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DEBTOR—CREDITOR REMEDIES: A NEW PROPOSAL

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The newly-promulgated Uniform Consumer Credit Code[1] is a manifestation of the necessity for sensible and uniform regulation of consumer credit. The recent enthusiasm for that Code affords an opportunity to develop an alternative system of debtor-creditor remedies in the consumer field. Several practical considerations surrounding consumer credit indicate a need for modification of the existing legal remedies in order to develop a system in which the commercial risk in consumer credit transactions can be predicted and reduced. The proposals suggested here conceptually develop a working base for new standard remedies in consumer credit transactions.[2] No attempt is made to outline fully the mechanics of operation for these proposals, but their possible implementation through the Uniform Consumer Credit Code or other existing credit laws is considered.

I

Adequacy of Debtor-Creditor Remedies in Commercial versus Consumer Credit Transactions

A brief glance at commercial credit operations indicates that sophisticated relationships have developed between parties to commercial

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1 Final draft approved by the National Conference of Commissioners on Uniform State Laws on July 30, 1968, and by the American Bar Association on August 7, 1968. Text of the final draft appears in the CCH Instal. Credit Guide No. 183 (extra ed. Aug. 19, 1968) [hereinafter cited as UCCC].

2 One of the authors briefly presented similar proposals in 21 Pers. Fin. L.Q. Rep. 24 (1966). Since that time, much has been written on the new uniform system of credit regulation presented by the UCCC, and the proposals developed herein have been conceptually revised and made more comprehensive to fill the gap in credit remedies left by the development of that Code.

A different system of credit remedies which would have an effect similar to these proposals was suggested in 1934 by Professor Wesley A. Sturges, who had the perspicacity to see the need for a comprehensive system of remedies to handle the complex problems of the future credit market. *See* Sturges, *A Proposed State Collection Act*, 43 Yale L.J. 1055 (1934).

financial transactions, particularly in the last several decades. Mortgage bonds with pledges of real property, plant, and equipment are devices used in complex secured commercial finance, and unsecured financing with reliance on the liquidity of the company's receivables and the management's ability to exploit potential earning power are commonplace arrangements.[3] The use of priorities in both secured and unsecured commercial financing has also been well developed. Second and even third mortgages are often issued to secure commercial transactions, and finance companies frequently employ varying forms of subordination for unsecured obligations. Virtually all commercial debt instruments provide for matters supplemental to the manner in which the obligation will be discharged. Provisions regarding amount of indebtedness, nature of business, and report requirements are typically incorporated, and in most instruments the events of default are set forth in detail.[4]

In personal finance, as contrasted with commercial finance, the relationships between creditors and debtors, with the single exception of real estate credit,[5] are less well defined. Consumer credit transactions are governed by a variety of instruments,[6] each subject to a number of different laws and regulations. Thus, the degree of consistency and certainty which relates to commercial finance and real estate credit is

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[3] This is especially true where small business financing is concerned. Many factors are considered more important to a sound extension of credit than the availability of specific assets. *See* Howell, *Financing—A Major Problem of Small Business*, 18 VAND. L. REV. 1683 (1965).

[4] For the myriad types of agreements and clauses available for credit transactions, see 2B J. RABKIN & M. JOHNSON, CURRENT LEGAL FORMS WITH TAX ANALYSIS 6-1001 to -1323 (1968).

[5] A real estate mortgage and its related documents not only clearly identify the security for the credit, but also define the rights and obligations of both parties. *See generally* S. MCMICHAEL & P. O'KEEFE, HOW TO FINANCE REAL ESTATE 1-21, 226-50 (3d ed. 1965); S. MAISEL, FINANCING REAL ESTATE 1-20, 291-313 (1965). *See also* Prather, *Economics, Morality and the Real Estate Loan*, 8 B.C. IND. & COM. L. REV. 475, 478-82 (1967).

The UCCC has excepted the home mortgage from its regulation of personal finance. "The exclusion is due to the Committee's belief that the problems of home financing are sufficiently different to justify separate statutory treatment . . . ." Jordan & Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387, 388 (1968). The UCCC does, however, regulate mortgages which provide for a finance charge in excess of 10%. UCCC §§ 2.104(2)(b), 3.104(2)(b). This "allows the Code to cover the high rate 'small loan' type of second mortgage transaction that has been such a source of consumer complaint." Jordan & Warren, *supra* at 388.

[6] The credit contract may be no more than a credit card receipt with the debtor's signature, or it may be a lengthy instalment sale contract heavily laden with small print. Not only do the contracts vary with the type of credit (instalment purchase, revolving loan, credit card transaction), but different creditors employ different forms and provisions for the same type of credit.

not found in consumer credit generally. These inconsistencies operate to the disadvantage of borrowers and creditors alike, but the most basic objection to the diverse and fragmented approaches to the extension of consumer credit is lack of control over the debtor's ability to repay. The potential creditor is unable to estimate accurately that factor of the transaction, and because of this uncertainty the borrower is likely to find credit more costly or more scarce.

The debtor-creditor remedies in consumer credit, unlike the sophisticated systems found in commercial finance, have failed to develop with the market. The diverse consumer remedies and defenses generally promote two objectives. First, they seek to provide recourse against an unscrupulous creditor who has violated regulatory statutes, which typically impose requirements and restrictions on the terms and conditions of the transaction and on the information that the creditor discloses to the debtor.[7] Each state has a different system for regulating the terms of the transaction.[8] Penalties which the debtor may invoke for statutory violations are extremely diverse, especially when the violation involves excessive interest charges.[9] In such cases the penalties range from avoidance of the entire debt[10] to forfeiture of part of the interest charged.[11] As far as penalties for violation of statutes are concerned, the present varied approach to debtor remedies will be mitigated considerably by the Consumer Credit Code, which presents a new regulatory system[12] that reaches a uniform compromise while extending improved protection to both parties.[13] The second objective of con-

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7 On statutory regulation of finance charges and disclosure provisions, see Johnson, *Regulation of Finance Charges on Consumer Instalment Credit*, 66 MICH. L. REV. 81 (1967); Jordan & Warren, *Disclosure of Finance Charges: A Rationale*, 64 MICH. L. REV. 1285 (1966).

8 See the charts listing requirements in various Retail Instalment Sales Acts compiled in B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION 254-322, charts 11-19 (1965). See also a discussion of the special problems related to the extension of credit to the poor in Comment, *Consumer Legislation and the Poor*, 76 YALE L.J. 745 (1967).

9 1 CCH INSTAL. CREDIT GUIDE ¶ 31, at 1402-06 (1968). On usurious interest and maximum rates in consumer credit transactions generally, see *Consumer Credit Symposium—Limiting Consumer Credit Charges by Reinterpretation of General Usury Laws and by Separate Regulation*, 55 NW. U.L. REV. 303 (1960). A discussion of statutory provisions regarding usury in many states is found in the same symposium, *Enforcement of Consumer Credit Regulation*, 55 NW. U.L. REV. 403, 413-17 (1960).

10 *E.g.*, MINN. STAT. § 334.03 (1965); N.Y. GEN. OBLIGATIONS LAW § 5-511 (McKinney 1964).

11 *E.g.*, IND. ANN. STAT. § 19-12-104 (1964); KY. REV. STAT. § 360.020 (1962); PA. STAT. ANN. tit. 41, § 4 (1954).

12 There are extensive provisions regulating the terms of the transaction (UCCC, art. 2, part 4; art. 3, part 4) and providing the debtor with effective remedies. UCCC art. 5, part 2.

13 *See* Felsenfeld, *Some Ruminations About Remedies in Consumer-Credit Transac-*

sumer remedies is the correction of abuses imposed by creditors through a substantial bargaining advantage. This objective is prevalent in statutory provisions protecting the debtor against unconscionable contractual requirements or limitations at the beginning of the credit transaction,[14] and in enactments guarding against unfair practices by the creditor in case of default.[15]

The remedies available to creditors to effect collections on defaulted consumer obligations antedate consumer credit as it is known and practiced today. The fragmented statutory provisions delineating creditor remedies are concerned with the creditor's capacity to recoup his capital after the debtor has violated the agreement.[16] In response to this problem, the Consumer Credit Code redefines existing remedies to create a uniform system, but it does not attempt to alter the type of remedies available to the creditor. Its remedies aim at the relationship

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tions, 8 B.C. IND. & COM. L. REV. 535 (1967). Some states have evaluated their statutory credit provisions and have made revisions to conform the statutes to the expanding credit market. *See* Rock, *Credit Reform in Illinois . . . The Age of Consumerism*, 49 CHI. B. REC. 91 (1967); 20 BAYLOR L. REV. 263 (1968).

14 *See, e.g.*, ILL. ANN. STAT. ch. 121 1/2, §§ 261, 262 (Smith-Hurd Supp. 1967); UCCC §§ 5.108, 6.111.

Although the contract itself may not be unconscionable, certain clauses may result in an unexpected loss of defenses by the debtor. These "waiver of defense" provisions have been severely criticised for their unconscionable nature. *See* Felsenfeld, *supra* note 13, at 549-53; Jordan & Warren, *supra* note 5, at 433-38; *cf.* CAL. CIV. CODE § 1804.2 (West Supp. 1967).

15 These statutes indirectly protect the debtor by limiting the creditor's remedies. There are limitations on the creditor's right to repossess the collateral (*e.g.*, CONN. GEN. STAT. ANN. § 42-98(a) (1958); MD. ANN. CODE art. 83, § 141(a) (1957); PA. STAT. ANN. tit. 69, § 623A (1965)), special requirements for sale of repossessed collateral (*e.g.*, UNIFORM COMMERCIAL CODE § 9-504(3) [hereinafter cited as UCC]; CONN. GEN. STAT. ANN. §§ 42-98(d) to -98(f) (1958 and Supp. 1968)), restrictions on the creditor's right to a deficiency judgment (*e.g.*, CAL. CIV. CODE § 1812.5 (West Supp. 1967); ILL. ANN. STAT. ch. 121 1/2, § 526 (Smith-Hurd Supp. 1967); PA. STAT. ANN. tit. 69, § 627 (1965)), and restrictions on the creditor's right to accept an assignment of wages as security for a debt or to impose a garnishment on the debtor's wages in case of default. *See* CURRAN, *supra* note 8, at 128-29, 338-47 (1965).

On unconscionable conduct in collecting debts, see UCCC § 6.111; Jordan & Warren, *supra* note 5, at 425-27. For a creditor-oriented policy consideration on restricting remedies, see Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 478-86 (1968).

16 Criticism or praise of a particular remedy is usually based on the effectiveness of that remedy. On repossession of collateral generally, see CURRAN, *supra* note 8, at 110-13; Felsenfeld, *supra* note 13, at 556-58; Hogan, *A Survey of State Retail Instalment Sales Legislation*, 44 CORNELL L.Q. 38, 61-65 (1958). On deficiency judgments generally, see Felsenfeld, *supra* note 13, at 558-62. On wage assignments and garnishment generally, see CURRAN, *supra* note 8, at 128-29; Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 CALIF. L. REV. 1214 (1965); Felsenfeld, *supra* note 13, at 562-65; Note, *Wage Garnishment as a Collection Device*, 1967 WIS. L. REV. 759.

of an individual debtor to his individual creditor, but they do not include within their scope the equitable and efficient disentanglement of the complex credit arrangements made possible by the availability of consumer credit today. Thus, repossession, deficiency judgments, garnishment and other specific remedies will still be the basic remedies available to the creditor although their application has been modified by the Credit Code.[17]

The system of debtor and creditor remedies, even as revised by the Credit Code, gives insufficient consideration to the basic objectives underlying all consumer credit. From the debtor's standpoint, this objective is the ability to obtain credit at a reasonable price without severe risk to his present or future financial status. On the creditor's side, it is the ability to extend credit profitably with minimized risk of loss in case of default. The recent growth in the volume of consumer credit (approximately 1360 percent between 1939 and 1967)[18] indicates the necessity of recognizing and fostering these objectives. And an even more persuasive case for a system of remedies which concentrates on these objectives is presented by the correlation of the increase in consumer credit with the increase in bankruptcy petitions filed on behalf of overextended debtors.[19]

It is no longer possible to evaluate the adequacy of debtor-creditor remedies in terms of a single transaction between a single lender and single borrower.[20] Today's borrower is typically indebted to several other creditors who also must be considered in fashioning an appropriate remedy for a potential lender. At the same time, the cost of credit to a potential borrower can be reduced by providing the lender with an adequate method of estimating the risk of credit already extended.

The existing remedies, and those promulgated by the Credit Code, extend ample protection to both parties against violation of the credit relationship by the other. But practical considerations of the credit

17 *See* UCCC §§ 5.101 to 5.108.

18 53 FED. RESERVE BULL. 1628 (1967). In 1939 the amount was $7,222,000,000. In July of 1967, $95,115,000,000. It has increased 136% from 1962 alone. *Id.*

19 *See* Miller & Kopp, *Abuses of Consumer Credit—A View from the Bankruptcy Court,* 4 AM. BUS. L.J. 241 (1966). The tactics of the creditor also contribute considerably to the volume of bankruptcies. *See Consumer Credit Symposium—Relief for the Wage-Earning Debtor: Chapter XIII, or Private Debt Adjustment?* 55 NW. U.L. REV. 372, 378-79 (1960).

20 A basic criticism of much of the great mass of consumer credit legislation now in effect is that it is premised on a series of assumptions that are rapidly becoming obsolete. These assumptions are: (1) that the typical consumer credit transaction is the single, isolated instalment sale or loan . . . .

Jordan & Warren, *supra* note 5, at 388.

transaction indicate a need for an additional system of remedies to protect both the debtor from himself, by encouraging the wise use of personal credit and the avoidance of overextension, and the creditor from himself and other creditors, by preserving that degree of consumer discipline necessary to prevent a deterioration in the quality of credit. Any legislative controls attempting to deal directly with all specific abuses of consumer credit will likely be too complex to be successful. Rather, "legislation should deal with those aspects of the exchange that may create such problems. It should aim not to expunge the problems but to minimize them."[21] A simplified equitable structure of creditor and debtor remedies based upon the liquidity and the earning power of the consumer could mitigate many of the abuses found in consumer credit.

II

Practical Considerations of the Extension of Consumer Credit

A characteristic common to all forms of financing is the relationship between the rate of return to the creditor and the expenses and risks assumed by him. The rate of return associated with the extension of consumer credit includes three separate cost elements: (*1*) the money cost to the creditor of the credit extended; (*2*) the cost of handling the transaction; and (*3*) the cost of the risk of nonpayment. Normally, the first two elements do not vary significantly from one geographical area to another. The cost of the risk, however, may vary considerably between states because of the different statutory remedies provided. The more the creditor must rely on the debtor's willingness or ability to repay, the greater is the risk of the transaction. Creditors operating in states with comprehensive creditor remedies will have a smaller risk of loss.[22]

The influence of these diverse remedies on extensions and collections of consumer credit is worthy of qualitative analysis. Traditionally there have been three "*C*'s" associated with credit: Capacity, Character, and Collateral. In current practice collateral has functioned more to reduce the exposure of the lender than to secure him entirely from loss; few consumer credit transactions are completely collateralized. Competition has reduced down-payment requirements for auto-

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[21] B. Curran, Legislative Controls As a Response to Consumer Credit Problems 22 (1968).

[22] For discussions of the operation of various state laws relating to creditor remedies, see authorities cited note 16 *supra*.

mobiles, furniture, or appliances to the point where the cash value of the merchandise being financed frequently is less than the unpaid balance on the contract for a substantial part of its term. As a result, capacity and character of the borrower are of greater importance than collateral in the granting of consumer credit. These two important factors are related respectively to the borrower's ability to repay and to his willingness to repay.

The capacity or ability of a borrower to repay depends upon the amount of his discretionary income (that portion of his net pay left over after meeting necessary living expenses). Although the national average discretionary income per household unit tends to increase over a long period of time, in a large majority of cases discretionary income cannot be expected to increase materially over the relatively short period (three years or less) for which most consumer credit transactions are written. Moreover, there is a possibility that such discretionary income could be reduced significantly in that period if unexpected illness were encountered, if the debtor's or his wife's employment were terminated or if their hours of work were reduced. Thus, the short term probabilities for any given household unit are such that any increase in discretionary income will at best be a modest one and any reduction in discretionary income might be a significant one. As a consequence, a given borrower's ability to repay tends to decrease as the amount he is obliged to repay increases; the degree of risk associated with him varies inversely with his ability to repay. Because risk is one of the cost elements in consumer credit transactions, it follows that this greater degree of risk must be offset by a larger rate of return to the creditor. It should also be noted that borrowers have only two sources of funds available for the payment of their indebtedness—current net assets and future discretionary income. Neither source of funds is controlled by law and thus the debtor's ability to pay, as a factor of the transaction, is not affected by the remedies available to creditors.

The character or willingness of any borrower to repay depends upon two factors: his sense of responsibility and the outside pressures which can be brought to bear to coerce him into paying. The former, of course, is an intangible which cannot be considered in legal remedies drafted for the creditor. But the pressures which may be used to force repayment are basically legal in nature and involve the use or threatened use of available creditor remedies resulting in either loss of equity in pledged collateral or allocation of future income through garnishment or assignment of wages.

The foregoing analysis leads to four conclusions with respect to the interaction of rate of return to the creditor and the aggregate volume of credit which can be extended to any given borrower. First, there is a certain amount of credit that can be extended to some borrowers in the absence of any creditor remedies. This conclusion refers to those borrowers having adequate capacity to repay and the self-discipline to do so. Legal remedies need not be resorted to by creditors dealing with borrowers of this type, and consequently, the presence or absence of collection laws does not affect their credit worthiness.

Second, the amount of credit that can be extended to some borrowers varies with the effectiveness of the legal remedies available to the creditor. This conclusion is applicable to those borrowers who possess adequate capacity to repay but lack the self-discipline to allocate their income in such a manner as to repay their obligations in accordance with their respective terms. In these cases, the mere fact that creditor remedies exist is frequently sufficient to persuade the borrower to repay his obligation; the threat of legal action rather than the legal action itself influences his willingness to pay. The extent to which such threats influence that willingness to pay depends, at least in part, on the effectiveness of the legal remedies available to the creditor. This explains why a company that operates in several states having different collection laws does not necessarily extend the same amount of credit to the same type of borrower in each state. A single example illustrates the complex procedure of estimating the risk when the creditor is faced with two different systems of creditor remedies. Suppose Mr. *X* has a poor payment record but owns property, resides in, and is employed in state *A* which permits a confession of judgment clause to be included in the evidences of indebtedness but which does not permit attachment of wages. Mr. *X* could probably obtain some credit in state *A* because the creditor could resort to the action of the judgment clause to compel repayment. It is doubtful, however, that Mr. *X* could obtain credit in neighboring state *B* which permits wage attachments but will not enforce confess judgment clauses. If Mr. *X* were to sell his property in state *A* and move to rented quarters in state *B* while retaining his employment in state *A*, it is doubtful that he could obtain any credit because he possesses no real estate which can be subjected to a judgment clause and he is employed in a state which does not permit attachment of wages. If, however, he obtained employment in state *B*, he would probably again be able to obtain credit because the wage attachment available to the creditor could offset his poor paying habits. If Mr. *X* retained his residence in state *A* and shifted his employment to state *B*, it is possible he could obtain credit in both states despite his poor paying record because there is a remedy for each creditor. This example illustrates that the amount of credit available to a given risk can fluctuate as the effectiveness of the creditor remedies varies. Since this conclusion applies to certain individuals, it must also apply to some extent to the borrowing public as a whole. Consequently, a significant change in the legal collection remedies in a given state without an offsetting change in some other factor related to the extension of credit (such as the rate of return) affects the volume of credit extended.

The third conclusion is that creditor aversion to substantial modification of their remedies is less related to the ability to transact any amount of business successfully (some business can be transacted in the absence of creditor remedies) than to the ability to maintain a given volume of business at a given profit level. That the scope of operations is adjusted to fit a given environment is demonstrated by the recognition that successful consumer credit operations are presently conducted under a wide variety of creditor remedies, some of which can be described only as ineffective. Objections to doing away with garnishment proceedings or confession of judgment clauses are not based on inability to operate without those remedies because those remedies are not essential to successful operation. Such objections then must be based upon the belief that elimination of these remedies would adversely affect the volume of profitable business.

The fourth conclusion is that creditors who enjoy a high rate of return can permit their borrowers to be obligated for a larger amount of credit. This conclusion rests principally on the relationship between risk and ability to repay. The greater the amount to be repaid, the lower is the individual's ability to repay, and thus the risk to the lender increases. If this increased risk can be offset by a higher rate of return, the creditor who can obtain such a higher rate can permit a borrower to carry more indebtedness than can a lender charging a lower rate. This conclusion has an important consequence. If an individual reaches his credit limit at one interest rate, he is still eligible for additional credit from another creditor who charges a higher rate.

It should be apparent that properly granted credit can be undermined by subsequent extension of credit. Such grants occur because all creditors, unless they have enforceable liens on specific assets, are treated alike in the event of either bankruptcy or the pro-rating of an individual's obligations. This is so despite the fact that the rate of return associated with each credit extension differs. One creditor might require the net income from twelve to fifteen consumer credit transactions to offset the expense of charging off one default while another's ratio might be eight to one or as low as four to one if his overall rate of return is particularly high. Obviously one creditor who needs a lesser degree of collectibility can make unprofitable the credit previously extended by a creditor who needs a greater degree of collectibility to break even. Accordingly, the main objective of any proposal for a new set of debtor-creditor relationships should be to minimize the probability of having sound, previously extended credit undermined by subsequent actions.

III

A Proposal for Consumer Credit Remedies

In terms of available remedies, consumer credit transactions may be divided into two distinct classifications: secured and unsecured credit. This proposal recognizes only these two forms of consumer credit for purposes of defining remedies. The remedies and requirements proposed for each class of credit are applicable to that class only.[23]

A. *Secured Transactions*

The Uniform Commercial Code and the Uniform Consumer Credit Code have developed consistent practices which control most of the abuses in secured consumer credit. The instrument evidencing the transaction should clearly indicate that a secured transaction is involved and describe the security in distinct terms.[24] The Uniform Commercial Code establishes a perfection procedure for secured credit transactions and governs these security transactions in almost all states.[25]

[23] This does not mean that partially secured transactions will be prohibited. A creditor will still be able to enter any credit transaction with any secured-unsecured ratio he wishes. He will, however, be required to follow certain special procedures in order to perfect adequately his interests under these proposals. *See* pp. 264-66 *infra*.

[24] The factors required to render a security interest enforceable are set forth in § 9-203 of the UCC, and the formal requisites of a financing statement are outlined in § 9-402. Both sections require a statement indicating the types or describing the items of collateral. Such description is sufficient, according to § 9-110, "if it reasonably identifies what is described." Although it may be argued that more specificity should be required for a consumer transaction than for a commercial security interest, § 9-110 nonetheless requires a sufficient description for consumer security interests. It is not likely that the collateral held by the consumer, on which a security interest is attached, is so fungible as to be easily confused with other collateral owned by him. Consumers usually have only one or two cars, only one set of furniture, etc. A description of these items may be sufficiently specific if it only refers to the item or items generally.

[25] The requirement of filing a financing statement to perfect a security interest is found in UCC § 9-302. Where the financing statement is to be filed is governed by § 9-401.

However, the Commercial Code has excepted a large area of consumer credit transactions from the perfection requirements. Section 9-302(1)(d) indicates that a purchase money security interest in consumer goods need not be filed in order to be perfected. The creditor is therefore in a vulnerable position if the debtor-buyer disposes of the goods to another consumer who lacks notice of the security interest[26] and especially if, as is here proposed, the creditor's remedy in secured consumer credit transactions is drafted specifically to discourage the creditor from maintaining any action except with respect to the specified security. Accordingly, provisions should be adopted which require a creditor who takes a security interest in consumer goods to file the instrument evidencing the security interest in all cases in order adequately to protect that interest. Thus, the practice suggested as prudent by the Uniform Commercial Code is simply made mandatory.[27]

Restricting the secured creditor to the specified security would alleviate other problems. The abuses of the secured party's rights in case of default and the use of deficiency judgments have prompted detailed and complex procedures for repossession and resale of the collateral.[28] To insure that a secured creditor will rely on his bargained security interest, deficiency judgments should not be available to him. The Consumer Credit Code significantly promotes this cause for consumer credit sales by restricting the creditor's remedy in some cases to the repossession of the collateral or to a suit on the debt without the benefit of the collateral to satisfy the judgment. Section 5.103 provides in part:

> (1) This section applies to a consumer credit sale of goods or services.
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> (2) If the seller repossesses or voluntarily accepts surrender of goods which were the subject of the sale and in which he has a security interest and the cash price of the goods repossessed or surrendered was $1000 or less, the buyer is not personally liable to the seller for the unpaid balance of the debt arising from the sale of the goods, and the seller is not obligated to resell the collateral.
>
> (3) If the seller repossesses or voluntarily accepts surrender of

[26] Such a buyer takes free of the security interest if other requirements are met. *See* UCC § 9-307(2).

[27] Comment 3 to UCC § 9-307 indicates with respect to a purchase money security interest in consumer goods:

> A secured party may file a financing statement (although filing is not required for perfection). If he does file, all buyers take subject to the security interest. If he does not file, a buyer who meets the qualifications [of § 9-307(2)] takes free of the security interest.

[28] *See* UCC §§ 9-503 to 9-507. Abuses still occur despite the UCC's comprehensive provisions. *See* Jordan & Warren, *supra* note 5, at 440-41.

goods which were not the subject of the sale but in which he has a security interest to secure a debt arising from a sale of goods or services or a combined sale of goods and services and the cash price of the sale was $1000 or less, the buyer is not personally liable to the seller for the unpaid balance of the debt arising from the sale.

(4) For the purpose of determining the unpaid balance of consolidated debts or debts pursuant to revolving charge accounts, the allocation of payments to a debt shall be determined in the same manner as provided for determining the amount of debt secured by various security interests (Section 2.409).

(5) The buyer may be liable in damages to the seller if the buyer has wrongfully damaged the collateral or if, after default and demand, the buyer has wrongfully failed to make the collateral available to the seller.

(6) If the seller elects to bring an action against the buyer for a debt arising from a consumer credit sale of goods or services, when under this section he would not be entitled to a deficiency judgment if he repossessed the collateral, and obtains judgment

(a) he may not repossess the collateral, and

(b) the collateral is not subject to levy or sale on execution or similar proceedings pursuant to the judgment.

The section is limited, however, to consumer credit sales, and does not involve consumer loans. The principle of requiring a secured creditor to evaluate the risk of the transaction in terms of the collateral used to secure the debt applies equally to consumer loans and consumer sales. Also, the potential abuses of deficiency judgments—namely, resale of the collateral at an unusually low price[29] and the disproportionate expenses of repossession and resale—are prevalent in both types of financing. Although the lender is not in an equal commercial position with a vendor to handle the resale of repossessed collateral, he has two other alternatives: (*1*) he can sue for the debt under section 5.103(6) and relinquish all rights to recover from the collateral; or (*2*) he can grant credit on an unsecured basis and be able to recover from the debtor's assets under the priority system described below.

Moreover, the abolition of deficiency judgments in the Consumer Credit Code has been restricted to cases where the cash price of the sale does not exceed one thousand dollars. This effectively excepts a large part of secured consumer transactions, including most automobile financing, from the scope of that provision. However, the objections which have been made to deficiency judgments are equally applicable to both large and small transactions. Although strenuous arguments

29 The UCC requires that resale be accomplished in a commercially reasonable manner. But § 9-507(2) considerably weakens the debtor's ability to prove non-compliance with that standard.

have been advanced against the total abolition of deficiency judgments,[30] an effective system of credit regulation should attempt to eliminate possible variables which will affect other credit transactions.

Under this proposal and the Consumer Credit Code, the secured creditor has an alternative remedy to effectively regain his capital—that is, to sue on the debt—if he chooses to ignore the collateral. This proposal therefore includes the abolition of deficiency judgments without regard to the dollar amount of the transaction. However, it is important to note here that the secured creditor will be more restricted in pursuing his alternative remedy under these proposals. If he chooses to sue on the debt and acquire a judgment against the debtor, as a judgment creditor he will be entitled to a garnishment of the debtor's wages under the Consumer Credit Code.[31] But since the debtor's wages constitute the major resource for satisfaction of unsecured creditor claims under these proposals,[32] the secured creditor who is seeking to avoid a bad bargain by ignoring the collateral and suing on the debt should not be able to upset the system of payment for unsecured creditors by obtaining a prior right to the debtor's future income. Therefore, a secured creditor who seeks to satisfy his judgment against the debtor by obtaining a garnishment of his wages will, in effect, institute thereby the procedure described below when a default occurs in an unsecured obligation. The judgment of the secured creditor will be treated as the last in the series of unsecured transactions, and all prior perfected unsecured creditors will be satisfied by the distribution of the debtor's wages before the judgment of the secured creditor is paid. Thus, although the judgment creditor may still attempt to satisfy his judgment from the debtor's assets other than the original collateral securing the debt,[33] a provision incorporating the foregoing proposal will prevent him from usurping the unsecured creditors' rights to the most important fund available for their satisfaction in case of default —the debtor's future income.

All creditors entering secured consumer transactions should be subject to provisions similar to section 5.103, without any dollar limitation on the availability of deficiency judgments, and should be discouraged thereby from looking beyond their collateral to recover in case of default. These provisions will force the creditor to carefully

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30 *See* Kripke, *supra* note 15, at 476-78.

31 UCCC § 5.104.

32 *See* pp. 262-64 *infra*.

33 A secured creditor who chooses to sue on the debt cannot, under the UCCC, satisfy his judgment out of the collateral originally securing the debt. UCCC § 5.103(6). However, as a judgment creditor he can levy on any of the debtor's other assets.

evaluate both the risk of the transaction and the sufficiency of the security and to rely heavily on the pledged collateral to satisfy the debt. To protect the creditor under this proposal, and to impress upon him the importance of the collateral in the secured consumer transaction, all security interests in the consumer goods should be perfected by filing in accordance with the Uniform Commercial Code.

B. *Unsecured Transactions*

The opportunity for economic abuse of credit also arises in unsecured obligations. But the remedies in this area have concentrated on individual transactions with no attempt to control the unsecured credit market generally.

Control should be imposed by providing that unsecured credit transactions must also contain a financing statement which would clearly indicate that an unsecured transaction was involved. These financing statements should be filed in a central place or listed with a central credit bureau in each trade area, and the act of filing would constitute perfection of the unsecured debt. Also, a minimum dollar amount or a minimum time limit should be established, thereby excepting the very smallest or most current unsecured transactions from these requirements.

Additional statutory provisions should be enacted to provide for an order of preference in the repayment of a debtor's unsecured obligations based upon the chronological order in which the obligations were perfected. Unperfected debt would, of course, be given the lowest priority. When a statement is not filed because the debt is below the minimum dollar amount or is to be repaid in less than the minimum time limit, the debt will nevertheless be treated as a perfected unsecured debt as of the date of the transaction. Instead of perfecting individual transactions under a revolving credit account, the system will require filing the debt at specified maximum ceilings.[34] Finally, the

34 As long as the credit account remained below the ceiling no filing would be necessary. The individual debts would be considered perfected on the date of each transaction. As payment is made, a "first-in, first-out" system could be used to determine which obligations are discharged. Above the ceiling, the creditor would file as the total amount of the debt approached certain regular levels in order to warn other creditors of the outstanding debt. For example, if the ceiling were $500 the creditor would file the account when it exceeded that amount. He would also file the debt at the next maximum level, *e.g.*, $1,000, to perfect all transactions conducted while the aggregate obligation is between $500 and $1,000. Each transaction would remain protected in the preference system as of the date incurred so long as the creditor filed at each required level. When the credit account exceeded $1,000, a new filing would be made at the next maximum level, *e.g.*, $1,500, and the excess of the debt over $1,000 would remain perfected.

priority system will become effective upon default, at which time an aggrieved creditor will have the right to bring a simplified action to require a percentage of the debtor's income to be allocated to the discharge of his obligations in accordance with the preferential order previously described. Under this system, it will not be possible for a subsequent creditor to coerce the debtor into preferring him while neglecting current payments to a prior creditor. Nor will it be possible for a debtor to voluntarily prefer any subsequent creditor without promptly satisfying former obligations. This system of subordination will dissuade a creditor, who through one means or another is able to obtain a high rate of return, from extending credit to his marginal point thereby forcing other creditors with a lower rate of return beyond their respective marginal points. If the last creditor causes an eventual default in any obligation, he will be obliged to wait until all previously incurred debts are discharged before he receives any repayment. Naturally, if no default occurs, the remedies will not be invoked and debtor-creditor relations will remain unchanged.

Moreover, because these statutory provisions will provide for a judicially-supervised orderly discharge of the debtor's unsecured obligations, discharges in bankruptcy should be prohibited.[35] In the very rare instances involving incapacity or inability to obtain employment, provisions should be made for the temporary suspension of payments by the debtor until such time as gainful employment may be obtained. At that time, retirement of the previously incurred obligations in an orderly fashion should be required in accordance with the established preferences. In all other cases, the Wage Earner Plan of Chapter 13 of the Bankruptcy Act[36] should be mandatory, instead of optional. Further, the Bankruptcy Act should be amended to provide that distribution under the Wage Earner Plan be made in accordance with the unsecured creditor priority system suggested above. This requirement prevents the debtor's circumvention of the obligation to pay all creditors by the filing of a petition in bankruptcy.[37] By filing a petition

35 In a case where debts are so excessive when compared to income possibilities that payment by supervised discharge or a Wage Earner's Plan would be hopeless, bankruptcy should be allowed as it is after three unsuccessful years under the Wage Earner's Plan. *See* 11 U.S.C. § 1061 (1964). This should be a rare case, however, since it takes only one creditor to put the debtor into the discharge system and thus discharge will begin before the debtor is too far "over his head."

36 11 U.S.C. §§ 1001-86 (1964).

37 The percentage of Wage Earner Plans to total non-business bankruptcy cases filed each year is extremely small. In 1967, 191,729 non-business bankruptcy cases were filed but only 31,963 of these were Chapter 13 petitions. DIRECTOR OF ADMIN. OFFICE OF U.S. COURT, ANN. REP. 167, 169 (1967).

for a Chapter 13 plan, he, in effect, initiates the same judicial process that one of his creditors could initiate under the proposal for unsecured credit outlined above—that is, the court will effect a composition of his debts out of his future earnings.[38] The possibility that the debtor will never be able to satisfy his obligations is provided for under a debtor-initiated plan,[39] just as it would be in a creditor-initiated plan under this proposal.[40]

The objective of these proposals is to provide a system of remedies which forces the creditor to exercise more restraint in extending credit.[41] The purpose here has been to attack an underlying problem of consumer credit and to propose a system designed to minimize that abuse, rather than to correct its manifestations. At the same time, the creditor's position is improved because, under a priority system for unsecured credit, he can more accurately predict the value of the risk and can more easily evaluate the prospect of being repaid.[42]

C. *Partially Secured Transactions*

Since debtor-creditor remedies under the proposals are defined exclusively in terms of secured and unsecured credit, partially secured

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38 11 U.S.C. §§ 1021-23 (1964). On the operation of the Wage Earner Plan of Chapter 13 generally, see *Consumer Credit Symposium*, *supra* note 19.

39 Section 1061 provides that the debtor may be completely discharged after three years under a Wage Earner Plan if the court is satisfied he will never be able to satisfy his obligation. 11 U.S.C. § 1061 (1964).

40 *See* note 35 *supra*.

41 This result has been urged by many writers who have considered the problem of debtor over-extension. *See, e.g.*, Miller & Kopp, *supra* note 19, at 248.

42 It is important to note here that Professor Homer Kripke has already persuasively argued against revolutionary change in debtor-creditor remedies in his recent article, cited in note 15 *supra*. Professor Kripke's main contention regarding remedies is that most abuses of consumer credit occur at the poverty level, and that creditor remedies should not be uniformly restricted to attempt to cure malfunctions in a minor percentage of the operations of a large enterprise. Moreover, he argues that the bulk of default problems arise as a result of the debtor's change in circumstances, rather than the creditor's willingness to extend credit to an already over-extended consumer.

It is not the purpose of these proposals to restrict the creditor's ability to collect. In fact the proposals for an unsecured preference system will increase the probability that he will be paid. For secured transactions, the restriction on deficiency judgments only requires him to look to the collateral which he has accepted as security, or to be prepared to sue for the debt and relinquish all rights to the collateral. Such alternatives are fair to both parties, and the creditor's risks are more clearly defined under this system than under existing laws.

It cannot be denied that the debtor's change of circumstances creates serious problems in consumer credit transactions. The practical considerations relating to this problem are discussed at pp. 254-58 *supra*. But whether or not the uncontrolled extension of credit is the root of all consumer credit evil, even Professor Kripke will have to agree that until some plausible method of regulating the debtor's individual circumstances is found, the regulation of the extension of credit is better than nothing.

credit should be treated as two separate types of debt. A creditor may grant credit on a partially secured basis, taking a security interest in some collateral for a specified portion of the debt, and treating the remainder as an unsecured debt to be satisfied from the debtor's general assets in case of default. However, under the proposals, such a creditor is required to follow two procedures in order to perfect his interest in the collateral and to establish his claim in the unsecured preference system. He must segregate that portion of the debt that is to be secured, and must follow the regular procedures for perfecting a security interest. In case of default, his recovery is either restricted to the secured collateral for the secured portion of the obligation or determined by suit for that amount without recourse to the collateral as provided by section 5.103(6) of the Consumer Credit Code. To recover the amount of the debt that the creditor has designated as unsecured, he must file as an unsecured creditor and be placed in the chronological preference system. This portion of the debt is then satisfied in its order of preference if the debtor defaults. If the debtor undertakes a Chapter 13 plan, this unsecured portion of the obligation is satisfied under that system, and the remainder of the debt, which the creditor has designated as secured, is satisfied from the collateral securing that amount.

The creditor, of course, must make the difficult determination of the amount of the debt to be secured by a given collateral. Two opposing interests, however, force him to make an apportionment between secured and unsecured debt that will be fair to the debtor and to other creditors. The creditor will want sufficient collateral behind the secured portion in case of default. Depending on the type of collateral used, the value of the collateral may have to be two or three times the amount of the secured debt. Thus, a creditor will want to assign a small portion of the debt to the collateral to adequately secure it, especially since his basic remedy will involve the collateral. But because a security interest is safer than perfected unsecured debt, the creditor will want as much of the debt as possible secured. Therefore the creditor must strike a medium between these two factors for his own protection. In doing so the abuse of tying up excessive collateral will be avoided.

This procedure reconciles the partially secured transaction with the proposed remedies for secured and unsecured extensions of credit. By forcing the creditor to segregate the secured and unsecured amounts of the obligation, and by requiring him to follow separate procedures for each, deficiency judgments will be eliminated and the notice value of the proposals will be preserved. Further, subsequent creditors, whether secured or unsecured, will be able to accurately estimate their risks in their respective spheres of credit extension.

D. *Implementation of the Proposals*

The proposals suggested herein are adaptable to existing and proposed statutory regulation of consumer credit and could be included in such enactments by minor amendments and additions.[43] The most appropriate vehicle for implementation would be the Uniform Consumer Credit Code. The Code makes two major classifications of consumer credit: consumer credit sales consisting of credit transactions involving the sale of goods, services, or an interest in land to the debtor;[44] and consumer loans consisting of credit transactions involving the payment of money or arrangements for the payment of money.[45] Within these broad classifications are secured and unsecured transactions.[46] Consumer credit sales of goods will often be secured. Similarly, consumer loans may be secured or unsecured by whatever collateral is agreed to by the parties.

Article 5 of the Consumer Credit Code defines creditor and debtor remedies and penalties, and that article could easily be expanded to incorporate the proposal for an unsecured credit preference system. The requirement for an unsecured credit financing statement and the designation of an appropriate place to record such statements, however, would be more appropriate in article 9 of the Uniform Commercial Code, which contains similar provisions for secured transactions. The proposed limitations on deficiency judgments in the Consumer Credit Code[47] could be expanded and modified to include the foregoing pro-

43 As a practical matter, the implementation of these proposals does not deal with the rare instances involving tort claims. The number of consumer credit transactions affected by tort claims is minimal compared to the number involving debtor-creditor remedies generally. It would be desirable, of course, to make laws relative to tort claims compatible with the proposals being advanced, but any discussion of how this could be accomplished is beyond the scope of this article.

44 *See* UCCC § 2.104.

45 *See id.* § 3.104.

46 The UCCC excepts certain transactions from the scope of its coverage. Sales made pursuant to a lender credit are one example. Credit sales of and loans for the purchase of an interest in land with a credit service charge of less than 10% are also excluded, and loans secured by business collateral the value of which is substantial in relation to the amount of the loan are excepted. Otherwise, all secured and unsecured credit transactions with a consumer (other than an organization) for personal, family, household, or agricultural use, with an amount financed of less than $25,000 payable in instalments or with a credit service charge, are included in the Code's provisions. UCCC §§ 2.104, 3.104.

47 *Id.* § 5.103.

posals for secured credit transactions. The provisions regarding wage garnishments[48] could be expanded to reconcile that remedy with the preference system for unsecured credit. Moreover, it would be desirable to include simplified provisions for the repossession of collateral in the Consumer Credit Code, since the abrogation of the remedy for deficiency balances from consumer credit transactions will remove the requirement of complex protective provisions regarding repossession of collateral in those transactions.[49]

Suitable definitions of "secured" and "unsecured" credit transactions should be provided in the Credit Code because the proposed system of remedies requires that they be mutually exclusive. This differentiation will not affect the other remedies presently included in article 5 since they are applicable to both secured and unsecured transactions.[50]

The National Conference on Uniform State Laws is considering provisions for wage earner receiverships to be used in article 8 of the Consumer Credit Code.[51] The receivership proposals suggested in this article could easily be incorporated there. An amendment to the Federal Bankruptcy Act would also be required to provide that such receiverships or the Wage Earner's Plan of Chapter 13 are mandatory in place of bankruptcy in states adopting the Consumer Credit Code, unless the court finds that the debtor is permanently incapacitated or unable to obtain employment. The amendment would further provide that payments will be distributed according to the preference systems established by the Code.

CONCLUSION

The proposed system of restricting secured and unsecured claims to their respective remedies while uniformly requiring filing and perfection can hardly be objected to as revolutionary. Although a

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48 *Id.* §§ 5.104 to 5.106.

49 The UCC is the present authority on proper repossession and disposition procedures. UCC §§ 9-503 to 9-507. These provisions are drafted with a view towards maximum protection of the creditor and debtor in the process of retaking and reselling the collateral, and for collecting any deficiency. The drafters of the Consumer Credit Code chose to leave the Commercial Code provisions intact with only two exceptions. *See* Jordan & Warren, *supra* note 5, at 440-41. If deficiency judgments were excluded altogether, these procedures on retaking and resale could be simplified considerably.

50 These include provisions regarding wage garnishment, UCCC §§ 5.104 to 5.106, extortionate extensions of credit, *id.* § 5.107, and unconscionability. *Id.* § 5.108.

51 Article 8 has been reserved in the final draft for the inclusion of wage earner receivership provisions after they have been considered by the committee.

great distinction is made between collection remedies involving collateral on the one hand and income allocation on the other, the basic difference between the two is only a matter of time. A borrower's equity in existing collateral is, in effect, the result of savings of past income. Wage assignments and the like are an allocation of future income. Both forms of remedies are allocations of income; neither form has the capacity to generate income that otherwise has not existed or will not exist. Thus, a system that assigns to each type of debt a remedy that utilizes the same "collateral" on which the creditor relies seems appropriate.

There may be other objectionable features in the proposed system. The statutory weakening or elimination of existing creditor remedies may reduce the amount of credit generally available to consumers. Although such a change in remedies may make responsible creditors more cautious in extending credit, it is entirely possible that the marginal operators will not exercise caution.[52] But the reduction in the amount of credit available will affect only those individuals who are unable to discipline themselves adequately to maintain a good payment record. Reduction of the amount of consumer credit available to them would not necessarily be detrimental either to them or to society as a whole. And clearly the imposition of greater control over the credit market as a whole will result in less opportunity for abuse of credit controls by marginal operators. The marginal operator may still be able to grant credit to an over-extended debtor, but the preference system will make it considerably less profitable to do so. Nor will the system result in a decrease in the amount of sound credit available to consumers, because the remedies operate only in the event of default.

A more general objection to the proposal is that a preference system for unsecured credit is unwieldy. But even the most efficient form of control is unwieldy when it is introduced to a previously uncontrolled area. The establishment of a perfection system for unsecured transactions in a central credit bureau in each trade area has been suggested before.[53] Coupled with a statutory preference system, it would provide badly needed control over the extension of unsecured consumer credit. The system is certainly no more unwieldy than the analogous present statutory requirements relating to secured transactions. And the basic problem resulting from the increased availability of un-

52 *See* CURRAN, *supra* note 21, at 19.

53 *See, e.g.,* Mr. C. Virgil Martin's testimony before the Illinois Legislative Committee, *paraphrased in* Miller & Kopp, *supra* note 19, at 244.

secured credit—overextension of the debtor resulting in his inability to repay—parallels the problem of multiple security interests in the same collateral. Moreover, current computer capabilities could make the operation of the system prompt and efficient; for example, a computer system interlocking the central credit areas would alleviate the problem of the transient debtor.

On the other hand, acceptance of these proposals would promote both the wise use and the prudent extension of consumer credit through the injection of statutory discipline into the consumer credit transaction. The uniform nature of these remedies would simplify debtor-creditor relationships because the rights and the risks of each party would be clearly defined. The statutory preference system would prevent marginal operators from undercutting sound credit extensions and debtors from abusing the bankruptcy law. The effect of the proposals would be to require debtors to satisfy their obligations in almost every case, and to force creditors to carefully evaluate the risk of the transaction when credit is extended. Substantial benefits will accrue to all parties as a result of this regulation of the consumer credit industry.