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THE UNPROTECTED CONSUMER-MAKER UNDER THE UNIFORM COMMERCIAL CODE

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The Uniform Commercial Code was drafted for the purpose of modernizing and making more realistic the law of commercial transactions. Using prior case law and statutes as a frame of reference, the drafters of the Code have made notable changes in commercial law.

Some of the opponents of the Code had indicated that the transition from prior law would be difficult and would engender confusion. This, however, does not appear to be true. For example, the transition in Pennsylvania has been relatively smooth in the field of negotiable instruments. The courts have simply looked to the date of the instrument in order to ascertain which law should be applied. If the instrument was signed prior to the effective date of the Code, prior law was applied.[1] While conceivably some questions could arise as to whether a particular right "flows" from the transaction under the transitional provision of the Code,[2] none have confronted the courts. It was also contended that the new terminology would cause extended litigation. This predicted wave of litigation, however, never came. In approximately seven and one half years in a highly commercialized state with a population of over eleven and one half million, there are only seventeen published opinions dealing primarily with commercial paper in which the courts have based their decisions upon Code provisions.[3] In the few cases which did reach the courts, the new terminology did not appear to cause undue confusion.

Despite its forward outlook, some of the results under the Code in the area of commercial paper have not been entirely satisfactory. One weakness in particular is that the consumer-maker lacks sufficient protection in dealings involving negotiable paper. The purpose of this article is to analyze this lack of protection through an examination of the Code and cases decided under its provisions, and to suggest possible amendments which would alleviate the problem.

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1. See, *e.g.*, Roller v. Jaffee, 387 Pa. 501, 128 A.2d 355 (1957). See also, DELDUCA AND KING, COMMERCIAL CODE LITIGATION xvi (1960) (Mimeographed book at Dickinson School of Law) for a complete list of cases decided since the enactment of the Code but governed by the provisions of the Negotiable Instrument Law.

2. It might be contended that while a note was made prior to the Code, the rights stemming from an endorsement or from an act after the Code had taken effect must be enforced under applicable law at the time of such endorsement or act.

3. Of this number, approximately three-fourths of these decisions were on the trial court level. See DELDUCA AND KING, COMMERCIAL CODE LITIGATION, *supra* note 1.

CONFESSION OF JUDGMENT

The Code permits notes to contain "confession of judgment" clauses unless such clauses are invalid under state law.[4] While there are laws invalidating such clauses in most states, they are valid in Pennsylvania.[5]

In most of the cases thus far, judgment has been entered on the notes involving such clauses.[6] This places the consumer-maker at a considerable disadvantage. Ordinarily he must either pay the judgment or incur the expenses of an attorney in order to institute an action to open the judgment. If he chooses the latter course of action, the maker has the burden of convincing the court that he has a sufficient defense. Generally, the decision of the court on this matter will not be disturbed unless there has been an abuse of discretion. The consumer-maker in these instances is "liable until proven not liable." If the maker is found to have a defense, and judgment is opened, the procedure is still an expensive luxury.

Moreover, it is difficult to ascertain the number of instances where the consumer-maker has paid the judgment rather than going through the time, expense and worry of litigation which is necessary to open it. He often is unable to finance litigation, and is generally unaware of his legal rights. Add a judgment—a symbol of judicial backing—to the threats of foreclosure on a man's car or house (which even if not legally feasible are a considerable worry to the maker) and the factors which make the contest uneven become more apparent. Also, where judgment is confessed and entered, the consumer-maker may not only be faced with a judgment for the amount of his purchase, but for considerable attorney fees and costs as well. Thus for example, on a debt of 390 dollars, seventy dollars in attorney's fees may be added into the judgment.[7] Not only is the consumer burdened with a defective piece of merchandise, but also with a judgment in excess of the obligation he may have thought he was incurring.

Thus the Code section permitting judgment clauses ignores the realities of the burden placed upon the consumer who signed the note.[8] The argu-

4. UNIFORM COMMERCIAL CODE § 3-112(d) and Comment two.

5. PA. STAT. ANN. tit. 12A, § 3-112(d) (1953).

6. See DELDUCA AND KING, *supra* note 1 at 113-157.

7. Transcript of Record, p. 17a, Budget Charge Accounts, Inc. v. Mullaney, 187 Pa. Super. 190, 144 A.2d 438 (1958).

8. The only shaft of light in this dark area occurs when a time note contains a term that the judgment may be confessed at "any time." This term destroys the negotiable character of the note, and the maker's original defenses against the payee are good against institutions which have purchased the note. However, it is improbable that most notes will contain this latter term, since it has this effect. Sufficient advantage is obtained by commercial interests with the simple confession of judgment clause, which enables them to enter judgment after defalt of payment. The effect of the above-mentioned clause could be availed of by the use of a demand payment term. Atlas Credit Corp. v. Leonard, 56 Lanc. Rev. 57, 57 Pa. D.&C. 2d 292 (1957); Fidelity Trust Co. v. Gardiner, 191 Pa. Super. 17, 155 A.2d 405 (1959).

ment that such clauses are necessary for the flow of commercial paper would seem to fail when it is realized that this "flow" is continuing unabated in the vast number of states in which they are invalid. The permitting of such clauses also does not promote the purpose of uniformity which underlies the Code.

HOLDER IN DUE COURSE

Due to the apparent inadequate protection which the Code provides for the consumer, the majority of the cases that have arisen under it involve questions in this area. The 1952 draft of the Code provided, among other things, that the holder, in order to be a holder in due course, must have taken the instrument "in good faith, including observance of the reasonable commercial standards of any business in which the holder may be engaged."[9] Good faith was further defined as "honesty in fact."[10] Thus both a subjective and objective standard were provided.[11] This meant that banks and finance companies could not blindly shut their eyes to facts which indicated that there was fraud involved in the original transaction and still obtain the benefits of a "holder in due course." It also gave the consumer an opportunity of using objective facts to show that the holder should not be given this status. This alleviated the difficult task of attempting to show the holder's state of mind. The maker could obtain these facts by use of modern procedural developments such as the taking of depositions and requiring the production of documents. The use of such methods of discovery was sustained in a recent case.[12] Even so, the difficulty of showing that there had been a deviation from "reasonable commercial standards"[13] made this measure

9. UNIFORM COMMERCIAL CODE § 3-302(1)(b).

10. UNIFORM COMMERCIAL CODE § 1-201(19).

11. Historically, there has been a fluctuation between requiring and not requiring holders to satisfy objective standards in due course. In the earliest cases in this area, the courts were not confronted with the problem of whether the holders had departed from the reasonable standards of their trade. However, the courts did use such language as "bona fide . . . in the course of currency, and in the way of his business." Miller v. Race, 1 Burr. 461, 97 Eng. Rep. 398 (K.B. 1758). This indicates that the courts might have held that a departure from such standards prevented one from being a holder in due course, if they had been presented with such an issue. The cases which were later decided, however, definitely followed the subjective standard. Lawson v. Weston, 4 Esp. 56, 170 Eng. Rep. 640 (K.B. 1801). Nevertheless in 1824, the court in Gill v. Cubitt, 3 B.&C. 466, 107 Eng. Rep. 806 (K.B. 1824) held that the holder was not a holder in due course if he took the note under circumstances which might have excited the suspicions of a prudent and careful man. Later the courts gradually returned to the subjective standard of determining good faith. See Crook v. Jodis, 5 B & Ad. 909, 110 Eng. Rep. 1028 (K.B. 1834); Goodman v. Harvey, 4 Ad. & E. 870, 111 Eng. Rep. 1011 (K.B. 1836); BRITTON, BILLS AND NOTES § 100 (1943). However, it has been asserted by some authorities that the courts have implicitly required a conformance with reasonable commercial standards in order for there to be good faith. See UNIFORM COMMERCIAL CODE § 3-302, Comment 1 (1952). The Code brought back the objective test in conjunction with the subjective test of honesty in fact.

12. Backman & Co. Inc. v. Brubaker, 56 Lanc. Rev. 289 (1958).

13. See note 9, *supra*.

of dubious value. In most situations thus far, the consumers have apparently been unable to effectively utilize this requirement to their advantage.

One reason why this provision did not alleviate completely the problem of the unprotected consumer is that it failed to cope with a basic part of the underlying problem. The technical analysis of this type of case as being primarily a question as to which of two "innocents," the maker or holder, should suffer is not realistic in many cases. The consumer often signs papers in connection with the purchase of goods without reading them. The print is often rather fine and difficult to read, and various technical business and legal terminology is often scattered throughout the paper. The forms are standard printed ones and there is generally not the element of bargaining as to what shall be the terms or type of arrangement. The average man often feels that he has neither the time nor understanding to read all of this printed matter. Indeed, there are even "rare" situations where persons such as law students, professors, and lawyers have been known not to read the fine print of papers signed by them. The consumer usually receives no assistance from the seller who is too "busy" with other matters to explain and interpret these forms. Moreover, the salesman, who is generally skilled in the art of persuasion, usually finds little difficulty in convincing the buyer that it is unnecessary to read the papers.[14] Thus, it is unrealistic to say that the consumer is "negligent" in not reading the form and should be the one to suffer the loss.

The institutional holder, on the other hand, is in the business of discounting paper. It has the resources and facilities to ascertain the reliability of those from whom it purchases the paper. It can restrict its purchases to payees or holders who are reliable. Also, in many cases the institution is able to telephone, telegraph or write the maker to inform him where to make his payments after it has purchased the note, and it would not be too burdensome in some of these cases for it to contact the maker before it purchased the note.[15] Moreover, the institution handles a number of transactions and is able to spread its losses, whereas the individual consumer cannot.

Objections to the "reasonable commercial standards clause," however, were raised by strong financial interests which contended that it would substantially impair the flow of commercial paper.[16] It was argued that it would bring back the doctrine of *Gill v. Cubitt*,[17] which allegedly caused the discrediting of Bank of England notes on the continent in 1824. Several

14. Transcript of Record, p. 29a, First Pennsylvania Banking and Trust Co. v. DeLise, 186 Pa. Super. 398, 142 A.2d 401 (1958); Transcript of Record, p. 14a, Budget Charge Accounts v. Mullaney, 187 Pa. Super. 190, 144 A.2d 438 (1958).

15. See, *e.g.*, Transcript of Record, p. 33a, First Pennsylvania Banking and Trust Co. v. DeLise, *supra* note 14.

16. 1 REPORT OF THE NEW YORK LAW REVISION COMMISSION 204 (1954).

17. 3 B. & C. 466, 107 Eng. Rep. (K.B. 1824).

things should be noted in regard to this point. First, there is little reliable evidence as to what effect this case actually had on the flow of commercial paper at the time. Secondly, the nature of the instrument and the particular economic setting of over one hundred years ago make this an invalid criterion of the present day effects of an objective standard. Indeed, a far better test would be the experience of Pennsylvania with this clause over the past seven years. Here, this standard did not result either in judicial confusion or in the impair of the flow of commercial paper.

Another criticism of this provision was that it would create the complex problem of deciding reasonable standards of diverse businesses.[18] This alleged problem, however, has not arisen thus far, and there is nothing to indicate that it will arise in the future. Although the courts generally have not been confronted with deciding cases upon this language, the determination of whether there has been a deviation from such standards should not be difficult if general commercial classifications are followed. It should also be noted that other sections of the Code currently contain requirements of "reasonable commercial standards" and the courts will be presented with the same type of problem when applying these sections.[19]

Nevertheless, even though these objections to the "reasonable commercial standards" clause did not prove to be valid when subjected to actual trial, the vested commercial interests handily won the battle. The objective standard of the good faith test was eliminated in the 1957 draft of the Code and in the 1959 Pennsylvania amendments.[20] The reason given by the drafters for this change was that it was "intended to make clear that the doctrine of an objective standard of good faith, exemplified by the case of *Gill v. Cubitt,* 3 B & C 466 (1824) is not intended to be incorporated in Article 3."[21] As the Code now stands, institutions still might be considered as holders in due course even though they do not follow reasonable commercial standards.

Defenses of the Consumer

The Code provides the maker of a note with a defense against the holder in due course where he has been induced by a misrepresentation to sign the instrument "with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms."[22] Several things should be

18. Britton, *Holder in Due Course—A Comparison of the Provisions of the Negotiable Instruments Law with Those of Article 3 of the Proposed Commercial Code,* 49 Nw. L. Rev. 430 (1954).

19. See, *e.g.,* Pa. Stat. Ann. tit. 12A, §§ 2-103(1)(6) and 3-406 (1959).

20. Pa. Stat. Ann. tit. 12A, § 3-302(1)(b) (1959).

21. See 1956 Recommendations for the Uniform Commercial Code issued by the American Law Institute and the National Conference of Commissions of Uniform State Laws § 3-302.

22. Pa. Stat. Ann. tit. 12A § 3-305(2)(c) (1959).

noted about this provision. One is that it retains the traditional distinction between fraud in the inception and fraud in the inducement.[23] While it does furnish the consumer with a defense in situations where the misrepresentation prevents him from ascertaining the character of the instrument, it does not protect the consumer in cases where the fraud of the payee has been related to the product, performance, or other aspects of the transaction. Yet fraud in this latter area may be even more difficult to discover. Thus this historical distinction fails to take into account difficulties of equal magnitude for the consumer in the area of fraud in the inducement.

Not only are the defenses of the consumer limited to fraud in the inception, but even where such fraud on the part of the payee can be shown, the consumer-maker must show that he had been induced to sign the instrument with "neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms."[24] While the comment to the section lists a number of factors which should be taken into account in deciding this issue, the section is so worded that it is difficult for the court to hold in favor of the consumer. Thus in one case the court found a reasonable opportunity to obtain knowledge of the documents and terms even though it appears that one of the consumers had little formal education, another could not read the fine print, and their friend who was present did not read the documents because of the fast and continuous talking of the salesman.[25] While the courts should utilize the factors mentioned in the comments to protect the consumer when possible, this court, as others, undoubtedly felt strongly constrained by the statutory language. The court, in ruling against the consumer, noted that there was no evidence that the salesmen would have refused to let the consumer examine the papers if he had asked.[26] This, however, ignores the fact that the consumer often does not ask because of the prevalent "pressure methods" used by the "skilled" salesman. Two other factors in these situations which often prevent the consumer from ascertaining the nature of the paper or its terms are: (1) the physical characteristics and arrangements of the papers,[27] and (2) the overall complexity of the scheme.[28] The unworkable nature of the section is more apparent when it is

23. Also referred to as "real" or "essential" fraud, and "fraud in the essence," or "fraud in factum."

24. See note 22, *supra*.

25. First National Bank of Philadelphia v. Anderson, 5 Bucks 287, 7 Pa. D.&C.2d 661 (1956).

26. *Ibid.*

27. Often the consumer does not realize he is signing a judgment note since it is a part of the same sheet of paper as is the contract. First National Bank of Philadelphia v. Anderson, 5 Bucks 287, 7 Pa. D.&C.2d 661 (1956).

28. Transcript of Record, pp. 27a-34a, First Pennsylvania Banking and Trust Co. v. DeLise, *supra* note 14; Transcript of Record, pp. 18a-22a, Budget Charge Accounts v. Mullaney, *supra* note 14.

noted that the maker not only has the burden of establishing evidence showing the payee's fraud, but also of showing that he had no reasonable opportunity to ascertain the nature or terms of the instrument.[29]

ALTERATIONS

In a situation where a note contains blank spaces which are not filled in by the consumer when he signs, but are later unscrupulously filled in, the holder in due course may enforce the instrument as completed.[30] Also in situations where the note is altered and the maker's negligence contributes to the alteration, the bank or finance company may enforce it as changed.[31] The main theory behind this provision is that the maker of the note is negligent in "setting it afloat upon a sea of strangers" and must bear the consequences.[32] The concept of negligence in consumer transactions is not entirely realistic in its application. It is relatively easy for the seller to convince the consumer that the blanks will be filled in when the exact interest is figured or other minor costs are ascertained. In addition, the seller may merely tell him that some of the blank spaces in the standard printed form do not pertain to this type of transaction. The consumer, who has already filled in numerous blanks and the price to be paid on the main agreement, does not realize that it is also necessary to fill in other spaces. Thus, while businessmen might be held to a standard of filling all blanks and spaces, it is unrealistic to expect the consumer to do so.[33]

SUGGESTED AMENDMENTS

Amendments to Article Three are necessary if the consumer is to be protected and the policies of the Code implemented. Modern financing practices make this an area of utmost importance, and the effect of other provisions of the Code benefiting the consumer may be rendered nugatory by the sections of Article Three which deprive him of his defenses.

In drafting such amendments it must be recognized that different rules are necessary for the consumer and the businessman acting for his company. As mentioned previously, it is unrealistic to operate on the assumption that the consumer will fully read or understand the paper presented to him in a personal transaction. Nor is it reasonable to expect him to consult a lawyer

29. PA. STAT. ANN. tit. 12A, § 3-307 and Comments (1954).

30. PA. STAT. ANN. tit. 12A, § 3-407(3) (1959); see also First National Bank of Philadelphia v. Anderson, *supra* note 25; Century Appliance Co. v. Groff, 56 LAW. REV. 67 (1958).

31. PA. STAT. ANN. tit. 12A, § 3-406 (1959).

32. PA. STAT. ANN. tit. 12A, §§ 3-406 and 3-407 and Comments (1954).

33. The weaknesses outlined above regarding Article Three should not restrain states from adopting the Code, since these weaknesses exist under the NEGOTIABLE INSTRUMENTS LAW and are not aggravated by the Code.

whenever entering into such purchases. Likewise, it may be difficult for him to ascertain when signing the note whether there has been any fraud relating to, or defects in, the product or subsequent performance. He is generally unskilled in business matters and no semblance of equality exists between him and the seller.

An amendment giving fuller protection to the consumer could be made to the section relating to defenses against holders in due course. It could be provided that the holder in due course does not take the instrument free from the defenses of a person who has executed the note in connection with the purchase of "consumer goods."[34] This type of clause could easily be worded to fit into the listed exceptions to the rights of a holder in due course under Subsection two of Section 3-305. This would furnish protection for the consumer and at the same time still retain the general concept of holder in due course for transactions between businessmen. While in a few given instances there might be questions as to whether "consumer goods" were involved, generally this should not be a problem. It should be noted that the courts will be faced with the same issues in interpreting other sections of the Code in which the term "consumer goods" is used.[35] Nor should this distinction cause any great problems for banks and financing companies purchasing notes. Generally they will be able to tell by the name and manner in which the note is signed, the amount, and the name of the payee of the note, whether the maker is a consumer and consumer goods are involved. In addition, such problems usually will not arise for the purchaser of a note who is dealing only with reliable companies.

Slight amendments to several other sections should also be made to complete the protection given to the consumer. Section 3-112 should be changed so that confession of judgment terms will not be valid in cases where the maker is purchasing consumer goods for his personal consumption. Likewise, the consumer should be exempt from the provisions of Section 3-406 concerning alterations and Section 3-407 which permits the holder in due course to enforce an incompleted instrument as completed.

Since these concepts are of such an important and fundamental nature, they should be included within the Code, rather than being left up to individual states to enact as separate legislation. While in various states separate acts have been passed which protect the consumer in isolated areas such as the purchase of a motor vehicle,[36] these do not give the overall protection which

34. The definition of "consumer goods" is found in PA. STAT. ANN. tit. 12A, § 9-109 (1959).

35. PA. STAT. ANN. tit. 12A, §§ 9-204, 9-206, 9-302, and 9-307 (1959).

36. See, *e.g.*, PA. STAT. ANN. tit. 69, § 615 (1947); see also Maleson, *Commercial Law*, ANNUAL SURVEY OF MASSACHUSETTS LAW Ch. 6 (1959), for a discussion of other separate legislation designed to protect the consumer.

is needed.[37] More important, however, is the fact that separate legislation within each state on such basic and fundamental concepts would create a lack of uniformity and defeat one of the major purposes of the Code.

While these amendments to the Code would certainly not solve all of the problems of the consumer today, they would aid him in a major problem area. They would also bring about a higher commercial standard by banks and finance companies. The invalidity of the somewhat nebulous argument that the "flow of commercial paper will be impaired" is demonstrated by a continuing of financing in the few areas where the consumer is given protection by special legislation and in the areas of financing accounts receivable.[38] Nor would these amendments affect the vast area of financial arrangements and the use of negotiable instruments as between businessmen. With these changes, the Code may better reflect realism and bring about a new era in commercial law—that of "the protected consumer."

37. It has been contended that the Code repeals by virtue of the general repealing provision all inconsistent acts, among which, seem to be the Motor Vehicle Sales Finance Act: First National Bank of Millville v. Horwatt, 192 Pa. Super. 581, 162 A.2d 60 (1960).

38. Sutherland, *Article 3—Logic, Experience, and Negotiable Paper,* 1952 WISC. L. REV. 230.