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The March 1997 UCC Article 9 Drafting Committee Meeting: A Victory for Consumers?

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By Alvin C. Harrell

I. Introduction

A. The March 1997 Meeting

The Uniform Commercial Code (UCC) Article 9 Drafting Committee's March 7-9, 1997 meeting in Washington, D.C., to review the February 1997 draft of proposed Article 9 revisions and to consider the Final Report of the Drafting Committee's Consumer Issues Subcommittee, noted in several books, including The Law of Mortgages and Security Interests, Section 7.1992 (with Professor Fred H. Miller), Professor Harrell is also Chair of the Publications Subcommittee of the Consumer Financial Services Committee of the Business Law Section of the American Bar Association and Editor of the National Survey of Consumer Financial Services Law in the Lawyer's Reporter. He chairs an ABA UCC Committee Task Force on Debt and Financial Services, and is a Committee Task Force on State Consumer Credit, Texas Banker, and Executive Director of the Conference on Consumer Finance Law, a member of the American College of Commercial Finance Lawyers, and the American Bankers Association. He codes the UCC Article 9 Legislative Review Subcommittee of the Ohio Bar Association.

protection consumers. She argued that these proposals are the result of lengthy and carefully considered deliberations on the part of the Consumer Issues Subcommittee of the (Article of the 9 Drafting Committee) and that this work should not be discarded. Ms. Hillebrandt argued that these modest proposals are essential to offset the pro-creditor revisions being included in the Article 9 revisions, and rejected the argument that inclusion of the consumer provisions will inhibit the enactment process. She also rejected the argument that the proposed consumer provisions will benefit defaulting consumers at the expense of other consumers, characterizing the higher credit costs that may result as a form of insurance against insolvency on consumers who ultimately could default.

B. Consumer Representatives

Ed Heiser spoke on behalf of the consumer representatives. He argued that what the consumer representatives have termed "modest" proposals are not modest at all. He noted again the tremendous stakes: $650 billion in auto finance, and over $200 billion in finance company debt; plus consumer secured banking credit (over $1 trillion in all). He noted that these transactions are already very heavily regulated, and that most of these regulations did not exist 40 years ago when the UCC was drafted. He asserted that consumer credit was already sufficiently regulated outside the UCC. He also noted that the credit industry did not come to the revision process with an agenda, but was willing to work for improvements in the law. But for consumer credit transactions this has come to mean proposals with an anti-creditor slant, and the industry cannot be expected to approve this.

He argued that there are no significant compensating improvements in the proposed Article 9 for consumer lenders. He asked the commercial lender representatives on the Drafting Committee if they would vote for proposals imposing new costs, burdens, penalties and technical requirements on their industry with no significant benefit in return. (Their response was silence.) He argued that the consumer advocates have proposed a huge agenda so they can now claim they have compromised and made concessions when significant parts of their agenda are approved.

Ms. Heiser claimed that the consumer advocates are representing primarily defaulting consumers, a thin layer of the market of interest primarily to plaintiff lawyers. He argued that non-defaulting consumers do not want to pay the higher rates that will be necessary to pay off a few defaulting debtors under the proposed revisions, even if you call it "insurance." He argued that the lower current rates available on new auto loans are probably a result of the current procedures in Article 9, and that it is anti-consumer to propose rules that will raise these rates.

Mr. Heiser further argued that any debt protections that are needed should be applied to all debtors and creditors, not just secured consumer lenders, and that any specialized consumer provisions should be separately considered as part of a comprehensive consumer credit code. He noted that increased difficulty in collecting consumer debts will mean higher consumer costs, and that this is a social policy issue not suitable for resolution by the Article 9 Drafting Committee. He argued that the proposed notice requirements offer no real protection to consumers, only imposing higher costs on both lenders and consumers in order to create an opportunity for plaintiff lawyers to generate litigation over trivial and harmless errors.

II. Other Comments

Article 9 Drafting Committee Chairman William Burke expressed appreciation to all of those who have tried to resolve the differences between the creditor and consumer groups. Dom Rapaus noted that creditors are getting a bad deal error rule in the February 1997 draft and suggested that consumer creditors adopt a different approach. Bill Solomon noted the revisions include class action lawsuits on the basis of technical errors, noting that there is already a tidal wave of such litigation.

Bill Zadikoff questioned the assumption that the consumer representatives represent consumers. He noted that consumer representatives purport to represent all consumers, but questioned whether this is so. Mr. Zadikoff also, in the consumer context, improvements that clarify the law (the traditional UCC goal) are deemed "anti-consumer" because they diminish the prospects for litigation; he argued that most consumers would not agree with this view of "consumer protection." He argued that consumers generally would face lower costs and clearer rules over litigation opportunities for a few defaulting consumers under the proposed procedure in Article 9, and that it is anti-consumer to propose rules that will raise these costs.

Mr. Hillebrandt responded that consumers cannot participate directly in this process and therefore need representatives, who do the best they can to represent consumer interests as they see them. She argued that the only new consumer protections in the proposed revisions are:

1. A statutory right of reinstatement after 60% of the price is paid;
2. A reciprocal attorney fee provision;
3. A required statutory right to notice of calculation of the deficiency; and
4. Anti-waiver provisions.

Bill Solomon noted that less than one percent of consumer loans involve repossession, arguing again that the proposed changes will benefit only a few consumers and their lawyers at the expense of the other 99%.

Il. The Final Report of the Consumer Issues Subcommittee

A. "Consumer Secured Transactions"

Professor Marion Benfield described the Final Report of the Consumer Issues Subcommittee. The first recommendation is a definition of "Consumer Secured Transaction," expanded to cover consumer intangibles. The definition would include loans for personal, family or household purposes with a cap except $100,000 for consumer intangibles. This definition is important because it would trigger the new consumer protection rules in Article 9. Ed Heiser noted that the importance of this definition will depend on the scope of these rules; he also objected to the broad scope of the definition, which would bring many large ticket secured transactions with sophisticated borrowers. He suggested that the definition track the $25,000 cap in the Truth-in-Lending Act. Mary Stump noted the problems associated with mixed personal and business collateral. This may become a particular difficulty in a dispute with regard to consumer intangibles. Marion Benfield noted this is the reason for the proposed $100,000 cap, meaning that only smaller transactions would be covered.

The Final Report notes that, unlike current law, business-purpose loans would be excluded even though secured by consumer collateral. This would provide a benefit to commercial lenders, by exempting them from the new consumer protection rules, even when they take consumer collateral for commercial loans. However, it provides no benefit to consumer lenders, he noted.

Judge Hillman and Gail Hillebrand opposed use of a dollar cap to exclude large-dollar transactions. The Final Re-
vote at the 1997 NCCUSL Annual Meeting in Sacramento, California in late July 1997 favored deletion of the proposed $500 statutory penalty for any violation of the new consumer complaint notification rule. Thus, to retain the notice requirement but limit the remedy to actual damages.

D. PMIS Allocation

The Final Report provides a statutory rule for allocation of payments among the purchase money security interest (PMSI) and non-PMSI collateral. Bill Solomon noted that one stated justification is that this is the current rule in most jurisdictions, and urged the use of the same require- ments for other consumer issues (as opposed to the tendency of the consumer-related proposals to create new laws).

E. Constructive Strict Foreclosures

The Final Report notes that the consumer representatives object to language in the current proposals that makes constructive strict foreclosure in consumer cases. The current draft requires consumer consent before strict foreclosure occurs (which bars a deficiency judgment). The Final Report approves the consumer position by adopting the position that a contrac- tual or statutory right that can be enforced by a party in a timely fashion is considered to be a consumer's claim. Therefore, the consumer's right to a deficiency judgment is recognized.

F. Waivers and Disclaimers

The Drafting Committee was inclined to defer to the Article 2 Drafting Committee regarding the consumer's ability to waive his or her rights. Ed Heiser noted that this will likely preclude the consumer from waiving his or her right to a deficiency judgment.

III. The AFS Proposals

Ed Heiser presented the proposed rules for the American Financial Services Association's (AFSA) consumer proposals in Pt. III of this article are refer- ences to the AFS proposals.

One proposal is that the waiver provi- sions at revised section 9-600 be equally applicable to consumer and business debtors and be less restricted.

The AFS proposal for section 9-600 would require the debtor to turn over the collateral to the secured party upon default. Carl Brilliebend argued that this can be very difficult in many cases. He also argued that it is not enforceable as a matter of public policy, and is unnecessary in the statute. Bill Solomon argued that this is a fundamental part that should be valid as a matter of public policy, and as a predi- cate for creditor enforcement remedies. Brad Smith queried whether this was intended to apply to pre-demand and post- contained scenarios. The answer was no, and a consumer would have a good faith re- claim for the defenses. It was also emphasized that this is not intended to change the rules on the need to balance the interests of consumers, it was not the intent to balance the interests in self-help repossessions. The proposal is not intended to be self-executing, but merely to discourage post-demand efforts of the debtor to hide or dispose of the collateral.

The AFS proposal for section 9-610(c) would provide a safe harbor allo- lowing, as commercially reasonable, any disposition that does not vary unreason- ably from generally accepted practices. This was inspired by similar clauses in UCC Article 3 at section 3-108(a)(7). Bill Solomon noted that this is an effort to address the ambiguity in the commer- cial reasonableness standard, which is subject to varying interpretations and yet is crucial as a determination of the lender's rights and liabilities. He urged that this would allow a consistency of routine practices without fighting the
new proposals of this Subcommittee were virtually all approved.

In many previous meetings, there had been a notable effort to present a balanced approach by couples, some points to both the creditor and debtor representatives, though there was also a noted pro-
pensity to defer significant decisions. At the March meeting, this changed somewhat; one creditor cited concern after another was firmly rejected. The

Professor Mooney argued two points: 

1) That the supplier's claims would be limited to the cash acquired by the supplier; and the state obligations or options to allow individual state decisions on the sensitive priority issue. The result

was not entirely an isolated occurrence. Though previous meetings had been more restrained, the March meeting was the culmination of a series of discussions and Drafting Committee votes tending to concede significant points to the consumer representatives. But many of these previous votes and decisions were sufficiently tentative, or at such a late stage of the process, that those who disagreed could entertain hope that the rough edges would later be re

The process is not yet over and nothing is yet final, but a pattern of consumer representative victories is now apparent. Interested parties may now find that consi-

deration of the ultimate implications is warranted.

A. A Scorecard of Consumer and Creditor Groups' Victories

A "tally" similar to the following list of consumer and creditor group successes was distributed by the consumer group at the March, 1997 meeting, following complaints by creditor representatives that their interests were being short-changed. It should be emphasized that this tally was created hastily and is not intended as a comprehensive listing. Moreover, your author has edited and an-
dated the original list slightly, so that the consumer representatives should not be held responsible for any errors. Nonetheless, the presentation was as a rough approximation of the relative suc-

cesses of the consumer and creditor groups in the Article 9 revision process to date. In the present analysis, and presumably incorporated as of the Feb-

uary 1997 draft.

1. New Protections for Consumers

Reciprocal attorneys fees (section 6-928).

A statutory right to reinstatement of a default (if 60% of the cash price has been paid) (section 6-922).

State account debtor protection law preserved.

Some additions to the required notice of sale language (section 9-613(b)).

Waivers require additional evidence of actual agreement (section 9-623).

Required notice of calculation of deficiency (section 9-614). A

Account debentures protected from split payment demand (not only consumers) (section 9-404).

Price deemed a term issue, at interested party sales (sections 9-610(b), 6-614(c)).

New higher standard of good faith (including "fair dealing") (section 9-620(c)).

Definition—No statutory dam-
ages in consumer goods com-
certional lending transactions (sections 9-102(a), (h), 9-526).

PMSI—Loss of transformation rule/codification of dual status (section 9-104(b)).

Expansion of PMSI to mixed collateral (section 9-104(b), (c)).

Absolute sale (in some states) unless state legislature provides otherwise by statute (section 9-625(b)).

Consecutive strict foreclosure eliminated in commercial lending cases.

Express statutory authorization for simultaneous exercise of remedies (commercial and consumer loans) (sections 9-601(a)).

Eliminate signature on financing statement (primarily affects commercial transactions) (section 9-302).

Cap on statutory damages in class actions (section 9-627(c)).

3. Preservation of Consumer Protection Despite Commercial Law Change

Differing rate for harbor notice of disposition (section 9-613).

Deposit account scope not expanded (section 9-112(c)(2)).

Return requirement for possession of property prior to strict foreclosure (section 9-618(b)(3)).

Partial strict foreclosure extended only for commercial loans (section 9-618(g)).

Guarantors of consumer obligations continue to get debtor protections (sections 9-102(a)(12), 9-618(h)).

Prohibition of sale to rescouse party (debtor party language preserves current law) (not consumer only).

Assignment formul for PMSI (section 9-104 (3)).

Rules for creation of consumer intangibles (not consumer only).

Statutory penalty preserved for consumer secured transactions.

4. Consumer Provisions Previously Sought, But No Longer on the Table

Cancellation of election of remedies (anti-defi-

ciency). Eliminate "manifestly" unrea-
sable.

Prohibition on overcollateralization.

Prohibition of "unreasonable" collateral.
QUARTERLY REPORT

It was pointed out by a neutral observer at the March, 1997 meeting that the statutory penalty and attorney fees provision is the heart of the problems from the consumer representatives' perspective. There is potential for generating litigation and liability on the basis of the kinds of minor errors that occur in almost any transaction, and if this could be resolved it might break the "logjam" and the other issues would be subject to compromise. In response the consumer representatives questioned how it is possible that this point is non-negotiable, as it is essential to the consumer's ability to fund litigation and to their policy decision making. The consumer representatives have consistently maintained that the law is to be avoided a regulatory enforcement mechanism to protect consumer interests, the effectiveness of consumer litigation must be enhanced. This consumer protection is deemed to require efforts to enhance the prospects for consumer litigation. Among a group of lawyers this is an easy sell, and it appears that the Drafting Committee has embraced this foundational concept.

Considerable implications flow from this basic concept. Efforts to simplify and clarify the law, and to facilitate the enforcement of private agreements, the traditional UCC mandates, may be viewed as discouraging litigation and therefore inappropriate. Instead, with regard to consumer transactions the focus has been on creating litigation opportunities for consumers and their lawyers. This was strenuously rejected by the consumer representatives, but it was apparent that for whatever reasons the interests of the consumer representatives and the drafters were not in the context of the Article 9 revisions. This raises obvious issues with regard to whether this is an optimal approach from the standpoint of consumers generally and society as a whole. It was argued at the March, 1997 meeting that there is a divergence of interests between the one percent of consumers who suffer repossession and the other 99%, and that the consumer representatives are primarily concerned with one percent and their lawyers, at the expense of consumers generally. The consumer representatives emphasize that it is not generally known in advance which one percent will suffer repossession, so that all consumers are potential beneficiaries. The other parties pointed out revisions increasing the opportunities for recovery by defaulting debtors will inevitability raise the cost of consumer credit for nondefaulting borrowers. Therefore it seems apparent that there is some divergence of interests as between consumer borrowers. It was argued at the March, 1997 meeting, and seems likely, that nondefaulting consumer borrowers would prefer lower financing costs and easier access to credit as an alternative to enhanced litigation opportunities for defaulting debtors. It was noted that consumer loan rates for prime borrowers are extraordinarily low under current law, and at least in part to the streamlined and less restrictive legal regime in Article 9. This article is changed to increase the likelihood of litigation and creditor liability when secured parties seek to enforce their security interests in consumer collateral, these costs (and the availability of such credit) will be adversely affected. In this debate the consumer representatives were countering on the side of defaulting debtors, and in this sense the support of the consumer representatives was obviously coincident with the interests of the plaintiffs' bar. To the extent that increased litigation prospects for defaulting consumers benefit the plaintiffs' bar representatives, who do not suffer repossession it seems appropriate to recognize and consider this when the Article 9 revisions are part of public policy choices being confronted. These of which interests (nondefaulting borrowers or defaulting borrowers and their lawyers) should be favored? Creditor representatives and some neutral observers seem confident that this was put to a public vote the decision would favor the 99% of consumers who do not default, and this must be deemed likely (if for no other reason than the 99% so greatly outnumber the other one percent). But the public does not participate directly in such a vote, and the question is whether a more enlightened panel of experts should reach a different conclusion based on narrower alternative public policy considerations. To some extent this is what the Article 9 Drafting Committee has done, and while the reasons for any group vote are difficult to ascertain, the result is an apparent decision to create litigation incentives as an enforcement mechanism to protect defaulting consumers from abusive creditor practices. This represents a significant public policy change, and may have important implications for the state level, may have a major impact on the future of consumer secured lending. If nothing else, this means that state legislatures considering enactment of revised Article 9 should be made aware that the revisions may incorporate important social judgments that diverge from the current Article 9 and perhaps deserve independent review and consideration.

D. What Will It All Mean?

The Article 9 revisions are still a long way from enactment, and these issues will still need to be developed. The issues are becoming, but the proposals are sufficiently advanced that some consideration of their likely effects is warranted.

First, the increased complexity of the proposed revisions and the resulting prospects for increased litigation may well adversely affect the availability of consumer secured credit. Some lenders are likely to withdraw from the consumer lending market or at least raise their unsecured rates. This may increase the trend away from relatively low-cost secured consumer lending, toward higher

28. Professor Leiters, appropriately depicted as the Consumer Champion, was improperly described as being non-42 and not even ready to be involved. For the sake of a Committee's credibility and in order to maintain the same for the stakeholders, the laborious task of blanketing the non-42 was assigned to the one percent who were interested.

29. See e.g., ( Blanket, supra note 7).

30. See current DCC § 11-02.

31. The purpose of the Article 9 Drafting Committee is one of clarification, it does not and cannot properly initiate or create substantive law. It has been observed that if the consumer representatives see "flaws" they are walled off from the process.

32. What is meant by the responsible examiner? To my knowledge the only liability is for the known and not for any other kind of liability, even if the consumer representatives are "flawless." A derogation to the credit card business is likely to occur in the credit card business, even if the consumer representatives are "flawless."
cost alternatives such as credit cards and pawn shops. 36

Second, the cost of consumer secured credit likely will rise, as nondefaulting bor-
rowers bear the costs of increased remedies for defaulting borrowers.

Third, increased consumer credit litigation is likely. Whether this will become another
Fair Debt Collection Practices Act 37 remains pending, but it cannot be denied that en-
hanced litigation opportunities will result. It is interesting to speculate who the primary tar-
gets may be. Sub-prime lenders are obvious targets, because their borrowers’ high default rates necessitate a high volume of enforce-
ment actions. Larger creditors are obvious targets, because of the potential for class actions
(which remain attractive under the proposals despite the caps voted at the March, 1997
meeting). Small, less sophisticated lenders (such as community banks) will also be likely targets, because of their limited availability to devote resources to compliance with more complex statutory requirements.

Fourth, the results seem predicated on the belief that consumers are unable to adequately control their own legal affairs through consen-
sual arrangements. 38 There seems to be an underlying assumption that the consumer is ignorant and gullible, and does not understand the contracts he or she signs. Therefore, the basic elements of contract law (including the enforceability of contracts) have been called into question or even rejected, and are to be limited through statutory restrictions and con-
er consumer litigation.

Since many of us frequently disagree with the personal decisions that are made by others (particularly very subjective consumer judgements), this is always an easy sell. It is easy to conclude that decisions made by other consumers are foolish, and a highly educated group of lawyers is particularly apt to believe that its judgement is superior to that of ordi-
nary consumers. Reference to a few examples of particularly foolish consumer behavior may be all that is needed to make the case for ad-
ditional legal oversight.

Perhaps the creditor’s superior knowledge, experience and bargaining power mean that additional oversight is needed. 39 But the endor-
sement of this judgement in the UCC re-
vision process represents a significant public policy change, a decision that state law should de-emphasize its common law and economic market foundation in secured transactions. Apparently the Article 9 Drafting Committee has decided that it is time to undertake a move-
ment in this direction, and this may well be subject to a widespread consensus in the lo-
legal community and even the public at large. It may also be that the movement in this di-
rection is modest. But the direction of the change is significant, and the consumer will lose some freedom of contract as a result, be-
cause of the impaired enforceability of con-
sumer contracts. It is not a simple matter of increasing the “protections” for consumers at no cost to consumers or society. Rather it is a matter of establishing a new direction for state secured transaction laws, moving away from the traditional contract-based system toward a more paternalistic approach.

Finally, a crucial question is: How much impact will these changes have? The con-
sumer representatives generally suggest that only the “bad actors” in the lending industry, who engage in abusive practices, would be affected. Neutral observers have made the same point, and perhaps society can rely on the courts to use their discretion to limit the impact to egregious cases. Many lender re-
representatives take comfort in the notion that they are not a likely target because they treat their customers fairly, and no one can deny that this is a helpful strategy.

On the other hand, this approach has its limits. Fairness, and egregiousness, are to some extent in the eyes of the beholder. A common and well-established business prac-
tice may be deemed egregious by a judge who lacks commercial experience (indeed, it was this phenomenon with regard to after-acquired property that added to pressures for Article
9). 40 Absurd cases, hopefully aberrational, abound, and one reason for the revision of Article 9 is to reduce the impact of such deci-
sions. To open the door to a new range of litiga-
tion on the basis of minor and harmless er-
or, leaving it to the good sense of the courts to distinguish between real and imaginary problems and avoid interference with nonabusive practices, is to abdicate the re-
ponsibility to provide needed guidance for the courts and is an invitation to nonuniform case law.

VIII. Conclusion

While Article 9 in its current form is working well in the context of consumer transac-
tions, there are other reasons to support the revisions of Article 9. Most obviously, if Ar-
ticle 9 does not evolve to deal with changes in other laws and commercial practices, to ad-
dress ambiguities, uncertainties and poorly reasoned cases, and to accommodate new technologies, state law will become increas-
ingly obsolete and probably nonuniform. Many people believe the current filing sys-
tem is near breakdown in some jurisdictions (although evolving technologies may solve some of these problems with or without Ar-
ticle 9 revisions). In the absence of an updated Article 9, this may lead to pressures for fed-
eralization of secured transactions law. There may be disagreement as to the extent of these threats, but they are issues to be considered.

A case can also be made that the conces-
sions made to the consumer representatives in the Article 9 revisions are modest. A num-
ber of the consumer-related proposals are unquestionably modest, and the significance of the remainder is at least open to debate. Most of the consumer proposals that have been adopted by the Drafting Committee probably will not be very important for most lenders; most of those rejected are likewise of limited significance. But there are a few consumer advocacy proposals that have been adopted by the Article 9 Drafting Committee that both consumer and creditor representa-
tives probably would deem to be important. 41

Apparently the Drafting Committee has gone as far as it feels it can go in accommo-
dating the concerns of creditor representatives about these proposals without losing the sup-
port of the consumer representatives. The im-
lications of these proposals have been ad-
dressed above. It will now be up to other in-
terested parties to decide for themselves whether these proposals are modest, reason-
able or otherwise advisable as a part of a re-
vised Article 9, and whether they represent a victory for consumers.

36. See, e.g., Alvin C. Harrell, Commentary: The Rise of Bank Sub-
ordination and Why It Must Continue, 30 Colum.Bus.L.Q. Rep. 321 (1995). The trend toward banking consolidation and the resulting growth of large nationwide banks have already been supported by the increasing complexity of consumer credit laws, and the proposed Article 9 revisions also provide to reform-
these trends. The growth of customer leasing as an alter-
native to consumer lending will also be reinforced.


38. This is an interesting predicate for a law designed to alleviate voluntary transactions. See current UCC § 1-102(5)(c) (1966) (see Woodward, supra note 3).

39. See, e.g., Woodward, supra note 3. Though it should be noted that in your author’s experience it is sometimes the debtor who has superior knowledge and experience, and sometimes even lack of knowledge, as to the specific transaction at hand. The observa-
tion, based on 35 years of personal experience with small community lenders, is backed in sale examples, perhaps because it often fits readily into the stereotypes. Possibly this is an example of what Professor Woodward has called “a partiality in thinking that may defy the polar ideologies about contracting...and the backgrounds of those involved in the UCC revision process.” Id., at 266-67.

40. See UCC § 9-204, Official Comment 2.