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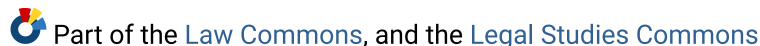
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A New Uniform Code of Consumer Credit

*Danielle D'Onfro**

Introduction

All levels of government want to regulate consumer credit, albeit not necessarily for the same reasons. At the federal level, there is the Truth in Lending Act (TILA),[1] the Home Owner Equity Protection Act of 1995 (HOEPA),[2] the Federal Trade Commission Act (FTCA),[3] actions and guidelines by an alphabet soup of federal regulators,[4] and now the Dodd-Frank Act.[5] At the state level, there are statutes aimed directly at lending[6] and laws banning unfair and deceptive acts or practices (UDAP). Before the credit crisis of 2008, there was a pattern of permissive federal regulators using preemption to thwart states' efforts to regulate consumer credit more tightly. State regulators tended to ramp up their rules in response to specific questionable practices by lenders, while federal regulators cleared away these state-imposed rules in favor of their own policies, including policies of not regulating consumer credit.

There are several reasons for these conflicting agendas. Focusing first on benign sources of conflict, problems in consumer credit, notably predatory lending, are difficult to define.[7] Even if they can agree that some kinds of credit are harmful, regulators must balance the desire to extend credit down the socio-economic ladder against the desire to protect borrowers from the kinds of credit that destroy wealth rather than create it.[8] This concern

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[1] 15 U.S.C. § 1601 (2006).

[2] *Id.* § 1639.

[3] *Id.* §§ 44–58.

[4] Most federal financial regulators have consumer protection powers, but they have not used these powers despite widespread evidence of deceptive practices in the years preceding the credit crisis. *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. Pa. L. Rev. 1, 89 (2008).

[5] Pub. L. 111-203, 124 Stat. 1376-2223 (2010).

[6] As of 2005, 26 states had passed laws targeting predatory lending. Baher Azmy, *Squaring the Predatory Lending Circle,* 57 Fla. L. Rev. 295, 405–410 (2005). By 2007, forty states had passed such laws. Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting off More Than They Can Chew?*, 56 Am. U. L. Rev. 515, 515 n.3 (2007) [hereinafter Peterson, *Preemption*].

[7] A former director of the Office of Thrift Supervision, Ellen Seidman, has famously adopted the obscenity test for predatory lending: "You tend to know predatory lending practices when you see them, but trying to come up with a neat definition is difficult." Ellen Seidman, Dir., Office of Thrift Supervision, Dep't of Treasury, Strategies for Combating Predatory Lending in Our Neighborhoods (Feb. 23, 2000), *available at* http://www.ots.treas.gov/_files/87073.pdf.

[8] This tension appears in two similar empirical studies of North Carolina's predatory lending law. Both found that subprime lending fell after the passage of the laws, but they reached different conclusions about what this drop meant. *Compare* Gregory Elliehausen & Michael E. Staten, *Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Preda-*

affects both the content and structure of regulation since complying with multiple layers of regulation, even if they are similar, may raise the cost of credit, thereby limiting its reach.

Less benign is the problem of capture. Capture occurs when "through lobbying the regulated firm is able to win the hearts and minds of the regulators," putting them into the "what is good for GM is good for America" mentality.[9] In the recent credit crisis, these conflicting priorities likely led to the Office of the Comptroller of the Currency's (OCC) lax enforcement of consumer protection rules. The OCC oversees both consumer protection and bank safety and soundness, which some commentators describe as code for "profit."[10] The former head of the OCC's experience was with the banks, the bulk of his present work was with the banks, and the banks had more direct access to his attention than consumers.[11] It should be unsurprising that when choosing which problems to tackle, he choose safety and soundness over consumer protection.[12] When a regulator has multiple goals, its challenge is striking the right balance. Capture threatens that balance. The structure of regulation is as important as its content.

Dodd-Frank improved the structure of consumer credit regulation at both the state and federal levels. At the federal level, the Consumer Financial Protection Bureau (CFPB) added a layer of oversight focused exclusively on consumers' concerns. While the CFPB may be a bulwark against the banks' efforts to capture their historical federal regulators, it is not immune from capture. Similarly, because its actions are subject to input from the other financial regulators, capture elsewhere may hobble it over time.

At the state level, assuming that Dodd-Frank altered the preemption landscape, there is now room for states to insert their own consumer financial protection laws. During the drafting process, banks fought to preserve

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tory Lending Law, 29 J. Real Estate Fin. & Econ. 411 (2003) (arguing that the 14% reduction in subprime lending in North Carolina that occurred after it implemented stringent laws against predatory lending showed that the cost of compliance was a reduction of the availability of credit to lower income borrowers), *with* Roberto G. Quercia et al., *Assessing the Impact of North Carolina's Predatory Lending Law*, 15 Housing Policy Debate 573, (2004), *available at* http://www.kenan-flagler.unc.edu/assets/documents/CC_Assessing_NCPredLaw.pdf (arguing that the reduction in subprime lending shows that the law works as intended).

[9] Ian Ayres & John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate 63 (1992).

[10] *E.g.*, Bar-Gill & Warren, *supra* note 4, at 90; Bob Herbert, *Derailing Help for Consumers*, N.Y. Times, Mar. 26, 2010, at A19, http://www.nytimes.com/2010/03/27/opinion/27herbert.html ("'Safety and soundness' is a euphemism for profitability. What's really being said is that when the profitability of the big banks and other financial agencies and institutions are in conflict with the fair treatment of consumers, it's the fair treatment of consumers that has to give way.").

[11] Andrew Martin, *Does This Bank Watchdog Have a Bite?*, N.Y. Times, Mar. 28, 2010, at B1, http://www.nytimes.com/2010/03/28/business/28dugan.html?8dpc.

[12] *See* Daniel Carpenter, *Why Consumers Can't Trust the Fed,* N.Y. Times, Mar. 16, 2010, http://www.nytimes.com/2010/03/17/opinion/17Carpenter.html (critiquing the proposal to put the Consumer Financial Protection Agency inside the Fed: "For one, the Fed is above all concerned with inflation and other systemic risks to the economy; given a conflict between avoiding threats to the economy and consumer protection, is it reasonable or fair to expect it to choose the latter?").

broad federal protection while consumer advocates and states sought to limit the OCC's preemption power and let states regulate consumer credit. Both sides are claiming victory.[13] At the very least, Dodd-Frank overturned the Supreme Court's decision in *Watters v. Wachovia Bank, N.A.*,[14] which held that subsidiaries enjoyed the same preemption as their corporate parents.[15] In other words, states may now regulate bank-owned mortgage brokers, lenders, and servicers, just as they would independent brokers, lenders, or servicers. Dodd-Frank may have recalibrated preemption by eliminating the field preemption enjoyed by national banks and their subsidiaries.[16] Given the amount of money at stake and the clout of the national banks, it seems likely that courts will have to decide this question. Despite this ambiguity, overturning *Watters* restores to states significant regulatory power.

This Essay argues that, despite their remaining ambiguity, the changes to preemption have created an opportunity to provide a less easily captured layer of oversight while remaining sensitive to the concern that each added layer of regulation increases the cost of credit. This layer should sit at the state level in order to reduce the risk of capture by vesting control in fifty discrete regulators. State-level regulation should be a uniform law, modeled on the Uniform Commercial Code (UCC) to prevent compliance costs from driving up the cost of credit to the exclusion of non-wealthy borrowers and from generating safety and soundness concerns for the banks. This idea is not new: thirteen states adopted a Uniform Consumer Credit Code (UCCC) promulgated in the 1970's, but the passage of Dodd-Frank and the lessons learned from the recent credit crisis suggest that we can do better.

Part I will explore structural arguments for a new UCCC. It will first look at the different motives of state and federal regulators and argue that state regulators are likely to be more responsive to consumers' needs than federal regulators. This subsection will build on both traditional arguments for federalism and recent scholarship on so-called blue-state federalism. Next, it will discuss the benefits and challenges to having a private body of experts promulgate a uniform law for states to enact.

Having made the case for a UCCC, Part II will delineate several general guidelines for its content. It will begin by reviewing existing federal regulation and identify how a state-based regime can complement these regula-

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[13] *See* Cheyenne Hopkins, *Preemption After Dodd-Frank May Not Be as Weak as You've Heard*, American Banker, Mar. 15, 2011, http://www.americanbanker.com/issues/176_50/preemption-1034399-1.html?ET=americanbanker:e6118:1509312a:&st=email&utm_source=editorial&utm_medium=email&utm_campaign=ABLA_Daily_Briefing_031411.

[14] Pub. L. 111-203 § 1045.

[15] 550 U.S. 1 (2007).

[16] The confusion is over how to interpret the law's reference to the Supreme Court's decision in Barnett Bank of Marion City, N.A. v. Nelson, 512 U.S. 25 (1996). Supporters of preemption argue that the reference to *Barnett* proves that the law did not change how the OCC can preempt state laws. Opponents argue that the reference proves that the OCC may only preempt state laws that "significantly interfere" with the federal program. Since 2004, the OCC has interpreted *Barnett* to grant it broad preemption power, rendering meaningless any requirement that it preempt state laws on a case-by-case basis. *See* Hopkins*, supra* note 13.

tions. Next it will draw lessons from arguably the most successful uniform law, the UCC. While this project may seem daunting, this section will then explain that states are already halfway there. All fifty states have a law of UDAP, which, if applied to consumer credit transactions, would satisfy the broad principles proposed here.

I. Structural Arguments for a UCCC

A. *Embracing Federalism*

States are in a better position than federal regulators to balance consumer protection with safety and soundness. They bear the externalities of failed credit yet have an incentive to keep the banks happy and healthy in order to preserve jobs and access to credit. For example, foreclosure depresses the property values of an entire neighborhood, while stressing all areas of the social safety net, from public assistance to the public schools attempting to educate distressed and displaced children.[17] Yet, if a state overregulates consumer credit, it may face similar problems as its citizens cannot afford the credit they need to secure their own housing. In other words, because they are closer to the problems, states are more likely to be responsive to their constituents needs than a federal regulator.

Critics of this responsiveness argument have focused on two issues: local level politics' susceptibility to capture by special interests and the lack of voter interest in local elections, making it unclear to whom local officials must respond.[18] Neither applies to consumer protection. First, the relative risk that special interests will capture fifty state legislatures and the drafters of a uniform law is small compared to the chance that they will capture a single agency. Second, even if voters pay little attention to state legislators, that modicum of democracy may be meaningful, especially compared to the federal alternative—unelected agency heads whose terms may extend beyond that of the president who appointed them. While a state legislature could adopt such stringent rules that credit would become unavailable, or decide that no regulation is the best kind of regulation, the question remains: which level of government is more likely to make the right decision?

State and local leaders have taken the lead in confronting some of the nation's most intractable problems. They have done so despite the Bush Administration's zeal for using preemption to undo their efforts.[19] Many com-

[17] *See* The Pew Charitable Trusts, Defaulting on the American Dream (2008), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Subprime_mortgages/defaulting_on_the_dream.pdf.

[18] *See* Erwin Chemerinsky, *The Values of Federalism*, 47 Fla. L. Rev. 499, 527–28 (1995).

[19] *See* Michael Calhoun, Ctr. for Responsible Lending, Perspectives on the Consumer Financial Protection Agency, Testimony Before the U.S. House of Representatives Committee on Financial Services (Sept. 30, 2009), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/cfpa-calhoun-testimony.pdf; *see also* Robert A. Schapiro, *Not Old or Borrowed: The Truly New Blue Federalism*, 3 Harv. L. Pol'y Rev. 33

mentators have studied the growth of federal preemption against state efforts to regulate consumer credit and have observed that rather than furthering a uniform system, it created a lightly regulated space in which lenders exploited then exported gaps in each state's regulations while leaving states powerless to close these gaps.[20]

Preemption even led states to create exemptions in their non-preempted laws.[21] For example, they excluded credit transactions from UDAP and passed parity laws excusing state-chartered banks from rules that could not reach nationally-chartered banks due to preemption. States passed these parity laws so that state-chartered institutions could compete against federally regulated institutions.[22] In other words, the federal policy of no regulation effectively prevented states from regulating their own businesses.

While it may be tempting to see the current willingness to regulate at the federal level as an opportunity to take a top-down approach, this position is ignorant of its surroundings. David Barron warns of "crowding out," which is the process by which the winning party assumes both that it is the best decision maker and that it will get to make the decisions forever.[23] When the federal government crowds out state actors, there are fewer creative minds tying to solve social problems and greater barriers to experimenting with new policies. We may not be inclined to view this as a bad thing until the party holding that position no longer shares our views. Where the federal government has complete power to add substance to consumer protection laws, it has the power to remove substance with equal efficiency.

A better approach to regulating consumer credit would spread power among experts—the states—while coordinating their efforts so as to minimize costs for businesses and maximize clarity for consumers. Limiting compliance costs is essential because an increase in the cost of credit limits the credit available to precisely the people that the laws attempt to protect. Moreover, uniformity provides critical predictability for consumers moving between states. A uniform law would capture the benefits of regulation at the state level while preserving the efficiencies of nationwide regulation.

(2009); David J. Barron, *Foreword: Blue State Federalism at the Crossroads*, 3 HARV. L. POL'Y REV. 1, 1–2 (2009).

[20] *See* Bar-Gill & Warren, *supra* note 4, at 69–70 (cataloguing the preemption debate); *see also id.* at 91 ("In theory, the banking agencies have authority to investigate new products, to develop new regulations, and to police those new regulations. The relevance of such power, however, is diminished by the agencies' lack of interest in exercising this power.").

[21] CAROLYN CARTER ET AL., NAT'L CONSUMER LAW CTR., UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 1.1, § 2.2.1 (7th ed. 2008).

[22] *See* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 74–76 (2005) [hereinafter Peterson, *Federalism*] (describing state parity rules).

[23] Barron, *supra* note 19, at 5.

B. *Drafting and Passing a Uniform Law*

Uniform laws are well-established in the United States. Their main promulgators are the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI). NCCUSL is a non-profit comprised of 300 uniform law commissioners whose work is primarily funded by state appropriations. The ALI is a non-profit composed of no more than 3000 members elected from the legal elite—practitioners, professors, and judges—who publish Restatements, Model Rules, and Principles, all of which aim to clarify the law and nudge it towards best practices. After NCCUSL or the ALI drafts a new uniform law, it is not binding until passed by state legislatures or adopted by the states' courts. Before they are binding, uniform laws may be highly influential.

In the late 1960's and early 1970's, Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming adopted a Uniform Consumer Credit Code.[24] While this code contains many good sections, it is built on rigid rules, such as interest rate caps, that leave little room for lenders to try to bring credit to smaller, less affluent borrowers.[25] Other provisions do not pass constitutional muster.[26] Starting from scratch is likely to yield a simpler, more cohesive law that is palatable to a greater number of states.

While drafting a uniform law does not guarantee its passage,[27] several factors suggest that the moment is ripe for trying again. Consumer financial protection has the public's, the media's, and lawmakers' attention. Moreover, as the CFPB gets up and running and courts clarify how Dodd-Frank altered preemption, states are likely to need to modify their consumer lending laws. This flux may create an opportunity to encourage states to pass a uniform law. Depending on how courts interpret Dodd-Frank's modifications to preemption, it is also possible that the consumer credit industry will support a standardizing state-level regulation. If industry does support a uniform law, consumer groups must be vigilant that industry does not dictate the drafting process.[28]

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[24] For a catalog of state laws implementing the 1968 and 1974 Uniform Consumer Credit Code, see Cornell University Law School, *Uniform Business and Financial Laws Locator*, http://www.law.cornell.edu/uniform/vol7.html#concc.

[25] *E.g.*, ME. REV. STAT. tit. 9A, § 2-201 (2009) (setting permissible APR's between 15% on loans over $2,300 and 30% on loans under $1,000). While these rates may seem high, they may in fact be cheaper than the other options facing a family that is short on cash at the end of the month. For example, the late fee and reconnection fee on an overdue utility bill may cost much more than a $500 loan at 36%.

[26] Midwest Title v. Mills, 593 F.3d 660 (7th Cir. 2010) (holding that Indiana's Uniform Consumer Credit Code regulated out-of-state commerce in violation of the Dormant Commerce Clause).

[27] Gregory E. Maggs, *Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code*, 71 U. COLO. L. REV. 541, 552 (2000) (describing the failure of projects covering payment transactions, computer information, and revisions to Article 2).

[28] Industry interests have hijacked the drafting process before. *See, e.g.*, Charles W. Wolfram, *Bismarck's Sausages and the ALI's Restatements*, 26 HOFSTRA L. REV. 817, 821–22

Finally, the very process of writing a UCCC may be transformative. The law may never become binding, but the fact that a team of the nation's experts spoke under the non-political aegis of either NCCUSL or the ALI could influence judges' interpretations of their own states' law.[29] The presence of a uniform law might also give a federal regulator pause next time she considers preempting all states' efforts in a field.[30] Preemption is after all a policy judgment,[31] and the fact that a non-political group of the nation's most expert attorneys has chosen to act at the state level might suggest that there is a strong policy reason not to favor preemption.

II. The Content of a UCCC

Detailing exactly what should go into the UCCC is beyond the ambition of this Essay—there is a reason why teams of experts from NCCUSL and the ALI spend years drafting revisions to existing uniform laws. Instead of proposing specific provisions, the following sections delineate broad guidelines and make a few suggestions for future drafters, whether they be tasked with creating a uniform law or, in the meantime, updating their state's code.

A. Complementing Federal Regulations

State regulation duplicating federal regulation is likely to raise compliance costs even if the two regimes do not contradict each other. Afer all, industry must learn the law to know that it duplicates federal law. To minimize the risk that added federal regulation would raise the cost of credit, a UCCC should focus on filling gaps in the existing federal regime. Where it is available, drafters should use data to determine which parts of the federal regime are working well and which need help. Absent data, the second best option is to look to behavioral economists since they have identified many shortcomings in the current federal regime. An investigation of the federal regime must begin with TILA[32] because it has dominated modern federal consumer credit regulation.

(1998); C. Scott Pryor, *How Revised Article 9 Will Turn The Trustee's Strong-Arm Into a Weak Finger: A Potpourri of Cases*, 9 Am. Bankr. Inst. L. Rev. 229, 230–231 n.7–11 (2001).

[29] It is rare that a Restatement or other non-binding law dramatically changes the course of a field of law, but it remains possible. One only has to consider the Restatement (Second) of Torts, which arguably created products liability law to see the potential power of a Restatement. *See* Wolfram, *supra* note 28, at 820.

[30] At the very least, it gives some of the nation's best lawyers an interest in fighting preemption insofar as it would undo their work.

[31] *See* Brief of the Chamber of Commerce of the United States of America as Amicus Curiae in Support of Respondents, Cuomo v. The Clearing House Assn. LLC, 129 S. Ct. 2710 (2009) (No. 08-453), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/08-453_RespondentAmCuUSCoC.pdf.

[32] 15 U.S.C. §§ 1601–1693 (2006).

1. *Understanding TILA*

TILA was and, depending on how the CFPB interprets its mandate, may still be, the cornerstone of federal predatory lending regulation. Passed in 1968, it requires lenders to uniformly disclose the terms of financial products to help consumers make meaningful comparisons between products. It standardizes the calculation of the annual percentage rate and requires the disclosure of this rate as the "finance charge"[33] or "annual percentage rate" (APR).[34] Before its passage, it was nearly impossible for consumers to compare the actual cost of credit because even the most basic contract terms lacked any standard definition.[35] Commentators have noted that TILA remains the vanguard of consumer protection policy both because of its wide application and because "Congress explicitly chose to use *disclosure*, rather than direct, substantive regulation of the market as the primary, though not sole, mechanism for achieving TILA's various goals."[36] Despite successfully raising awareness of the true cost of credit[37] and increasing competition in the consumer credit market,[38] Congress weakened TILA in 1980, alleging that it had become too complex for consumers to understand and for even well-meaning lenders to follow.[39]

While Congress has worried about TILA being too complex, consumer advocates have argued that its flaws are more basic. Critics of TILA usually note first that the timing of the disclosures virtually guaranteed that consumers will not read them and even if consumers did read them, the disclosures would be unlikely to influence behavior.[40] Historically, home mortgage and home equity borrowers received final TILA disclosures at the time of closing, when they had already psychologically committed to the loan and for various financial and social reasons were highly unlikely to back out if they noticed a problem.[41] Commentators have noted that the terms of the actual loan offered have surprised borrowers at closing because they believed they were going to receive a different mortgage product.[42]

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[33] § 1605.

[34] § 1606.

[35] Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 Fla. L. Rev. 807, 875–76 (2003) [hereinafter Peterson, *Understanding*].

[36] Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 Cornell J. L. & Pub. Pol'y 199, 203 (2005) (emphasis added).

[37] Elizabeth Renuart et al., Nat'l Consumer Law Ctr., Truth in Lending § 1.2.2, at 6 (7th ed. 2010) (in 1969 less than 15% of the population was aware of prevailing APR's compared to 55% in 1977).

[38] S. Rep. No. 96-368, at 16 (1980), *reprinted in* 1980 U.S.C.C.A.N. 236, 252.

[39] *Id.*

[40] Edwards, *supra* note 36, at 204 (summarizing the dominant critiques levied against TILA).

[41] *See* Peterson, *Federalism*, *supra* note 22, at 17–19 (describing how the closing process all but guarantees that TILA and RESPA disclosures will go unread).

[42] One study suggests that the disclosures in brokered loans were less likely to be accurate than those in loans made directly between the lender and the borrower. J. Michael Collins,

Other critics note that while TILA regulates what lenders must disclose, it does not regulate how they disclose it.[43] Lenders can undermine disclosures by presenting them as mere formalities or by presenting them alongside more interesting information that will win away the borrowers' attention.[44] Under TILA, the use of model forms is a complete defense to any claim of liability unless there is an error in the numbers.[45] Compliance with TILA's written disclosure requirements gives lenders and brokers a carte blanche to talk exclusively about the low teaser rate and refinancing options, although the true cost of the loan is much higher. This kind of rule substitutes form for substance. For disclosure to work, the borrower needs both to read the form and to take it as the final word of the credit's terms.

The problem of getting consumers both to read and understand disclosures reappears when deciding how much detail to give consumers. Where the requirements are too general, lenders may be able to hide costs in unregulated terms. Where they are too specific, it becomes easy for lenders to comply with the letter of the law without complying with its spirit. Additional information may increase clarity, but it can also increase length and complexity, thereby increasing the risk that consumers will ignore the disclosures altogether.[46] Another common problem is that lenders write their disclosures above the eighth-grade level at which most American adults

How Good is the Good Faith Estimate? How Truthful is the Truth in Lending Act? Comparing Mortgage Loan Disclosures to Settlement Documents, 16 (July 13, 2010), *available at* http://ssrn.com/abstract=1563536.

[43] Michael S. Barr et al., New Am. Found., Behaviorally Informed Financial Services Regulation 6–7 (2008), *available at* www.newamerica.net/files/naf_behavioral_v5.pdf.

[44] The use of model forms or otherwise complying with the written disclosure requirements are not defenses where the borrower receives additional paperwork that contradicts the information on the disclosure. *See, e.g.*, Leon v. Wash. Mut. Bank, F.A., 164 F. Supp. 2d 1034, 1040 (N.D. Ill. 2001).

[45] 15 U.S.C. § 1604(b) (2006) ("A creditor or lessor shall be deemed to be in compliance with the disclosure provisions of this title with respect to other than numerical disclosures if the creditor or lessor (1) uses any appropriate model form or clause as published by the Board . . ."). This defense even applies if the lender modifies the form provided that they do not change its "substance, clarity, or meaningful sequence of the disclosure." *Id.* § 1604(b)(2)(B).

[46] *See* William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 Va. L. Rev. 1083, 1115–16 (1984) (finding that shopping for a mortgage was "more a function of people's emotional response than a rational assessment of the costs and benefits of further search"); *see also* W. Kip Viscusi, *Using Warnings to Extend the Boundaries of Consumer Sovereignty*, 23 Harv. J. L. & Pub. Pol'y 211, 230 (1999) (describing the costs of excessive warnings but nonetheless advocating for a warnings-based regulatory system over one that limits consumer choice).

read.[47] In other words, consumers may not understand what disclosures mean even if they read them and take them seriously.[48]

TILA, for all its flaws, remains essential as well since it standardizes the language of credit. As a set of rules in need of regular updating, it is best managed at the federal level, since even the time it would take for all fifty states to enact a uniform rule could disrupt the market and raise the cost of credit. Nonetheless, there is plenty of room for states to make improvements. There is no single best solution to these communication problems, but ignoring them is unhelpful. Instead, behavioral economics can help uncover strategies for overcoming these problems.

2. *Borrowing from Behavioral Economics*

Recent scholarship in behavioral economics seeks to address TILA's shortcomings by recognizing that the lending industry is outmaneuvering its ex-ante, rules-based approach and trying to build in safeguards. In their 2008 article, *Behaviorally Informed Financial Services Regulation,* Michael S. Barr, Sendhil Mullainathan and Eldar Shafir address the shortcomings of such an ex-ante, rules-based approach to financial services regulation by proposing two changes: first, a set of "sticky" opt-out approaches favoring conventional mortgages like the 30-year fixed-rate; second, an ex-post component to TILA that would ask "whether the lender meaningfully conveyed the information required for a typical consumer to make a reasonable judgment about the loan."[49] They describe this first component as falling between standard disclosure and direct product regulation.[50] Under the "sticky" opt-out model, lenders *must* offer borrowers a conventional loan product, but they are permitted to continue offering alternative products if they also provide additional disclosure and accept heightened liability for failure to adequately disclose the risks.[51] As economists have observed, "the existence of myopic consumers creates equilibrium shrouding that is immune to such competitive pressure."[52] That is, the rest of the industry is

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[47] U.S. Gov't Accountability Office, GAO-06-929, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 38 (2006), *available at* http://www.gao.gov/new.items/d06929.pdf. Even the Securities and Exchange Commission requires disclosure materials to be written at the sixth- to eighth-grade level, which is striking since it may not be unreasonable to assume that most recipients of SEC disclosures are more sophisticated than recipients of credit card and other consumer lending disclosures. *Id.*

[48] This misunderstanding is the product of consumer bias. Sophisticated firms that regularly conduct business with consumers can adjust their behavior over time to best use these biases to their advantage. *See* Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q. J. Econ. 505, 505 n.1 (2006) (cataloguing the literature on "markets in which sophisticated firms interact with consumers who may have psychological biases").

[49] Barr, *supra* note 43, at 7.

[50] *Id.* at 8.

[51] *Id.* at 9.

[52] Gabaix, *supra* note 48, at 507. Myopic consumers are those who "incompletely analyze the future game tree," meaning that they may fail to realize what a disclosed credit term

more likely to adopt the questionable practice than to compete with other players on that term. By making best practices "sticky," Barr and his co-authors hope to prevent bad practices from overwhelming good practices.[53]

While it may be politically difficult to require lenders to offer particular products, a tiered system of rebuttable presumptions could approximate these kind of "sticky" defaults. A rough sketch of what the tiers could look like on debt secured by the family home is as follows: the safest, most traditional kinds of debt would be presumed valid unless the borrower makes a clear showing of fraud. Non-traditional debt that leaves the borrowers' highest debt-to-income ratio (DTI)[54] under a certain threshold (Threshold 1)[55] will be presumed valid unless the borrower makes a facial showing of a deceptive act.[56] Debt that brings the borrowers' highest DTI over Threshold 1 but under a second threshold (Threshold 2) will be presumed invalid unless the lender makes a facial showing that the parties bargained for these terms.[57] Finally, debt that brings the borrowers' highest DTI over Threshold 2 will be presumed invalid unless the lender can show by a preponderance of the evidence that the two parties engaged in sophisticated negotiations and that the borrower understood the risk.

There is a lot of room to fine-tune the policy within this framework. For example, the burdens placed on the lender for debt secured by real estate other than the family home could be lower than those placed on debt secured by the family home. The purpose of the tiers is to encourage lenders to offer borrowers safe and affordable credit and to provide strong disincentives, both in the form of litigation costs and increased liability, to engage in foul play. This is an attempt to functionally recreate Barr's "sticky" opt-out system. Shifting the burden from the borrower to show that there was a flaw in

means to them. *Id.*; *see also* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1118 (2009) ("When lenders respond to a demand for financing that is influenced by borrower psychology, the resulting loan contract will feature deferred costs and a high level of complexity."); Richard Hynes & Eric A. Posner, *The Law and Economics of Consumer Finance*, 4 AM. LAW & ECON. REV. 168, 170–177 (2002).

[53] Barr, *supra* note 43, at 8–11.

[54] The highest DTI should reflect the most expensive point in the loan, which is the real test of whether or not the borrower can afford it.

[55] Recognizing that some high-cost areas may require thresholds that prove dangerous elsewhere, states should determine their own threshold and consider setting it low and exempting high-cost areas as opposed to setting it high for the entire state.

[56] This provision might resemble recent amendments to TILA including a "presumption of validity" for high-cost loans when lenders satisfy the requirements of "(1) [v]erifying repayment ability; (2) determining the consumer's repayment ability using largest scheduled payment of principal and interest in the first seven years following consummation and taking into account property tax and insurance obligations and similar mortgage-related expenses; and (3) assessing the consumer's repayment ability using at least one of the following measures: a ratio of total debt obligations to income, or the income the consumer will have after paying debt obligations." Truth in Lending Act, 73 Fed. Reg. 44, 522, 548–49 (July 30, 2008) (codified at 12 C.F.R. § 226.34(a)(4)(iii)).

[57] Consumer advocates lobbied for a presumption of violation in certain circumstances to accompany the presumption of compliance discussed above in note 55, but the FRB declined to include these in the final rule, citing industry concerns that increased litigation would raise the cost of credit. *Id.* at 44, 543–50.

the loan, to the lender to show that the loan was in compliance, exposes the lender to significant upfront litigation costs, including attorneys' fees and production, even if they ultimately win. Given the money to be made from high-cost loans, this added cost is likely essential to encourage lenders to offer safe and affordable credit.

B. Learning from the UCC

Because of its widespread adoption, the UCC serves as a model not only for how to pass a uniform law but also for what principles make for successful uniform laws. In addition to uniformity, two UCC goals stand out as critical for improving consumer credit regulations: adaptability and consistency with other areas of law. Both are ultimately principles of legal realism—a recognition that business is about strategic behavior.

1. *Bringing Llewellyn's Wisdom to Consumer Credit Contracts*

As many commentators have noted that Karl Llewellyn breathed much Legal Realism into the Code, including a preference for standards over rules and remedies aimed at making the injured party whole.[58] While some commentators have bemoaned the UCC's lack of rules,[59] and indeed subsequent revisions have tightened some of its standards,[60] commercial law has flourished in the past sixty years. The UCC provides a set of defaults so that corporations do not have to build a full code of law into each contract. These are the kinds of things that corporations would bargain for if they had to and can bargain around if they want to.[61] Despite offering such flexibility, the UCC also contains basic protections for less sophisticated parties.[62] Llewellyn's legal realism thus neither held hands nor permitted rampant op-

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[58] *See, e.g.*, Maggs, *supra* note 27, at 543 (describing how Llewellyn succeeded in giving the Code some of his jurisprudential ideas); *see also* WILLIAM L. TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT (1973).

[59] *E.g.*, David Mellinkoff, *The Language of the Uniform Commercial Code*, 77 YALE L.J. 185, 185–86 (1967) ("The word *reasonable,* effective in small doses, has been administered by the bucket, leaving the corpus of the Code reeling in dizzy confusion.").

[60] *See* Maggs, *supra* note 27 (describing how revisions to the Code have moved away from Llewellyn's approach).

[61] The preference for standards over rules is strong. The usual quantity for any metric is "reasonable" (so UCC § 2-217 allows for cover without "unreasonable" delay and § 2-715 also allows for incidental damages expenses reasonably incurred). This "reasonableness" standard is a deferral to the courts to do the right thing should the agreement fall apart. Lenders contracting with consumers may be wary of giving courts this kind of power because the consumer, as the little guy losing his home to the big bad bank, may unfairly get better treatment from the court. The counter to this is twofold. First, banks may be everyone's favorite villain, but our obsession with "personal responsibility" cuts against their fears of bias. Defendant banks can paint plaintiffs as living beyond their means and raising the cost of credit for everyone. Second, the risk that banks may face disadvantages in a state court may provide the right incentive to take care with consumers who lack real bargaining power and whose cognitive biases may be known by the lender.

[62] The most explicit example of this is UCC § 2-302, which permits courts not to enforce any part of a contract for the sale of goods that it finds unconscionable after it grants the

portunism. By including these values in the UCCC, we would give consumers the same kinds of protections that exist for corporations. Realism in consumer law means basing disclosure policies on empirical evidence, including behavioral science and not only abstract notions of personal responsibility.

To be successful, a UCCC should be drafted to accommodate a changing marketplace. Adaptability is a hallmark of commercial law.[63] When consumer law forgets that there are corporations on one side of the transaction, it will be outmaneuvered.

2. *Rationalizing Consumer Credit Law to Functionally Similar Areas of Contract Law*

Inconsistencies between areas of law invite harmful opportunism. Total consistency is an admittedly utopian ideal but rampant exceptions create anomalies. Consumer credit is so rife with anomalies that the normal rules of contracting barely seem to apply. If consumer credit were wholly different from other forms of contract, these exceptions may make sense; but it is not. The result is that courts now enforce contracts between consumers and their lenders that they would not enforce in any other context. Yet when consumers contract with lenders, it is unclear that they expect to have fewer protections, even common-law protections, than when they contract for other goods or when corporations contract with each other.

For example, many fees function as liquidated damages clauses or penalties, so they should be subject to the same limitations.[64] UCC § 2-718 permits liquidated damages "but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty."[65] There is a disconnect in how the law treats late payments for purchases in cash versus late payments for purchases on credit. Similarly, it is doubtable that a court would permit one party to a contract between two businesses to unilaterally change its terms and then condition continued performance on acceptance. Such unilateral changes

parties "reasonable opportunity to present evidence as to its commercial setting, purpose and effect." UCC § 2-302 (1977).

[63] Gerald T. McLaughlin, *The Evolving Uniform Commercial Code: From Infancy to Maturity to Old Age*, 26 Loy. L.A. L. Rev. 691, 697–98 (1993) (citing the broad definition in Article 9 of "general intangibles" as "any personal property . . . other than goods, accounts, chattel paper, documents, instruments, and money" as an example of the kind of open-textured provisions that accommodates changing business practices).

[64] For more on penalties as liquidated damages provisions, see generally Seana Valentine Shiffrin, *Are Credit Card Fees Unconstitutional?*, 15 Wm. & Mary Bill Rts. J. 457, 460–64 (2006).

[65] UCC § 2-718 (1977). Similar limitations existed in the common law before the UCC. *See, e.g.*, Davy v. Crawford, 147 F.2d 574, 575 (D.C. Cir. 1945) ("If . . . it appears that the stipulation is designed to make the default of the party against whom it runs more profitable to the other party than performance would be, it will be void as a penalty.").

are the norm in consumer credit contracts despite recent laws trying to narrow this practice.[66] Rationalizing consumer credit law to other kinds of contract law is a way to give consumers the same protections that businesses negotiate for themselves but that consumers cannot negotiate for since they lack any real bargaining power.

C. Building on UDAP

Writing a new uniform law to govern such a large and diverse sector of the American economy may seem like a daunting task, but it need not be. Every state already has a law prohibiting unfair and deceptive acts and practices. These statutes are not yet perfectly uniform, but most resemble the Uniform Deceptive Trade Practices Act[67] or the FTCA, and some even treat FTC regulations as their own.[68] In many ways, a UCCC is only necessary because the main consumer creditors have persuaded states to exempt them from UDAP laws.[69] The UCCC would undo these exemptions by reproducing a UDAP standard targeted specifically at consumer credit. If the UCCC is to be a law for the future as much as for the present, it cannot concern itself with the bad practices dominating today's news.[70] UDAP will provide a flexible ex-post standard for policing consumer credit.

State UDAP laws typically list practices that are *per se* unfair or deceptive and provide an ex-post standard under which courts may determine that additional practices are deceptive.[71] Practices can be unfair without also being deceptive or deceptive, but not also unfair.[72] A deceptive practices claim requires a misrepresentation but not a showing of harm, whereas an unfairness claim requires a showing of harm but no showing of misrepresentation. FTC jurisprudence says that a deceptive practice is one where a material representation, omission, or practice is likely to deceive a reasonably acting consumer.[73] Unlike fraud, there is no *scienter* requirement, meaning that it

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[66] *See, e.g.*, Credit Card Accountability Responsibility and Disclosure Act, Pub. L. No. 111-24, 123 Stat. 1734 (2009).

[67] Carter, *supra* note 21, §§ 1.1, 4.1. As of 2010, only eleven states had adopted the Uniform Deceptive Trade Practices Act (UDTPA), which NCCUSL promulgated in 1964 and revised in 1966, http://www.nccusl.org/update/uniformact_factsheets/uniformacts-fs-udtpa.asp. After TILA, the UDTPA was practically inapplicable to consumer credit since it did not apply to "conduct in compliance with the orders or rules of, or a statute administered by, a federal, state, or local governmental agency." UDTPA § 4(a)(1) (1966).

[68] Carter, *supra* note 21, § 1.1, Appx. A.

[69] *Id.* § 2.1.1.

[70] To facilitate innovation without fear of liability, lenders should be able to receive an ex-ante determination that a new product is not deceptive. States would retain the flexibility to determine that certain practices are *per se* deceptive, but such a list should not be part of the UCCC.

[71] Carter, *supra* note 21, § 4.2.1. Many jurisdictions include anything that the FTC has determined to be deceptive in their list of *per se* deceptive practices.

[72] *Id.* § 4.2.2.

[73] FTC Policy Statement on Deception, contained in letter of James C. Miller. III (FTC Chair) to Senator Bob Packwood (Oct. 14, 1983), http://www.ftc.gov/bcp/policystmt/ad-decept.htm; *see also* Jack E. Karns, *The Federal Trade Commission's Evolving Deception Pol-*

is irrelevant whether the defendant knew a practice to be unfair or deceptive.[74] Under FTC jurisprudence, a practice is unfair if it "causes or is likely to cause substantial injury to consumers which is not reasonably available by the consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[75] Preying upon known consumer cognitive biases can make harm "unavoidable."[76] At their core, UDAP statutes limit the doctrine of *caveat emptor*.[77] There is no reason to think UDAP is less suited to credit transactions than it is to other commercial transactions.

Conclusion

Both Congress' decision to limit federal preemption of state consumer protection laws and this proposal to promulgate a uniform state law rest on the same question of trust. Lax federal oversight in the hands of a highly innovative industry enabled the abuses that precipitated the most recent credit crisis. Failures elsewhere could lead to the next one. One lesson from this crisis is that regulatory redundancy can be a good thing. Of course, this redundancy requires careful management to limit lenders' compliance costs. This proposal for a uniform standard is ultimately one for uniform uncertainty. Adaptability is uncertainty. Accordingly, it will have greater compliance costs than TILA alone. Regulators should not hesitate to embrace this uncertainty because its benefits to consumers, states, and the taxpayer-funded social safety nets, outweigh these increased compliance costs. Needless to say, they should expect bellyaching from industry.

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icy, 22 U. Rich. L. Rev. 399 (1988) (describing the history and impact of this policy statement).

[74] Carter, *supra* note 21, § 4.2.3.1.

[75] The Federal Trade Commission Act Amendments of 1994, Pub. L. No. 103–312, § 9 (1994). "Substantial injury" includes a small harm inflicted upon many people. S. Rep. No. 130 (1994), *reprinted in* 1994 U.S.C.C.A.N. 1787–88.

[76] Carter, *supra* note 21, § 4.3.2.3.

[77] *Id.* § 1.2.