1997

UCC Article 9 Drafting Committee Considers October 1996 Draft

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I. Introduction

The Uniform Commercial Code (UCC) Article 9 Drafting Committee met November 1–3, 1996 in Chicago, Illinois to consider the October 1996 draft of proposed revisions to Article 9.[1] At this meeting the Drafting Committee reviewed difficult issues relating to accessions, low-price foreclosure sales to creditor-related parties, tort claims, "realty paper," and other issues of importance to consumers and consumer lenders. In addition, this meeting featured a dramatic announcement that the Consumer Creditors Group was withdrawing from the Subcommittee on Consumer Transactions.[2]

As usual the November 1996 meeting was chaired by William M. Burke, Chair of the Article 9 Drafting Committee. Also present were the Reporters, Professors Steven L. Harris and Charles W. Mooney, Jr. Mr. Burke convened the meeting and announced that the next meeting would be held at the Omni Sheraton Hotel in Washington, D.C. on March 7–9, 1997, with a subsequent meeting to be held November 14–16, 1997 in Chicago and final approval of revised Article 9 expected in the summer of 1998.

II. Initial Deliberations

A. Code Structure and Organization

Professor Harris noted that the October 1996 draft is restructured to break the larger sections into smaller separate sections. As a result the new section numbers vary considerably from old Article 9, and for example old Part 5 (Remedies) has now become Part 6 in the October 1996 (and February 1997) draft.

B. Bankruptcy and Other Issues

There were comments to the effect that some of the more active members of the National Bankruptcy Review Commission (NBRC)[3] view the secured transactions market in static terms, and may not fully account for the probability that changes in the law will affect creditor behavior. Ed Smith reported on the Article 9 Drafting Committee Task Force on Bankruptcy-Related Matters, indicating that some members of the NBRC are cognizant of these issues and are aware of the economic importance of secured credit. He suggested that further dialogue and consideration of the economic impact of the proposed bankruptcy changes is needed. There was a consensus that some of the more radical proposals for bankruptcy reform are not warranted.[4]

Harry Sigman distributed a new proposed form UCC 3 (Financing Statement change) and discussed other financing statement issues, including the problem of bogus filings. Neil Cohen reported on the UNCITRAL Receivables Financing Project.

C. Circular Priorities

Professor Harris then discussed a memorandum of October 10, 1996 by the Reporters, on circular priorities. The Reporters asked for discussion as to whether

1. For background on the Article 9 Drafting Committee and references to articles describing prior meetings of the Drafting Committee, *see* Alvin C. Harrell, *UCC Article 9 Revisions Confront Issues Affecting Consumer Collateral*, 49 Consumer Fin. L.Q. Rep. 256, n.1 (1995) (listing certain prior articles). The October 1996 draft has now been superceded by a February 1997 draft.

2. For an example of the work of this Subcommittee, *see Report of the Consumer Issues Subcommittee of the UCC Article 9 Drafting Committee*, 50 Consumer Fin. L. Q. Rep. 332 (1996); *see also* Alvin C. Harrell, Commentary: *The Article 9 Revisions—What Should be Done*, *id.* at 220; and *infra* Pt. II. D.

3. *See* Alvin C. Harrell, *The Need for Consumer Bankruptcy Reform*, 50 Consumer Fin. L. Q. Rep. 197 (1996); Alvin C. Harrell, *The Agenda of the National Bankruptcy Review Commission*, in this issue.

4. *See also* Jeffrey S. Turner, *The Broad Scope of Article 9 is Justified*, 50 Consumer Fin. L. Q. Rep. 328 (1996).

these are issues that should be dealt with in the statute. Bob Zadek and Marion Benfield opined that the problems are infrequent in practice, and are being adequately handled by the courts. There was a consensus that Article 9 does not need to be cluttered with additional rules to cover these issues. Don Rapson suggested this would be appropriate for a PEB Commentary, which could then be integrated into the revised Article 9 Official Comments. This was informally approved.

D. Consumer Issues

Professor Benfield then reported for the Subcommittee on Consumer Transactions.[5] He reported that the creditor representatives had withdrawn from the Subcommittee on grounds that the proposed consumer credit revisions are not cost-effective in comparison to current Article 9. The creditor representatives were reported to have stated that they believe current Article 9 is superior to the proposed revisions. As a result the Consumer Issues Subcommittee did not have any new proposals for the Drafting Committee to consider. Ed Hieser then spoke on behalf of the creditor representatives, noting that consumer lenders are not asking for anything in revised Article 9, and are being asked to make major concessions without receiving anything in return. Mr. Hieser reported that the consumer finance industry believes the proposed consumer revisions would have a significant adverse impact on the cost and availability of consumer credit and therefore cannot support the revisions as currently proposed.

Ed Smith responded that there have been indications that the revisions cannot be enacted in some states without addressing consumer protection issues. He distributed a letter from some state attorneys general as an example. Ed Hieser responded that this letter is less than it seems, in that some state officials apparently signed the letter as a general matter without consideration of the specifics or implications of the proposed revisions. He argued that evidence such as this letter should not be a basis for decisions by the Drafting Committee. Bob Zadek commented that the consumer issues involve social and political issues, as compared to the legal efficiencies involved in the commercial transaction issues. He urged that the Article 9 Drafting Committee is ill-suited to make these social and political judgments, and that efforts to do so will jeopardize the ability of the process to achieve needed consensus regarding legal efficiencies. Bill Burke noted that all of this is the result of an effort to be politically inclusive, so that every viewpoint can be represented. He noted that the Drafting Committee must continue with the process, and urged all parties to continue their participation.

5. *See supra* note 2.

III. Accessions

Professor Mooney then discussed a Reporters' memo of October 10, 1996 (Reporters' memo) covering accessions and commingled goods. The memo distinguishes three categories of goods: (1) attached goods, (2) incorporated goods, and (3) commingled goods. Attached goods are those attached to other goods without losing their separate identity, and which can be removed without injury to the attached goods or the whole (*e.g.*, a radio installed in a vehicle). Incorporated goods are similar except that they cannot be removed without serious injury to the whole (*e.g.*, an alarm system integrated into a mobile home).

The basic rule under proposed section 9-332 is that a security interest in attached goods continues after their attachment and will have priority over subsequent security interests in the whole (essentially preserving this priority as if such attachment had not occurred). With regard to pre-attachment claims against the whole (which extend to the attached goods after attachment), proposed section 9-332 gives priority to the holder of the security interest in the attached goods, "except with respect to future advances made by the holder of a perfected security interest in the whole without knowledge of the security interest in the attached goods and before it is perfected."[6] There was discussion of whether the element of "knowledge" should be eliminated. Professor Harris argued that the other priority rules should be applied, so that for example if the whole is sold to a buyer in the ordinary course that buyer would take free of the security interest in the attached goods.

The Reporters' memo raises but leaves open the question of priority when the competing security interests (in the attached goods and the whole) are perfected after the goods are attached. The three options are: (1) priority for the claim against the attached goods; (2) priority for the claim against the whole; and (3) priority for the first in time. Bob Zadek argued for a first in time rule; others argued for a rule based on the system governing real estate fixtures, but Professor Mooney noted that the practices for fixtures are quite different from personal property accessions. There was a consensus that purchase money priority should be recognized in this context. There was also a consensus that detached goods should continue to be subject to the perfection and priority of a prior security interest in the whole, and that attached goods automatically become subject to a security interest in the whole (although this is inherent in the Article 9 system rather than being expressed specifically). It was noted that many security agreements specifically cover attachments, accessions, and replacements, though this should be unnecessary.

Incorporated goods present more difficult issues. Bob Zadek argued that rules should be devised which do not require dismemberment of the whole in order for the security interest in the incorporated goods to be enforced. This could be done by recognizing a proportionate claim to proceeds from a sale of the whole (and possibly the right to force a sale of the whole, although there is disagreement on this). Ed Smith articulated a proposal

6. Reporters' memo of October 10, 1996, at 3. *Cf.* current § 9-312(7) (also generally recognizing the priority of future advances); current § 9-301(4) (same, subject to exceptions).

based on this proportionate value approach for security interests perfected by filing, which would preclude removal of incorporated goods but would give the secured party a proportionate security interest in the whole. Gail Hillebrand questioned whether this would allow the appliance financer to claim a security interest in the entire mobile home; the answer was yes, except that the appliance financer normally will not file (because of the automatic perfection for purchase money security interests in consumer goods). The basic point is that incorporated goods cannot or should not be removed, so the law should seek to resolve competing claims by allocating claims to the whole.

Commingled goods would also be subject to an allocation formula, as under current section 9-115. In effect, incorporated goods would be treated like commingled goods, if the secured party perfected by filing. A security interest in incorporated goods would continue in the whole, but would only be perfected as to the whole if there was a filing against the whole or similar perfection.[7] The security interest could not be enforced by removal. Competing security interests would rank equally, with a proportionate allocation of the sales proceeds. Marion Benefield questioned this approach, contending that a security interest in the whole should only be achieved by the usual means, and removal should be the remedy for incorporated goods. Upon a vote of the Drafting Committee, Professor Benefield's proposal was favored.

Professor Mooney then directed attention to the problem where a security interest is perfected by filing and the collateral is attached to goods subject to a competing security interest perfected by certificate of title lien entry (*e.g.*, components are attached to a motor vehicle). Professor Mooney argued that the security interest in the component should continue to be perfected after attachment, so as to have priority over lien creditors. There was unanimous agreement on this.

However, the real issue is priority as against the certificate of title lien entry. The unanimous view was that the security interest in the component (perfected by filing) should be subordinate to a certificate of title lien entry, regardless of which was first in time, and that all parties who take or claim via the certificate of title should prevail over a security interest in a component perfected by filing.[8]

Frank Suarino argued for a provision specifying the circumstances in which attachments become subject to the certificate of title, and specifying that a security interest in a vehicle would automatically cover attachments to the vehicle. While this should be current law, the cases are not always clear. The Reporters agreed to consider adding appropriate language.

IV. Low-Priced Sales of Collateral to Creditor-Related Parties

The meeting then turned to sales of collateral at artificially low prices to the secured party or a related party. Professor Mooney indicated that there was an emerging consensus in favor of stipulating that the sales *price* in a repossession sale to the secured party or a related party must be commercially reasonable.[9] Previously the Drafting Committee rejected judicial determination of an appropriate price as a dispositive issue, due perhaps to the inability of courts to deal consistently with valuation issues. But Professor Mooney suggested that review of the price may be the best way to deal with collusive sales at low prices being used to increase the debtor's deficiency. Under this view, an inadequate sales price could not be deemed reasonable no matter how excellent the sales procedure. Harry Sigman suggested that the sales price should be considered only if the sale was to a related party *and* the price was very low. There was a consensus on this point.

While all of these sentiments are commendable, there is no way to escape the fact that this would mean that courts would be overriding the market price in estimating the value of collateral, something they are ill-equipped to do. Perhaps to avoid this, Harry Sigman argued alternatively that the debtor should be allowed an extended redemption period to repurchase the collateral at the repossession sale price. Don Rapson argued that the adequacy of the price should be an issue only for purposes of determining the amount of the deficiency.[10]

Your author has some concern that there will be a spill-over effect, in that courts will allow sales prices to be attacked as commercially unreasonable even if no deficiency is sought.[11] Ed Hieser noted that the result of the proposal would be that a creditor who buys at a higher price, to avoid a distress sale price to a third party, would as a result become subject to attack for buying at an inadequate price. This might encourage lenders to let unrelated third parties buy the collateral no matter how low the price, to the detriment of both lenders and borrowers. It may also encourage judicial sales as a means to establish an enforceable sales price and deficiency. All of this would tend to reduce creditor recoveries and increase deficiency judgments, the opposite of what is intended.

The risk being addressed is that a secured party may bid an artificially low price at the repossession sale, in order to maximize the claim to a deficiency. Professor Mooney noted that this deficiency

7. Attachment of the security interest to the whole would be automatic (a "deemed security interest"), but perfection would not and would require perfection by a customary means. The Reporters were comfortable that the automatic attachment would not constitute a statutory lien under the Bankruptcy Code, 11 U.S.C. § 545.

8. Professor Michael Greenfield questioned whether the PMSI component supplier should always lose to the certificate of title lien entry holder, but the consensus was that the certificate of title should be paramount.

9. Current law provides that the sales procedure must be commercially reasonable, but generally eschews judicial determination of an appropriate price, on grounds that this is best left to the market.

10. This is consistent with Mr. Rapson's previously stated position that deficiencies should be based on "fair" value rather than the sales price at the repossession sale.

11. Harry Sigman seemed to raise this issue by suggesting that there is a danger in putting the sales price "in play," in that courts may focus on that issue rather than the commercial reasonableness of the sale. He emphasized a need to keep the analysis focused on the deficiency, so that the price issue does not come to dominate collateral sales issues generally.

claim may never be subjected to judicial scrutiny if non-judicial collection measures are utilized.[12] But several commentators then emphasized the need to restrict this higher level of judicial scrutiny regarding the price to collusive sales at a nominal price where the creditor is seeking to collect a deficiency.

Bob Zadek noted that this entire analysis cuts against the traditional Article 9 view that nonjudicial resolutions should be encouraged, in that this approach would encourage judicial foreclosure as a means to obtain a judgment outside of Article 9. Ed Hieser noted that in Wisconsin, laws inhibiting nonjudicial remedies have generated a high level of judicial foreclosures, at higher cost and with lower sales prices for all concerned. Harry Sigman urged that this rule be limited to a few egregious case, by using a standard that will limit judicial scrutiny of the sales price to cases where the sales price is "nominal" or "outrageous." In contrast Gail Hillebrand argued for such scrutiny any time the price is "unreasonable."

Four options were subjected to a vote (regarding sales to the lender or related parties):

1. Current law (procedurally correct sales are primary evidence of market value).

2. Same, with exception for "nominal" or "outrageous" sales prices.

3. Incorporate a valuation component (*e.g.* require a sale at "fair value").

4. Require a commercially reasonable price in sales to the lender or related parties.

The vote of the Drafting Committee was split and not decisive, and the decision was postponed to the next meeting.

David McMahon urged as a fifth alternative a provision allowing the parties to agree on the use of price guide figures in lieu of the actual sales price, as a safe harbor for creditors. Steve Harris noted that this would not be allowed under the current draft, which prohibits partial strict foreclosure in consumer cases, a prohibition that has been previously supported by the consumer advocates. Mr. McMahon's proposal would reverse this position, based on the use of a formal price guide as a protection against an inadequate collateral valuation. Yvonne Rosmarin emphasized that this proposal would require the consent of the consumer and that use of a price guide would provide sufficient consumer protection. There seemed to be a consensus favoring Mr. McMahon's proposal, on the part of both creditor and debtor representatives. However, Ed Hieser noted some risk that the use of price guides might "bleed over" into other issues, and that the use of price guides is not always simple and clear. (Previous meetings have discussed the limited usefulness of standard price guides as regards collateral, such as vehicles, for which actual sales prices can vary dramatically due to variations in condition, appearance, public taste, regionable economic conditions, etc.) Mr. McMahon countered that the procedure would be voluntary. On a formal vote the Drafting Committee declined to approve the McMahon proposal.

V. Bogus Filings

It was noted that when the problem of bogus filings first arose a few years ago it was considered a minor problem, but that it has become a serious issue in a some areas. The problem arises when groups use bogus UCC filings to disrupt the filing system as a means of political retribution. There are reports that farmers have been unable to plant their crops because bogus filings have impaired their ability to get secured loans. In some areas hundreds or more bogus filings have been made, and there have also been reports of valid filings being rejected as a part of programs to combat bogus filings. No easy solutions have been found.

Criminal sanctions are an obvious possibility, but there are also reasons to resist criminalization of the filing process. Bob Zadek has suggested that debtors be notified of new filings and have a specified period to object, but this would be expensive and cumbersome to administer. Others have suggested use of debtor code numbers to authenticate filings, but the same objections can be made. These proposals run counter to efforts to streamline the system and make it more efficient. There is also a conflict between advocates of systems that allow searchers access to only a computer summary of filings, versus those who prefer the "open drawer" approach that allows any financing statement to be filed and examination of the full financing statement. There was opposition to any solution that would require the filing office to examine and/or make any judgment regarding individual filings.

A motion was made by Brad Smith, to allow under revised section 9-519 a debtor to send a request for termination of a financing statement to the filing office. A copy would be sent to the secured party, and if the secured party did not respond within a specified time the filing would be deemed released. If the creditor did respond, the debtor's request for termination would have informational value only. This motion carried. A motion by Bob Zadek, that the secured party of record be notified each time a termination statement is filed, also carried.

VI. Application of Article 9 to Nonagricultural Liens

The Article 9 Drafting Committee has proposed to bring within Article 9 cer-

12. If a deficiency judgment is sought, or the repossession sale is otherwise challenged in court, the problem is solved because as a practical matter the court will scrutinize the sales procedure for evidence of fraud or collusion. Of course, if non-judicial collection measures are used and the matter is not challenged in court the proposed solutions (which require judicial scrutiny) will never be invoked and will be no more effective than current law. And regardless of what the Article 9 Drafting Committee does, the Fair Debt Collection Practices Act and state deceptive trade practices laws will continue to provide protection to consumers against collection of collusive or fraudulent debts.

tain agricultural liens.[13] The American Bar Association, Business Law Section, Subcommittee on Relation to Other Law was asked to report on the possibility of similarly bringing nonagricultural liens into Article 9. This effort was chaired by Meredith Jackson, who reported on this project at the November 1996 meeting of the Drafting Committee.

Ms. Jackson noted a conflict between the need to bring order to the legal environment for statutory liens by expanding the scope of Article 9, and the risk of expanding a sophisticated commercial statute to cover unsophisticated lienors now protected more directly by other law (by imposing a new requirement for filing a financing statement). On the other hand, many statutory lienors do not have an effective remedy under current law, and expanding Article 9 to cover these liens would increase their effectiveness in many instances.

The report concluded that the rationale for including agricultural liens applies "correspondingly to other nonpossessory statutory liens."[14] Ms. Jackson noted that nonagricultural lienors are a less cohesive group than agricultural lienors, making political consensus more difficult. Bob Zadek also commented that state statutory liens are a result of state political cultures and are not likely to be easily overridden by Article 9 revisions. On the other hand, a limited clarification of priority and enforcement rules for these liens would represent an improvement in the law for all concerned.

Ed Smith moved that the Reporters draft proposed revisions in accordance with the Subcommittee report. This motion carried.

VII. Tort Claims As Collateral

Professor Mooney briefly described Professor Harold Weinberg's *Quarterly Report* article on security interests in tort claims,[15] and a letter of August 15, 1996 from Hugh E. Reynolds, Jr. of Indianapolis, Indiana, regarding tort claims as collateral. This article and letter had been previously distributed to attendees. The latter focuses on the duties an assignee would owe to the tort feasor. Putting this aside for the time being, the meeting focused on Professor Weinberg's *Quarterly Report* article and the more fundamental issues relating to the possible expansion of Article 9 to cover tort claims. Professor Mooney began the discussion by asking: What is different about tort claims, and why should they not be included in Article 9?

Jeff Turner noted that tort and contract claims are frequently intermixed in litigation today, and it is difficult if not impossible to separate them for purposes of Article 9. Others agreed that this fact supports the inclusion of tort claims in Article 9. There seemed to be general agreement with the analysis and conclusions in Professor Weinberg's article.

David McMahon then noted that the consumer advocates oppose this expansion of Article 9; in response to the argument that consumers need this expansion to facilitate their access to credit, he reminded the meeting that the consumer advocates generally do not believe that consumers need more credit.[16] Gail Hillebrand argued that the reasons for inclusion of tort claims are limited to commercial torts, and that the same reasons do not apply to tort claims of natural persons.[17] Professor Mooney responded that natural persons may need access to cash during pendency of the action, just like commercial entities. Bob Zadek also noted that there is already an active consumer credit market for loans secured by tort claims, and that these revisions would reduce the cost and uncertainty of such loans. Neil Cohen also pointed out that these claims are already alienable, and seemed to question why the consumer would be better served by the current system of hidden and unclear rules as opposed to being under Article 9.[18]

There was a consensus that favored inclusion of tort claims in Article 9. Professor Mooney then questioned how this should be limited. There was a consensus that personal injury claims should be excluded from Article 9, even if otherwise alienable under state law. There was also a consensus that claims specifically made inalienable under other law should be excluded. Gail Hillebrand then argued for exclusion of claims that arise outside an individual's trade or business. A vote of the Drafting Committee favored this proposal.

Bob Zadek dryly noted the "hubris" of this group of largely upper class lawyers (the Article 9 Drafting Committee, advisors, and observers) in deciding that middle class consumers should not be able to undertake voluntary transactions they desire to make, and effectuating that decision by declining to provide clear and understandable legal rules for such transactions. Some observers commented that the Drafting Committee vote on this issue reflected the continuing propensity of the Drafting Committee to reject proposals opposed by the consumer advocates, perhaps due to concern that the revisions might otherwise be labeled as "anticonsumer."

Professor Julianna Zeken of Villanova University School of Law argued that security interests in tort claims should be allowed only if new value is given to the debtor, on grounds that otherwise the benefit would go to the creditor rather than the debtor. Professor Mooney responded that repayment of a debt that previously provided funds to the debtor is a benefit to the debtor, and the same argument can be made in any after-acquired property context. David McMahon pointed out that such a tort claim probably can also be claimed as proceeds of the creditor's other collateral, but Jeff Turner noted that the claim to proceeds may be difficult to establish. Hamline University Professor Linda Rusch noted that if the debtor is insolvent the loser will be unsecured creditors. Ed Hieser argued that the debtor might need to retain the proceeds to repair the damage (*e.g.*, environmental damage) caused by the tort feasor; he suggested tort claims should not be subject to claim under an after-acquired property clause. The consumer advocates agreed and the Drafting Committee also agreed, on a split vote. This raised questions about how one determines the point at which a tort claim becomes present rather than after-acquired property.

The Reporters then asked whether tort claims should be treated as a general intangible or should be a separate category of collateral. The latter would further clutter the UCC but the former would not require a specific description in order to cover this collateral. Gail Hillebrand and Professor Zeken argued that it is important for a separate and specific description to be required so that a debtor will be aware what is being alienated. A vote of the Drafting Committee favored this position.

VIII. Instruments Secured by Real Estate

A letter of October 1, 1996 from James A. Newell, Associate General Counsel of Freddie Mac, was presented, expressing concern about the proposed rule to allow perfection by filing as to instruments secured by a real estate mortgage. There was a concern that this provision might allow perfection by filing to interfere with the customary possessory perfection in secondary market transactions.[19] The letter, however, endorses the proposal that Article 9 specify that the mortgage follows the debt.

Proposed section 9-327(c)[20] would address the former concern by providing that a possessory security interest in an instrument will prevail over a conflicting security interest perfected by filing.[21] Professor Rusch argued that it would be better to tie this issue to the holder in due course doctrine, as under current section 9-309, but the Reporters disagreed, arguing that a narrow and specific exception to the first-in-time rule would interfere less with the remainder of the UCC.

The meeting next considered proposed section 9-607(b) (a title clearing provision for assignees of realty paper).[22] This would permit nonjudicial foreclosure of a security interest in a note and mortgage/deed of trust, by filing an affidavit and a copy of the security agreement in the real estate records. There were concerns about the relationship between this and proposed section 9-327, discussed above. The provision was retained, with authority delegated to the Reporters to modify or remove the provision as needed in negotiations with real estate interests.

IX. Section 9-111—Sufficiency of Description

Proposed section 9-111(b)[23] would require a description of a deposit account "by item, as all of the debtor's deposit accounts, or as an identified class of the debtor's deposit accounts."[24] There was a discussion of "super generic" (all encompassing) collateral descriptions. Don Rapson queried whether a description covering "all assets" would cover non-Article 9 collateral. Professor Harris responded that this would depend on other law; the security agreement would be valid as a contract outside of Article 9 for purposes, for example, of creating a common law pledge.

The Drafting Committee voted to preclude the use of super generic ("all assets") descriptions in the security agreement, though such descriptions would be allowed in financing statements. This preserves current law regarding security agreements. There was a consensus that use in the security agreement of broadly defined Article 9 terms (*e.g.*, "all accounts") is permitted and desirable.

Proposed section 9-209 was then reviewed. This requires a secured party to comply with a debtor's request for an accounting within two weeks and provides a $500 statutory penalty for a failure to do so. This was approved.

X. Other Issues

A. Choice of Law (Revised Sections 9-301, 9-302, 9-306)

The differences between consumer and business choice of law and perfection rules raises questions in cases where a sole proprietor or partner does business in both capacities.

B. Lien Creditors

Should the current rule at section 9-301 be preserved, giving the lien creditor priority over a filed but not yet perfected security interest? Proposed section 9-315(a)(2) (and Comment 1) retains prior law, despite the view of many that this is an anomaly. Could this give a lien creditor priority over a revolving credit lender whose balance drops to zero (thereby de-attaching and losing priority)?[25]

13. *See, e.g.*, proposed § 9-105(a)(33) (October 1996 tentative draft) (defining "secured party" to include the holder of an agricultural lien); proposed § 9-112(a)(2) (October 1996 draft) (describing scope of Article 9 to include agricultural liens); proposed §§ 9-302, 9-308, 9-309, 9-314, 9-315, 9-319 (October 1996 draft) (perfection and priority of agricultural liens).

14. Conclusion of Report of the ABA, Business Law Section, UCC Committee, Subcommittee on Relation to Other Law, Re: Inclusion of Nonpossessory Liens in Article 9 (Oct. 1996).

15. Harold R. Weinberg, *Tort Claims as Collateral: Impact on Consumer Finance*, 49 Consumer Fin. L. Q. Rep. 155 (1995).

16. *See generally* David B. McMahon, *The Theoretical and Practical Underpinnings for Consumer Provisions in Revised Article 9 of the UCC*, 50 Consumer Fin. L. Q. Rep. 183 (1996).

17. It should be noted that the proposal is limited to claims for economic injury; personal injury claims are not to be included.

18. More specifically, he asked the consumer advocates whether they were opposing clarification of the rules or were opposing the concept of alienability (which was not the question at issue).

19. *See, e.g.*, current UCC §§ 9-302(1)(a), 9-304, 9-305; Matter of Staff Mtg. & Inv. Corp., 550 F.2d 1228 (9th Cir. 1977).

20. Featured in brackets for discussion purposes at page 80 of the October 1996 draft.

21. *Cf.* current § 9-115 (5)(a) ("control" of investment property prevails over filing); current §§ 9-308, 9-309 (generally recognizing the priority of a purchaser for value who takes possession).

22. Page 135 of the October 1996 draft, in brackets for discussion purposes.

23. Page 21 of the October 1996 draft, former § 9-110.

24. *Id.*

25. *See, e.g.*, William E. Carroll and Alvin C. Harrell, Texas Kenworth Co. v. First National Bank: *The Wrong Side of Coin-O-Matic*, 16 Okla. City Univ. L. Rev. 81 (1991).

C. Buyers in the Ordinary Course

Should the limitation at current section 9-307, confining the rule protecting buyers in the ordinary course of business to security interests created "by his seller," be revised or eliminated? The consensus was that the current text is satisfactory. Should the priority rules at proposed sections 9-315(b), (c), and (d) have a similar limitation? Should investment securities be added to section 9-315(b)? The consensus on the latter question was yes.[26]

D. Receivables and Consignors[27]

Since "security interest" is defined in section 1-201(37) to include consignments, the rule allowing a lien creditor to prevail over unperfected security interests will allow lien creditors to prevail over unperfected consignors.[28] The same applies to a debtor-seller of receivables as to a buyer who fails to perfect. The debtor-seller subsequently could resell or encumber the sold receivables to a third party who would have priority if he or she was the first to perfect.[29]

E. Future Advances

The future advances provisions have been combined in proposed section 9-320. Proposed section 9-320(a) specifies the only circumstance in which the time of the advance is relevant. No substantive change is intended from prior law, but the intent is to clarify that in any case not specified at section 9-320(a) the time of the advance does not control priority.[30]

Proposed section 9-320(b) is derived from current section 9-301(4) and is designed to conform Article 9 to the federal Tax Lien Act.[31] The proposal brings this and all other future advances rules into a single section at proposed section 9-320.[32] Proposed section 9-320(c) does the same for competing buyers, replacing existing section 9-307(3).

Harry Sigman suggested a stronger statement that proposed section 9-320(a) is the exception and restating the general rule to the contrary. This seems well advised in view of the propensity of some courts to become confused over future advances issues.[33]

F. PMSI—Section 9-322

Should a purchase of a negotiable document of title confer purchase money priority on the purchaser?[34] The Reporters think not (consistent with current law[35]), but included such a provision in brackets for discussion purposes. The consensus was to delete the bracketed language.

Proposed section 9-322(b) would allow purchase money priority in inventory to carry over to chattel paper proceeds (contrary to current law).

G. Proposed Section 9-334—Priority of Security Interests in Certificate of Title Goods[36]

If a state issues a certificate of title covering goods subject to a security interest perfected by any means in another state: (1) a buyer other than a dealer would take free of the security interest to the extent the buyer gives value and takes delivery of the goods after issuance of the certificate and without knowledge of the security interest; and (2) the security interest from the prior state would be subordinate to a conflicting security interest that attaches and is perfected after issuance of the certificate and without knowledge of the prior security interest. This carries forward the general theme that a good faith claim or interest taken for value and without notice in reliance on a certificate of title will have priority over a claim or interest perfected by other means.

H. Incorrect Financing Statement

Proposed section 9-335 provides that a filed financing statement, containing information described in proposed section 9-515(b)(5) (*e.g.*, whether or what type of organization the debtor is) that is incorrect, is subordinate to the rights of a purchaser who relied on the incorrect information.[37] This is intended to protect reliance parties only, though the potential extent of the rule is not completely clear.[38] Harry Sigman argued against attempts to fine-tune this rule to cover every possibility, but sought statutory clarification that this rule is intended to protect only reliance creditors. However, the Drafting Committee voted for more extensive clarification.

I. Rights of Third Parties

On page 92 of the October 1996 draft the Reporters question whether new choice of law rules are needed to govern third party rights. Generally the Article 9 choice of law rules govern only debtor and secured party issues. Should the Article 9 choice of law rules also apply to related third party issues, such as a contract clause that prohibits assignment of an account, chattel paper, or payment intangible?[39] Neil Cohen argued that such choice of law rules should be provided as a better solution than reliance on the general choice of law rules at UCC section 1-105. Obviously the issue could have great significance, for example if the law of one state prohibits a waiver of the section 9-404(h) prohibition and the law of another interested state does not.

J. Assignments and Agreements Not to Assert Defenses

Proposed section 9-403,[40] subject to other consumer laws, permits an agreement between an account debtor and assignor, not to assert against any assignee, claims that the account debtor may have against the assignor, if the assignee takes in good faith and without notice.[41] This is not enforceable with regard to the defenses assertable against a holder in due course.[42] The Drafting Committee approved a motion by Ed Smith clarifying that this does not bar such rights under other law.[43]

Proposed section 9-404 provides that absent an agreement not to assert defenses, the rights of an assignee are subject to the terms of the contract between the account debtor and assignor and any defense of the account debtor against the assignor which accrues before the account debtor receives notice of the assignment. This claim can only be enforced as a reduction in the amount due on the contract.[44] This language is intended to follow the language at UCC section 3-305.

Concern was expressed that proposed section 9-404(c) (carrying forward prior law) could subject an account debtor to contract changes by reason of an assignment of which the account debtor has not had notice. The Reporters agreed to consider this issue.

X. Conclusion

As the foregoing may suggest, the current Article 9 revision process is subjecting the purposes and rules of Article 9 to an unparalleled level of scholarly and practical scrutiny, as befits the premier commercial law in the world today. While the process sometimes yields disagreement, it also often yields valuable insights and even consensus on needed reforms. While the process is not perfect, it has demonstrated a superiority in many respects to other methods of rule-making and legislation.

But as the process has become more open, it has also become more political. This is less a problem with regard to commercial transaction issues, in that broad consensus is often possible regarding clear improvements in the law, but has become a serious problem with regard to consumer protection issues. The latter are inherently subject to regional and political divisions, and the extent to which these divisions can be satisfactorily resolved in this forum remains to be seen, even at this late stage in the process.

26. Professor Mooney noted that the philosophy of the UCC is to treat lien priorities in terms of subordination or priority, while the rights of buyers are addressed in terms of "taking free" of competing claims.

27. Reporters' Comment 3, page 64-65 of the October 1996 draft.

28. Revised §§ 9-315(a)(1) and 9-319 carry forward the rule of proposed § 9-114 of the 1996 Annual Meeting Draft.

29. *See also* proposed § 9-319 (same). *Cf.* Thomas E. Plank, *When a Sale of Accounts is to a Sale: A Critique of Octagon Gas*, 48 Consumer Fin. L.Q. Rep. 45 (1994).

30. *See, e.g.*, Carroll and Harrell, *supra* note 25.

31. 26 U.S.C. §§ 6321-6323 (1982).

32. *Cf.* current §§ 9-301(4), 9-307(3), 9-312(5), and 9-312(7). In addition, proposed § 9-320(d) in the October 1996 draft would replace current § 2A-307(4). Former § 9-312(5) (the first to file rule) is now proposed § 9-319(b) in the October 1996 draft.

33. *See, e..g*, Carroll and Harrell, *supra* note 25.

34. *See* Reporters' Comment 1, page 76 of the October 1996 draft.

35. *Id.*

36. Pages 89–90 of the October 1996 draft, former § 9-103(c)(6).

37. Would this allow the trustee in bankruptcy to claim such status under 11 U.S.C. § 544(a)?

38. *Id.*

39. *See, e.g.* proposed section 9-404(h), page 98 of the October 1996 draft, prohibiting such a contract clause.

40. Page 94 of the October 1996 draft, derived from current § 9-206.

41. Proposed § 9-403(a).

42. Proposed § 3-403(c). This would include the "real" defenses. *See* UCC §§ 3-302, 3-305.

43. *See also* Reporters' Comment 2, page 94 of the October 1996 draft.

44. Proposed § 9-404(a), (b), page 96 of the October 1996 draft.

Follow up: Premises Owner's Liability

The previous issue of the *Quarterly Report* contains an article dealing with the liability of business establishments for the injury of patrons on the premises. *See* Professor Vicki Lawrence MacDougall, *Premises Liability After the KFC Case: The Potential Liability of a Commercial Establishment to a Customer Injured by Provocation of an Armed Robber,* 50 Consumer Fin. L. Q. Rep. 397 (1996). Highlighting the importance of these issues, *The Wall Street Journal* recently covered similar issues in a front page story. *See* Louise Lee, *Lots of Trouble—Courts Begin to Award Damages to Victims of Parking-Area Crime,* Wall Str. J., April 23, 1997, at A1.