The Role of the Holder in Due Course Doctrine in Consumer Credit Transactions

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By DAVID J. BENSON* and ALPHONSE M. SQUILLANTE**

It has been said that the law is like "a single-bed blanket on a double bed and three folks in the bed and a cold night. There ain't ever enough blanket to cover the case, no matter how much pulling and hauling, and somebody is always going to nigh catch pneumonia."¹ Perhaps nowhere in the law is that metaphor more apropos than with respect to the law concerning the holder in due course doctrine as it is applied in consumer credit transactions.

In the typical case, a consumer purchases a product from a seller who has the consumer execute a promissory note payable to the seller in the amount of the unpaid purchase price of the product plus interest and any other carrying charges. The seller then either fails to deliver the product, or the product which is delivered is defective or otherwise fails to meet the consumer's expectations.

The consumer then seeks rectification of the shortcoming in the seller's performance and, when such action is not forthcoming, stops making payments on the promissory note which he executed at the time of the purchase. It is usually at this stage that the consumer realizes that his promissory note has been negotiated to someone to whom the law refers as a "holder in due course" and that, according to the law, the consumer must continue making the payments on the note notwithstanding the fact that the product is defective or has not been delivered to him.

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¹ R. WARREN, ALL THE KING'S MEN 145 (1946).
In response to the consumer's allegation that such a rule of law is patently unfair, the holder in due course (which is likely to be a finance company or a bank) points out that if it were not accorded holder in due course status it would not purchase promissory notes from the seller. If the seller could not sell promissory notes received in payment for his goods, the seller would not take the consumer's promissory note because the seller lacks the resources to finance his own sales; and if the seller would not take the consumer's promissory note, the consumer would be unable to make the purchase until he had saved sufficient cash or had made arrangements to obtain credit from another source. Thus, on a theoretical plane at least, if too much protection is given to the consumer the financer may be unwilling to finance, the seller unable to sell, and the consumer unable to buy. On the other hand, the protection traditionally given the financer by the holder in due course doctrine has resulted in consumers having to pay for goods which are defective or never received.

This article examines the role played by the holder in due course doctrine in the tripartite relationship of consumer, seller and financer. The article first reviews recent challenges to the doctrine as manifested in legislative proposals and judicially imposed limitations. It then analyzes the failure of these efforts to produce uniformity in the treatment of holders of commercial paper arising from consumer credit transactions, and concludes with an assessment of what is needed to achieve such consistency in the future.

The Holder In Due Course Doctrine

The holder in due course doctrine is not new. The concept was recognized in England as early as 1758 in Miller v. Race, and in the United States as early as 1842 in Swift v. Tyson. Indeed, part of the criticism which might be made of the holder in due course doctrine is that it was born in a period of history in which methods of transportation and communication were still quite primitive. Because of the slow methods of transportation and communication, it was perhaps necessary to afford a high degree of protection to remote holders of commercial paper, since it was impossible for such holders to make quick checks...
of the circumstances giving rise to the issuance of commercial paper before purchasing that paper. With the advent of "instant" communication, however, it might be argued that the purchaser of commercial paper can immediately ascertain whether the maker has any defense to the instrument prior to acquiring it and that there no longer is a need for the holder in due course doctrine.

The doctrine in any event remained relatively unassailed from the time of its inception sometime in the mid-eighteenth century until the latter half of the twentieth century. It was not until the 1960's that the first major assault was mounted by critics of the concept. This assault was launched in the area of consumer credit transactions and was manifested in a spate of legal articles, court decisions, and legislative activity.

With a doctrine of such long standing coming under attack by critics from all quarters, it is not surprising that the holder in due course doctrine was identified as another "citadel" presumably destined to go the way of the requirement of privity in products liability law. It does


6. See notes 16-75 & accompanying text infra.

7. See Murphy, supra note 4, at 667, wherein the analogy is drawn between the recent attacks upon the holder in due course doctrine and those made upon the requirement of privity of contract in products liability cases. The attack on the privity doctrine was of course the subject of the late William Prosser's famous articles: Prosser, The Assault Upon the Citadel (Strict Liability to the Consumer), 69 YALE L.J. 1099 (1960); Prosser, The Fall of the Citadel (Strict Liability to the Consumer), 50 MINN. L. REV. 791 (1966). Prosser in turn derived his theme from Justice Cardozo's famous statement: "The assault upon the citadel of privity is proceeding in these days apace." Ultramares Corp. v. Touche, 255 N.Y. 170, 180, 174 N.E. 441, 445 (1931).
not seem coincidental that the assault on the holder in due course doctrine in the consumer credit context roughly parallels the development in the United States of "consumerism." Indeed, the calling into question of the holder in due course doctrine as it relates to consumer credit transactions seems an integral part of the consumer movement in the United States.

The aspect of the holder in due course doctrine which has been questioned is that which results in the consumer—the maker of the note—being precluded from asserting many of the defenses which would otherwise be available to a buyer of goods or services. The facet of the doctrine which insulates such a holder from claims by other persons of ownership of the note is generally regarded as insignificant in the consumer credit situation, as most notes are given directly to the financer by the seller and seldom become lost or stolen.8

The cutting off of defenses, however, is deemed significant in the consumer credit situation. It is currently effectuated through section 3-305 of the Uniform Commercial Code (UCC), which provides that a holder in due course takes such an instrument free from all defenses of any party to the instrument except for those which are generally deemed "real" defenses.9 The real defense of greatest importance in the consumer credit situation would seem to be that of fraud in the factum, or what the UCC describes as "such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms. . . ."10

The real defenses available to the maker of a promissory note

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9. Uniform Commercial Code [UCC] section 3-305 provides:

To the extent that a holder is a holder in due course he takes the instrument free from

(1) all claims to it on the part of any person; and

(2) all defenses of any party to the instrument with whom the holder has not dealt except

(a) infancy, to the extent that it is a defense to a simple contract; and

(b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and

(c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and

(d) discharge in insolvency proceedings; and

(e) any other discharge of which the holder has notice when he takes the instrument.

10. UCC § 3-305(2)(c).
against a financer who is a holder in due course would appear to be applicable in a fairly limited class of cases. For the most part those cases would involve the more blatant forms of consumer fraud, as where the consumer is tricked into signing a negotiable instrument under the belief that he was signing something else.\(^\text{11}\) The defenses which the consumer cannot assert against the financer, on the other hand, would seem to include those which are more likely to apply in the typical consumer sales situation. Thus, in a suit brought by a financer who is a holder in due course, the consumer does not have available those defenses which are generally termed “personal” in nature.

One such personal defense is want or failure of consideration.\(^\text{12}\) This situation is likely to arise where the seller is to provide goods or services in the future and fails to perform. Such a seller at the time performance is due may be insolvent, absent from the jurisdiction, or otherwise unable or unwilling to deliver the goods or perform the contract as promised. Nonetheless, the consumer must continue to pay the financer or risk being sued for the unpaid balance, interest and usually costs of collection, including attorney’s fees.

Equally unavailable to the consumer is the defense of breach of warranty.\(^\text{13}\) Thus, where the goods delivered by the seller fail to conform to either express or implied warranties, the buyer must continue to pay the financer on the note.

The consumer is also precluded from asserting the defense of non-delivery or delivery for a special purpose.\(^\text{14}\) For example, the buyer might enter into an agreement with the seller whereby the buyer can return the goods to the seller if the buyer is not satisfied. If the consumer also signs a promissory note which is negotiated to a holder in due course the note must be paid by the consumer, notwithstanding the fact that he wants to return the goods or has already done so.

The consumer is also prevented from asserting the defense that, although he knew he was signing a promissory note, he was fraudulently induced to enter into the transaction.\(^\text{15}\) Thus, where a homeowner is told that a swimming pool company wants to build a swimming

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12. Goetz v. Bank of Kansas City, 119 U.S. 551, 556 (1887); see UCC § 3-306(c).
13. See, e.g., Deavenport v. Green River Deposit Bank, 138 Ky. 352, 128 S.W. 88 (1910); UCC § 3-306(b).
14. See, e.g., Quebec Bank v. Hellman, 110 U.S. 178 (1884); UCC § 3-306(c).
15. Stevens v. Pearson, 138 Minn. 72, 163 N.W. 769 (1917); see UCC § 3-306(b).
pool for him for advertising purposes, and that the promissory note is simply evidence of the homeowner's good faith and will be destroyed or returned to him after the pool is shown to a number of prospective customers, the homeowner is still liable on the note to the financer.

The foregoing examples of the operation of the holder in due course doctrine in consumer credit transactions are not intended to be exhaustive, nor are they intended to present all of the equities of the seller, the financer or the consumer. They are merely intended to exemplify the types of situations which the authors believe have given rise to the attacks on the holder in due course doctrine in consumer credit transactions. An analysis of those challenges follows.

**Challenges to the Holder In Due Course Doctrine**

**National Commission on Consumer Finance**

While the passage in 1968 of the Federal Consumer Credit Protection Act\(^\text{16}\) (which includes what is more commonly referred to as the "Truth in Lending" Act) did not affect the application of the holder in due course doctrine in consumer credit transactions, it did create the National Commission on Consumer Finance (NCCF).\(^\text{17}\) This commission was charged with the responsibility of studying and appraising the consumer finance industry.

The final report of the NCCF was issued in December 1972.\(^\text{18}\) Part of that document was concerned with remedies available to creditors engaged in the business of consumer finance. The NCCF sought to discover which remedies were essential to the credit industry in collecting consumer loans and which were not. In pursuit of that information, the NCCF conducted a survey of creditors engaged in the purchase of promissory notes executed in connection with consumer credit transactions. One of the members of the commission has indicated that of the banks surveyed, only 8 percent considered the holder in due course doctrine to be of prime importance in effecting collection of consumer paper;\(^\text{19}\) of the finance companies responding, none suggested that the holder in due course doctrine was essential to the collection

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\(^{19}\) Johnson, Creditors' Remedies and Rate Ceilings: Some Study Results of the National Commission on Consumer Finance, 26 PERSONAL FINANCE L.Q. REP. 64, 65 (1972).
of consumer loans.\textsuperscript{20} Both banks and finance companies did indicate, however, that the holder in due course doctrine was relied upon by them in legal actions to collect loans in default.

In addition to surveying consumer credit financers, the NCCF studied a number of states which had abolished or limited the holder in due course doctrine in order to ascertain the effect of such abolition or limitation on creditors, sellers and consumers.\textsuperscript{21} The NCCF project showed that:

1. \textit{Consumer finance companies purchased less \ldots consumer goods paper; and \ldots}
2. \textit{The total amount of \ldots consumer goods credit made available in the retail market declined.}\textsuperscript{22}

From the study the NCCF concluded that abolishing or limiting the holder in due course doctrine "would have the greatest impact on consumers who are marginal credit risks and on those businesses which serve \ldots such consumers."\textsuperscript{23} The commission noted that as a result of the reduction in consumer goods credit caused by the abolition or limitation of the holder in due course doctrine, many businesses dealing mainly with high risk customers would probably be forced out of business. The high risk consumer would consequently find it more difficult to find credit or, if credit was found, would be faced with higher finance charges to offset the risk involved.\textsuperscript{24}

Having surveyed the banks and finance companies regarding their attitudes toward the holder in due course doctrine and having analyzed the effects of abolition or limitation of the holder in due course doctrine in certain states, the NCCF recommended that the doctrine be abolished with respect to consumer finance. The report concluded:

Notes executed in connection with consumer credit transactions should not be "negotiable instruments"; that is, any holder of such a note should be subject to all the claims and defenses of the maker (the consumer-debtor). However, the holder's liability should not exceed the original amount financed. Each such note should be required to have the legend "Consumer Note-Not Negotiable" \ldots printed on its face.\textsuperscript{25}

The commission felt that although the abolition of the holder in due course doctrine in consumer transactions might result in high risk con-

\begin{itemize}
\item \textsuperscript{20} \textit{Id.}
\item \textsuperscript{21} The states involved were California, Connecticut, Hawaii, Massachusetts, New Hampshire, New York and Vermont. \textit{Consumer Credit Report, supra} note 18, at 1, 23.
\item \textsuperscript{22} \textit{Id.} at 36.
\item \textsuperscript{23} \textit{Id.}
\item \textsuperscript{24} \textit{Id.}
\item \textsuperscript{25} \textit{Id.} at 35.
\end{itemize}
sumers finding it difficult to obtain credit, such consequences would be offset by the general improvement of the quality of goods and services provided to all consumers. This latter change would result from dealers being forced to improve or to risk losing the market for their commercial paper.

The NCCF recognized that in such a scheme the financer would bear much of the responsibility for policing the practices of sellers; it concluded, however, that financers were in a much better position than consumers to monitor a dealer's performance since, if a dealer has too many customer complaints or has a reputation for sharp business practices, the financer can simply refuse to purchase more of that dealer's paper. The consumer, on the other hand, usually learns of the sharp practices too late to protect himself and does little to warn other potential buyers.

Merely abolishing the holder in due course doctrine in consumer credit transactions in order to achieve the goal of preserving the consumer's defenses assumes that the seller in the tripartite relationship will be the one who extends credit to the consumer and then negotiates the promissory note to the financer. If, however, the consumer applies directly to a financer, perhaps at the suggestion of the seller, and obtains a loan with which he makes the purchase from the seller, the abolition of the holder in due course doctrine will have no effect on the duty of the consumer to repay the loan which he obtained directly from the financer. It is no defense to the financer's action on the consumer's debt that what the consumer purchased with the proceeds of the loan was worthless.

Aware of this obvious device for avoiding the effect of the abolition of the doctrine, the NCCF also recommended that the use of the so-called "direct loan" be limited in consumer credit transactions. The commission did not suggest that all direct loans to consumers be abolished or limited, but did recommend that where the financer is closely identified or connected with the seller, the consumer's defenses on the sales contract should be preserved in any action by the financer on the direct loan used to purchase those goods. This limitation would appear to prohibit the seller from forming a separate finance company to engage in direct loaning to consumers. It would also appear to preclude any arrangement whereby all of a seller's customers would be re-

26. Id. at 36-37.
27. Id. at 36.
28. Id. at 37-38.
ferred to a specific financer, especially where the seller received a commission for such references.

The report indicated that, in recommending the abolition of the holder in due course doctrine and the limiting of direct loans in consumer credit transactions, the commission had to weigh the needs of small businessmen to secure capital to enter and remain in markets serving consumers or marginal credit risks against the need to protect consumers in general. The NCCF had no doubt about which way that balance should tip, concluding that “[t]he inevitable reduction in availability of consumer credit in some markets will be more than offset by increased consumer confidence in the market as a whole.”

The NCCF study represented the first comprehensive examination of the whole field of consumer finance in the United States. Although the report was technically made to Congress and contained over forty recommendations requiring federal action, it contained another sixty recommendations requiring state proceedings.

The Uniform Consumer Credit Code

By the mid-1960's, the growing challenge to the holder in due course doctrine had taken form in a number of state legislative enactments which abolished or limited the doctrine in a variety of consumer credit transactions. Commentators of the time noted that the challenge, which had been manifested in the enactment of a wide variety of state statutes, was unsatisfactory and poorly organized. It became apparent that if the ad hoc erosion of the doctrine continued state by state, the result would be an endless array of conflicting and confusing statutory schemes, a result equally intolerable to consumers, sellers and financers. With the various state approaches to consumer credit problems already having resulted in a lack of uniformity, and the prospect of a consistent approach to the problems being bleak, the National Conference of Commissioners on Uniform State Laws quite appropriately undertook the formulation of a uniform law concerning consumer credit.

The result of the commissioners' work was the promulgation in 1968 of the Uniform Consumer Credit Code (UCCC). While the

29. Id. at 38.
32. See, e.g., Curran, Legislative Controls as a Response to Consumer-Credit Problems, 8 B.C. IND. & COM. L. REV. 409 (1967).
UCCC deals with a number of consumer credit problems, one of the major changes it effected was the abrogation of the holder in due course doctrine. This was accomplished in the following provision:

In a consumer credit sale or consumer lease, other than a sale or lease primarily for an agricultural purpose, the seller or lessor may not take a negotiable instrument other than a check as evidence of the obligation of the buyer or lessee. A holder is not in good faith if he takes a negotiable instrument with notice that it is issued in violation of this section. . . .

In order to ensure that the consumer's claims and defenses, preserved by the elimination of the holder in due course doctrine, would not be circumvented by the seller's use of contracts containing a provision whereby the consumer waives his defenses against any assignee of the sales contract, the UCCC provided two alternatives for state adoption. Alternative A made such waiver-of-defense clauses unenforceable but limited the liability of the assignee to the amount due on the contract. Alternative B gave effect to the waiver-of-defense clause if the consumer had not notified the holder of any defense within ninety days.

The UCCC did not, however, limit loans made directly to the consumer by a financer. This factor has been viewed as an important loophole and has been one of the major criticisms of the act. Such criticism would seem well founded. The UCCC has also been challenged on the ground that someone acquiring the paper without notice that it was given in a consumer credit transaction can still be a holder in due course, thereby cutting off the consumer's defenses. The validity of this criticism is somewhat doubtful; it would seem easy for courts to entertain the presumption that someone who takes an instrument drawn by an individual in favor of a retail establishment has notice that it was given in violation of the UCCC. In addition, the UCCC made the acceptance of such paper by the seller a misdemeanor, a

34. Id. § 2.404 (Alternative A).
35. Id. § 2.404 (Alternative B).
37. Id. at 288.
38. UCCC section 5.302 provides in part:
A person is guilty of a [misdemeanor] and upon conviction may be sentenced to pay a fine not exceeding $5,000, or to imprisonment not exceeding one year, or both, if he willfully and knowingly

. . . .

(3) . . . fails to comply with any requirement of the provisions of this Act

. . . .
factor which should tend to discourage businesses from accepting such paper as a regular course of conduct.

The UCCC has not only been criticized by those who feel that it does not go far enough in its protection of the consumer. Ever present is the seemingly endless debate between consumer advocates and financers as to the need and desirability of retaining the holder in due course doctrine in consumer transactions. Further, criticism of the UCCC has not been limited to the provisions affecting the holder in due course doctrine or to the provisions affecting waiver-of-defense clauses, but has also extended to other provisions of the act. As a result of the controversy which has raged over the desirability of adopting the UCCC, only seven states have enacted it, and two other states have substantially followed the UCCC in drafting their own consumer credit acts. However, only four states adopted verbatim UCCC section 2.403, abrogating the holder in due course.

In view of the almost universal adoption of the UCC, the lack of acceptance of the UCCC must have been a disappointment to the National Conference of Commissioners on Uniform State Laws. In recognition of the failure of the UCCC, the conference appointed a special committee to review that code. Not surprisingly, the special committee reached the conclusion that the UCCC was no longer generally acceptable to state legislatures. As a result of that conclusion, the committee developed several redrafts of the UCCC which were recently adopted by seven states.


43. Louisiana is the only state which has not adopted the UCC.

44. Alfred A. Buerger, Chairman; Walter D. Malcolm, Vice Chairman; Frederick H. Miller, Co-Reporter-Draftsman; William D. Warren, Co-Reporter-Draftsman; Robert W. Johnson, Reporter-Economist. UCCC Working Redraft No. 6, CCH INSTALLMENT CREDIT GUIDE No. 299, Aug. 1, 1974, at vi.

THE HASTINGS LAW JOURNAL

finalized in Working Redraft No. 6 and submitted to the Commissioners on Uniform State Laws.48

Although the redrafts were primarily concerned with changes in sections of the UCCC which did not concern the holder in due course doctrine, Working Redraft No. 6 continues and strengthens the prohibition on the use of negotiable instruments in consumer credit transactions.47 That redraft also contains an attempt to plug the direct-loan loophole, which was the subject of much criticism of the original UCCC. The Working Redraft No. 6 provision causes the direct-loan financer to be subject to the consumer's claims and defenses arising out of the purchase of consumer goods where the financer and the seller have a close relationship and where the financer is closely connected with the seller with regard to the transaction in question.48 Working Redraft No. 6 also strengthens Alternative A and eliminates Alternative B with respect to the waiver-of-defense clause.49

The changes which were made in the UCCC in Working Redraft No. 6 should eliminate much of the criticism of the UCCC by consumer advocates and, thus, should result in the adoption of that code by a number of states which would not otherwise have been so disposed. It might also be argued, however, that those changes will strengthen opposition to the UCCC by groups representing financers and sellers. It therefore seems doubtful that there will be a rush to adopt the UCCC as amended by final Working Redraft No. 6.

The National Consumer Act

In response to the failure of the UCCC to gain acceptance and the criticism of those who felt that it did not go far enough in protecting consumers, the National Consumer Law Center50 drafted the National Consumer Act (NCA).51 The NCA is generally viewed as more consumer oriented than the UCCC,52 and the provisions of the NCA affecting the holder in due course doctrine differ from those of the

46. See UCCC Working Redraft No. 6, CCH INSTALLMENT CREDIT GUIDE No. 299, Aug. 1, 1974.
47. Id. at xv; see id. § 3.307.
48. Id. at xv-xvi; see id. § 3.405.
49. Id. at xv; see id. § 3.404.
50. National Consumer Law Center, Inc., One Court Street, Boston, Ma. 02108 (1973 address).
51. NATIONAL CONSUMER ACT [NCA] (1970) (drafted by the National Consumer Law Center pursuant to an OEO grant).
52. See, e.g., Stengel, Should States Adopt the Uniform Consumer Credit Code?, 60 KY. L.J. 8, 44-45 (1971).
UCCC. Specifically, the NCA provides that one who holds a note arising from a consumer credit transaction cannot be a holder in due course notwithstanding such person's lack of notice that the note came from a consumer transaction.53 Under the UCCC a person can be a holder in due course of a negotiable instrument arising from a consumer goods transaction if he takes the instrument without notice of its origin.54

One critic of the NCA has written that the act proceeds on the theory that the consumer and the financer are mortal enemies,55 and that "[i]n [the National Consumer Law Center's] zeal to 'protect' the consumer the net result of their effort would be . . . to destroy the availability of credit from legal sources to many consumers and to raise its costs for most all consumers."56 Since the promulgation of the NCA in 1971, Wisconsin has been the only state which has relied on it to a substantial extent in drafting its own consumer credit statute.57

Model Consumer Credit Act

In response to the criticism leveled against the National Consumer Act and its general lack of acceptance, the National Consumer Law Center drafted the Model Consumer Credit Act (MCCA),58 which is a revision of the National Consumer Act.

With respect to the holder in due course doctrine, this revised act differs from the NCA in that the blanket prohibition against a holder in due course of consumer credit paper found in the NCA has been limited in the MCCA:

(3) The lender or transferee of the lender has no liability . . .
if

(a) with respect to the lender who acts in good faith he establishes by a preponderance of the evidence that he did not know and had no reason to know that the proceeds of the loan, or any part of them, would be used in a consumer transaction . . . .59

Thus the MCCA would abrogate the holder in due course doctrine for both direct and indirect consumer loans where either the lender or a

53. NCA § 2.405.
54. UCCC § 2.403.
56. Id.
59. MCCA § 2.603(3).
transferee of the lender knew or had reason to know that the loan was a consumer loan. The act spells out a number of situations where the lender will be presumed to know that the note arose from a consumer transaction. 60 Most of those situations evidence some continuing relationship between the seller and the lender, such as where the lender provides the forms for the notes, the seller is given a commission for financing the deal through the particular lender, or the lender makes the payment of the loan proceeds directly to the seller.

The MCCA also differs from the NCA in that the newer act differentiates between those lenders who take the paper in good faith and those who do not with respect to the scope of their liability. The NCA provides that the lender is liable to the consumer for the consumer’s claims arising out of the transaction up to the total amount the consumer has to pay in the entire transaction, even though that liability might exceed the amount that the lender loaned to the consumer. 61 The MCCA, however, limits the liability of a lender who takes the paper in good faith, without notice of any claims or defenses, to the amount of the loan used in the purchase, plus finance charges. 62 This limitation does not apply to a lender who takes the paper with notice of the consumer’s claims or defenses. 63

Drafted in 1973, the MCCA has not yet been adopted by any state legislature.

Proposed Federal Trade Commission Regulation

In 1971, the Federal Trade Commission (FTC) proposed a regulation designed to end the use of the holder in due course doctrine to cut off consumers’ claims and defenses in retail installment sales. The proposed regulation provided:

If any contract, for the sale or lease of consumer goods or services . . . requires or involves the execution of a promissory note or other instrument of indebtedness, it constitutes an unfair and deceptive act or practice for any such retail seller to:

(a) Fail to have inscribed upon the face of such note [a notice that the holder of the instrument takes subject to any defenses or claims by the purchaser against the seller notwithstanding any agreement to the contrary]. 64

The proposal was met with a good deal of criticism, some of which came from consumer advocates who feared that the rule would super-

60. MCCA § 2.603(4)(a-k).
62. MCCA § 2.603(2).
63. Compare MCCA § 2.603(1), with id. § 2.603(2).
sede more favorable existing or pending state legislation. As a result of the challenges from consumer advocates, the finance industry, and retail merchants, the FTC ultimately withdrew the proposed regulation.65

Part of the criticism came from the National Retail Merchants Association, which argued that the abolition of the holder in due course doctrine would result in less credit or higher rates or both. Reference was made to the NCCF report which concluded that where the doctrine had been abolished, there was likely to be a reduction of credit to high risk consumers, resulting in some small retail merchants serving those consumers going out of business.66 The association also contended that the proposed rule was unnecessarily harsh inasmuch as it attempted to make the retailer the policeman of arrangements between financial institutions such as banks and consumers, and that the regulation would have the effect of superseding all state legislation concerning the holder in due course doctrine, which the retail merchants felt the FTC could not and should not do.67

The proposed FTC regulation also received criticism from the National Consumer Finance Association in a report prepared by a subcommittee of its law committee.68 The report took the position that although some action concerning the holder in due course doctrine was necessary, the proposed FTC regulation was unacceptable. The report concluded by noting that if some new legislation had to be adopted, the UCCC best strikes the balance between safeguarding the consumer and protecting the financer's right to ensure payment of consumer loans.69

Perhaps one of the reasons that the proposed FTC regulation met with such opposition was the fact that, unlike other suggested consumer credit reform measures, it would result in the interjection of a federal regulatory agency into the traditional tripartite consumer credit transaction, with all the attendant enforcement proceedings, burdensome reporting procedures and the like. With such opposition it is unlikely

65. See Consumer Credit Report, supra note 18, at 35.
69. Id. at 77-78.
that the FTC will attempt to revive the proposed regulation unless state efforts to deal with the problem continue to fall short of supplying a consistent and uniform solution. It remains possible, however, that some other federal agency or Congress might choose to take action affecting the holder in due course doctrine in consumer credit transactions.

Miscellaneous State Statutes

As indicated above, the UCCC has been adopted in one form or another in seven states, and substantially followed in two others. The National Consumer Act has been relied upon, together with the UCCC, in one state. In the remaining forty-two American jurisdictions, there is either no statutory limitation on the holder in due course doctrine or there is one or more of a hodgepodge of statutory restrictions which almost defies classification. Suffice it to say that these limitations range from sweeping abolition of the holder in due course doctrine to elimination of the doctrine in specific consumer transactions such as home improvements, motor vehicles or home solicitations; to abolition of the principle in consumer transactions involving goods worth less than a specified dollar amount; to postponement of the doctrine for five, thirty, forty-five, sixty or ninety days after the goods are delivered or after the financer notifies the consumer that the consumer's promissory note has been negotiated to that financer in order to afford the consumer an opportunity to assert his defenses within those times.

It is difficult to conceive of an area of the law in which the rights of individuals vary so dramatically from state to state as do the rights of consumers, sellers and financers involved in consumer credit transactions. Multistate sellers and financers in particular must experience a sense of bewilderment with the seemingly infinite variety of regulations with which they are confronted. The need for uniform state legislation being self-evident, one must wonder why attempts to move the states to adopt uniform laws have failed so dismally and with such regularity. Some of the causes of this failure have been suggested in the foregoing

70. See note 36 supra.
71. See note 41 supra.
72. See note 57 supra.
73. Including the District of Colombia and Puerto Rico.
74. For an excellent attempt to classify the state statutes, see Willier, Need for Preservation of Buyers' Defenses—State Statutes Reviewed, 5 U.C.C.L.J. 132, 133 (1972).
75. Id.
discussions concerning the UCCC, the National Consumer Act and the Model Consumer Credit Act; those and other reasons are discussed further below.

Decisional Developments

The Close Connectedness Doctrine

Early Challenges

The initial judicial challenge to the holder in due course doctrine in consumer credit transactions came long before the primary legislative activity. In 1940, in *Commercial Credit Co. v. Childs*, the Supreme Court of Arkansas startled the commercial community by holding that a finance company was not a holder in due course of a promissory note negotiated to it by the seller of an automobile.

The defendant purchaser of the automobile claimed that the vehicle was defective and that he had been fraudulently induced to sign the contract which contained the promissory note in question. In determining that the finance company was not a holder in due course of the note and was therefore subject to the defendant's personal defenses, the court noted that the promissory note contained a printed assignment to the finance company; the forms executed by the defendant were furnished to the seller by the finance company; and the assignment took place on the same day that the note was executed. These factors, held the court, all indicated that the finance company was "so closely connected with the entire transaction or with the deal that it can not be heard to say that it, in good faith, was an innocent purchaser of the instrument for value before maturity." This close connection between the seller and the finance company, reasoned the court, was tantamount to the financer's being a party to the transaction from its inception and, thus, it was not eligible for holder in due course status.

*Commercial Credit Co. v. Childs*, while setting forth a novel approach to the problems generated by the traditional role played by the holder in due course doctrine in consumer credit transactions, had little immediate impact outside of Arkansas. It was not until ten years later that a court in another jurisdiction, California, adopted what came to be called the "close connectedness" doctrine enunciated in *Childs*. That court, in *Commercial Credit Corp. v. Orange County Machine Works*, applied the holding of *Childs* to a commercial credit transac-

76. 199 Ark. 1073, 137 S.W.2d 260 (1940).
77. *Id.* at 1077, 137 S.W.2d at 262.
78. 34 Cal. 2d 766, 214 P.2d 819 (1950).
tion rather than a consumer transaction. The case involved the purchase of a mechanical press wherein a contract and note executed by the defendant were assigned to Commercial Credit. The lower court held that Commercial Credit was not a holder in due course of the note. In affirming, the California Supreme Court noted that the finance company had supplied the seller with forms and had twice consulted by telephone with the seller regarding the impending transaction. Further, the court found that the finance company had approved the details of the transaction and had advanced money to the seller with the understanding that the contract and note would be assigned to it upon completion of the sale. The court ruled that the finance company "was a moving force in the transaction from its very inception, and acted as a party to it."79 It therefore denied holder in due course status to the finance company and allowed the consumer's defense of failure of consideration.

In 1953, Childs and Orange County Machine Works provided the Supreme Court of Florida with the rationale for denying holder in due course status to a finance company in Mutual Finance Co. v. Martin.80 In applying the close connectedness doctrine of Childs and Orange County Machine Works, the Florida court noted that, in the sale of the food freezer and meat saw to the consumer, the finance company had prepared and furnished to the seller printed forms for the conditional sales agreement with a promissory note attached. The printed forms designated the finance company as the assignee of both the conditional sales contract and note. The court further noted that the contract and note stated that payment was to be made at the finance company's office, that the finance company had approved the terms of the purchase upon investigation of the buyer's credit standing, and that the company had taken assignment of both the contract and the note the day after their execution.

The court was aware that its decision might place a burden on finance companies, but stated: "We believe the finance company is better able to bear the risk of the dealer's insolvency than the buyer and in a far better position to protect his interests against unscrupulous and insolvent dealers."81

Thus, by 1953, only Arkansas, California and Florida had used the close connectedness concept to alter the traditional role played by the holder in due course doctrine in credit transactions. During this

79. Id. at 771, 214 P.2d at 822.
80. 63 So. 2d 649 (Sup. Ct. Fla. 1953).
81. Id. at 653.
period, some courts considered close connectedness and rejected it; and at least one court felt that if the holder in due course doctrine were to be abrogated, it was up to the legislature to do so. In 1954, in a decision which seemed to mark the end of the growth of the close connectedness doctrine, the Supreme Court of Wisconsin emphatically rejected the close connectedness doctrine on facts similar to those in Childs.

In Implement Credit Corp. v. Elsinger the note in question was on a form supplied to the dealer by the finance company and contained a printed assignment of the note to the company. The note and an accompanying sales contract were assigned to the financer on the same day that they were signed by the customer. The court held that the relationship of the dealer and the finance company was not so close as to justify treating the finance company as a party to the sales transaction. The court expressly rejected the reasoning of Childs and Mutual Finance, stating:

We can perceive of no reason based upon either logic or public policy why a finance company or bank which supplies such blank printed forms should be held thereby to have constituted the dealers their agents, or should be deemed to have participated in the sale by the dealer to the customer, including the execution of any contract, mortgage, or note which the customer may have executed to the dealer.

Following Implement Credit, judicial activity with regard to limiting or altering the holder in due course doctrine came to a virtual halt. This period of inactivity continued relatively uninterrupted until 1967, with only an occasional decision adding other states to the list of those rejecting the close connectedness concept and an occasional lower court decision embracing the doctrine.

Unico v. Owen

In 1967 the New Jersey Supreme Court adopted the close con-
nectedness doctrine in *Unico v. Owen*. The decision was heralded as an important assault on the holder in due course doctrine, and is now recognized as the leading close connectedness case.

*Unico* involved a sales contract whereby the consumer agreed to buy 140 stereo record albums which were to be delivered in a period of over five years. Payments on the note were to be completed in thirty-six months. In addition to receiving the record albums, the buyer was to receive a new stereo record player at no charge. All the customer actually got under the agreement were the initial 12 albums and the record player. He continued paying on the note for twelve months until he realized that the records would not be forthcoming, at which time he ceased making payments. Unico sued the customer for the amount due on the $819.72 time balance plus penalties and a 20 percent attorney's fee.

In applying the close connectedness doctrine, the court focused on the “hyper-executory character of the performance, agreed to by Universal [the seller],” and held:

For purposes of consumer goods transactions, we hold that where the seller's performance is executory in character and when it appears from the totality of the arrangements between dealer and financer that the financer has had a substantial voice in setting standards for the underlying transaction, or has approved the standards established by the dealer, and has agreed to take all or a predetermined or substantial quantity of the negotiable paper which is backed by such standards, the financer should be considered a participant in the original transaction and therefore not entitled to holder in due course status.

In addition to the court's apparent limitation of its holding to cases where the seller's performance is highly executory, the court restricted its holding to the defense of failure of consideration, stating:

We reserve specifically the question whether, when the buyer's claim is breach of warranty as distinguished from failure of consideration, the seller's default as to the former may be raised as a defense against the financer.

It is somewhat odd that *Unico v. Owen* has come to be recognized as the leading case adopting the close connectedness doctrine inasmuch as the doctrine was enunciated in *Childs* twenty-seven years earlier in

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89. See, e.g., Murphy, *supra* note 4.
90. See, e.g., J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 479 (1972) [hereinafter cited as WHITE & SUMMERS].
91. 50 N.J. at 107, 232 A.2d at 408.
92. Id. at 122, 232 A.2d at 417.
93. Id. at 123, 232 A.2d at 417.
a fact situation much less compelling than in Unico. Childs had suggested that the close connection could be found in the mere fact that the promissory note was on a form provided by the finance company and contained a printed endorsement to the finance company.94 In Unico the nexus between the seller and the finance company involved much more than the mere providing of printed forms containing an endorsement to the finance company. While Unico did involve a printed promissory note which contained an endorsement of the note to the finance company, it was also shown that Unico, the finance company, was a partnership formed for the express purpose of financing the sales of Universal Stereo. Further, Unico was given extensive rights of control over the business operation of Universal Stereo.

One factor which may have contributed to the recognition of Unico as the leading case on the close connectedness doctrine is the fact that the decision was rendered by the highest court in a densely populated, highly industrialized and business-oriented state. Another consideration might be the timing of the decision: Unico came at a time when consumer advocates were becoming increasingly restive with the holder in due course doctrine in consumer credit transactions. The various states' efforts to abrogate or limit the doctrine had already been deemed inconsistent and unsatisfactory. In addition, it had been fourteen years since the highest court of any state had adopted the close connectedness principle.95 Also, perhaps part of the reason Unico took on importance was the fact that Unico came from "the people who brought you Henningsen v. Bloomfield Motors Inc."96 In view of the tremendous impact which Henningsen had on the privity of contract requirement in products liability cases, it is not surprising that Unico was seen by some as another Henningsen.

The nature of the sales contract makes Unico a less clear application of the close connectedness doctrine than it would otherwise be. However, the fact that the court stressed the nature of the consumer's defense, the emphasis on the highly executory nature of the seller's performance, and the limitation of the holding to the defense of failure of consideration are suggestive more of a desire by the court to narrow the immediate impact of the decision than they are of any meaningful legal or logical distinctions. Why should the rule be different in the

94. See notes 76-77 & accompanying text supra.
95. The Supreme Court of Florida had adopted the doctrine in 1953. See Mutual Finance Co. v. Martin, 63 So. 2d 649 (Sup. Ct. Fla. 1953). See notes 80-81 & accompanying text supra.
situation where the product crumbles into dust after being delivered than in the situation where that product was never delivered at all? And should the buyer who was fraudulently induced to make purchase be subject to less protection than a person to whom the product was never delivered? Beyond those possible exceptions to the application of the close connectedness doctrine, Unico contained little in the way of legal theory which could be called unique or innovative.

After Unico v. Owen

The development of Unico as the leading case espousing the close connectedness doctrine would be much easier to understand if it had been followed by a rash of cases throwing aside the holder in due course doctrine in favor of the hapless consumer. However, unlike the period following Henningsen, the judicial activity since Unico has been relatively limited, and the characterization of Unico as "seminal" by some observers\textsuperscript{97} seems somewhat misleading.

In the seven years since Unico, courts in only three states have followed that decision. In American Plan Corp. v. Woods,\textsuperscript{98} an Ohio appeals court applied the close connectedness doctrine where the financier had investigated the practices of the seller, had supplied the seller with notes and other forms, had investigated the credit of each purchaser, and had reserved the right under its agreement with the seller to reject any note which it deemed to be risky.

In Calvert Credit Corp. v. Williams\textsuperscript{99} a District of Columbia court utilized the close connectedness concept where a number of customers were defrauded through a "referral plan" involving the purchase of television sets. Upon discovery that the television sets were defective, the buyers defaulted in their payments and the finance company filed suit. The court refused to recognize the finance company as a holder in due course because it had prearranged finance charges, approved of the "referral plan," and also approved each customer. The court noted that without such ratification, "even a customer who had signed a sales contract was unable to get a television from [the seller]. The jury could properly have concluded that appellant was so intimately involved in every step of the sales process that [the seller] was, in fact, appellant's agent."\textsuperscript{100}

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\textsuperscript{97} Id. at 479-80.
\textsuperscript{98} 16 Ohio App. 2d 1, 240 N.E.2d 886 (1968).
\textsuperscript{99} 244 A.2d 494 (D.C. App. 1968).
\textsuperscript{100} Id. at 496.
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In Jones v. Approved Bancredit Corp., the Supreme Court of Delaware found close connectedness where the seller and financer were both wholly owned subsidiaries of the same parent corporation. The financer was called a “finance department” of the parent corporation and had the same officers and directors as did the parent. The parent corporation also controlled the directors and officers of the seller. The financer further had the power to impose conditions upon any particular transaction entered into by the seller. The court stated:

Under the totality of facts and circumstances of this case, we hold that the rule of balance should be adopted and applied; that it should operate in favor of the installment buyer for the reason that, in our opinion, [the financer] was so involved in the transaction that it may not be treated as a subsequent purchaser for value.

In the same seven years since Unico, courts in Connecticut and Wisconsin considered the close connectedness doctrine and rejected it. It would seem, therefore, that the most that can be said of Unico is that it may have raised the number of jurisdictions which have abrogated the holder in due course doctrine through the application of the close connectedness principle from scarcely a handful of states to a handful of states.

Other Judicial Challenges

Using what might be described as a variation on the close connectedness theme, some courts have held that a financer who is the endorsee of the note and the assignee of the sales contract, and who is familiar with the terms of the sales contract, takes the note subject to the terms and conditions of the sales contract executed in conjunction with the note. This, of course, is an application of the “contemporaneously executed documents” rule and is addressed to the requirements that the instrument, in order to be negotiable, must contain an unconditional promise and that in order to be a holder in due course one must take the instrument without notice of claims or defenses.

Most cases using the contemporaneously executed documents rule were decided prior to the enactment of the UCC. The court in Unico relied on the rule to some extent and noted that, even though the

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101. 256 A.2d 739 (Del. 1969).
102. Id. at 743.
104. See, e.g., International Finance Co. v. Rieger, 272 Minn. 192, 137 N.W.2d 172 (1965); Local Acceptance Co. v. Kinkade, 361 S.W.2d 830 (Sup. Ct. Mo. 1962).
events in Unico occurred prior to the effective date of the UCC in New Jersey, section 3-119 of the UCC was consistent with the court's application of the rule to preclude the finance company from being a holder in due course.\textsuperscript{106}

It can be argued, however, that section 3-119 read with other sections of the code does not operate to change the traditional protection given to the financer as a holder in due course without a showing that, at the time of the purchase of the paper, the financer had notice of the particular provision of the sales contract and knew that the customer had a claim pursuant to that provision. Section 3-119(1) provides:

As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by another written agreement executed as part of the written agreement executed as part of the same transaction, except that a holder in due course is not affected by any limitation of his rights arising out of the separate written agreement if he had no notice of the limitation when he took the instrument.\textsuperscript{108}

About this provision, the drafters stated that

a purchaser of the instrument may become a holder in due course although he takes it with knowledge that it was accompanied by a separate agreement, if he has no notice of any defense or claim arising from the terms of the agreement.\textsuperscript{107}

It would seem from that section and comment that, even though the financer knew of a provision in the contract whereby the seller guaranteed some particular aspect of the goods, unless the financer had knowledge of a claim at the time the paper was negotiated he would not be bound by that provision. This interpretation of section 3-119 (1) is supported by section 3-304(4), which provides in part:

Knowledge of the following facts does not of itself give the purchaser notice of a defense or claim

(b) that [the instrument] was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof . . . .\textsuperscript{108}

The comment to section 3-304(4)(b) indicates that the section should be read together with section 3-119 and that "[i]f the purchaser has notice of any default in the promise or agreement which gives rise to a defense or claim against the instrument, he is on notice to the same extent as in the case of any other information as to the existence of

\textsuperscript{105} 50 N.J. at 122, 232 A.2d at 416-17.
\textsuperscript{106} UCC § 3-119(1).
\textsuperscript{107} Id. § 3-119, Comment 4 (emphasis added).
\textsuperscript{108} Id. § 3-304(4) (emphasis added).
Thus, the validity of those cases which hold that the financer takes subject to the terms of the sales contract, simply by virtue of being familiar with or being the assignee of the contract is open to serious question.

Another way some courts have avoided the consequences of the holder in due course doctrine in consumer credit transactions is to find that a financer who is familiar with the unscrupulous business practices of a particular seller is not a holder in due course of that seller's paper because such a holder lacks the required good faith. Thus, in Financial Credit Corp. v. Williams,110 the financer was denied holder in due course status as the seller's bad business reputation was known to the financer, the note was one of a package deal involving 480 similar notes, and the notes were purchased at an 80 percent discount.

A Pennsylvania court in Norman v. World Wide Distributors111 seemed to go even farther in holding that where the financer has a suspicion about the seller's practices, there is a duty to inquire into those practices. In Norman, the finance company was alleged to have been aware of the seller's sales techniques and frequent name changes. The finance company was also allowed to purchase the paper at large discount rates. The court stated that "where circumstances are such as to justify the conclusion that the failure to make inquiry arose from a suspicion that inquiry would disclose a vice or defect in the title, the person is not a holder in due course."112

The Supreme Court of Illinois took a novel approach to denying holder in due course status to a finance company in Household Finance Corp. v. Mowdy.113 Mowdy involved a note accompanied by a sales contract. The contract failed to conform to an Illinois statutory requirement that such documents contain the following notice which had to be in at least ten-point bold type:

**NOTICE TO BUYER**

You have the right to give the assignee named (or if no assignee is named, to give the seller) written notice of any defense or right of action which you may have against the seller within 5 days of delivery of the merchandise described herein. If a notice is not

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109. *Id.* § 3-304, Comment 9.
110. 246 Md. 575, 229 A.2d 712 (1967).
received within that time, you may not assert such defense or right of action against the assignee.\textsuperscript{114} Although the statute did not govern promissory notes, the court held that the failure of the contract to comply with the statute not only nullified that document but also made it impossible for anyone to be a holder in due course of a negotiable instrument arising out of such a transaction, even though the fact of noncompliance was not evident from an examination of the note.

It has been noted that a common theme of all decisions denying holder in due course status to financers is that the financer is a finance company and not a bank.\textsuperscript{116} Perhaps the most logical explanation of this phenomenon is that banks are careful to purchase paper only from dealers who have good business reputations and who have a proven record of satisfactorily answering customer complaints. There might also be a greater likelihood that a larger lending institution would take a loss or seek redress from the dealer where it is obvious that the consumer has really been taken and that to pursue the consumer will result in a loss of good will. Another reason why finance companies are involved is that in several of the cases the finance company was created to service the particular dealer. With a bank, such a situation would be extremely unlikely. Whatever the explanation, the absence of litigation involving banks suggests that the financer does have a strong potential for controlling the business practices of retail merchants.

Assessing the impact of the judicial challenges on the holder in due course doctrines is not an easy task. While it is one thing to count up the states whose courts have limited the holder in due course doctrine, it is quite another to determine the extent to which financers in states whose courts have not limited the holder in due course doctrine have been influenced by cases like \textit{Unico} in selecting reputable dealers from whom to purchase consumer notes. What would seem clear from the judicial challenge to the holder in due course doctrine is that if the doctrine is to be generally limited in consumer credit transactions, it is unlikely that such a broad change will be effected by the courts. Thirty-four years after \textit{Childs}, one still finds that the close connectedness doctrine has been adopted by courts in only a handful of states and the number of states in which courts have found some other basis for limiting the holder in due course doctrine is likewise limited in number.

\textsuperscript{114} Consumer Fraud & Deceptive Business Practices Act, ILL. REV. STAT. ch. 121-1/2, § 262D (1967).

\textsuperscript{115} WHITE & SUMMERS, supra note 90, at 483.
The Failure of the Challenges

Whether the challenges to the holder in due course doctrine are viewed by one in favor of retaining the doctrine or by one bent on its abolition, both would agree that the challenges have been unsuccessful. The real failure is not in the inability to achieve abolition of the holder in due course doctrine, but in generating a lack of uniformity which is perhaps unequalled in American jurisprudence. As a result of the challenges, rather than being faced with a fairly universal, clear-cut, although arguably unjust, rule—the holder in due course doctrine—one is now faced with a hodgepodge of state statutes, a variety of decisional approaches, and number of proposed "uniform" acts and redrafts of acts all purporting to deal effectively with the problem of balancing consumer protection with commercial protection. Why have the challenges to the doctrine resulted in such a situation and why has the uniformity called for by the problem been so elusive?

It is perhaps obvious that the primary reason for the failure of the challenges is that there has been and continues to be fundamental disagreement over the basic proposition that the holder in due course doctrine should be changed. Undoubtedly the fundamental disagreement concerning the desirability of retaining the holder in due course doctrine is due in part to, or is at least aggravated by, the lack of empirical data on which to base any sort of a meaningful judgment.

This dearth of empirical evidence would seem to have affected the question in two significant ways. First, although no one would question that the purchase of paper arising from consumer goods transactions is a multibillion dollar business, no systematic attempt has been made to determine the actual extent to which the holder in due course doctrine works injustice upon consumers. There is no data indicating what proportion of the millions of consumers making payments on promissory notes which have been negotiated to banks or finance companies are being forced to pay for products which were never delivered, were not in compliance with warranties, or were sold to the consumer through the use of fraudulent business practices. While it is tempting to make statistical projections based upon reading the close connectedness cases that suggest that consumers are being "reamed, steamed and 116. The former national director of the OEO legal services offices has reported that he sent questionnaires to 267 projects and received 103 responses, of which 59 were deemed to be sufficiently detailed to be meaningful. Those reports indicated that in the 59 projects over 14,000 cases were handled in which the holder in due course doctrine played a significant role. Speaker, Holder in Due Course—Burden of the Poor, 5 U.C.C.L.J. 146 (1972).
dry cleaned" with great regularity, without the availability of accurate statistics it is impossible to deal meaningfully with the contention that the number of cases in which the holder in due course doctrine works injustice to the consumer is so small that the benefits to be gained from the elimination of the doctrine will be more than outweighed by the detriments.

Second, in order to weigh the benefits to be derived from eliminating the holder in due course doctrine against the detriments, one must also know what those disadvantages are. While there is more empirical data regarding the detriments to be suffered than the benefits to be derived, even that data would seem insufficient to provide a reliable basis in deciding whether to retain or abolish the doctrine.

The evidence which is available has resulted from studies which have sought to measure the impact of certain laws limiting or abolishing the holder in due course status. One such work surveyed the effects of provisions of the Connecticut Home Solicitation Sales Act of 1967, which provided that the obligation to pay arising from a home solicitation sale could not be evidenced by a negotiable instrument. With regard to the impact on financers and dealers, the Connecticut study indicated that “[t]he clearest consequence of the Act has been a marked reduction in institutional financing of business engaged in door to door sales.” In addition to the financers’ buying less home solicitation consumer paper, the report noted that the financers had increasingly resorted to agreements with the dealers whereby the dealers agreed to repurchase the paper from the financer if the consumer refused to pay. Such agreements give the financers a status similar to a holder in due course but with the financer running the risk that the dealer will become insolvent.

While the study did reveal that no bank or finance company surveyed had raised its interest rates on home solicitation loans or increased its reserve account for such dealers, over one-third of the thirty-two dealers who had received “incentive payments” prior to the act for every transaction financed through the bank or finance company

117. White & Summers, supra note 90, at 483.
118. Case Study, supra note 4, at 618.
119. Conn. Gen. Stat. Ann. § 42-136 (Supp. 1974). However, the section provides that a promissory note which is negotiable on its face in violation of the statute may be enforced by a holder in due course. Id. § 42-136(d).
120. Case Study, supra note 4, at 637.
121. Id. at 640.
122. Id.
no longer receive them. The study also showed that more than 50 percent of dealers indicated that it was more difficult to obtain financing, and some had even gone out of business. With the dealers losing the incentive payments, finding it harder to find a market for their paper and getting paid less for that paper, they experienced higher costs; and these costs, the study noted, were probably passed on to the consumer.

While the Connecticut study made no attempt to ascertain how many consumers had been directly helped by being able to assert defenses which would otherwise have been cut off, it did observe that the act had the beneficial impact of causing the financers to make more extensive investigations of the dealers whose paper they purchased. This increased investigation resulted in the elimination of many of the fraudulent dealers who were unable to obtain financing. Another important result of the act was the increased use of direct loans between the financers and consumers to avoid the impact of the act. This aspect of the study would seem to have particular relevancy to any legislative proposal which does not address the direct loan problem.

While immensely valuable because of the scarcity of such research, the Connecticut study as a whole would seem to be of limited value in resolving the broad question of whether the holder in due course doctrine should be abolished in all consumer goods sales. The nature of the Connecticut act necessarily limits the applicability of conclusions which can be drawn from the report. The act applied only to a limited category of consumer transactions, a group arguably including many of the dealers most likely to be guilty of consumer fraud and shoddy workmanship. The act also made no attempt to regulate direct loans, a factor which might have had a significant effect on the impact of the act. Thus, while the Connecticut research suggests some of the ramifications of eliminating the holder in due course doctrine on a limited basis, it would seem that state legislatures should have more empirical data than that generated by that study before being asked to eliminate the holder in due course doctrine in all consumer credit transactions.

Another study was carried out with the purpose of determining the effect of the enactment of the UCCC on the credit industry of

123. Id. at 643.
124. Id. at 643-44.
125. Id. at 653-54.
126. Id. at 639.
127. Id. at 655.
128. Id. at 642.
That work, like the Connecticut study, made no findings concerning the number of consumers who directly benefited from the act by being able to assert defenses which otherwise would have been cut off. The Utah study likewise involved an enactment which did not purport to limit direct loans. The Utah act did, however, apply to a broad range of consumer transactions, and the findings made in the Utah study supported many of the conclusions drawn by the Connecticut report.

Thus the Utah researchers noted that where increased costs were encountered by dealers as a result of the UCCC, those costs were passed on to the consumer. The study also noted that the impact of the UCCC had not been as great as feared by the financiers, but attributed this factor to the lack of knowledge by the consumers of their rights, especially among low income consumers.

While the Utah study involved an act which was much broader than the Connecticut law, the fact that the Utah UCCC did not limit direct loans and the sparseness of the empirical data generated by the Utah work would suggest that something more is needed in the way of a comprehensive, systematic analysis of the problems created by the elimination of the holder in due course doctrine before legislators can be expected to take a definitive position for or against abolition.

The scarcity of empirical evidence in the area has not, however, precluded critics of the holder in due course doctrine from alleging that the finance companies should bear the risk of loss in consumer credit transactions because they have the financial ability to withstand such losses, they are in the business of credit, and they can protect themselves through reserve funds, repurchase agreements and high discount rates. Nor has the sparsity of such data prevented those critics from asserting that the finance companies should bear the risk of loss because they are better able to investigate and control the practices of dealers.

While all such criticism may prove to be valid, it is nevertheless important to ascertain how many consumers such critics are seeking to protect and at what cost to consumers at large. Before state legislators

129. Note, Utah's UCCC: Boon, Boondoggle, or Just Plain Doggle, 1972 Utah L. Rev. 133.
130. Id. at 134.
131. Id. at 144.
can intelligently decide whether to abolish the holder in due course doctrine, it would seem that the cost to be borne by all consumers should be ascertained. Perhaps of equal importance to the lack of empirical data is the fact that the debate has been basically a political one with strong special interest groups representing retailers, finance companies and banks on the one hand, and sometimes strong, sometimes not so strong special interest groups representing consumers on the other hand. It can hardly be doubted that much of the lack of uniformity in the state enactments concerning consumer credit has been due to the shifting balance of power of these interest groups from state to state.

In such a context, it might be questioned whether additional empirical data will really affect whether a particular state limits or abolishes the holder in due course doctrine. It would seem clear, however, that if the evidence generated by further studies demonstrates that the doctrine can be eliminated with a minimal impact on sellers and financiers and a slight increase in the cost of credit spread over all consumers, the polarity of the positions previously taken might be mitigated to the point where some form of uniform legislation would become mutually acceptable and thus be assured of passage. Of course, further empirical data might have the effect of perpetuating the lack of uniformity if that data turns out to be ambiguous or shows that the cost to the consumers, sellers or financiers may be too high to elicit their support of any proposed legislation or changes in existing laws.

Conclusion: The Future of the Holder in Due Course Doctrine

Regardless of one's attitude toward the holder in due course doctrine as a general proposition, the present fragmented, inconsistent and confusing treatment of that doctrine in consumer credit transactions should not be long tolerated. It is apparent from the little empirical data currently available that the holder in due course doctrine cannot be abolished without cost to someone, and that someone is most likely the consumer. If that cost does not place an undue burden on the consumer, the holder in due course doctrine in consumer credit transactions should be abolished. Its elimination would not only achieve a much-needed uniformity, but would bring the rule of law into conformity with what the reasonable American citizen would expect it to be.

It is in the area of uniform legislation proposed for adoption by the states that the greatest potential lies for achieving the goal of uni-
form treatment of the holder in due course doctrine in consumer credit transactions. From the past judicial challenges to the holder in due course doctrine, it appears doubtful that courts will provide the moving force in achieving some level of consistency and uniformity of treatment of the doctrine. The number of jurisdictions that have judicially limited the doctrine is not substantial, and their approaches have varied. Indeed, further judicial challenges might well result in a greater degree of confusion and fragmentation than has been witnessed thus far. New judicial holdings based on a wide range of variable degrees of close connectedness or good faith might work against the achievement of a well-reasoned, uniform approach to the problem.

With the promulgation of the final redraft of the UCCC and the promulgation of the National Consumer Act and the Model Consumer Credit Act, it has become apparent that a greater consensus is developing among the proponents of the abolition of the holder in due course doctrine. This consensus centers on the elimination of the doctrine in practically all consumer credit transactions, the limitation of liability of the financer to the amount financed or still due on the loan, and some control over direct loans. Of the legislation proposed, it appears that some form of the UCCC as amended in the sixth redraft will be the most likely vehicle for achieving the uniformity and consistency called for by the present state of affairs. While the Model Consumer Credit Act differs little from the sixth redraft of the UCCC in treatment of the holder in due course problem, the fact that the latter was proposed by the Conference of Commissioners on Uniform State Laws may carry more weight with state legislatures.

Even with a greater level of unity and strength among the supporters of such legislation, it is foreseeable that the sixth and final redraft of the UCCC will encounter opposition from financers, retail merchants and consumer advocates sufficient to block its passage in many states. Without being fully apprised of the consequences of abolition of the doctrine, these groups will continue to refrain from giving their vital support to any uniform legislation.

Thus, the achievement of success in attaining uniform treatment of the holder in due course doctrine seems dependent upon the availability of new empirical data, showing that the doctrine can be abolished and that direct loans can to some extent be limited to a cost which the financer, seller and consumer can each live with. If such evidence is not forthcoming, it would seem that the present state of affairs will continue relatively unchanged until popular feeling runs so high as to
motivate Congress or some agency of the federal government to take action, a possibility which no one concerned with the problem views with much favor. Nonetheless, the perpetuation of the present patchwork pattern of state statutes is an equally unsatisfactory prospect. With empirical data available, legislators will be able to assess meaningfully the impact of eliminating the holder in due course doctrine in consumer credit transactions. A realistic appraisal of the costs of such abolition will provide a sound basis for decision and should ultimately pave the way for the needed uniformity.