article 9 to reciprocal attorneys' fees.<sup>176</sup>

The Article 9 draft has been criticized by members of the American Law Institute as enabling a secured party to "lock up" all of the debtor's property. Professor Elizabeth Warren of Harvard Law School described the Article 9 draft as permitting secured creditors "to plow the corners of the field."<sup>177</sup> Even commentators which are generally favorable to secured credit have characterized the Article 9 draft as expanding the rights of creditors. One commentator stated: "The revision will substantially expand the scope of transactions covered by Article 9 . . . ."<sup>178</sup> Commenting on the February 1996 draft, Barkley and Barbara Clark described the scope expansions as including payment intangibles and commercial deposit accounts.<sup>179</sup>

The Article 9 draft will benefit secured creditors by changing legal rules to favor the secured creditor's rights in circumstances where today a borrower or an unsecured creditor might prevail and by providing new business efficiencies, particularly with respect to the filing system.

Some drafters of the original Article 9 criticized it as the product of excessive influence by the secured credit industry.<sup>180</sup> The Article 9 draft will be even more unbalanced than it was when Professor Gilmore criticized it in 1951<sup>181</sup> if it does not exempt consumers from the commercial secured transactions changes and address more serious consumer problems. To date,

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174. See *infra* Part III.C.8.

175. See *infra* Parts III.C.4 & 5.

176. See *infra* Part III.C.9.

177. Memorandum from Professor Elizabeth Warren, Harvard Law School, to Council of the American Law Institute (Apr. 25, 1996) (on file with author) (regarding a proposed Article 9 set aside for unsecured creditors).

178. *Most Recent Draft of Revised Article 9 Contains Many Changes From Current Law*, CLARK'S SECURED TRANSACTIONS MONTHLY, June 1996, at 3.

179. The Clarks also list tort claims as an area of expansion. At its November 1996 meeting, the drafting committee voted to exclude personal injury and non business tort claims from Article 9. Until June of 1996, the Article 9 draft also contained a proposal to expand Article 9 to reach many types of interests in insurance policies. At the June 1996 meeting, the drafting committee voted to exclude insurance from Article 9.

180. Gilmore, *supra* note 78, at 48.

181. *Id.*

the Article 9 drafting committee has voted to take some steps to improve Article 9 for consumers.<sup>182</sup> It has voted to limit some of the new, pro-creditor draft changes solely to commercial secured transactions. It has voted to address three key problems that consumers face under current Article 9, but has declined to address others.<sup>183</sup> However, it has also voted in favor of several provisions that would place consumer borrowers in a worse position under revised Article 9 than under the current article.<sup>184</sup>

*2. The Procedure That the Article 9 Drafting Committee Has Used to Address Consumer Issues Has Provided for Careful Thought on the Issues but Also Created Added Hurdles for Any Pro-Consumer Change*

The procedure used by the Article 9 drafting committee has created a much higher de facto burden for the addition of provisions benefiting consumers than for provisions solving problems faced by secured creditors. Consideration of consumer issues was at a serious procedural disadvantage because the drafting committee consistently chose to discuss proposed changes to the Code as if they would affect only *commercial* secured transactions. Then, if the change was adopted for commercial transactions, the question before the drafting committee was: "Why shouldn't consumers be subject to the same (changed) rule?" When the drafting committee debated a particular proposed change, it attempted to limit discussion solely to the impact on commercial secured transactions. If the committee adopted the change, however, consumer advocates were expected to show why the same change should not be extended to consumers. In other words, consumer representatives were forced to carry the burden of showing that there should be different rules for consumer and commercial transactions even where

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182. Readers examining the 1996 annual meeting draft of Article 9 should be aware that that draft is *not* a good indicator of what the Article 9 drafting committee has since voted to do with consumer issues. The Article 9 drafting committee, at its October 1996 meeting, approved consumer secured transaction rules which are far narrower. Oct. 1996 Draft Art. 9, *supra* note 28. For example, the drafting committee has approved a right to reinstatement for payment defaults, but only when a debtor has paid sixty percent or more of the principal. *Id.* § 9-622. It has eliminated section 9-504A which would have restricted the collection of certain small deficiencies. *Id.* § 9-610. It has also declined to adopt the absolute bar rule as a uniform rule for consumer secured transactions.

183. These issues include low prices paid at disposition sales, overcollateralization, repeated refinancing (sometimes called "flipping"), and an overbroad definition of default. *See infra* Part III.C.7.

184. *See infra* Parts III.C.4, .5 & .6.

consumer representatives were seeking only to retain the current law in consumer secured transactions. After the creation of the Consumer Issues Subcommittee in 1995, consumer issues also were generally deferred until the Consumer Issues Subcommittee completed its work. This meant that the discussion about whether a change should be applied to consumers occurred months after that change in law had become part of the draft, when any doubts about its wisdom, even in the commercial context, would have faded.

In response to the direction of the Conference's Executive Committee, the Article 9 drafting committee appointed a Consumer Issues Subcommittee chaired by Commissioner Marion Benfield. That committee engaged in extensive discussion before it recommended any pro-consumer changes to the draft. This included several full- and half-day meetings by the Consumer Issues Subcommittee with consumer advocates and counsel for creditors. Although this provided a thorough airing of the issues, it also meant that pro-consumer proposals to Article 9 had to meet a much higher procedural burden than procreditor proposals. Changes to Article 9 favorable to creditors, such as the ten-day safe harbor, the addition of partial strict foreclosure, and the elimination of constructive strict foreclosure, did not undergo any similar subcommittee process. The drafting committee simply added those changes to the draft after one or more discussions.

### *3. Results of the Article 9 Consumer Subcommittee Process*

The Article 9 Consumer Issues Subcommittee recommended two types of Article 9 rules for consumer secured transactions.<sup>185</sup> The first type of rule exempts consumer transactions from some of the more sweeping changes being made in the Article 9 draft for commercial secured transactions. In these places, the different rule for consumer secured transactions simply means preserving existing law for consumers. The Consumer Issues Subcommittee recommended, and the drafting committee agreed, not to apply certain changes in law being made for commercial secured transactions to consumers. The changes which were limited to commercial transactions include: the short ten-day safe harbor for the time of notice of a disposition sale; the bare-bones safe harbor form for notice of the sale of collateral in a commercial secured transaction; the addition of partial strict foreclosure; and the addition of deposit accounts.

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185. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10.

The Consumer Issues Subcommittee also recommended, and the drafting committee approved, some modest improvements in Article 9 for consumer secured transactions. These are reciprocal attorneys' fees for a prevailing consumer if the creditor has included an attorneys' fees provision in the security agreement; a right of reinstatement after the debtor has paid more than sixty percent of the principal (in the last one-third or later of the debt); and some changes in the treatment of disposition sales in which the creditor or an affiliated party purchases the collateral. An important new notice of how a deficiency was calculated also appears likely to be included.<sup>186</sup> These rules for consumer secured transactions will partially ameliorate the pro-creditor imbalance caused by the many other changes to Article 9. Unfortunately, the draft also contains a new defense for creditors to the existing Article 9 statutory damages remedy and has no effective mitigation of the harmful effects on consumers of a broad expansion in the definition of a purchase money security interest ("PMSI"); and, as of January 1997, does nothing outside of the interested party context to tighten the broad standard of commercial reasonableness which has permitted low prices on disposition of collateral.

*4. There is No Adequate Basis for Introducing a New Defense to Statutory Damages into Article 9*

Representatives of consumer creditors, particularly the in-house automobile finance companies and the American Financial Services Association, a trade group for finance companies, asked the Article 9 Consumer Issues Subcommittee to reduce or eliminate the availability of statutory damages after a consumer proves that a seller has violated Part 5 of Article 9.<sup>187</sup> The Consumer Issues Subcommittee recommended against this type of cutback from existing law. It states in relevant part:

Article 9 now contains a few provisions protective of consumers. The most significant of those provisions is that part of 9-507 which gives consumers a statutory remedy unrelated to actual damages for failure of secured parties to comply with Part 5 of Article 9 on foreclosure. That and other consumer provisions in Article 9 have been in place for

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186. The drafting committee voted for such a notice at its March 1997 meeting.

187. Section 9-507, along with the rest of Part 5, was renumbered in the October 1996 draft. The new section number is 9-627(d).

more than 30 years without major changes in the states. That indicates that they are generally acceptable. Therefore, we are not inclined to recommend changes in those provisions which would reduce their consumer protective aspects. We agree with the position taken by the Article 2 Consumer Subcommittee that the revision process should do no harm to consumer interests. For example, it would not be wise to remove the present penalty provisions of 9-507 even though creditors make a case that those penalties are punitive and often bear no relationship to the degree of harm caused by the particular failure involved.<sup>188</sup>

Despite the written recommendation of the Consumer Issues Subcommittee against modifying the statutory damages now available under Article 9, the Article 9 drafting committee voted to add a new defense to statutory damages. This new defense represents a serious new hurdle to an adequate remedy after a consumer proves a violation of Part 5 of Article 9. The new defense is a bona fide error type defense to statutory damages. This new section 9-627(d) would add a defense to statutory damages for a non-intentional good faith error made despite the maintenance of reasonable procedures to avoid the error.

Because the new defense was not recommended by the Consumer Issues Subcommittee, there is no written record of why it was adopted by the drafting committee. The arguments made for it were primarily that an "innocent technical violation" should not trigger a statutory penalty. This argument ignores the fact that statutory damages serve not only a deterrence function, but they also provide a simple, low-cost substitute to expensive litigation, which requires time consuming questions about the amount and scope of actual damages. If a creditor violates Article 9, a consumer may

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188. Memorandum from Article 9 Drafting Committee, Consumer Issues Subcommittee (Marion Benfield et al.) to Article 9 Drafting Committee, Advisors, and Observers 3 (May 29, 1996) (on file with author) [hereinafter May 1996 Art. 9 Consumer Issues Subcommittee Report]. The new defense was added to the October draft in § 9-627(d). The Consumer Issues Subcommittee's interim report of October 7, 1996 tentatively recommends that the new defense be available only for certain types of information required in various notices but that limitation was not adopted. Memorandum from the Article 9 Drafting Committee, Consumer Issues Subcommittee to the Consumer Task Force Members (Oct. 7, 1996) [hereinafter Oct. 1996, Art. 9 Consumer Issues Subcommittee Report].

The Article 2 Consumer Issues Subcommittee (and Article 2 drafting committee, in adopting their subcommittee's report) reached a similar conclusion. They said that existing provisions protective of consumers should not be eliminated absent "compelling evidence" that the provision no longer serves. Article 2 Drafting Committee, Consumer Issues Subcommittee, Thoughts on the Treatment of Consumer Issues in a Revised UCC Article 2, at 3 (on file with author).

suffer in a variety of ways, including a lower sale price, a higher deficiency, an inability to bid at the sale, or perhaps other harm. The amount of harm flowing from the violation can be both difficult and expensive to quantify and prove. The simple statutory damages formula eliminates these issues, simplifying the litigation and reducing the likelihood that difficulties of proof will allow Code violations to occur without consequence.

The only enforcement of Article 9 is private enforcement.<sup>189</sup> If individual consumers do not sometimes raise issues of compliance with the Code, there will be no consequences of a violation. It is difficult for low- and middle-income consumers to find affordable attorneys. Many legal services programs no longer offer representation on consumer matters.<sup>190</sup> A middle-income consumer who is being pursued for a deficiency of few thousand dollars is unlikely to be able to pay a lawyer up front, hoping for an eventual recovery to offset the deficiency. The need for deterrence also makes statutory damages important. If a creditor is sued on only one percent of its violations, and the damages are limited to the damages of that one percent of persons who sue, then a rational, profit-maximizing creditor will violate the statute regularly, profiting from the benefits taken from the ninety-nine percent of those who do not sue the creditor.

Well-known commentators have recognized that statutory damages are useful for deterrence and as a form of liquidated damages. White and Summers, for example, state in part: "Compensatory damages are a modest deterrent to creditor misbehavior in nickel and dime consumer transactions. It is not surprising, therefore, that the drafters installed a statutory penalty in 9-507 to up the ante for those who abuse the consumer."<sup>191</sup>

Barkley Clark characterizes the minimum civil penalty as a liquidated damages provision allowing the consumer debtor to avoid the need to prove actual loss.<sup>192</sup> Clark also recognizes the importance of the statutory damages provision, stating: "This minimum civil penalty, quietly tucked away in a corner of § 9-507(1), is probably the most glittering nugget of consumer

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189. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-501 rptr.'s cmt. 1.

190. Severe funding cuts have forced many of those programs to limit their legal assistance to poor consumers to urgent matters such as housing and access to government benefits. Simon, *supra* note 43.

191. 4 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 34-19 (4th ed. 1995).

192. BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 4.12[4] (1993).

protection found in all of Article 9.”<sup>193</sup> The Article 9 drafting committee has now voted to cut back on the availability of statutory damages. The new defense represents a significant reduction in the meager level of consumer protection provided by current Article 9. Moreover, the new defense could weaken the basic obligation of commercial reasonableness in the disposition of collateral, because, as drafted, it would apply to all violations of Part 6, including violations of the duty to dispose of collateral in a commercially reasonable manner.<sup>194</sup>

5. *The Broadened Definition of a Purchase Money Security Interest Selected by the Article 9 Drafting Committee Will Harm Consumers*

The Article 9 draft expands the definition of a purchase money security interest (“PMSI”) in two ways in new section 9-104 (old section 9-107). First, a refinancing of a PMSI would remain a PMSI to the extent of the refinanced PMSI.<sup>195</sup> This codifies the “dual status” rule for defining a purchase money security interest.<sup>196</sup> It rejects the “transformation” rule that PMSI status is lost on refinancing. Fifteen jurisdictions use the transformation rule, which mandates the expiration of a purchase money security interest if the original loan is refinanced or consolidated.<sup>197</sup> Sixteen jurisdictions use the dual status

193. *Id.*

194. This is the version in the October 1996 draft. The Consumer Issues Subcommittee of the Article 9 drafting committee has tentatively recommended narrowing this new defense so that it would apply only to certain numbers in identified notices. Oct. 1996 Art. 9 Consumer Issues Subcommittee Report (recommendation number 2). That recommendation reads, in relevant part:

5) Recommend that the “bona fide error” defense be available as to some, but not all, of the information required to be given in various notices to consumer debtors. For example, perhaps there should be no bona fide error defense as to the time and place of an auction sale, or of the time after which a private sale will be held.

That recommendation, however, was not adopted at the March 1997 drafting committee meeting.

195. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-107 (renumbered in Oct. 1996, Draft Art. 9, *supra* note 28, § 9-104).

196. *Id.*

197. See *Snap-On-Tools, Inc. v. Freeman*, 956 F.2d 252 (11th Cir. 1992) (holding that a purchase money security interest in tools does not survive consolidation of debts where the allocation of payments was inadequate to determine which tools secured their purchase); *Matthews v. Transamerica Fin. Serv.*, 724 F.2d 798 (9th Cir. 1984) (holding that loan refinancing destroys the purchase money nature of a security interest); *Rosen v. Assoc. Fin. Serv. Co.*, 17 B.R. 436 (D. S.C. 1982); *In re Rushdi*, 174 B.R. 126 (Bankr. D. Idaho 1994); *In re Carter*, 169 B.R. 227 (Bankr. M.D. Ga. 1993); *In re Butler*, 160 B.R. 155 (Bankr. D. Idaho 1993); *Parish v. Lincoln Fin. Co.*, 147 B.R. 187 (Bankr. E.D. Mo. 1992); *In re Baker*, 139 B.R. 468 (Bankr. W.D. Mo. 1992); *In re Adoptante*, 140 B.R. 940 (Bankr. D. R.I. 1992); *In re Kruse*, 116 B.R. 708 (Bankr. D. Neb. 1990); *In re Moody*, 97 B.R. 605 (Bankr. D. Kan. 1989); *In re Bowen*, 87 B.R. 70 (Bankr. E.D. Mo. 1988); *In re Challinor*, 79 B.R. 19 (Bankr. D.

approach, while four use the principle of novation. The case law remains open in the sixteen other jurisdictions.

If one believes that refinancing helps consumers to arrange for lower interest rates, then preservation of the purchase money security interest, at least in theory, could benefit consumers. However, the policy implications are different if the refinance adds new collateral and extends the interest in collateral which otherwise would have been paid off for a longer time. For example, suppose a consumer separately purchases a television set and then a couch from a creditor, who continues its interest in one purchase to the next purchase. In this case, the redefinition of PMSI to include the television set gives the creditor an extra threat to make when collecting on the debt for the couch. The creditor can now threaten to repossess both the couch and the television set, instead of just the couch. As a result, consumers could remain subject to collateral-based collection activity after the first item of collateral has been fully paid for. The Article 9 drafting committee has voted in favor of a mandatory allocation formula for consumer secured transactions, which could partially ameliorate this problem.<sup>198</sup> Codifying the dual status definition of a PMSI could give creditors both within and outside of bankruptcy added collection leverage to threaten to repossess household goods collateral. Under the FTC Credit Practices Rule, a creditor may not take a security interest in certain household goods unless the interest is a PMSI.<sup>199</sup> Paid-for household goods covered by the rule cannot be taken as collateral. The redefinition of a PMSI to include refinancing may permit creditors to retain a claim on household goods for a longer period of time. The longer the time period that the creditor can claim these goods, the more collection leverage the creditor will have to threaten to retake goods needed for daily living. The National Consumer Law Center has reported that roughly two-thirds of finance company loans are refinances.<sup>200</sup> The presence of a refinance rate higher than that for other consumers could suggest that refinancing is more aggressively "sold" in the finance company market, perhaps because it increases fee

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Mont. 1987); *In re Wandler*, 77 B.R. 735 (Bankr. D. N.D. 1987); *In re Janz*, 67 B.R. 553 (Bankr. D. N.D. 1986); *Franklin v. ITT Fin. Serv.*, 75 B.R. 268 (Bankr. M.D. Ga. 1986); *In re Mason*, 46 B.R. 119 (Bankr. E.D. Mich. 1985); *Haus v. Barclays Am. Corp.*, 18 B.R. 413 (Bankr. D. S.C. 1982); *Ashworth v. McMahon's Furniture*, 16 B.R. 645 (Bankr. C.D. Cal. 1981); *Coronado v. Beach Furniture & Appliance, Inc.*, 7 B.R. 53 (Bankr. D. Ariz. 1980).

198. May 1996 Art. 9 Consumer Issues Subcommittee Report, *supra* note 188.

199. FTC Credit Practices Rule, 16 C.F.R. § 444.2 (1996).

200. *Flipping Takes a Hit in the Seventh Circuit*, 14 NCLC REPS. CONSUMER CREDIT & USURY ED. 12 (1995).

income. The redefinition of a PMSI to reach refinancing also creates a second way to avoid the FTC Credit Practices Rule. A creditor who has a PMSI in household goods could retain a security interest in the household goods by refinancing the PMSI and adding new unsecured debt in addition to the amount refinanced. Under draft section 9-104 the refinanced loan would remain a PMSI to the extent of the original PMSI even if the new loan could not otherwise have been collateralized by household goods. The draft then calls for payments to be allocated first to the unsecured portion of the debt, leaving the creditor with collection leverage over the household goods for a longer time, as well as improved status in bankruptcy with respect to these household goods for a longer time.<sup>201</sup>

In bankruptcy, the new, expanded definition of a PMSI will mean that some liens otherwise avoidable will no longer be avoidable. For example, liens on goods such as household goods, work tools, and health aids are avoidable under section 522(f) if they are both non-possessory and non-purchase money.<sup>202</sup> Treating the refinance of a PMSI on these goods as a new PMSI may preserve liens on such items that otherwise might be avoidable.

The Article 9 Consumer Issues Subcommittee addressed the bankruptcy issues and it recommended that the drafting committee add a comment to the new definitional section that

mak[es] it clear that the revision of 9-107 is not intended to prevent bankruptcy courts from holding that for purposes of 522(f) a refinancing or consolidation of debt results in loss of purchase money status. In bankruptcy, judges may decide that even though revised 9-107 adopts a clear "dual status" rule, that rule need not apply to a 522(f) avoidance proceeding.<sup>203</sup>

The sentiment behind the comment is helpful. However, if bankruptcy judges look to state law to determine the status of a particular extension of credit, the change in statutory language adopting the dual status rule seems more likely to influence the result than a comment suggesting that bankruptcy judges may choose to ignore the newly codified state law PMSI definition.

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201. The Consumer Issues Subcommittee discussed this aspect of the issue, but had not yet addressed it in its report as of January 1997. There seemed to be agreement in the Subcommittee and at the March 1997 meeting of the drafting committee that the allocation rule should require that payments be allocated first to secured debt in a mixed PMSI/unsecured debt transaction in order to facilitate the release of the PMSI.

202. 11 U.S.C. § 522(f) (1994).

203. May 1996 Art. 9 Consumer Issues Subcommittee Report, *supra* note 188, at 18-19.

The Article 9 draft also expands the definition of a purchase money security interest by proposing to codify as a PMSI any loan where the collateral is mixed between purchase money and non-purchase money collateral.<sup>204</sup> Consumer advocates are concerned that this mixed collateral element of the definition could encourage the over-collateralization of loans. Existing law restricting purchase money status to those loans where all the collateral is purchase money should have the effect of discouraging over-collateralization.

As discussed in Part III.C.10, refinancing by finance companies has been a way to increase fees and charges paid by consumers. It can result in consumers paying more, not less, in interest and fees over the life of the refinanced loan. Over-collateralization also can drive up fees, by increasing the dollar value of collateral upon which high-priced property insurance is sold. By preserving PMSI status for all refinances, the proposed definition may facilitate unneeded and high-cost refinancings. By giving PMSI status to all mixed collateral transactions, it may also encourage the taking of unneeded collateral.<sup>205</sup>

#### 6. *The Article 9 Draft Deprives Courts of the Doctrine of Constructive Strict Foreclosure*

The comments to section 9-505 state that the draft is intended to eliminate the doctrine of constructive strict foreclosure.<sup>206</sup> The doctrine of constructive strict foreclosure provides an equitable tool for a court to reach a just result when a secured party has waited an unreasonably long time before disposing of collateral. This equitable tool may be particularly needed in consumer cases because the triggering event—the long delay—is inherently likely to prejudice the consumer's ability to prove the amount of harm from the delay. The later the disposition, the more difficult it will be for a consumer to disprove the creditor's assertion of what the value would have been if the sale had been held in a timely fashion. For example, in one case seen by a consumer credit counselor, a creditor allegedly accepted surrender of a mobile home and then waited a full year to sell the home, incurring additional

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204. July 1996 Annual Meeting Draft, Article 9, *supra* note 10, § 9-107(e) (renumbered in Oct. 1996 Draft, Art. 9, *supra* note 28, § 9-104(e)).

205. See *infra* Part III.C.10.

206. July 1996 Annual Meeting Draft, Art. 9, *supra* note 10, § 9-505 rptr.'s cmt. 1. This section has since been renumbered in Oct. 1996 Draft, Art. 9, *supra* note 28, §§ 9-618, 9-620 & 9-623.

costs of \$6000 which it added to the debt. The additional costs of holding the collateral far exceeded the amount finally realized on the home. This consumer was unable to repay the deficiency, but her guarantor was solvent. The delay harmed the guarantor in several ways. First, he had to resurrect information about what the mobile home market was a year earlier, rather than simply presenting recent value information. Second, he was deprived of notice of the magnitude of his liability under the guarantee for a full year. A person who knows that he has a large matured liability under a guarantee might make different financial choices than someone who has not been asked to pay under a guarantee. A delay in disposition is a delay in the certainty of this obligation and a loss of time to rearrange one's financial affairs to accommodate it.

The doctrine of constructive strict foreclosure would permit a court to reach an equitable result when the consumer thought the surrender of the collateral would end the obligation. Consumer credit counselors and attorneys who represent consumers have said that consumers often believe that voluntary surrender ends the obligation.<sup>207</sup> They also report that when a secured party requests or accepts surrender, that party does not inform the consumer that a deficiency may also be owed after the surrender.<sup>208</sup> Under the revised draft, the consumer will receive a notice that he or she may owe a deficiency when he or she receives the notice of sale, but a long delay in selling may also mean a long delay before receiving notice. A long period of inaction by the secured party after accepting the surrender of collateral may feed the consumer's misconception that the obligation is completed, leaving the consumer surprised and unprepared when, six months or a year later, he or she is first contacted by the creditor's collection department or by a collection agency.

Retaining the doctrine of constructive strict foreclosure would not require a court to find it. Instead, the doctrine would remain an equitable tool which courts can be expected to use sparingly, just as they do today.<sup>209</sup>

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207. Meetings and conversations held between the author and consumer credit counselors serving various California counties.

208. *Id.*

209. For an application of the doctrine of constructive strict foreclosure, see *Moran v. Holman*, 514 P.2d 817, 820 (Alaska 1973) (creditor repossessed defendant's truck, used it for purposes other than preservation, and did not initiate a suit on the debt for four months). The court's rationale was an equitable one:

Usually, due to his poor financial position, the debtor has scant prospect of obtaining an attorney, and the amount involved is often too small to justify legal services. The possible remedies are thus

7. *The Increased Focus on Intangible Collateral Makes It Necessary to Modernize the Restriction on After-Acquired Consumer Property to Reach Intangible Consumer Property*

Where a consumer is borrowing primarily on the security of a tangible item, such as a car, it is highly unlikely that the creditor will give the consumer better rates or terms if the loan agreement also identifies as collateral intangible consumer property which the consumer has not yet acquired (such as, for example, a future seller carry-back note on a house which the consumer sells; or a mutual fund qualifying under the definition of investment property which the consumer has not yet opened). Nonetheless, current section 9-204 restricts after-acquired property clauses only for consumer goods, not for intangible property owned by consumers. The draft carries forward the current section without change on this issue.

The Article 9 draft adds consumer investment property as Article 9 collateral. It also generally increases the ease of enforcing a security interest in intangibles. For example, intangibles now may be strictly foreclosed upon even if they are not in the possession of the secured party.<sup>210</sup>

The policies behind the prohibition of interests in after-acquired consumer goods of current law should also apply to consumer intangible property. In particular, a consumer is unlikely to be offered more credit or improved credit terms based upon property that he or she does not yet own. However, permitting a non-reliance creditor to tie up after-acquired consumer intangibles may prevent the consumer from securing other credit with those intangibles in the future. Consumers could be harmed by expanded security interests in after-acquired intangible collateral because those interests could

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illusory in most cases. On the other hand no substantial burden is imposed upon the creditor by requiring him to take action within a reasonable time and to abstain from making inconsistent use of the repossessed collateral.

*Id.* See also *In Re Boyd*, 73 B.R. 122, 124-25 (Bankr. N.D. Tex. 1987) (creditor took debtor's boat, used it for three months and did not make a commercially reasonable disposition when converting it to its own use); *Shultz v. Delaware Trust Co.*, 360 A.2d 576, 578 (Del. Super. Ct. 1976); *Wisconics Eng'g, Inc. v. Fisher*, 466 N.E.2d 745, 763 (Ind. Ct. App. 1984); *Haufler v. Ardinger*, 28 U.C.C. Rep. Serv. (CBC) 893, 897 (Mass. Dist. Ct. 1979) ("[A] secured party should not be permitted to profit by his own failure to furnish requisite notice by both retaining the property for his own use and then seeking additional recovery from the debtor."); *Millican v. Turner*, 503 So. 2d 289, 291 (Miss. 1987); *General Elec. Credit Corp. v. Pro-Sat Communications, Inc.*, 11 U.C.C. Rep. Serv. 2d (CBC) 407, 411 (Tenn. Ct. App. 1990) (collateral unsold after three years); *Service Chevrolet, Inc. v. Sparks*, 660 P.2d 760, 763 (Wash. 1983).

210. Oct. 1996 Draft, Art. 9, *supra* note 28, § 9-618.

permit a creditor to invoke judicial process to take property which would otherwise be exempt from execution after a judgment. State laws generally exempt a portion of a consumer's income and certain types of consumer assets from execution of a judgment. These exemption from execution laws create a quasi-"fresh start" outside of bankruptcy for the consumer whose judgment creditors otherwise would have a claim on all the consumer's assets and income. Allowing creditors to sweep after-acquired consumer intangible property into security agreements would interfere with the policy of those state exemption statutes.

In addition, as Professor William Woodward has observed, some general intangibles owned by a consumer are in the nature of a claim for payment for personal services.<sup>211</sup> Intangibles such as a stream of royalty payments or income generated by a patent fall into this category. A secured creditor is prohibited by law from taking a security interest in future, unearned wages. Professor Woodward has pointed out that permitting after-acquired interests in consumer intangibles generated by future services or work would frustrate the policies underlying anti-wage assignment rules.<sup>212</sup> For these reasons, the limitation on after-acquired consumer goods in section 9-204 should be extended to reach after-acquired consumer intangibles.

8. *The Draft Fails to Fully Address a Key Problem That Consumers Have Faced Under the Code: Low Values on Disposition of Collateral*

a. *The Problem of Low Values on Disposition Sales*

A continuing problem for consumers under Article 9 is that courts uphold sales that deliver low disposition prices as commercially reasonable. In theory, a good sale should obtain a market price. However, case law shows that trial courts have upheld sales as commercially reasonable which return far less than the apparent market price. In addition, studies dating back over twenty years show low prices on disposition sales relative both to published values and to subsequent sales of the same collateral.<sup>213</sup> Further, even if the

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211. Letter from Professor William Woodward to professor Marion Benfield (May 20, 1996) (on file with author); Letter from Professor William Woodward to Professor Marion Benfield (Mar. 6, 1996) (on file with author).

212. *See supra* note 211.

213. *See infra* note 233.

commercial reasonableness standard should work in theory, it presents factual questions that can be resolved only through expensive litigation. It can be difficult and expensive for a consumer to develop and offer proof of a bad sale procedure because typically only the creditor knows how the sale was conducted.

There are not a large number of reported cases discussing consumer issues because most consumers with financial problems leading to default are unlikely to be able to afford to pursue a claim through appeal. However, the case law does show that trial courts have accepted as commercially reasonable sales which yielded far less than any reasonable market value of the consumer goods collateral. In *Central Budget Corp. v. Gannett*,<sup>214</sup> the Gannetts purchased a used 1963 Buick for a retail purchase price of \$1627.50 in 1968. Approximately three months later, the assignee of the note repossessed the car and sold it at auction for \$300.<sup>215</sup> The auction sale was advertised only once and it was attended by five or six persons, some of whom may have been employees of the dealer.<sup>216</sup> Although the disposition sale was held only three months after the initial sale, the price was less than one-fifth of the earlier price. Despite these facts, the trial court in *Gannett* upheld the deficiency claim.<sup>217</sup> On appeal, the *Gannett* court held that commercial reasonableness required "a good faith attempt to dispose of the collateral to the parties' mutual 'best advantage' and that . . . marked discrepancies between the disposal and sale prices signal a need for closer scrutiny, especially where, as here, the possibilities for self-dealing are substantial."<sup>218</sup> Although the New York court in this case ultimately denied recovery of the deficiency based on the questionable sale, it did so in 1975, seven years after the disposition sale. Most consumers lack the resources to retain an attorney for a seven-year fight over a deficiency claim.

In *ITT Industrial Credit Co. v. Chasse*,<sup>219</sup> a creditor repossessed a \$30,000 truck and after three years later sold it for \$7,500. Soon after, the creditor reacquired the truck for \$9600 (128% of the disposition sale price) and, one year later, resold it for \$15,000 (200% of the disposition price).<sup>220</sup> The *ITT*

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214. 368 N.Y.S.2d 268, 269 (App. Div. 1975).

215. *Id.* at 269.

216. *Id.* at 269-70.

217. *Id.* at 269.

218. *Id.* at 270 (citations omitted).

219. 25 U.C.C. Rep. Serv. (CBC) 914, 916 (Conn. Super. Ct. 1978).

220. *Id.*

court disallowed the portion of the deficiency claim which was greater than the stipulated wholesale value of the truck.<sup>221</sup> However, the consumer was required to litigate over the reasonableness of the sale in order to reach this result.<sup>222</sup>

In *Peoples Acceptance Corp. v. Van Epps*,<sup>223</sup> the Van Epps bought a five-year-old Pontiac for \$1,989 in November 1973. After five payments, Mr. Van Epps's health apparently caused them to miss their April payment.<sup>224</sup> The creditor repossessed the car in June 1974 and sold it for \$200.<sup>225</sup> The court said that the case "presents a situation of fairly recurrent nature."<sup>226</sup> The disposition sale price was just over one-tenth of the sale price seven months earlier. The court found that there was no evidence that the car had significantly depreciated while in Mr. Van Epps's possession.<sup>227</sup> The court also noted that there was evidence suggesting that in other transactions, this creditor had sold cars back to the dealership so that the dealership could resell them at a substantial profit.<sup>228</sup> Despite these facts, the trial court awarded a deficiency judgment, which the court of appeals reversed.<sup>229</sup> The consumer had to litigate for four years over the commercial reasonableness of a grossly low disposition sale price before the deficiency claim was finally set aside.

In *American Finance Corp. v. DeLong*,<sup>230</sup> a trial court awarded a deficiency judgment even though "American Finance Corporation sold, for \$155, an automobile with a suggested listed value of \$1275." The creditor did not present any evidence of factors which would explain the inordinate difference.<sup>231</sup> Although this deficiency judgment was overturned on appeal, the commercial reasonableness standard did not prevent the trial court from awarding a deficiency judgment. Professor William Henning, a Code scholar and a member of the Conference, has stated: "Despite the protective tone of Article 9, case law is replete with instances in which courts have sustained sales as commercially reasonable even though the collateral brought

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221. *Id.* at 918.

222. *Id.* at 916-17.

223. 395 N.E.2d 912, 914 (Ohio Ct. App. 1978).

224. *Id.*

225. *Id.*

226. *Id.* at 915.

227. *Id.* at 917.

228. *Id.*

229. *Id.* at 914, 918.

230. 437 A.2d 1100, 1101 (Vt. 1981).

231. *Id.*

significantly less than its fair market value."<sup>232</sup>

Other evidence of the problem of low values on disposition sales includes published studies spanning twenty years which show that disposition values for repossessed and surrendered automobiles are far below even wholesale published values. Studies in the late 1960s and 1970s found that creditors disposed of automobile collateral for only seventy-one to eighty-four percent of its wholesale value.<sup>233</sup> A Connecticut study found that prices at disposition sales were seventy-one percent of wholesale value and fifty-one percent of published retail values.<sup>234</sup> The same cars were then resold three to five months later for ninety-two percent of retail value.<sup>235</sup> A District of Columbia study examined data from 284 auto deficiency cases in the District of Columbia, Maryland, and Virginia.<sup>236</sup> The average price paid at the disposition sale was only eighty-one percent of wholesale and sixty-two percent of retail published values.<sup>237</sup> Another study examined over 200 deficiency suits filed in Alameda County, California, between 1971 and 1973.<sup>238</sup> This study found that deficiency credits averaged eighty-four percent of wholesale published values and sixty-four percent of retail published values.<sup>239</sup>

In 1994, the West Coast Regional Office of Consumers Union found that low values in disposition sales of automobile collateral remain a problem.<sup>240</sup>

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232. William H. Henning, *An Analysis of Durrett and Its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications*, 63 N.C. L. REV. 257, 278 (1985).

233. Philip Shuchman, *Condition and Value of Repossessed Automobiles*, 21 WM. & MARY L. REV. 15, 26 (1979) [hereinafter Shuchman, *Repossessed Automobiles*]; Philip Shuchman, *Profit on Default: An Archival Study of Automobile Repossession and Resale*, 22 STAN. L. REV. 20, 32 (1969) [hereinafter Shuchman, *Profit on Default*]; Martin B. White, *Consumer Repossessions and Deficiencies: New Perspectives from New Data*, 23 B.C. L. REV. 385, 395, 399 (1982); John C. Firmin & Robert Simpson, Note, *Business as Usual: An Empirical Study of Automobile Deficiency Judgment Suits in the District of Columbia*, 3 CONN. L. REV. 511, 516-21 (1971). These studies are discussed in more detail in Gail Hillebrand, *The Redrafting of UCC Articles 2 and 9: Model Codes or Model Dinosaurs?*, 28 LOY. L.A. L. REV. 191, 201-06 (1994).

234. Shuchman, *Profit on Default*, *supra* note 233.

235. *Id.* at 32-33. The Firmin & Simpson study also shows that these same cars are sold at or near their retail market value on the second resale. Firmin & Simpson, *supra* note 233, at 518, 520. The first resale (the disposition sale) is generally a private sale open only to automobile dealers. *Id.* at 516 n.29. The second resale, conducted by car dealers who were purchasers at the disposition sale, results in the highest possible price, because it is generally public, well advertised, and takes place on a dealer's car lot designed to attract a large number of buyers. *Id.* at 519-20.

236. Firmin & Simpson, *supra* note 233, at 513-14.

237. *Id.* at 518-19.

238. Ellen B. Corenswet, Note, *I Can Get It for You Wholesale: The Lingering Problem of Automobile Deficiency Judgments*, 27 STAN. L. REV. 1081, 1084 (1975).

239. *Id.* at 1085 n.18.

240. This research and the table in the text following this note were first reported by this author in

That Office examined court files in deficiency suits filed from January 1992 to May 1994. The court files showed disposition prices of seventy-three percent of published wholesale values (fifty-three percent of retail). In forty-seven of the fifty cases in the sample, the creditor characterized the vehicle's condition as average or good on a court-required report.

The following table shows the results of these four studies:

Study	Year	Disposition Sale Price as a Percent of Retail Value	Price as a Percent of Wholesale Value
Suchman	1969	51%	71%
Firmin & Simpson	1971	62%	81%
Corenswet	1975	64%	84%
Consumers Union	1994	53%	73%

There are several reasons why a creditor might sell an item for less than its full wholesale value. Auto financiers sometimes have business arrangements that insulate them from the ill effects of low sale prices. Creditors who purchase notes from automobile dealers may require the auto dealers to compensate them for losses suffered when car buyers default on loans the dealer originated.<sup>241</sup> The secured party also may have an incentive other than minimizing the deficiency when it sells a repossessed car or other consumer good. The secured party, for example, might simply wish to sell the collateral as quickly or cheaply as possible. *Ford Motor Co. v. Lyons*<sup>242</sup> provides an insight into another reason why a secured party might sell collateral for less than the best price. In that case, the Wisconsin Court of Appeals upheld a jury finding that cars retaken by Ford from an auto dealership were disposed of in

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*Model Codes or Model Dinosaurs*, *supra* note 233. Thippavone Phabmixay Ark, Fellow for Economic Justice, performed the research at the West Coast Regional Office of Consumers Union in June and July of 1994. Seventy automobile deficiency suits were reviewed, but the number was reduced to fifty cases because of incomplete court records.

241. David B. McMahon, *Commercially Reasonable Sales and Deficiency Judgments Under UCC Article 9: An Analysis of Revision Proposals*, 48 CONSUMER FIN. L.Q. REP. 64 (1994); Shuchman, *Profit on Default*, *supra* note 233, at 24-26; Corenswet, *supra* note 238, at 1081-82. The structure of one such reserve account is discussed in the Amended Answer and Counterclaim, *National Bank of Commerce v. Smith*, Nos. 89-C-934 89-C-2679 (W. Va., Kanawha County Cir. Ct. 1990).

242. 405 N.W.2d 354 (Wis. Ct. App. 1987).

a commercially *unreasonable* manner.<sup>243</sup> The evidence supporting the jury's finding of commercial unreasonableness showed that the repossessed cars were sold differently than cars owned by the dealer.<sup>244</sup> These differences included offering for sale all the cars that Ford owned first, while placing the dealer-owned disposition sale cars at the end of the dealer-only auction, and withholding dealer incentives normally offered by Ford on cars it sold for its own account.<sup>245</sup>

The disparity between the value of the goods, even as used goods, and the amount credited after a disposition sale is a key problem for consumers. Current Article 9 permits a secured party to sell the collateral in the way most convenient to it, so long as it meets the minimal standard of commercial reasonableness, and then to pursue the consumer for the deficiency even if the deficiency would have been lower if a different sale method had been selected. Consumers who believe that the secured creditor sold the collateral for too low a price, inflating the deficiency, have little recourse unless they can engage in long and fact-intensive litigation about the reasonableness of the sale.

*b. Solutions to the Issue of Low Values on Disposition Sales*

Consumer advocates have proposed a number of different approaches for tightening the commercial reasonableness standard in order to address the persistent problem of low values on the sale of collateral. All of those proposals have been vigorously resisted by the secured creditor observers to the Article 9 process. The Article 9 drafting committee rejected two of the proposals, a fair value proposal and a safe harbor for sales which deliver blue book value, for application to all disposition sales.

Approaches that could improve the situation for consumers under the Code with respect to low prices on disposition sales include requiring: the secured party credit to the debt an amount between the retail and wholesale value of the collateral, as is required in Connecticut,<sup>246</sup> at least the fair wholesale value of the collateral be credited against the deficiency; the amount credited to the deficiency be measured by the results of the next sale following the disposition sale; the disposition sale be a retail sale, or one

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243. *Id.* at 378.

244. *Id.* at 376 n.16.

245. *Id.*

246. CONN. GEN. STAT. ANN. § 36a-785(g) (West Supp. 1996).

which uses methods designed to bring the best possible price; or that the price paid at the disposition sale independently meet the standard of commercial reasonableness regardless of whether there is also evidence of a bad sale procedure.

The Connecticut approach and the fair value approach are the only two approaches that fully address the problem of low values on disposition of consumer collateral because they are likely to affect creditor behavior without litigation. Both of these approaches shift the focus from the sale procedure to the amount credited against the debt. Both would require that a secured party who wishes to pursue a deficiency first credit against the debt a particular amount to the account. Under the Connecticut approach, the credit would have to be the average of the retail and wholesale published values for the goods. Under the fair value approach, the credit would have to be within the range of published wholesale values for the same type of goods in their age and condition at the time of disposition.

These approaches would not prevent a creditor from choosing to sell the goods more quickly for a low price rather than taking steps to increase the sale price. However, that decision by the creditor would not affect the amount of deficiency owed by the consumer. A fair value rule would give the secured party the maximum incentive to actually get the fair value at the disposition sale and allow the party to choose to accept less at its own cost in order to serve its own convenience.

The fair value proposal is not new but is a modification of a proposal made by Mr. Donald Rapson.<sup>247</sup> Mr. Rapson correctly notes that procedures for the sale of a car by a lender, which meet the legal standard of commercial reasonableness, frequently produce no bidders at the sale.<sup>248</sup> He suggests that a deficiency should be uncoupled from the actual price received at the sale and instead tied to the price that would have been achieved if there had been a commercially reasonable sale.<sup>249</sup> To implement this approach, a new Section 9-504(6), or, under the new renumbering scheme, a new section 9-610(c), could be added, stating:

For consumer secured transactions, a secured party which wishes to pursue any deficiency otherwise permitted by contract and law shall credit against the indebtedness the greater of the proceeds of the

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247. Rapson, *supra* note 56, at 680-88.

248. *Id.* at 685 n.112.

249. *Id.* at 687.

disposition or the fair market value of the collateral, less reasonable costs of disposition. The secured party shall have the burden of showing that the amount of the credit meets this standard. A debtor in a consumer secured transaction is not liable for any deficiency unless the secured party proves that it complied with this subsection.

Other methods of addressing the issue of low values on disposition of collateral are not as effective as a fair value or wholesale/retail value credit requirement, because the other methods focus on the sale rather than the amount credited against the debt. They will require litigation to be implemented. One such method is to at least recognize that price, as an independent term of a disposition sale, must be commercially reasonable. If price is a term, then a consumer who is challenging an allegedly bad sale will be able to offer proof that the price was below the market. The creditor could then defend by showing that the market price was in fact lower for this collateral, perhaps due to its age, condition or other factors affecting the market. Treating price as a term that must be commercially reasonable would not invalidate every sale with a low price. Rather, a creditor whose sale brought a low price would have to prove to the court that the low price was in fact a commercially reasonable market price given market factors such as the age and condition of the goods. Whether and how the Article 9 draft eventually addresses this problem will tell a great deal about whether the UCC drafting process is fit to produce uniform laws affecting consumers.

*9. The Drafting Committee Has Voted to Address the Serious Issue of Low Prices at Disposition Sales Where the Buyer Is the Creditor or an Entity Affiliated with the Creditor*

The Article 9 drafting committee voted at its June 1996 meeting to address one subset of the issue of low values in disposition sales. That subset is the group of sales where the buyer is the secured party, a recourse party, or a party affiliated with the secured party. Where the parties have other business relationships, those relationships may remove the economic incentive to try to get a good price on the disposition. Where there is a dealer reserve account, for example, the secured party selling the collateral may be assured of being made whole by a payment from the reserve account regardless of the price paid at the disposition of the collateral. The Article 9 Consumer Issues Subcommittee recognized this problem, stating in part:

If the secured party, a person who is liable to the secured party for the unpaid debt (“recourse party”), or a person who is under substantial common ownership with the secured party (“related party”) can buy at the foreclosure sale, there is a positive incentive for them to buy at below the fair foreclosure value of the collateral. In all three cases, the actual “price” paid at the foreclosure sale is economically irrelevant to them except as it fixes the amount of deficiency. The lower the foreclosure sales price paid, the larger the deficiency which may be recovered from the debtor. And there is an opportunity for the secured party, recourse party, or related party to sell the collateral at a price which nets them more, sometimes substantially more, than the price they bid at the foreclosure sale.<sup>250</sup>

Reported cases illustrate how a secured party’s expectation of reselling the collateral after buying it at the disposition sale or a secured party’s relationship with the bidder may depress disposition sale prices. In *Credit Alliance Corp. v. Timmco Equipment, Inc.*,<sup>251</sup> a Florida trial court awarded a deficiency judgment even though the collateral had been damaged by fire while in the creditor’s possession and had not repaired prior to the sale. In reversing, the court of appeals held the failure to repair the fire damage was unreasonable and noted that “soon after” the disposition sale, the secured creditor resold the equipment for three times the price it had paid at the disposition sale.<sup>252</sup> This case suggests that a secured party may have an incentive not to secure the maximum price at the sale, particularly if it can resell the item and retain the difference in proceeds.

In *Savage Construction, Inc. v. Challenge-Cook Brothers, Inc.*,<sup>253</sup> a secured creditor failed to notify an interested party about an auction of the four cement mixers, even though the party was actually negotiating for the purchase of one of the cement mixers. The secured creditor purchased all of the mixers at auction for \$39,500 each.<sup>254</sup> The court said: “Within two weeks after the auction, [the secured creditor] sold two of the cement mixers for a combined cash price of \$99,000, plus tax, and the other two cement mixers for a total of \$94,000 plus tax on a conditional sales contract.”<sup>255</sup> In this case,

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250. May 1996 Art. 9 Consumer Issues Subcommittee Report, *supra* note 188, at 7.

251. 507 So. 2d 657, 658 (Fla. Dist. Ct. App. 1987).

252. *Id.* at 660.

253. 714 P.2d 573, 574 (Nev. 1986).

254. *Id.*

255. *Id.*

the auction sale brought \$158,000 and then the creditor/purchaser resold the same goods within two weeks for a total of \$193,000.<sup>256</sup>

In *Truck Center of Tulsa, Inc. v. Autrey*,<sup>257</sup> the Arkansas Supreme Court found that an alleged disposition sale was a "setup deal" for the purpose of inflating the deficiency. In that case, a creditor repossessed a Freightliner truck and resold it for \$18,000.<sup>258</sup> Then, the creditor, who was also the dealer, bought the truck for \$18,100 the next day and later sold it for \$39,000.<sup>259</sup> The debtor was eventually able to have the deficiency judgment set aside, but only after a four-year delay from the date of the repossession.<sup>260</sup>

The Consumer Issues Subcommittee recommended that the draft committee reporters prepare a proposal to address sales-to-self and sales-to-interested-parties.<sup>261</sup> In discussing that proposal, the subcommittee discussed both a fair value rule, limited to transfers of collateral from a consumer secured transaction, and a rule for higher scrutiny of the price paid in a sale-to-self, a recourse sale, or a sale to an affiliated party.<sup>262</sup> In discussing these possibilities, it stated:

A third possible way to protect against inflated deficiencies if the secured party, a recourse party, or related party buys at the foreclosure sale, is to subject to higher than usual scrutiny the price received and other aspects of the sale. For example, the secured party might be able to measure the deficiency by the price received only if a special showing is made that actual bona fide offers were received from unrelated prospective buyers, or that bona fide efforts to secure fair foreclosure value at the foreclosure sale were made. Under such a rule, if the secured party does not meet the higher standard of proof as to the reasonableness of the price received, or as to the efforts made in the sale to secure a reasonable price, the secured party, even though it had a commercially reasonable sale, would not be able to use the sale price to measure the deficiency.

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256. *Id.*

257. 836 S.W.2d 359, 366 (Ark. 1992).

258. *Id.* at 360-61.

259. *Id.* at 361.

260. *Id.* at 366-67.

261. May 1996 Art. 9 Consumer Issues Subcommittee Report, *supra* note 188, at 7-11.

262. *Id.* at 10-11.

It is perhaps relevant to the Drafting Committee thinking on the issues involved here that The Restatement of the Law of Property (Mortgages), Tentative Draft No. 5, Section 8.4, (approved by the American Law Institute this May) provides that in all actions for deficiency after a real estate mortgage foreclosure, the debtor may request that the fair market value of the collateral as of the date of foreclosure be determined. If such a request is made, any deficiency is based on the difference between the debt and the fair market value. But if no request is made for that determination, the deficiency is the difference between the foreclosure sales price and the debt. That rule is supported by statutory or judge made law in about half the states which apply to some or all real estate mortgage foreclosures.

Application of a fair market value test for deficiency recovery in all Article 9 transactions, even all consumer transactions, is probably not justified. Deficiency claims are likely to be smaller in consumer personal property transactions. Further, the Article 9 requirement that foreclosure sales be commercially reasonable protects against unreasonably low foreclosure sale prices. In contrast, the typical real estate foreclosure statute imposes judgment-sale-like procedures on real estate foreclosures which make it very unlikely that the real estate will bring a reasonable market price. Also, in real estate transactions it is much more likely that the mortgagee will bid in at the sale.

However, in consumer secured transactions in which the secured party, a recourse party, or a related party, buys at the foreclosure sale, it may be reasonable to require the person suing for a deficiency, on demand of the debtor, to make a special showing as to the reasonableness of the price received. In the absence of that proof, reasonable foreclosure value of the collateral might be the basis on which to determine the amount of the deficiency.

The Subcommittee has not fully considered possible methods, other than . . . those mentioned here, by which to protect against self-dealing in the three situations discussed here. Therefore, our recommendation is that the reporters be instructed to prepare provisions that subject to higher than usual scrutiny the price paid by a secured party, recourse party, or related party, and other aspects of any foreclosure sale in

which those parties buy the collateral. In preparing those provisions, the reporters are not limited to the suggestions made here.<sup>263</sup>

It remains to be seen whether the approach now being drafted to deal with this subset of the low value problem will have a broad and meaningful impact outside of litigated cases.

*10. The Drafting Committee Addressed a Major Consumer Problem in Providing for a Reciprocal Attorneys' Fees Provision*

One of the consumer problems under the current Article 9 that the draft does address is the availability of attorneys fees. Asserting a consumer's rights under the Code is expensive. Frequently, the issue of compliance with Article 9 will arise in a collection suit. A consumer who is being sued for a deficiency is highly unlikely to be able to hire an attorney and pursue a claim against the creditor for alleged violations of Article 9. The Article 9 drafting committee voted to provide some parity between the parties by providing that in a consumer secured transactions, a consumer debtor or guarantor would be entitled to an award of attorneys' fees after proving a violation of Part 5 of Article 9 if the loan documents included an attorneys' fees provision in favor of the creditor.<sup>264</sup> The drafting committee recognized that consumer borrowers are not in a position to bargain for inclusion of attorneys' fees provisions in their security agreements and that secured creditors include provisions entitling them to fees as a matter of course. The reciprocal rule creates a more level playing field between the secured creditor and the consumer.

Allegations that the availability of attorneys' fees will promote groundless litigation are unlikely to be borne out because these cases will remain fact-based and expensive to pursue.<sup>265</sup> The up-front expense, including costs for experts, of such litigation can be expected to continue to deter the filing of unwarranted suits. In addition, several states have reciprocal contract-based attorneys' fees statutes which should apply to security agreements, just as

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263. *Id.*

264. Draft, Uniform Commercial Code Revised Article 9, Secured Transactions; Sales of Accounts and Chattel Paper § 9-628 (Nat'l Conference of Comm'rs on Unif. State Laws, Feb. 1997), available at <<http://www.law.upenn.edu/library/ulc/ulc.htm>> (visited on Apr. 16, 1997).

265. Whether or not a sale was commercially reasonable is a factual question which cannot be determined quickly and easily prior to trial.

they apply to other types of contracts.<sup>266</sup> Those statutes do not appear to have interfered with the provision of secured credit or to have spurred unfounded litigation.

*11. The Assumptions Underlying Revised Article 9 Have Not Been Proven for Consumer Credit*

Both the flexibility granted to creditors under existing Article 9 and the broad extension of that flexibility under the Article 9 draft seem to be based on unspoken assumptions about the need for more credit and the benefits of secured credit. For example, seemingly implicit in the work of the Article 9 drafting committee is a goal that Article 9 should facilitate the extension of additional credit. There is, however, no evidence that consumers need more credit or that secured credit is any better for consumers than unsecured credit.

In just the past ten years, consumer credit card debt has tripled.<sup>267</sup> Credit card debt, which is usually unsecured, exceeds \$387 billion. In 1994, credit card companies mailed 2.1 billion solicitations for credit cards to consumers.<sup>268</sup> In June 1995, U.S. consumers had \$1.02 trillion in available credit on existing credit card lines.<sup>269</sup> Installment debt reached nineteen percent of after-tax income in 1995.<sup>270</sup> This figure does not include mortgages, home equity lines, or auto lease payments.<sup>271</sup> The number of secured credit cards in the United States has doubled since 1992, to over 900,000 in circulation.<sup>272</sup> There is simply no evidence that the availability of consumer credit is too limited, even for consumers with poor credit histories.<sup>273</sup>

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266. CAL. CIV. CODE § 1717 (West 1985 & Supp. 1996); FLA. STAT. ANN. § 57.105 (West 1994 & Supp. 1996); MONT. CODE ANN. § 28-3-704 (1994); OR. REV. STAT. § 20.096 (1995); UTAH CODE ANN. § 78-27-56.5 (1992); WASH. REV. CODE ANN. § 4.84.330 (West 1988 & Supp. 1996).

267. John Shmeltzer, *Credit Boom Is Helping U.S. Consumers Go Bust*, CHI. TRIB., Oct. 29, 1995, at 1, available in Westlaw, CHITRIB Database.

268. *Id.*

269. Christine Dugas, *Rising Tide of Debt: Many Families are Living on the Edge*, USA TODAY, Oct. 30, 1995, at 1, available in 1995 WL 2954808.

270. *Id.*

271. *Id.*

272. MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY 108 (Michael Hudson ed., 1996) [hereinafter Hudson].

273. Indeed, the trade press reports indicate that lending to consumers with poor credit is a profitable market which many lenders are entering. See, e.g., Lisa Foikenscher, *Recruiting Big Issuers to Secured Cards*, AM. BANKER, Sept. 6, 1995, available in 1995 WL 10176016; Daniel Kaplan, *Banks Join Race to Buy Subprime Auto Lenders*, AM. BANKER, Aug. 21, 1995, available in 1995 WL 6918488; Edward Kulkosky, *Keycorp Forms Unit Focusing on Consumer Finance*, AM. BANKER,

Perhaps the most intuitive of all of the assumptions regularly made about secured credit is that it is cheaper than unsecured credit. In an ideal economic world, this would be true. However, it is not always true in consumer credit. Unsecured credit cards are available to consumers at interest rates ranging from six to twenty percent, with the most common interest rate between sixteen and eighteen percent.<sup>274</sup> According to statistics compiled by the State of California for 1993, the median annual percentage interest rate charged by personal property brokers, a type of finance company offering secured credit, was a range of twenty to almost twenty-five percent on loans up to \$2500, and a range of fifteen to almost twenty percent on loans of \$2500 to \$9999.<sup>275</sup>

Another unspoken assumption about Article 9 is that refinancing is generally good for debtors. This is undoubtedly true for commercial debtors, and has been true for many middle-income homeowners nationwide in times of falling interest rates. For low-income consumers, however, refinancing has traditionally been a tool to exploit and abuse the consumer.<sup>276</sup> Justice Posner's 1996 opinion in *Emery v. American General Finance, Inc.* illustrates the way that refinancing of secured credit can dramatically increase a consumer's costs.<sup>277</sup> Justice Posner observed that not all consumers are able to protect themselves in the credit market.<sup>278</sup>

In *Emery*, a consumer received a solicitation for additional credit.<sup>279</sup> When the consumer inquired about the new credit, she was presented with papers to refinance an existing loan.<sup>280</sup> The refinance apparently resulted in additional

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Sept. 6, 1995, available in 1995 WL 10176005; *Old Formula Proves Beneficial to Lender*, MORNING NEWS (Wilmington, DE), May 20, 1994, available in 1994 WL 13982446 (reporting that Beneficial Corporation expects record profits by lending money to poor people at high prices).

274. Linda Sherry, *1995 Credit Card Survey: High Rates Obscured by "Teaser" Come-Ons*, CONSUMER ACTION NEWS, Mar./Apr. 1995, at 1.

275. FIN. SERVS. DIV., BUS., TRANSP. & HOUS. AGENCY, STATE OF CAL., 1993 ANNUAL REPORT: OPERATION OF FINANCE COMPANIES LICENSED UNDER THE PERSONAL PROPERTY BROKERS LAW, CONSUMER FINANCE LENDERS LAW AND COMMERCIAL FINANCE LENDERS LAW 14 sched. J.

276. For a discussion of how this has been done with home secured credit, see NORMA PAZ GARCIA, *DIRTY DEEDS: ABUSES AND FRAUDULENT PRACTICES IN CALIFORNIA'S HOME EQUITY MARKET* (W. Coast Reg. Office, Consumers Union of U.S., Inc. Oct. 1995); see also KEVIN BYERS, *FAST CASH FOR HOMEOWNERS: A STUDY OF MORTGAGE LENDING BY CONSUMER FINANCE COMPANIES IN THE RICHMOND, VIRGINIA METROPOLITAN AREA*, June 1994, at 14-15 (reporting that nearly two-thirds of all loans made by finance companies are refinancings of existing borrowers, and suggesting that an aggressive cycle of refinancing is one of the phenomena that trap low income and minority borrowers into high-cost sources of credit).

277. 71 F.3d 1343 (7th Cir. 1995).

278. *Id.* at 1347.

279. *Id.* at 1345.

280. *Id.* at 1345-46.

cash to her of \$200, plus approximately \$200 in increased insurance and other fees or expenses.<sup>281</sup> The court said that in order to receive this extra \$200 to \$400 in credit, the borrower's interest rate remained at thirty-six percent, while her payments increased by \$18.73 for each of the remaining thirty months of her loan.<sup>282</sup> In addition, the creditor added six payments to the loan.<sup>283</sup>

Justice Posner discussed the cost of refinancing for this consumer, stating:

The increment in cost to her came to about \$1,200, paid over three years, and this is for the right to get only \$200 now. The cost to her of borrowing \$200 in this way was roughly three times as great as it would have been had she borrowed that amount for three years in a separate loan at the annual interest rate of 36 percent. By our calculation, the implicit interest rate that she paid for the \$200 loan exceeded 110 percent per annum. This was not disclosed on the Truth in Lending Act form that Emery received because the Act treats the transaction as a reborrowing of the original amount of the loan plus \$200. So much for the Truth in Lending Act as a protection for borrowers.<sup>284</sup>

These facts might seem surprising to those whose legal practice or experience has not exposed them to creditors who make loans at thirty-six percent annual interest rates. However, these facts would not be surprising to consumer advocates who have observed the practices of the consumer finance industry over the years.

A recent book, *Merchants of Misery*, reports similar problems faced by consumers with secured credit from finance companies.<sup>285</sup> This book contains reports of finance company practices from around the United States.<sup>286</sup> It includes, for example, a report of a consumer who attempted to borrow \$2,000 from Associates Financial.<sup>287</sup> The book reports that the consumer received an interest rate of over thirty-three percent, plus \$1,200 in added

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281. *Id.* at 1346.

282. *Id.*

283. *Id.*

284. *Id.* at 1346.

285. Hudson, *supra* note 272.

286. *Id.* The book also documents problems experienced by poorer or less educated consumers in dealing with other financial services vendors. *See, e.g., id.* at 180-96.

287. *Id.* at 3.

charges for insurance and other items.<sup>288</sup>

*Merchants of Misery* also contains a report from a journalist who investigated the practices of California finance companies.<sup>289</sup> A large finance company asked the journalist to provide a car valued at \$7,000 as security for a \$1,500 loan.<sup>290</sup> That loan would be made at an annual interest rate of 24.5%.<sup>291</sup> Having more collateral to offer does not seem to have lowered the rates in this case. Another California finance company offered the same reporter a rate of 25.3%.<sup>292</sup>

Assumptions about the way the world operates are reflected in the policy judgments made in the draft. If one believes that entities covered by a statute usually will not go to the outer limits of permitted conduct, one might be inclined to give more latitude. The reports found in *Merchants of Misery* and facts such as those recited by the *Emery* court suggest that some of the creditors whose conduct is governed by Article 9 are likely to test the limits of the law. The lack of familiarity with the industries where this type of conduct may occur can lead to the rejection of needed legal rules in favor of flexibility, without realizing that flexibility can provide an opportunity for abuse.

The assumption that both refinancing and more credit are always good for debtors has had a demonstrable policy outcome in the Article 9 draft. This is shown both in the broad definition of purchase money security interests which includes refinancing and in the tendency of the draft to expand the types of collateral in which an Article 9 security interest can be taken.

#### IV. THE NONUNIFORM AMENDMENTS MADE TO ARTICLES 3 AND 4 ILLUSTRATE THE TYPES OF QUESTIONS STATE LEGISLATORS CAN BE EXPECTED TO ASK ABOUT ARTICLES 2, 2B AND 9

The nonuniform amendments made to UCC Articles 3 and 4 show that legislators will amend uniform laws if they find them unfair to consumers. These amendments occurred despite the lack of any organized or national consumer opposition to Articles 3 and 4.<sup>293</sup> Those nonuniform amendments

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288. *Id.*

289. *Id.* at 30-41.

290. *Id.* at 39.

291. *Id.*

292. *Id.* at 41.

293. There was state-level consumer opposition in Massachusetts and West Virginia. The revisions had not yet passed in Massachusetts as of the summer of 1996.

were remarkably similar, suggesting that the issues could have been handled uniformly in the drafting process. The nonuniform amendments to Articles 3 and 4 cover reducing the opportunities for a new bank fee for copies of checks, preserving state policies requiring the provision of a nontruncated checking account, requiring a certain amount of information provided on checking account statements, preserving the consumer's ability to prove payment without having the original check, avoiding the likelihood that the new procedure for postdating could create new bank fees and permit defrauding of consumers, and modifying the allocation of risks and benefits of not examining signatures on checks.

#### *A. Truncation-Related Amendments*

Many of the nonuniform amendments to Articles 3 and 4 address the effect of truncation on consumers. Articles 3 and 4 promote the nonreturn of checks by extending the obligation on the consumer to examine not only bank statements, which include returned checks, but also those that do not.<sup>294</sup> As the law encourages truncation, consumers are less likely to be able to get their original checks back with their statements as a matter of course. In addition, as truncation spreads, banks are more likely to charge a fee for copies of checks.

Articles 3 and 4 facilitate the opportunity for a new fee, but then do not set or cap that fee. State legislatures addressed this issue by requiring from two to five free copies of checks per statement period. California, Colorado and Washington require two free copies of items per statement period, upon request of the customer.<sup>295</sup> In Washington, these requests must be fulfilled within ten business days.<sup>296</sup> The West Virginia legislature amended Article 4 to require eighteen free copies of checks per year.<sup>297</sup> The New Hampshire

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294. U.C.C. § 4-406 (1995).

295. CAL. COM. CODE § 4406(b) (West Supp. 1996); COLO. REV. STAT. ANN. § 4-4-406(b) (West 1996). California, Colorado, and Washington also required that if items are not returned to the customer, the bank must include on the statement a phone number that customers may call to request an item or copy of an item. CAL. COM. CODE § 4406(a) (West Supp. 1996); COLO. REV. STAT. ANN. § 4-4-406(a) (West 1996); WASH. REV. CODE ANN. § 62A.4-406(a) (West 1995 & Supp. 1996).

296. WASH. REV. CODE ANN. § 62A.4-406(b) (West 1995 & Supp. 1996). By a non-Code statute enacted through the same bill as the revised Articles 3 and 4, Washington also limits the charge for items after the first five per statement period to fifty cents per item plus search time at a fee not higher than the search time charge for complying with an IRS summons. WASH. REV. CODE ANN. § 30.22.230 (West Supp. 1996).

297. W. VA. CODE § 46-4-406(g) (1993).

legislature required that the cost of all copies of checks be reasonable and that the bank provide, on request, up to ten items or copies of items per statement period.<sup>298</sup> The New York Law Revision Commission recommended that section 4-406 be amended to require return on request of at least two free items, or copies of items, per statement period.<sup>299</sup>

Legislatures in some states amended Articles 3 and 4 to preserve state statutes which require offering a nontruncated checking account. The New Hampshire legislature amended section 4-406 to permit banks to decline to return items only "if the customer agrees."<sup>300</sup> The Vermont legislature imposed a nonuniform amendment requiring that if the customer so requests, items or copies of items paid shall be returned with the account statement.<sup>301</sup> If the customer does not so request, then the bank may provide a statement containing the information detailed in section 4-406.<sup>302</sup> The West Virginia legislature amended Article 4 to require banks to offer "at least one account, at a reasonable charge," where all items or legible copies of the items are returned.<sup>303</sup> The New York Law Revision Commission recommended that section 4-406(a) be amended to require that checks be returned with the statement on the accounts of natural persons unless the bank has an account which offers check return.<sup>304</sup> In Massachusetts, the state policy favoring availability of a nontruncated account has been a major stumbling block to the adoption of Articles 3 and 4. The Massachusetts Commissioners engaged in negotiations with the Consumers Coalition, the Attorney General's office, the Office of Consumer Affairs, and the Massachusetts Bankers Association to try to address this issue. As of Fall 1996, it appeared likely that the eventual solution will treat the existing state statute requiring offering of a nontruncated account as trumping Articles 3 and 4.

Two state legislatures and the New York Law Revision Commission have also addressed the amount of information a consumer should receive on a truncated account statement. Section 4-406(a) defines as adequate a bank statement which contains only the item number, amount and date of

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298. N.H. REV. STAT. ANN. § 382-A:4-406(b) (1994).

299. NEW YORK LAW REVISION COMM'N, PROPOSED REVISIONS TO UNIFORM COMMERCIAL CODE ARTICLES 3 AND 4 INTERIM REPORT 16 (Aug. 1995) [hereinafter N.Y. LAW REVISION COMM'N REPORT].

300. N.H. REV. STAT. ANN. § 382-A:4-406(a) (1994).

301. VT. STAT. ANN. tit. 9A, § 4-406(a) (1994).

302. *Id.*

303. W. VA. CODE § 46-4-406(g) (1993).

304. N.Y. LAW REVISION COMM'N REPORT, *supra* note 299, at 15-16.

payment.<sup>305</sup> The actual items need not be returned, nor must the statement provide the name of the payee.<sup>306</sup> Article 4 excuses banks from providing the name of the check payee regardless of how inexpensive it might be to provide that information in the future. California and Washington placed a “sunset”—an automatic expiration—on this broad safe harbor.<sup>307</sup> The New York Law Revision Commission has also recommended a “sunset” provision to prevent freezing in this minimal amount of information as all that will ever be required regardless of technological progress.<sup>308</sup>

### *B. Proof of Payment*

Some state legislatures also saw a gap in new Article 4 with respect to proof of payment after destruction of a check. Section 4-406(b) authorizes the destruction of original checks so long as the capacity to furnish copies is retained for seven years.<sup>309</sup> There is no minimum time period for retention of original checks. The West Virginia legislature made a non-uniform amendment stating that a bank’s return of a copy of the item and the statement is prima facie evidence of payment.<sup>310</sup> The California legislature made a similar change to its Evidence Code.<sup>311</sup> The New York Law Revision Commission recommended that section 4-406(b) be amended to require that a copy of both sides of the item be provided on request.<sup>312</sup> It further recommended that the bank be liable for damages for failure to provide a copy within a reasonable time.<sup>313</sup> The damages are presumed to be equal to the amount of the check, but they may be modified upon proof of additional evidence.<sup>314</sup>

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305. U.C.C. § 4-406(a) (1995).

306. *Id.* Although former Article 4 did not require the return of paid items, the new section explicitly extends the obligation of the consumer to discover errors to statements which omit payee information and do not include return of the checks.

307. In both cases, the safe harbor expires on January 1, 1998, unless extended by future legislation. CAL. COM. CODE § 4406(g) (West Supp. 1996); WASH. REV. CODE ANN. § 62A.4-406(a) (West 1995 & Supp. 1996).

308. N.Y. LAW REVISION COMM’N REPORT, *supra* note 299, at 4, 17-18.

309. U.C.C. § 4-406(b) (1995).

310. W. VA. CODE § 46-4-406(g) (1993).

311. CAL. EVID. CODE § 670 (West 1995), 1992 Cal. Stat. 914.

312. N.Y. LAW REVISION COMM’N REPORT, *supra* note 299, at 19-20.

313. *Id.*

314. *Id.*

### C. Unintended Effects of Requirement for a Postdating Order

Some state legislatures also recognized that Article 4 inadvertently created a new tool to defraud consumers by requesting a postdated check. Section 4-401(c) authorizes banks to honor a postdated check whenever submitted unless a postdating order has been filed.<sup>315</sup> Article 4 does not contain any mandated disclosure of the new legal right of banks to honor checks before their date. This opens the door for fraudulent inducement of a postdated check by persons who induce the check based on the consumer's belief that it is not yet good, then promptly cash it. The interim report of the New York Law Revision Commission recommends conditioning the right to honor the check before its date upon notice to the customer in the account agreement or in a subsequent conspicuous written notice stating that the check may be honored before its date.<sup>316</sup> The California legislature addressed this problem by adding to the bill containing Articles 3 and 4, an amendment to its Unfair Business Practices Act. That amendment prohibits the practice of both inducing and cashing a postdated check before its date unless the recipient of the check provides written notice that a postdated check may be cashed immediately.<sup>317</sup>

Several state legislatures have also addressed the probability that the new requirement for filing a postdating order under Article 4 could create a new fee opportunity for banks. The Washington legislature amended Article 4 to prohibit charging a fee for filing a postdating order.<sup>318</sup> The West Virginia legislature amended Article 4 to require a bank to accept up to nine postdating orders per year without charging a fee for filing the notice and monitoring the account for the check.<sup>319</sup> The New York Law Revision Commission recommended that Article 4 be amended to require no charge for the first twelve postdating orders filed per account per year.<sup>320</sup>

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315. U.C.C. § 4-401(c) (1995).

316. N.Y. LAW REVISION COMM'N REPORT, *supra* note 299, at 8.

317. CAL. BUS. & PROF. CODE § 17538.6 (West Supp. 1996). West Virginia made a similar change to its Unfair and Deceptive Acts and Practices statute using a companion bill. That change made it illegal to solicit or accept a postdated check with the intent of presenting it for early payment or to represent that postdating will prevent the early payment of a check and then either present the check before its date or lack reasonable procedures to prevent premature presentation. W. VA. CODE § 46A-6-110 (1995). Statutory damages, penalties, and fees and costs apply in the event of a violation of this section. *Id.*

318. WASH. REV. CODE ANN. § 62A.4-401 (West 1995).

319. W. VA. CODE § 46-4-401(c) (1993).

320. N.Y. LAW REVISION COMM'N REPORT, *supra* note 299, at 8. Another issue that two states addressed was whether the process of posting sections would authorize abuse. Section 4-402(c) contains new language stating that the payor bank may make its determination of the customer's

#### *D. Standard of Care*

The final area of nonuniform changes in Articles 3 and 4 made by state legislatures relates to the obligation of care owed by a bank to its customers. Section 4-406(e) changes the results in a situation where the lack of care by both the customer and the bank contributed to the loss.<sup>321</sup> Under the former section, a bank was responsible if both it and the customer were negligent.<sup>322</sup> Under the new section, the customer is responsible if it was negligent unless the customer proves that the bank's failure "substantially contributed" to the loss.<sup>323</sup> If "substantial contribution" is proven, then the bank and the customer share the loss.<sup>324</sup> This section places additional liability on a bank customer. Bank negligence must be a substantial contributor to the loss before any liability will attach. The California legislature eliminated the qualifier "substantial" from section 4-406(e) before adoption.<sup>325</sup> The New York Law Revision Commission has recommended modifying section 4-406 to spread

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account balance for a decision to dishonor for insufficient funds at any time between the time the item is received and it is returned. U.C.C. § 4-402(c) (1995). On its face, new section 4-402(c) appears to authorize a bank to debit checks before posting credits received on the same day, thus maximizing bounced checks and bounced check fees. The California and West Virginia Codes include official comments stating that a bank would fail to act in good faith if its failure to credit deposits of funds available for withdrawal as of right prior to debiting items caused the account to be overdrawn. CAL. COM. CODE § 4402 cmt. 4 (West Supp. 1996); W. VA. CODE § 46-4-402 cmt. 4 (1993).

The California comment reads, in relevant part:

In determining whether a check presented for payment will create an overdraft, the prevailing banking practice is to first credit the customer's account for deposits made on the day of presentment. If that credit represents funds available for withdrawal as of right, it is taken into account in determining whether the check presented for payment will or will not create an overdraft. A bank failing to follow that practice would not be acting in good faith if the failure caused the customer's account to be considered overdrawn.

CAL. COM. CODE § 4402 cmt. 4 (West Supp. 1996).

As a practical matter, a bank outside of California or West Virginia should not rely on revised section 4-402 for authority to dishonor debits before posting credits. In a meeting preceding the California comment and nonuniform amendments, representatives of the Conference of Commissioners on Uniform State Laws stated in the presence of the author that section 4-402 had never been intended to authorize a process of posting that would maximize bounced checks. Thus, the California comment may provide insight to courts in other states about the purpose and limits of section 4-402, and about the degree to which the obligation of good faith can influence conduct which appears to be expressly authorized by specific code provisions.

321. U.C.C. § 4-406(e) (1995).

322. U.C.C. § 4-406(3) (amended 1990).

323. U.C.C. § 4-406(e) (1995).

324. *Id.*

325. CAL. COM. CODE § 4406 (West Supp. 1996).

some of the risks of lack of sight review of signatures to the bank.<sup>326</sup> It would treat the absence of sight review as a negligent behavior when applying the comparative negligence standard.<sup>327</sup>

Section 3-103(a)(7) expressly defines ordinary care not to require sight examination of checks so long as the bank complies with its own procedures and those procedures do not vary unreasonably from general banking usage.<sup>328</sup> Previously, there was an argument that sight review would be required, at least in some cases. "Sight review" means visual examination of the check and signature by a human being. Banks and the Conference argued vigorously, and persuasively, that sight review of items before payment is simply too expensive to be worthwhile. However, the full benefit of eliminating sight review accrues to the bank, while the cost of foregoing this review is shared by the bank and the customer. When a customer is the victim of a series of forged or altered checks which the customer does not discover, but which might have been found before payment through sight review, the change in the definition of ordinary care will reallocate these losses entirely to the customer.

The New York Law Revision Commission report recognizes the need for high-speed check clearing and characterizes any requirement for sight review of all checks as unrealistic.<sup>329</sup> At the same time, it concludes that the change

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326. N.Y. LAW REVISION COMM'N REPORT, *supra* note 299.

327. *Id.*

328. U.C.C. § 3-103(a)(7) & cmt. 5 (1995).

329. The report states in relevant part on the issue of ordinary care, sight review, and preclusion:

The proposed definition of "ordinary care" has been criticized as encouraging banks to examine fewer checks because the resultant losses will be borne by the customers. The Commission believes that this criticism overstates the likely effect of the revised definition on bank operations. After all, the losses resulting from most failures to detect forgeries will be continue to be borne by the bank, because it is absolutely liable to its customer unless the customer's actions place it within the sphere of a preclusion rule, and such preclusion cases are unusual, representing only a small fraction of all checks.

The real question is whether the definition of ordinary care results in an equitable allocation of losses for cases in which a customer's conduct initially places him or her within a preclusion rule. The Commission believes that the answer to this question is no.

The inappropriateness of the proposed revision is best seen by comparing the benefits and costs to the bank of examining checks individually in the absence of customer conduct that triggers preclusion with those benefits and costs in a preclusion situation. In the absence of circumstances that result in preclusion of the customer's claim, the rules in Articles 3 and 4 result in the payor bank being absolutely liable for paying a check over the forged signature of its customer. Nonetheless, payor banks examine the drawers' signatures on only a tiny fraction of checks presented to them. The reason is simple - it is less expensive to recredit a customer's account for the occasional forged check than it is to perform a sight examination of all checks presented. Thus, by

in the definition of ordinary care leads to an unfair allocation of loss in the preclusion situation under sections 3-406(b) and 4-406(e).<sup>330</sup> Therefore, the Law Revision Commission recommends that the preclusion of sections 3-406 and 4-406 be modified so that the comparative negligence rule comes into play as against the payor bank if it has failed to examine the item and that failure contributed (under section 4-406(e)) or substantially contributed (under section 3-406(b)) to the loss.<sup>331</sup>

#### *E. Lessons from the State Response to Articles 3 and 4*

The New York Law Revision Commission recommended rejecting one aspect of the loss allocation in UCC Articles 3 and 4 proposed by the ALI and NCCUSL.<sup>332</sup> It also recommended a variety of other nonuniform amendments to Articles 3 and 4 to address problems in those uniform acts for

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choosing to examine only certain checks (typically those over a particular amount), a bank gets the benefit of the cost reductions compared to the cost of examining every check and bears the losses flowing from the failure to detect forgeries that would have been discovered in a sight examination. In other words, in non-preclusion situations the bank bears 100% of the cost of failing to detect forgeries that would have been detected by a sight examination.

Compare this with a preclusion situation. Assume, for example, that (i) a bank has paid a check over a poor forgery of the drawer's signature that would easily have been detected had the bank examined the check, (ii) the bank's decision to not examine the check was consistent with its internal procedures and with general banking practice (and, thus, is consistent with the proposed definition of "ordinary care"), (iii) the customer fits within one of the preclusion rules, and (iv) as between them, the bank's failure to examine the check (which would have detected the obvious forgery) was 80% responsible for the loss and the customer's action that triggered the preclusion was 20% responsible. Under the proposed rule, the customer would be totally precluded from its claim against the bank because the bank would be held to have exercised ordinary care in paying the check. Thus, the existence of the 20% responsibility of the customer would relieve the bank of 100% of the cost it otherwise would have borne.

Therefore, it appears that the application of the proposed definition of ordinary care in the context of these preclusion rules is likely to provide the same sort of windfalls to banks that the "contributory negligence rule" of current Article 3 (abandoned in the revision in favor of a comparative causation system) occasionally provides to customers. The Commission does not believe that such windfalls are appropriate. Accordingly, it recommends amendments to the Official Text of the proposed revisions that are designed to compare the customer's responsibility for the loss with the loss flowing from the bank's failure to exercise ordinary care or to examine the check to detect alteration or forgery of the drawer's signature (even if that failure does not, itself, constitute failure to exercise ordinary care). So amended, the bank would bear a portion of the loss if sight examination would have revealed the forgery or alteration.

N.Y. LAW REVISION COMM'N REPORT, *supra* note 299, at 15-16.

330. *Id.*

331. *Id.*

332. *Id.*

consumers.<sup>333</sup> Other states have also made a variety of nonuniform amendments. Perhaps these nonuniform amendments could have been avoided if serious attention had been paid in the drafting process to the consumer impact of the legal changes in Articles 3 and 4.<sup>334</sup>

The state solutions to the problems posed by Articles 3 and 4 are surprisingly similar. This indicates that the Conference and the ALI could have achieved more uniformity if they had fully examined and addressed these questions when drafting their uniform law.

The fact that state legislators in a number of states were willing to make so many nonuniform changes in the highly technical subject matter of Articles 3 and 4 strongly suggests that the Conference and the ALI cannot expect state legislators to simply accept a recommendation that UCC articles offered for enactment are the work of experts and must be accepted in full. If legislators were willing to ask how these payment system statutes would affect their constituents, they are far more likely to ask those same questions when the Conference presents to them laws governing such ordinary transactions as the purchase of consumer goods, licensing of software, and loans secured by automobiles and other personal property.

The nature of the nonuniform amendments that some states made to Articles 3 and 4 suggests that state legislators will not be satisfied with sweeping statements that the UCC revisions are the product of an intensive and expert process. Instead, legislators can be expected to ask the sponsors of UCC legislation the same questions that the Conference and the ALI ought to examine before adoption of any article of the Uniform Commercial Code. Those questions include:

1. How does this change affect consumers?
2. Are consumers' existing rights or remedies under the statute or

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333. *Id.*

334. For more information on the impact of Articles 3 and 4, see Mark E. Budnitz, *Consumer Issues in the Revised Articles 3 and 4 of the UCC*, 47 CONSUMER FIN. L. Q. REP. 119 (1993); Mark E. Budnitz, *The Consequences of Bulk in Our Banking Diet: Bulk Filing of Checks and the Bank's Duty of Ordinary Care Under the 1990 Revision to the Uniform Commercial Code When It Honors Forged Checks*, 63 TEMPLE L. REV. 729 (1990); Gail Hillebrand, *Revised Articles 3 and 4 of the Uniform Commercial Code: A Consumer Perspective*, 42 ALA. L. REV. 679 (1991); and Edward L. Rubin, *Efficiency, Equity and the Proposed Revision of Articles 3 and 4*, 42 ALA. L. REV. 551 (1991).

For a discussion of how the California legislature decided to require nonuniform amendments to Articles 3 and 4 in the absence of any consumer-group opposition to the revisions, see Gail Hillebrand, *UCC Articles 3 and 4 in the California Legislature: A New Focus on Consumer Protection in Uniform Law Proposals*, 47 CONSUMER FIN. L. Q. REP. 123 (1993).

other law being weakened or discarded?

3. Do the changes in law which are made to promote efficiency have side effects which change the balance of rights and obligations or the allocation of risks between consumers and commercial entities?

4. Does the statute provide adequate remedies which consumers will actually be able to use?

The ability of the Conference and the ALI to analyze and respond to these questions goes to the heart of their credibility as uniform law bodies.

#### V. PROPOSED STRUCTURAL CHANGES TO THE UNIFORM LAW DRAFTING PROCESS

The serious structural barriers to full participation by affected groups in the UCC drafting process make it particularly critical that the Conference and the American Law Institute critically examine proposed drafts for fairness to all affected groups, with particular care taken to consider the impact on industries and groups *other than* those most directly affected by the revision.

To date, the full Conference has asked these difficult questions about the draft of Article 2B, but not about the draft of Article 9. The Conference also has completed a year-long Consumer Issues Subcommittee process for Articles 2 and 9. However, the key question asked of those subcommittees seemed to be whether anything should be done about consumer issues at all in the Code. Apparently the Conference leadership did not ask those subcommittees to analyze the myriad changes to the Code being proposed by the drafting committees, or to provide analysis and recommendations about whether those changes would be fair to consumers in their transactions under the Code. To its credit, the Article 9 Consumer Issues Subcommittee did undertake this type of analysis, at least with respect to those issues raised before it by consumer advocates, if not with respect to all of the many other changes in the Article 9 draft. The members of the Conference raised the question of fairness to consumers explicitly in connection with Article 2B at their summer 1996 meeting. The effect of the widespread expressions of concern by the members of the Conference will not be known until the Article 2B drafting committee completes its revised draft. However, less than four months before that draft is scheduled for a final reading, the draft still has not achieved a reasonable balance between the interests of licensors and licensees.

The American Law Institute has taken a careful look at the Article 9 draft

with respect to how it will affect unsecured creditors in bankruptcy and the bankruptcy process. It has not yet made the same examination with respect to the impact on small business debtors or consumer debtors.<sup>335</sup> Without careful examination and analysis of the impact of proposed legal changes and new laws on both consumers and other under-represented groups by both the Conference and the ALI, it is unlikely that the final products will meet the high standards for objectivity which the product of a law reform process should satisfy.

What is to be done? Should the uniform law process be abandoned in favor of individual state legislative efforts or federal law?<sup>336</sup> Several improvements to the uniform law process should be attempted before abolition is recommended. One such improvement is the funding by the Conference and the ALI for both time and travel for consumer representatives to attend drafting committee and Conference meetings and to provide the Conference and the ALI with practical information and analyses about how proposed changes in the law would affect consumers.<sup>337</sup> However, travel

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335. Individual voices within the ALI, however, have started to ask important questions. *See, e.g.*, Letter from Professor William J. Woodward, Jr. to Professor Marion Benfield, Chair of the Article 9 Consumer Issues Subcommittee (Mar. 6, 1996) (on file with author). Professor Woodward points out that Article 9's authorization of security interests in after-acquired property of individuals other than consumer goods may interact with its broadened definition of intangibles to permit conferral of an interest in the revenue stream from a patent or copyright for a future invention or future work. *Id.* at 2. He suggests that permitting an after-acquired interest in this type of property of individuals is inconsistent with the public policies that prevent or restrict assignment of future wages. *Id.* at 2-3.

336. In writing about the weaknesses in the uniform law process of drafting Articles 3 and 4, Professor Rubin has suggested that federal law is the proper approach, at least for law related to the payment system. Rubin, *supra* note 77, at 773-81.

Consumer advocates generally argue that federal law has a place in the regulation of national commerce, but that such federal law should accommodate more protective state laws, in order to permit states to serve as laboratories for experimentation and to maximize their ability to preserve important state policies for the protection of state citizens. Federal consumer protection statutes generally take this approach, permitting more protective state laws so long as they are "not inconsistent" (i.e., it is possible to comply with both the state and the federal statute). Truth in Lending Act, 15 U.S.C. § 1610 (1994); Fair Debt Collection Practices Act, 15 U.S.C. § 1692n (1994).

337. This proposal would not provide funds for the work of this author. Consumers Union does not accept funds which are raised from business or corporate sources, even if they are administered or awarded by a nonprofit entity. However, other organizations which ably represent consumers, including resource-strapped legal services programs and public consumer assistance offices, might be able to accept such funds. In this time of extremely tight budgets, it is highly unrealistic to expect legal services programs to be able to volunteer the time of their attorneys to a process as long and as technical as UCC revision. *See, e.g.*, Barringer, *supra* note 47 (discussing the inability of many legal services programs to accept cases posing legal issues ranging from landlord-tenant law to car repossessions). To its credit, the American Law Institute has provided travel funding to an attorney representing the National Consumer Law Center on Articles 2 and 9. It also has provided travel

funding is no panacea. Adding one or two consumer representatives to a roomful of licensor, seller, or creditor representatives has only so much impact. Moreover, the absence of stable funding for many organizations which represent consumers creates the probability of turnover which is detrimental to effectiveness in this type of a long and collegial process. This can be partially addressed by inducing law professors who teach in the consumer area or who have prior practice experience representing consumers to participate in the process. However, academics may not feel comfortable with the kind of visibility or persistence that is needed to be effective when one is consistently outnumbered ten-to-one by industry representatives holding a contrary point of view.

Another change that could be considered would be to limit the number of industry representatives to whom speaking privileges are conferred at drafting committee meetings. Federal regulatory agencies sometimes use a process called regulatory negotiation, or "reg-neg," in which each affected group is given a specific number of seats at the table for discussion of the scope, parameters and language of a regulation. This process can suffer from an imbalance of time, money and expertise, but it can reduce the skewing effect on an imbalance in the sheer number of participants per group in the process.

The American Law Institute could select its drafting committee representatives by appointing people whose expertise, practice background, and points of view are not yet represented by the members selected by NCCUSL. The ALI has a somewhat broader membership than the NCCUSL, has many more members upon which to draw, and has the flexibility in member selection to diversify its membership somewhat more quickly than does the NCCUSL. The American Bar Association also could use its advisor slots to bring added diversity of viewpoints and practice backgrounds to the drafting committees.

In selecting its members for a drafting committee, the Conference and the ALI should attempt to select members with diverse practice backgrounds to the maximum possible extent. Both the Conference and the ALI should also institutionalize attention to the impact of proposed legal changes on consumers and on other under-represented parties. To do this, each group could commission reports, at least annually, to analyze how the changes in each pending draft to date will affect such consumers and other under-

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funding to a public interest lawyer to speak on behalf of consumers in the drafting process for Article 2B.

represented groups, and to propose changes that would ameliorate any ill effects identified. Even more importantly, each organization should create an internal function, analogous to a public adviser, to participate in the work of the drafting committees and advise the drafting committees, the leadership, and the membership of each institution about the probable impacts of the drafts on consumers and other under-represented groups.

Another step that should be considered is the use of a public adviser. The public adviser concept was developed in the public utility field to help counterbalance the power of regulated industries in utility retaking. The public adviser helps the public to navigate the procedure of the Public Utilities Commission. It assists members of the public in learning how to present information to the decisionmaking body. In California, the public adviser is required by statute to publish an annual guide that describes the scheduled proceedings and decisions to be made in the coming year, including names and phone numbers of persons with responsibility for specific matters.<sup>338</sup> An analogous report for the uniform law process would identify key issues being considered for change, in plain and understandable language, and could be widely distributed to legal services groups, consumer groups such as the members of the Consumer Federation of America, and consumer professionals, including the members of the American Council on Consumer Interests and the National Association of Consumer Agency Administrators.

For Article 9, for example, the questions posed for comment would include the basic question that is driving the Article 9 revision: "Should secured creditors prevail over unsecured creditors and borrowers to a greater extent than they now do?" It would also include important subsidiary questions such as "Should the Code be changed to favor refinancing of finance company loans to a greater extent than current law?" and "Should creditors be able to deprive consumers of statutory damages available under current law if the creditor can show that its violation of law resulted from a bona fide error?" These questions will be decided by the draft of Article 9, but they are not obvious on the face of the draft to nonlawyer consumer professionals, volunteers running U.S. consumer groups, or consumer attorneys who do not specialize in Article 9. On the face of the Article 9 draft, for example, the question about whether refinancing should be more favored is presented in the context of an obscure change to the definition of a PMSI.

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338. CAL. PUB. UTIL. CODE §§ 321, 321.5 (West Supp. 1996).

A simple annual report describing how under-represented groups will be affected by changes contemplated by the drafting committees might also motivate increased participation by a variety of other under-represented groups. For example, a group representing the interests of small businesses is unlikely to respond to a 200 page Article 9 draft in the mail. However, that same group might express strong feelings in response to a simple, plain language query about the basic policy question in the Article 9 revision: "Should secured creditors prevail over unsecured creditors and borrowers to a greater extent than they now do?" A group representing small businesses might also express strong views about the accuracy or inaccuracy of the drafting committee's assumption underlying the Article 9 revision that making it easier for secured creditors to tie up every personal property asset of a small business and its owner will improve the amount or terms of credit offered to small businesses.

Another approach which could be considered is the use of a "consumer ombudsman," a person or group of persons within the Conference charged with evaluating the effect of proposed Code changes on consumers at the earliest possible time and seeking changes to ameliorate harm that proposed changes would otherwise impose on consumers.

These proposals have serious limits. A public adviser can make it easier to comment on drafts, but in this author's experience written comments have limited effect if the commenter is not present at the drafting committee meetings to orally present and pursue the point. In addition, a consumer ombudsman is unlikely to be effective in the collegial, informal world of the NCCUSL or the ALI if the ombudsman functions only at the staff level. Instead, a committee of full members of each body would have to undertake the job of contributing this viewpoint on an ongoing basis. The Conference leadership would have to convince potential committee members of their commitment to the consumer inapt oversight function before members could be expected to contribute the large amount of time necessary to perform that work effectively.<sup>339</sup> One or more members of an "under-represented interests" committee would have to be appointed as full members of each drafting committee. Those members would have to commit to learn about the area and to serve as a "watchdog" on a set of issues which may be unfamiliar. In addition, the Conference leadership would have to make the reports of the

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339. The efforts of the leadership of the ABA Business Law Section to diversify the voices heard in the Business Law Section provided the inspiration for this idea.

“watchdog” committee available to its members along with the drafts, to promote thoughtful discussion about the impact of the changes on consumers and other under-represented groups being proposed.

American Law Institute member Harry Sigman has suggested that drafts should remain in circulation longer as a means to promote public discussion and debate before enactment.<sup>340</sup> This could be helpful, if there is a process for thoughtful reconsideration of the draft in the light of issues identified in that comment period. Such a step cannot substitute, however, for more fundamental improvements in the drafting process. If the NCCUSL and the ALI cannot afford to both solicit and independently develop information about how proposed changes in law will affect consumers, then they should not be promulgating changes to the Uniform Commercial Code which affect consumers.

## VI. CONCLUSION

State legislatures are unlikely to enact revised UCC articles if they overwhelmingly favor secured creditors or licensors. A perception that the uniform law drafts do not include workable rules for consumer commerce may also hurt the reputations of the Conference and the ALI as objective crafters of uniform law. Five states made nonuniform amendments to Articles 3 and 4 on consumer issues. The New York Law Revision Commission has recommended additional nonuniform amendments to Articles 3 and 4. The willingness of state legislators to make nonuniform changes in the highly technical Articles 3 and 4 suggests that state legislators will carefully scrutinize the drafts of Articles 2, 2B, and 9 for adverse impacts on consumers when those drafts are presented for enactment.

In recent years some academics have severely criticized the uniform law drafting process by suggesting that it is or can become a captive of affected industries. As of the summer of 1996, the Article 2 drafting process had not shown that weakness. The Article 2B drafting process, although dealing with similar issues, had dramatically illustrated the possibility of a drafting committee approving a seriously unbalanced draft.

The Article 2 drafting committee has examined Article 2 in the light of contracting practices, especially the widespread use of standard form

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340. Harry C. Sigman, *Improving the UCC Revision Process: Two Specific Proposals*, 28 *LOY. L.A. L. REV.* 325, 325-32 (1994).

contracts and the role of remote sellers, in creating expectations about the goods being sold. The drafting process has recognized the vast changes in commerce which have occurred since Article 2 was first written.<sup>341</sup> The product of the Article 2B drafting committee gives less reason for optimism about the ability of the uniform law drafting process to create balanced proposed legislation. That draft, which was presented to the Conference in the summer of 1996 and heavily criticized by members of the Conference at that time, favored the interests of software and information providers. Although it has been somewhat improved since then, it still authorizes all unexpected and unreasonable standard form contract terms if there was a manifestation of assent or if the consumer would not have refused the whole contract. It still would create a statutory right for a licensor to reach into the computer of a private consumer or a small business and seize the licensor's software out of it without warning or legal process. It still would preempt some aspects of state consumer protection statutes. The scope of the further changes to the Article 2B draft before it is presented for adoption will show whether or not the uniform law drafting process can produce sound public policy in the face of high industry interest.

Whether the Article 9 drafting process will produce a draft which is fair for consumers remains unknown. There are causes for very serious concern. The draft consistently codifies pro-creditor rules previously left to case law. It creates a new defense interfering with statutory damages recoverable under existing Article 9, and it fails to fully address the full problem of low values in the sale of collateral. The Article 9 draft also unquestionably tilts the playing field between a small commercial borrower and its creditors, giving

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341. The author has participated as an observer for Consumers Union to the Article 2 drafting process since 1992. In some ways, the Article 2 process is an example of how a uniform law process should work. The Article 2 drafting committee has listened to both the consumer representatives and to the many industry representatives who have participated in its meetings. The drafting committee has rejected many changes in the text of Article 2 proposed both by consumer advocates and by affected industries. At the same time, it has developed a theoretically sound new section to address a key legal and practical issue that arises in consumer commerce—the use of standard form contracts and terms.

Three serious qualifications must accompany this praise of the Article 2 drafting process. First, the absence of travel funds and of staff has severely restrained the participation of consumer representatives and organizations at many consumer organizations for such a sustained process. Second, representatives of small businesses as buyers have not participated to a large extent, perhaps for the same reasons. Third, as discussed in Part I on structural barriers, it is natural for decisionmakers to assume that the experiences of others are fundamentally similar to their own. Such an assumption can unintentionally but severely bias a process against persons who have lower levels of sophistication or bargaining power than is common among upper and upper-middle income attorneys and law professors.

the creditor new forms of Article 9 collateral, making it easier to take an Article 9 security interest in all the assets of a small business, and eliminating some of the remedies now available to the business debtor if its creditor fails to fulfill its obligations under Article 9. On the other hand, the Article 9 draft contains a few changes which will be valuable to consumers, including a stronger standard for evaluating dispositions involving a potential conflict of interest (voted for but not yet in the draft), reciprocal attorneys' fees for consumers, and a limited right of reinstatement. An important notice of how deficiencies are calculated has also been approved. The final shape of these three drafts will tell whether the uniform law drafting process is a viable model for law creation.

**APPENDIX A**  
**OPEN ISSUES AFFECTING CONSUMERS IN THE OCTOBER 1996 ARTICLE 9 DRAFT**  
 (Part 6 issues are listed first)

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-601(b)	9-501	Cumulative exercise of creditor's remedies	Permits creditor's remedies to be exercised cumulatively, as under current law, but also adds that the remedies may be pursued simultaneously.	The broad authorization for simultaneous pursuit of remedy should be limited to "when that pursuit is not for the purpose or effect of harassment."
9-603	9-501(3)	Standards for fulfillment of obligation	Permits parties to define standards for fulfillment of non-waivable obligations by contract.	Should parties imposing preprinted security agreements be able to define their obligations so long as their definitions are "not manifestly unreasonable," or should such definitions have to meet a reasonableness test? What is the real protection of the commercial reasonableness standard if parties can define as per se commercially reasonable any conduct, so long as that definition is not manifestly unreasonable? Recommend deleting bracketed language so that the standard is tied to reasonableness.
9-604	9-501(4)	Real and personal property	Eliminates one form of action rule which some states have under other law, permitting creditor to pursue personal property before real estate collateral.	Changes the law in some states. Could leave fewer assets available to pay off real estate collateralized debt if creditor can seek to liquidate the real property first. Recommend that Article 9 and its comments not attempt to displace one form of action rules in state real estate or other non-Code laws.

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-607(a)	9-502	Collections by secured party	Bracketed material would add a statutory right in the account creditor to exercise the rights and remedies of the debtor (i.e., foreclose, repossess, etc.) with respect to the account debtor and the collateral which secures the account.	Would a secured party be more likely than the original account creditor to foreclose or repossess? If this is commonly provided for now by contract, why should the statute provide for it in the absence of a contract term?
9-608	9-502	Application of proceeds	Repeats language from current law that, unless otherwise agreed, debtor is liable for any deficiency.	Because some states prohibit deficiencies for some types of consumer transactions under other law, the general statement of entitlement to a deficiency in this section should be amended to refer to "unless otherwise agreed or prohibited by other law."
9-610	9-504	Disposition of collateral	Adds a new sentence that "If commercially reasonable, a secured party may dispose of collateral at any time and place and on any terms."	The new sentence might encourage courts to focus more on sale procedure rather than an unduly low price. This would be harmful to consumers whose collateral is sold for a low price. This new sentence appears unnecessary and should be deleted.
9-610(b)	9-504	All terms must be commercially reasonable	Repeats current law requirement that all terms of a disposition sale be commercially reasonable. Drafting committee voted in November 1996 to treat price as a term which must also be commercially reasonable.	With price as a term of the sale, an unreasonably low price should render a sale commercially unreasonable unless it is explained by the creditor. Discussion is still ongoing about limiting the violation to instances where the low price is used to calculate a deficiency by an affiliated party. Violation of the standard for the reasonableness of disposition price must be tied to a meaningful remedy, any rule or affiliated party sales should not disturb existing case law treating price as a term.

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-612	9-504	New safe harbor as to time of notice	Adds a bracketed twenty-one day safe harbor as to the time of notice in consumer secured transactions.	If any safe harbor is used, twenty-one days is the right number. It is still bracketed in the draft for discussion. However, the Consumer Issues Subcommittee recommended that there be no safe harbor as to the time of notice in consumer secured transactions. The notice of sale is a safeguard on the wholly private disposition contemplated by Article 9. The use of a short commercial safe harbor creates pressure for a safe harbor in consumer secured transactions as well. Both safe harbors as to time should be eliminated.
9-616	9-504(5)	Sale to a recourse or similar party	This section appears designed to carry forward the restriction on these sales serving as a disposition sale now found in section 9-504(5).	This section may preserve useful current law only if the bracketed language in section 9-616(a)(2) is omitted. That language should be stricken.
9-617	9-504(5)	Title clearing transfers	Creates a new provision for title clearing transfers which are not disposition sales by the secured party.	Does not require that the secured party dispose of the collateral within any specified time period after the title clearing sale. Once the creditor has transferred the collateral out of the consumer's name, it should have to act promptly to dispose of the collateral and credit the proceeds of the disposition to the debt. If this section is retained, it should be amended to permit the title clearing transfer only within thirty days before disposition.
9-618	9-505	Full and partial strict foreclosure	1) Adds partial strict foreclosure for commercial transactions and, by reason of	1) The exclusion of consumer secured transactions from the expansion to partial strict foreclosure is helpful. Consideration should be given to whether

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
			<p>the way the definitions are structured, for investment property if the secured party is a securities intermediary.</p> <p>2) Expands ability to strictly foreclose on collateral without possession in non-consumer transactions, and in those consumer transactions where the collateral is of the type which cannot be perfected by possession.</p>	<p>investment property should be excluded from any strict foreclosure. Strict foreclosure, in theory, could permit a secured party to retain investment property with a face amount of more than the debt, if the person receiving an offer of full strict foreclosure does not act upon it.</p> <p>2) Whether there will be effects on consumers of this change is not clear. Perhaps the possession requirement of current law should be retained for strict foreclosure, at least in consumer secured transactions.</p> <p>3) A drafting problem interferes with the sixty percent rule for consumer secured transactions. The sixty percent rule requires disposition rather than strict foreclosure unless the consumer has accepted the proposal. Section 9-618(f). However, silence is defined as an acceptance in section 9-618(d)(2). This is a drafting problem which should be resolved so that the sixty percent rule is not eliminated by failure to respond to a proposal for strict foreclosure.</p>
9-618 comments		Eliminates the equitable doctrine of constructive strict foreclosure	The comments to the 1996 annual meeting draft state the intent of the draft to eliminate constructive strict foreclosure.	Constructive strict foreclosure is a useful equitable doctrine which courts may use to respond to long delays in disposition by creditors. It should remain available. The comment purporting to eliminate it should be removed.

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-622	none	Reinstatement	Provides a one-time right of reinstatement for payment defaults if sixty percent of the principal or cash price has been paid.	This is a limited but useful addition. In a loan with a four-year term, sixty percent will not be paid down and the right to reinstate will not arise until approximately the last year of the loan. Bracketed language not yet considered would make this right not waivable or subject to variation by agreement. Without this protection, the statutory right will be routinely waived. This right should be made non-waivable.
9-623	9-504, 9-505, 9-506	Waiver of reinstatement, redemption, or notice of sale	This section addresses waivers by consumers. It appropriately limits consumer waivers to post-default waivers. It contains bracketed language which would follow the approach used in Article 2 in the disclaimer of warranty, to permit the waiver only if the secured party established by clear and affirmative evidence that the consumer expressly agreed to its terms.	<p>1) The expressly agreed standard should be retained and the brackets removed in § 9-623(c).</p> <p>2) The bracketed language contains a good standard for post-default waivers, whether or not the consumer expressly agreed to them. This is essential to avoid the situation where, when the consumer tries to surrender the goods, he or she is presented with a sheaf of papers and told that they must be signed to accomplish the surrender. The Article 9 Consumer Issues Subcommittee has decided to take no position on the issue of waiver, in part because the same issue arises in Article 2 and is still under discussion there. Reinstatement and notice of sale should be non-waivable. If they are to be waivable, it should be only by an express agreement after default. To achieve this, the language in brackets should be included in the draft, minus the clear and affirmative evidence portion.</p>

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-624(b)	none	Offset of any amount barred against actual damages	Section bars any recovery for actual damages, if a deficiency has been reduced or barred. The bar applies regardless of whether the actual damage exceeds the amount by which the deficiency was reduced.	The reduction of the deficiency should serve as an offset, rather than as a complete bar, of actual damages. This could be done by adding at the end of section 9-624(b), "unless those damages exceed the amount eliminated or reduced."
9-624(c)	9-507	Statutory damages	The term "credit service charge" in current section 9-507 is replaced with "the interest or finance charge."	The comments should indicate that the change in terminology is not intended to change the result.
9-102 (27)		Definition of value	Value will now be defined to include unqualified commitments, even if advances have not yet been made.	This may mean that in some circumstances, a secured party will prevail over others because it will have given new value within the meaning of this section even if it has not advanced new funds.
9-627(d)	none	New defense to statutory damages	Adds a new good faith error defense to statutory damages available to consumers who prove a violation of part 5 (now part 6) under current section 9-507. The Consumer Issues Subcommittee recommended a substantially narrower rule, but that recommendation is not slated to be discussed by the drafting	The new defense is likely to reduce deterrence of Code violations and to interfere with the compensatory aspect of statutory damages. The consumer who suffers a Code violation suffers the same harm whether or not the violation was made in good faith. As it appears in the draft, defense also undermines the obligation of commercial reasonableness, by permitting a secured party who does not act in a commercially reasonable manner to claim a bona fide error.

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-102(a)(8)		Defines consumer transaction	<p>committee until March 1997.</p> <p>Uses well established "primarily for personal, family, or household purposes" test, but defines consumer secured transaction as requiring both that the primary purpose of the loan is for personal, family or household purposes, and that the collateral is consumer purpose property.</p> <p>This definition means that business borrowers who put up consumer goods as collateral will not receive the benefit of any of the new consumer protection provisions, and will</p>	<p>The Consumer Issues Subcommittee's October 1996 report, which is subject to change, recommends that this new defense be limited to certain numbers in notices which do not relate to the time, place or manner of sale. The new defense be eliminated from the draft, or, if not eliminated, showed narrowed to non-serious errors in the numbers for the amounts to redeem or reinstate in the notice of sale, and to non-serious errors in the numbers in the new/proposed notice of calculation of deficiency.</p> <p>1) The categories of exclusion by type or value of collateral should be eliminated. "Personal, family or household purpose" of the loan is a well-established standard.</p> <p>2) Should all consumer transaction safeguards, including those on waiver, no partial strict foreclosure, and others, be inapplicable to security entitlement collateral (including some mutual fund accounts) pledged by consumers to their brokers? If not, the definition needs modification.</p> <p>The Consumer Issues Subcommittee's October 7, 1996 report recommends that there be no dollar cap on the amount of a transaction which can be a consumer secured transaction. The drafting committee approved that approach. It avoids problems with a dollar cap</p>

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-104(e)	9-107 silent on this point	Allocation formula in consumer secured transactions	<p>be deprived of statutory damages that are now awardable to them in connection with a noncomplying disposition. An example of this excluded borrower is a small business who pledges both business assets and personal consumer goods as collateral for a business loan.</p> <p>The definition also excludes any transaction to the extent that the collateral is a security entitlement under Article 8 and is in the control of the secured party.</p>	<p>which could become outdated, or could be too low to reach important consumer secured transactions. Large and important consumer loans such as mobile home financing are personal property secured loans in many states.</p>
			<p>1) The draft proposes an allocation formula which allocates payments to unsecured debt before to earlier-incurred PMSIs. The Consumer Issues Subcommittee discussed this issue at its October 31, 1996 meeting and seemed inclined</p>	<p>1) Allocation first to unsecured debt could create a loophole to defeat the purposes of the FTC Credit Practices Rule, because if refinance payments are credited first to an unsecured portion of a refinanced debt, then the household goods in which the PMSI has been refinanced will remain "on the hook" as collateral for a longer time. Payments should be allocated to PMSI portion of debt before unsecured or any other debt.</p>

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-104(f)	9-107 silent on this point	Purchase money security interest definition	<p>against the idea that payments be credited first to the unsecured debt.</p> <p>2) Restriction on waiver or variation by agreement in the allocation formula is bracketed in the draft for future discussion.</p> <p>Defines a PMSI to continue to the extent of the PMSI collateral in a refinance, and to exist to the extent of the PMSI collateral in a mixed collateral transaction.</p>	<p>2) Allocation formula will be illusory unless not variable by agreement or waivable. Recommend that bracketed language permitting variation by agreement in § 9-104(e) be deleted.</p> <p>Broadens the definition of PMSI in many jurisdictions. May remove a deterrent to overcollateralization and the taking of unneeded "bonus" collateral. May harm consumers in bankruptcy. Unless a strong, mandatory, and non-variable allocation formula is included, may give creditors more collection leverage by permitting them to retain an interest in household goods for a longer time than is permissible under current law. Recommend deleting the new and expanded definition of PMSI and reverting to current section 9-107, which does not attempt to codify rules on refinancing or mixed collateral.</p>
9-111(a)	9-110	Sufficiency of description	<p>The comments to this section in the 1995 annual meeting draft version stated that "all assets" descriptions are adequate. In November 1996, the drafting committee voted</p>	<p>Recommend endorsing the portion of the change, which has not yet been added to the draft, to disallow "all assets" descriptions in security agreements.</p>

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
			not permit an all assets definition in a security agreement, but to permit them in financing statements.	
9-113(7)(A)	none	Health care receivables	Scope expanded to cover a transfer of receivables by a healthcare provider.	Impact, if any, is unknown.
9-203(a)(1)	none	Security interests in investment property	Appears to authorize a security interest to be created by control plus possession, in the absence of a security agreement.	Does this mean that a securities intermediary, which has control and possession, will have a security interest in investment property it holds without any security agreement with its customer creating that interest? Recommend that a security agreement should be required to create all security interests.
9-204	9-204	After-acquired property	Retains the current prohibition on security interests in after-acquired consumer goods.	The policy reasons behind a prohibition on taking after-acquired consumer goods seem to apply equally to after-acquired intangible property owned by consumers. A consumer is unlikely to obtain better credit terms based on the security of something he or she may or may not own in the future. Recommend that this section be modernized to include after-acquired intangible property as well as consumer goods in consumer secured transactions.
9-209	9-208	Request for an accounting	Retains current law for a request for a statement of account, adds request for an accounting. The drafting	This section is an improvement over current law, but it does not substitute for the post-disposition notice of calculation of deficiency which is sought when a deficiency is to be collected.

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-304(a)(1)	new	Choice of law for perfection in deposit accounts	Permits the deposit agreement to select its jurisdiction for purposes of this part. Seems to contemplate that the depository could choose any jurisdiction as its jurisdiction "for purposes of this . . . article." This issue will affect consumers only if some states make non-uniform changes to permit deposit accounts in consumer secured transactions.	<p>The requirement that the request be in a writing or record will slow down the process of getting information. A consumer who is seeking a statement of account because of a dispute or question about the account will experience an unnecessary delay in getting the needed information because of the writing or record requirement. An oral request for a statement of account should be sufficient.</p> <p>1) Does this create a risk of a "race to the bottom," as jurisdictions vie for a version of Article 9 most favorable to banks?</p> <p>2) Does this risk thwarting the policy of local law which adopts the exclusion of deposit accounts in consumer secured transactions from Article 9, if a choice of law provision in the deposit agreement chooses the law of a state with a non-uniform amendment on this issue? This problem could be avoided by excluding the scope section of Article 9 from matters covered by this choice of law section.</p> <p>Similar issues to those in section 9-304 above.</p>
9-305(a)(4)(A)	new	Choice of law for perfection of security interests investment property	Permits the securities intermediary to select jurisdiction for purposes of this part. Seems to contemplate that the intermediary could choose any jurisdiction as its jurisdiction "for purposes of	

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-310 (a)(2)	new	Perfection of interests in deposit accounts	this . . . article.” Permits perfection of security interests in deposit accounts only by control.	The control restriction is useful. The same “control only” rule should be applied to security interests in investment property.
9-312(c)	new	Investment accounts	Permits perfection of security interests in investment accounts both by control and by other means.	See comment directly above.
9-313(a)(4) and 9-313 (a)(5)	one is new, other is based on 9-306	Proceeds	Treats tort claims, warranty claims, and insurance as proceeds “to the extent of the value of the collateral.”	<p>1) Regarding insurance, this is improved over current section 9-306 in that insurance for damage to the collateral is proceeds only “to the extent of the value of the collateral.” In section 9-313(a)(4), however, this formula may pick up otherwise excluded tort claims. If the collateral is worth \$5,000, but the damage to it is \$2,000, this language would treat as proceeds the full amount of a \$5,000 claim consisting of a claim for the \$2,000 in property damage and for \$3,000 in personal injury. This could be resolved by changing “the extent of the value of the collateral” to “to the extent of the value of the harm to the collateral.”</p> <p>2) Treating tort claims as proceeds could complicate the settlement of those claims or interfere with the policies of tort law.</p>

10/96 Draft Section	Current Article 9 Section	Topic	Change	Comments/Recommendations
9-316(a)	9-307	Buyers in the ordinary course of business	Current section 9-307 protects buyers in the ordinary course of business from security interests. In the new section, this protection does not apply if the goods are in the possession of the secured party under section 9-311. Possession under section 9-311 includes acknowledged holding by a bailee.	Will some consumer buyers in the ordinary course of business who now would take free of a security interest become subject to the security interest if the goods are delivered through a bailee? This section may require further work to avoid this result.
Passim	none	Electronic records	When will a record be an adequate substitute for a writing?	The drafting committee voted in November 1996 to broadly permit an authenticated record in places where Article 9 now requires a signed writing. Places where this change was made include the request for an accounting. More thought needs to be given to this issue to ensure that a consumer who has conducted the transaction on paper receives paper notices.

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APPENDIX B  
PROVISIONS SOUGHT IN ARTICLE 9 REDRAFT TO  
CREATE FAIRNESS AND BALANCE FOR CONSUMERS

Topic	Provision Sought
<b>Absolute Bar Rule</b>	Keep but eliminate nonpersonal liability, permit statutory damages in some cases, and apply to all consumer transactions.
<b>Anti-Deficiency Rule</b>	See calculation of deficiencies.
<b>Attorneys' Fees</b>	Add for prevailing consumers only, not prevailing parties.  Restrict fees awardable under contractual attorneys' fees clauses to fifteen percent of amount at issue.  No attorney's fees for creditors' in-house counsel. Creditor's attorney's fees must be reasonable, necessary, and out-of-pocket.
<b>Collection of Account by Secured Parties</b>	Consumer should be protected if he pays original creditor or any other party with rights to collect; party with security interest in only part of a payment should not be able to seek partial payment from consumer. Consumer should be protected from multiple demands for payment of the same accounts.
<b>Calculation of Deficiencies/Commercial Reasonableness Standard</b>	Anti-deficiency rule for claims below \$10,000; not enough is at stake for individual consumers to afford to litigate commercial reasonableness (any number below \$10,000 will be out of date long before the Article is ready for another revision). Require credit of fair value of goods regardless of sale price if sale is to secured party, original creditor, recourse dealer, arranger, assignor of original loan, or party related to one of these by contract or affiliation.
<b>Constructive Strict Foreclosure</b>	If no disposition within ninety days, constructive strict foreclosure takes place and therefore no deficiency can be sought or collected.
<b>Consumer Transaction Definition</b>	Uniform definition, not menu. Ceiling of \$100,000 or no ceiling. Must include mobile homes even if not otherwise covered by any ceiling selected.

Topic	Provision Sought
<b>Deposit Accounts</b>	Exclude consumer transaction (checking) accounts, exclude or limit for some other consumer accounts. Basic restrictions: no taking when there is other tangible collateral, no interest in after-acquired account, no blanket "all accounts" grant, not available where set-off would not be available against the same funds, and either the account must be created at the time that the security interest is created, or the consumer must notify the depository institution that he or she desires to create a security interest in the existing account.
<b>Fair Value Rule</b>	See calculation of deficiencies.
<b>Full Strict Foreclosure</b>	Keep the sixty percent rule, which allows a consumer to choose to force the sale, Eliminate implication in the draft that there must be consent to full strict foreclosure.
<b>Good Faith</b>	Move to objective standard per Study Group suggestion.
<b>Menu Approach</b>	Opposed, support a uniform definition for consumer transactions.
<b>Notice of Sale</b>	Improve notice of sale, include way to learn amount, notice of possibility of deficiency.
<b>Notice of Calculation of Deficiency Amount</b>	<p>First claim for deficiency should contain information from which consumer can determine how the deficiency was calculated, including:</p> <ul style="list-style-type: none"> <li>• amount of deficiency claimed</li> <li>• amount of original debt</li> <li>• payments credited</li> <li>• pre-default charges added and basis for those charges</li> <li>• post-default charges added and basis for those charges</li> <li>• rebates credited</li> <li>• amount credited on disposition of collateral and date of disposition.</li> </ul>
<b>Nuisance Collateral</b>	Prohibit taking of collateral without significant economic value (i.e., the family dog, the child's bike).
<b>Partial Strict Foreclosure</b>	Opposed for consumer transactions, not demonstrated benefit, possibility of abuse.
<b>PMSI Definition</b>	Preserve current law, reject broader definition now in the draft.

Topic	Provision Sought
Private Sale	<p>Not an auction (no "dealer only" auctions).                      Advertising same as for public sale, <i>intra</i>.                      Financing terms offered comparable to those available for original sale or for similar product at circumstances otherwise the same as the original sale.                      See transfers prohibited above.</p>
Public (Auction) Sale	<p>Required advertising comparable to that of a seller in the business of selling goods (e.g., not legal notices only).                      Must be enough buyers or continue sale.                      Continuation if no reasonable minimum bid.                      "Brother-in-law" bid practices not permitted.                      Terms of sale more flexible than "cash."                      These provisions need not be applied if secured party credits to the debt the fair value of the collateral.</p>
Redemption	<p>Consumer should get notice of right to redeem along with notice of sale, and should have right to redeem.</p>
Right to Reinstate (Before Repossession)	<p>Add a right to reinstate.</p>
Right to Cure (After Repossession)	<p>Add a right to cure.</p>
Safe Harbor: Time of Notice	<p>Add exception where circumstances render unreasonable.</p>
Secured Parties' Ability to Enforce Obligations of Account Debtors	<p>Clarify that Code authorization for secured party to collect accounts provided as security is no broader than the ability of the original creditor to collect those accounts. Defenses, including estoppel, that would have been available against the party who pledged the account remain available.</p>
Segregation of Consumer Issues to a Separate Part	<p>Avoid.</p>
Simultaneous Exercise of Creditor's Remedies	<p>Disallow if it has purpose or effect of harassment.</p>
Sixty Percent Rule	<p>Retain current law.</p>
Statutory Damages	<p>Needed to deter violations of the Code, allow to secure along with absolute bar,</p>

Topic	Provision Sought
	make available for all violations of the Code, not just those dealing with disposition of collateral.
Tort Claims	Omit consumer tort claims.
Unconscionability	Add, use 2A-108 for a model, include unconscionability, inducement, and collections.
Waiver	Consumer protections—in addition to being nonwaivable, parties should not be able to define standards in a form agreement with a consumer to measure whether consumer protection sections of the Code have been complied with.

APPENDIX C  
 TREATMENT OF CONSUMER BUYERS AND LICENSEES UNDER CURRENT AND DRAFT  
 REVISED ARTICLE 2 COMPARED TO DRAFT ARTICLE 2B  
 (in the order in which they arise in Article 2B)

ISSUE	CURRENT ARTICLE 2	REVISED ARTICLE 2	REVISED ARTICLE 2B
<p><b>1. Definition of conspicuous</b></p>	<p>A term is conspicuous when a reasonable person against whom it is to operate ought to have noticed it. [1-201(10)].</p>	<p>A term is conspicuous if a reasonable person against whom it is to operate would have noticed it, or is in a form that would enable the recipient's computer to take it into account. [2-102(7)].</p>	<p>A term is conspicuous if a reasonable person against whom it would operate would have noticed it, or it was designed so that the recipient's computer could take it into account and respond to it. Terms are conspicuous by definition even if a reasonable person would not have seen them if they are in larger or contrasting type or color; are in capitals or any size, no matter how small; and in several other circumstances. [2B-102(a)(6)].</p>
<p><b>2. Relationship with consumer protection statutes</b></p>	<p>Article 2 does not impair or repeal any statute regulating sales to consumers. [2-102].</p>	<p>Transactions remain subject to any applicable consumer protection law of the state. [2-105(a)(2)].</p>	<p>Consumer protection statutes are generally preserved, but are eliminated if they: 1) require a different means to satisfy a requirement of a writing or a signature; 2) contain a different definition of conspicuous; or 3) require actual consent to terms. [2B-104(b)(1)-(4)].</p>
<p><b>3. Unconscionability</b></p>	<p>Contains unconscionability provision. [2-302].</p>	<p>Extends unconscionability to unconscionable inducement to contract. [2-106].</p>	<p>Declines to extend unconscionability to inducement [2B-109], interferes with application of unconscionability to disclaimers of implied warranty [2B-406(e)], and may interfere with the doctrine of unconscionability in 2B-703(c), addressing remedy limitations.</p>

ISSUE	CURRENT ARTICLE 2	REVISED ARTICLE 2	REVISED ARTICLE 2B
4. <i>Oral modification</i>	Oral modifications, such as post-sale promises to repair a defect, are enforceable by consumers as modifications except where a "no oral modification" clause has been separately signed. [2-209(2)].	Oral modifications are enforceable by consumers. "No oral modification" clauses are not effective against consumers. [2-210(b)].	"No oral modification" clauses enforceable against consumers if there is "manifest assent," although no signature. [2B-303(b)]. Manifest assent may include not returning the software after learning of the term.
5. <i>Standard form contracts</i>	Silent.	Terms which could not reasonably have been expected by the non-drafter do not become part of the contract unless expressly agreed to. [2-206(b)].	A term, even if unexpected, is excluded only if a reasonable licensor should know that the term could cause the ordinary reasonable licensee to refuse to contract if brought to his or her attention. [2B-308(b)]. Even these terms are effective if the licensee "manifests assent" to the term. [2B-308(c)(2)].
6. <i>Liability for viruses</i>	Not covered.	Not covered.	Licensor liable only if the virus was present because the licensor did not exercise reasonable care. Liability for viruses introduced due to lack of reasonable care can be eliminated through a disclaimer for all software delivered over the Internet. [2B-318].
7. <i>Exclusion of implied warranty</i>	If the exclusion is in writing, it must be conspicuous. Language	Exclusions must clearly call the charge to the buyer's attention. Exclusions must	There is no requirement that the exclusion be clear. Exclusions must be in a record. There is no qualifier to "as is" for the circumstances of the transaction.

ISSUE	CURRENT ARTICLE 2	REVISED ARTICLE 2	REVISED ARTICLE 2B
	<p>such as "as-is" is generally sufficient unless the circumstances indicate otherwise. [2-316].</p>	<p>be in writing for consumer contract only. Language such as "as-is" is generally sufficient in commercial contracts unless circumstances indicate otherwise. In consumer contracts, a disclaimer operates only if buyer expressly agreed to it. [2-318(c)].</p>	<p>Only exclusions for a mass-market license must be conspicuous [2B-406].</p>
<p>8. <i>Effect of sample or model</i></p>	<p>A sample or model which is made part of the basis of the bargain creates an express warranty that the goods will conform to the sample or model. [2-313(1)(a)].</p>	<p>A sample or model creates an express warranty if it is furnished by the seller to the buyer unless a reasonable buyer would have believed otherwise and becomes part of the agreement. [2-403(a)].</p>	<p>A sample or model is defeated by "exact or technical specifications" in the contract. [2B-408(1)]. Does this make sense when laypersons could be shown a model and later given inconsistent specifications?</p>
<p>9. <i>Right to reject</i></p>	<p>Current law permits any party to reject goods prior to acceptance if the goods do not conform to the contract in any respect. [2-601]. For consumers, rejection is an easy way to</p>	<p>Buyer's ability to cancel the sale and demand a refund will be limited by a new right for the seller to make one attempt to cure any non-material defect. Creates new factual hurdles which may</p>	<p>Mass-market buyer's ability to refuse appears to be preserved only if the software is delivered on a tangible medium, not if delivered electronically [2B-609].</p>

ISSUE	CURRENT ARTICLE 2	REVISED ARTICLE 2	REVISED ARTICLE 2B
	return the goods and demand a full refund, or to accomplish a refund by crediting a credit card or stopping payment on a check.	complicate a consumer's ability to cancel after delivery of an unsatisfactory product. [2-709].	
<b>10. Consequential damages</b>	Available unless excluded, excluder clause must not be unconscionable, and excluder for personal injury is <u>prima facie</u> unconscionable. [2-302, 2-709]. Under caselaw, excluder may also fail if a limited remedy fails of its essential purpose.	Available unless excluded, excluder clause must not be unconscionable, and excluder for personal injury is <u>prima facie</u> unconscionable. Excluder may also fail if remedy fails of its essential purpose. [2-105, 2-810].	Available unless excluded. No minimum adequate remedy provision as found in the Article 2 draft. [2B-706].
<b>11. Third party beneficiaries</b>	Three alternatives, each permits beneficiary status to some third parties.	Still under discussion, possible new interplay in which tort claims take precedence if they exist. Contract claim remains if tort does not provide a cause of action.	Permits contract to eliminate all third party beneficiaries except persons in the family or household of the licensee.
<b>12. Specific performance</b>		Permits contract to specify that seller may secure	Permits contract to specify that seller may secure specific performance for future payments even when

ISSUE	CURRENT ARTICLE 2	REVISED ARTICLE 2	REVISED ARTICLE 2B
13. <i>Self-help remedy for licensor</i>	N/A	specific performance even when ordinary standards for that remedy are not met. Decision in March 1997 to eliminate specific performance for payment to circumstances is not yet reflected in the draft.	ordinary standards for that remedy are not met. Limits specific performance for payment to the obligation to make future payments. [2B-711]. Raises the possibility of contempt penalties against a consumer for nonpayment.  Creates a new, non-judicial self-help disablement remedy, if provided for in the contract, and subject to certain other restrictions. [2B-716].

Revised Article 2 citations are to the Jan. 1997, Draft, Art. 2, *supra* note 11.  
Revised Article 2B citations are to the Mar. 1997, Draft, Art. 2B, *supra* note 20.

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