UCC Article 9 Drafting Committee March 1996 Meeting Considers Consumer-Related Collateral

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The Article 9 Drafting Committee Consumer Issues Subcommittee issued a tentative discussion draft (dated February 27, 1996) summarizing comments on various issues, as a basis for discussion at the March 1996 meeting of the Drafting Committee in Chicago. This article describes your author’s interpretations of the tentative positions taken by the Subcommittee on some of the issues which have been raised by the members of the Subcommittee. The tentative nature of the positions taken is emphasized by the use of the phrase “Subcommittee inclination.” It should be emphasized that your author is not a member of this Subcommittee or the Article 9 Drafting Committee and did not attend the Subcommittee meeting at which these positions were developed. This discussion of consumer issues is derived from and is heavily indebted to the Discussion draft of February 27, 1996 issued by the Consumer Issues Subcommittee and the oral report of the Subcommittee delivered at the March 8–10, 1996 meeting of the Drafting Committee; your author would like to express his appreciation to Professor Marion W. Benfield, Jr., Chair of the Consumer Issues Subcommittee, for permission to use this material. However, this article does not represent a position of the Subcommittee and your author is responsible for any errors.

The Subcommittee report specifically disclaimed any intention to indicate a decision on the desired scope of consumer provisions in Article 9, or whether any Article 9 Part 5 consumer protections should be in a separate part, or in bracketed or unbracketed sections in Part 5. Decisions on these issues will have to follow development of a consensus as to which substantive consumer law provisions should appropriately be part of Article 9.

The Subcommittee also reminded participants that it is at the bottom of a chain of command that has five additional levels: the full Drafting Committee, the National Conference of Commissioners on Uniform State Laws (NCCUSL) Executive Committee, the full NCCUSL, the Council of the American Law Institute, and the membership of the American Law Institute.

3. This article is not intended as a transcript or minutes of the meeting. Moreover, the author has the best of the proposed revisions and discussions thereof, resulting in a possible lack of accuracy. Readers should consult the February 15, 1996 draft for more specific information.
5. Harrell at the “Discussion draft.”
Parties' Ability to Fix Standards (Proposed Section 9-501(e))

Present section 9-501 permits the parties to agree to standards for the performance of the creditor's duties under Article 9. These agreements are not manifestly unreasonable. The consumer representatives have argued that for consumer transactions the world "manifestly unreasonable" should be dropped so that the "commercial standard" would be acceptable only if "unreasonable." The concern is that the "manifestly unreasonable" standard gives too much discretion to creditors to impose onerous standards on consumers. Lenders generally oppose a different standard for consumer and commercial transactions.

The following alternatives were considered by the Consumer Issues Subcommittee:

- Provide different rules for consumer and for commercial transactions.
- Apply "not manifestly unreasonable" to all security agreement.
- Apply "not unreasonable" to all security agreements.

The Subcommittee announced an intention to leave Article 9 unchanged, with a "reasonable" standard for both consumer and commercial transactions. However, the Subcommittee recommended a comment to section 9-501(c) that the "sophistication and bargaining power of the parties is a relevant factor in applying the not manifestly unreasonable test." The Subcommittee also expressed doubt that the difference in wording would have any significant impact on decisions, as either way a court could apply a stricter test to consumer transactions than to commercial ones. But reaffirming the current rule will maintain the consistency of a uniform statutory standard.

The consumer representatives also proposed adding at the end of proposed section 9-501(e) the following: "However, the parties' agreement may not eliminate or reduce the obligation of the creditor to act reasonably in disposing of the collateral and to act in a commercially reasonable manner." The Subcommittee indicated an inclination to accept this recommendation, while noting that the added language is probably unnecessary. This change would concern that while the parties can fix standards, these standards must still result in commercially reasonable conduct. Current section 1-102(3) allows the parties to set standards for compliance within standards of good faith, diligence, reasonableness and care if the parties' agreement is not manifestly unreasonable.

There was concern that the language proposed by the consumer representatives could lead to a negative inference that the current section 1-102(3) provision is not similarly limited. The consumer representatives want the day provision or no safe harbor, arguing that ten days is too short a period to permit the defaulting consumer to attempt to redeem or reinspect the collateral which may involve arranging additional financing. The creditor representatives have argued for a ten days period for both commercial and consumer or no safe harbor at all.

The Subcommittee announced its intention to adopt the ten day period for commercial borrowers and a 15 day safe harbor for consumers but a vote by the Drafting Committee favored eliminating any statutory safe harbor period. All parties raised the concern that the proposed section 9-501(e) would create significant problems of lost interest and the costs of keeping and protecting collateral during statutorily imposed delays, but that there may be some value to consumers in having a somewhat longer period to assess their options after a repossession.

Contents of the Notice of Intended Sale—Proposed Section 9-504(f)

Currently Article 9 does not require the notice to the debtor to say anything except that the collateral will be sold on a stated date (by private sale). At section 9-504(k) and (l) the current draft requires a somewhat more extensive notice. Subsection (k) applies to commercial transactions, setting out a safe harbor form to be used. Subsection 9-504(3) of the current draft (also a safe harbor provision) or after a stated date (by private sale). It required providing more specific information regarding the debt in the notice of disposition in any individual case probably would not be very expensive, magnified over millions of transactions the cost would not be significant. Moreover, it would be a waste in the many cases in which no re- demption is contemplated, and would create administrative costs and unnecessary mistakes which might later be the basis for a claim that the notice was inaccurate or the sale commercially unreasonable, with resultant penalties. On the other hand the Subcommittee concluded that a small imposition on the creditor, to require that the notice inform the debtor of the right to redeem (or reinspect) and of the possibility of a deficiency, is warranted. This could be included in standard language inserted in every notice.

Prohibition of Collection of Small Deficiencies—Proposed Section 9-504(a)

Bracketed language at proposed section 9-504(a) of the February 15, 1996 draft would deny the secured party a deficiency judgment if the obligation does not exceed a specified amount at the time of default. The Drafting Committee decided to include such a right, and a notice that the recipient may be liable for a deficiency if the proceeds of the sale are insufficient to cover the debt plus the costs of repossession and sale. The Subcommittee also concluded that the payoff or reinstatement figures should be given in writing once the consumer requests that information. The Subcommittee raised the question whether the debtor should be required to make an appropriate proposal for commercial borrowers as well. It noted that redemption occurs at any time, in 10% of the repossessions and at the time of repossession or after a stated date (by private sale). This would be a significant burden for the debtor, but the rate would be reduced in the many cases that no re- demption is undertaken, and would create administrative costs and unnecessary mistakes which later might be the basis for a claim that the notice was inaccurate or the sale commercially unreasonable, with resultant penalties. On the other hand, the Subcommittee concluded that a small imposition on the creditor, to require that the notice inform the debtor of the right to redeem (or reinspect) and of the possibility of a deficiency, is warranted. This could be included in standard language inserted in every notice.

Right to Reimburse the Debt—Proposed Section 9-506(b)

Proposed section 9-506(b) would provide consumers a right to reinstate the debt (and thereby avoid acceleration of the debt) by making past due payments, plus a number (to be stipulated) of regularly scheduled instalment payments or, if there are no regularly scheduled payments, on a number of payments as necessary to cover the total unpaid secured obligation. Consumer representatives argued that defeasance of consumer debtors should be accorded this right. They argue that default is often the result of a temporary interruption of income or sudden required expenditures that, if there is a statutory right to redeem, consumers who are in that situation, if they can reinstate, will often be able to complete payment of
their obligations. In contrast, lenders argue that their self-interest will cause them to allow write-off in these cases when that is indicated. The strictly positive effect would significantly increase creditor losses due to unanticipated restructurings by debtors acting in bad faith. The practical reason for issuing an inclination to provide a statutory right to reinstate 11, at the time of default, the debtor has paid 80% or more of the principal amount of the debt.

One automobile creditor reported that 80% of the debtors who are permitted by the creditor to reinstate their contracts by paying past due amounts subsequently default leading to a second repose period. That experience indicates that the creditor’s self-interest provides substantial pressure to allow reinstatement that is justified and perhaps in many unjustified cases. While there may be isolated creditors whose procedure is to never reinstate and to encourage defaults in order to repossess, the number of such creditors is small enough that a responding by imposing a statutory requirement in all situations is not justified. On the other hand, if the debtor has paid substantial part of the debt, there is an assumption that there may be more equitability to the collateral which the consumer manages to keep as security for future consumption. Where 60% of the debt has been paid, some believe it is more likely that the value of the collateral would cover the debt (if there is a subsequent default). Of course, given the basic nature of consumer collateral, it is also quite possible that the value of the collateral may have depreciated even more than 60%. A possible variation would be to allow a creditor to avoid reinstatement by going to court to obtain a judgment which is then reviewed by the court. All of this would likely increase the cost of the debt at the present stage, thereby raising overall the cost of consumer credit. The Consumer Subcommittee has not addressed the issue of how much past due payments a debtor should be required to pay to reinstate.

III. Absolute Bar Rule—Proposed Section 9-507

Currently Article 9 Part 5 requires at section 9-504 that a creditor who is in the process of enforcing a lien on collateral to conduct the sale in a commercially reasonable manner. Current section 9-507 provides remedies for failure to comply with those requirements. The basic remedy in current section 9-507 is damages caused by the failure to comply. Under current section 9-507, for example, if a commercially reasonable sale would have produced $12,000, and the creditor conducted a commercially unreasonable sale which produced only $11,000, the damages are $1,000. If, therefore, the deficiency after the foreclosure sale was $5,000. The creditor could recover $4,000 ($5,000-$1,000). However, ten or so states have adopted an absolute bar rule, providing that if a secured party has failed to comply with the statutory provisions, it is barred from exercising the lien. In the above example, therefore, the creditor would lose the entire $5,000, rather than only the $1,000 damage caused. Most states, however, have rejected the absolute bar rule and have adopted a rebuttable presumption rule under which a creditor that failed to comply with Article 9 cannot recover a deficiency unless it overcomes a presumption that a proper foreclosure would have sold the goods would have sold for the amount of the debt. Some courts have adopted a more pro-creditor position that, even though a creditor has failed to comply with Part 5, it can recover a deficiency unless the debtor proves the harm that was suffered because of the failure to comply.

In addition, under current section 9-507, there are statutory damages in consumer transactions, to the amount of the finance charge plus 10% of the cash price, if a credit sale, the finance charge plus 10% of the cash price, if the creditor fails to comply with Part 5 shall recover $2,000. The other $4,000 of the potential deficiency is foregone.

On the other hand, if the statutory penalty was only $2,000, the creditor would not be able to recover any deficiency, and thereby would suffer a "penalty" of $3,000. A creditor representatives frequently object to this kind of discrepancy between actual damages and the statutory penalties.

In contrast to the February 15, 1996 draft, the Consumer Issues Subcommittee indicated an inclination to retain the present section 9-507 penalties without an absolute bar rule (assuming that the rebuttable presumption rule would apply). As noted, the present section 9-507 penalties will in many cases give the consumer a windfall in that the consumer’s recovery will be in excess of any actual harm caused by the default. On the other hand, the Subcommittee suggested that it sees some justification for a bar rule in consumer transactions. The reasons for a bar rule in consumer transactions. But, more practically, the Subcommittee certainly stated that it would be difficult to eat back on a consumer commodity which has been in the UCC without serious complaint for 30 years or more and has been involved partly by the courts. If it is assumed that the baseline is the present UCC there is probably very little practical difference between the present rule and the February 15, 1996 draft. There will be a difference only when the deficiency is greater than the statutory penalty. Given the reports of strong opposition to the absolute bar rule expected that an amendment on the floor at the NCCUSL Annual Meeting, and the likelihood that adding an absolute bar to the present section 9-507 would reduce the deficiency from the statutory penalty would only merely provide an additional recovery to the debtor, the Subcommittee tentatively concluded that it is better to leave the present UCC rule as is.

1. Attorneys’ Fees—Proposed Section 9-507

Currently Article 9 does not give creditors a right to attorneys’ fees if they prevail on a claim that the creditor violated the foreclosure rules. The draft Article 9 Part 5 is therefore not entitled to recover attorneys’ fees for providing consumer transactions. That is, if the security agreement provides for attorneys’ fees for the creditor, a prevailing consumer debtor is also entitled to attorneys’ fees. This draft also provides that the court may award attorneys’ fees to prevailing consumer debtors even if the security agreement did not allow recovery of attorneys’ fees by a prevailing secured party.

The Consumer Issues Subcommittee expressed an inclination to adopt the reciprocal attorneys’ fee provision, but not the selection of transaction’s fees in other cases. The stated reason is that, in consumer transactions, a creditor who contracts for attorneys’ fees should be subject to attorneys’ fees if the consumer establishes that the creditor failed to comply with Article 9 Part 5. However, this line would not be addressed to the problem associated with a combination of statutory damages for minor and harmful errors as the trigger for a claim to attorneys’ fees, which is driving so much of the litigation under the Fair Debt Collection Practices Act.

Security agreements used in consumer transactions very often provide for attorneys’ fees. Therefore giving the court a discretion to allow attorneys fees in other types of cases would provide attorneys’ fees in very few, if any, additional cases. Of course, if the reciprocal rule led creditors to redefine the provision for attorneys’ fees, the security agreements in an effort to avoid a reciprocal liability, that would presumably, be a benefit to consumers on an equivalent cost to lenders. In consumer transactions, the attorney fee proposals are among the most controversial included in the Subcommittee report, and will be discussed at greater length in future articles in this journal.

J. Strict Foreclosure As to Market Securities—Proposed Section 9-505

It has been suggested that since Article 8 brings security interests in mutual funds shares into Article 9, section 9-505 should be extended. There is no reason why a market party is not able to take mutual fund shares in satisfaction of the debt under section 9-505. The reason is that section 9-505 would be road to permit the secured party to take shares with a market value in excess of the debt without any obligation to account to the debtor for the surplus in value above the debt.

At the March, 1996 meeting, the Consumer Issues Subcommittee indicated an inclination against including a special provision in the statute, preferring to deal with the problem by a comment. The Subcommittee noted that the same concern exists with Chapter 10. There are types of collateral other than mutual fund shares which may have a clear market value and which can be sold on a recognized market at the current market price. Agricultural commodities and publicly traded securities come to mind. The problem is that it knows of no instance of abuse by a secured party taking such goods in excess of the debt in satisfaction of the debt under section 9-505. It should be unnecessary to specifically deal with the statute in such an obvious misuse of the section. There was a consensus that this is what the courts are for. However, the Consumer Subcommittee indicated that it would be appropriate to add a comment to section 9-505 inserting a note to such cases taking all of the collateral in satisfaction of a smaller debt would be a violation of the good faith obligations imposed by the Code.

K. Interests in or Claims Under Insurance Policies

The February 15, 1996 draft brings rights under insurance policies into Article 9 but proposed section 9-104(a) would exclude from Article 9 transfers
by an individual of an interest in or claim under any policy or insurance which cov- ers health care costs, in injury or disabil- ity of an individual, the loss of employ- ment or income by an individual, or funeral or burial costs. The consumer representatives have proposed that all individual life insurance policies be ex- cluded from Article 9, reasoning that such policies are intended to provide family income upon the death of the policy- holder and are, therefore, similar to wages that are not subject to security interests. As of this writing, the Subcommittee had not yet formed a position on this issue.

The Subcommittee indicated that it believes this is more than hypothetical issues. For example, key man insurance is an important business tool. Similarly, the ability to pledge a right to insurance on an individual’s life as security for a busi- ness loan might be important to a con- sumer. The Subcommittee considered whether taking security interests in life insurance could be prohibited in consumer trans- actions, but expressed a sen- sitivity to consumer financial needs and indicated that it would be reluctant to want to bar such transfers. The Subcommittee also noted that any lender that legally or financially transfers for security should be covered by Article 9 rather than a common law regime. From a consumer perspective, clear rules under Article 9 might prevent consumer fraud that is currently considered

I. Deposit Accounts

In bracketed language at section 9-206 the December 15, 1995 draft excludes from Article 9 the transfer of an

M. Tort Claims

The February 15, 1996 draft would give security interests in tort claims within Article 9 but proposed section 9- 10(A)(c) would exclude from Article 9 “a transfer by individual of any tort or dam- ages resulting from an injury to an individual.” The consumer repre- sentatives propose that all tort claims of an individual be excluded. Again, this would leave assignments of tort claims to the common law.

The Consumer Issues Subcommittee expressed uncertainty as to what the proper coverage of tort claims should be. Again, the issue is not whether tort claims can be taken as collateral (i.e., assigned as security) but whether such transfers should be within Article 9. Under other state law, tort claims for personal injury may or may not be assignable but other tort claims are commonly assignable. The Subcommittee also noted that individuals may have tort claims which are es- sentially business claims, such as a claim for interference with trade secrets, includ- ing a breach of contract, improperly us- ing "confidential" materials. Therefore, the Subcommittee recommended a purely business nature of the claim.

II. Limitation on Waiver of Defenses Clauses in Section 9-206

Current section 9-206 and proposed section 9-206 in the February 15, 1996 draft permit waiver of defenses clauses in security agreements (subject to any such statute or decision that establishes a dif- ferent rule for buyers or lessors of con- sumer goods). The consumer representa- tives have recommended that the Federal Trade Commission (FTC) rule prohib- iting waiver of defenses clauses in certain transactions be incorporated into Article 9.

The Subcommittee expressed a pref- erence for leaving current section 9-206 as is. Adding the proposed language would give essentially no actual addi- tional protection to consumers. The FTC rule already does that. The only possible situation in which the statute would give greater protection would be a case in which the FTC required legend did not appear in the agreement and the trans- fer was able to successfully argue that it took without notice of the fact that the transaction was a consumer transaction subject to the FTC rule. The Subcom- mittee concluded that this is a fairly unlikely scenario. Any transferee of a contract originally signed by an individ- ual or a dealer would be covered by current law. In recently revised UCC Article 3, the issue is addressed in the same way as in present section 9-206: “This section (stating the requirements for holder in due course status) is subject to any law limiting status as holder in due course in particular classes of transac- tions.”

There was a consensus that this approach is satisfactory.

O. Obligations of the Consumer Account Debtor to Pay Assignee

Alternatives A and B of the February 15, 1996 draft of section 9-318(b) provide dif- ferent approaches regarding no- tification to the account debtor of payment. Alternative A allows the account debtor to pay the assignee even though the account debtor knows that the assignment is only a partial assignment. Alternative B makes a notice of partial assignment ineffective. A consumer debtor is likely to pay a notifying as- signee; therefore it seems inappropriate to say that the notification is "ineffective" unless there is also a provision clearly permitting the assignee to pay the account debtor in reliance on the notice. There- fore, the Subcommittee expressed some preference for Alternative A. However, the Subcommittee noted that the issue arises also in assignments of rights against business debtors and the Draft- ing Committee has not yet decided whether to apply the rule of subsection 9-318(h) to business debtors. The con- sumer representatives have agreed that greater protection would be for consumers who are notified of an assignment, but the Subcommittee took no position on the matter. In section 9-318(h) the Committee rem- inded the Drafting Committee that the effect of the statutory rule on consumer debtors must be kept in mind.

P. Description of Collateral in the Financing Statement

The February 15, 1996 draft of sec- tion 9-9(g)(2) provides that “a statement to the effect that the financing statement covers all assets or all personal property is sufficient to indicate that the collateral is covered by the financing statement.” The consumer representatives have pro- posed that this “all assets” or “all personal property” description be not sufficient in consumer transactions. Present Article 9 requires the financing statement to indi- cate the types of, or describe the items of, collateral. Under the present language counts have split on whether a generic description such as “all personal prop- erty” or “all assets” is sufficient. Of course, even if the financing statement claims “all assets,” the security agree- ment may be more limited and the cur- rent draft contains no similar provision specifically approving an “all assets” description in the security agreement.

The Subcommittee expressed an in- clination to bar an “all assets” descrip- tion in the financing statement in con- sumer transactions. An “all assets” descrip- tion in a consumer transaction cannot be entirely true, since Article 9 (at current section 9-204(2)) prohibits a se- curety interest in all "consumer goods other than accessions, and the FTC imposes certain restrictions on the finance purchase money security interests in consumer goods at 16 C.F.R. section 444.2. As a result, nearly all consumer secured lending is on specific items of collateral, rather than on the strength of "all assets" as is more common in com- mercial loan transactions. Moreover, most consumer goods are either subject to automatic perfection (under current section 9-302(1)(d)), or certificate of title lien entry perfection (pursuant to current section 9-302(2)(b)). Therefore, the only imposition on consumer creditors is at a result of this would be to take away (for certain nonpurchase money loans) the ability of perfection which an “all as- sets” rule gives.

The Subcommittee also noted that if new approaches to the drafting of fi- nancing statements not signed by the debtor, it is possible that consumer debtors will not know what the description in the financing statement is. That is an is- sue which will likely be considered as to all debtors, not just consumer debtors.

Q. Discussion at the March Meeting

Michael Ferry responded at the March, 1996 meeting on behalf of the consumer representatives, expressing concern that the consumer positions were not moving sufficiently to address the concern that any further reduction in consumer protections would be unacceptable. Ed Heiser responded that virtually all pro- posals have come from the consumer side, so any compromise on those issues represents a net gain for the con- sumer advocates.

III. Bankruptcy Task Force

Bankruptcy Task Force Chairman Ed Smith noted that some of those on the bankruptcy side of the Task Force (serv- ing as a liaison between the Article 9 Drafting Committee and the Bankruptcy Review Commission) appear philosophi- cally opposed to secured credit and view any improvements or in expansion of Article 9 as an inappropriate reaffirma- tion of secured credit. He reported that the Task Force agreed to submit two re- ports, one commenting on the technical aspects of the proposed revisions, the other addressing broader philosophical issues.
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Presumably the latter will include consideration of whether secured creditors should be given priority over "non-advancing creditors" in bankruptcy, as under current law. The term "non-advancing creditors" refers to non-creditors and others who cannot adjust their claims voluntarily, as opposed to Article 9 secured creditors who can adjust their claims in advance. Ed Smith noted in a presentation on a paper by Professor Elizabeth Warren (Reportee for the Bankruptcy Review Commission) suggesting that secured creditors be subject to a "carveout" to help fund the bankruptcy estate and claims of non-advancing creditors.

IV. International Secured Transactions

Chairman Burke distributed a report describing international efforts to prescribe uniform rules governing cross-border secured transactions. Neil Cohen, Chair of the new Drafting Committee Task Force on International Secured Transactions, reported that the Task Force was considering two issues: (1) how to craft the Drafting Committee address issues in Article 9 to facilitate international secured transactions, and (2) what can be done to facilitate improvements in international laws governing secured transactions and internal laws in other countries that affect international secured transactions?

Professor Mooney noted a companion project dealing with mobile goods and a report, entitled "Unincorporated International Institute for the Unification of Private Law, Study Group for the Preparation of Uniform Rules on International Trusts and Titled Securities Equipment," was distributed with materials for the Article 9 Drafting Committee meeting. Professor Mooney invited comments and participation in this project. Professor Peter Winship reported on another UNGTARI project dealing with receivables financing and international securitization. Ed Smith noted that there is considerable goodwill among the participants in these international discussions and solicited input from businesses as well as legal representatives. Neil Cohen noted that many countries lack the basic legal foundation that U.S. lawyers take for granted.

V. Filing System Reform

Harry Siggman reported that in the February 15, 1996 Article 9 draft (page 139) is a copy of the national financing statement, now officially approved for acceptance in all 50 states. A financing statement amendment form had not yet been approved.

He also noted progress in the area of electronic filing, which has been tested successfully and was expected to be available in Texas during the spring of 1996. He reported that Kansas has a proprietary electronic system and has agreed to conform to the Texas system, and numerous other states have agreed in principle or are moving in that direction. A LEXUS representative attended this meeting of the Drafting Committee. It was also noted that there is a pilot project regarding an electronic title system for motor vehicles, and a proposed commentary, published in the UCC Reporting Service, in which "debtors' signature exists in electronic filing.

VI. Certificate of Title Issues

A. Section 9-103(c)(4)

The Drafting Committee considered the February 15, 1996 draft of section 9-103(c), dealing with certificate of title collateral, beginning with proposed section 9-103(c)(4). Section 9-103(c)(4) deals with the question of when a security interest, perfected by certificate of title lien entry in one state, becomes imperfect by reason of some event in a second state. The February 15, 1996 draft provides two alternatives.

Alternative A (proposed section 9-103(c)(4)) provides that perfection ceases when the certificate is "surrendered" (bracketed language offered for consideration would add "and canceled by the issuing authority") in the second state.

Alternative B would provide for perfection "at the time the certificate becomes imperfect under the law of the first jurisdiction."

The significance of this distinction is that under Alternative B a secured party's perfected security interest would continue to be perfected under the law of that state as long as that state had a valid certificate of title outstanding, whereas under Alternative B a "surrender" (an undefined term of the certificate in another state would cause lapse of perfection. There seemed to be a consensus favoring Alternative B.

B. Section 9-103(c)(5)

Discussion then turned to proposed section 9-103(c)(5), dealing with the continuance of perfection after movement of the collateral to a second state. Again, two alternatives were presented. Alternative A would provide for continuation of perfection until the earlier of (1) the time the security interest would have become unperfected in the first state or (2) four months after the goods become covered by a certificate of title in the second state, and thereafter if the security interest is perfected in the second state within the earlier of these periods. This would provide a four month grace period for perfection in the second state, after the second state has become applicable. If there is no perfection within this time period, the security interest would become unperfected and would be deemed as having been unperfected at all times in the second state as against a purchaser for value. This change would cure current law by, in essence, providing a four month grace period for perfection in the second state after the certificate of title in the second state is surrendered. It was noted that favoring the creditor in the first state as opposed to current law. Proposed section 9-103(c)(5), Alternative B, provides that a security interest perfected in one state would remain perfected after becoming covered by a certificate of title in a second state until it would have become unperfected in the first state, except that if the perfected secured party does not take steps to reperfet in the second state before the earlier of (1) lapse of perfection in the first state or (2) the expiration of four months, the security interest would become unperfected as a purchaser for value at any time after the new title is issued. In contrast, Alternative B would provide some much more protection for the secured creditor in the first state, as the first security interest would not become unperfected in the second state as against a lien creditor or other claimant not a purchaser for value.

Peter Sussman expressed continuing concern, as he has during prior meetings, urging that issuance of a new certificate of title in the second state (which could be obtained by法人), should not cause the prior security interest to become unperfected. He favored Alternative B as the closest equivalent to that position, and other commentators likewise favored Alternative B.

It was noted that this could create a circularity problem, but Professor Harris reported that this could be dealt with by means of a resolution similar to that in Bankruptcy Code section 724(b). He also noted that problems could arise in actual transactions. Ed Smith argued that Alternative B could "draw fire" from the bankruptcy bar, but as a disavowal of the claim of the trustee in bankruptcy (as lien creditor). On a poll of the Drafting Committee, as between Alternative A and B, the vote was evenly split.

Regarding the impact of these rules on a buyer of the collateral at a lien creditor's judicial sale, it was noted that such a buyer would take only the rights of the lien creditor (and therefore in many instances would be subordinate to the Article 9 security interest, as described above), unless the buyer purchased by way of taking a "clear" certificate of title under the rules described above.

C. Effect of Retractive Nonperfection

Reporters' Explanatory Note 3 to proposed section 9-103 describes the impact of proposed section 9-103(c)(5), Alternative B, with regard to "retractive nonperfection" as against lien creditors. In effect, if the secured party fails to reperfet in the second state within the four months, at the end of the four months the security interest is traced as unperfected in the second state, "both prospectively and retroactively" as against purchasers for value but not lien creditors. As noted, this could create circularity problems, e.g., where the security interest has priority over a lien creditor with priority over a purchaser who has priority over the security interest. This could also be deemed to create a preferential transfer in bankruptcy, e.g., if a new statutory lien were created in the second state as against a lien obtained during the four month Article 9 grace period.

The Reporters proposed to deal with this problem by new statutory provisions on perfection of perfection in section 9-103(c)(5) to a rule of subordination pattern on Bankruptcy Code section 724(b).

D. Section 9-103(c)(6)

Proposed section 9-103(c)(6) deals with the problems that may arise when collateral subject to lien entry perfection becomes covered by a certificate of title issued in another state that does not reflect the prior perfected security interest (a "clear" certificate of title).


22. See id., art. 9, § 6.02.

23. See UCC 9-103(c)(6) and Bankruptcy Code § 561, 11 UCC 2; 3

24. 11 UCC § 2.411. See supra § 4.10.

25. See supra § 4.10.

26. See UCC § 9-103(c)(6) and Bankruptcy Code § 561, 11 UCC 2; 3.

27. See UCC § 9-103(c)(6) and Bankruptcy Code § 561, 11 UCC 2; 3.

28. 11 UCC § 2.411. See supra § 4.10.

29. See id., art. 9, § 6.02.

30. 11 UCC § 2.411. See supra § 4.10.

31. See supra § 4.10.
It was then considered whether Article 9 should go beyond the provisions of section 9-504(q) in order to provide a specific alternative totaling rule that would not depend on the existence of such a rule under other law. There was a consensus in favor of such a rule.

B. Impact of Federal Filing Requirements

Proposed sections 9-302(c)19 and 9-303(c)20 would provide that a federal rule on filing or registration of securities interests would preempt Article 9 only to the extent the federal filing is mandatory and exclusive. For example, the Federal Aviation Act provides a mandatory and exclusive system for certifying aircraft, and a federal court could then order a securitization agreement to be used in all future transactions involving aircraft. Therefore, Article 9 should not be preempted as to the lower rated engines. Other examples of mandatory or nonexclusive federal rules include the Truth in Lending Act and the Uniform Commercial Code. The proposed revisions would not consider the issue in the context of Article 9-306 transactions.

VIII. Proceedings—Proposed Section 9-306(d)

Proposed section 9-306(d) would provide that the opportunity to establish a statutory rule would be available to parties other than the court, and that the court would have discretion to decide whether to allow the filing of a statutory rule. The Reporters agreed that the court should have this discretion and, moreover, that the court should have the discretion to decide whether to allow the filing of a statutory rule.

IX. Section 9-308—Purchase of Chattel and Instruments

Should filing be allowed as a means to perfect a security interest in negotiable instruments? The question was raised whether the filing and the definition as drafted would bring into or exclude from the term inappropriate classes of rights or property. The term "account" was then expanded to include those types of intangibles that should be subject to perfecting by filing. This allows covering certain types of "intangibles" that are not currently covered by Article 9-308 originally included in instruments that are not subject to a filing requirement. The term "accounts" was expanded to include obligations for services rendered or to be rendered, ownership obligations, a policy of insurance, energy consumed or to be consumed, and a vessel charter.

X. Section 9-203(a)(3)—Attachment

Under the proposed revisions, if the owner of chattel paper sells it, but the buyer does not take possession, the seller could create a security interest (with priority over the buyer) despite having sold the collateral. Proposed section 9-206(d) recognizes this in an excepted rule to the rule that the debtor must have rights in the collateral in order for the security interest to attach. Thus a secured party that takes possession and perfects a possessory security interest after the sale could have priority over a prior buyer or secured party who did not perfect by possession.

XII. Section 9-206—Agreements Not to Assert Defenses

The Drafting Committee voted to delete the bracketed language on lines 7-9 on page 69 of the February 15, 1994 draft (in proposed section 9-206(a). Proposed section 9-206(c) does not provide for a filing requirement, as proposed section 9-206(c) does not include the term "account" in the definition of "intangibles." Section 9-206 does not preempt this field, as proposed section 9-206(c) does not provide for a filing requirement, as proposed section 9-206(c) does not include the term "account" in the definition of "intangibles." Section 9-206 does not preempt this field, as proposed section 9-206(c) does not provide for a filing requirement, as proposed section 9-206(c) does not include the term "account" in the definition of "intangibles." Section 9-206 does not preempt this field, as proposed section 9-206(c) does not provide for a filing requirement, as proposed section 9-206(c) does not include the term "account" in the definition of "intangibles." Section 9-206 does not preempt this field, as proposed section 9-206(c) does not provide for a filing requirement, as proposed section 9-206(c) does not include the term "account" in the definition of "intangibles."
good faith.

The definition of good faith would be revised to include observance of reasonable customary standards. It was noted that this may be done in the Article 1 revision, obviating a need to decide the issue in Article 9. This change to the current definition may have significant implications for Article 9 secured parties, in effect providing an additional avenue of attack on almost any aspect of a secured transaction, on grounds of breach of this new good faith standard.

XVII. Possessory Security Interests

The February 15, 1996 draft includes revisions to sections 9-205(1), 9-207(b), 9-305(c), and 9-506 Note, relating to possessory security interests. Among other things this would allow the secured party in possession to repossess the collateral (i.e., grant a security interest in the collateral to a third party). The secured party would be liable to the debtor for any infringement on the debtor’s rights to redeem, although language to this effect at proposed section 9-205(b) was deleted as an unnecessary duplication of the rules at Article 9 Part 5.

Proposed section 9-305(c) in the draft eliminates Alternative A of the previous draft, requiring acknowledgment by the bailee to the secured party that the bailee holds for the benefit of the secured party, in order to create perfection by possession of the collateral. Alternative B of the previous draft has become subsection (c) in the February 15, 1996 draft, allowing perfection by notice to a bailee in possession of the collateral, as long as the bailee acknowledges that it has received notice of the security interest. The Drafting Committee voted to further revise this language to provide perfection when the bailee acknowledges that it holds possession on behalf of the secured party, some-what returning to the rule at old Alternative A.

Linda Hayman asked whether the notice and acknowledgment could cover after-acquired property. The Drafting Committee agreed that this should be allowed.

XVIII. Relation to Article 2

Professor Richard Spiegel again joined this meeting to discuss Article 2 issues.

A. Consignments

Section 9-102(a)(x) treats the consignee as good of the owner and the consignor as a purchase money secured party. As a result, all consignments are brought within Article 9.75 Although the proposed definition of consignment excludes certain de minimis consumer transactions and other traditional exceptions.

Section 9-114 was revised to provide simply that a consignee has the rights of an assignee. Section 9-116(c) was revised to provide that the consignor is in the position of a purchase money secured party. This represents a significant change from prior drafts. Professor Spiegel and others expressed approval and commented that the drafters had not addressed the problem of a debtor in the situation of a lien or simply being up to his or her bank accounts by way of a blanket collateral description in the financing statement, as this proposal would not provide for perfection by filing.

C. Buyers in the Ordinary Course

Proposed section 9-307(b) specifies that section 9-307(b) permitting a buyer in the ordinary course of business to take free of a security interest does not apply to collateral in the hands of the secured party. This adds the problem of transfers88 Pursuant to discussions at the previous meeting,89 the definition of “buyer in the ordinary course of business” was revised to focus entirely on the ordinary course of the seller’s business.90

D. Bulk Transfers

Section 9-301(a)(3) and (b)(2) were revised to delete bulk transfers and adopt instead the broader term “buyer in the ordinary course.”

XIX. Deposit Accounts

A. The Basic Approach

Revisions affecting deposit accounts were made as the proposed sections 9-104(12), 9-117 Note, 9-203(a), 9-302(a)(14), 9-304(a), 9-308, 9-312(j), 9-312a, 9-318A, and 9-502(c). The basic approach is to require perfection by notice and an acknowledgment from the depository institution. By doing so, we solve the problem of a debtor in the situation of a lien or simply being up to his or her bank accounts by way of a blanket collateral description in the financing statement, as this proposal would not provide for perfection by filing.

What is the role of the Drafting Committee in revising the draft and what changes were made to the sections related to security interests and consignments?
It should be noted that issues relating to coverage of consumer deposit accounts have not been decided, and the above referenced revisions have been designed in the context of commercial rather than consumer deposit accounts. It remains likely that consumer transaction accounts will continue to be excluded from Article 9.

D. Transferees of Funds

Proposed section 9-308A would provide that a transferee of funds from a deposit account takes free of a security interest in the account unless the transferee acts in collusion with the debtor.41 This is designed to protect innocent transferees and the needs of the payment system. It would permit the secured party to prevail over a transferee only in the event of "collusion." Bob Zadek argued that the secured party's claim should be limited to damages for fraud, rather than allowing a claim to proceed. Professor Harris responded that this was previously considered (and was included in prior drafts) but that the Drafting Committee rejected the inclusion of tort concepts in Article 9. A mere reference to other law would be too oblique and an invitation to nonuniformity.

XX. Other Filing Issues

At page 133 of the February 15, 1996 draft appears in bracketed language a proposed section 9-402 (in) specifying that a financing statement may be filed before the security interest attaches. The proposed language is self-evident and consideration was given to deleting this language in order to reduce the length of section 9-402. The proposed language was retained.

At page 137 appears a list of information errors justifying rejection by the filing officer of a preferred financing statement.42 This includes a failure to specify whether the debtor is an individual or an organization, and if the debtor is an organization a failure to note the type, jurisdiction, or identification number of the debtor.

Proposed subsection 9-402(f)43 would provide that information in the financing statement that is incorrect would result in subordination to a purchaser of the collateral who gives value in reasonable reliance on the incorrect information.44 The Drafting Committee voted to retain this provision.

Proposed section 9-406 would deal with multiple secured parties of record,45 providing that each such party may file its own separate amendment, continuation statement, etc., and this would not affect the rights of the other parties under the financing statement. A Reporter's Note to section 9-402(2) deals with perfection as to a group of lenders by filing under the name of a lenders' agent.

Proposed section 9-403(j)46 provides that upon lapse due to a failure to properly file a continuation statement the security interest would be retroactively rendered unperfected as against a competing purchaser. The language at line 18 including lien creditors in this protection was deleted by unanimous vote of the Drafting Committee. The Drafting Committee decided that the grace period for filing a continuation statement at proposed section 9-403(k)47 should continue to be six months.

At page 149 a new proposed section 9-406A would allow the successor to a secured party to act either in its own name or under the name of the party it succeeds. At page 158 a new proposed section 9-415 would govern the claims of debtors regarding improper filings or the secured party's failure to file a required termination statement.

New (bracketed) language at section 9-402(c) (2) and (3)48 would specify the correct method of listing in the financing statement the name of an estate (the name of the trust or, if no name is specified, the name

82. Proposed § 9-403 (5).
84. The broad definition of "purchaser" at proposed § 1-201 (32) would continue to include secured parties. See page 201 of the February 15, 1996 draft.
88. 41
89. Page 130 of the February 15, 1996 draft.
94. Creditors' Interest in R. Thomas Communications, Inc. v. 166 B.R. 846 (S.D. W. Va. 1994), to the extent that when a secured claim is not perfected in accordance with the security agreement, the secured party is entitled to specific performance and for damages for breach of contract of sale under the UCC.