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UNCONSCIONABLE SECURITY AGREEMENTS: APPLICATION OF SECTION 2-302 TO ARTICLE 9

While freedom of contract has long been a paramount principle of Anglo-American law,¹ courts have generally refused to enforce unconscionable contracts. However, instead of declaring such contracts unconscionable per se, courts have found other legal bases upon which to set aside these agreements.² Thus, unconscionable contracts have not been enforced ostensibly because there was a lack of mutuality, or because the written agreement was interpreted as not reflecting the intent of the parties.³ Use of these judicial techniques has resulted in uncertainty and confusion, and has provided no adequate basis for holding unconscionable contracts illegal per se.⁴

Section 2-302 of the Uniform Commercial Code⁵ introduces the concept of unconscionability as a basis for voiding contracts. The section states:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Section 2-302 primarily continues traditional judicial policy of refusing enforcement of unduly harsh agreements,⁶ but it is innovative in that it allows the courts to make a direct "conclusion of law" as to the question of unconscionability.⁷

Most courts have been reluctant to extend the use of section 2-302 beyond agreements involving the sale of goods. This reluctance is illustrated by the decision in *Hernandez v. S.I.C. Fin. Co.*⁸ where an action was brought against a finance company by debtors to declare exempt property covered under a security agreement. The plaintiffs

¹ See generally Pound, *Liberty of Contract*, 18 *Yale L.J.* 454 (1909); Williston, *Freedom of Contract*, 6 *Cornell L.Q.* 365 (1921).

² Note, *Species of Inadequacy of Consideration Which Have Induced Judicial Refusal to Attach Obligation to Promises*, 27 *Colum. L. Rev.* 178, 179 (1927).

³ Williston, *supra* note 1, at 371.

⁴ Llewellyn, *Book Review*, 52 *Harv. L. Rev.* 700, 703 (1939).

⁵ All references to the Uniform Commercial Code are to the 1962 Official Text.

⁶ Lef, *Unconscionability and the Code—The Emperor's New Clause*, 115 *U. Pa. L. Rev.* 485, 530 (1967).

⁷ U.C.C. § 2-302, Comment 1.

⁸ 79 *N.M.* 673, 448 *P.2d* 474 (1968).

borrowed money from the defendant finance company. Unable to repay this loan, they executed a new note for the unpaid balance secured by furniture owned by the plaintiffs. The plaintiffs, who were of Spanish descent were found by the court to have received no formal education in English, and it appears that they could speak and read English only with difficulty. The plaintiffs argued that, because of their lack of familiarity with English, the security agreement was unconscionable and should be denied enforcement under section 2-302. In rejecting this argument, the court held that the plaintiffs had failed "to note that the Section [2-302] is part of the Uniform Commercial Code applicable to sales, and by its terms does not apply to security transactions."⁹ The court then discussed the common law approaches to unconscionability and stated that:

Mrs. Hernandez' signature was on the agreement and the trial court found that both plaintiffs understood English. There is ample evidence to support this finding. In addition, we cannot say that as a matter of law the transaction was so grossly unfair that it should have been denied enforcement under the common law.¹⁰

The type of standardized chattel mortgage used in *Hernandez* has often confused individuals well educated in English and thoroughly familiar with American credit procedures. Use of such an agreement in the *Hernandez* case, wherein the debtors were at a disadvantage because of their lack of familiarity with commercial language and custom, presents a situation with obvious potential for unconscionability. In such a situation the court should carefully examine the circumstances before enforcing the agreement. However, since the *Hernandez* court refused to apply section 2-302, the facts surrounding Mrs. Hernandez' signing of the agreement were not carefully examined to determine whether the terms of the agreement were really comprehended by her.

Despite the view expressed in *Hernandez* that section 2-302 applies only to sales, the case aptly illustrates that the problem of unconscionability is not limited to sales or contracts for sale. Security agreements such as that in the *Hernandez* case are also subject to abuse. This comment will analyze the concept of unconscionability as outlined in section 2-302 and as developed by the courts. The scope of section 2-302 will be examined as well as the protection afforded by Article 9 against the enforcement of unconscionable security agreements. It is concluded that it is reasonable and desirable to extend the applicability of section 2-302 to unconscionable security agreements.

I. THE SCOPE OF ARTICLE 2

The application of section 2-302 is limited by the scope of Article 2 which is set out in section 2-102 as follows:

⁹ Id. at 675, 448 P.2d at 476.

¹⁰ Id.

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

This section has been interpreted as conclusively prohibiting the application of Article 2 beyond sales.¹¹ However, close examination of the language of section 2-102 fails to support the conclusion that Article 2 was intended to be limited only to sales. The Article applies only to "transactions in goods" rather than to the readily available, narrower limitation to "sale of" or "contract for sale of goods." Moreover, while "sale" and "contract for sale" are defined in the Code,¹² "transactions" is not.¹³ Thus, many contractual agreements other than sales can properly be termed "transactions in goods."

Use of the term "transactions" has been interpreted to allow application of certain provisions in Article 2 to an equipment lease. In *Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House*,¹⁴ the plaintiff lessor moved for summary judgment in an action to enforce an equipment lease against the defendant lessee. The lessee argued that the lessor had breached express and implied warranties of merchantability concerning the leased equipment. The lease contained an express disclaimer of warranties of merchantability. The validity of this disclaimer was central to the court's consideration of the plaintiff's request for summary judgment. Determination of this issue presented the threshold question of whether the Code applied to the instant agreement.

In answering this question, the court centered upon the details of the lease involved. The yearly payments called for by the lease were such that after completion of the five year term of the lease, the lessee would have paid to the lessor an amount greater than the cost price of the leased equipment. Renewal terms of one year duration were then available to the lessee at his option for a nominal cost, apparently for as long as he desired to renew. Therefore, the right of exclusive use of the leased equipment belonged to the lessee indefinitely. The court

¹¹ See 1 New York Law Revision Commission Report, Study of the Uniform Commercial Code at 355-56 (1955).

¹² U.C.C. § 2-106.

¹³ The broad scope of the term "transactions" in section 2-102 is further expanded by the use of the qualifying phrase "unless the context otherwise requires." If Article 2 was intended not to apply beyond sales, the introduction of this phrase would have been unnecessary. The accompanying Comment does not define the phrase. It is thus left to the courts to determine what constitutes the required "context" in order to bring an agreement within the scope of Article 2. A court might well use the phrase to apply Article 2 to problems not governed by other Articles in the Code.

¹⁴ 59 Misc. 2d 226, 298 N.Y.S.2d 392, 6 U.C.C. Rep. Serv. 132 (N.Y. City Ct. 1969). For further discussion of problems in this area, see Comment, The Extension of Warranty Protection to Lease Transactions, 10 B.C. Ind. & Com. L. Rev. 127 (1968).

held that the practical effect of this arrangement was that the lessee had become a purchaser of the equipment.¹⁵ Since the lease thus had the same economic effect as a sale, the court reasoned that it would be anomalous if the instant agreement were subject to a body of law different than that covering sales.¹⁶ The court stated:

Clearly, a "transaction" encompasses a far wider area of activity than a "sale," and it cannot be assumed that the word was carelessly chosen. . . . The use in some sections of of the words "contracts for sale" and in others, of the word "contracts" can also be taken to mean that the scope of the Article was not limited to a transaction involving solely a "sale" with "title" and "property" as its symbols and marks.¹⁷

The court went on to hold that relevant provisions of Article 2 governed the lease in question, that the disclaimer was not "conspicuous" within the meaning of section 2-316(2),¹⁸ and that any implied or express warranties of merchantability were not thereby modified.¹⁹

The process of determining the scope of a section within Article 2 entails two steps. Both section 2-102 and the limiting provision of the particular section must be examined. Therefore, the question whether section 2-302 applies to Article 9 must be determined by examining the limitations intrinsic to that section. *Hertz* demonstrates that section 2-102 is sufficiently broad to extend the coverage of Article 2 beyond mere contracts for sale and to apply to other types of transactions including secured transactions.

II. THE SCOPE OF SECTION 2-302

Section 2-302 itself is not limited to sales contracts. Unlike other sections within Article 2, section 2-302 contains no limiting terms such as "buyer" or "seller." Use of the term "contracts" rather than the more limited "contracts for the sale of goods" tends to increase the scope of the section.²⁰ Further, the Official Comment to section 2-302

¹⁵ 59 Misc. 2d at 229, 298 N.Y.S.2d at 395, 6 U.C.C. Rep. Serv. at 135. See also *Associates Discount Corp. v. Palmer*, 47 N.J. 183, 219 A.2d 858 (1966), which held that the statute of limitations provided for in U.C.C. § 2-725, could be applied to a deficiency suit upon a purchase money security agreement. The court held that § 2-102 excluded from Article 2 agreements which operate *only* as security devices.

¹⁶ 59 Misc. 2d at 229, 298 N.Y.S.2d at 395, 6 U.C.C. Rep. Serv. at 135.

¹⁷ *Id.* at 231, 298 N.Y.S.2d at 397, 6 U.C.C. Rep. Serv. at 136.

¹⁸ U.C.C. § 2-316(2) provides:

Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

¹⁹ U.C.C. § 2-316(2).

²⁰ See 1 New York Law Revision Commission Report, Study of the Uniform Commercial Code 355 (1955).

refers to past decisions involving dissimilar facts and applying varying theoretical approaches to the problem of unconscionability.²¹ The Comment stresses that these cases should guide the application of section 2-302.²² Moreover, the Comment states that courts should exercise discretion in deciding how best to avoid unconscionable results in any particular agreement.²³

The broad scope of section 2-302 is further emphasized by its lack of a specific definition of unconscionability. The purpose of the section is stated to be the prevention of oppression and unfair surprise rather than the reallocation of any risks that have been agreed to.²⁴ These limitations are necessarily vague in order to allow for the intended broad application of the section to many forms of unconscionable agreements on a case by case basis.²⁵ However, since relatively few cases have discussed section 2-302, this broad development has not occurred.

Of those cases utilizing section 2-302, the court's definition of unconscionability in *Williams v. Walker-Thomas Furniture Co.*²⁶ is most complete:

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration.²⁷

Clearly the court does not indicate that the problem of unconscionability is necessarily contingent upon the presence of a *sales* transaction. The aspects of unconscionability enumerated in *Williams* could reasonably be found in a transaction intended to be a security agreement as well as in a sale.

Thus, neither the limitations intrinsic to section 2-302 nor the

²¹ Compare *Kansas City Wholesale Grocery Co. v. Weber Packing Corp.*, 93 Utah 414, 73 P.2d 1272 (1963) with *Meyer v. Packard Cleveland Motor Co.*, 106 Ohio St. 328, 140 N.E. 118 (1922). Both cases are cited in U.C.C. § 2-302, Comment 1. In *Kansas City*, a clause limiting the time allowed for registering complaints was held ineffective as to a shipment of catsup whose defects could be discovered only by microscopic analysis. *Meyer* held invalid a specific waiver clause which purported to supercede the implied warranty of fitness of a dump truck intended for ordinary use.

²² U.C.C. § 2-302, Comment 1.

²³ U.C.C. § 2-302, Comment 2.

²⁴ U.C.C. § 2-302, Comment 1.

²⁵ Peters, Remedies for Breach of Contract Relating to the Sales of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 202-03 n.10 (1963).

²⁶ 350 F.2d 445 (D.C. Cir. 1965).

²⁷ *Id.* at 449.

definition of unconscionability preclude application of that section to secured transactions. An examination of the manner in which the concepts in the Code are generally developed and applied will further indicate that application of section 2-302 to Article 9 is justified as being within the intent of the drafters.

III. THE ANALOGICAL DEVELOPMENT OF THE CODE

The applicability of section 2-302 to secured transactions is supported by the fact that the Code is not only an articulated body of law but also a source of new law.²⁸ The drafters of the Code realized that rigid statutory provisions cannot cope with the continually changing realities of commercial transactions. Section 1-102, establishing the rules of construction of the Code as a whole, states that "this Act shall be liberally construed and applied to promote its underlying purposes and policies." Where specific provisions of the Code fall short in meeting particular problems, the Code is intended to "provide its own machinery for the expansion of commercial practises."²⁹ This machinery consists primarily of flexible judicial interpretation of the Code "to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices."³⁰

The Comment accompanying section 1-102 cites *Agar v. Orda*³¹ as an example of the type of judicial interpretation to be applied to the Code. In *Agar*, provisions of the Uniform Sales Act dealing with seller's remedies³² were applied to a contract for the sale of choses in action, notwithstanding that the Uniform Sales Act was limited to goods rather than things in action. The Comment approves of the position taken by the *Agar* court, and states that the provisions of a broad act should be applied where reason and policy so require, even where the subject matter has been intentionally excluded from the act in general.³³ Thus, the Code is structured to enable the courts, through analogical development, to expand the Code itself.³⁴ Use of a particular section is intended to be determined by the policy of that section rather than by strict adherence to narrow language within the section.

Utilizing this broad approach, courts have expanded the application of section 2-302 to certain problems beyond sales. *In re Elkins-Dell Mfg. Co.*³⁵ was an action in bankruptcy to enforce a bank agreement to advance funds against an assignment of accounts receivable. Elkins-Dell had gone bankrupt eight months after entering into a loan

²⁸ Franklin, On the Legal Method of the Uniform Commercial Code, 16 Law & Contemp. Prob. 330, 334 (1951).

²⁹ U.C.C. § 1-102, Comment 1.

³⁰ Id.

³¹ 264 N.Y. 248, 190 N.E. 479 (1934).

³² Uniform Sales Act §§ 144, 156.

³³ U.C.C. § 1-102, Comment 1.

³⁴ King, The New Conceptualism of the Uniform Commercial Code, 10 St. Louis L.J. 30, 40 (1965).

³⁵ 253 F. Supp. 864 (E.D. Pa. 1966).

agreement with Fidelity America Financial Corporation. The agreement stipulated that Fidelity was to advance the bankrupt 75 per cent of the value of the accounts assigned, but was obligated to take only those accounts of the bankrupt determined acceptable within the discretion of Fidelity. Elkins-Dell was prohibited from borrowing funds from any source other than Fidelity, and from disposing of its accounts or other assets, without first obtaining the written consent of Fidelity. Thus, the bankrupt "had the obligation to finance only through Fidelity, but Fidelity had the power to refuse to supply the bankrupt with funds."³⁶ In addition, Fidelity had the right to receive and dispose of all mail addressed to Elkins-Dell, and the latter also waived the right to file for voluntary bankruptcy or to appoint a receiver without the written consent of Fidelity.

The referee in bankruptcy had found the agreements "so one-sided in favor of Fidelity . . . as to be unenforceable in a court of conscience."³⁷ In reviewing the referee's finding, the court held that in this case a bankruptcy court could properly grant equitable remedies,³⁸ provided discretion was used, since a bankruptcy court is often the only forum available to the plaintiff.³⁹ Accordingly, the court emphasized the need to carefully consider the agreement within the context of the parties' business relationship. Since the referee had based his finding of unconscionability only on the terms of the contract itself, the court remanded the matter for hearings to evaluate the commercial circumstances surrounding the agreement.⁴⁰

The *Elkins-Dell* decision does not squarely rest upon section 2-302. In fact, the court expressly rejected the "invitation of the trustees to hold § 2-302 applicable to agreements other than sales contracts."⁴¹ Yet, the court drew heavily upon section 2-302 for guidance in determining the aspects of unconscionability. After examining the traditional bases upon which unconscionable agreements are denied enforcement, such as adhesion, duress, and inadequacy of consideration, the court refused to strike down the agreement on any of these grounds because both parties to the agreement were commercially aware businessmen.⁴² In support of this position, the court recognized that the policies of section 2-302 should be applied so as to avoid a disturbance of the allocation of risks. The court noted that knowledge

³⁶ Id. at 866.

³⁷ Id. at 867.

³⁸ Id. at 869.

³⁹ Id. at 870. The court held that *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948), had established, as a matter of federal law, that unconscionability is a valid equitable defense. However, the court noted that in *Campbell Soup*, denial of specific performance to the plaintiff left the plaintiff with further recourse available at law. In *Elkins-Dell*, because of the nature of Fidelity's claim against the bankrupt defendant, the bankruptcy court was the exclusive forum available to the plaintiff.

⁴⁰ 253 F. Supp. at 874.

⁴¹ Id. at 873 n.4.

⁴² Id. at 871, 873 n.4.

UNCONSCIONABLE SECURITY AGREEMENTS

by the parties is generally assumed in contracts between businessmen; thus unfair surprise is improbable.⁴³

Though the court recognized that section 2-302 is directly applicable only to sales contracts, its conclusion that the parties should be afforded reasonable opportunity to present evidence as to the commercial setting of the agreement was based on the section.⁴⁴ The court also relied upon the use of section 2-302 in *Williams* (which involved an installment sales contract), noting that such consideration of the commercial setting was even more essential in bankruptcy cases than in sales cases.⁴⁵ Although the court in *Elkins-Dell* refused to explicitly apply section 2-302 to bankruptcy actions, it is clear that the court in fact relied on the section's theoretical bases. Short of expressly stating that section 2-302 controls questions of unconscionability in a bankruptcy context, the court for all practical purposes relied on the section as if it specifically applied to bankruptcy matters.

The application of section 2-302 to bankruptcy proceedings in *Elkins-Dell* parallels the method used by the court in *David v. Manufacturers Hanover Trust Co.*⁴⁶ In *David* a depositor brought an action against a bank, alleging that the defendant bank had negligently paid funds out of the plaintiff's checking account and in so doing had defamed his credit. The bank moved to have the action tried without a jury. The bank's motion was based upon waivers signed by the plaintiff which were contained in monthly statements of account and in signature cards used in opening the account. The statements and signature cards had no caption to designate their use as other than for their obvious purpose and, the jury trial waiver clauses were in fine print. In denying the defendant bank's motion for a non-jury trial, the court found the waiver clauses void because they were not signed with the intent required to waive this right.⁴⁷

Stressing the importance of the right to a jury trial, the court introduced in full the text of section 2-302⁴⁸ and the *Williams* definition of unconscionability.⁴⁹ In evaluating section 2-302, the court stated that the section empowered courts to police unconscionable contracts.⁵⁰ Unlike *Elkins-Dell*, the *David* court did not consider the question whether section 2-302 is limited to sales contracts.

The degree to which the decision in *David* rests upon section 2-302 is unclear. The court heavily emphasized the importance of preserving the right to trial by jury.⁵¹ The case could reasonably have been decided solely on this issue. Further, the discussion of section

⁴³ Id. at 871.

⁴⁴ Id. at 873.

⁴⁵ Id. at 874.

⁴⁶ 55 Misc. 2d 1080, 287 N.Y.S.2d 503 (N.Y. City Ct. 1968).

⁴⁷ Id. at 1083, 287 N.Y.S.2d at 506.

⁴⁸ Id. at 1083-84, 287 N.Y.S.2d at 507.

⁴⁹ Id. at 1084, 287 N.Y.S.2d at 508.

⁵⁰ Id. at 1083, 287 N.Y.S.2d at 507. The court made no reference to "sales" contracts.

⁵¹ Id. at 1083, 287 N.Y.S.2d at 506.

2-302 was limited, and the court neglected to define the extent to which section 2-302 serves as authority supporting the holding. The court's reliance on section 2-302 is nevertheless evident from its use of the *Williams* interpretation of the section to focus upon the fact that the waivers were in fine print. Therefore, notwithstanding its limitations, *David* demonstrates the desirability of applying section 2-302 to a transaction not involving a contract for sale.

IV. THE DIRECT APPLICATION OF SECTION 2-302 TO UNCONSCIONABLE SECURITY AGREEMENTS

The applicability of section 2-302 to unconscionable security agreements is illustrated by *Unico v. Owen*⁵² which involved a retail installment sale of one-hundred and forty record albums accompanied by a "free" record player. The buyer, Owen, signed a contract with Universal Stereo Corporation providing for specified payments over a thirty-six month period. This contract contained a clause providing that if the buyer signed a promissory note of the same date as the making of the contract, such note was not in payment of the sale but was a separate negotiable instrument. In addition, the signing of the contract was made subject to several provisions contained in fine print on the reverse side of the contract. Among these was a clause purporting to waive defenses of failure of performance by Universal against subsequent assignees of the contract. The contract also contained an assignment of Universal's rights thereunder to Unico, a partnership separate from Universal. A promissory note executed by Owen and endorsed from Universal to Unico specified the same schedule of installment payments as contained in the sale contract.

After signing these agreements, Owen received from Universal the record player and an initial delivery of twelve albums under the contract. Owen received no further albums, although he continued the installment payments for twelve months. No additional deliveries were made because Universal had become insolvent, at which point Owen stopped making payments. Unico then notified Owen that payments were owed directly to Unico on the note, and instituted suit for the balance due. The trial court held that Unico was not a holder in due course of the note and that Universal's default of performance under the contract barred recovery by Unico.⁵³

⁵² 50 N.J. 101, 232 A.2d 405 (1967).

⁵³ Supplementing this denial of the status of a holder in due course to Unico, the court specifically found unenforceable the clause providing that if Owen signed a promissory note of the same date as the sales contract such note was not in payment of the contract. The court stressed that the Code did not directly apply since the agreement in question was signed prior to the adoption of the Code in New Jersey. However, the court relied upon the Code as a statement of principle in support of its position, stating that the holding was consistent with U.C.C. § 3-119(1) which provides:

As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as a 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

UNCONSCIONABLE SECURITY AGREEMENTS

In an opinion by Judge Weintraub, the New Jersey Supreme Court upheld the lower court on the basis that Unico was not a holder in due course.⁵⁴ The court found that Unico was so closely involved with the entire transaction that it was for all practical purposes a party to the agreement between Owen and Universal, and not an innocent purchaser for value. Thus, Universal's default was upheld as a valid defense.⁵⁵

The court held that the waiver of defense clause was contrary to public policy.⁵⁶ The court noted that section 9-206(1) denies enforcement of contract rights to assignees who are not holders in due course.⁵⁷ It was further stated that special treatment by section 9-206 of cases involving consumer goods must be considered in the context of section 2-302:

[S]ection 9-206 in the area of consumer goods sales must as a matter of policy be deemed closely linked with section 2-302 . . . which authorizes a court to refuse to enforce any clause in a contract of sale which it finds unconscionable. We see in the enactment of these two sections of the Code an intention to leave in the hands of the courts the continued application of common law principles in deciding in consumer good cases whether such waiver clauses as the one imposed on Owen in this case are so one sided as to be contrary to public policy.⁵⁸

written agreement if he had no notice of the limitation when he took the instrument.

⁵⁴ The court found that Unico had been formed expressly for the purpose of financing Universal, and that it was an established practice for Universal to endorse such notes to Unico. Further, the court noted that Unico was familiar with the details of the standard sales contract used by Universal. 50 N.J. at 124, 232 A.2d at 417.

⁵⁵ Id.

⁵⁶ The court found the clause void for three specific policy reasons:

(1) it is opposed to the policy of the Negotiable Instruments Law which had established the controlling prerequisites for negotiability, and provided also that the rights of one not a holder in due course were subject to all legal defenses which the maker of the instrument had against the transferor. N.J.S.A. 7:2-58; (2) it is opposed to the spirit of N.J.S. 2A:- 25-1, N.J.S.A., which provides that an obligor sued by an assignee "shall be allowed all defenses he had against the assignor or his representatives before notice of such assignment was given to him." (It is conceded here that plaintiff gave no notice of the assignment to defendant); and (3) the policy of our state is to protect conditional vendees against imposition by conditional vendors and installment sellers.

50 N.J. at 124, 232 A.2d at 417-18.

⁵⁷ U.C.C. § 9-206(1) provides:

Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the Article on Commercial Paper (Article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

⁵⁸ 50 N.J. at 125, 232 A.2d at 418.

The court examined section 9-206 in light of section 2-302 for two reasons. First, the court interpreted section 9-206 as establishing the area of consumer goods sales as needing specialized treatment.⁵⁹ Then section 2-302 was referred to as outlining the remedy of refusing enforcement to unconscionable sales contracts or clauses.⁶⁰ It is not maintained that the *Unico* court intended to extend section 2-302 beyond consumer sales problems; however, *Unico* clearly involved more than a mere contract for sale. The waiver clause, while contained in an installment sales contract, was in issue only insofar as it affected the security agreement. The note, which was signed as part of a complex sales transaction,⁶¹ was actually a security agreement which the court, relying on section 2-302, refused to enforce. Moreover, this security agreement, while different in form from simple security agreements, was similar to the latter in operation and effect. Thus, the reasoning of this case may be applied to all such agreements.

V. TREATMENT OF UNCONSCIONABILITY WITHIN ARTICLE 9

No section of Article 9 provides adequate remedies for unconscionable security agreements. Some sections may appear to deal with the problem but careful analysis indicates their inadequacy. For example, section 9-501(3) is limited to the regulation of rights to secured collateral *after* debtor default.⁶² Focusing on this aspect obviously does not meet the initial problem of avoiding unconscionable security agreements. Similarly, section 9-206(1),⁶³ which provides that waiver of defense clauses remain subject to any applicable consumer protection legislation, is also too limited in scope to be effective against unconscionable security agreements. This was demonstrated in *Unico* where the court did not directly rely on section 9-206(1), but also looked to section 2-302 for necessary support of its decision.⁶⁴ Thus, since specific provisions in Article 9 are inadequate to protect

⁵⁹ The importance of the Code as a statement of policy in situations where it does not strictly control is illustrated by the court's reference to § 9-206(1). Since the agreement in question was entered into before the Code was adopted in New Jersey, the Code did not apply to the agreement. Yet, the court referred to the subsequent legislative enactment of § 9-206(1) in support of its policy arguments.

⁶⁰ 50 N.J. at 125, 232 A.2d at 418.

⁶¹ The complexity of the *Unico* fact situation illustrates an aspect of security agreements which supports their inclusion within the scope of Article 2 "transactions." As is seen in *Unico*, security agreements involve some element of a transaction in goods. In such transactions fairness requires that the underlying policy of the Code be applied rather than allowing this policy to be limited by technicalities. See Hawkland, Article 9 Methodology, 9 Wayne L. Rev. 531 (1963).

⁶² U.C.C. § 9-501(3) provides:

To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral . . . but the parties may by agreement determine the standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable.

⁶³ *Supra* note 57.

⁶⁴ 50 N.J. at 125, 232 A.2d at 418.

against unconscionable security agreements, section 2-302 remains the only provision in the Code capable of providing an effective remedy. Moreover, this section allows for flexibility, that is, the direct examination of the commercial setting of the security agreement,⁶⁵ necessitated by the varying forms of unconscionable security agreements.

The fact that Article 9 incorporates existing consumer protection legislation also appears to provide some protection,⁶⁶ but in reality it is of limited effect. Such narrow consumer statutes are inherently unable to accommodate a variety of fact situations as exemplified by *Hernandez*.⁶⁷ There the plaintiff-debtors alleged that the property attached by the defendant-finance company was exempt under a New Mexico statute⁶⁸ protecting certain property held by widows or heads of families from execution sales. The court recognized that the purpose of the exemption statute is to protect debtors from becoming destitute.⁶⁹ However, the court held that it was not the intention of the statute to deprive individuals of their rights to property and that Mrs. Hernandez' encumbrance of her furniture by signing the instant security agreement was an exercise of such a property right.⁷⁰ Consequently, the court refused to apply the exemption statute to the property in question.⁷¹

In addition to the exemption statute, the plaintiffs also invoked the New Mexico Small Loans Act,⁷² claiming that the finance company violated the statute by failing to supply receipts showing allocation

⁶⁵ Supra note 40.

⁶⁶ U.C.C. § 9-203(2) provides:

A transaction, although subject to this Article, is also subject to*, and in the case of conflict between the provisions of this Article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein.

Note: At * in subsection (2) insert reference to any local statute regulating small loans, retail installment sales and the like.

The foregoing subsection (2) is designed to make it clear that certain transactions, although subject to this Article must also comply with other applicable legislation.

This Article is designed to regulate all the "security" aspects of transactions within its scope. There is, however, much regulatory legislation, particularly in the consumer field, which supplements this Article and should not be repealed by its enactment. . . .

⁶⁷ 79 N.M. 673, 448 P.2d 474 (1968).

⁶⁸ N.M. Stat. Ann. §§ 24-5-1, 24-6-7 (1967).

⁶⁹ 79 N.M. at 675, 448 P.2d at 476.

⁷⁰ *Id.* The court's reasoning as to the intention of the exemption statute is not convincing. Certainly, the "property rights" of debtors are infringed by the statute to the extent that it limits the effect of agreements entered into by debtors as to certain types of property. The court's brief dismissal of this statute fails to present any facts in Mrs. Hernandez' situation which might make reference to the purpose of the statute irrelevant.

⁷¹ *Id.*

⁷² N.M. Stat. Ann. § 48-17-44(a)(2) (1967). The plaintiffs also invoked N.M. Stat. Ann. § 48-17-49(a) (1967), which required such a security agreement to be signed. The court held that the statute did not apply since Mrs. Hernandez' signature was on the agreement.

of each installment and the unpaid balance. The court declined to determine the effect of such failure to supply receipts under the statute since failure to comply with this statute would not require that the agreement be found unenforceable.⁷³

It is difficult to fairly criticize the court's refusal to apply the above statutes since the decision contained few details concerning the security agreement. However, it is apparent that the only statutory coverage the plaintiffs could reasonably invoke was section 2-302. No specific statutory provision could be invoked to cover the precise issue, that is, whether a person unfamiliar with the language and business customs should be bound by an unconscionable security agreement. This issue depends upon the determination of a wide variety of factual circumstances, and consumer protection statutes cannot adequately deal with such a problem. There are therefore no available judicial remedies concerning unconscionable security agreements other than section 2-302.

It is suggested that the section may be used in conjunction with existing consumer protection legislation, to cover problems not adequately provided for by such statutes. Thus, section 2-302 could be employed in the absence or inadequacy of any other non-Code remedies. Such a balanced approach offers flexibility and would be more effective than exclusive reliance on statutory remedies.

CONCLUSION

Section 2-302 would provide an effective remedy for unconscionable security agreements presently lacking in Article 9 or elsewhere in the Code.⁷⁴ Placement of the section in Article 1 would remove the present limitations as to its applicability. That Code-wide application of such general provisions as section 2-302 is workable is demonstrated by the continued viability of section 1-203 requiring good faith dealing in all transactions under the Code. The court in *Elkins-Dell* utilized the provisions of section 2-302 without determining whether the section applies beyond sales problems. The decision demonstrated the effectiveness of section 2-302 in providing policy guidelines in the distinctly non-sales area of bankruptcy proceedings. The example of *Elkins-Dell* could be advantageously imitated by courts dealing with the problem of unconscionable security agreements.

Whether the provisions of section 2-302 should be applied as directly controlling or followed only as policy guidelines is relatively unimportant. What is important is that courts overcome the legalistic,

⁷³ 79 N.M. at 675, 448 P.2d at 476.

⁷⁴ The inherent flexibility in the approach of section 2-302 to the problem of unconscionability, of course, demands a degree of judicial self-restraint to avoid purely arbitrary decisions. Such restraint was evident in *Elkins-Dell* where the court held that the referee who refused to enforce the contract on general equity principles should have first investigated the commercial setting of the agreement as required by section 2-302, and, consequently, remanded for such a determination by the referee. *Supra* p. 134. See also Comment, Commercial Decency and the Code—The Doctrine of Unconscionability Vindicated, 9 Wm. & Mary L. Rev. 1143, 1154 (1968).

UNCONSCIONABLE SECURITY AGREEMENTS

technical barriers preventing the straightforward treatment of the problem of unconscionability. Judicial reluctance to overcome technical distinctions as exemplified by the brief dismissal of section 2-302 in *Hernandez*, should be discouraged because such a refusal to apply section 2-302 to a security agreement when the section would have been applied if the transaction had been simply an installment sale, is based on an artificial distinction. The technical distinctions between such transactions are outweighed by the necessity of reaching an equitable result and the advantages of applying section 2-302 to reach that result.

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