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# Consumer Transactions and the Code: Some Considerations

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# Consumer Transactions and the Code: Some Considerations

*By Kathleen Patchel and Amelia H. Boss\**

## **INTRODUCTION**

The Uniform Commercial Code (Code or U.C.C.) is somewhat unique among “commercial codes.” Unlike the commercial codes of civil law countries, it always has covered consumer as well as commercial transactions. As one critic noted in a study of the original Code, “it treats the merchant and the non-merchant alike, and subjects the occasional transaction of the farmer or college professor, if it is of a type covered by the Code, to the same rules which govern the commercial deals of professional traders.”<sup>1</sup> Because of the volume of consumer transactions, applying the Code to those transactions greatly extended its coverage, and thus the advantages of certainty and predictability that uniform rules provide. Covering consumer transactions, however, created a problem for the Code drafters and its sponsoring organizations<sup>2</sup> that, at least so far, has proven intractable. To what extent should consumer transactions be viewed as sufficiently different from commercial transactions so as to require distinct rules?

The original debate over this issue “was one of the most violent in the history of the Code’s drafting.”<sup>3</sup> Some of the drafters took a fairly aggressive approach towards providing different rules for consumer trans-

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1. 1 STATE OF NEW YORK LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE 109 (1955).

2. The Uniform Commercial Code is a joint venture of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI).

3. 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 9.2, at 293 (1965).

actions. The original drafting scheme for Article 9, for example, “contemplated a thorough coverage of the special problems involved in the field of consumer finance, along the lines of the Retail Installment Selling Acts which [had] been widely enacted since approximately 1940.”<sup>4</sup> The May 1949 draft of Article 9 recognized consumer goods financing as a separate category of financing that had its own special rules,<sup>5</sup> including prescribed disclosure requirements,<sup>6</sup> a right to reinstate or redeem collateral by tendering the installments due,<sup>7</sup> absolute bar of any deficiency judgment for failure to comply with the repossession and sale requirements,<sup>8</sup> a right to notice before repossession in certain instances,<sup>9</sup> a provision subjecting holders in due course of consumer notes to contract defenses if they asserted rights against the collateral,<sup>10</sup> a prohibition on waiver of defense clauses,<sup>11</sup> rules dealing with lay-away plans<sup>12</sup> and add-on sales,<sup>13</sup> a limit on the effectiveness of an after-acquired property clause,<sup>14</sup> and statutory minimum damages.<sup>15</sup>

Of all these provisions only two—the limit on after-acquired property clauses<sup>16</sup> and the minimum damages rule<sup>17</sup>—survived intact in Article 9. Gilmore states:

4. *Id.*

5. Consumer transactions were treated in Part 6, Consumer Goods Financing, of what was then Article 7. *See* May 1949 Draft of Article 7, *reprinted in* VIII UNIFORM COMMERCIAL CODE DRAFTS 658 (1984) [hereinafter U.C.C. DRAFTS].

6. U.C.C. § 7-611 (Tent. Draft May 1949), *reprinted in* U.C.C. DRAFTS, *supra* note 5, at 669 (regulating the form of the contract to be used, and requiring that it contain an itemized disclosure of the elements making up the time price, and that it “conspicuously” indicate that the contract gave the secured party the right to repossess on default).

7. *Id.* § 7-606, at 664-65 (stating right to reinstate); *id.* § 7-607(2), at 665 (stating right to redeem).

8. *Id.* § 7-605(3), at 663. U.C.C. § 7-605(3) also placed the burden of establishing compliance with possession and sale requirements on the secured party. *Id.*

9. *Id.* § 7-605, at 662-64 (requiring 20 days notice of self-help repossession when the consumer had paid more than 60 per cent of the obligation). U.C.C. § 7-605 also provided for a right to notice of a 10-day redemption period in situations not covered by the 20-day notice provision.

10. *Id.* § 7-612, at 671-72.

11. *Id.* § 7-108(3), at 589-90.

12. *Id.* § 7-610, at 668-69.

13. *Id.* § 7-613, at 672-73.

14. *Id.* § 7-602, at 659-60.

15. *Id.* § 7-607, at 665-66. The May 1949 draft also included provisions setting out the form for notices, and specifically providing that certain items would be deducted in calculating the outstanding indebtedness. *See id.* § 7-605(3), at 663 (secured party must adjust the amount of the indebtedness for any unearned charges, such as prepaid insurance and interest); *id.* § 7-609(2), at 667 (discharging consumer from indebtedness to the extent of any insurance proceeds received by secured party).

16. *Id.* § 9-204(2) (1995). Unless otherwise noted, all citations are to the 1995 Official Text of the U.C.C.

17. *Id.* § 9-507. Part 5 also contains a provision on strict foreclosure, not found in the May 1949 draft, which prohibits strict foreclosure in consumer cases if the debtor has paid 60%

The motives which led to the decision to abandon the consumer to his fate were mixed: some of those who took part in the debate felt that the consumer provisions were "social legislation," inappropriate in a general codifying statute; others felt that the provisions unfairly discriminated against banks and finance companies engaged in consumer finance; still others felt that the provisions were so weak that they gave merely an illusion of protection and would be ineffective to curb abuses believed to exist.<sup>18</sup>

This opposition convinced the drafters "of the demonstrated impossibility of arriving at a satisfactory solution."<sup>19</sup> Although the final version of Article 9 retained "consumer goods" as a separate type of collateral, with very few exceptions, it applied the same rules to consumer and commercial financing.<sup>20</sup> The decision whether to differentiate between consumer and commercial transactions was left to other law, and a statutory Note was included to make the point that the regulatory provisions of retail installment sales acts, small-loan legislation, and the like should not be repealed when the Article was enacted.<sup>21</sup>

Other original Code articles had a similar drafting history. For instance, although early drafts of Article 4 reflected "sensitivity to consumer interests,"<sup>22</sup> the final version of Article 4 (as well as its companion Article 3) contained no rules distinguishing between consumer and nonconsumer transactions. The extent to which the final product treated consumer transactions as distinct, however, varied from article to article. While Articles 3 and 4 made no distinctions, others, such as Article 9 and Article 7, contained a few instances of differentiation based on nonmerchant status,<sup>23</sup> and Article 2 included a number of provisions that relied on a distinction between merchants and nonmerchants.<sup>24</sup> Although there was some criti-

of the cash price in the case of purchase money security interests or 60% of the loan in other situations and has not renounced his rights in the collateral. *Id.* § 9-505(1).

18. 1 GILMORE, *supra* note 3, § 9.2 at 293.

19. *Id.* at 294.

20. *See id.* ("The upshot was that, although the 'security' aspect of consumer goods transactions (for example, filing) continued within the coverage of the Article, the intention to regulate abuses was expressly disclaimed.")

21. *Id.*; *see* U.C.C. § 9-203(4) (making Article 9 subject to certain other state statutes); *id.* Note (stating § 9-203(4) is designed to make clear that certain transactions subject to article 9 must also comply with other legislation and noting that supplemental legislation is particularly found in the consumer area).

22. Edward L. Rubin, *Efficiency, Equity, and the Proposed Revisions of Articles 3 and 4*, 42 ALA. L. REV. 551, 555 (1991) [hereinafter Rubin, *Efficiency, Equity*].

23. *See* U.C.C. § 7-210(2) (establishing separate procedure for enforcement of a warehouseman's lien for "goods other than goods stored by a merchant").

24. *See id.* § 2-104 cmt. 2 (listing the special provisions as to merchants). Comment 2 explains that these special merchant provisions are of three kinds. Some "rest on normal business practices which are or ought to be typical of and familiar to any person in business." *Id.* Some rest on "a professional status as to particular kinds of goods." *Id.* A third group apply to both those who have knowledge of business practices and knowledge of particular goods. *Id.*

cism of the original Code's treatment of consumer transactions,<sup>25</sup> the approach of generally applying the same rules to consumer and commercial transactions seemed to resolve the "consumer question" for purposes of the Code.

The consumer question, however, resurfaced when the sponsoring organizations began the current round of Code revisions. The treatment of consumer transactions in the 1990 revisions to Articles 3 and 4 of the Code in particular provoked a number of articles critical not only of the substance of those revisions, but also of the process by which the Code is drafted.<sup>26</sup> That discussion has blossomed into a more general and ongoing dialogue about the efficacy of the uniform laws process.<sup>27</sup>

Currently two of the articles with the greatest impact on consumers—Article 2 on sales and Article 9 on secured transactions—are in the midst of revision. Although other nonuniform state and federal consumer protection legislation supplements these articles in some respects, these two articles still provide the basic background law for regulation of consumer transactions.<sup>28</sup> Thus, once again, the drafters and sponsoring organizations are struggling with the "consumer question."

The working drafts of both Articles 2 and 9 contain a number of provisions that differentiate between consumer and commercial transactions.<sup>29</sup> Once again, however, differential treatment of consumers has

25. See, e.g., Frederick K. Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 YALE L.J. 334, 335 (1952) (attacking Article 4 as "an unfair piece of class legislation" and accusing the Code's sponsoring organizations of "a deliberate sell-out").

26. See generally Rubin, *Efficiency, Equity*, *supra* note 22; Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising U.C.C. Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993); Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993). The Article 3 and 4 revisions followed the pattern established in the original drafting process: initial proposed drafts included a number of provisions designed to protect consumers, but the final draft abandoned these provisions in the face of opposition. See Fred H. Miller, *U.C.C. Articles 3, 4, and 4A: A Study in Process and Scope*, 42 ALA. L. REV. 405, 407-08 (1991); Rubin, *Efficiency, Equity*, *supra* note 22, at 557-58.

27. See Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform Laws*, 25 J. LEGAL STUD. 186 (1996); A. Brooke Overby, *Modeling UCC Drafting*, 29 LOY. L.A. L. REV. 645 (1996); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 PA. L. REV. 595 (1995); Robert Scott, *The Politics of Article Nine*, 80 VA. L. REV. 1783 (1994); 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. REV. 325 (1994); Harry C. Sigman, *Improving the UCC Revision Process: Two Specific Proposals*, 28 LOY. L. REV. 325 (1994).

28. Jean Braucher, *Politics and Principle in the Drafting of UCC Consumer Protection Provisions*, 29 U.C.C. L.J. 68, 69 (1996).

29. The 1996 Annual Meeting Draft (July 12—July 19, 1996) of Article 2 includes several consumer-specific provisions that have no counterpart in the current Article 2, including U.C.C. § 2-206(b) (holding consumer not bound by terms of standard form contract he could not reasonably expect to be included); *id.* § 2-316(e) (stating special rules for disclaimer of implied warranties); *id.* § 2-709(d) (consumer buyer given greater protection where limited

caused controversy. Objections to the inclusion of consumer specific provisions were raised not only by the interested industries, but also by members of the National Conference of Commissioners on Uniform State Laws (NCCUSL) at its August 1995 meeting. After the August 1995 meeting, the Executive Committee of NCCUSL recommended that each drafting committee study the consumer issue and report back to the July 1996 annual meeting.<sup>30</sup> NCCUSL appointed consumer subcommittees for both articles to make recommendations on the consumer question, and both of those subcommittees submitted reports to the full drafting committees.<sup>31</sup> These reports were considered by both the Scope and Program Committee and the Executive Committee of NCCUSL at its 1996 Annual Meeting. The result of this consideration was two resolutions dealing with consumer issues. With respect to Article 2, the resolution took the position (i) that there should be no lessening of consumer protection under the new revisions; (ii) that consumer provisions along the lines of those contained in the Article 2 drafts were appropriate; and (iii) that consumer provisions should be part of the revision as a whole, and should not be contained in bracketed language making adoption by states optional. The Article 9 resolution called for continuing protection of consumers, stated that consumer provisions should not be bracketed, and asked the Drafting Committee to report back more fully on specific consumer issues over the coming year. These resolutions indicate that, although views on the manner in which consumer transactions should be treated in these two most im-

warranty fails of its essential purpose); *id.* § 2-317(c) (permitting an implied warranty of merchantability to survive despite conflict with an express warranty); *id.* § 2-318 (making it easier for remote consumer buyers to recover consequentials in certain circumstances); and *id.* § 2-714 (no reduction in the statute of limitations in consumer contracts). Most of the new consumer-specific provisions tentatively proposed for Article 9 are found in Part 5, dealing with remedies upon default. Consumer specific provisions in Part 5 of the 1996 Annual Meeting Draft (July 12—July 19, 1996) of Article 9 include U.C.C. § 9-501(c) (prohibiting waiver of Part 5 rights by debtors or consumer obligors); *id.* § 9-504(i) (special rule for waiver of notice); *id.* § 9-504(j) (longer time period for reasonable notification of disposition); § 9-504(l) (different form for notification of disposition); *id.* § 9-504(m) (including consumer obligors in deficiency notice requirement); *id.* § 9-504A (limiting deficiency claims based on amount of outstanding debt); *id.* § 9-505 (distinguishing as to requirements for strict foreclosure in some respects and prohibiting acceptance of collateral in partial as opposed to full satisfaction of debt); *id.* § 9-506 (giving consumer debtors and obligors a right to reinstate and setting out different waiver rules); *id.* § 9-507 (providing different rules regarding collection of deficiencies when secured party has failed to comply with Part 5 and providing for award of attorneys' fees). The 1996 Annual Meeting Drafts of Articles 2 and 9 are available on the World-Wide-Web at <http://www.upenn.edu/library/ulc/ulc.htm> and are on file with *The Business Lawyer*, University of Maryland School of Law.

30. Braucher, *supra* note 28, at 68.

31. The Article 2 subcommittee was chaired by Gerald Bepko, Chancellor of Indiana University Purdue University Indianapolis. Its other two members were California Assembly member Byron Sher and Boris Auerbach, formerly general counsel of Federated Department Stores. The Article 9 subcommittee was chaired by Marion Benfield, professor of law at Wake Forest School of Law. Its other members were Henry Kittleson and Sandra S. Stern.

portant articles of the Code are far from unanimous, a middle ground for treatment may slowly be crystallizing within NCCUSL.

The purpose of this Article is not to propose an answer to the question of consumer treatment in the Code. As past and present events illustrate, it is a difficult one, and one to which the authors probably would give different answers, at least in some respects. The purpose of this Article is to try to inform the debate by discussing some of the underlying considerations. The approach is to explore the roads not taken—to consider the alternative drafting approaches of exclusion of consumer transactions and inclusion without any differentiation, and the reasons why those approaches are unsatisfactory solutions to the question of the appropriate treatment of consumer transactions in the Code.

### ***THE BASIC APPROACHES***

Three basic drafting approaches to consumer transactions and the Code are, at least theoretically, available. First, consumer transactions could be removed from the Code completely. The scope of the articles of the Code could be restricted to “commercial” transactions; “consumer” transactions, however defined, would be expressly excluded from Code coverage. Second, the drafters could opt for an approach that treats consumer and commercial transactions identically. Under this approach, consumer transactions would be covered by the Code, but they would be governed by the same rules as those governing nonconsumer transactions. The same rules would apply to sophisticated businesspersons in their dealings with each other as apply in their dealings with consumers. Third, consumer transactions could be covered by the Code, but viewed as sufficiently different from transactions between businesspersons so as to require distinct rules, at least with regard to certain issues. The third of these alternatives is the one that almost without exception has been utilized by the Code drafters. An analysis of the other two approaches and why they usually are rejected in drafting Code articles, however, helps refine the issues involved in deciding upon the appropriate treatment of consumer transactions under the Code.

#### ***EXCLUDE CONSUMER TRANSACTIONS***

The first approach, exclusion, has a venerable history as a Code drafting technique. The scope of the original Code was determined in part by a desire to avoid inclusion of controversial issues.<sup>32</sup> There also is precedent for treating commercial and consumer interests separately. The original “law merchant” from which the commercial law evolved was a law de-

32. Patchel, *supra* note 26, at 100-01 (noting drafters excluded certificate of title provisions, car-trusts and insurance to avoid political opposition from affected interest groups).

veloped among merchants in their dealings with each other,<sup>33</sup> and in accordance with that tradition, civil law commercial codes focus on rules governing merchants in their commercial dealings.<sup>34</sup> Indeed, within the Code itself, Article 4A has taken this approach by excluding from its coverage funds transfers governed by the Electronic Fund Transfer Act,<sup>35</sup> the federal statute governing electronic funds transfers involving consumers.<sup>36</sup>

With the notable exception of Article 4A, however, exclusion has not been the Code's approach with regard to consumer transactions. Nor is it an approach the drafters are likely to adopt now in connection with the Articles 2 and 9 revisions. First, the sheer number of transactions covered by even a relatively conservative definition of "consumer transaction" would mean that exclusion of consumer transactions from the Code would destroy much of its comprehensiveness, and thus much of its utility in bringing uniformity to the law. Imagine if all the purchases and loans for "personal, family or household purposes"<sup>37</sup> were excluded from Articles 2 and 9. The number of transactions covered by those articles, as well as their importance, would dwindle significantly. Consumer transactions clearly constitute a large segment of the transactions currently covered under the Code.<sup>38</sup>

A Code that excluded consumer transactions also would have trouble being enacted. Both business interests that traditionally have supported adoption of the Code in state legislatures and consumer interests probably would oppose it. From the perspective of businesses who do any significant

33. See Memorandum of K.N. Llewellyn Replying to the Report and Memorandum of Task Group 1 of the Special Committee of the Commerce and Industry Association of New York, Inc. on the Uniform Commercial Code (Aug. 16, 1954), reprinted in STATE OF NEW YORK LAW REVISION COMMISSION, 1 HEARINGS ON THE UNIFORM COMMERCIAL CODE 106, 107 (1954) [hereinafter HEARINGS]:

The practice [of having merchant only rules] is ancient, not new. Before Lord Mansfield there were merchants' courts which made merchants, and only merchants, answer to the proper obligations of merchants. Lord Mansfield incorporated into the common law, if one cares to really examine the cases, not "The Law Merchant," but "The Law of Merchants' Peculiar Obligations."

34. See WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT 311-12 (1973) (noting that one reason the U.C.C. is not a commercial code "in the continental sense" is that its application is not restricted to contracts between merchants).

35. 15 U.S.C. § 1693(a)-(r) (1994 & West Supp. 1996).

36. See U.C.C. § 4A-108 (excluding these transactions).

37. See *id.* § 9-109(1) (defining "consumer goods" as goods "used or bought for use primarily for personal, family or household purposes"). Article 9's definition of consumer goods has become the standard definition for consumer transactions.

38. Cf. Braucher, *supra* note 28, at 78. Professor Braucher notes that the typical sales or secured transaction in terms of number and probably dollar volume as well is either a consumer or a "quasi-consumer" type transaction—one involving unrepresented buyers or debtors entering transactions without "customized negotiation" and without an understanding of the boilerplate in the forms they sign.

volume of consumer business, a Code that excluded consumer transactions obviously would lose much of its utility.

Code coverage of consumer transactions, however, also is important to consumers. Nonuniform state law increases the transaction costs for businesses, and those costs usually are passed on to consumers. Moreover, nonuniform consumer provisions make it more difficult for consumers to utilize them. Replacing the current “crazy-quilt complexity” of federal and nonuniform state statutes that address consumer sales and credit issues with uniform Code provisions arguably might increase consumer access to legal redress “by consolidating more useable consumer protection in the Code, where lawyers in general practice are more likely to find it.”<sup>39</sup> Further, including consumer rules in the Code may make it more likely that those rules will be enacted. If consumer legislation is presented to the legislature as a distinct statute or even as bracketed language making its adoption as part of the Code optional with the states, business interests may use their considerable lobbying resources to oppose it. On the other hand, if consumer provisions are integrated into the Code, then those same lobbying resources may very well be arrayed in support of its passage because on the whole the Code is beneficial to business.<sup>40</sup>

A Code that excluded consumer transactions also would present state legislatures with something of a quandary. If consumer transactions were no longer covered by the U.C.C., then what law would govern them? The Code has dominated the areas it covers for over thirty years. At the time of its passage in states, the legislation it replaced was repealed. Although common law may have continued to develop in some areas—for instance, with regard to contracts not governed by Article 2—in other areas the common law is stagnant at best, and perhaps nonexistent.

Further, the argument that state and federal consumer protection laws have made the Code “unnecessary” with regard to consumer transactions is simply untrue. Federal consumer legislation and state consumer protection laws are not comprehensive—instead, they build on the base provided by the Code, addressing particular inadequacies.<sup>41</sup> State consumer legislation is limited to specific types of transactions (e.g., “lemon laws” in connection with new car sales) or to specific issues (e.g., warranty law). Federal legislation is designed to redress specific problems, such as the disclosure of credit terms addressed by the Truth in Lending Act. The bulk of consumer transactions and issues are not covered by other law. Indeed, in some states without consumer protection laws or developed bodies of products liability law, Code rules, such as Article 2’s rules gov-

39. *Id.* at 69.

40. It is true that business interests might try to get states to eliminate consumer friendly provisions at the enactment stage, but that would put them at odds with other proponents of the Code, whose goal is to have the Code enacted without amendment in order to preserve uniformity.

41. *Id.*

erning implied warranties<sup>42</sup> and disclaimers,<sup>43</sup> function as the primary source of consumer protection. Clearly, consumer transactions could not be excluded from the Code without the passage of other legislation to replace it. In short, it probably is simply too late to take consumers out of the Code.<sup>44</sup>

### *TREAT CONSUMER TRANSACTIONS THE SAME*

The second basic approach would include consumer transactions in the Code but not give them distinct treatment. This treatment of consumer transactions also has precedent in individual Code articles. The pre-revision versions of Articles 3 and 4 make no distinctions based on consumer status. A similar approach was proposed but rejected during the original consideration of Article 2. The Commerce and Industry Association of New York (Association) objected to Article 2 in the New York Law Revision Commission Code hearings on the basis that it set up different rules “for persons regarded as ‘merchants’ and those dealing in goods but regarded as ‘non-merchants’ in particular transactions.”<sup>45</sup> The Association argued that “legal rules should be definite and apply to all persons” and that “[a]ny variation dependent on the business or character of the parties would result in many difficulties in application and also many inequities.”<sup>46</sup> Thus, the Association proposed that Article 2’s merchant rules should instead be applied to all buyers and sellers without regard to their professional status.<sup>47</sup>

42. U.C.C. § 2-314.

43. *Id.* §§ 2-316, 2-718, 2-719.

44. This is true, at least, with regard to original Code articles like Articles 2 and 9, which “now serve as the basic background law of sales and secured loans to consumers.” Braucher, *supra* note 28, at 69. New articles may be able to use a merchants only approach. Article 4A, for instance, was drafted to fill a gap in the law—the lack of any comprehensive regulation of wholesale wire transfers. Prefatory Note, U.C.C. Article 4A. Consumer funds transfers already were addressed in a comprehensive fashion by federal law. Therefore, its drafters were able to limit its coverage to nonconsumer transactions. In contrast, consumer leasing was not addressed comprehensively on either the state or federal level at the time that Article 2A on the leasing of goods was drafted by NCCUSL in 1987. Article 2A not only covers consumer transactions, but contains specific consumer rules as well. Article 2B, in its present formulation, covers consumer transactions under the more general rubric of mass-market licenses.

45. Report on Articles 2 and 6 of the Uniform Commercial Code by Task Group 1 of the Special Committee on the Uniform Commercial Code of the Commerce and Industry Association of New York, Inc., *reprinted in* 1 HEARINGS, *supra* note 33, at 86, 87.

46. *Id.* at 94.

47. *See id.* at 99 (stating U.C.C. § 2-314’s implied warranty of merchantability should apply to any person who sells goods, not just merchants); *id.* at 102 (stating U.C.C. § 2-603’s obligation of a rejecting buyer to follow seller’s instructions with regard to rejected goods should not be limited to merchant buyers); *id.* at 103 (stating U.C.C. § 2-605’s rule that a merchant buyer waives objections not included in a statement of defects requested by the seller should apply to all buyers).

Professor Karl Llewellyn's response to the Association's proposal identifies the fundamental problem with treating consumer and commercial transactions exactly the same. Llewellyn stated: "The building of rules of law is by its very nature based on classification. Sound and wise building of rules of law calls for sound and wise classification of the problem-situations. Such classification makes for justice-in-result."<sup>48</sup> Llewellyn argued that the merchant rules in Article 2 were "rules which lay upon a person professionally involved in the field those obligations which should properly be laid upon such persons."<sup>49</sup> To apply those same rules—rules such as the implied warranty of merchantability<sup>50</sup> and the rejecting buyer's duty to follow the seller's instructions for disposal of goods<sup>51</sup>—to "householders or farmers or lawyers . . . as such"<sup>52</sup> would be "unreasonable,"<sup>53</sup> an "absurdity,"<sup>54</sup> and (Llewellyn had such a way with words) "just ununderstandable."<sup>55</sup>

Treating consumer and commercial transactions the same implies that those transactions *are* the same—or, at least, so nearly the same as to make no difference. In fact, though, the sales and loan transactions covered by Articles 2 and 9 come in many different shapes and sizes. From washing machine purchases to long term supply contracts, from car loans to leveraged buy-outs, "transactions can be placed on a continuum from small transactions involving an unrepresented consumer, at one end, to large

48. Memorandum of K. N. Llewellyn Replying to the Report and Memorandum of Task Group 1 of the Special Committee of the Commerce and Industry Association of New York, Inc. on the Uniform Commercial Code (Aug. 16, 1954), *reprinted in* 1 HEARINGS, *supra* note 33, at 106, 108.

49. *Id.* at 107.

50. U.C.C. § 2-314 (1).

51. *Id.* § 2-603(1).

52. 1 HEARINGS, *supra* note 33, at 125 (Proponents of the Code "do not believe that householders or farmers or lawyers have, as such, the responsibilities of businessmen in regard to properly rejected goods, and they do believe that sellers who sell to such persons should carry the burden of picking up non-conforming and rejected goods.").

53. *Id.* at 125 ("[T]elling a householder to send back three tons of properly rejected coal from his cellar would be unreasonable.").

54. *Id.*

55.

[T]hat the implied warranty of merchantability should be extended to every seller, is just ununderstandable. . . . How a group of merchants can arrive at the conclusion that ordinary persons, who do *not* deal in goods of the description, should be held to this type of responsibility is quite beyond ordinary understanding, beyond the understanding of a hundred years of case law, beyond the understanding of Mr. Williston in his [Uniform Sales] Act, Section 15(2).

*Id.* at 122; *see also id.* at 125 (discussing U.C.C. § 2-605's rule that a merchant buyer waives objections not included in a written statement of defects requested by the seller; precluding "an informed buyer who knew the circumstances and background" of the transaction from raising unstated objections "is not the equivalent of the arrival at 137 Hancock St. of a seller representative seeking to take down as final what Mrs. O'Leary says before she even gets around to consulting the priest, let alone a lawyer.").

deals involving two parties both represented by counsel, at the other.”<sup>56</sup> Treating them all the same would require that the drafters draft rules that would apply with equal facility—and equal justice—to this wide range of transactions. Although such rules certainly are possible with regard to some issues, it is hard to imagine that they are possible with regard to all issues. For some issues, if the rules were to have any specificity at all, this would be quite a task indeed.

It also seems unlikely that business interests would want such a Code. First, distinguishing consumer transactions from business transactions may produce rules favorable to business. For example, under U.C.C. section 9-302(1)(d), a purchase money security interest in consumer goods is automatically perfected without filing or possession.<sup>57</sup> This filing exemption is based on the nature of consumer transactions: large volume, legally informal and unsophisticated, and involving relatively small amounts of money. Given the large volume of consumer transactions, a filing requirement would overburden the filing system.<sup>58</sup> The cost of filing also would be sufficiently great in relation to the small amounts involved that it could add to the price of consumer goods.<sup>59</sup> Further, the parties to consumer transactions are less likely to search the records.

People who extend credit to the typical . . . consumer have not the faintest interest in whether any of his personal property (with the possible exception of his automobile) is encumbered; a store opening a charge account or a bank making a small loan is interested only in whether the customer or borrower has a regular job and a reputation for paying his bills.<sup>60</sup>

Purchasers of consumer goods also are not likely to consult the files. Most consumer purchasers probably do not even know the filing system exists, much less how to access it; “dealers are interested in the profits on selling the new models, not in the largely fictional value of the turn-ins.”<sup>61</sup> This automatic perfection rule obviously benefits sellers, and because most purchase money security interests are assigned immediately to banks or finance companies, it also benefits commercial lenders.<sup>62</sup>

Second, distinguishing between business and consumer transactions allows for a flexibility in drafting not available if all transactions are treated exactly the same. Business interests thus may prefer a Code with specific consumer rules because it allows the drafters to create rules for business

56. Braucher, *supra* note 28, at 78.

57. U.C.C. § 9-302 (1)(d).

58. ROBERT L. JORDAN & WILLIAM D. WARREN, SECURED TRANSACTIONS IN PERSONAL PROPERTY 76 (1992).

59. *Id.*

60. 2 GILMORE, *supra* note 3, § 19.4 at 534.

61. *Id.*

62. *See id.* at 536 (stating that the primary beneficiaries of § 9-302(1)(d) are lenders).

transactions where, if those same rules also were proposed for application in a consumer context, they undoubtedly would be opposed. For example, proposed revisions in the latest draft of Article 2 make it easier for sellers to disclaim implied warranties in business transactions. Such a liberalization of disclaimers, however, is less acceptable in a consumer context, leading to the introduction into the Article 2 revisions of different standards for warranty disclaimers in consumer and nonconsumer transactions.<sup>63</sup> Similarly, while it may be desirable to recognize the validity of form contracts in most business transactions, the use of such forms in the consumer context traditionally has been subjected to greater scrutiny. This has led the drafters of the Article 2 revisions to propose different rules to govern the validity of form contracts in consumer and nonconsumer transactions.<sup>64</sup>

Third, business interests might find a Code that made no distinctions between consumer and commercial transactions problematic because that approach is at odds with what courts have done. No one looking at the case law can deny that consumer status can be an important—whether or not an openly acknowledged—factor in a court’s commercial law decisions, particularly with regard to certain issues. Even if the language of the Code does not make any distinctions in treatment between consumer and commercial transactions, courts interpreting the Code will find them, if they believe they are required. For example, even though neither negotiable instruments law nor the final version of Article 9 placed any limits on holder in due course status in consumer transactions, the courts did so, bending the requirements of holder in due course status to deny it because they felt it unfair to require a consumer to pay a debt to the seller’s financier when the consumer never received what he paid for and the seller’s insolvency meant the consumer never would.<sup>65</sup> Similarly, although the final version of Article 9 contained no provision barring a secured party from collecting a deficiency judgment if the secured party fails to comply with

63. U.C.C. § 2-316 (Proposed Discussion Draft, July 12—July 19, 1996) (available on the World-Wide-Web at <http://www.upenn.edu/library/ulc/ulc.htm> and on file with *The Business Lawyer*, University of Maryland School of Law).

64. *Id.* § 2-206.

65. *See, e.g.*, *Unico v. Owen*, 232 A.2d 405, 4 U.C.C. Rep. Serv. (Callaghan) 542 (N.J. 1967) (denying holder in due course status to lender affiliated with seller); *Mutual Fin. Co. v. Martin*, 63 So. 2d 649, 653 (Fla. 1953) (“We think the buyer—Mr. & Mrs. General Public—should have some protection somewhere along the line.”); *General Inv. Corp. v. Angelini*, 278 A.2d 193, 197, 9 U.C.C. Rep. Serv. (Callaghan) 1, 6 (N.J. 1971) (“[I]n evaluating the circumstances, we recognize that the unique policy considerations attendant upon consumer home repair transactions . . . require us to closely scrutinize the existence of good faith in these situations.”); *Jones v. Approved Bancredit Corp.*, 256 A.2d 739, 742, 6 U.C.C. Rep. Serv. (Callaghan) 1001, 1004 (Del. 1969) (noting the need in consumer goods financing “for a balancing of the interest of the commercial community in the unrestricted negotiability of commercial papers . . . against the interest of the installment buyers . . . in the preservation of their normal remedy of withholding payment” when they have a valid defense).

the requirements for repossession and sale, a number of courts have created an absolute bar rule, and they have done so most often in consumer cases.<sup>66</sup>

Court imposition of distinctions not found in the Code based on consumer status not only alters the Code's rules, it also creates uncertainty. Often, it is unclear to what extent the court's decision is based on the consumer nature of the transaction. The court's rationale—grounded as it must be in Code provisions that do not themselves recognize any distinction based on consumer status—is likely to be phrased in terms that could apply to nonconsumer transactions as well. Thus, the “close alignment” rationale for denying holder in due course status, while most often applied in consumer cases, has been applied by some courts to deny holder in due course status in nonconsumer cases as well.<sup>67</sup> Similarly, courts have barred deficiencies with regard to commercial as well as consumer loans.<sup>68</sup>

Therefore, a Code that treats business and consumer transactions the same can create something of a predicament for the commercial interests that must operate under it. On the one hand, the language of the Code seems to say they can do certain things; on the other hand, case law interpreting the Code in consumer cases says otherwise. Yet, if businesses try to distinguish precedent on the basis that it involved a consumer transaction, the neutral nature of the Code language may turn on them. The court may simply say, as the Eleventh Circuit did in *Southtrust Bank of Alabama, N.A. v. Borg-Warner Acceptance Corp.*:<sup>69</sup>

We see no reason to limit the holding of [prior precedent] to consumer . . . cases. . . . Nothing in the language of [the] U.C.C. . . . distinguishes between consumer and commercial transactions . . . . We see no policy reasons for creating a distinction where the drafters have not done so.<sup>70</sup>

Codifying different rules for consumer and commercial transactions in situations where the courts are likely to find them anyway serves to clarify the law, making its application more certain.<sup>71</sup>

66. *See, e.g.*, *Wilmington Trust Co. v. Connor*, 415 A.2d 773, 28 U.C.C. Rep. Serv. (Callaghan) 900 (Del. 1980); *Randolph v. Franklin Inv. Co.*, 398 A.2d 340, 25 U.C.C. Rep. Serv. (Callaghan) 1199 (D.C. App. 1979); *see also* BARKLEY CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 4.12[5][a], at 4-217 (1993) (discussing absolute bar cases).

67. *See, e.g.*, *St. James v. Diversified Com. Fin. Corp.*, 714 P.2d 179, 1 U.C.C. Rep. Serv. 2d (Callaghan) 121 (Nev. 1986).

68. *See, e.g.*, *Allis-Chalmers Corp. v. Haumont*, 371 N.W. 2d 97, 41 U.C.C. Rep. Serv. (Callaghan) 689 (Neb. 1985) (applying absolute bar rule in favor of guarantors of farm implement dealer).

69. 760 F.2d 1240, 40 U.C.C. Rep. Serv. (Callaghan) 1601 (11th Cir. 1985).

70. *Id.* at 1242, 40 U.C.C. Rep. Serv. (Callaghan) at 1604 (refusing to limit the transformation rule to the consumer bankruptcy context in which it was developed and denying purchase money priority to a floating lien on inventory).

71. *Cf.* 1 HEARINGS, *supra* note 33, at 116 (statement of Karl N. Llewellyn) (making similar points about Article 2's merchant rules).

One argument that has been made in support of the proposition that the same rules should apply to consumer and nonconsumer transactions is that, with regard to many issues, the same characteristics making consumer transactions candidates for distinct treatment are present in nonconsumer transactions as well. Assuming the paradigm of the consumer transaction is one in which the consumer lacks sufficient bargaining power, ability, or financial incentive to negotiate over terms, that paradigm also encompasses many small businesses, and, indeed, potentially encompasses any situation where negotiation is not the model.

While the premise of this argument—that problems of bargaining power, ability, and financial incentive to negotiate are present in many nonconsumer transactions—is persuasive, the conclusion that, therefore, there should be no consumer-specific rules is not. Instead, this premise suggests that for some issues the appropriate classification is not “consumer” and “nonconsumer,” but rather one based on a distinction between negotiated and nonnegotiated transactions.

The current draft of Article 2B, the new article dealing with (among other things) the licensing of software, adopts this approach with regard to “shrink wrap” contracts. Article 2B uses the phrase “mass market license” to describe situations where the licensee is presented with a form license on a “take it or leave it” basis, whether that licensee is a consumer, small business, or large entity.<sup>72</sup> Article 2B then provides special rules dealing with mass market licenses,<sup>73</sup> in essence making it unnecessary to have specific “consumer” rules on this issue. Thus, while some may cite Article 2B as an example of an area in which distinctions based on consumer status are unnecessary, Article 2B is more accurately characterized as an attempt to expand consumer-like protection to other entities needing protection in the bargaining process.

### *MAKE DISTINCTIONS*

The third approach—to include consumer transactions in the Code, and recognize them as sufficiently different from business transactions so as to require different rules in particular situations—is the approach that the Code drafters have followed most often. With the exception of Article 4A, the U.C.C. always has applied to consumer as well as commercial transactions, and most of its articles contain at least a few provisions that recognize a distinction based on level of sophistication or professional

72. See U.C.C. § 2B-102(36) (Proposed Discussion Draft July 12—July 19, 1996) (available on the World-Wide-Web at <http://www.upenn.edu/library/ulc/ulc.htm> and on file with *The Business Lawyer*, University of Maryland School of Law) (defining mass market license).

73. See *id.* § 2B-308 (stating contract formation rules for mass market licenses).

status.<sup>74</sup> Certainly, both Articles 2 and 9 always have followed this approach.

The discussion of the two other possible approaches suggests why this is so. Consumer transactions are too numerous and too integral a part of the commercial law as it has developed in the United States to make their exclusion either practical or wise. On the other hand, consumer and commercial transactions do have distinct characteristics that in certain situations make it impractical or unfair to treat them the same. Therefore, the best approach is to include consumer transactions in the Code, but provide distinct rules in situations where the nature of those transactions require them.

This is perhaps not a very profound conclusion—almost everyone in the current debate has assumed that consumer transactions will be covered, and that they will in some respects be treated differently from other transactions. The current debate over the proper treatment of consumer transactions—as were its predecessors—is not a debate about “approach” at all. Rather, it is a debate about the substance of particular provisions. The issue is not whether consumer transactions will be treated differently, but when and how much. This, too, is perhaps a rather obvious point, but it is an important one to keep in mind. The fact that the debate is over substance and not approach can be too easily lost. When the substance of consumer provisions becomes hotly debated, the traditional response has been to eliminate the controversial provisions and leave consumer issues to “other law.”<sup>75</sup> While this sounds like a drafting approach, it is in fact a policy choice about the substance of the U.C.C. provisions that will govern consumer transactions. It is a substantive choice that consumers will be treated the same as businesspersons and that the differences in consumer transactions do not require distinctive treatment with regard to those issues.

Unfortunately, the third approach is not only the best way to deal with consumer transactions in the Code, it is also the most difficult. Llewellyn said that “the sound and wise classification of the problem-situations” leads to “justice-in-result.” The problem, of course, is determining which classifications are sound and wise. Soundness and wisdom can have many facets. They can be defined in terms of practicality as well as “justice-in-result.” “Justice-in-result” can mean different things to different people.

74. The 1990 revisions to Articles 3 and 4 have even removed those articles’ status as examples of treating consumer and commercial transactions exactly the same for all purposes by adding definitions of “reasonable care” and “good faith” that require from business persons “the observance of reasonable commercial standards.” *See id.* § 3-103(4) (defining “good faith” to include “observance of reasonable commercial standards of fair dealing”); *id.* § 3-103(7) (defining “ordinary care” as “in the case of a person engaged in business . . . observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged”).

75. Patchel, *supra* note 26, at 124.

Deciding that consumer transactions are sufficiently different from business transactions so that some distinctive treatment is required is a much easier task than deciding—provision by provision—when and to what extent the rules should be different. Making policy choices about the substance of the commercial law is no easy task. Finding a way to reconcile the divergent interests of business and consumers is a task that has eluded the drafters of the Code from its inception. Yet, these are the tasks that the drafters of the Articles 2 and 9 revisions and the sponsoring organizations that must approve their efforts have before them.

The rationales for rejecting both complete exclusion and undifferentiated inclusion suggest, however, that these are important tasks, and ones well worth the effort. They also suggest that both business and consumer interests should be interested in helping the drafters achieve those goals. Both business and consumer interests can benefit from having their relationship governed by a uniform, comprehensive statute. Both, therefore, have a stake in making the current efforts to provide such a statute work.

There are differences between the current revision processes for Articles 2 and 9 and previous revision efforts that give some small cause for hope that these drafters could succeed where others have failed. First, both drafting committees have made an effort to include lawyers representing consumer interests in the process as official observers.<sup>76</sup> Although business lawyers still vastly outnumber consumer lawyers among the observers,<sup>77</sup> there is a formalized consumer presence in the drafting committee meet-

76. The principal consumer representatives for both Articles 2 and 9 are Gail K. Hillebrand of Consumers Union and Yvonne W. Rosmarin, formerly of the National Consumer Law Center and now in private practice. Not only have these two lawyers had to serve as the principal spokespersons for consumer views in both the Article 2 and 9 drafting committee meetings, but they have had to play that role as well in all the various Business Section committees that have been reviewing aspects of the drafts. Other representatives of consumer interests in the drafting committee meetings include David McMahon of West Virginia Legal Services and Michael Ferry of Legal Services of Eastern Missouri, along with several academics.

77. As Professor Braucher notes in a recent article, “[w]ell-financed industries still literally loom over the process because they can afford to fund many observers.” Braucher, *supra* note 28, at 71. The cost associated with providing consumer representation in the drafting process is a very serious issue. Consumer lawyers do not have clients who can subsidize their participation in the drafting process. Public interest organizations like Consumers Union and the National Consumer Law Center have limited staff and limited resources, particularly in a time of federal funding cut-backs.

The funding issue has proven critical to the ability of the drafters to obtain the consumer views that will allow them to deal adequately with consumer issues in the drafting process. People concerned about the process have set up a fund with the National Consumer Law Center in Boston, which is now receiving private donations earmarked for funding the participation of consumer representatives at U.C.C. drafting committee meetings. The ABA Section of Business Law also has established a consumer fellowship program that provides three fellowships to support the participation of consumer representatives at ABA meetings where U.C.C. drafts are discussed. Despite these attempts, the need to assure that lack of funding does not prevent adequate consumer representation in the drafting process remains.

ings.<sup>78</sup> In addition, the Article 9 drafting committee has a consumer task force made up of representatives of both industry and consumer interests, which meets to try to reach consensus on the appropriate treatment of consumer issues. Thus, in this revision process, the drafters have had the benefit of hearing the views of both business and consumer representatives, and those representatives have had the benefit of hearing each other.

Second, there are signs that the politics of the process may be different from that in which previous drafting projects occurred. A primary consideration for NCCUSL in drafting Code articles always has been the “enactability” of the final product. Because the ultimate goal is to create uniformity of state commercial law, quick and uniform passage has been viewed as the measure of a drafting project’s success.<sup>79</sup> In the past, enactability always pointed in the direction of abandoning differential treatment of consumer transactions because of the objections of business interests who had the political clout to block enactment in the state legislatures.<sup>80</sup> Enactability, however, no longer points so clearly in one direction. While consumer interests, unlike business interests, do not have organized, effective lobbies in every state, they do have them in some states, and some of those states, such as California and New York, are very important commercial states, whose enactment of Code proposals is crucial to the Code’s overall success.<sup>81</sup> Consumer groups, therefore, may not need to have the capacity to prevent enactment in every state in order to have an impact

78. Observers are present throughout drafting committee meetings and are permitted to speak. After discussion of an issue, the drafting committee may ask the observers to vote by a show of hands to give the drafting committee a sense of the room. Votes of the drafting committee members also are taken by a show of hands, and in the presence of the observers. The recorded votes of the drafting committee members taken at drafting committee meetings suggest that while the observer “show of hands” on a particular issue may well reflect the underrepresentation of the consumers, the votes of the drafting committee do not necessarily reflect that imbalance.

79. Patchel, *supra* note 26, at 92.

80. The belief that including different rules for consumer transactions would prevent enactment of the Code, grounded in the experience of the original Code drafters, was reinforced by NCCUSL’s experience with another piece of uniform legislation, the Uniform Consumer Credit Code (U.C.C.C.). Only eleven states enacted one of the two versions of the U.C.C.C., usually with substantial nonuniform amendment. The U.C.C.C. often is cited as evidence of NCCUSL’s inability to get uniform legislation containing consumer provisions enacted. *See, e.g.*, Miller, *supra* note 26, at 414 n.21. Enactability concerns were the primary reason for abandoning the consumer provisions in the Article 3 and 4 revisions. *See id.* at 408 (“It is sometimes true that a statute no one likes is a good one, and that may have been true of the [New Payments Code], but such a statute also is not one that is likely to be enacted.”). *See generally*, Patchel, *supra* note 26 (tracing the history of the influence of “enactability” on the Code drafting process).

81. Adoption of the original Code by the State of New York was so important that the recommendation of that state’s Law Revision Commission not to adopt the Code without extensive revision had a chilling effect on the willingness of other states to adopt it and led to an extensive revision of the Code incorporating most of the Commission’s recommendations. Patchel, *supra* note 26, at 106.

on enactability. For instance, the 1990 revisions to Articles 3 and 4 only passed in California after nonuniform amendments were added addressing consumer concerns,<sup>82</sup> and New York still has not enacted those revisions.

The response of NCCUSL's commissioners also reflects this shift in the significance of enactability as a criterion for determining the appropriate treatment of consumer transactions. While some NCCUSL commissioners at the August 1995 meeting objected to the drafts of Articles 2 and 9 because they thought their states would not enact the revisions if they contained significantly more consumer-specific rules than the current versions of those articles, other commissioners said their states would not enact the revisions unless they did contain consumer rules. Similarly, at the 1996 meeting of NCCUSL, where revisions to Article 2 and Article 9, as well as the new Article 2B, were discussed, there was substantial floor discussion emphasizing the need to recognize consumer interests and to strike an appropriate balance in all revision projects. It seems clear that enactability will continue to be an important goal of the uniform laws process, and thus a consideration in the drafters' decisions about the substance of Code provisions. Enactability, however, no longer can be automatically equated with exclusion of consumer-specific provisions to which some business interests may object. Thus, the days when enactability was *the* determinative factor in making policy choices about the substance of Code provisions dealing with consumer issues may well be over.

## **CONCLUSION**

The current revision process for Articles 2 and 9 has forced the Code drafters and their sponsoring organizations to once again face the difficult problem of the extent to which consumer transactions should be treated differently from commercial transactions in the Code. Recent events have demonstrated that this issue continues to be a complex and difficult one. The need to answer the "consumer question" in a practical, balanced and fair way—to make the "sound and wise classification" that will lead to "justice-in-result"—is more pressing than ever. The drafters have before them not only a challenge, but an opportunity. Articles 2 and 9 provide the basic law for the regulation of consumer transactions. Their revision provides a testing ground of the uniform laws process as a source of modern commercial law. Clearly the answer that the drafters, and ultimately the sponsoring organizations, give to this question will be an important one, both for the uniform laws process and for the Code.

82. See generally Gail K. 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).