Introduction to Symposium on Revised UCC Article 9

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Introduction to the Symposium

By Alvin C. Harrell

In early 1990 the Permanent Editorial Board (PEB) for the Uniform Commercial Code (UCC), in conjunction with its sponsors,1 established the PEB UCC Article 9 Study Group, to study and consider the possible need for revision of Article 9.2 The Study Group spent several years engaged in a comprehensive study of UCC Article 9, the primary law governing security interests in personal property and generally recognized as the most innovative and important part of the UCC. On December 1, 1992, the Study Committee issued its Report,3 recommending Article 9 revisions in three broad categories: (1) Revisions to broaden the scope of Article 9 to include personal property; (2) revisions to improve the public service function of perfection by filing; and (3) revisions to clarify and improve the provisions in old Article 9 Part 5 regarding enforcement of security interests.4 The Report also recommended miscellaneous improvements affecting such things as the relationship between Article 9 and non-UCC liens, security interests in proceeds, and pursuit of money security interests.5 But the Report concluded that old Article 9 was “fundamentally and conceptually sound,” and accepted the traditional purposes of the UCC as a guide for the proposed revisions.6

In 1993 the sponsors of the UCC adopted revisions recommended by the Study Committee, by assembling a UCC Article 9 Drafting Committee to consider and draft proposed revisions for consideration by the NCCUSL and ALI.7 The Drafting Committee and Reporters (along with various advisors, task forces, officers and others) drafted, circulated, considered, and revised numerous tentative drafts of proposed Article 9 revisions.8 The proposed revisions were considered for approval by the ALI and NCCUSL in the summer of 1998.9 The revisions were offered to the states for enactment with the 1999 legislative sessions, with a uniform effective date of July 1, 2001.

To a significant extent, the Drafting Committee followed the agenda of the Study Group Report, proposing for consideration revisions based on the Study Group recommendations. The disposition of these proposals by the Drafting Committee varied, however, with most proposals being favorably received (though often revised) and others not. Some issues of the consumer creditor groups converged on the importance of the UCC revision process after the UCC Article 9 and Article 4 revisions were approved by the ALI and NCCUSL,10 and were very active participants in the Article 9 Drafting Committee meetings from the beginning.

As most the Article 9 Drafting Committee was focused on a wide range of consumer protection issues throughout the Article 9 revision process, thus interrelating additional commercial and philosophical issues normally not addressed in the context of commercial law. At times the divergence of views on these issues seemed to threaten disruption of the process,11 and until very late in the process the outcome on some of these issues remained uncertain. Your author and others have previously described some of the disputes relating to proposed consumer issues, and the historic compromise that finally resolved the impasse.12

The Article 9 Drafting Committee formed a Consumer Issues Subcommittee in an effort to reach a compromise between the consumer and creditor representatives, and the resulting report and recommendations were offered as a basis for compromise.13 However, some of the recommendations were unacceptable to creditor representatives,14 and the consumer representatives continued to press for additional consumer transaction rules. At one point the divisions were so deep that the creditor representatives withdrew from the Consumer Issues Subcommittee and announced an inclination to oppose enactment of the revisions if the proposed consumer transaction rules were included.15

The consumer issues represented the most contentious aspect of the Article 9 revision process. For awhile it seemed possible that these issues would not be susceptible to uniform resolution on a nationwide basis, meaning that the consumer transaction proposals could essentially black the entire revision process. Fortunately, this did not happen, and a historic consumer issues compromise was reached, allowing all parties to agree on a new uniform text. The specifics are described in Tom Buiteweg’s article in this Symposium, suffice it to say here that all of those involved in developing this compromise deserve the thanks of those who appreciate the importance of revised Article 9.

III. Fundamental Considerations in the Revision Process

Early in the Article 9 revision process, various fundamental observations were made regarding the process and the textual environment facing the Article 9 Drafting Committee, including:

A. More Open Process

The uniform law drafting process today is far more open to diverse viewpoints than in the past. Consumer advocacy groups and organizations are very active, for example, in contrast to previous uniform law revision efforts.

The process now follows more and less an isolated academic exercise than...
in the past. For better or worse, this is affecting the end product, particularly with regard to consumer issues.

B. Common Law Versus Regulatory Models

Law revision efforts always face a choice between the common law model (essentially uniform basic principles, largely contract, to effectuate the conduct of private parties) and the regulatory model (typically including detailed requirements, strictly construed, and possibly with punitive remedies such as statutory goals, to effectuate social goals by mandating involuntary behavior). The latter typically embraces an in consumer, approach, using strict penalties for harmless errors, in order to inspire trea and intimidation as compliance tools. The UCC traditionally has embraced the former approach, and the Article 9 Drafting Committee generally sought to do likewise, but there have been some con- cessions to the regulatory approach, again particularly in the consumer area.

C. Absusive Consumer Practices

Sellers, the Drafting Committee has had to confront a basic conflict between the traditional goal of facilitating business transactions (which the consumer perceived need to concede a role for social and political judgements that certain classes of business need special protections against abusiveness. The con- benefit analyses needed to resolve such conflicts proved elusive and often in- consistent, but the consumer issues compromise largely mooted the issue.

D. Uniformity and Enactability

The Drafting Committee had to confront periodic conflicts between the goals of uniformity and enactability; for a time it seemed to be a contest of one side or the other. Consumer protection and consumer issues were to the rescue, and the Committee adapted the system of law to accommodate consumer issues.

The UCC traditionally has compromised effort made to be sure revised Article 9 is non-discriminatory.

J. Other Problem Areas

Aside from the consumer issues, difficult issues arose in the context of baill onment, baill onment, the extraordinary business, commingled goods, "all as- sets" claims, deposit accounts, tort claims, structures, settlements, and in- surance. Difficult, measured, and sometimes hotly-debated decisions were made re- lating to the resolution of many other issues. As with the consumer issues, the result- ing compromises have been highly acclaimed and widely embraced by interested parties and resolve many problem areas under old Article 9.

K. Scope

One way in which revised Article 9 is significantly expanded is in its scope. On the one hand, the new article elaborates and adds to the old. On the other hand, the new, in many respects, is wholly new. This is particularly notable in the new sections dealing with the rights of certain classes of personal property and money (including the Uniform Commercial Code Common Law, and the Uniform Commercial Code Creditors' Rights). This new approach is due in considerable part to the increasing recognition of the importance of these issues. The new article is not a complete expansion of the old, however, but rather a selective expansion to address areas where the old did not provide the needed protection.

L. Uniformity of Article 9

Most of the UCC Activities are limited in scope to specified classes of personal property. For example, Article 2 is limited to sales of goods, Article 3 is limited to negotiable instruments, Article 4 is limited to letters of credit, Article 7 to documents of title, and Article 8 to investment property including securities entitlements and financial assets. Conversely, Article 5 is comprehensive in that it includes in its definition of "consumer," unwitting or not, the buyer of personal property for either his own use or to resell. This is a significant difference between the UCC and the Uniform Commercial Code (UCC) provisions, which are generally limited in their application to transactions in which possession of the property is retained by the seller.

1. Changing Technology

As noted above, with a few notable exceptions, the Drafting Committee fa- cilitated the integration and segmentation of consumer protection provisions. Segre- gated provisions would have favored the commoditization in some states, by facilitat- ing deflection or amendment of provisions deemed unsatisfactory in such states with- out structural alteration of the primary role in the main text. However, this ap- proach was rejected at the insistence of consumer groups, and the integrated approach was adopted. Again, the consumer issues compromise largely mooted this issue.

2. Fundamental Policy Issues

The Reporters repeatedly tried to em- phasize the participant's mandate to "first, do no harm." Fundamental policy choices that form the basis of Article 9 were, for the most part, not revisited. Aside from the consumer issues and a few other mat- ters, the focus was on improving the old law rather than making new law. For those who view law revision efforts pri- marily as an opportunity to overturn the current system of law, this may have ren- dered the effort a disappointment.

3. Filing System Issues

One of the most significant revisions for commercial lenders is the new na- tional filing system. This provides a more complete and efficient filing process. The new system has the potential to greatly reduce the time and cost of filing and searching for records. It also allows lenders to more easily track and manage their loan portfolios.

4. Sales of Accounts and General Intangibles

Most of the UCC Activities are in scope of specified classes of personal property. For example, Article 2 is limited to sales of goods, Article 3 is limited to negotiable instruments, Article 4 is limited to letters of credit, Article 7 to documents of title, and Article 8 to investment property including securities entitlements and financial assets.
cially recognizes a right of set-off arising under other law, and most states recognize the doctrine of set-off against a deposit account. This is because the depositor's interest in the deposit accounts is considered a security interest in the collateral. Therefore, if the depositor were to use the collateral to secure a loan, the creditor would have a security interest in the deposit accounts. This means that if the depositor defaults on the loan, the creditor can foreclose on the deposit accounts. However, in many states, the doctrine of set-off is limited to situations where the depositor has a legal right to set-off against the creditor. In such cases, the depositor can use the deposit accounts to offset the amount owed to the creditor. The doctrine of set-off is generally recognized in most states, but the specifics of how it is applied can vary from state to state. The depositor's right of set-off is a valuable protection for the depositor, as it allows them to offset the amount owed to the creditor from the deposit accounts. However, it is important to note that the depositor's right of set-off is subject to the limitations of the state's law, and the depositor should consult with a legal professional to determine the specifics of how set-off is applied in their state.
agricultural lien. Section 9-315 then provides rules governing the perfection as to proceeds of a security interest, but comment 9 to revised section 9-315 notes that revised Article 9 does not similarly provide for continuation of an agricultural lien in proceeds. That depends on other law, including the law creating the lien.

In essence this will permit a person who provides goods or services to a farmer, in the ordinary course of the provider's business, and thereby obtains a statutory lien under other law, to "perfect" that lien under Article 9 and thereby gain access to the Article 9 rules on priority and enforcement. It is believed that this will provide a significant incentive for agricultural lienors to comply with Article 9, thereby giving public notice of their claims and avoiding the "secret lien" problem, in order to utilize the clear and certain priority and enforcement rules of Article 9 (as a superior alternative to the generally unclear and uncertain rules otherwise governing the priority and enforcement of statutory liens). This does not convert statutory liens, created by other law outside Article 9, into Article 9 security interests; it merely provides an Article 9 mechanism for perfection, priority, and enforcement of such liens.

In terms of priority, an agricultural lien not perfected under Article 9 would be treated like an unperfected security interest, and generally subordinated to perfected security interests and other lien creditors. Perfected agricultural liens will have priority based on the normal first-in-time rule, under optional provisions, a "Production Money Security Interest" (PMSSI) would be given the equivalent of purchase money priority as to crops and their proceeds, if certain requirements are met (e.g., perfection by filing when new value is given, and direct notice to competing perfected secured parties).

The revised Article 9 system for agricultural liens has been widely lauded, and a number of parties have urged expansion of this system to cover other (non-agricultural) statutory liens. The American Bar Association, Business Law Section, UCC Committee Subcommittee on Relation to Other Law prepared a Report on "Inclusion of Nonpossessor Statutory Liens in Article 9," analyzing these issues. The Report, dated September 1996, was presented to the Article 9 Drafting Committee on November 2, 1996 by Meredith S. Jackson, Chair of the Subcommittee on Relation to Other Law. The Report generally recommends extending the revised Article 9 provisions on agricultural liens to cover other nonpossessor statutory liens. The Article 9 Drafting Comment did not adopt this, but it remains on the table for possible future consideration.

Commentary: Predatory Lending

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and in litigation. Part II in the next issue will focus on related developments at the state level. While the future direction of these developments necessarily will depend largely on political trends, the current debate on these issues makes consideration appropriate at this point.

II. Implications for the Credit Markets

Despite periodic lip-service to the contrary, the state and federal agencies that are most active with regard to Predatory Lending do not always seem well-attuned to the potential for damage to the credit markets that could result from some of their proposals. From the standpoint of a mortgage lender, some of these proposals seem so severe, on top of an already very difficult legal environment, that an exodus of legitimate lenders from the affected markets seems likely to result if such proposals are implemented.

One must admit that we have heard this before, and yet consumer credit has expanded dramatically even as the legal environment has become more complex and difficult. And this is not to suggest that all subprime lending will stop if any of these proposals is implemented. But it also should be admitted by proponents that such proposals have costs. While consumer credit is widely available today, the average cost of such credit has apparently moved upward in conjunction with new consumer protection laws and regulations, so that overall consumers today are paying considerably more than they were 25 years ago.

There can be little doubt that much of this increase is due to the more complex, sometimes punitive, always litigious and often economically damaging legal environment faced by consumer creditors today. Surely no one seriously believes that society can impose these kinds of costs and risks on creditors without experiencing a corresponding increase in the cost of such credit. Therefore an appropriate question for policy makers is whether even higher credit costs (perhaps, at some point, in the form of reduced credit availability) should be imposed on consumers in order to provide additional protections against Predatory Lending.

All of this may sound familiar to those familiar with the modern history of consumer credit. In the early part of this century, unrealistic usury laws stifled legitimate creditors in many states, and the result was a serious problem with illegal loan-sharking in some communities. The lesson was learned, the laws were (mostly) reformed, and our highly competitive credit markets are the result. Let's hope we don't have to learn that lesson again, the hard way.

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