

# **The Shame of the AConsumer Compromise@ in Revised UCC Article 9**

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## **I. Background**

Revised UCC Article 9 (RA9) was promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and The American Law Institute (ALI) in 1998, after more than eight years of study and drafting. Subsequently, through early 2000, mostly Atechnical@ changes to the statutory text and official comments were made by a standby committee and approved by NCCUSL and the ALI. On July 1, 2001 RA9 became effective in all but three states and by January 1, 2002 it was effective in all states.

By all accounts the promulgation and rapid enactment of RA9 was a striking legislative success. Some will argue that the legislative efforts were greatly assisted by the so-called Aconsumer compromise@ struck by the drafting committee with advocates of both consumer creditor and consumer debtor interests who participated in the drafting process. I question the value of the compromise in the enactment process. But even if the compromise did provide material value in obtaining rapid enactment, did that benefit justify the inclusion of incoherent provisions in RA9?

## **II. The AConsumer Compromise@**

The background, rationale, and substance of the Aconsumer compromise@ were described in the Reporters= Prefatory Note 2 to the March, 1998, draft of RA9. That Note is set out in full below.

REPORTERS= PREFATORY NOTE  
MARCH, 1998, DRAFT

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**2. Consumer Transactions.** During the February, 1998, meeting of the Drafting Committee in Rosemont, Illinois, the Drafting Committee approved in principle, and asked the Reporters to incorporate in this draft, a list of proposed revisions relating to consumer transactions. Most of the proposals, but not all, relate to Part 6, Default. The chair of the Drafting Committee presented the proposals as a compromise, explaining that if the package of proposals were accepted by the Drafting Committee and its sponsors, representatives of consumer

creditors involved in the process would actively support, and advocates of consumer interests involved in the process would not oppose, enactment of revised Article 9. The chair explained further that the alternative would be widespread opposition, with pitched battles in the various legislatures during the enactment process. This controversy could delay or inhibit enactment of the revisions. The compromise grew out of discussions among creditor and consumer representatives, a special consumer subcommittee organized by the NCCUSL leadership, and the chair of the Drafting Committee.

Under the proposal, several provisions of the prior draft would be deleted: Sections 9-104(d) and (e) (allocation of payments for determining purchase-money status in consumer transaction); 9-613(b)(3) (notice of disposition containing minor errors not seriously misleading is sufficient); 9-622 (reinstatement rights of consumer debtor or secondary obligor); 9-624(d) and (e) (reduction of secured party's liability for statutory damages by amount of loss of deficiency or actual damages awarded to consumer); 9-625, Alternative A (absolute bar rule alternative for consumer transactions); 9-627(d) (bona-fide error defense to statutory damages); 9-627(e) (limitation on recoveries in class actions); 9-628 (reciprocal attorney's fees in consumer transactions).

The proposal also calls for revision of several other provisions. Sections 9-104(f) and (g) (approving Actual status@ rule and setting burden of proof) would be applicable only to non-consumer transactions, as would Section 9-625, Alternative B (rebuttable presumption rule). Either the definition of Abuyer in ordinary course of business@ would not be revised to provide that BICOB status depends on a possessory right as against the seller, or the proposed provisions in revised Article 2 would accompany revised Article 9 to provide protection for a prepaying buyer. (We have chosen the latter approach. See the Appendix.) The comment to Section 9-111 would contain no examples of sufficient collateral descriptions in consumer transactions (e.g., the previous approval of Aall jewelry@ would be deleted). Sections 9-403 and 9-404 would be expanded to make effective the FTC's anti-holder-in-due-course rule (when applicable) even in the absence of the required legend. Section 9-614A (post-disposition notice) would be revised to provide for a somewhat more general statement of how a deficiency or surplus was calculated. The comments to Section 9-614 would be modified to delete any statement that Aprice@ is not a term of a disposition that is required to be commercially reasonable, and an explanatory comment would be added to the effect that a low price mandates enhanced judicial scrutiny of the terms of a disposition. Finally, Section 9-618 would be revised to prohibit partial strict foreclosure for consumer goods.

In implementing these changes, we generally have drawn the line between Aconsumer-goods transactions@ and other transactions. As defined, if the secured obligation was incurred for personal, family, or household purposes

and any of the collateral is consumer goods, then the transaction is a consumer-goods transaction even if other collateral is not consumer goods. Occasionally, as in Section 9-624(c)(2), we have drawn the line between consumer-goods and other types of collateral.

This draft, like most earlier drafts, includes explanations of changes from the prior draft and Reporters' Comments. Also as in the earlier drafts, we offer in these Comments and explanations our analyses of the pros and cons of proposed changes and the likely effects on litigation and transactions in practice. We assume that this approach is especially important in connection with the compromise proposals, inasmuch as most of the members of the Drafting Committee did not participate in the discussions and, consequently, may be unaware of the various considerations that were discussed.

We have done our best to implement the compromise. However, inasmuch as we did not participate in the discussions that culminated in the list of terms from which we worked, the draft and our Comments may not always capture the intended compromise completely and accurately. Although we sought and obtained guidance from the consumer subcommittee and selected officials of NCCUSL, time did not suffice to enable us to incorporate comments from representatives of consumer and creditor interests. We plan to solicit comments from the representatives before the meeting and will present to the Drafting Committee any suggested changes arising from those comments.

### **III. Procedural Critique**

The so-called consumer subcommittee that generated the consumer compromise met outside the normal drafting committee process. There is nothing unusual about that approach in a uniform law drafting process, especially when a long and complicated statute is involved. What were unusual, however, were the manner and terms of presentation of the compromise to the drafting committee. It was also unusual to keep the reporters out of the loop. In effect, the participants other than the creditor and consumer advocates were mediating. So long as the creditor and consumer advocates were happy, all would be fine. What mediator would want pesky reporters around exposing the risks and other defects of their agreement?

The compromise was presented to the drafting committee as a complete package, but without any advance notice of the nature of the proposals. Its proponents made a take it or leave it pitch. They argued that a delicately balanced compromise had been reached between consumer interests [read defaulting consumer interests] and creditor interests. Any material changes would upset the balance. Moreover, they suggested that absent the drafting committee's agreement to the compromise, legislative enactment would be in jeopardy. At the February 1998 meeting the drafting committee approved the compromise in principle by a vote of ten in favor and one abstaining.

Essentially the same pitch was made to NCCUSL and the ALI during the process of further review and final approval. During that process there was little if any discussion of the merits of the proposal or of the value of the various provisions (on which the drafting committee had already agreed) that the compromise required to be dropped from the draft.

### III. Substantive Critique

Several important consumer-related provisions were cut from the draft in accordance with the compromise. The omitted provisions reflected a balance that the drafting committee believed to be fair and workable. Neither the consumer advocates nor the creditor advocates were particularly happy with the balance struck by the drafting committee, which suggests that the balance may have been just about right. But the creditor advocates were the more disgruntled. Plainly, they had fallen victim to the superior advocacy of the consumer advocates. The compromise presented them with an opening to declare victory.

The general trade-off made by the creditors, who very much favored dropping the disfavored provisions under the compromise, was to allow advocates for consumers to argue for favorable rulings in the courts with little or no statutory guidance. For example, RA9 rationalizes the rules for determining when and to what extent a security interest is a purchase-money security interest (PMSI). It embraces the dual status approach, under which PMSI status is not destroyed, for example, if the collateral also secures nonpurchase-money obligations. Under the compromise, this approach was made inapplicable to consumer transactions. No alternative rule was provided for consumer transactions. After 8 years of work, an important issue for consumer transactions was left by the wayside. Moreover, the compromise required a provision that calls on courts not to draw any inference from the statute as to the appropriate rule for consumer transactions, but instead instructed the courts that they may continue to follow existing approaches. As if that were not enough, the consumer advocates *did not have any real interest in the PMSI characterization under Article 9*, where it matters only for perfection and priority purposes. Instead, they were preserve arguments in favor of the transformation rule in bankruptcy cases (lien avoidance of nonpossessory, nonpurchase-money security interests under Bankruptcy Code ' 522(f)) and under the FTC's holder in due course rule (same issue), without having to confront a conflicting PMSI rule in RA9.

A similar move was made in the case of the pre-RA9 conflicting approaches to the consequences of a secured party's failure to comply with former Article 9's provisions in enforcing a security interest. The pre-compromise draft provided an alternative for applying the so-called absolute bar rule in consumer transactions. It also provided for a version of the so-called rebuttable presumption rule as its principal approach. Under the compromise, the absolute bar alternative was scrapped and the rebuttable presumption approach was limited to non-consumer transactions. The rule for consumer transactions was left to the courts, with no inferences, as were the PMSI reforms described above. Former Article 9 contained no hint that the absolute bar rule could be applied. RA9, however, now contains a strong, powerful indication that an approach other than the rebuttable presumption rule clearly is thinkable for consumer transactions. How could a court not draw this inference? Should counsel for

consumer debtors in rebuttable presumption states (pre-RA9) argue for courts to reject that rule in favor of the absolute bar rule?

Finally, might these self-evident deficiencies have been outweighed by the benefits of speedy and uniform enactment of RA9 by the states? This was the mantra of the proponents of the compromise. But consumer credit regulation is in no way uniform in the states now, nor has it ever been. Some states may have expanded the uniform version of RA9 to incorporate more protection. Others might have omitted some of the protections. But I see little incentive to oppose the whole project over these minor differences.

#### **IV. Teaching about the Consumer Compromise: How and Why**

I enjoy explaining the consumer compromise to my students. It normally inspires a lively discussion about the legislative process. I ask them to evaluate the rapid enactment rationale for the compromise. I ask them how they would rule as a judge in the face of the silence on the consumer PMSI and enforcement scenarios. I ask them to try to get inside the heads of both the consumer and the creditor advocates. There must be any number of equally fine approaches to teaching about the compromise.

Of more interest, perhaps, is *why* I believe considering the compromise in class is useful. First, it provides a colorful picture of the nitty gritty negotiations inherent in the legislative process. The discussion focuses on real people who are making real arguments about public policy. Second, the discussion makes clear that the roles of individuals in the process do make a difference. The proponents of the compromise had a decisive effect on the direction of the treatment of consumer transactions in RA9. That I did not care much for the process or the result is beside the point. Individuals who decide to cause the law to change are the driving force in the process. Finally, the discussion provides an opportunity to make the point that in the future the students should recognize their responsibility to give something back to the system. Most students have a stereotypical view of *pro bono* work as the representation of indigent individuals or under-represented groups or causes. That work is, of course, important. But toiling in the realm of law reform work provides an opportunity to have an impact on the lives of millions of individuals.