Updated 1995 Annual Meeting Draft Considered by UCC Article 9 Drafting Committee

Alvin C. Harrell, Oklahoma City University School of Law

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This draft includes revisions made in response to presentation of the prior (May, 1995) draft at the Annual Meeting of the National Conference of Commissioners on Uniform State Laws (NCCUSL) in August, 1995. Professor Marion W. Benfield, Jr. initially chaired the December 1995 meeting pending the arrival of Drafting Committee Chair William W. Burke, and announced the formation of a Subcommittee on Consumer Transactions, consisting of Professor Benfield, Sandra S. Stern, and Henry M. Kittleson. The purpose of this Subcommittee is to consider the conflicting views on consumer protection issues and make recommendations to the full Drafting Committee, which will then present recommendations to the Executive Committee of NCCUSL for decision. It is expected that the decisions will then be implemented by the Drafting Committee with the assistance of the Reporters.

Harry Sigman then presented a report on filing system issues. He reported that "dummy" electronic test filings had been made in Texas and estimated that the Texas system would be on-line and operational by early 1996. He distributed copies of a standard national form of financing statement, which is now acceptable in all 50 states (though some states may charge a nonstandard fee for its use).

Both Reporters (Professors Steven L. Harris and Charles W. Mooney, Jr.) were present for the Miami meeting, and they provided a review of specific revision issues. Chairman Burke then arrived and presided through the remainder of the meeting.

II. Sales of Accounts and Chattel Paper

A. The Octagon Problem

Professor Harris described various issues in addressing the Octagon problem, concluding that wholesale revision of Article 9 is unwarranted in response to an aberrational case. Instead, he noted that the November 15, 1995 draft contains two alternative approaches: an exclusion for Octagon-like transactions in proposed section 9-104(f); and an automatic perfection rule for such transactions at proposed section 9-302(a)(11). The first of these, proposed section 9-104(f), would exclude from Article 9 sales of accounts, chattel paper, and "payment intangibles" not having financing characteristics. The alternative would be a similar exception to the filing requirements, at proposed section 9-302(a)(11). Two choices were thus presented: total exclusion (section 9-104) or automatic perfection (section 9-302). The latter would expand the scope of Article 9 and reduce Article 9-other law conflicts. However, on a vote of the Drafting Committee, a majority opposed the shift of the exclusions from section 9-104 to section

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1. Earlier 1995 drafts and Drafting Committee meetings have been previously described in this journal. See, e.g., Alvin C. Harrell, UCC Article 9 Revisions: Consumer Intangibles, 44 Consumer Fin. L. Q. Rep. 226 (1995), at n. 1 (citing previous articles).


4. A term defined in proposed § 9-106(9) page 59 of the November 15, 1995 draft, is in a form of general Intangibles in which the debtor's principal obligation is to pay money. See infra Pt. II. 1.
B. Exceptions for Casual Assignments

Proposed section 9-302(a)(5) would expand the rule providing automatic perfection for assignments of less than a significant part of the assignor's accounts to additionally cover chattel paper and payment intangibles. But under current law the question always been: "significant part" of what? What about the "casual and isolated transactions" language in the comment to current section 9-302? The new Act would replace the "significant part" with a test (

9-302. The result was a consensus to leave the exclusions in section 9-104.

C. Section 9-207

Current section 9-207 imposes certain duties on a secured party in possession of chattel paper or payment intangibles. Under proposed section 9-207, the secured party's duty to perfect is limited to cases where the chattel paper is re rescued against the debtor. 3

D. Section 9-208

Current section 9-208 entitles the debtor (defined at section 9-105(1)) to include sellers of accounts and chattel paper in a confirmation of the secured party's interest in the collateral. The question was raised: Does the seller of accounts, chattel paper or payment intangibles need section 9-208? It was proposed that section 9-208 be eliminated. Don Rapson urged that this section is not a problem, and should not be changed; Brad Smith enjoined the elimination of section 9-208. Rapson proposed an amendment clarifying the coverage of such securities in Article 9 and elsewhere in Article 9. 4

E. Automatic Temporary Perfection

Under proposed section 9-304(a)(4), automatic temporary perfection would be extended to cover chattel paper. The section was raised: Should section 9-304(e) be eliminated or should chattel paper be added to section 9-304(e)? It was proposed that section 9-304(e) be a 21-day period of automatic temporary perfection allows a certificate of deposit to be renewed or delivered as collateral, as a temporary security interest in possession. But (under current law as well as the proposed 
9-207(5) would be required to prove the "significant part" contended with (a fixed not yet designated) percentage test and would limit the role to transactions not in the ordinary course of business.

Professor Harris noted that this is not intended to be a planing tool, and raised the issue: Should the same contain a percentage test? Brad Smith and Neil Cohen quibbled whether the entire provision should be dropped. The Drafting Committee favored the lutter approach, thereby abandoning the effort to address judicial nonuniformity in this area. The Drafting Committee similarly voted not to add chattel paper to section 9-302(a)(5).

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accounts and chattel paper, but these changes were not individually discussed.

2. The Concept and Impact of "Payment Intangibles"

This discussion occupied an entire afternoon of the December 1995 meeting. The discussion focused on the impact of the recent rulings on loan participations, securities, and secondary-market transactions. The discussions were far-reaching and encompassing, too much so to be related here. Generally, the proposal addresses perfection and priority issues arising out of sales of rights to securities, but would be considered general intangibles. It focuses on a new defined term, "payment intangibles," a form of general intangible in which the "debtor's principal obligation is to pay money." The perfection and priority of a security interest in these payment intangibles, and the expansion of the scope of Article 9 to cover sales of payment intangibles, raise a number of difficult new issues that were discussed at length and at various presentations at the December 1995 meeting.

A crucial question is whether a sale of allon participation in Article 9 collateral (accounts, chattel paper, etc.) is a payment intangible so as to alter the nature of the collateral under Article 9. Today such a transaction is sale of a general intangible, not covered by Article 9. Under the proposed revision the result would be largely unchanged, though the participation would be characterized as a payment intangible and Article 9 would apply. But if the sale is a participation, the sale would not be treated as a sale of a payment intangible. This would not be converted to a payment intangible. This could change the result, and it is not clear whether this sale of a participation is a sale of the underlying asset or something new (e.g. in the nature of a payment intangible). This issue was unresolved. Also unresolved was the extent to which the filing would be required for perfection as to payment intangibles. Proposed section 9-320(a)(11) was approved, to incorporate the current section 9-104(f) rule, protecting a sale of accounts or chattel paper as part of a sale of a business, or for purposes of collection, or for performance. However, the November 15, 1995 draft would have moved this protection from section 9-104 to section 9-302, thereby placing such transactions into Article 9 for other purposes while still protecting them from the Article 9 filing requirements, and expanding the scope of the perfection to cover similar sales of payment intangibles. As noted above at Pt. II.A., the consensus at the December 1995 meeting favored leaving the provision in section 9-104.

Section 9-318(b)

On page 154 of the November 15, 1995 draft there is a proposed revision creating a new section 9-318(b), to apply only to sales of payment intangibles (there is also a possible limitation such sales by financial institutions). The proposal would eliminate in such transactions the ability of the assignee to give notice to the account debtor direct payment to the assignee, where the agreement between the assignee and account debtor so provides. (Today section 9-318(c) does not apply to sales of general intangibles, due to the limited scope of Article 9.) While the scope of section 9-318 would be changed, to cover sales of payment intangibles, the purpose is to retain the current insufficiency of "payment intangibles" (proposed section 9-318(b)) to sales of payment intangibles (to preserve the result under current law).

Professor Benfield then asked how often the current statutory penalty at section 9-507(1)(b) is invoked, noting that this penalty will be larger than (if deficiency judgment) the automatic early default penalty. Bill Solomon argued that current section 9-507(1)(b) is too pathetically small and should be deleted. He noted that the rebuttable presumption rule has been adapted in the vast majority of states that have these cross-referenced to the same section, and asked consumer advocates for their views. He noted that flexible standards coupled with draconian penalties is a dangerous combination, because of the risk that societal standards may shift and be applied retroactively.

Gail Hillebrand said the consumer advocates cannot retreat from the absolute bar rule or statutory penalty because these remedies now exist in the UCC or other law in some states, and that the consumer advocacy community would not accept such a retreat. The creditor representatives expressed concern that the proposal would change the Article 9 bar rule in another Debts Collection Practices Act, where consumer lawyers can use large windfalls based on minor, technical and harmless violations. The issues were left unresolved.

Professor Benfield closed the meeting by announcing that there would be another meeting of the Consumer Intangibles Subcommittee in March 1996 to allow reaction to the forthcoming Subcommittees' proposals. The second Article 2 draft proposal would update current sections 2-326, relating to the right of consignees as against Article 9 security interest and other creditors of the consignee. The revision would continue to give priority to creditors of the consignee unless the consignee meets certain requirements. The current trend is to further limit the consignee's rights to comply with Article 9 in order to achieve priority.

Professor Spalding also addressed the problems that have arisen with regard to buntings and processing contracts. For these issues neither the current UCC nor the Article 2 or November 15, 1995 Article 9.
regarding this proposal (proposed section 2.9-307(a)), the vote was almost evenly di-
vided, with numerous abstentions, sug-
gestig a need for additional drafting and
consideration.

VI. Report of Bankruptcy Task
Force

ABA UCC Committee Chair Ed
Smith reported on the Article 9 Drafting
Committee's bankruptcy Task Force,
challenged with considering the relation
between UCC Article 9 and the Bank-
ruptcy Code and the impact of the pro-
posed Article 9 revisions on bankruptcy
law.5

There has been a general concern ex-
pressed by some bankruptcy lawyers that
the cumulative effect of the Article 9 re-
visions will significantly enhance the
rights of secured creditors at the expense
of other bankruptcy claimants (among other
things resulting in a diminution of the
estate available to pay the bankruptcy
debror's counsel). It may be expected
that bankruptcy lawyers may tend to re-
quire improvements in the law governing
secured transactions (which generally are
protected from other claims in bank-
rruptcy) and the advocacy of bankruptcy
interests may come to represent a new
threat to the Article 9 revision process.
It was noted at the December 1995 meet-
ing that two diverging trends are becom-
ing evident: Improvements in Article 9
accessibly come in an improvement in
the rights of secured creditors at the state
level, while at the federal level (and in
bankruptcy) the debtor's rights are often
shrouded in paramour. These diverging
trends at the state and federal levels may
become manifest in the dis-
ferring perspectives of the Article 9 Draft-
ing Committee and the Bankruptcy Re-
view Committee.6

Consistent with these trends, Ed Smith
reported that the bankruptcy counsel rep-
resentatives on the Bankruptcy Task
Force generally have resisted expansion of
the scope of Article 9 and other changes
that would enhance the secured party's claim to the collateral against
the bankruptcy estate. There was also
concern that a consumer debtor's bank-
rupcy "fresh start" might be adversely
affected by these changes.

Professor Moore noted that the argu-
ments against improving the law of sec-
ured credit (as well as taking the same
approach in Article 9) are not likely to
be funded on an unsound basis even if
secured credit was wholly abol-
ished, so that the public policy benefits
from improvements in secured transac-
tions law go unrecognized. Jeffrey Furrer
noted that many bankruptcy advocates
assume that "adequate protection" under
Bankruptcy Code Section 362(a)(1) is an
essential substitute for enforcement of
a security interest. There was a dis-
cussion resulting in a consensus that
these assumptions are in error. Ed Smith
then reported on bankruptcy counsel argu-
ments that over-secured creditors should
be converted into slightly under-secured
creditoes, on grounds it would improve
creditor monitoring of collateral. It was
noted that this would represent a dis-
ruption to creditors' consciously negotiated contractual posi-
tion, without compensation.

It was reported that two agendamia
appear to be driving the bankruptcy ar-
guments: First, an effort to "tax" secured
claims in bankruptcy to fund administra-
tion expenses (e.g., the debtor's attorney
fees). This generates an old proposal, pre-
viously rejected due to a lack of sup-
port, to give administrative expense pri-
ority over secured claims. It would also
give debtors tremendous pre-bankruptcy
leverage over lenders, in that debtors
could threaten lenders with bankruptcy
knowing this would mean an immediate
statutory "cure-out" or reduction in the
creditor's claim. Second, there is a
need to protect tort claims in bankruptcy at
the expense of consensual secured creditors.
This apparently is a high priority for trial
lawyers' groups.

Professor Moore floated the possible
creation of a statutory lien in favor of
tort claimants in Article 9, with priority
over non-bankruptcy security interests
in personal property, as a means to gener-
ate discussion of these issues. The brief
discussion was lively, and the clear con-
clusion was that this idea is speculative
and untested and would not be useful even
for discussion purposes. Ed Smith noted
that efforts to add a more comprehensive
Article 9 system have generally been op-
posed by the bankruptcy bar.7 Jeff Turner
suggested that there is an underlying the-
inning of a broad attack on the enforce-
ability of secured credit in bankruptcy, and
that there is a view among bank-
rupcy counsel that a secured claim
should be merely the beginning of a ne-
gotiation process in bankruptcy, to deter-
mine how much a creditor should recover,
which ultimately be resolved on the
basis of various other factors.

VII. Perfection by Possession

Revised sections 9-304 and 9-30514
would continue to recognize perfection
by possession, but would provide that
possession is the same for perfection as
for attachment.8

Perfection by possession of cer-
tificated securities was "unpacked" from
section 9-115 and moved to section 9-305
with the other rules on perfection by pos-
session. A similar "unpacking" is in-
tended with regard to other section 9-115
rules, as part of a planned effort to gather
all attachment rules together, all perfec-
tion rules together elsewhere, etc.

3. S. 1225, 106th Cong., 2d S


1. The proposal is in paragraphs 8-10 of the proposed Article 9-307.


5. 6 U.S.C. § 9-304(b).


7. See note 14 supra.


Proposed section 9-107(c)(4) requires that, for perfection by possession, the goods in the possession of a bailee, a person in possession other than the debtor (the bailee) must acknowledge the collateral to be of the benefit of the secured party. Language in brackets is under consideration, to require that the acknowledgment be in writing. The bailee's role would be voluntary; no third party bailee would be required to acknowledge the notice or to assume the duties of bailee or of the secured party. This would reduce the utility of perfection by notice to a bailee.

On a vote of the Drafting Committee, the vote favored: (1) current law; 4 votes; (2) perfection by notice: 2 votes; (3) notice plus acknowledgment of duties: 4 votes; (4) current draft: 3 votes (attnomention without duties). Should a lesser qualify as a third party bailee for these purposes? The consensus was no. The divided vote and abstentions suggested a need for further discussion and consideration.

VIII Proposed Section 9-107 (Purchase Money Security Interest Defined)

The new definition at proposed section 9-107(a)64 would define purchase money security interest (PMSI) as a security interest in "purchase money collateral" that secures a "purchase money obligation incurred with respect to that collateral," or is an "inventory purchase money security interest" (a term defined at proposed section 9-107(d)). The latter provision would allow an inventory security interest to be a PMSI if the loan was obtained to acquire inventory, without the notice of wrongdoing that the funds actually were used to purchase the specific collateral. The definition of "purchase money obligation" (proposed section 9-107(b)) and "purchase money collateral" (proposed section 9-107(c)) are also defined.

The question was raised as to whether a PMSI should be limited to goods and fixtures, or should be extended to other collateral recognizable to possession.2 The within the Article 9 Drafting Committee Bankruptcy Task Force and the Bankruptcy Review Commission that some PMSIs should be available in bankruptcy.2 After this discussion the consensus seemed to shift toward the view that a refinancing of a PMSI by a different creditor would not be a PMSI.2 The grace period for perfection of a PMSI, at section 9-312(c), would be extended to 20 days at proposed section 9-312(c).2 Other grace periods and purchase money priority rules would be provided for specified types of collateral (e.g., "production money crops," inventory, livestock, investment property, and deposit accounts). The Reporters addressed the priority of multiple, competing PMSIs, at proposed section 9-312(g) (Alternatives A and B).2 Alternative A provides for equal sharing between the PMSIs, Alternative B ties priority to use of the loan proceeds for purchase of the collateral. A first-in-time rule was also discussed. Professor Harris advocated Alternative B, as provided for a first-in-time rule where both were "enabling lenders" who contributed to the purchase price. The Drafting Committee was evenly split as between Alternatives A and B.

The Conference on Consumer Finance Law presents
RECENT DEVELOPMENTS IN DEBT COLLECTION AND BANKRUPTCY
October 11, 1996 - Embassy Suites Hotel • Dallas, TX

9:00 - 9:50
Overview of Current Issues in Debt Collection Law
Alfred C. Harris
Professor of Law, Oklahoma City University and of Counsel, Prichard & Prichard,
Oklahoma City, OK

10:00 - 10:50
Avoiding Liability and Defending FDPCA Cases
Ready Miller
The Miller Law Firm
Dallas, TX

11:00 - 11:50
Avoiding and Defending Class Action Liability Under the Fair Debt Collection Practices Act
Lawrence Young
Hughes, Watters & Askozner, L.L.P
Houston, TX

11:50 - 1:30
Lunch (on your own)

1:00 - 1:50
Update on Consumer Chapter 7 Bankruptcy Issues and Developments
William J. Norton, III
Board, Commins, Cooper & Berry
Nashville, TN

2:00 - 2:50
Update on Consumer Chapter 13 Bankruptcy Issues and Developments
Gary Hildbold
Chapter 13 Trustee
Terre Haute, IN

3:00 - 3:50
Update on Preferences and Fraudulent Transfers
Michael R. Rochelle
Rochelle & Rochelle
Austin, TX

For more information or a registration form, call (800) 664-1445 or FAX your request to (800) 664-3385.