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Commentary: Should the Statutory Penalty at UCC Section 9-507(1) be Combined with Prevailing Party Attorney Fees?

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I. Introduction

The last sentence of Uniform Commercial Code (UCC) section 9-507(1) currently provides that if a secured party violates any provision of Article 9 Part 5 (Remedies):

> If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten percent of the principal amount of the debt or the time price differential plus 10 percent of the cash price.[1]

As discussed *infra*, this constitutes a statutory penalty for even harmless and minor errors, a type of provision that, in combination with a rule allowing the prevailing party to recover attorney fees, has created havoc in the context of certain other laws such as the Truth in Lending Act[2] and the Fair Debt Collection Practices Act.[3]

In contrast, UCC section 9-507(1) has not created significant problems in the past, possibly because there is currently no provision in UCC Article 9 permitting a party who successfully alleges a trivial error to recover attorney fees.[4] It is the combination of a statutory penalty for trivial errors and the right to recover attorney fees on the basis of such a penalty that has proved so troublesome in the context of other laws.[5] Previously, the drafters of the UCC (and most other state laws) have avoided this troublesome combination. Now, however, the UCC

* Your author would like to thank Professor Fred H. Miller for his assistance in commenting on this article. However, the conclusions are solely those of your author and do not reflect the views of any other person or any organization.

1. UCC § 9-507(1). References are to the 1991 uniform text unless otherwise noted.

2. 15 U.S.C. § 1601 *et seq. See infra* Pt. IV.

3. 15 U.S.C. §§ 1692-1690*o*. *See infra* Pt. V.

There are a number of other statutes, mostly federal consumer credit laws such as the Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691e(d), that allow recovery of prevailing party attorney fees by a consumer. However, some of these do not provide for recovery of a set amount of statutory penalty for minor, harmless errors, as the basis for a claim to attorney fees. Other of these statutes involve evidentiary burdens for the consumer that are greater than under § 9-507(1). For example, compare the difficulty of asserting a successful claim under the ECOA with the relative ease of asserting a technical violation of Article 9 Part 5. However, it should be noted that there can be technical violations of the ECOA form requirements and litigation has not occurred over this.

It must also be admitted that (even with the increased complexity of the proposed revisions), Article 9 does not impose the kind of technical and ambiguous requirements provided in

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3. *(Continued from previous column)*

the Fair Debt Collection Practices Act (FDCPA), which have proven so troublesome in conjunction with a statutory penalty and prevailing party attorney fee provision. For an argument that proposed revised Article 9, which may provide for reciprocal attorney's fees for consumers if the secured party contracts to recover fees for itself, and have an error defense, will not replicate the FDCPA experience, *see* Fred H. Miller, *Consumer Issues and the Revision of U.C.C. Article 2*, 35 Wm. and Mary L. Rev. 1565, at 1577 n.45 ("the nature and context of the asserted violation may be more important than the remedy") (citations omitted).

A listing of "Selected Federal Statutes Providing Attorneys Fees to Prevailing Individuals...," provided to the UCC Article 9 Drafting Committee by consumer representatives, appears as Appendix A at the end of this article (*supra* this issue at 267).

4. However, the same experience is true in Oklahoma even though a separate statute has long allowed recovery of such fees.

5. As noted *supra* at note 3, the context and nature of the violation giving rise to a cause of action may be significant. It is not the right to a prevailing party attorney fee *per se* that is troublesome, but the combination of this right in the context of a statutory penalty triggered by even the slightest technical error. In these circumstances, the probability that some minor error can be found as a basis for the statutory penalty, thereby creating a prevailing party claim to attorney fees, creates almost insurmountable litigation odds for the creditor.

For, example, as suggested *supra* at note 3, the ECOA is "spongy" in the sense of absorbing abuse by plaintiffs. In contrast the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. §§ 1692-1692*o*, is not; FDCPA violations are relatively easy to allege. *See infra* Pt. V. Therefore, defense litigation is very risky in FDCPA cases, providing the plaintiff with extreme negotiating leverage. Hopefully, revised Article 9 will be more like the ECOA in this regard, though only time will tell; *e.g.*, based on the evolving litigation as to what is "commercially reasonable." *See generally* Miller, *supra* note 3.

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Article 9 Drafting Committee[6] is proposing to adopt this combination as a part of the proposed revisions to Article 9.[7]

II. The Report of the Article 9 Drafting Committee's Subcommittee on Consumer Issues

The Report of the Consumer Issues Subcommittee of the Article 9 Drafting Committee appears elsewhere in this issue and has been previously discussed in this journal.[8] The Subcommittee was formed in an effort to seek a consensus on the very difficult consumer credit issues that have been presented to the Article 9 Drafting Committee. At times the divisiveness of these issues has seemed to threaten the entire Article 9 revision project and thereby jeopardize the modernization and continuing viability of state commercial laws. The stakes are very high, and the likelihood of success has sometimes seemed in doubt.[9]

Out of this difficult environment the Consumer Issues Subcommittee crafted a series of compromises that sharply reduced the decibel level of the arguments on both sides of the debate. For the first time it seemed that a satisfactory compromise might be reached (though no one expected either side to be entirely satisfied).[10] The Consumer Issues Subcommittee is to be commended for its efforts, and it should be noted that the Report of the Subcommittee was designed to be taken or rejected as a whole rather than considered piecemeal. The Article 9 Drafting Committee generally accepted this approach and, with a major exception in the case of the Subcommittee's recommendation regarding consumer deposit accounts, adopted the Subcommittee Report intact at the June, 1996 Drafting Committee meeting.

Your author understands the importance of compromise and consensus in this process, and recognizes the difficult task of the Consumer Issues Subcommittee. But as one would expect, creditor representatives have serious reservations about several aspects of the Report. In particular, it appears that one aspect of this compromise, the proposal to allow prevailing party attorney fees on a reciprocal basis whenever one party has contracted for such, may have significant adverse and unanticipated consequences when combined with the section 9-501(1) statutory penalty.

III. The Reciprocal Attorneys' Fee Proposal

The first proposal considered in the Report of the Consumer Issues Subcommittee is the reciprocal attorneys' fee provision at section 9-507 of the May 1996 draft of the proposed Article 9 revisions (the section numbers have since been changed). Under this proposal, if the security agreement provides that a prevailing creditor would be entitled to recover its attorney fees, a prevailing consumer would also be entitled to recover attorney fees.[11]

The Consumer Issues Subcommittee Report endorsed this proposal, favoring inclusion of a reciprocal attorney fee provision in the statute. The reason, as stated in the Subcommittee Report, is that it seems fair that a creditor who is claiming a right to prevailing party attorney fees should be subject to a reciprocal claim "if the consumer establishes that the creditor failed to comply with [Article 9] Part 5. . . ."

A problem with this view is that such a rule can never be truly reciprocal as long as only one party (the secured creditor) but not the other is subject to a statutory penalty for even the most harmless, technical, or minor error.[12] It is the combination of this statutory penalty with a prevailing party attorney fee provision that creates serious public policy concerns.[13]

IV. Policy Implications of the Proposal—the TIL Experience

There has previously been extensive experience with the combination of a statutory penalty for trivial errors and a provision allowing collection of

6. *See, e.g.*, Alvin C. Harrell, *Updated 1995 Annual Meeting Draft Considered by UCC Article 9 Drafting Committee*, 49 Consumer Fin. L. Q. Rep. 411 (1995); Alvin C. Harrell, *UCC Article 9 Revisions Confront Issues Affecting Consumer Collateral*, 49 Consumer Fin. L. Q. Rep. 256, n. 1 (1995) (listing previous articles).

7. For an explanation of the background and reasons for this proposal, *see* Fred H. Miller, *Consumers and the Code: The Search for the Proper Formula*, (forthcoming). The basic premise is that the proposed Article 9 revisions represent a finely crafted compromise designed to be widely enacted, that these revisions will relieve pressure for even more restrictive rules, and that secured parties acting in good faith and in accordance with reasonable commercial standards are unlikely to be penalized. *Id.* Furthermore, Professor Miller suggests that any effort to re-open this issue may result in provisions that are even more onerous from the creditor's perspective, such as a broad statutory right of the defaulting debtor to re-acquire repossessed collateral by reinstating the loan. *Id.* Your author concedes the possible validity of these points. *See, e.g., infra* Pt. II.

8. *See, e.g.*, Alvin C. Harrell, *UCC Article 9 Drafting Committee March 1996 Meeting Considers Consumer-Related Collateral*, 50 Consumer Fin. L. Q. Rep. 95 (1996).

9. This concern was reinforced when it was announced at the November 1996 meeting of the Drafting Committee that creditor representatives have withdrawn from the Consumer Issues Subcommittee in frustration over the direction of the proposed revisions.

10. The creditor representatives have noted that they are not requesting any changes in current law, and that all proposals for change have come from the consumer side, so that "compromises" inevitably advance the consumer advocates' agenda, with no benefit to creditors.

11. The May 1996 draft also would permit a court to award attorneys' fees to a prevailing consumer, on a discretionary basis, even if the security agreement did not provide for such recovery by the secured party. The Consumer Issues Subcommittee considered and specifically rejected this proposal.

12. Professor Miller has pointed out that even if the § 9-507 statutory penalty can be invoked on the basis of technical and harmless errors, in practice the courts are unlikely to do so absent egregious creditor behavior. *See* Miller, *supra* note 3. While your author concedes that this is likely, it would seem that some statutory guidance would be preferable to complete reliance on the good sense of the courts.

13. The Subcommittee Report notes that the proposed reciprocal attorneys' fee proposal might lead secured parties to eliminate attorneys' fees provisions from consumer security agreements, and suggests that this would benefit consumers. Perhaps ironically, this would be less important in the case of "subprime" lending to less-credit-worthy borrowers, where deficiency judgments already are considered to be of little value and lenders compensate for this by charging considerably higher interest rates. *See generally* Michael W. Dunagan, *Repossession Issues, Deficiency Judgments and Bankruptcy Considerations for Sub-Prime Auto Lenders*, 49 Consumer Fin. L. Q. Rep. 384 (1995). Because the secured party's attorney fee normally would be an addition to the deficiency judgment, which often cannot be collected anyway, in the case of subprime loans deletion of a contractual attorney fee provision would easily protect the lender at minimal cost by merely reducing an already uncollectible deficiency. The proposal should therefore have little effect in that context. The impact on "prime" lending (where the creditor may reasonably rely on the prospect of collecting any deficiency and its attorneys' fees) could be quite different, however, and it is likely that the current low interest rates in that market would be increased to compensate for the creditor's loss of a right to recover attorney fees. Whether this would result in any net gain for consumers, as specifically presumed in the Subcommittee Report, seems questionable. It is more likely that non-defaulting prime-rate consumers would pay more in return for defaulting consumers being relieved of liability for the creditor's attorney fee. Consumer representatives, however, believe that this "insurance approach" is of benefit to all consumers, as it spreads the risk of specific impacts without regard to fault, apparently a common policy judgment today.

attorneys' fees by the prevailing party. Indeed, those familiar with the evolution of the federal Truth in Lending Act[14] and Regulation Z[15] before the Truth in Lending Simplification Act in 1980[16] may have a sense of *deja vu* about the whole thing. As stated by Professors Rohner and Miller, in *The Law of Truth in Lending*:[17]

> Aside from legislative changes, the dominating characteristic of TIL law during the 1970s was its capacity for producing disputes and uncertainty over proper disclosure technique. As implemented in the Federal Reserve Board's Regulation Z, TIL was a technically intricate set of requirements. *Any* non-compliance subjected creditors to possible civil actions by their customers and to administrative agency displeasure. The automatic recovery of minimum statutory damages in private actions seemed to invite consumers—especially consumers in default or needing leverage against the creditor—to allege TIL violations, real or fancied. The resulting flood of litigation produced an apparently unending, and inconsistent, stream of judicial interpretations and reinterpretations of TIL requirements. At the pragmatic level, an adverse court opinion could mean the creditor would have to redesign its disclosure forms, at considerable expense and always with the prospect that some court would find the "corrected" form also in violation. Initially with the goal of supplying creditors with guidance, the Federal Reserve Board and its staff issued interpretations of the TIL rules. The number of these advisories ultimately exceeded 1,500. This administrative gloss on the regulation often seemed to confuse as much as it clarified, and, of course, it could not resolve the problem of multiple judicial interpretations. From these seeds grew the movement toward TIL reform.[18]

With the benefit this experience, it is surprising that the Article 9 Drafting Committee would vote to insert a similar regime into Article 9.[19] Moreover, for those who would demand a more recent example of the problem, the Fair Debt Collection Practices Act is instructive.

V. The Fair Debt Collection Practices Act (FDCPA)[20]

The FDCPA includes a statutory penalty and a prevailing party attorney fee provision.[21] Over the past few years there has been a large number of FDCPA cases brought against collection lawyers and other debt collectors alleging technical violations of a statute that is susceptible to varying interpretations in the context of complex day-to-day transactions. Because of the likelihood that a minor, technical error can be successfully alleged in almost any case, most defendants cannot prudently run the risk of liability for the litigation costs of both parties, costs that could easily run $25,000–$50,000 or more. Therefore, most of these cases are settled without going to trial, for payment of around $5,000–$10,000, creating a virtual gold mine for debtors' counsel who can generate large numbers of cases.

As a result the FDCPA provides a tremendous incentive for lawyers to create questionable litigation on a large scale, despite the lack of actual damages, for the purpose of generating claims to attorney fees. This is questionable public policy even in the context of a federal consumer protection law;[22] it surely has no place in the primary state commercial law, a law that is otherwise a model of the UCC's dedication to simplicity, clarity, liberal construction, and the expansion of commercial practices through recognition of custom, usage, and agreement of the parties.[23]

It has been noted that while the FDCPA may be complex and ambiguous, Article 9 traditionally is not. Furthermore, the statutory penalty at section 9-507(1) has not created significant problems in the past. But these arguments are misleading. True, Article 9 is unusually well drafted, and has worked extraordinarily well in the past. But two qualifications should be emphasized in this regard: (1) Article 9 in general, and the statutory penalty at current section 9-507(1) in particular, have not been subject to widespread litigation abuses at least in part because in the past debtors' counsel have not been entitled to claim attorneys' fees based on technical violations;[24] and (2) revised Article 9 is likely to be somewhat more complex, and therefore more susceptible to claims and litigation based on technical violations, than the current statute. With respect to both issues, revised Article 9 (as currently proposed) is different from the current statute. Therefore, the exemplary track record of current Article 9 over the past four decades does not necessarily presage a continuation of that record under the proposed revisions. The question is not whether Article 9 has worked well in the past, but whether it is good public policy to change Article 9 to make it more like the FDCPA, by simultaneously introducing more complexity, additional compliance burdens, and prevailing party attorney fees on top of a statutory penalty for minor, harmless and technical errors.

VI. The Politics of Section 9-507

A political problem is that Article 9 already contains the statutory penalty at current section 9-507(1). As noted, this rule has not caused significant problems to date, and therefore there is little pressure to delete it. In addition, the Article 9 Drafting Committee apparently has decided that the consumer protections currently in Article 9 will not be reduced; the only question is which new consumer provisions will be added. Because of this, it has not been possible to make a strong case for removing or modifying the current statutory penalty.

Nonetheless, the statutory penalty at current section 9-507(1) is likely to be a source of significant problems in conjunction with the proposed revisions to Article 9, and (since section 9-507(1) is apparently "off limits") this is likely to generate creditor opposition to other proposed consumer provisions that would provide broader-based benefits to aggrieved consumers. Early in the Article 9 revision process, some creditor representatives offered to "trade" elimination of the statutory penalty at section 9-507(1) for inclusion of a reciprocal attorney fee provision.[25] This would have allowed consumers with real damages to fund their lawsuits through contingency fee arrangements, while discouraging attorney-driven litigation based

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14. 15 U.S.C. § 1601 *et seq.*

15. 12 CFR Pt. 226.

16. Pub. L. 96-221, 94 Stat. 168.

17. ROHNER AND MILLER, THE LAW OF TRUTH IN LENDING ¶ 1.02[2] (in press 1997).

18. *Id.* (emphasis in the original). On the other hand, this mostly was true in closed-end credit; open-end credit largely escaped. Why? Was it because open-end credit was unsecured (and therefore more easily handled in bankruptcy), and included a valued payment mechanism? Or was it the nature of the rules? *See supra* note 4.

19. One possible solution is to incorporate a bona fide error defense at § 9-507, and at this writing such a defense has been proposed. *See* Miller, *supra* note 5. However, experience with the FDCPA suggests that such a defense may be narrowly construed and hence of limited value. *See, e.g.*, Laurie A. Lucas and Alvin C. Harrell, *Understanding the FDCPA: A Comprehensive Analysis of Recent Case Law*, 49 Consumer Fin. L.Q. Rep. 301, 309 (1995) (noting that the courts usually limit this defense to clerical errors and also require proof of procedures

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designed to prevent the error in question). Such a defense would, of course, be better than none.

Another possible solution suggested by Professor Miller is to limit the range of violations to which the statutory penalty applies, as in Truth in Lending Simplification. This approach offers obvious merit, but would require further massaging of, and complexity in, the proposed revisions.

20. 15 U.S.C. §§ 1692-1692*o*. For an argument that the concerns expressed below are overstated in the context of Article 9, *see* Miller, *supra* note 3.

21. 15 U.S.C. § 1692k(a)(2)(A), (a)(3).

22. *See, e.g.*, Johnson v. Eaton, 1996 WL 137322 (5th Cir. U.S. Ct. App. April 11, 1996) (plaintiff could be considered the "prevailing party" for purposes of claiming attorney fees even if the FDCPA violation was technical and there were no actual damages). Quere—Could a contrary interpretive formula provide a reasonable key to resolving these issues in proposed revised Article 9?

23. UCC § 1-102(1), (2).

24. Interestingly, Oklahoma already allows prevailing party attorney fees in many Article 9 cases. *See* 12 Okla. Stat. §§ 936 and 939. While these provisions are not as clearly applicable to Article 9 transactions (in comparison to the proposed section 9-507 provision, which would apply directly as part of the Article 9 remedy structure), it is noteworthy that these Oklahoma provisions have not yet yielded the kinds of mischief evident in the FDCPA cases. Does this mean that the concerns expressed in this article are unfounded? Or merely that the additional research and advocacy necessary to discover §§ 936 and 939 and connect them to the Article 9 statutory penalty in the context of a harmless error has so far created a challenge sufficient to discourage most consumer credit attorneys? Unfortunately, the answer is unclear. But the absence of a clear answer suggests that caution is warranted. For an argument that these concerns are overstated, *see* Miller, *supra* note 3, at 1577-78 and n.48.

25. It should be noted that there was not universal agreement on this point among creditor representatives, and some might consider the other trade-offs likely to accompany such a change to be worse than the current proposal. Nonetheless, this approach offers considerable promise and there may be some benefit in revisiting this approach at a later stage or during the state law enactment process.