Oklahoma City University School of Law

From the SelectedWorks of Alvin C. Harrell

1993

Revising Article 9: Selected Comments on the UCC PEB Study Group Article 9 Report

Alvin C. Harrell, Oklahoma City University School of Law

Available at: https://works.bepress.com/alvin_harrell/262/
Revising Article 9: Selected Comments on the UCC PEB Study Group Article 9 Report

By Alvin C. Harrell

Article 9 governs security interests in personal property and has been enacted in some form in all 50 states. On December 1, 1992 the PEB Study Group issued its report, recommending in general terms a series of revisions to Article 9. This article will briefly summarize and update a selection of the proposed recommendations along with a few personal observations of this author.

The PEB Study Group Report recommended the formation of a drafting committee to prepare specific revisions to Article 9. Such a committee was subsequently formed, with Professors Steve L. Harris and Charles W. Mooney serving as the Reporters. It should be emphasized that the PEB Report is stated in general terms (though it focuses on specific issues) and that it is only recommendatory. The proposed revisions will undoubtedly evolve during the drafting process with some being rejected, some changed and others added, and therefore the revisions represent (in Professor Fred Miller's words) a “moving target.” Therefore the recommendations in the PEB Report, and the analysis in this article, are already to some extent obsolete. Nonetheless, one purpose of this article is to help alert interested parties to the possible directions of the changes, so as to encourage such parties to provide desired input as the revision process continues.

II. General Observations

The PEB Study Group is to be congratulated for identifying and compiling a laundry list of common Article 9 problem areas, providing a useful framework for considering needed improvements in the law. For those of us who teach in this area of law, the PEB Report is "de ja vu all over again" in that it capsulizes the full range of Article 9 problem areas that we confront each semester.

Partly because of concerns encountered during the state enactment process for revised UCC Articles 3 and 4 in California, the Article 9 Drafting Committee is emphasizing an open revision process reflecting input from a wide range of diverse groups (including the Conference on Consumer

---

1. Both the UCC and the PEB are jointly sponsored by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institute ("ALI"). See (Continued in next column)

2. See Fred W. Miller, The Revision of UCC Article 9 & 47 Consumer Fin. L.Q. Rep. 257 (1993). Copies of the full report may be obtained from:
   Osler Department
   The American Law Institute
   4025 Chestnut Street
   Philadelphia, PA 19104-3909
   (Continued from previous column)


Finance Law). Both consumer and industry interests are being requested to advise the drafting committee; all interested parties are invited to participate by submitting their views. While these efforts are salutary and probably necessary given today's sophisticated spatial and political realities, it remains to be seen whether this will produce a better product. There is some obvious risk that diverse political interests on individual issues will produce the kind of disjointed text that regularly emanates from the same kind of process in the U.C.S. Congress. Of course there is little similarity between the two processes, and this comparison is grossly unfair to the U.C.S. reviser process, but the point remains. Today's a divisive process means a more polarized one; at the very least the drafting Committee and Reporters are faced with a heightened challenge in comparison to previous years. On the other hand, it may make enactment easier, and a perfect law never enacted is not much of a contribution. The PEB Report represents an excellent beginning, and it will be interesting to see how the product evolves as the revision process unfolds.

III. General Approach of the Proposed Revisions

The PEB Report confines the basic choice between the model of a common law approach (using general, bright line rules of universal application) versus the model of a regulatory approach (with more detailed rules that seek to micro-manage different issues in an often vague or inconsistent manner in order to achieve targeted results and political balance).5 The PEB Report generally favors the former approach, as does current Article 9 (and indeed the entire U.C.C.). Many of us who have practical experience with both models probably will agree that this choice is essential to the smooth functioning of commerce at all levels of a complex economy.6 The PEB Report likewise does not seek to review or revise the basic principles that serve as the foundation for Article 9, or to readjust the nature of the relationship between secured and unsecured creditors.

6. Consistent with the overall purposes of the UCC, the proposed revisions seek clarifica-

tion and simplification of the law as a means to facilitate commerce, by enhancing the ability of private parties to craft trans-

tactions to suit their individual needs.7 There is obvious tension between this goal and the requirement to protect con-

customers or other groups to the extent they are perceived as lacking the ability to represent themselves in such transactions. Thus a continuing issue is to be decided is the extent to which Article 9 should be turned into a consumer protection law.

7. Specifically, many of the commercial financ-

ing interests represented in the revision pro-

cess seem eager to make common cause with consumer advocates on such issues. The simple solution, suitable from both of these perspectives, is to carve out a series of special exceptions or protective rules for consumer transactions. The consumer representatives clearly like this approach, and many commer-
cial lenders seem prone to, in effect, give them what they want so long as they don't interfere with purely commercial transactions and don't go to Washington where the results may not be as well considered.

The loser in such a compromise tends to be the consumer finance industry, including difficult community banking institutions and other consumer lenders, who may be the most underepresented group advising the Draft-

ing Committee unless they begin to take their participation. The Conference on Con-

sumer Finance Law has accepted an invita-

tion to join the process, and hopefully this will help address the problem. Other inter-

ested parties should do the same. In any event, most of those involved in the revision process seem to appreciate the common-

uniformity that could result if certain consumer protection provisions were to be included and then challenged in the state legislatures by community banking or other lender groups. Perhaps for such reasons, the

PEB Report generally eschews any effort to bi-

ficature Article 9 into separate commercial and consumer codes. But this remains an open issue as the revision process continues, and interested parties should make their views known.

As difficult as it may be for those of us

to recognize current uncertainties by using the PEB Report as a kind of super-

commentary or other persuasive authority, the Reporters have made clear that the PEB Report is very tentative and is not intended to constitute persuasive authority as to matters of current law.

IV. Highlights of Some Proposed Revisions

Subsequent articles in this journal will feature item-by-item descriptions of many of the proposed revisions, as they evolve. For now, a few of the more controversial issues will be noted, so as to provide a sampling of some of the difficult questions to be faced and a perspective on the relationship between these issues and their more mundane (but no less important) brethren. The Reporters and Drafting Committee seem well aware of the legislature's directive, "First - do no harm," as well as the UCC battle cry, "Remember the federal Food, Drug, and Cosmetic Act," and are making an effort to rationalize and clarify the law without creating new problems. The notes below reflect these difficult questions, those involved and will truly challenge this effort.

A. Local v. National Filing

Perhaps the most important, and in some ways the most controversial, issue con-

trolled by the PEB Report is reform of the UCC filing system. While in some states the current system is working just fine, in others large lag times and other problems are apparent. Simply making filings, including computerized filings, con-

tact title searches exist.

The PEB Report proposes to allow for-

other as to the threat to the public interest. A companion proposal, to be included in a single filing by the debtor.

8. Some concern has been raised over the need for a single filing by the debtor.


25. Id. at 37 (1975).
secure repayment of the purchase price. Others would allow the buyer to complete the purchase by complying with the terms of the purchase contract (including installment payments), while others propose an outright repossession, foreclosing on the collateral or the debtor's property (whichever the seller in the proper case or under the proper circumstances may wish) to the purchase price and all interest and charges thereon.

The REB report does not propose any clarification of the relationship between the UCC and the law of real estate. Apparently, the failure of previous, extensive efforts to draft a new REB commentary on the issues suggested that the task was just too daunting. However, the REB report does recommend revising section 9-201(1) to clarify that a "sale or other party with a limited interest in the collateral has "rights in the collateral" that are subject to attachment or sequestration of a security interest. This should help prevent a sale of collateral from creating a secret lien immune from competing claims.

The REB report also recommends amending the Uniform Fraudulent Transfer Act to further rationalize the statutory treatment of equitable liens and claims, and to ensure that further guidance be provided to creditors and others in the interests of a common policy or a REB commentary.

C. Deposit Accounts

1. PEProposalsection

The REB report recommends bringing deposit accounts within the scope of Article 9, permitting creation and perfection of an Article 9 security interest in an account as original collateral for the first time.43 While this would provide important clarification in an area now governed by the relatively amorphous concepts of "deposit" law, common law, and administrative freeze,44 obstacles remain in the form of disagreements regarding the full integration of security interests in deposit accounts into Article 9.45

One such hurdle was tentatively overcome by the recommendation in the REB Report that depositary institutions should have no obligation with regard to security interests in favor of third parties, unless and only to the extent that the institution agrees to such an obligation or is subject to judicial process.46

A more difficult series of questions arises with regard to the relative priorities of a third party security interest against a claim (by means of setoff, common law pledge, or security interest) of the depositary institution. The REB Report notes that a bank should be entitled to exercise its right of setoff over a competing third party claim (an anticipated departure from current law in many jurisdictions). However, the REB Report also noted that a bank's right of setoff is subject to a challenge as to whether a security interest in favor of the bank should be entitled to priority over a third party security interest, or whether the bank should be required to file a financing statement and be subject to the general first-to-file-come-first rule at section 9-201(7).

Second, the REB Report suggests that a basic security interest in a deposit account should be recorded by depositors with the financial institution to make sure that banks are aware of their rights in their own deposit accounts, since the bank would have to be preceded by a title search, UCC-1 filing, and a subsequent "gap check."47 These loans would likely have to be processed through the loan department rather than the savings department, and the process could take days rather than minutes.

Another potentially vexatious problem would be a failure to provide for filing as the exclusive means of perfection but exclude from Article 9 any loan on a consumer deposit account. While this may reflect a compromise position (illustrating again a corollary of interests among commercial lenders and consumer advocates), the result would be a new range of questions relating to the purpose of the loan (again the truth in lending experience may be instructive) while leaving consumers and their lenders with the uncertain (and nonuniform) legal structure of the common law pledge.

2. Related Developments

Several concurrent trends may affect the deposit account proposal. While the "checkless society" has been promised (or threatened) for decades and has yet to materialize, it is nonetheless obvious that technology is having a significant impact on deposit accounts. One example involves the various federal programs to deliver electronic benefit transfers ("EBT"). These programs may create an entirely new range of security interests in take accounts as a condition for delivery of federal benefit payments. A future Article in the Quarterly Report will analyze these issues, but suffice it to say that this point may develop that these developments may affect the treatment of deposit accounts under Article 9.

The generally related development is illustrated by the New Jersey Consumer Checking Account Act ("NJCCA"),48 which requires depositary institutions to offer a basic checking account pursuant to certain terms specified in the statute. Noncompliance with the account terms must be approved by the New Jersey Department of Banking. While it is not clear that this bill would preclude a security interest in such an account, it is possible that a wave of similar or related state (or federal) enactments could at some point affect security interests in consumer deposit accounts.

Finally, and perhaps most importantly, the Article 9 revision process is being preceded by revision of Article 8 of the Code.49 At this point, it is too early to determine whether the Article 9 revision process is not final, so no definitive judgements can yet be reached, but in relation to Article 9 the Article 8 project is well advanced (details will follow in a future issue). It appears likely that, under revised Article 8 and comparison revisions to Article 9, a security interest in a securities account will be subject to perfection by a means (e.g., filing) that will protect against lien creditors (including the trustee in bankruptcy) but will not impair the ability of the securities depositary to execute market trades, effect a setoff, enforce a security interest, etc. This basic structure is deemed essential to the smooth functioning of the securities markets.

Assuming that this approach reaches formal approval and becomes part of the uniform text of the UCC, it may set a precedent for security interests in bank accounts. Many of the same considerations that warrant unrestricted access to the security accounts by a securities depositary (the need for liquidity, for example) apply equally to a bank depositary account. If a banking institution had to check the UCC records before allowing a deposit withdraw-

2. Basic Priority Rules

In discussion of the PEProposition, some have argued for a further priority rule based on the "first in time" rule. However, it has been argued that a depositary institution should not be given priority over a party whose claim to the funds came after the funds were paid to the bank (since the funds were deposited subject to the prior claim), so that a bank customer should only be able to reach unencumbered security interest in the customer's "property" in the funds, after deducting the prior claim. In this view an Article 9 debtor could only alienate or pledge whatever interest he or she has, subject to any prior interest that is good against the debtor. It is sometimes said in this regard that the secured party cannot stand "in the shoes of the debtor"; that is, after all, the law of assignee, a fundamental tenet of contract law. Unfortunately, this view seems to essentially create a priority system based on the time of attachment, is flawed, and even
The Conference on Consumer Finance Law (the "Conference") has accepted an invitation from William M. Burke, Chair of the Uniform Commercial Code Article 9 Drafting Committee, to participate in the work of the Drafting Committee as it considers proposed revisions to UCC Article 9. The Conference will be represented at meetings of the Drafting Committee, and will seek to provide input as regards matters of interest to Conference members.

The Article 9 Drafting Committee is a project of the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institute ("ALI"). Professors Charles W. Mooney and Steven L. Harris serve as the Committee's Reporters for the Article 9 revision project.

The Drafting Committee is seeking input from all interested persons, and the Conference is pleased to be participating in the process. As the work of the Drafting Committee progresses, selected developments will be noted in the Quarterly Report. If you have concerns that you would like to have addressed, feel free to contact the Conference representative, Professor Alvin C. Harrell. Professor Harrell can also arrange for copies of drafts to be sent to you for the cost of postage and handling.

Ten Banking Trends in the 1990s - A Sea Change for America

(Continued from page 365)

and keep the herd together; but if public policy were the herd off the cliff, this just means they will all go over together (an apt description of the thrift crisis). Fourth, financially healthy institutions are no longer safe; the utility model means that healthy institutions are just as likely as insolvent ones to be destabilized and pushed into a downward spiral by a regulatory focus that breeds agency enforcement actions on the basis of technical errors, inadequate policies and procedures, CRA deficiencies or the lack of a bureaucratic management system. The age of banking, as we have known it for over 200 years, is over. But what (if anything) will take its place? As these trends develop, the very nature of our economy, and our society as a whole, will depend on the answer to Joe Norton's question.

17. See, e.g., Robert R. Glucks, The Sick That Failed Bank Reform, Wall Str. J., Dec. 13, 1983 (noting the likelihood that another wave will be stalled by consolidation of the basic regulatory agencies). In a recent letter to the editor of the American Banker, Bert Ely reminded his readers of this possibility, but argued that it will have to change: Once the regulatory cost of playing field is levied, which event must happen, the process of doom will be expected - and probably delayed - by the vigorous growth of commercial bank lending to sound borrowers.

15. See, e.g., J. McCune, Jack-in-the-Box, in Community Bank: Draw a City of Fail, Amer. Banker, Oct. 21, 1993, at 9 ("The regulations are killing the independent banks."); it is ironic that the Clinton administration is advocating the establishment of a new system of community development banks, just as it is in the process of destroying the existing system of community banks.

16. It remains uncertain that the economists who promote this, instead clashing with every other possible explanation for the economy's slow growth since 1980 and consistently predicting that prosperity is just around the corner. See, e.g., Karen Penn, The Balance Cycle's Dead, Am. Banking & L. Rev., Oct. 4, 1993, at 76.