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UCC Article 9 Revisions Confront Issues Affecting Consumer Collateral

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I. Introduction

The Uniform Commercial Code ("UCC") Article 9 Drafting Committee met March 3–5, 1995 in Chicago, Illinois, to discuss the February 10, 1995 tentative draft of proposed revisions to Article 9. The Drafting Committee met again on June 9–11, 1995 in Washington, D.C.[1] to discuss the May 1995 draft of proposals subsequently presented at the 1995 Annual Meeting of the National Conference of Commissioners on Uniform State Laws (NCCUSL).[2] These fifth and sixth meetings of the Article 9 Drafting Committee continued to refine the proposed Article 9 revisions, with an important difference: The Drafting Committee considered specific proposals dealing with secured transaction issues that had been discussed more generally during prior meetings, and had proved so divisive during such discussions.

As discussed previously in this journal,[3] all discussions remain tentative. Nonetheless, at the March and June, 1995 meetings of the Drafting Committee, the Reporters provided specific consumer protection proposals for discussion purposes, without prejudging the ultimate decision as to whether such revisions should be included and, if so, whether such revisions should be integrated or segregated in Article 9.

Some of the proposed consumer protection provisions would significantly alter the enforcement of security interests in consumer collateral. These proposals are described *infra*. The discussions at these meetings highlighted both the difficulty and the importance of these issues. Interested parties should review these matters and make their views known without delay, as decisions are currently being made with regard to many of these issues.

II. Overview of Consumer Issues in Article 9

At the March 1995 meeting Gail Hillebrand of Consumers Union began the discussion of consumer issues by noting that consumer transactions are covered by Article 9, and arguing that the current Article 9 provisions need to work but that some don't work for consumer transactions. She contended that auto finance transactions are a major part of the Article 9 problem, stating that there are an estimated 500,000 auto repossessions each year. Ms. Hillebrand argued that consumers are limited in their ability to pursue their legal rights, as they do not have a continuing relationship with a lawyer or significant bargaining power. She indicated that most of consumer defaults are due to interruption of income, and reiterated the position that creditors often do not seek to maximize the collateral resale price.

Edward J. Hieser responded on behalf of consumer lenders, arguing that consumer protection issues are better treated in consumer credit codes. He disputed the contention that consumers have difficulty obtaining legal representation, noting that consumer litigation is common and seems to be increasing.[4] He noted that default due to interruption of income is still a default which impairs the creditor's recovery. He argued that additional consumer provisions in Article 9 would raise the cost of credit and raise credit underwriting standards.[5]

Mr. Hieser suggested that four tests be met before any new consumer-oriented provisions are adopted as part of Article 9:

1. That there be a *demonstrated* need (not merely reports of isolated cases).
2. That it be clear the proposal will solve the problem.
3. That it be clear the benefits outweigh the disadvantages.
4. That it be clear that Article 9 is the place for a remedy.

At this point Don Rapson proposed that Article 9 expressly recognize that the collateral resale price is a factor to be considered in determining whether the sale is commercially reasonable even if the sales procedure is otherwise satisfactory.[6]

Harry Sigman then asked whether Article 9 should distinguish between consumer passenger vehicles and commercial vehicles. If it is primarily a consumer auto and pickup problem, is a "new and used car" uniform act needed as an alternative to revising and complicating Article 9? Ms. Hillebrand responded that the problems extend beyond vehicles. Jack Burton commented that the Uniform Consumer Credit Code (U3C) is 21 years old and is now somewhat dated in its coverage of certain consumer issues.

It was then asked whether the proposed consumer revisions would raise the cost of credit. The consumer advocates argued that the creditor group had failed to provide evidence that any of the particular proposals up for discussion would increase the cost of credit, although those proposals had been under discussion in the consumer task force for a year or more. Others urged that such a result is self-evident.[7]

Ms. Hillebrand pointed out that the Drafting Committee is being presented with consumer issues in three distinct categories: The first category includes areas where consumer representatives are asking the Drafting Committee to preserve for consumers some existing rights now accorded by Article 9 to all debtors which the revision comtemplates eliminating for commercial debtors. Second, consumer advocates are asking that new pro-creditor changes to Article 9 proposed by the Study Group or Drafting Committee not be extended to consumer transactions where there has been no demonstrated need for them and there is a likelihood of harm to consumers. The third category is enhanced consumer protections to modify the effects of Article 9 in consumer secured transactions. Only the third and final category, Hillebrand stated, contains proposals for affirmative change in Article 9. All of the proposed differences between consumer and commercial rules in the first two categories become necessary, she argued, only because the Drafting Committee is affirmatively reducing debtor rights in certain situations where there is no justification to do so for consumer debtors.

III. Definitional Issues

Attention then turned to the February 10, 1995 Draft. Proposed section 9-105(a)(2) would define "affected obligor" to include those who have a stake in the collateral, *e.g.*, a surety or other person affected by sale of the collateral though not the owner. A primary obligor who does not put up collateral would not be included because such a person is fully liable for the debt (*e.g.*, to the surety) despite any sale of the collateral.

Under proposed section 9-105(a)(8), "debtor" would be defined to include a person who created the security interest *or* to whom the debtor transferred the collateral, *if* the secured party knows that the debtor has transferred the collateral.

Don Rapson and Harry Sigman questioned whether the bench and bar will understand these concepts. The Reporters responded yes, because the concepts are intuitive and would solve several current problems. Other proposed definitions include a proposed section 9-105(a)(5) definition of "consumer debtor"; a proposed section 9-105(a)(6) definition of "consumer obligor"; and a proposed section 9-105(a)(7) definition of "consumer [secured] transactions." The issues involved relate primarily to the question of who receives "notice" under Article 9 Part 5. Harry Sigman asked whether it would be better to provide a separate notice requirement rather than complex definitional provisions. The Reporters agreed to consider this, noting it is difficult to understand the connotations of changes when they relate to numerous other sections. But the Reporters again noted that the problem is already complex and that arguably the proposed revisions would solve it.

The bracketed language at proposed section 9-105(a)(2) is intended to deal with the situation where the secured party does not know of the lack of recourse against an "affected obligor." The objec-

* This article describes specific discussions and debates during two 1995 meetings of the UCC Article 9 Drafting Committee. Nonetheless, this is not intended as minutes of those meetings and does not represent an official record of the meetings. Many of those named in the article have contributed to making this article as accurate as possible, and your author would like to express his appreciation to all of those who reviewed and commented on an earlier draft. Gail Hillebrand, David McMahon, Don Rapson , and Steven O. Weise deserve special mention for contributing substantial improvements to the article, though of course your author is responsible for any remaining errors.

In his capacity as the American Bar Association Section of Business Law Advisor to the Article 9 Drafting Committee, Mr. Weise authors regular reports summarizing the deliberations. To receive copies, contact Mr. Weise at the offices of Heller Ehrman White & McAuliffe, Los Angeles, (213) 244-7831.

1. As at prior meetings, Drafting Committee Chair William M. Burke presided and Reporters Steven L. Harris and Charles W. Mooney, Jr. were present to discuss the latest draft of proposed revisions. For background information on the Article 9 Drafting Committee and the Article 9 revision project, *see* Fred H. Miller, *The Revision of Article 9*, 47 Consumer Fin. L.Q. Rep. 257 (1993); Alvin C. Harrell, *Revising Article 9; Selected Comments on the UCC PEB Study Group Article 9 Report*, 47 Consumer Fin. L.Q. Rep. 385 (1993); David B. McMahon, *Inadequacy of Commerically Reasonable Sales and Deficiency Judgments Under UCC Article 9: An Analysis of Revision Proposals*, 48 Consumer Fin. L. Q. Rep. 64 (1994); Alvin C. Harrell, *Update on Consumer Issues in the UCC Article 9 Revision Project*, 48 Consumer Fin. L. Q. Rep. 68 (1994); Alvin C. Harrell, *1994 Meetings Refine Proposed Article 9 Revisions*, 48 Consumer Fin. L. Q. Rep. 326 (1994); Michael M. Greenfield, *Article 9 and Consumer Transactions: The Need for Revision*, 48 Consumer Fin. L. Q. Rep. 483 (1994); Edward J. Heiser and Robert J. Flemma, Jr., *Consumer Issues in the Article 9 Revision Project: The Perspective of Consumer Lenders*, 48 Consumer Fin. L. Q. Rep. 488 (1994).

2. With the American Law Institute, sponsor of the UCC. The revision process represents a moving target and to some extent these 1995 drafts (and this article) are already out of date, as the Drafting Committee has continued to work and the proposals have evolved accordingly.

3. *See supra* note 1.

4. *See, e.g.*, Maurice L. Shevin, *Chaos in the Consumer Finance Industry in Alabama*, 48 Consumer Fin. L.Q. Rep. 313 (1994).

5. *See also* Alvin C. Harrell, *Disclosure of "Acquisition Fees" in Assignments of Consumer Chattel Paper*, 49 Consumer Fin. L.Q. Rep. (1995).

6. *See also* Donald J. Rapson, *Repurchase (of Collateral?) Agreements and the Larger Issue of Deficiency Actions: What Does Section 9-504(5) Mean?*, 29 Idaho L. Rev. 659 680-703 (1992-93).

7. By coincidence, your author had just read a stock market analysis by a Wall Street brokerage firm that follows the stocks of large consumer finance companies, recommending the shares of these larger companies because the regulatory and litigation burden is driving smaller competitors out of business, thereby reducing competition and driving up the rates on consumer loans. So at least one disinterested observer believes that the legal environment is a factor affecting the cost of consumer credit. It seems likely that legal risks and complexities are a force driving consolidation in the consumer lending business. Presumably, Article 9 should not abet this trend toward consolidation in the industry, and hopefully the Drafting Committee will not ignore this issue. Unfortunately the small lender is probably the most underrepresented group attending meetings of the Drafting Committee.

tion was made that this would give the secured party an easy excuse not to notify, on grounds of not having sufficient knowledge regarding lack of recourse. There was some consensus that the bracketed material should be deleted.

The question was then raised: Is a credit insurer an "affected obligor" entitled to notice? The consensus was yes, since it fills the role of a surety/guarantor. The Reporters agreed to consider the issue with regard to compensated sureties. Under the current proposal such are probably included in the term "debtor." The question was raised: What about a debtor who formerly owned but sold the collateral? Is this a debtor or an "affected obligor"? This party seemed to be included in both definitions. Should it depend on whether the party is primarily or secondary liable? There was a consensus that this person should have a limited right to receive notice but uncertainty as to the best way to achieve the result. It was then noted that a proposed section 9-105(a)(16) "obligor" would be a "person [other than the debtor]..." Therefore, a former debtor who transfered the collateral would no longer be a debtor, but would be an "affected obligor" entitled to notice under Article 9 Part 5 only if known to the secured party.

Under proposed section 9-105(a)(8) of the February 10, 1995 draft, "debtor" would include a transferee of the collateral if the secured party knows of the transfer *and* transferee, even if the transferee is not liable on the debt, and even if the transfer was wrongful. Frank Suarino posed two questions: (1) What if the secured party knows the identity but not the location of the transferee? (2) Does "transfer" include a transfer of possession without title? Responding to the second question, Professor Mooney noted that "transfer" includes transfer of any legal interest *e.g.*, a purchase or lease but not a bailment.

What about third party lessors who buy from troubled debtors and lease to uncreditworthy lessees—would the lessee have a right to notice? This was not resolved. It was noted that a failure to give notice to such a lessee could trigger the section 9-507 penalty and loss of a deficiency, due solely to the debtor's wrongful transfer. The purpose of the proposal is to protect the innocent transferee who will lose his or her equity in the collateral if it is repossessed and sold, but there was concern over the possible impact on innocent secured parties without notice of the transfer. It was questioned whether failure to give notice to such a transferee bars recourse against the debtor under the proposed absolute bar rule.

Other questions were also raised: Should the law protect only a transferee who gives notice to the secured party? Would sending payment to the lender constitute notice? Professor Michael Greenfield urged that the latter rule is necessary, as otherwise consumers would not know of the need to give notice.

Professor Mooney then suggested leaving the proposed section 9-105(16) definition the same, defining "transfer" in a comment, and dealing with the issue of the penalty to the secured party in section 9-507. The secured party taking payments from a transferee would "acquiesce" under section 9-105(a)(16), making the transferee a debtor entitled to notice. This would represent a trap for the secured party who accepts payments without noting the change of debtor. Professor Jim Rogers suggested that these issues should not be resolved using the definition of debtor, because that term is used in so many places.

It was noted that any "knowledge"-based rule is fraught with peril. Professor Mooney agreed, noting that these new efforts to protect transferees have created significant new drafting difficulties for the Reporters.

The definition of "consumer [secured] transaction" at proposed section 9-105(a)(7) would trigger any consumer remedies under the February 10, 1995 draft. Ed Hieser urged the Drafting Committee to leave in the bracketed term "secured" to distinguish these from unsecured transactions and avoid any implication of broader coverage of unsecured debt. Professor Greenfield countered that the transactions subject to the definition will be limited solely to secured transactions by reason of the scope of Article 9, so there is no need to insert "secured" in the definition. Ed Hieser then urged that "secured" be left in because it makes this clear and because "consumer transaction" might be a term used or defined in the contract or other law, causing confusion.

In the definition at proposed section 9-105(a)(7) of the February 1995 draft, the term "personal, family or household purposes" is borrowed from other law. Then the February 1995 draft further defines the scope of the trigger term at subsections (i), (ii), (iii). Both the collateral and the purpose of the loan must be consumer-related in order to trigger the definition. It was also suggested that the term "natural person" be inserted as a limiting factor in the definition. Gail Hillebrand said the initial use of the collateral should govern even if the use or purposes later changed. Professor Greenfield suggested that only the loan purpose and not the type of collateral should be the test, pointing out the "personal, family, or household purpose" standard is a recognized standard in consumer credit.

Professor Rogers noted that all of the stated concerns relate to disposition of the collateral. Why not focus on section 9-504 rather than the definitional provisions, with a focus on the use of the property rather than the purpose of the loan (*e.g.*, a car used by consumer would be covered even if there was a business purpose for the loan). Neil Cohen commented that Article 9 has always focused on the collateral not the debt, *e.g.*, Article 9 already provides special rules for "consumer goods." He suggested that there has always been a focus on consumer goods under section 9-504 regardless of the purpose of the loan, and that the purpose of the loan is a foreign concept under Article 9. Professor Greenfield disagreed.

Professor Mooney then asked whether the Drafting Committee should offer a menu of alternatives. Professor Marion Benfield suggested limiting the choices to two. It was then argued by several creditor representatives that it would be better to exclude consumer issues from Article 9 altogether—that inclusion of consumer issues will add complexity be-

yond need or reason, and that this is unnecessary due to the extensive adoption of separate consumer credit codes. It was noted that the U3C has been unpopular (adopted in only 11 states)—and questioned whether Article 9 should be burdened with this, perhaps making it unadoptable. However, Commissioner Burton pointed out that the U3C goes far beyond anything being proposed for Article 9 so that its lack of adoption is not a fair test of the ability to enact the more modest proposals under discussion for Article 9. It was urged that merely defining the scope of "consumer secured transaction" alone would add great complexity. Ed Smith responded that the revisions may not be enacted in Massachusetts unless Article 9 has consumer provisions because of the strong consumer influence in the Massachusetts legislature. Others opined that the situation in New York is the same.

Don Rapson noted that complex consumer protection revisions could create the potential for substanital class action liability. He suggested instead a focus on fair dealing and deficiency judgment issues affecting consumers, which are the source of most consumer concerns. He also urged that the risk of class actions for consumer protection provisions be limited as is the Truth in Lending Act. Jack Burton and several others then reiterated the view that the revisions will not pass the ALI, NCCUSL and some states without consumer protections. Votes were taken on several alternatives, with the majority favoring an absolute bar of deficiency judgments for transactions below a certain dollar amount.

With regard to the definition of default, there was a consensus that Article 9 should defer to the agreement of the parties; this would represent no change from current law. The consumer advocates argued that some creditors use immaterial defaults as an excuse to repossess collateral. Jeff Turner then asked: why would any creditor do this? David McMahon of West Virginia Legal Services Plan responded that his clients face a practice known as "churning" in which the seller/creditor sells a car, collects a few payments, repossesses, and resells the vehicle.[8] It was proposed that there be an Article 9 definition to limit default in consumer cases to (1) nonpayment and (2) material impairment of collateral. This was generally rejected as being likely to breed frivolous litigation.

IV. Proposed Section 9-507

In the February 1995 draft, proposed section 9-507(b) would provide that where the secured party violates Article 9, the debtor can recover any surplus, except where a deficiency would be barred; *e.g.*, only for violations of sections 9-502, 504, 505 (not, *e.g.*, for a section 9-503 wrongful repossession). If a deficiency is barred for any other reason, the debtor could also recover statutory damages/surplus in addition to the bar of a deficiency. It was urged that section 9-503 be added to proposed section 9-507(b).

Under proposed section 9-507(c), the secured party has the burden of proving compliance; if the secured party fails, under section 507(c)(3)(i) the secured party's claim to a deficiency judgement is barred. In other cases, the deficiency would be reduced by the amount of the loss caused by the violation.

The purpose would be to use the absolute bar rule as a proxy for damages if Part 5 is violated, in order to avoid litigation over actual damages, by using the bar as an exclusive Part 5 remedy in most consumer cases. An objection was raised: If the secured party commits an egregious violation, should the bar be the debtor's only Article 9 remedy? This would, for example, exclude punitive damages. A vote of the Drafting Committee rejected Don Rapson's suggestion that the remedies for violating Part 5 should be limited to those set forth in Article 9, *e.g.* section 9-507, and that relief outside of Article 9 should be barred.

Proposed section 9-507(c) would preserve the rebuttable presumption rule for non-consumer cases; only consumer cases would be subject to the absolute bar rule. Ed Hieser argued that this would take Article 9 far beyond existing consumer credit codes.

A question was raised: Would the absolute bar rule raise required down payments or the cost of consumer credit? It was argued that this cannot be proved though, as noted *supra*, to many this point seems obvious. Nonetheless, several of those present argued that this would not affect lender behavior or the cost of credit. They pointed out that several major states have the absolute bar rule in place—often not limited to consumer credit—and yet credit remains available to consumers in those states. Others argued that an absolute bar rule would diminish the incentive of consumer borrowers to pay the debt once the value of the collateral falls below the loan balance, thereby increasing defaults and inevitably affecting the terms of consumer credit.

Upon a vote, a majority of the Drafting Committee favored an absolute bar rule coupled with a cap on the amount that could be barred, but there was also significant support for codifying the current rebuttable presumption rule. Don Rapson then queried whether contractual provisions governing secured party recourse against a dealer in a consumer secured transaction would allow the dealer to get the advantage of the loss of deficiency against the consumer. Professor Mooney suggested that this should be resolved in the dealer recourse contract. Don Rapson took the position that Article 9 should not give the dealer or any commercial secondary obligor the benefit of the absolute bar rule.

Professor Mooney then raised another question: If there are multiple items of collateral, should an error with regard to a one item of collateral wipe out the entire deficiency? Wipe out the claim to the remaining collateral? Proposed section 9-507(c)(3)(ii) would wipe out personal liability but preserve recourse against other collateral, subject to a rebuttable presumption of commercial reasonableness, so the debtor could still object to a low resale price. Should a secured party in a consumer transaction, who is subject to the absolute bar rule, be able to

8. This practice is noted in M. Hudson, IRE Journal, Jan.-Feb., 1995, at 9.

pursue other collateral under 9-507(c)(3)(ii)? The vote on the Drafting Committee was unanimous that this should be allowed.

It was noted that the absolute bar rule does not have any impact on the actual amount of the creditor's liability unless this remedy would exceed the statutory penalty. The Drafting Committee then rejected placing any limitation on a secured party's class action liability in Article 9.

Proposed section 9-507(h) (attorney fees) would allow a prevailing *consumer* (only) to recover attorney fees. Ed Hieser said that attorney fees either should not be addressed or should apply equally to both sides. Harry Sigman noted a California statute that makes a unilateral attorney fee provision in a contract mutually applicable. Ed Hieser said this would be better than the current draft. A vote of the Drafting Committee favored leaving out attorney fee provisions entirely. However, upon a subsequent vote there was very little support for keeping the statute silent, as under current law.

Instead, there was considerable support for a rule that would allow a prevailing consumer to recover attorney fees unless the creditor couldn't get them, in which case it would be optional with the court. If a creditor has a contractual right to an attorney fee, this would be made reciprocal by the statute. There was also significant support for this rule with additional discretion to the court to award attorney fees to the consumer if the creditor's right was unenforceable. There was virtually no support for a rule to bar attorney fees for both sides, or to mandate an award for either side that prevails.

V. Proposed Section 9-501

With regard to proposed section 9-501(d) in the February 1995 draft, Ed Hieser urged elimination of the proposed distinction between "reasonable" and "manifestly unreasonable." Manifestly unreasonable was intended to suggest more shocking behavior. Ed Hieser also said there should be no difference on this issue between consumer and commercial cases. Professor Mooney said the difference was due to the use of adhesion contracts in consumer cases, justifying greater scrutiny. The response was that the term "reasonable" already includes these considerations. Several argued that the bifurcated standard is a bad idea as a policy matter, absent compelling reasons not yet articulated. Brad Smith supported this and argued that all parties should be subject to a manifestly unreasonable standard. A proposal to adopt the "manifestly unreasonable" standard for all cases passed in a close vote but a substantial minority voted to keep the bifurcated standard in the current draft. The Reporters agreed to reconsider this issue.

VI. Proposed Section 9-504

Should the secured party have the option to repair/recondition the collateral prior to sale? In the February 1995 draft of proposed section 9-504(a) this was left in brackets for the NCCUSL and the ALI to consider.

Under the February 1995 draft, a disposition of collateral would include a warranty of title, possession and quiet enjoyment, unless disclaimed in writing by specific language before the sale. Harry Sigman objected to language requiring a "specific" disclaimer, as that might require more than the customary Article 2 disclaimers. The Reporters agreed to conform this to the Article 2 revisions.

Under proposed section 9-504(b)(2), there would be no duty to apply non-cash proceeds until liquidated, but if the secured party wanted to give immediate credit it would have to do so in a commercially reasonable manner.

Under proposed section 9-504(b)(3), there is a question regarding who gets the surplus if collateral is repossessed from a transferee. The original debtor or the new owner? Harry Sigman suggested interpleader, others suggested a statutory "safe harbor" for the secured party who refunded the surplus to the debtor shown on the secured party's records.

Under proposed section 9-504(c), there would be a good faith purchase rule protecting third parties who receive cash proceeds in good faith and without notice that they are subject to a senior claim. Ed Smith raised the question: Should this be extended to noncash proceeds? The Reporters agreed to consider this and suggested an inclination to expand the rule to cover noncash proceeds.[9]

Under proposed section 9-504(d) the Reporters rejected using a "laundry list" of commercially reasonable or unreasonable factors, in order to avoid unnecessary complexity. As a result this concept was largely left as is. Consumer advocates sought more guidance and definition of the concept of "commercially reasonable," pointing out that they commonly see such ineffective sales methods as a little advertised auction on the courthouse steps, a sign in the lobby, or a phone call to three local dealers, all of whom are customers of the lender. A vote of the Drafting Committee rejected this and reaffirmed the Reporters' approach.

Jack Burton noted that the proposed Article 2 revisions are including specific guidelines for resale remedies. Consumer advocates claim that ineffective sales are common, therefore more specific allowable factors are needed to govern collateral sales. Chairman Burke offered to put this in a Comment. Frank Suarino pointed out that independent finance companies and small banks don't have the options that GMAC or a dealership may have, *e.g.* selling repossessed collateral at retail. He argued that a sale in a bank parking lot, after reasonable advertisement efforts, may be the best option for a small bank and its customers. It was noted that allowing the courts to second guess the parties on this would generate lots of litigation. It was noted again that, under proposed section 9-504(e), any party with a property interest in the collateral would receive notice of the sale ("the debtor or any affected obligor"). In the February 1995 draft there is also a duty to give notice to any other second party who held a security interest 20 days prior to the notification date, that was perfected by filing—this language remains tentative and is under continuing consideration.

9. *See also infra* Part XIII.C.

Under proposed section 9-504(f), a debtor *other than a consumer obligor* may waive the right to prior notification of disposition. For a consumer such a waiver would be ineffective unless the secured party proves by "clear and convincing evidence that the signer understood and expressly agreed to its terms." Ed Hieser noted that this would provide a virtually impossible standard for creditors to meet. Brad Smith sought a standard based on objectively demonstrable evidence rather than a consumer's state of mind. Consumer advocates countered that consumers don't read or understand the contracts they sign. This raises fundamental problems for a legal regime based on contract law. Professor Fred Miller argued for a standard based on evidence of an express agreement. Ed Hieser noted that any consumer should be able to understand a simple waiver statement. Upon a vote, the Drafting Committee favored Professor Miller's proposal that, for a consumer obligor, written waiver after default should be effective if the secured party proves that the signer *expressly* agreed. The Reporters then agreed to give consideration to expanding this rule to cover all obligers—there was no opposition to this.

Proposed section 9-504(g) in the February 1995 draft would provide a statutory notice of sale period: 21 days or more in consumer cases; 10 days in other cases. These time periods would be "safe harbors" and a shorter time could be reasonable but the secured party would have the burden of proving this. Both consumer and creditor advocates argued against set time periods, with the creditor representatives preferring the "commercially reasonable" standard in current law, and the consumer advocates preferring that standard to a 10 day safe harbor. The Reporters agreed but the commercial lenders wanted the safe harbor left in for commercial transactions. The consumer lenders said it would be a mistake to provide a safe harbor for commercial but not consumer transactions. Professor Benfield questioned whether consumers always need more than ten days notice. David McMahon responded that ten days is not enough time, due to mailing delays, persons whose jobs require travel, and the need to act on the notice by trying to induce buyers or finding the funds to bid. The committee voted to reject the 10 day safe harbor for consumer transactions. However, a series of votes to select between a a 15 day safe harbor, a 21 day safe harbor, or to retain the current Article 9 standard of reasonable time were inconclusive. This issue was not resolved.

The discussion then turned to proposed section 9-504(i)—a safe harbor "notice of disposition" form. It was questioned whether such a form is needed. The consumer representatives stated that they had not sought to add a safe harbor notice form, but that if such a form were added to the UCC, the one which had been proposed in the draft was too sketchy for consumer transactions. Ed Hieser said the notice provided for in proposed section 9-504(h) for commercial cases is sufficient; there is too much potential for error in the proposed consumer form, creating a likelihood of technical error that could lead to a bar of deficiency judgment and other penalties, resulting in unnecessary risks. He argued that a better approach would be to use the commercial form at proposed section 9-504(h) with the addition of a warning clause regarding the deficiency but excluding the more complex disclosures and calculations in proposed section 9-504(i). Michael Ferry supported the more extensive disclosure requirement; others argued that a shorter, simpler form would be more likely to be read and understood by consumers. Ed Hieser suggested leaving out the loan data numbers and providing a phone number to call for more information. Frank Suarino suggested this would lead to more workouts and would encourage communication between the creditor and debtor, but some consumer advocates disagreed, arguing that their clients already experience difficulty in obtaining information by phone from creditors.

The discussion seemed to be moving toward a consensus that the notice need not include specific calculations, and Chairman Burke asked the consumer and creditor groups to consult, but several consumer advocates then argued again that the notice should include specific amounts. Professor Miller then raised issues and comparisions regarding current requirements under other law and current industry practices.

Ed Hieser agreed that the notice should include notice of the right to redeem and notice of the risk of a deficiency, with a telephone number. David McMahon suggested that there may be a problem with creditors providing fraudulent payoff information in order to discourage debtors from redeeming the collateral.

Proposed section 9-504(j) would require post-disposition notice to the debtor regarding calculation of the deficiency or surplus. David McMahon supported this on grounds the consumer needs to know the amount of the resale price, rebate of unearned interest, etc. Ed Hieser objected that the consumer can request this information before or during a lawsuit for the deficiency, and Article 9 should not burden creditors with the cost of this new obligation in every case. Several commentators urged that if this is a good idea for consumer debtors it is also needed for small business debtors, and consumer lenders should not be singled out for disparate treatment. The Drafting Committee voted in favor of the proposed notice requirement in consumer transactions. A vote was then taken on whether it should also be required for commercial lenders: A majority of the Drafting Committee voted to extend this notice requirement to commercial transactions.

Proposed section 9-504A would prohibit churning (as described previously at the meeting by David McMahon), where collateral is purchased by a party related to the secured party at an Article 9 sale for purposes of determining the deficiency, then resold within a short period of time at a price much higher than the Article 9 sales price. This revision would require that any surplus received in excess of the initial sales price be credited or paid to the debtor. It was pointed out that if the target is collusive sales, it will be easy to circumvent by manipulating the time and sale price of the resale. The consumer creditors group urged that collusive sales are commercially unreasonable under current law and that this is a more effective standard. The Drafting Committee then voted to reject the proposed revision. However, it indicated a willingness a consider another anti-collusion proposal in the future if such a proposal did not immunize some conduct as a by-product of defining other conduct as prohibited.

The Drafting Committee then discussed the possibility of a similar proposal applicable to all collateral sales (commercial and consumer). Professor Mooney suggested that a comment on collusive sales would be a better approach.

Proposed section 9-504A is also an election of remedies provision that would bar a deficiency judgment in repossession cases below a stated dollar amount, in effect requiring the lender in such cases to choose between repossession and pursuit of a deficiency judgment.[10] Professor Mooney noted that the likely effect of this provision would be to require consumers to provide more collateral in such cases, to compensate for loss of the deficiency; others argued that it would also diminish the credit available to and raise credit costs for low income and marginal borrows. Professor Miller urged that this is a social policy decision that may affect the cost and availability of credit.[11] The Drafting Committee favored this provision by a margin of one vote.

VII. Proposed Section 9-505(i)

This provision of the February 1995 draft would allow partial strict foreclosure in commercial cases, based on a calculation of the "minimum collateral value" based on a "qualified report" determining such value, if the debtor consents. The question was raised: Should this be allowed for consumers? The February 10, 1995 draft would allow it with the safeguards that the amount credited had to be an amount found in a standardized price publication. The consumer advocates favored this as a means to encourage use of standardized price quotations as the basis for deficiency judgments; creditor representatives were concerned that this might spill-over to determine commercially reasonable prices in other cases. It was argued that variations in vehicle condition render such price guidelines worthless in many cases, and that repossessions tend to be in below-average condition. The consumer advocates argued that if the standard quotation price is higher than the price at an actual sale, the proposal would in effect allow the secured party to buy his or her way out of a commercial reasonableness battle by accepting a lower deficiency based on the standard quotation price. The consumer creditor representatives indicated that they would prefer to fight the commercial reasonableness battle rather than risk widespread acceptance of standard price quotations as the basis for a deficiency judgment. The Drafting Committee voted to reject a proposed safe harbor for the use of standard price quotations in determining the deficiency judgment. However, in the February 10, 1995 draft, consumer collateral not subject to standard price quotations could be accepted and retained by the secured party only in full satisfaction (rather than partial satisfaction) of the debt. This was the result of a vote at an earlier meeting to reject the extension of partial strict foreclosures to consumer secured transactions.

VIII. Section 9-506

Proposed section 9-506(b) of the February 1995 draft would provide for a right of reinstatement in consumer cases, by tender of: (1) the amount due at the time of tender (without acceleration) including delinquency, default or deferral charges plus legal expenses, and (2) perhaps a "performance deposit" to compensate for the lender's increased risk of loss or damage to the collateral. Gail Hillebrand urged that the risk of damage by the debtor could be handled by a provision allowing the creditor to refuse reinstatement where there is a reason to fear such damage. In response it was argued that this would be too vague and inadequate as a safeguard, and would likely breed litigation regarding the reasonableness of a creditor's usual concern that it will never see the collateral again.[12] It was argued that this would be an open invitation to the dishonest debtor, who lost his or her previous gamble to avoid repossession, providing a second opportunity to escape with the car or otherwise destroy or wrongfully dispose of the collateral. However, the Drafting Committee discussion focused almost entirely on secured parties who do not act in good faith, rather than debtors who act in bad faith in an effort to "work" the system and avoid payment of their debts. The Drafting Committee voted seven to four to include a reinstatement provision in the draft.

IX. Good Faith

At the March 1995 meeting Don Rapson distributed a proposal urging that the broader standard of "good faith," incorporating "reasonable commercial standards of fair dealing," recently added to Articles 2, 2A, 3, 4, 4A, and 8,[13] also be included in Article 9. The result would be to require "reasonable commercial standards of fair dealing" in addition to "honesty in fact" in every aspect of Article 9 transactions, including drafting of security agreements and enforcement of security interests. However, it would be made clear that priority issues are not to be impacted by the parties' good faith. There was considerable concern about the

10. *Cf.* U3C § 5-103. But this is different because the proposed Article 9 provision would affect *all loans* with a balance *at the time of default* below a certain amount, rather than being based on the original loan amount. The Reporters agreed to reconsider this trigger point.

11. *See supra* Part II. *See also* discussion this text *supra* at Part IV.

12. A creditor who declined to allow reinstatement after a difficult and costly repossession, for fear that the debtor would be even more vigorous in seeking to frustrate a subsequent repossession, could be expected to be hit with an allegation that the creditor unreasonably cut off the debtor's statutory right to reinstate. An aggressive consumer could allege loss of employment, career, family, peace of mind, and perhaps artistic talent as a basis for a claim to significant consequential damages. As a practical result, creditors could be forced to return collateral to dishonest debtors despite the real prospect that the collateral would be lost as a result.

13. *See* UCC §§ 2-103(1)(b), 2A-103(3), 3-103(a)(4), 4-104(c), 4A-105(a)(6), 8-102(a)(9); Donald J. Rapson, *Why Revised Articles 5 and 9 Should Incorporate a Standard of "Good Faith" That Depends on "Honesty in Fact," and "Reasonable Commerical Standards of Fair Dealing,"* UCC Bulletin (Clark Boardman, April 1995).

potential impact of this proposal, but there was also extensive support expressed.

X. Filing Issues

Proposed section 9-402(a) in the February 1995 draft would authorize a financing statement to reflect the name of the secured party's agent rather than the secured party, to facilitate loan participation arrangements. Proposed section 9-402(b) would specify that a failure to indicate the representative capacity does not affect the sufficiency of the financing statement.

Proposed section 9-402(a) would also provide that a description of collateral as "all assets" or "all personal property" is sufficient. The requirement that the debtor sign the financing statement would be deleted. To protect debtors from wrongful filings, section 9-402(*l*) would provide for a statutory penalty and actual damages. The possibility of a good faith or bona fide error defense to the statutory penalty was considered but rejected.

The February 1995 Draft would eliminate the current statutory form of a financing statement, and at the March 1995 meeting the Drafting Committee discussed whether a substitute form should be included. Harry Sigman argued that this is the only way to achieve uniformity nationwide. The statutory form would be applicable only to paper filings, and would not affect electronic filings. There was a unanimous vote in favor of this proposal.

Proposed section 9-402(d) would specify that use of a trade name is irrelevant. The Drafting Committee considered but did not decide whether trusts should be covered by a special rule.

Under proposed section 9-402 a filing would be seriously misleading if a party could not find the filing under a search of the debtor's correct name; if a search under the correct name would find the filing, the filing would be sufficient.[14]

Under proposed section 9-402(i), alternative A, a secured party could add or release collateral in a financing statement or otherwise change the financing statement by filing an amendment that identifies the original financial statement by date and file number. If an amendment adds collateral it would be effective as to the added collateral only from the filing date of the amendment. Proposed alternative B is similar except that it would require filing of an amended financing statement instead of an amendment to the financing statement. There was some preference for alternative B but it was agreed to leave both options open.

Under proposed section 9-402(j), the rules in Article 9 governing a "financing statement" would also apply to amended financing statements and continuation statements. Under section 9-402(*l*), an amendment would have to be authorized by the debtor, with a penalty provision for violations.

Proposed section 9-403 deals with what constitutes a record. Failure to include required information would not preclude perfection if the financing statement is accepted for filing, but if the filing is properly rejected there would be no perfection. Proposed section 9-403(b) would provide bases for refusal by a filing officer to accept a financing statement for filing. Rejection for any other reason would make the filing officer liable for a statutory penalty and actual damages, under proposed section 9-402(d). Section 9-402(e) would require the filing officer to give notice of a rejection for filing within seven days, again with a statutory penalty and actual damages for violation. There was a consensus that the filing officer penalty provisions should be deleted. Section 9-402(f) would reverse current section 9-402(2) to provide for lapse after five years even if the debtor is in bankruptcy (or other insolvency proceeding).[15] Section 9-402(g) would extend the "window period" for filing a continuation statement, from six months to a period of one year.[16]

XI. Certificate of Title Choice of Law

A. Basic Choice of Law Rule: Proposed Section 9-103(c)(4)

Certificate of title and related issues were considered by the Article 9 Drafting Committee during its meeting in Washington, D.C. on June 9–11, 1995. This meeting considered the May 1995 draft later presented at the July 28– August 4, 1995 NCCUSL Annual Meeting (1995 Annual Meeting Draft).

Perfection, the effect of perfection and the priority of competing security interests would be governed by the law of the state whose certificate of title covers the goods. The point at which goods "become covered" by a certificate of title is defined at proposed section 9-103(c)(2)(ii). This could occur before a certificate is issued by the state, for example at the time an application for a certificate is submitted. Under proposed section 9-103(c)(3), no other connection with that jurisdiction would be needed to trigger a choice of that state's law. This would allow the parties to choose the state of registration and perfection.

If more than one state has issued a certificate of title, the latest valid title would control. The proposal would eliminate the factor of "registration" because that term is ambiguous and multiple state registrations are common.

If the goods are located in a state where such collateral is not covered by a certificate, but the debtor applies for a certificate of title in another ("second") state, the second state's law would ap-

14. *See also* Jerald M. Pomerantz, *Trade Name Filings Under UCC Article 9: Anatomy of a Nonuniform Amendment*, 47 Consumer Fin. L.Q. Rep. 34 (1993); discussion *infra* this text at Part XIII. J.

15. This would address a number of problems. *See, e.g.*, William E. Carroll and Alvin C. Harrell, Casenote, *The Care and Feeding of Continuation Statements*, 44 Consumer Fin. L. Q. Rep. 144 (1990).

16. This would also address numerous problems. *See, e.g.*, William E. Carroll and Alvin C. Harrell, *UCC Section 9-403 and the Continuing Saga of Continuation Statements*, 48 Consumer Fin. L. Q. Rep. 88 (1994).

ply. This would represent a potential trap for lenders in the first state. Frank Suarino suggested an initial or "threshold" choice of law rule based on the state of the debtor's location (similar to the proposed new national filing rule), solely for purposes of determining whether a certificate of title is permissible. If so, a certificate of title could be issued by any state. The threshold question would be whether the goods *would be* covered by a certificate of title in the state where the debtor is located. Professor Mooney noted that this would be asking a hypothetical question with regard to the scope of the law of the debtor's jurisdiction. Frank Suarino responded that it would be a simple question to determine if such goods are covered by a certificate of title in that state.

Professor Mooney then proposed to allow perfection by a national (but not federal) filing that would be effective as against lien creditors, while still providing certificate of title perfection for the protection of buyers. This would create a regime similar to that for chattel paper.

The question was posed: Suppose the debtor took the collateral from a title certificate state, with a "clean" certificate of title, to a filing state, then granted a security interest perfected by filing in the second state, while the goods remained titled under the law of the first state. Would the security interest filed in the second state be unperfected? Yes, under the current draft, because choice of law would be governed by the law of the state that issued the certificate of title. This could represent a potential trap for lenders in the second state. The Frank Suarino and Professor Mooney proposals noted above would address this problem. After discussion the vote favored Professor Mooney's approach.

Another question was raised: What if Professor Mooney's proposal is adopted, creating a dual system that allows national filing as well as certificate of title perfection, and there is perfection on a certificate of title but no filing? The consensus was that this should be considered perfection, that filing should be a supplemental option to protect against lien creditors in the event the certificate of title lien entry system fails to do so.

Professor Mooney then posed a question: Should the revisions require certificate of title perfection as the exclusive method for *vehicles*, since this is universal, then apply the proposed "dual" rule, allowing perfection by filing as a supplemental alternative, for other certificate of title goods? A vote on the Drafting Committee was almost evenly split.

When would "coverage" of a state's law end? Under proposed section 9-103(c)(4)(i), coverage would end when the certificate is "surrendered" in an effort to get a new certificate, or under proposed section 9-103(c)(ii) when the goods become "covered" by another certificate from another jurisdiction.

When "coverage" ends, the proposed section 9-103(c)(5) four month rule would be triggered. Section 9-103 would no longer refer to "removal" of the collateral from the state because the goods may not be in the state that issued the certificate of title. A new four month rule would apply for four months after the goods "become covered" by the law of the new state. Frank Suarino noted that a lender in the first state would have no way to know the title was transferred (*e.g.*, in cases of fraud). It was noted that Professor Mooney's national filing rule would help address this problem, because a security interest perfected by a national filing would continue to be perfected as against lien creditors in the second state. In addition Frank Suarino proposed that the security interest perfected in the first state should be merely subordinated to innocent purchasers in the second state (while not being subordinate as against a lien creditor), rather than being completely unperfected as a result of the new choice of law in the second state (since lack of perfection would unnecessarily cause loss as against virtually everyone). Two votes were taken and again Professor Mooney's proposal was favored. After four months the security interest would ("expire") *retroactively* and be deemed to have been unperfected "at all times prior thereto," rather than only "since the removal." Again it should be noted that Professor Mooney's proposal for a supplementary national filing system would ameliorate this risk, at least as against lien creditors.

As noted *supra* at Part X, tolling by reason of the debtor's bankruptcy would be eliminated (section 9-403); the secured party would have to get relief from the automatic stay and reperfect. The Drafting Committee has not specifically dealt with duplicate certificate of title issues at section 9-103, because the problem is not limited to interstate situations.

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

Proposed section 9-103(c)(6) is a substantive priority rule. Professor Harris questioned whether this should instead be in Article 9 Part 3. The proposed rule would provide priority in the following circumstances upon purchase of collateral in reliance on a *clean* certificate of title in the second state: (1) a buyer for value who takes possession without knowledge would take priority (this would be an expansion of current law beyond protection of consumer buyers); and (2) a *lender* who relies on a clean certificate title also would be protected (*e.g.,* against a prior security interest or after acquired property clause or other prior claim perfected in another state). This would provide protection for such parties *even during* the four month grace period. For example, a buyer or subsequent lender could prevail where the debtor takes the collateral from a filing state to a title state. Of course if the first lender had possession of the collateral the new buyer or lender would fail the innocent purchaser test due to its failure to examine the collateral, but this would not help most lenders. Retention of the certiicate of title would help, but this is unlikely in a filing stte, and in any event would not be foolproof. The Drafting Committee then considered three options: (1) a proposal to revise section 9-103(c)(6) to reincorporate an absolute four month rule—the first secured party would win if the security interest was reperfected within four months; (2) a proposal to have section 9-103(c)(6) return to current parameters to protect only non-dealer buyers; and (3) a proposal that a "clean" certificate not be required for a buyer to prevail. Upon a vote the second proposal was favored.

C. Proposed Electronic Search System

Professor Mooney then proposed development of model provisions, possibly outside of Article 9, to allow a national electronic search/retrieval system and to reform certificate of title systems. The consumer representatives noted that it is essential that this new system not eliminate notation of the security interest on the certificate of title, since that is the only notice consumers receive of the existence of a security interest. They suggested it would be inappropriate and expensive to expect a consumer to check with a private filing system for the existence of a lien before purchasing a car on a weekend or late in the evening. Small banks and other lenders may share this concern. The American Bar Association UCC Committee Task Force on State Certificate of Title Laws was asked to consider and report on this proposal. Your author is chair of this Task Force and solicits input from interested parties.

D. Miscellaneous Issues *re* Certificates of Title

1. Attachment of Security Interests

The 1995 Annual Meeting Draft provides special rules for attachment regarding certificate of title goods, dealt with in the underlined portion of proposed Official Comment 3 to section 9-203 (page 64 of the 1995 Annual Meeting Draft).

2. Section 9-302(a)(4)

Proposed section 9-302(a)(4) would clarify the relation between automatic perfection for consumer goods and certificate of title goods. Also, filing for perfection would be distinguished from filing for priority purposes. There was a consensus to move this to an Official Comment.

3. Section 9-302(c)

Proposed section 9-302(c)(3) appears at pages 72-3 of the 1995 Annual Meeting Draft. Professor Harris noted that this provision should be unneeded due to the choice of law rule in proposed section 9-103. Reference to other state law is unneeded here because the forum's law will refer to substantive law from the other state. The consensus was to eliminate this provision.

4. Section 9-302(d)

Proposed section 9-302(d) (page 73 of the 1995 Annual Meeting Draft) provides that compliance with the requirements for certificate of title perfection is equivalent to perfection by filing for purposes of other Article 9 provisions. This is consistent with the functional test at current section 9-102. An explanation appears at page 89 of the 1995 Annual Meeting Draft (Comment 11 to proposed section 9-306).

5. "Gap" Issues

Since the law of the second state ("State B") will apply upon application for a certificate of title, if State B law says there is no perfection until a certificate of title is issued, there will be a gap between the choice of State B law and perfection under the law of State B. During this gap period, the security interest would be perfected in State B by a certificate of title lien entry in the prior state ("State A").

6. Name of Secured Party on Certificate of Title

Proposed section 9-408 (page 150 of the 1995 Annual Meeting Draft) deals with the situation where the secured party's name appears on the certificate of title but not as a lien entry, *e.g.* the secured party appears as owner or "legal owner." Proposed section 9-408 would supersede the state's title certificate law to allow perfection by the secured party's name appearing anywhere on the certificate of title using any of the listed terms.

7. Assignees

Under proposed section 9-302(b) (page 72 of the 1995 Annual Meeting Draft) an assignee would not need to do anything to continue perfection. This would not override a contrary state law but would eliminate any Article 9 argument that additional action is needed under Article 9. This would also apply where the record lien holder becomes an agent of the assignee.

The question was raised: Can a secured party with a filing or lien entry combine with or assign this to another lender with an unperfected security interest so as to create retroactive perfection? The consensus was no: Proposed section 9-302(b) only permits assignment of a *perfected* security interest.

8. Short Term Leases

If the collateral is inventory while on the dealer's lot, then becomes consumer goods while leased, the consensus was that the lender must perfect under both categories.

XII. The Federal-State Law Relation

A. Introduction

Professor Mooney began this discussion by noting the Code's minimalist approach. Many areas of concern involve intellectual property and the problem of unnecessary federal preemption—*i.e.*, more federal preemption than is needed to serve the federal interest. One possible solution is, of course, reform of federal law. In the meantime, the proposed Article 9 revisions are directed at working with federal law of whatever kind, and are designed seek the maximum reach of Article 9 to the extent not preempted.

B. Proposed Section 9-104(a)

Proposed section 9-104(a) (page 27 of the 1995 Annual Meeting Draft) alternative A would delete current proposed subsection (a) because a state cannot affect the extent of federal preemption, and to bar an inference of any greater Article 9 concession; proposed alternative B would restate the current list of excluded transactions as a mere educational tool without conceding any new preemption (emphasizing deference to federal law only "...to the extent..." of preemption). Harry Sigman proposed adding "only if and to the extent of" federal preemption. This was favored by the Drafting Committee. There is a basic desire not to extend the deference of state to federal law beyond the extent of federal preemption, *i.e.*, to have Article 9 apply to the greatest extent possible. The consensus favored alternative B as revised by the addition of Harry Sigman's language.

C. Filing Exceptions

Proposed section 9-302(c)(page 72 of the 1995 Annual Meeting Draft) recognizes that the exceptions to perfection by filing of a financing statement only apply where the federal filing is the *exclusive* means of perfection under federal law.

Hope was expressed that in the future federal lawmakers will be more specific about the relation and impact of federal law on important state law issues.

D. Title Clearing Provisions

The October 1994 draft included a proposed section 9-504(k) "title clearing" rule, contemplating a means to clear the title to collateral through the title registration and certification system. The secured party could get legal title in order to transfer title to a buyer, without the secured party's title being an Article 9 "disposition." This was inadvertently removed from the 1995 Annual Meeting Draft but there was wide support for inclusion because the ability to transfer title at the disposition sale or auction will increase marketability and the sale price.

XIII. Review of Selected 1994–1995 Issues at the June 1995 Meeting

A. Introductory Issues

1. Proposed Section 9-105(a)(2) "Affected Obligor"

"Affected obligor" would be defined essentially as a secondary obligor. There is no recourse against such by the debtor. Proposed section 9-105(a)(22) defines "obligor" as a person who owes an obligation or is otherwise accountable for the obligation. Proposed section 9-105(a)(10) defines "debtor" as a person with a property interest (not a security interest) in collateral, whether or not the obligor, and would include the seller of accounts, chattel paper or general intangibles.

2. Exculpatory Provisions

Under the 1995 Annual Meeting Draft a secured party owes no Article 9 duty to the debtor or an affected obligor unless the secured party knows the identity and how to communicate with such party. The secured party would not be liable under proposed section 9-507 to a party unless the secured party knows that party is a debtor or affected debtor, knows that person's identity and knows how to communicate with such party.

3. Deletion of Existing Section 9-112

Existing section 9-112 would be deleted.

B. Proposed Section 9-105(a)(3)

Under the 1995 Annual Meeting Draft a person "becomes bound" as a debtor by a security agreement when (1) by operation of law or contract the security agreement is effective to create a security interest in the person's property, or (2) a person becomes obligated under other applicable law for obligations of another person, including a security interest (*see also* proposed section 9-402).

Consider also proposed section 9-312(f) alternative A: The time when a new debtor "becomes bound" by a security agreement entered into by a prior debtor is deemed to constitute the time of filing for purposes of the priority rule at proposed section 9-312(h). Alternative A means that a secured party whose debtor acquires another debtor will not be subordinate to the acquiree's secured parties. As against a secured party of the acquiror, the secured parties of the acquiree will be deemed to have filed as of the time the acquiror becomes bound by the acquiree's security interest.

Alternative B would provide that a security interest perfected by a filing that is effective solely under proposed section 9-402A(a) and (b)(1) (page 128 of the 1995 Annual Meeting Draft) against a new debtor (*e.g.*, the acquiror, by reason of the acquisition) is subordinate to a security interest perfected in another manner. Proposed section 9-402A provides that (a) a filed financing statement is effective against a new debtor who acquires rights in that collateral, but (b) if a financing statement under (a) is seriously misleading as regards the new debtor: (1) the financing statement is effective only as to collateral acquired by the new debtor before and within four months after the new debtor becomes so bound, and (2) the financing statement is not effective as to collateral acquired by the new debtor after four months unless an amendment to the financing statement renders the financing statement not seriously misleading and is filed before the end of the four months. Alternative B provides a more specific subordination rule with a four month grace period.

C. Section 9-308A—Transferees of Funds from Deposit Accounts

If the transferee of funds does not know at the time of transfer that the transfer is wrongful as to the secured party, the transferee would not be liable to any person on any legal or equitable theory and takes the funds free of prior security

interests.[17] Some opposed limiting this rule on the basis of knowledge, while others urged an exclusion from liability for collecting banks.

D. Section 9-104(g) (Insurance) and Section 9-104(k) (Tort Claims)[18]

Under proposed section 9-104(g), Article 9 would not apply to a direct interest or claim in an insurance policy covering healthcare costs, injury or disability of an individual, loss of income or employment, or funeral or burial costs. This would bar only a direct Article 9 security interest in insurance, though a proceeds claim could still be traced into insurance proceeds.

Proposed section 9-104(k) provides that Article 9 does not apply to a transfer by an individual of any tort claim for damages from injury to an individual. However, proceeds of a tort claim for damage to the collateral would be specifically treated as proceeds of the security interest. At this writing these issues remain open and subject to discussion, though there appears to be some hesitancy to expand the scope of the reform process in these controversial areas.[19]

E. Sales of General Intangibles

The 1995 Annual Meeting draft brings sales of general intangibles into Article 9 but allows the parties to "opt out." There was concern that selective opting out at various stages might create an inconsistent pattern of inclusions and exclusions. As a result this area remains subject to review.[20]

F. Proposed Section 9-115

The Reporters noted the possibility that proposed section 9-115 could be "unpacked," with its rules being distributed among other proposed sections of Article 9. The relationship to proposed sections 9-117 and 9-305A was considered. It was also noted that support for including deposit accounts in Article 9 is lukewarm, and there is opposition to inclusion of consumer deposit accounts, while the inclusion of investment securities is less controversial, so that treatment of these categories is diverging despite their similarities and the generally admitted desirability of parallel systems.[21] The Drafting Committee seems to favor inclusion of commercial deposit accounts in Article 9 by a slight margin; if such accounts are to be covered, perfection by filing is heavily favored. There does not appear to be significant support for including consumer deposit accounts in Article 9. If only consumer deposit accounts are to be excluded, a new definition will be needed. The Reporters agreed to work on this.

G. Priority Rules for Instruments

The current draft provides a unitary rule for chattel paper at proposed section 9-308, as opposed to the current bifurcated rule. Priority would depend on purchase in the ordinary course of business, without knowledge, for value, and taking possession. Compare the rules for certificated securities (revised section 9-115(e)(6) of the 1994 uniform text) (possessory security interest prevails over perfection by filing).

H. Definitions

The definition of "jurisdiction of organization" is defined at proposed section 9-105(20) as the jurisdiction under whose law the entity is organized.

The definition of "registered entity" at proposed section 9-105(29) means an organization chartered under the law of a state (or the United States) for which a public record is organized.

The definition of "state" at proposed section 9-105(34) means a state, the District of Columbia, Puerto Rico, or any U.S. territory or insular possession.

I. Tracing Rules

On page 83 the 1995 Annual Meeting Draft provides alternatives A and B for tracing proceeds under proposed section 9-306(d). Alternative A recognizes the possibility of using outside tracing rules, while alternative B is more specific and directly approves the use of outside tracing rules. Proposed Comment 3 describes the lowest intermediate balance rule. There is a 21 day grace period for refiling at proposed section 9-306(e), up from ten days under current law. The troublesome rule at current section 9-306(4) would be deleted.[22]

J. Filing Issues

At proposed section 9-402(h) the draft provides a "seriously misleading" test: A financing statement is seriously misleading unless the filing office would discover it in a search conducted under the debtor's correct name pursuant to proposed section 9-413(c)(5).[23]

Proposed sections 9-403(a), (b), (f), and (g) deal with what constitutes filing, rejection, incorrect information and wrongful rejection. These standards affect the validity of the filing for purposes of determining whether the security interest is perfected.

For example, filing would not occur if the filing of the financing statement is rejected for certain enumerated reasons, including lack of required information.

17. *See also,* Financial Management Services Inc. v. Familia Corp., ICA-CV-92-0345 (Ariz. Ct. App. Jan. 17, 1995) (Article 3 holder in due course rules govern *re* claims to an instrument that is Article 9 proceeds). *Cf.* Official Comment to current § 9-306.

18. *See generally* Harold R. Weinberg, *They Came From "Beyond the Pale": Security Interests in Tort Claims*, 83 Ky. L.J. 443 (1994-95).

19. *Id.*

20. *See, e.g.*, Alvin C. Harrell, *1994 Meetings Refine Proposed Article 9 Revisions*, 48 Consumer Fin. L. Q. Rep. 326, 332 (1994).

21. *See generally, id.*, at 334-35.

22. *See* Comment 9 to proposed § 9-306; Peter G. Dillon and Alvin C. Harrell, *Anatomy of a Failed Statutory Provision: UCC Section 9-306(4)(d)(ii)*, 43 Consumer Fin. L. Q. Rep. 198 (1989).

23. *See* page 122 of the 1995 Annual Meeting Draft. *See also* Jerald M. Pomerantz, *Trade Name Filings Under UCC Article 9: Anatomy of a Nonuniform Amendment*, 47 Consumer Fin. L. Q. Rep. 34 (1993); discussion *supra* this text at Part X.

Incorrect information would not affect perfection except as against innocent purchasers who rely on the information.

K. Sales of Collateral

A letter from George Washington University School of Law Professor Luize E. Zubrow was considered, summarizing her recent law review article on sales of collateral.[24] Among other things Professor Zubrow argues that: (1) secured parties should be deemed to have a fiduciary duty to their debtors when disposing of collateral; and (2) secured parties could be allowed an additional fee, based on any enhancement in the sales price, as an incentive to maximize that price. The consensus on the Drafting Committee was that such a fee would not be helpful and that fiduciary concepts should not be introduced into the debtor-creditor relation.[25]

XIV. Perfection by Possession[26]

Perfection by possession has been criticized, and this was noted, but there was a consensus that this form of perfection has been recognized for centuries and should be retained. Professor Harris queried whether a definition of "possession" was needed, and Steven Weise urged that such a definition be included in an Official Comment. Bob Zadek noted that the concept of possession may have different purposes in Article 9,[27] so that a single, simple definition is not suitable. Brad Smith noted that the bailee issue is the one needing the most attention.

Two issues were the focus of the discussion: "control" and public "notice." Possession by the secured party may achieve both of these ends, but may also achieve one without the other. For example, notice may be given by a public sign coupled with security arrangements that are apparently effective but can be subtlely circumvented by the debtor. This might give sufficient notice to the world to constitute perfection but would not provide effective or exclusive control. Similarly, effective, strict control could be maintained by a secured party without the public notice needed to constitute perfection.

Some of the confusion in the cases derives from a failure of the courts to distinguish between the "control" and "notice" aspects of possession by secured parties.[28] The essential purpose of perfection (giving notice to the world) requires that a proper application of the rules on perfection by possession focus on whether the possession gives notice of the security interest to third parties.[29]

Two important issues are whether perfection by possession is effective as to certificate of title goods, and whether there can be a buyer in the ordinary course of business as to collateral in the hands of the secured party.[30] Proposed section 9-305(b) specifies that certificate of title goods are subject to perfection by possession only where perfection by possession is allowed under the law of the state of the applicable law under the proposed section 9-103(c)(5) choice of law rules, thus resolving the first of these issues.[31] The issue of buyers in the ordinary course will be taken up at a later meeting in the context of sales-related issues.[32]

There was considerable discussion regarding perfection by notice to a bailee. The question was raised: Should there be a rule in Article 9 governing perfection by notice to a bailee and specifying the rights and liabilities of the parties in such a scenario? This would govern such issues as whether consent by the bailee is necessary. Should it be necessary that the bailee "agree to hold" the collateral on behalf of the debtor, or at least "acknowledge" the security interest? It was noted that this would provide consistency with the "control" concepts in new Article 8 (and the conforming Article 9 revisions)[33] but would diminish the utility of perfection via notice to a bailee. Upon a vote the sentiment favored requiring an attornment agreement.

Should the term "bailee" be defined? It is defined in Article 7 but this does not fit or apply in Article 9. Should parties related to the debtor or under the control of the debtor be permitted to act as a bailee for purposes of perfection by possession? Most of these matters remain unresolved, but there seemed to be a consensus against allowing the debtor's agent or a related party to act as bailee for purposes of perfection.

Proposed section 9-205 (first sentence) would overrule cases to the contrary, by providing that a security interest is not invalid or fraudulent against other creditors by reason of the debtor's right to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods), accounts, chattel paper or proceeds. The second sentence notes that this does not otherwise relax the requirements for perfection by possession by the secured party or a bailee.

Proposed section 9-207 (duties of a secured party in possession), at proposed section 9-207(b)(5), would allow the secured party to repledge repossessed collateral on terms that do not impair the debtor's right of redemption.

24. Luize E. Zubrow, *Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 U.C.L.A. L. Rev. 445 (1994).

25. *See also* United States v. Terrey, 554 F.2d 685, 693 (5th Cir. 1977)(finding such a duty under Texas Law). Such a duty has generally been rejected in other cases. *See, e.g.*, Grudy v. Bank of La Place, No. 94-CA-1758 (Ct. App. 4th Cir. La. Sept. 15, 1995); Shamrock Drilling Fluids, Inc. V. Miller, 32 F.3d 455 (10th Cir. 1994); Peter G. Pierce III, *The Law's Excellent Banking Adventure—Recent Developments in the Bank-Customer Relation, Trends in Lender Liability and the Impact of New Articles 3 and 4*, 47 Consumer Fin. L. Q. Rep. 309 (1993); Warren L. Dennis and Michael I. Endler, Bank of America and Penthouse: *Is the Lender Liability Pendulum Swinging Back?*, 43 Consumer Fin. L. Q. Rep. 3 (1989); Peter G. Pierce and Alvin C. Harrell, *Financers as Fiduciaries: An Examination of Recent Trends in Lender Liability*, 42 Okla. L. Rev. 79 (1989); FRED H. MILLER & ALVIN C. HARRELL, THE LAW OF MODERN PAYMENT SYSTEMS AND NOTES ¶ 9.03(1992).

26. *See generally* Steven O. Weise, *Perfection by Possession: The Need for an Objective Test*, 29 Idaho L. Rev. 705 (1992-93).

27. The most obvious example is that possession for purposes of attachment under § 9-203 is different from possession for purposes of perfection under § 9-305.

28. *See* Weise, *supra* note 26, at 721.

29. *Id.*, criticizing *In re* Atlantic *Computer Systems, Inc.*, 135 B.R. 463 (Bankr. S.D.N.Y. 1992).

30. The correct answer under current law should be "no" in both cases, but there is occasional confusion in the case law on both points.

31. *See supra* this text at Part XI.

32. *See generally* Alvin C. Harrell, *Sales-Related Conflicts Between Articles 2 and 9*, 22 U.C.C. L.J. 134 (1989).

33. *See, e.g.*, proposed § 9-305A; Norwood P. Beveridge, *et al*, *Oklahoma Report On Revised Uniform Commercial Code Article 8 and Related Article 9 Amendments*, 66 Okla. Bar Ass'n. J. 1011 (1995).

XV. Future Article 9 Drafting Committee Meetings

Future meetings of the Article 9 Drafting Committee are proposed for the following dates. Like everything else, at this writing these remain tentative.

1. March 8–10, 1996
2. May 31–June 2, 1996
3. November 1–3, 1996
4. January or February, 1997

XVI. Summary and Conclusions

Most of the proposals described in this article represent unequivocal improvements in the law. Such revisions reflect the promise that the current revision process may continue the Article 9 tradition of adapting the commercial law to the customs and needs of parties engaged in voluntary transactions. It is this feature which makes the UCC so valuable to all society. A remaining, troublesome question, however, is the impact of contentious consumer issues, and whether these will taint the entire process so as to doom the revisions and the enactment process. Beyond this, the probable economic impact of the proposed consumer protection provisions remains in dispute.

At various meetings, members of the Drafting Committee periodically have asked whether the proposed consumer protection revisions would diminish competition and the availability of consumer credit and raise the cost of such credit. Some have asked for empirical evidence, but the fact is that the underlying issues are so complex and intertwined with other factors, and in such a state of flux, that quantitative models are likely to be oversimplified, manipulative, and all but useless. Yet there should be no question that some of the proposed consumer revisions would have an adverse impact on the supply and cost of consumer credit, and there should be no pretense to the contrary. While the extent of the effect may be in question, its direction and effect should be clear. It is easy to discount these consequences, as they probably would be gradual and diffused, while the immediate benefits would accrue directly to a few aggressive consumers (and their legal counsel). But these consequences could be quite significant from the standpoint of public policy, and these issues should not be ignored by the Drafting Committee. If the proposed consumer protection provisions are adopted, it may well be that Article 9 will be improved for commercial transactions, at the expense of consumer lenders. Small consumer lenders, such as community banks, would be particularly ill-served by some of the proposed changes. If community and state bankers' associations oppose the revisions, the enactment process could be jeopardized. Yet without significant concessions to the consumer advocates, the revisions may never get past the ALI and NCCUSL, or even the Drafting Committee, not to mention some state legislatures. It is a difficult, and as yet unresolved, conundrum.

Obviously, some carefully reasoned and tightly drafted compromises will be necessary if the Article 9 revision process is to reach its full potential. In addition, the revisions should be drafted so that the consumer protection rules can be modified or deleted on a state-by-state basis without impairing the integrity of the other provisions.

While significant disagreement is evident among those participating in the debates, the process of drafting uniform laws is conducive to reason and compromise. Thus, there is every reason for interested parties to add their voices to the debate before the final choices have been made. Those who wait may find that they have lost their opportunity to preserve their view of a reasonable regime of state laws governing consumer secured transactions.

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Articles Solicited on Small-Dollar Consumer Financial Transactions and Other Issues

The *Quarterly Report is* soliciting articles for publication relating to consumer financial services providers who offer small-dollar financial services. Examples of such providers would include small-loan companies, pawn shops, rent-to-own, check-cashing services, Western Union wire transfers, money-order companies, and perhaps used car dealers and seller-financing retailers.

Articles may describe relevant operational needs and concerns, the basic legal environment, characteristics of the markets being served, prospects for the future, and/or proposals for reform. Both state and federal law issues are appropriate. Articles focusing on business as well as legal issues are welcome.

In addition the *Quarterly Report is* soliciting articles on RESPA, CRA and fair lending, bank regulation and reform, high-cost mortgages, credit insurance issues, state debt collection laws, credit and debit cards, and consumer litigation.

Interested parties should contact the Editor of the *Quarterly Report*.