Article 9—An Agenda for the Next Decade*

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It is typical of Professor Grant Gilmore that his status as chief draftsman of Article 9 has never deterred him from questioning whether what was so largely his product could have been or could now be improved.¹ Not too long ago he contemplated a meeting of those who took part in the drafting of the Uniform Commercial Code (U.C.C.)² and who are still in the field. The invitees were to explore with one another problems unseen or unanswered in the early drafting days: to discuss alternative solutions to particularly persistent old problems and to formulate tentative answers to those nonexistent or at least generally unknown during the 1940s and 1950s. Some then active in the area have of course moved to other fields. And, as could easily have been predicted, death has taken its toll—including the great editor-in-chief Karl Llewellyn and Judge Herbert Goodrich, without whose combined editorial and organizational talents the Code might never have been born, as well as William Schnader, without whose generalship the Code probably never would have been adopted, as it has been, by all states but Louisiana.³

* The title obviously is borrowed from Plumb, Federal Liens and Priorities—An Agenda for the Next Decade, 77 YALE L.J. 228 (1967).

Although I am currently a member of the U.C.C. sponsor’s Permanent Editorial Board, no part of this article has been seen by or discussed with any other member of that Board; further, I would feel free to vote against any proposal made here if other members advanced convincing arguments against it.

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¹ Grant Gilmore and Allison Dunham were appointed co-reporters for Article 9 at an early date; they drafted much of the original statute. Professor Dunham later became absorbed with problems in other fields, whereas Professor Gilmore largely followed Article 9 developments throughout the period during which he and I were consultants to the Committee to Review Article 9. If anyone is to be singled out as the principal architect of Article 9, it is he. And though his colleagues on the ABA-ALI Committee on Continuing Legal Education (CLE) programs during the 1960s delighted in ascribing to him any infirmities in Article 9, in fairness it must be said that some of the problems resulted from changes made against his advice or in his absence. Due to a temporary illness, Professor Gilmore did not participate in the final meetings in the early 1970s of the Committee to Review Article 9.

² ALI, NAT’L CONF. OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE: 1972 OFFICIAL TEXT WITH COMMENTS (U.C.C.) [hereinafter cited by section number only]. Unless reference is made to another version, this article will refer to the official 1972 text and comments.

³ Mr. Schnader, on behalf of the Commissioners, largely directed the campaign for adoption of the U.C.C. Forty-nine states, as well as the Virgin Islands and the District of
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For reasons not related to its desirability, Grant Gilmore’s planned meeting was not held. Indeed, it may never take place. The concept behind it, however, provides an apt thesis for an article to commemorate its prospective sponsor’s accomplishments. I wish to pose some of the problems that would—or at least should—have been canvassed by Professor Gilmore’s group. More specifically, and perhaps more ambitiously, I wish to discuss questions that the draftsmen of the next major revisions of Article 9 will likely have to confront. Since Article 9 was partially redrafted in 1972, I assume that it will not receive comprehensive reconsideration for at least another ten years. What questions might be on the agenda of the 1988 Committee to Review Article 9, and how might they improve the present statute? 4

My original aim was to explore a number of different problems that future draftsmen might wish to consider—or to reconsider. As the exploration progressed, however, it became increasingly apparent that the most intriguing trouble spots now discernible derive from the same source: Article 9’s preservation of certain aspects of the old common law notion that “possession” of property is of utmost sig-

Columbia, have adopted the Code; Louisiana, the fiftieth state, has adopted only Articles 1, 3, 4, and 5. 1 U.L.A. Uniform Commercial Code 1 (1976).

My personal appreciation of the extent to which “General” Schnader contributed to the present near-uniformity of commercial law was heightened by my participation in the conference held by UNIDROIT (International Institute for the Unification of Private Law) in Rome in November, 1977. This organization, once an adjunct of the League of Nations, has been struggling since 1926 to secure adoption of uniform legislation on various narrow aspects of commercial law. Its secretariat is intimately familiar with like efforts by the European Economic Community, the United Nations, and the Hague Conference on Private International Law. Various participants expressed amazement that so large a body of law as is represented by the U.C.C. had actually been adopted by forty-nine jurisdictions in one generation. The absence of a need for treaties among states no doubt helped “General” Schnader in his efforts, but his accomplishment is nonetheless remarkable.

4. The Committee to Review Article 9, which was responsible for the 1972 revisions, was not given free rein to improve the law. Until the U.C.C. was widely adopted, there was an understandable aversion on the part of the sponsors to propose amendments, unless the former text was demonstrably wrong. By 1966, when the Committee was formed, the U.C.C. was strong enough to withstand the criticism that a proposal for a change was an admission that the editorial job was still unfinished. It was apparent that some improvements could be made. It was also apparent, however, that for an extended period of time the old Article 9 would continue in force in a number of states while the new Article 9 would be in force in others. Hence, the mandate of the sponsors limited the Committee to changes suggested by rejection of a particular provision by one or more states, by troublesome court decisions, or by criticisms in law reviews. Changes were not to be proposed for the sake of style, and a rethinking of major policies was not encouraged unless the prevailing text was plainly in need of change.

Anyone who knows Grant Gilmore will know that a meeting chaired by him would not have been so limited. His invitees would have been as free as the wind to consider any idea, regardless of its political or practical merits. My efforts here will be made in that spirit. They will, however, focus largely on Article 9, not only because it is the Article with which Grant Gilmore is principally associated, but also because my own U.C.C. experience is principally in the field of secured transactions.

1013
nificance in the field now known as secured transactions. In addition, these intriguing problems seem likely to proliferate in the near future. Hence, I have chosen to focus on the difficulties that attend the remnants of the "possession" idea, for they seem the most probable source of items for a 1988 agenda.

Happily, the result of this unpremeditated decision is an article peculiarly appropriate for its honoree. Professor Gilmore's penchant for history is well known. Indeed, Professor Gilmore, as author of the definitive work on the history of personal property security law, has laid the scholarly foundation for my present efforts. Thus the product of Professor Gilmore's draftsmanship will be criticized here with analytic tools that he himself has fashioned. This task is a fitting tribute to the personality of Grant Gilmore, whose eagerness to confront his own fallibility has surely been a large element in the success of his intellectual endeavors.

I. An Historical Preface

The idea that paramount significance attends the possession of property is the oldest concept of chattel security law. Until the early nineteenth century, the only way to create a valid security interest in personal property was by physical pledge—the transfer of possession of the property (collateral) by the debtor (the pledgor) to the creditor or secured party (the pledgee). An attempt to transfer a security interest in property that remained in the debtor's possession was considered fraudulent and invalid against third parties. This historic antipathy to nonpossessory security interests has two aspects crucial to my thesis. The first is the rationale for holding such interests fraudulent. It was assumed that potential creditors and purchasers would rely on a debtor's apparent ownership of assets physically in his possession; this was part of the basic common law doctrine of protecting creditors against undisclosed interests in property. In other words,

5. I refer, of course, to G. Gilmore, Security Interests in Personal Property (1965) [hereinafter cited without cross reference as GILMORE]. Professor Gilmore's treatise was written before the 1972 revisions of Article 9 but nonetheless remains the most persuasive source of authority for the history and general approach of the Article. The reader will be referred to later sources where pertinent.
6. Id. at 24-26, 86, 438-39.
7. Id. at 24, 40-41, 438-39.
8. Id.; see J. MacLachlan, Handbook of the Law of Bankruptcy 255-70 (1956). The only exception was that a pledgee could return the property to the pledgor for a "temporary and limited purpose," so long as this was not in the pledgor's interest. See Gilmore at 449-52.
9. This assumption was first articulated in Twyne's Case, 76 Eng. Rep. 809 (Star Chamber 1601), discussed in Gilmore at 24 n.1, 40-41; see Gilmore at 67.
it was a requirement that there be public notice of the creation of a security interest; physical pledge, presumably, gave that public notice. The second important aspect was the especial hostility reserved for a particular kind of nonpossessory security interest—the interest in after-acquired property, particularly in the form of inventory and accounts receivable. This hostility resulted less directly from the status attributed to possession but nonetheless may be traced to that source.

During the late nineteenth and early twentieth centuries, there developed an increasingly pressing need for credit secured by collateral that remained in the debtor's possession, especially after-acquired collateral and especially in the form of inventory and receivables. Slowly, debtors and creditors devised ways to overcome the obstacles posed by the two aspects of the possession idea noted above. The history of this struggle, manifested by a proliferation of security devices, is a fascinating story well told by Professor Gilmore; it need not be repeated here. The outcome, on the eve of the drafting of the U.C.C., was that nonpossessory interests could usually be successfully created; in the process, however, "the law of personal property security transactions [had come] to resemble the obscure wood in which Dante once discovered the gates of hell." Article 9 brought this "labyrinthine" mélange of personal property

10. GILMORE at 40-41, 438.
11. See generally id. at 27-47, 250-86.
12. The courts were often less than clear in articulating exactly why they objected to after-acquired property clauses, stock in trade mortgages, and early efforts to obtain valid liens on present and future accounts receivable—all predecessors to modern inventory and receivables financing. What became the most formidable objection, however, was that the debtor retained "complete power and dominion" over the collateral. That this concept is almost identical to the fraud idea, or "doctrine of reputed or ostensible ownership," that underlay the pledge is clear despite Justice Brandeis's explicit disavowal of this relation in the case that represents the height of judicial antipathy to after-acquired interests in accounts receivable. Benedict v. Ratner, 268 U.S. 353, 362-63 (1925). Although courts did not "apply directly to [accounts receivable] the doctrines of fraudulent retention of possession and of ostensible ownership" because generally "a creditor has no basis for assuming that a debtor's intangible assets are unencumbered," they nonetheless attempted to protect creditors "to some extent by adapting the basic ideas behind ostensible ownership to the case of choses in action. The most important development of this sort is known as the doctrine of Benedict v. Ratner." J. MACLAGHLAN, supra note 8, at 266 (footnotes omitted). Another source of judicial dislike was the principle that one cannot transfer that which one does not yet own, as modified by its derivative theory of "potential possession." In addition, some courts required that a secured party "perform some Baconian 'new act' to 'perfect his title' or 'ratify the [after-acquired property interest]'; this meant taking possession of the property, unless one of the early statutes providing for filing was in effect. GILMORE at 33, 31. The courts' attitude and the rationale for it, which are much more complex than my brief summary indicates, are well analyzed in id. at 27-47, 250-86.
13. See generally GILMORE at 5-250.
14. Id. at 27; see id. at 288-80.
15. The apt adjective is from J. MACLAGHLAN, supra note 8, at 257 (discussing states' doctrines of fraudulent retention of possession).
security law under one roof.\textsuperscript{16} It legitimized the status of nonpossessory interests and provided a workable mechanism—filing in a public office—for satisfying the requirement that potential creditors be put on notice that certain assets of the debtor might be subject to claims by others.\textsuperscript{17} The draftsmen, however, did not abandon established doctrine; indeed, they accepted "without question" the distinction between possessory and nonpossessory security interests.\textsuperscript{18} Article 9 retains a category of exclusively possessory security interests: certain types of collateral must be pledged, essentially in the old fashion. It likewise designates a category of exclusively nonpossessory security interests: for certain types of collateral, one cannot use the pledge. For most types of collateral, however, either method is permissible.\textsuperscript{19} On its face, then, Article 9 only slightly reduces the role of possession. But commercial developments in the years since its drafting suggest that its nonpossessory interests are of major importance and that its retention of exclusively possessory interests is of questionable utility and, indeed, sometimes proves to be little more than a stumbling block.

Article 9 rejected \textit{in toto} the old notion that nonpossessory interests in after-acquired property are suspect. It dramatically expanded the parties' freedom to create security interests in all kinds of after-acquired collateral, regardless of the ultimate nature of the collateral.\textsuperscript{20} The best-known example, and perhaps the most widely used financing device under Article 9, is the security interest in present and future inventory and accounts receivable. This is the so-called "floating lien," which secures a debt that may change in size and covers collateral that is amorphous and likewise changeable.\textsuperscript{21} The floating lien has

\textsuperscript{16} Article 9 applies to almost all transactions intended to create security interests in personal property or fixtures, as well as to most sales of accounts and chattel paper (often functionally equivalent to transfers for security). Section 9-102. Section 9-104 excludes certain transactions that might otherwise come within Article 9; these generally consist of transactions subject to overriding federal statutes or to special social legislation of the enacting state and transactions that are outside the normal range of commercial financing. The drafting history and intended scope of Article 9 are set out in \textsc{Gilmore} at 288-316.

\textsuperscript{17} \textsc{Gilmore} at 462-66. As Professor Gilmore points out, the filing system was not a new idea; most of the pre-Code statutes that had legitimized various nonpossessory security devices had required filing of some sort. \textit{Id.} at 462-63, 466-80.

\textsuperscript{18} \textit{Id.} at 290.

\textsuperscript{19} See pp. 1031-32 & notes 71-80 \textit{infra} (explaining in somewhat greater detail Article 9's approach to filing and pledge and noting exceptions to general rule).

\textsuperscript{20} \textsc{Gilmore} at 357. The basic provision is § 9-204(1), which states that "any or all obligations covered by the security agreement [may] be secured by after-acquired collateral." Section 9-204(2) adds a limitation for consumer goods given as additional security. Other sections implement this basic provision by explicitly negating obvious pre-Code obstacles. See, e.g., §§ 9-202 (making "title" to collateral irrelevant), 9-205 (repealing Benedict v. Ratner, 268 U.S. 353 (1925), \textit{see note 12 supra}). For an explanation of the Code's approach, see \textsc{Gilmore} at 354-66.

\textsuperscript{21} The Code does not use the term "floating lien," but this colorful term has long been applied to the Article 9 security interest in after-acquired property. \textit{See} 1 P.
two characteristics that are important here: it is inherently nonpossessory, and the collateral to which it is "attached" is "fluid" or interchangeable. Part II of this article will focus on these two aspects of the floating lien, in the context of bankruptcy law. The current Bankruptcy Act has been the most serious challenge to the validity of Article 9's nonpossessory security interest in after-acquired collateral. The proposed new Bankruptcy Act would codify for the first time two lines of case-law development in a manner that would legitimize not only the floating lien but also its underlying concept of interchangeable collateral. The remarkable success of the floating lien demonstrates a reversal of old attitudes and suggests that the significance of a secured party's right to demand "possession" of particular items of collateral is, if not already dead, well on its way to the grave. Part III then turns to the basic issue of the old pledge itself, particularly its public notice aspect. Article 9 preserved this aspect of "possession." The section that validates security interests despite the debtor's retention of possession is expressly limited to nonpossessory security interests, and the official comment emphasizes that "[t]he common law rules on the degree and extent of possession which are necessary to perfect a pledge interest . . . are not relaxed by this or any other section of this Article." The items of collateral that Article 9 designates as exclusively "pledgeable" have been central figures in recent developments in commercial practices. These developments concretize the implications of the proposed new Bankruptcy Act, with


22. The utility of the floating lien inheres in its nonpossessory nature and in the lack of restrictions on the types of collateral it may cover. For example, a manufacturer may convert raw materials into finished inventory, then sell the inventory to produce cash, chattel paper, or accounts. An Article 9 security interest in the raw materials may "flow" through the finished inventory into its proceeds and follow through as the proceeds are reinvested in new raw materials; the parties may repeat the cycle again and again, without executing any documents other than a properly drawn security agreement and a properly filed financing statement. For discussion of the floating lien and the filing system that facilitates it, see GILMORE at 359-65, 462-80.

It is true that some aspects of a floating lien could be preserved through a series of possessory security transactions; the ability to follow proceeds would not be too different from the ability to do so with respect to nonpossessory interests, for § 9-312(7), added in 1972, would allow a limited back-dating of priorities for future advances. By and large, however, each possessory security interest stands on its own feet. In the absence of a nonpossessory security interest and a nonpossessory method of "perfection" (e.g., filing), an after-acquired property clause, for example, would be nugatory unless the debtor made the physical transfer after obtaining rights in the collateral.

23. Section 9-205 (providing that "[t]his section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee").

24. Id., Comment 6.
its acceptance of the floating lien idea of interchangeable collateral: they suggest that “possession” may no longer be a particularly useful concept and may soon become as much an obstacle as nonpossession was in 1900. Article 9’s present structure cannot completely accommodate this change. Part III explicates the problem and offers some suggestions for the draftsmen who will have to adjust Article 9 to the changing commercial world.

II. Article 9 Security Interests and the Proposed New Bankruptcy Act

When a debtor enters or is thrown into bankruptcy, the secured creditor faces two distinct threats. The first is that his claim may not be recognized as a secured claim valid against the trustee in bankruptcy and entitled to priority over unsecured claims; this is a direct threat to the existence of his rights as a secured creditor. If his claim survives as a valid security interest, there is the further threat that the secured party will not be allowed to enforce his rights in the manner and at the time provided in his security agreement with the debtor. Restrictions on enforcement come in two forms: the temporary stay of proceedings against the debtor and the permanent alteration of the secured party’s rights. The risk of permanent alteration is greatest in reorganization proceedings, as opposed to liquidation (or straight bankruptcy), for the goal of reorganization is to preserve the bankrupt business as a going concern. This may require that the secured party be compensated in a manner other than through his contractual “right” to obtain possession of his collateral.

In 1970 Congress authorized the creation of the Commission on the Bankruptcy Laws of the United States. The Commission’s 1972 report furnished the basis for a number of bills in both Houses; the bill passed by the House of Representatives, H.R. 8200, has received the most attention and will serve as the focus for analysis here.

27. H.R. 8200, 95th Cong., 1st Sess., 123 CONG. REC. 6838 (daily ed. July 11, 1977) [hereinafter cited by section number only]. The House of Representatives passed H.R. 8200 on Feb. 1, 1978. See 124 CONG. REC. H478 (daily ed. Feb. 1, 1978). The latest Senate counterpart is S. 2266, 95th Cong., 1st Sess., 123 CONG. REC. S18244 (daily ed. Oct. 31, 1977). It differs materially on some provisions but corresponds to H.R. 8200 on most of the points that concern us here, although it generally departs less from present bankruptcy concepts than does H.R. 8200. The fate of these bills is highly uncertain, primarily because of the controversial issue of whether the new bankruptcy courts will be created under Article I or Article III of the Constitution. In all probability, however, a new Bankruptcy Act
8200 would update the text of the current Bankruptcy Act; most of its provisions are well supported by case precedent, although the cases have not always been free from ambiguity. Hence, the bill may be viewed to some extent as an expression of the response of federal bankruptcy law to changes in the commercial environment. The content of that response may likewise be viewed as an indication of the concepts or principles to which the commercial world attaches importance. Significantly, the policies embodied in H.R. 8200 with respect to the validity of security interests reflect a dramatic reversal of the old bias against nonpossessor-y security interests in changeable collateral. The new provisions that would “temporarily” limit enforcement of secured claims reflect a similar reversal, though they are less separable from considerations peculiar to bankruptcy law. For present purposes, the significance of H.R. 8200 is that it illustrates the changing nature of collateral—from “property rights” in specific items that a secured party can “possess” and sell to something more like a prior claim against a debtor’s fungible assets. The implications of these new provisions provide a valuable historical and conceptual backdrop for appreciating the problems discussed in Part III.

A. Validity of the Security Interest: A New Preference for the Floating Lien

Before and shortly after the U.C.C. came into effect, predictions were freely made that its most suspicious nonpossessory security interest, the floating lien on inventory and accounts receivable, would succumb to section 60 of the current Bankruptcy Act.\(^2\) Section 60 empowers the trustee in bankruptcy to nullify certain transfers by the debtor, including transfers for security, as “voidable preferences.”\(^2\)

will be in effect well before our mythical 1988 draftsmen begin their task. It seems unlikely that major changes will be made in the provisions that I wish to discuss here, regardless of whether the supporters of H.R. 8200 ultimately succeed in their quest for Article III tenure and status for the bankruptcy judges.

28. 11 U.S.C. § 96 (1970). Any security interest that falls within the proscription of § 60 can be invalidated by the trustee; see note 29 infra; nor is that section the limit of the trustee’s powers. See Bankruptcy Act § 67, 11 U.S.C. § 107 (1970) (power to invalidate certain liens and fraudulent transfers); id. § 70(c), 11 U.S.C. § 110(c) (1970) (“strong-arm” clause giving trustee rights and powers of hypothetical lien creditor); id. § 70(e), 11 U.S.C. § 110(e) (1970) (power to invalidate transfers “fraudulent” or “voidable” against any other creditor of bankrupt).

I focus on the floating lien not only because of the old hostility against such security interests, but also because its supposed conflict with § 60 has been a center of vociferous controversy. See 1 COOGAN, HOGAN & VAGTS § 9.03 (discussing trustee’s powers to invalidate security interests); notes 29 & 37 infra (citing literature).

29. A “voidable preference” is defined as

\[\text{a transfer} \ldots \text{of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent}\]
The idea is to prevent creditors from snatching additional collateral (or payment) during the period immediately preceding bankruptcy (the "preference period"), thereby depleting the estate and obtaining more than their fair share of the assets of the failing business. An early case, In re Portland Newspaper Publishing Co., seemed to bear out the predictions; in the Bankruptcy Court, Referee Snedecor read the Bankruptcy Act literally and found a legal preference where no economic preference, or depletion of the estate, was apparent. The district court reversed. When the case, then dubbed DuBay v. Williams, reached the Ninth Circuit, the district court's holding was affirmed: although some, possibly all, of the accounts covered by the floating lien had come into existence during the preference period,

and within four months before the filing by or against him of the [bankruptcy] petition... the effect of which... will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

Any such preference may be avoided by the trustee if the creditor... has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Bankruptcy Act § 60(a)(1), (b), 11 U.S.C. § 96(a)(1), (b) (1970) (emphasis added). Such a preferential transfer "enables a creditor to receive payment of a greater percentage of his claim against the debtor than he would have received if the transfer had not been made and he had participated in the distribution of the assets of the bankrupt estate." House Comm. on the Judiciary, Bankruptcy Law Revision, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 177 (1977) (to accompany H.R. 8200) [hereinafter cited as House Report]. Further justifications for the trustee's "avoiding powers" under § 60 are to deter the "race of diligence" by creditors who suspect that a debtor will file a bankruptcy petition and hence to further the policy of equality of distribution among creditors of a bankrupt debtor. See House Report, supra at 177-78; King, Voidable Preferences and the Uniform Commercial Code, 52 Cornell L.Q. 925 (1967).

The threat to an Article 9 floating lien should be apparent. Consider, for example, a secured party (SP) whose collateral consists of accounts and whose debtor (D) has filed a petition in bankruptcy. In a well-managed business, almost every account will have come into existence within four months of the filing of the petition. Assume that SP has made his advance and created his security interest much more than four months earlier. There is thus an antecedent debt, but cf. note 35 infra (noting ambiguity of antecedent debt question in light of § 9-108). If SP is intelligent enough to have followed D's affairs, he will probably have had reasonable cause to believe that D was insolvent at the time the accounts came into existence. Depending on when the trustee considers the "transfer" to have occurred, he might attempt to invalidate SP's secured claim as a voidable preference. For a good discussion of the problem, see Skilton, Security Interests in After-Acquired Property Under the Uniform Commercial Code, 1974 Wis. L. Rev. 925. For examples of early predictions that the trustee would succeed in such an endeavor, see Gordon, The Security Interest in Inventory Under Article 9 of the Uniform Commercial Code and the Preference Problem, 62 Colum. L. Rev. 49, 57 (1962); Kennedy, The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9, 14 Rutgers L. Rev. 518, 539-44 (1960); Riemer, Bankruptcy—Preference—Conflict between Section 9-108 of Uniform Commercial Code and Section 60(a) of Bankruptcy Act, 70 Col. L.J. 65, 66 (1965).

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1020
their "transfer," said the Ninth Circuit, had occurred long before, when the secured creditor had filed his financing statement.\textsuperscript{33} At face value, the reasoning of DuBay is faulty, for filing alone does not perfect a security interest under the Code.\textsuperscript{34} In addition, the language of the opinion was not limited to accounts and inventory, and the Code is ambiguous on whether early filing should insulate other kinds of after-acquired collateral from attack as preferences.\textsuperscript{35} Nevertheless, DuBay, along with the similar Seventh Circuit case, Grain Merchants v. Union Bank & Savings Co.,\textsuperscript{36} seemed to have settled the preference issue in the courts at least with respect to inventory and receivables, although academic controversy has continued.\textsuperscript{37}

Before Portland Newspaper had become DuBay, this writer and others had persuaded the National Bankruptcy Conference that the existing U.C.C. and bankruptcy law provisions could not provide a logical answer to a U.C.C. problem not foreseen by the draftsmen of section 60. A new committee, with Grant Gilmore as Chairman, was appointed to determine what the law ought to be. New drafts

\begin{itemize}
\item \textsuperscript{33} 417 F.2d 1277, 1289 (9th Cir. 1969). The Bankruptcy Act provides that the "transfer" occurs when the security interest becomes "so far perfected that no subsequent lien upon [the collateral] . . . could become superior to the rights of the transferee." Bankruptcy Act § 60(a)(2), 11 U.S.C. § 96(a)(2) (1970). Often this means filing. \textit{But cf.} pp. 1031-32 & notes 71-80 \textit{infra} (explaining "perfection" under Article 9); note 41 \textit{infra} (discussing problems in interpreting this test with respect to floating lien).
\item \textsuperscript{34} The security interest must also "attach" under § 9-203(a). \textit{See} pp. 1031-32 & notes 71-75 \textit{infra}.
\item \textsuperscript{35} The ambiguity is found in § 9-108, which provides that after-acquired collateral is, generally, not to be deemed security for "antecedent debt." Section 9-108 does not distinguish among types of collateral, but it is clearly aimed at protecting inventory and receivables financing. The section has been attacked as a sneaky attempt to circumvent the provisions of the Bankruptcy Act. \textit{See} Countryman, \textit{Code Security Interests in Bankruptcy,} 75 Com. L.J. 269, 275-76 (1970). DuBay did not rely on § 9-108: "The intent of the draftsmen to insulate [the floating lien] from preference attack is evidenced by § 9-108 . . . We do not reach the question, hotly contested by the parties, whether the Commercial Code draftsmen were successful in thus defeating a claim of preference." 417 F.2d at 1289 n.15. \textit{Cf.} Grain Merchants v. Union Bank & Savings Co., 408 F.2d 209, 218 (7th Cir.), cert. denied, 396 U.S. 827 (1969) (declining to pass on question but noting that court would be "reluctant" to hold that provision enacted by 49 states does not fall within § 60's reference to state law in lien creditor test for determining time of transfer). To my knowledge, no court has ever upheld a floating lien on the basis of § 9-108 alone. If § 9-108 were part of the Bankruptcy Act, there would of course be no question as to its validity. Section 547 of H.R. 8200 would accomplish much of what § 9-108 attempts. \textit{See} pp. 1022-24 & notes 40-41, 43-44 \textit{infra}.
\item \textsuperscript{36} 408 F.2d 209 (7th Cir.), cert. denied, 396 U.S. 827 (1969).
\end{itemize}
of section 60 were exchanged for several years, and a general consensus emerged in 1970.\textsuperscript{38} The Gilmore Committee's proposed redraft was recommended by the Committee to Study the Bankruptcy Laws; with many verbal changes, that draft has survived the various versions of the proposed new Bankruptcy Act. Although it has again been reworded as section 547 of H.R. 8200, the analytic structure of the Gilmore draft remains.\textsuperscript{39}

Proposed section 547 aims at a \textit{modus vivendi} between secured and unsecured creditors and, like all compromises, gives something to each side. With respect to inventory and accounts receivable, it would exorcise whatever remains of the old antipathy to the floating lien by scrapping the current preference test and replacing it with one that focuses exclusively on whether the secured party has improved his position economically, to the detriment of the estate.\textsuperscript{40} No longer would it be even arguably relevant that particular items of collateral had first come into the debtor's possession during the preference period; proper filing would protect the floating lien on inventory and accounts, subject only to the new economic preference test.\textsuperscript{41}


\textsuperscript{39} \textit{Compare} H.R. 8200 \textsection 547 with \textit{Gilmore Committee Report}, supra note 38, at 210-19 (proposed redraft of Bankruptcy Act \textsection 60).

\textsuperscript{40} H.R. 8200 \textsection 547(c)(5). This subsection sets up a two-point measuring system that compares the position of the transferee (or secured party) three months before the filing of the bankruptcy petition with his position at the date of filing. "Intervening fluctuations in the relationship between debt and collateral during the [three]-month period are ignored." \textit{Gilmore Committee Report}, supra note 38, at 216. For a detailed discussion of the new "economic preference" test, see Kronman, \textit{The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act}, 124 U. PA. L. Rev. 110, 141-58 (1975).

\textsuperscript{41} The relationship to the "possession" idea is somewhat murky but not quite indirect. Under \textsection 9-303(1), a security interest must "attach" in order to be "perfected" against subsequent lien creditors, \textsection 9-301(b). One of the requirements for attachment is that the debtor have "rights in the collateral," \textsection 9-203(1)(c). See pp. 1031-32 \& notes 71-80 infra (explaining Article 9's "perfection" rules). "Rights in" is not defined in the Code, and the term is not equivalent to "possession," although there is a conceptual relation. The difficulty this created under the Bankruptcy Act's "lien creditor" test for determining the time of "transfer," \textsection 9-204 provided that "the debtor has no rights . . . in an account until it comes into
This new advantage for the secured party, however, would not apply to other kinds of collateral. Here, in fact, the secured party would lose ground: although the preference period would be shortened from four months to three (a gain for the secured party), insolvency during the three-month period would be presumed (a gain for the trustee and unsecured creditors). More importantly, the implication of DuBay, that the "transfer" takes place not when the collateral comes into the debtor's hands but rather years earlier when the filing was made, would be expressly negated. For inventory and receivables,
this would be irrelevant, since the economic preference test essentially dispenses with the temporal element of "transfer." For other collateral, however, it would clarify an ambiguity in the case law to the clear disadvantage of secured creditors.

The historical irony in this approach is that it gives a preferred status to the floating lien on inventory and accounts, formerly the most endangered species of after-acquired property interests, and clearly declines to protect other types of collateral and other types of liens in the same manner. Although section 547 would not, for any kind of collateral, abrogate the traditional principle of "substitution" of collateral,\(^4\) it would significantly relax the requirement with respect to inventory and accounts. The division, of course, is not between "possessory" and "nonpossessory" interests except insofar as the floating lien is inherently nonpossessory.\(^4\) But this merely emphasizes the irrelevance of the distinction and does not detract from the illustrative value of my historical point.

F.2d at 1287-88. This reasoning "neglects the fact that under Article 9 itself, the after-acquired property interest is not perfected until the property is acquired" and "apparently . . . [would] mean that a pre-filed Article 9 security interest in after-acquired property can never be a preference." *Gilmore Committee Report, supra* note 38, at 218. Proposed § 547 of the Bankruptcy Act would negative DuBay by including the Article 9 concept that there is no perfection until the debtor has "acquired rights in the collateral." Section 9-203(l)(c). Thus a security interest in property acquired by the debtor during the three-month preference period would be treated as a transfer for antecedent debt, voidable as a preference. If the secured party had contemporaneously given equivalent new value, of course, he would not have obtained any preference, and his security interest would remain a valid secured claim. *See Gilmore Committee Report, supra* note 38, at 218-19.

45. It has always been the case that the substitution of one set of items of collateral for another of equivalent value does not constitute a "preference," in the same way that the transfer of a security interest in consideration for a contemporaneous advance does not constitute a transfer for "antecedent debt." For a brief discussion of the "substitution of collateral doctrine," see *Grain Merchants v. Union Bank & Savings Co.*, 408 F.2d 209, 217-18 (7th Cir.), cert. denied, 396 U.S. 827 (1969).

46. "Inventory" is not exclusively "nonpledgeable" under Article 9, that is, security interests in such collateral are not necessarily nonpossessory; one might even use the term "floating lien" to describe a field warehousing arrangement, under which a professional warehouseman acts as custodian of inventory, physically monitoring and controlling its continual replenishment and depletion on behalf of the secured party. *See GILMORE* at 146, 146-54 (describing field warehousing operation and noting that it was considered "a pledge, or a sort of pledge, or something that was more nearly like a pledge than it was like anything else"). "Accounts," on the other hand, are exclusively "nonpledgeable." *See* p. 1032 & notes 76, 77 *infra*. In practice, of course, the floating lien is almost always nonpossessory, that is, always perfected through filing. Except under a field warehousing arrangement, a creditor would seldom take possession of particular items of inventory in order to perfect his security interest, unless his intent were to bring business operations to a halt rather than to finance them on an ongoing basis. *Cf. GILMORE* at 149 (noting that, although it was always part of field warehousing "mystique . . . that filing was neither necessary nor desirable" and that lenders usually considered themselves pledgees, financing companies, "not much given to mysticism," almost always file anyway).
B. Limitations on Enforcement: Nonpossession and Interchangeable Collateral

At least since the early 1940s, secured parties should have been aware of the possibility that they might not be allowed to enforce their rights to take possession of and to retain or dispose of collateral under security agreements providing for such action upon default. The tendency to prevent secured parties from exercising their full rights is clear in the case law and is further evidenced in post-Code Bankruptcy Rules. H.R. 8200 would codify these restrictions in provisions that would apply to both liquidations and reorganizations.

Section 362 of the proposed Act would essentially duplicate the automatic stay provisions of the present Bankruptcy Rules: the filing of a bankruptcy petition would operate to stay enforcement of most legal actions against the debtor, including that of liens on his property. The stay would be automatic, but the secured party could bring about its termination or modification "for cause." Section 363 would allow the trustee to sell or continue to use the secured party's collateral,

47. See, e.g., Reconstruction Fin. Corp. v. Kaplan, 185 F.2d 791 (1st Cir. 1950) (repossession by secured party forbidden in Chapter X bankruptcy); cf. In re Third Avenue Transit Corp., 198 F.2d 703 (2d Cir. 1952) (recognizing public interest in permitting trustee in Chapter X bankruptcy to use proceeds subject to security interest, but holding that trustee had not met heavy burden of proof that use of these proceeds was absolutely necessary and would not injure secured party). The possibility that a creditor "otherwise compensated" could not enforce a lien on his original collateral was also recognized under the predecessor to Chapter X. See Consolidated Rock Prods. v. DuBois, 312 U.S. 510 (1941). For recent cases, see, e.g., In re Bermec, 445 F.2d 367 (2d Cir. 1971) (repossession by secured party forbidden in Chapter X bankruptcy); In re Yale Express Sys., 384 F.2d 990 (2d Cir. 1967) (same).


49. The sections discussed in the following text, with the exception of those pertaining to class approval of reorganization plans, would be "generally applicable" provisions. In theory, this would probably extend the trustee's powers in liquidation proceedings. The practical effect, however, would probably not be great. When the debtor's assets are substantial, liquidations are less common than attempts at reorganizations. Furthermore, the trustee in a liquidation has little reason to exercise greater powers than those under the automatic stay provisions, see note 48 supra; he would have no objection, for example, to a secured party's repossession and disposing of his collateral and turning over any surplus to the trustee, unless he thought he could obtain a higher price by disposing of such assets himself. See 1 COOGAN, HOGAN & VACTS § 9.021.


51. H.R. 8200 § 362(d)-(g). "Cause" includes "lack of adequate protection of an interest in property of [a] party in interest." These provisions bring into play id. § 361, which is aimed at protecting the secured party when his rights must be altered in the interest of allowing reorganization to proceed. See p. 1027 infra.
subject to important qualifications. If the collateral were "soft collateral"—collateral that would disappear if used, such as inventory, cash, or accounts—the debtor could use it for only five days; after that, he would be required to obtain court permission by showing, at a hearing, that the secured party would not be injured by the delay.\footnote{52} If the collateral were "hard," the debtor would have much greater freedom to use or sell, but the secured party could attempt to stop him.\footnote{53} This section is new in that it would codify the debtor's right to use collateral, but it is supported by precedents such as \textit{In re Bermec},\footnote{54} \textit{In re Yale Express Systems},\footnote{55} and pre-Code cases such as \textit{Reconstruction Finance Corp. v. Kaplan}.\footnote{56} Finally, section 364 sets forth rules that would govern the debtor's use of assets to raise new

\footnote{52}{H.R. 8200 § 363(a), (c)(2). Proposed § 363(a) defines "soft collateral" as "inventory, farm products, accounts, contract rights, general intangibles, cash, negotiable instruments, documents of title, securities, or chattel paper in which the estate and an entity other than the estate have an interest" (emphasis added). Section 363(c)(2) provides for notice and a hearing for the secured party before soft collateral can be used for more than five days. Debtor attorneys undoubtedly will argue that the five days is too short; secured creditor counsel will argue that in five days inventory and cash will have disappeared. The five days may well be changed before the section becomes law.}

\footnote{53}{Although proposed § 362 of the Bankruptcy Act does not speak in terms of "hard collateral," the phrase can reasonably be applied to all collateral not covered by subsection (a), such as machinery or motor vehicles. See note 52 \textit{supra}. Subsection (c)(1) concerns such property and provides that the trustee may "enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing." Subsection (e) permits any entity that has an interest in property proposed to be used, sold, or leased by the trustee to obtain a court hearing, at which the "trustee has the burden of proof on the issue of adequate protection."}

\footnote{54}{445 F.2d 367 (2d Cir. 1971). \textit{Bermec} was a Chapter X case, involving trailers purchased by the debtor on conditional sales contracts and then leased to others. The court of appeals affirmed Bankruptcy Judge Asa Herzog's decision, No. 71-B-291 (S.D.N.Y. July 15, 1971), which had allowed the debtor to continue to use the trailers, although they were subject to a security interest. Judge Herzog's decision relied on the trustee's willingness to pay to the secured party an amount equal to the depreciation on the trailers during their use—perhaps the first case in which permission to use collateral was tied to payment to a secured party.}

\footnote{55}{384 F.2d 990 (2d Cir. 1967). \textit{Yale Express} was factually similar to \textit{Bermec} but differed legally in that the payment to compensate for use was not required. An earlier decision in the same case had suggested the possibility that rental payments could be made to the secured party, 370 F.2d 433, 439 (2d Cir. 1967). But when the district court found that Yale Express was in no position to pay, the Second Circuit nevertheless affirmed an authorization of the debtor's use of the collateral, this time with the weak condition that the secured parties be made whole in the reorganization. \textit{Yale Express} gives the secured party less protection than would proposed § 361. \textit{See} p. 1027 \textit{infra}.}

\footnote{56}{185 F.2d 791 (1st Cir. 1950). This decision permitted the trustees of Waltham Watch, in a Chapter X bankruptcy, to use cash subject to the secured party's lien for the purpose of converting unfinished watch parts into saleable watches. The court reasoned that the secured party would not be injured by this use of cash, since the finished watches would be worth far more than the unfinished parts. The secured party must have thought differently, or he would not have fought such a long battle in the courts. \textit{Kaplan} relied on an earlier railroad reorganization case, \textit{Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & Pac. Ry.}, 294 U.S. 648 (1935). 185 F.2d at 793-97.}
money, under which a secured party might find that a new lender shared his security or even came ahead of him.\(^{57}\)

All these sections would be subject to the “adequate protection” standards of proposed section 361. The court would have to protect the secured party by requiring periodic payments to compensate for any decrease in value of collateral that remained beyond the reach of the secured creditor;\(^{58}\) by giving the secured party different or additional collateral to replace that for which he had contracted;\(^{59}\) or by transforming his secured claim into an administrative claim entitled to priority under proposed section 503(b)(1), provided that the court found as well that the estate would have assets to make this priority meaningful.\(^{60}\) The court might also approve other methods to compensate for loss.\(^{61}\) On paper, these protections look good for the secured party. But debtors are often unable to make periodic cash payments; just as frequently, they can furnish no additional or substitute collateral. In such cases, the secured party would have to rely on the bankruptcy judge’s ability to predict accurately whether the estate would have sufficient assets to pay administrative expenses. The judge’s guess might well prove wrong, especially if made early in the proceedings, when the guesses are often long ones.

Significantly, these proposed bankruptcy sections purport to protect the secured party not through his interest in his specific collateral, but rather through some form of compensation that may involve other collateral or other assurances; they use and expand the U.C.C. concept of “substitutability” of collateral. This feature is carried even further in the provisions of H.R. 8200 that would allow courts to approve reorganization plans without the consent of one or more classes of creditors. Class acceptance of a plan would be excused if the class claims were “unimpaired.”\(^{62}\) Reinstatement of an original maturity date generally would not be an impairment;\(^{63}\) moreover, class claims would be unimpaired if the plan gave the class cash or other “property” (excluding securities of the debtor) equal to the “value” of each

\(^{57}\) H.R. 8200 § 364(a) would allow the trustee to “obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under § 503(b)(1) of this title as an administrative expense.” If such credit were not allowable as an administrative expense, subsection (c) would permit the trustee, after notice and a hearing, to obtain credit with priority over all administrative expenses or secured by a junior lien on property already subject to a lien.

\(^{58}\) Id. § 361(1).

\(^{59}\) Id. § 361(2).

\(^{60}\) Id. § 361(3).

\(^{61}\) Id. § 361(4).

\(^{62}\) Id. § 1129(a)(8)(B).

\(^{63}\) Id. § 1124(2)(B).
creditor's claim. Even if class claims were impaired, and the class had not given its approval, the court could nonetheless confirm the plan provided that no secured creditor would receive more than the value of his claim and that each secured creditor would receive property (here not excluding securities of the debtor) equal to the allowed value of his claim. Hence a secured party might have to be satisfied with an entirely new claim or collateral for which he never contracted, despite rejection of the substitution by him or his class as a whole.

These restrictions on the rights of secured creditors may raise constitutional issues that far exceed the scope of this article. The significant point here is that they depend on the same conceptual device as does the floating lien—that collateral can be amorphous and changeable without losing its character as collateral. If, in a reorganization, a secured party winds up with something different from the collateral to which his original lien was attached, the substitution will not be cause for legal concern. This contrasts starkly with the old notion that a secured party can, upon default by his debtor, repossess his collateral and “make himself whole” to the extent the collateral is worth the amount of the debt. In such a framework, what happens to the debtor and his other creditors is a matter of indifference to the secured party. But judicial and regulatory developments have long suggested that this is no longer the case, and H.R. 8200 would continue the trend.

Significantly, H.R. 8200, in perhaps its most basic provision, pays little attention to who has possession of property in which the bankrupt (or the debtor in reorganization) has an interest: the estate, under proposed section 541(a)(1), would include “all legal or equitable interests of the debtor in property as of the commencement of the

64. Id. § 1129(b)(1)(B)(iii).
65. Id. § 1129(b)(2)(A). Neither “property” nor “value” is defined in the proposed Act.
66. The trustee has considerable powers, which are probably constitutional, under the current Bankruptcy Act and Rules and judicial interpretations of the so-called “crain-down” provisions that permit approval of plans that creditors reject. See generally 6 COLLIER ON BANKRUPTCY ¶¶ 10, 3.29-34, 7.37-47, 9.21 (1977); 6A id. ¶¶ 10.03, 10.14, 10.17; 9 id. ¶¶ 9.15-21.

H.R. 8200 would extend these powers; whether they could amount to a “taking” under the Fifth Amendment may well become a matter of some debate. For a discussion of these issues in the context of an earlier version of the proposed reorganization provisions, which were considerably less protective of secured parties’ rights, see Coogan, Broude & Glatt, Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills, 30 Bus. LAW. 1149 (1975). The issue is hardly new; in Consolidated Rock Prods. v. DuBois, 312 U.S. 510 (1941), for example, Justice Douglas held that a secured party has no constitutional right to continue an interest in his specific collateral so long as he is “adequately compensated. . . . [I]t is not material out of what assets [he] is paid . . . .” Id. at 550.
case," with certain exceptions not relevant here. Proposed section 543 (b)(1) would require any custodian possessing such property to turn it over to the debtor or trustee. And, under proposed section 542(a), any other person possessing property that the trustee could use or sell under proposed section 363 would likewise have to surrender possession. Thus a creditor who obtained possession prior to the commencement of the bankruptcy proceedings would often have no advantage over a creditor who did not take possession. These provisions represent a break even with the current bankruptcy law, under which "the jurisdiction of the bankruptcy [court] is limited by the concept of possession, either actual or constructive."67

This is not to say that H.R. 8200 generally distinguishes between possessory and nonpossessory interests as such. But in at least one crucial area—the preference provisions—it protects interests likely to be nonpossessory well beyond the point at which it refuses to protect interests more likely to be possessory. The reorganization provisions, with their broad endorsement of "interchangeable" collateral, depart even more from tradition. The "lien" on specific "property" has become, in essence, a claim to priority—a far cry from the mortgage on Blackacre and the closely related concept that possession of a particular item of property or collateral is of overriding legal importance.68

What is of overriding importance, both in the preference provisions of proposed section 547 and in the sections that would limit enforcement, is business necessity, in the form of an increased need for credit. The wail of the bankruptcy referee in Portland Newspaper is illustrative: in the good old days, a business enterprise was financed primarily by its owner, and, in time of trouble, its assets were available for distribution to unsecured creditors; now, businesses rely on credit far more heavily, and the increase takes the form of secured credit, at

67. House Report, supra note 29, at 43 (footnotes omitted). This is not true of Chapter X cases. Id. at 43 n.304. For a taste of the voluminous literature on what constitutes "possession" by the debtor, see sources cited in id. at 43 n.304, 305, 307 & 309. A particularly good treatment of the issue is Note, Scope of the Summary Jurisdiction of the Bankruptcy Court, 40 Colum. L. Rev. 489 (1940). The reasons for expanding the jurisdiction are set out in 1 Report of the Commission to Study the Bankruptcy Laws of the United States, supra note 26, at 88-92.

68. The floating lien of Article 9, though it covers constantly changing items of collateral, is nonetheless tied to the type or types of collateral described in the security agreement. The description in the security agreement, however, is "sufficient whether or not it is specific if it reasonably identifies" the collateral. Section 9-110. This section frees the parties of the common pre-Code requirements for excessively detailed descriptions of collateral (the "serial number" test), see Comment to id., and makes the true floating lien feasible. Cf. Grain Merchants v. Union Bank & Savings Co., 408 F.2d 209, 215-17 (7th Cir.), cert. denied, 396 U.S. 827 (1969) (espousing "entity theory" of Article 9 floating lien, which, although it "floats" over constantly changing specific items, is firmly attached to a very definite bundle of collateral).
The least to a large extent. Quite often this means credit secured by the floating lien on inventory and accounts, hence the recognition that such security interests must be protected against wholesale invalidation as voidable preferences. The limitations on enforcement are tied more to a different practical consideration recognized by debtors and creditors alike: the sacrifices that result when liquidation values are substituted for going concern values dictate compromises by all during efforts to salvage a debt-ridden business through reorganization.

Both these responses to commercial need—the preference provisions and the limitations on enforcement—have little in common with the importance formerly attached to collateral that a secured party “possesses” or even collateral of a nature specific enough that it could be “possessed.” Rather, they embrace the diametrically opposed concept of interchangeable collateral. This development is quite significant, for Article 9 itself now faces problems stemming from further commercial developments, and it appears that the best solution will have something in common with the bankruptcy response: a move away from the old notion of “possession.” With H.R. 8200, the tendency is away from the old bias against nonpossessor security interests, especially in “fluid” collateral. Article 9 has, of course, already taken that step. For Article 9, the move now required is one away from the more basic aspect of “possession,” the public notice aspect, which Article 9 accepted and perpetuated.

III. Possession and Public Notice: The Challenge for Article 9

The decreasing importance of the concept of possession is even clearer outside the bankruptcy area. One of the most striking developments in commercial practices in recent years has been the effort to eliminate in a variety of contexts the need for “paper” evidences of interests or claims. The trend creates severe problems for Article 9. 69

69. 3 U.C.C. Rep. at 214:
   The old-fashioned method of operating a business on the strength of equity capital and unsecured bank credit based upon the financial integrity of the debtor seems to be giving way to the modern trend of financing business operations in reliance upon a floating lien on current assets with little or no regard for equity capital. . . . These methods leave the daily suppliers and employees in a perilous position. I know of no studies that confirm Referee Snedecor’s comments in Portland Newspaper, but most businessmen would find it hard to disagree.

70. The floating lien, of course, covers “interchangeable” collateral only to a certain degree. See note 68 supra; cf. § 9-306(2)-(4) (automatic transfer of security interest in collateral covered by security agreement to proceeds of that collateral). The enforcement limitations of H.R. 8200 are even broader; instead of a lien that “floats” over changing items of collateral, they contemplate a lien that drifts away completely from the collateral to which it was moored by the security agreement. This would be tempered somewhat in liquidation, as opposed to reorganization, proceedings; in liquidation, the liens might often be allowed to find their moorings. See note 49 supra.
Article 9—An Agenda for the Next Decade

9, for the representative piece of paper usually falls within the category of exclusively pledgeable collateral, and the consequence of eliminating it is that the collateral becomes exclusively nonpledgeable. And then one must file to perfect one’s security interest, an alternative that would appear, at first blush, to be unsatisfactory for a number of reasons—although, as I will suggest, we may have to change some notions here.

Before exploring the problems that this creates, one must grasp the essence of the Article 9 approach to “perfection.” This requires, in the first instance, an unraveling of the awkward semantics of section 9-303. The first two sentences of section 9-303(1) state that “perfection” consists of all of the steps specified in section 9-203(1) to cause a security interest to “attach,” plus one or more of the steps specified in sections 9-302, 9-304, 9-305, and 9-306 as necessary to “perfect.” Section 9-305(2) uses the term “perfect” to cover both these requirements; this is the proper and only sensible meaning of “perfection.” But the last clause of the first sentence of section 9-303(1) is less artistically phrased; moreover, sections 9-302, 9-304, 9-305, and 9-306, which specify when certain steps such as filing are required for “perfection,” do not even mention the co-requirement of attachment. The language, although not incorrect, is certainly inartistic and has led to the use of “perfection” to refer to the steps required by the enumerated sections of Part 3 of Article 9 alone, even though satisfaction of those steps does not create a perfected security interest unless the attachment requirements of section 9-203(1) have also been met. “Perfection” was used to describe the effect of complying with

71. Under § 9-203(1), a security interest “does not attach unless (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral . . .; and (b) value has been given; and (c) the debtor has rights in the collateral.”

72. These sections deal with U.C.C. filing, see generally § 9-302; federal or state filing and notation on certificates of title, see § 9-302(3), (4); transfer of possession of the collateral, § 9-305; and permanent or temporary excuse from these requirements, §§ 9-302 (1)(d) (filing not required for purchase money security interest in consumer goods); 9-304 (4), (5), 9-306(2), (3) (temporary excuse from filing with respect to instruments, documents, and proceeds in certain circumstances).

73. The entire sentence reads as follows (emphasis added): “[a] security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken.” Section 9-303(1) (emphasis added). The next sentence adds that “[s]uch steps are specified in Sections 9-302, 9-304, 9-305 and 9-306.”

74. At least two distinguished courts of appeals seem not to have understood this. See DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969); Grain Merchants v. Union Bank & Savings Co., 408 F.2d 209 (7th Cir.), cert. denied, 396 U.S. 827 (1969). In each case, the court stated that after a U.C.C. financing statement had been filed, no unsecured creditor could have obtained a superior lien by legal process. This is simply not true. See notes 34 & 73 supra. In each case, however, there had in fact been more than a filing (i.e., the attachment requirements of § 9-203(1) had been met), so perhaps the opinions were imprecise rather than truly inaccurate.
the specified sections of Part 3 simply for lack of a ready phrase to
describe their real purposes: to specify when public notice of the cre-
ation of a security interest is required and to set out (indirectly) an
appropriate method of giving that public notice.75

Public notice is required to perfect virtually all security interests
under Article 9. The requirement can be satisfied in one of two basic
ways. “Notice filing” in a public office—a central Article 9 concept
and in most respects a significant improvement over pre-Code systems
—is a permissible means of notice for security interests in most types
of collateral;76 it is the only permissible method for “accounts” and
“general intangibles.”77 Article 9 also recognizes the old-fashioned
pledge as a public notice mechanism; filing, with the two exceptions
noted above, is excused when the collateral is in the possession of the
secured party.78 The pledge is the exclusive method of notice for
“instruments” and money.79 The upshot is that one must file as to
accounts and general intangibles; one must take possession of instru-
ments and money; and one may do either in most other cases.80

75. The text of Article 9 does not, unfortunately, specifically articulate the “public
notice” requirement. Professor Homer Kripke, in the early days of Article 9, once casually
mentioned the desirability of a phrase such as “giving (or excusing) public notice,” but
neither he nor I followed this up at a time when it could easily have been done. Logically,
of course, this underlying rationale is obvious; otherwise, the sponsors might as well have
required secured parties to stand on their heads or look toward Mecca or perform some
other ritual in order to perfect their security interests. In any event, the rationale is clear
from the official comments. See, e.g., § 9-302, Comment 1. And, of course, history makes
the rationale crystal clear. See GILMORE at 438-39, 462-64.

76. The general provision is § 9-302, which is phrased in terms of when filing is not
required. The various exceptions are briefly summarized in note 72 supra. Numerically,
filing (under the U.C.C. or some other system) is probably the most important method of
public notice; notation on automobile title certificates would probably be next.

77. By virtue of omission from § 9-305 (“When Possession by Secured Party Perfects
Security Interest Without Filing”) and from the other exceptions to § 9-302, filing is
required to perfect security interests in accounts and general intangibles. But cf. § 9-306
(2), (3) (temporary automatic perfection of security interest in proceeds).

78. Section 9-302(1)(a) (filing not required when collateral is in possession of secured
party under § 9-305); § 9-305 (possession by secured party perfects security interest in
letters of credit, advice of credit, goods, instruments, money, negotiable documents, or
chattel paper).

79. Section 9-304(1). This too must be qualified in light of §§ 9-304(4), (5) (temporary
automatic perfection of security interests in instruments, negotiable documents, and goods
in possession of bailee), 9-305(2), (3) (temporary automatic perfection of security interest
in proceeds). If an instrument forms a part of chattel paper, perfection as to the whole
(i.e., as to the chattel paper along with its accompanying instrument) may be by filing.
Sections 9-105(1)(b), 9-304(1).

80. The overgeneralization in the text must be read in light of the exceptions and
qualifications listed in notes 72 & 76-79 supra. The most significant exception, in terms
of sheer numbers, is the provision for notation on vehicles’ certificates of title, § 9-302
(3)(c), (4). Such security interests are so common that this mechanism might even be
considered a third “basic way” of satisfying Article 9’s public notice requirement. In addi-
tion, it bears repetition to emphasize that neither filing nor taking possession alone suf-
fices to “perfect”: the security interest must also attach under § 9-203(1).
This oversimplified description should serve to introduce some questions that the 1988 Committee to Review Article 9 would do well to answer. The sections that follow query the continuing validity of the underlying assumptions of the pledge, expose some problems that confront the Article 9 scheme as “paperless” transactions become more common and more desirable, and speculate on what alternative methods of public notice might better serve the modern commercial world.

A. Does the Pledge Really Give Public Notice?

The assumption behind the pledge is that, if a debtor retains possession of property he does not own “free and clear,” he may use these apparently unencumbered assets to deceive potential creditors or purchasers. Hence, if such fraud is to be prevented, encumbered assets must be removed from the debtor’s control.81 Article 9 implements the pledge through three basic provisions. Section 9-302(1)(a) excuses filing, and no other form of public notice is required. Section 9-203(1)(a) excuses the requirement of a writing signed by the debtor that describes the collateral when “the collateral is in the possession of the secured party pursuant to agreement.” Thus the transfer of possession satisfies the statute of frauds provision as well as the public notice requirement. Finally, section 9-305 deems a secured party to be in possession if any bailee has possession and is notified of the secured party’s interest in the collateral.82 The text does not require that the bailee in any way act for the secured party, but the official comment contemplates that the bailee will function as the secured party’s “agent,” or at least be free of the debtor’s control. It then adds that the bailee need not transfer the property to the secured party or even acknowledge that he now holds the property on the secured party’s behalf.83

The 1988 Committee to Review Article 9 should thoroughly reconsider each aspect of this mode of “perfection” through possession. Its most fundamental function—providing public notice—seems of questionable utility, even if the secured party himself takes possession. Without possession, of course, the debtor could not obtain false credit through another physical pledge, nor could he deceive a potential creditor into relying on his possession and apparent ownership of the

81. See pp. 1014-15 and notes 8 & 12 supra.
82. The secured party’s “possession” dates from the time the bailee receives notification of the secured party’s interest. Section 9-305.
83. Id., Comment 2. Cf. § 8-313(1)(d) (“Delivery [of an identified investment security still in the possession of a third person] to a purchaser occurs when . . . [the third] person acknowledges that he holds for the purchaser . . . .” (emphasis added)).
collateral. Many items of pledgeable collateral, however, would never be seen by inquiring creditors. A second security interest could be created through filing in certain cases, and in any event the debtor could sell the collateral despite his nonpossession. Often, it would only be by pure accident that a prospective creditor would learn that certain of the debtor's property was unavailable because now in the possession of someone else. Whatever significance there is in the pledge

84. This could happen, assuming fraudulent intent on the part of the debtor, in almost any case involving collateral that can be either pledgeable or nonpledgeable. If the prospective creditor were satisfied to check the public filing system and the prospective debtor's own financial records, he could easily be misled. Even if the prospective secured party were to send his detective to the prospective debtor's place of business, the detective would not see pledgeable items such as stocks, bonds, or cash. Cf. GILMORE at 463-64 (footnote omitted) (emphasis added):

It has often been suggested that modern techniques for the collection and communication of credit information have made filing systems unnecessary and obsolete. A businessman or a banker, it is said, in determining whether to extend credit or make a loan relies, not on public records, but on financial statements—balance sheets and profit and loss statements—submitted to him or to a specialized credit information agency by the prospective borrower. Public files, even if they are easily available, will be rarely consulted; they can in any case never be relied on since no filing system, including that established by Article 9, is comprehensive in the sense that a check of the files will reveal all possible encumbrances. So long as alternative methods of perfection are provided—such as possession by the secured party or the notation of liens on certificates of title—which do not depend on filing, a search of the files will always be inconclusive and crucial information must be procured from the borrower's financial statements. Since these statements are the best available, indeed the only available, sources of comprehensive credit information, and since they are in fact regularly relied on in granting credit and loans, they should, the argument runs, be made the basis of a truly modern system of creditor protection; public files should be scrapped and appropriate safeguards introduced to protect people misled by false or incomplete statements. The reef on which this ingenious and attractive argument usually founders is, of course, what these appropriate safeguards should be.

Financial statements, of course, rarely reflect a debtor's current status; they may be months behind. Thus representations by the debtor are usually required as well.

85. If the prospective creditor of note 84 supra filed to perfect a security interest in collateral that the debtor had pledged to someone else, his claim would be subordinate to that of any creditor who had already either filed or perfected a security interest in the same collateral. See § 9-512(a); cf. § 9-304(2) (if goods are in possession of issuer of negotiable document, security interest in document takes priority over any security interest in goods perfected while goods are held by such issuer).

86. See note 87 infra. The bailee too could sell the collateral, see note 88 infra. As for buyers of goods not in the ordinary course of business, see § 9-507(3) (protection against certain future advances by secured party). For protection of holders in due course and good faith purchasers of instruments, negotiable documents, and chattel paper, see §§ 9-308, 9-309.

The other side of the coin appears when creditors of a seller are deemed to rely on the seller's possession of goods he has already sold. This is primarily an Article 2 problem. See generally Jackson & Kronman, A Plea for the Financing Buyer, 85 Yale L.J. 1 (1975); Skilton, Buyer in the Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters), 1974 Wis. L. Rev. 1; Speidel, Advance Payments in Contracts for Sale of Manufactured Goods: A Look at the Uniform Commercial Code, 52 Calif. L. Rev. 281 (1964). As for the exposure of the pre-paying buyer to the seller's secured creditor, see Chrysler Corp. v. Adamatic, 59 Wis. 2d 219, 208 N.W.2d 97 (1973), noted in Jackson & Kronman, supra at 22 n.87, 23 n.91, 30 n.124 & 37 n.147.
idea lies not in the secured party's possession but in the debtor's non-
possessing, and nonpossession no longer gives much warning that the
property is subject to a security interest.

Indeed, it may be that even the assumption that the debtor, by
surrendering physical possession to the secured creditor, also surrenders
control over the collateral is no longer a valid premise. Until recently,
at least this much was taken for granted, and the secured party in
possession could entertain a justifiable belief that the debtor could
not physically dispose of the collateral, even to a buyer in the ordi-
nary course of business. But the New York Court of Appeals has re-
cently told us otherwise. This not only reemphasizes that the pledge
is a dubious means of giving public notice but also underscores the
need for our 1988 Committee to question the wisdom of another aspect
of the current rules of pledge—the exception from the statute of frauds
requirement of a security agreement that is signed by the debtor and
that describes the collateral. A debtor who surrenders possession may
have delivered the property for repair or for safekeeping or on lease.
Delivery in and of itself is not proof of purpose; certainly it is not
proof of the amount of debt secured or of the terms of the agreement.
When the collateral is in the possession of a bailee, both the public
notice assumption and the exception from the statute of frauds becomes
even more questionable, and the need for a fresh approach becomes
correspondingly clearer. It can happen all too easily that the bailee
is either unconscious of or unconcerned about his duties as the se-
cured party's "agent" and will allow the debtor to exercise control
over the collateral.88

that a buyer in the ordinary course of business took free of a possessory security interest
in the goods. Section 9-307(1) protects "ordinary course" buyers of goods from security
interests "created by [the seller even though the security interest is perfected and even
though the buyer knows of its existence." Professor Kripke, who participated in the
Tanbro case during its later stages, discusses the decision in his recent article, Should
Section 9-307(1) of the Uniform Commercial Code Apply Against a Secured Party in
Possession?, 33 Bus. Law. 153 (1977). He argues that the Code (presumably § 9-307(1) or
§ 1-201(9), which defines "buyer in ordinary course of business") be amended to exclude
from the "buyers of goods" protection of § 9-307(1) any goods subject to a possessory
security interest. The Tanbro decision might affect goods held in a public warehouse as
well as those in the seller's possession. On § 9-307(1), see generally Skilton, supra note 86.

88. Suppose D delivers his diamond-studded watch to the local jeweler for repairs. He
then decides to use the watch as collateral, and SP agrees to advance him money in re-
turn for a security interest in the watch. SP by mail (or SP's secretary by telephone)
"notifies" the local jeweler of D's agreement that the jeweler is to hold the watch for SP.
Note that the jeweler is not under SP's control; indeed, under § 2-402(2), (3), if an Article
9 bailee is engaged in selling such goods, he can sell the collateral to a buyer in the
ordinary course of business, and the buyer takes free and clear of any security interest in
the property. And here, where the jeweler is a bailee only by the accident of possessing a
Public filing or recording systems were originally considered "merely as a less desirable alternative to possession." Perhaps the question of whether public filing suffices to replace a physical change of possession should now be reversed: is the surrender of possession really the equivalent of some kind of public record of the existence of a security interest? It is obvious that creditors usually bottom their credit judgments on examinations of their debtor's financial statements, not on his possession or nonpossession of particular items of property. The notion of public notice through filing may also be overplayed, but, on the whole, placing even a sketchy warning on the public record seems a much more effective way to protect the rights of all affected parties. The unfortunate dilemma is that neither the existing Article 9 filing system nor the physical pledge seems quite adequate or appropriate for the types of security transactions that are emerging from new developments in commercial practices.

B. "Paperless" Instruments: Problems for Article 9

Developments in business practices during the last decade evidence a growing need for some method of conducting commercial transactions, including but not limited to the creation and perfection of security interests, without having to handle the traditionally necessary watch in need of repair and likely has little interest in the financial problems of his customer's creditors, it is quite possible that he would allow his customer to control the disposition of his property.

It is true that § 9-205, which repeals the "policing" rule of Benedict v. Ratner, 268 U.S. 353 (1924), by providing that "[a] security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to [use or dispose of collateral or proceeds] ... or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral," expressly states that it does not relax the requirements of possession when the collateral is held by a bailee. The Comment to § 9-205 emphasizes that the "common law rules on the degree and extent of possession ... necessary to perfect a pledge interest" are retained and that a secured party may lose his perfected security interest if he "allow[s] the debtor access to and control over the goods." Section 9-205, Comment 6.

There have been some intriguing cases dealing with the question of whom a bailee is acting for. In In re Dolly Madison, Inc., 351 F. Supp. 1038 (E.D. Pa. 1972), the district court held that an escrow agent could not be a proper bailee of stock certificates because it held for both parties. The Third Circuit affirmed per curiam, 480 F.2d 917 (3d Cir. 1973), and then had to eat its words when confronted with In re Copeland, 391 F. Supp. 134 (D. Del. 1975), aff'd in relevant part, 531 F.2d 1195, 1202-05 (3d Cir. 1976). See also Heinicke Instruments Co. v. Republic Corp., 543 F.2d 700 (9th Cir. 1976), discussed at pp. 1041-42 infra.

89. Gilmore at 438; see id. at 462.
90. An Article 9 financing statement usually gives precious little information, but even the skimpiest will tell any potential creditor who bothers to look that the debtor has done or may do something to encumber a type or types of his property. See § 9-402(l) (financing statement sufficient if it contains names and addresses of parties, appropriate signatures, and "a statement indicating the types, or describing the items, of collateral"). On the rationale of this type of "notice filing," see Gilmore at 466-80.
piece of paper. In part they reflect as well recent changes in methods of handling commercial transactions brought about by the electronic age. Two specific problems that arose from these developments have already been addressed and supposedly solved. The 1988 Committee will have to decide whether the solutions devised are, as I suspect, less than ideal, and whether the declining commercial importance of paper that embodies the rights of the parties signifies a corresponding decline in the importance of "possession."

1. Federal "Book Entry" for United States Bonds

Not too many years ago, federal fiscal authorities became disturbed over the number of robberies of federal government bonds, principally while in transit from one holder to another. During a brief period, several very substantial amounts had been stolen, and it was feared that United States bonds might become unattractive to some of the Treasury's biggest customers. This led to a search for a safer method of transferring ownership or other interests without the physical transfer of an instrument in a form convenient to a thief.

"Instruments" (such as United States bonds) are exclusively pledgeable collateral under Article 9; perfection thus requires the transfer of possession of a piece of paper enticing to a thief. Why, the federal fiscal authorities asked, could not the instrument, or at least its transfer, be eliminated and the rights of the holders (including secured parties) be evidenced in some other fashion? Article 9 offered some help—if Authority X physically possessed bonds in which other parties held interests, transfers could be made among the parties by "notification" to Authority X as a section 9-305 bailee, followed no doubt by some proper record. The bonds in Authority X's vault would not have to be disturbed. But such a procedure is limited in its scope; further, it demands that someone physically possess the bonds. A section 9-305 arrangement would have immobilized some bonds, but the interested parties desired not merely to immobilize the bonds but rather to eliminate the vexing piece of paper entirely.

Hence, the federal authorities, dissatisfied with what could be done under state law, devised a new solution—federal "book entry," a mechanism by which bonds could be delivered through banking channels to a Federal Reserve Bank, an appropriate entry made on the federal books, and the bonds themselves burned. Upon demand, the bank that had deposited the bonds could be issued an equivalent amount evi-
denced by new pieces of paper. Clearfield Trust Co. v. United States\textsuperscript{92} and related cases\textsuperscript{93} apparently authorized federal preemption on a matter so closely related to federal fiscal interests, and in 1972 a Federal Reserve regulation\textsuperscript{94} preempted the area—except that the method of perfecting security interests in the cremated bonds was left largely to state law, that is, to Article 9. The regulation simply provided that the entire book entry mechanism would be deemed to have the effect of a pledge of the bonds.\textsuperscript{95} State law entered at the point at which it became necessary to perfect the security interest by giving notice to the bailee under section 9-305.

This solution, however, was flawed, as illustrated by the following hypothetical put to me by a New York law firm that represented one of the banks. Bondholder delivers $1,000,000 in designated United States bonds to Small City Bank for safekeeping. Small City Bank accepts the bonds as a favor to a valued depositor, but because it has inadequate physical facilities for storage, it ships the bonds to its correspondent Albany Bank. Albany Bank, however, has only modest facilities; it forwards the bonds to New York City Bank, which deals heavily in United States bonds. New York City Bank knows of the new Federal Reserve regulation and transfers the bonds to the “Fed.” The Fed, in accordance with the regulation, makes a notation of the receipt of the bonds from New York City Bank and then burns them. Bondholder, in Small City, now decides to borrow $500,000 from Y Bank against the bonds he delivered to Small City Bank. He knows nothing of their successive transfers or of their subsequent destruction. Y Bank has no problem with Bondholder’s credit, but how should it proceed mechanically? If there can really be a “bailment” of non-existent bonds, who is the bailee whom Y Bank must notify under section 9-305? Albany Bank? New York City Bank? Clearly, it is not the Fed, for not only does the regulation seem to negate this possibility,\textsuperscript{96} but the Fed’s record also stops with its immediate depositor, who is not Bondholder.

\textsuperscript{92} 318 U.S. 363, 366 (1943), \textit{as amended}, 318 U.S. 744 (1943) (per curiam) (“rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law”).

\textsuperscript{93} See, \textit{e.g.}, National Metropolitan Bank v. United States, 323 U.S. 454, 456 (1945) (commercial paper); \textit{cf. United States v. Standard Oil Co.}, 332 U.S. 301, 311, 305-11 (1947) (extending \textit{Clearfield Trust} rule beyond context of commercial paper, but emphasizing that “question . . . is chiefly one of federal fiscal policy”).


\textsuperscript{95} 31 C.F.R. § 306.118(b) (1972).

\textsuperscript{96} The regulation never mentioned the problem and did not authorize the Federal Reserve to perform the function of a bailee.
It was the general opinion of bank counsel that section 9-305 would be interpreted to require notification to the only bank of which Bondholder had any knowledge—Small City Bank. But this answer was not free from doubt, and banks do not like to make loans aggregating billions of dollars on what is "probably" the law. Bondholder’s property, after the burning, was a right to obtain a new piece of paper, that is, a general intangible as to which perfection would have been through filing—an idea that may have been ahead of its time. Perhaps Article 9 could have been amended to allow Bondholder to perfect a security interest in his right to get a new bond in some other way, but amending the federal regulation was much easier. In the end, the banks persuaded the Federal Reserve to displace state law completely with a further regulation.\textsuperscript{97} As a result, a large chunk of secured transactions in government bonds is now governed by federal law and thus largely withdrawn from the jurisdiction of Article 9.

In this instance Article 9 was unable to meet a highly specialized change in commercial practice. The possibility of filing as to a right that might later be reconverted into an instrument (a new bond) was scarcely discussed; the bar was unaccustomed to the idea. Resort to federal preemption was no doubt an appropriate solution to the immediate problem, but the experience is troubling for two reasons. The first is the nature of the solution—a declaration by federal fiat that a nonpledge has the effect of a pledge. Federal book entry is a unique security system concocted to govern an area in which possession of an instrument is the sole traditional method of perfecting a security interest; it bears no resemblance to "pledge," and its connection to the requirement of public notice of security interests is none too close. Perfection through possession may have deep historical roots, but must we distort the facts by "deeming" that there has been a transfer of possession when in fact there is nothing to possess? Draftsmen in 1988 should devise a straightforward and more flexible method of perfecting security interests in a debtor's assets when, for good reasons, his assets are no longer represented by a piece of paper.

The second troubling aspect of the federal book entry experience is the source of the solution—federal preemption of state law. If it is necessary or desirable to permit security interests in important segments of commercial practice to be perfected by new methods, should not Article 9 be revised to provide those methods? A federal filing

\textsuperscript{97} 38 Fed. Reg. 7078 (1973), codified at 31 C.F.R. §§ 306.115–122 (1976). The amended regulation now makes clear that the Federal Reserve is not the bailee and provides that notification is to be made to the depositary that maintains the account of the pledgor. 31 C.F.R. § 306.188(b) (1976).
system may sometimes be appropriate, but federal preemption should not be relied on as a panacea for deficiencies in state law. The next time a problem arises, even with respect to federal securities, the relation to governmental purposes may be less direct, and preemption may not be an alternative. If United States bonds were the only example of a need for new means of giving the required public notice of the creation of a security interest, the absence of a solution in Article 9 would be relatively unimportant. But they are not the only example; the problem has surfaced elsewhere, most notably in the context of investment securities, and it seems unlikely to diminish in importance.

2. Investment Securities and the Proposed New Article 8

Investment securities—stock, bonds, or other evidences of indebtedness—are "instruments" under Article 9. The serious difficulties that can attend the required transfer of a necessary piece of paper in security transactions surfaced with the tremendous increase in transactions in investment securities during the late 1960s. The resulting "paperwork crunch" intensified the need to reduce the large volumes of paper involved in such transactions, and the result was a new section in the Code's article on investment securities—section 8-320.

Insofar as it affects the creation and perfection of security interests, section 8-320 is built around sections 9-304 and 9-305 but does not replace either. With the aid of definitions elsewhere in Article 8, it allows the pledge of an investment security to be effected by making appropriate entries on the books of a "clearing corporation" to reduce the account of the pledgor and increase that of the pledgee.

Clearing corporations organized pursuant to section 8-320 seem to have solved part of the problem of the paperwork crunch, but at best

98. See note 79 supra (general perfection rule and temporary, limited exceptions).

99. For brief summaries of the "paperwork crunch" problems, see HONNOLD, CASES AND MATERIALS ON THE LAW OF CREDIT TRANSACTIONS AND CONSUMER PROTECTION 170-73 (1976); PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PROPOSED REVISION OF ARTICLE 8 AND RELATED CHANGES IN OTHER ARTICLES RECOMMENDED BY THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE IN, XV (1977) [hereinafter cited without cross reference as PROPOSED REVISION OF ARTICLE 8]. See also Coogan, The New UCC Article 9, 86 HARV. L. REV. 477, 558-63 (1973), reprinted in 1 COOGAN, HOGAN & VAGTS §§ 3A.01-07, -07[1] (discussing § 8-320 and citing literature).

100. A clearing corporation is "a corporation all of the capital stock of which is held by or for a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934." Section 8-102(3). Cf. PROPOSED REVISION OF ARTICLE 8 § 8-102(3) (proposing changes in definition of "clearing corporation" not here relevant).

101. The securities must have been shown on the books of the clearing corporation in the account of the pledgor. Section 8-320(1)(c).
they do no more than ameliorate the larger problem of dealing in securities without depending on stock certificates. A recent Ninth Circuit case offers an instructive example. A corporate officer had assigned to a bank a large number of unissued shares of a new private offering of his corporation’s stock, as security for the loan that had allowed him to purchase them. The officer directed the corporation to send the stock certificates directly to the bank, but actual issuance of the certificates was delayed by the need for approval by an outside authority. Probably through error, the certificates, when finally issued, were sent to the corporation, and a different creditor attached them before they could be forwarded to the bank. The bank claimed that the officer’s instructions to the corporation constituted notice to a bailee under section 9-305 and that its security interest had been perfected. The Ninth Circuit disagreed: not only was the corporation insufficiently independent of the debtor’s control for its possession of the certificates to have been adequate public notice, but there had also been no “bailment.” Prior to actual issuance of the shares, the debtor had possessed no “instrument” that he could bail; hence his rights in the shares were general intangibles, as to which the only method of perfection was U.C.C. filing. In this respect the case differed from the federal book entry situation, which was complicated by the regulation’s “deeming” that an actual pledge had occurred.

The Ninth Circuit’s decision was probably correct under the existing provisions of Article 9, but filing, as currently constructed, may seem of doubtful wisdom as a method of perfecting security interests in investment securities, at least in our present way of thinking.

102. Heinicke Instruments Co. v. Republic Corp., 543 F.2d 700 (9th Cir. 1976).
103. The loan transaction actually went through an intermediary, who subsequently dropped out of the picture. See id. at 701.
104. 543 F.2d at 702. “General intangibles” is the catch-all definitional category of Article 9. “‘General intangibles’ means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money.” Section 9-106.
105. 543 F.2d at 702. See p. 1032 & note 79 supra.
106. The present filing systems require the recordation of a written “financing statement,” see § 9-402, and generally impose both filing and search fees, see §§ 9-403(1), (5) (filing fees), 405(1), (2) (filing and search fees), 9-406 (filing fees for release statements), 9-407(2) (optional section) (search fees). A financing statement generally remains effective for five years after filing, § 9-403(2), unless specifically terminated pursuant to § 9-404. Moreover, there are filing offices not only in each state but also in many localities. See § 9-401(1) (three alternatives for combinations of statewide and local filing); 3 U.L.A. Uniform Commercial Code 256-40 (1968) (cataloging states adopting various versions of § 9-401(1)).

These requirements, along with the decentralization of the system, necessarily impose burdens of time, expense, and inconvenience—burdens that make the system unsuitable for rapid or frequent transactions (such as those in investment securities), especially if the transactions are often interstate. See note 147 infra. Cf. Gilmore at 463 (noting
Perhaps the case can be regarded as a freak, but it is a simple illustration of a common problem that arises whenever one wishes to create a security interest in shares of stock that one owns but that are not represented by a stock certificate. Many, perhaps most, mutual funds discourage their shareholders from requesting certificates, and many corporations offer dividend reinvestment plans, under which frequent issues of shares would be a nuisance. A shareholder, however, may wish to borrow against his unissued shares. If no certificate is issued, there exists no “instrument” for someone to “possess” or “bail.” Perhaps we must learn to accept the Ninth Circuit’s reasoning, but, until we do, a prospective secured party will not feel very secure with perfection through filing on the theory that unissued stock is a general intangible, and the shareholder may find it necessary to demand that his shares be represented by a certificate if he wishes to borrow against them.

Worried members of the securities industry continued their problem-solving efforts after the successful creation of section 8-320. Non-Code groups, principally the Committee on Stock Transfers of the American Bar Association’s section on Corporations, Business and Banking, drafted a new Article 8. With modest changes, that ABA draft has now been approved by the Code sponsors, the American Law Institute and the National Conference of the Commissioners on Uniform State Laws. The proposed Article 8 would supplement and replace certain sections of Article 9. But it would adhere to the central concept of “possession,” even where there is nothing to possess.

“the unfortunate fact that the [pre-Code] filing systems tended to proliferate” and that this “made the filing system as a whole cumbersome, expensive to maintain and ineffective to serve its principal functions . . . of providing creditors with an easily available method of checking on a borrower’s financial status [and of] providing lenders . . . [with] an easy and certain method of perfecting their security interests”).

That the draftsmen were aware at least of the time burden is evidenced by the various provisions for temporary automatic perfection of certain nonpossessory transactions. Sections 9-301(2); 9-304(4), (5); 9-306(2), (3).

107. If a creditor, following Heinicke, filed to perfect a security interest in a right to obtain stock for which no certificate had yet been issued, and the debtor, after obtaining a certificate, pledged it to a second creditor who qualified as a bona fide purchaser, the purchaser would have priority under § 9-309. This accords with the treatment of a filed security interest in an account that is later transformed into a negotiable instrument; the claim of a holder in due course will defeat that of the secured party who filed as to the account. Section 9-309.

108. PROPOSED REVISION OF ARTICLE 8. The Permanent Editorial Board explicitly acknowledges its debt to the ABA Committee. See id. at ix-x, xv.

109. See id. at 85-91 (setting out proposed changes in Article 9). Essentially, the changes would exempt security interests in investment securities from the perfection requirements of Article 9, in accordance with the scheme outlined in the text that follows.

110. The proposed Article 8, as the following text makes clear, does not rely on perfection through filing on the theory that certificateless stock is a general intangible. I do not know whether filing was seriously considered by the draftsmen of the new Article 8, but the Permanent Editorial Board did not give it any great thought.
The new Article 8 supposes that state corporate law allows or will be amended to allow corporations to issue "uncertificated securities," rights in which would not be embodied in an "instrument" or other piece of paper. By definition, an uncertificated security would be a general intangible; the certificated security would remain an instrument, essentially unchanged. The creation, perfection, and termination of security interests in both certificated and uncertificated securities would be governed entirely by new section 8-321, which provides that "[a] security interest in a security is enforceable and can attach only if it is transferred to the secured party or a person designated by him pursuant to a provision of subsection (1) of Section 8-313." Any such "transfer" by one with rights in the security to one who has given value would create a fully perfected security interest.

The critical corollary is section 8-313(1), which defines "transfer." With respect to perfection of security interests in certificated securities, the basic method would remain physical transfer of possession. If the security were controlled by a third party, there would be several alternatives. Book entry through a clearing corporation would be one; book entry plus confirmation to the pledgee would be another. With respect to most security interests in uncertificated securities, section 8-313(1)(b) contemplates a form of book entry—registration by the issuing corporation. An initial security interest in uncertificated securities could be created by registration of transfer, which duplicates the effect of outright transfer of a certificated security into the name of the pledgee; or it could be created by registration of pledge to create a "registered pledgee," which duplicates the effect of a pledge.

111. Section 9-105(i) would be amended to include only certificated securities in the definition of "instrument." PROPOSED REVISION OF ARTICLE 8, at 85. Uncertificated securities would, by process of elimination, be "general intangibles" within the catch-all definition of § 9-106. See note 104 supra. Other proposed changes in Article 9 make this quite clear. See PROPOSED REVISION OF ARTICLE 8, at 85.

112. Id. § 8-321(1).
113. Id. § 8-321(2).
114. Id. § 8-313(1)(a) (an analogue to current § 9-304(1)).
115. See id. § 8-313(1a)(a), (c), (d), (e), (g); id. at xviii-xix (Reporter's Introductory Comment explaining proposed changes). If the controlling party is a financial intermediary that is not a clearing corporation, confirmation to the transferee must accompany book entry. Id. § 8-313(1)(d). This provision is designed to afford "objective evidence" of a transfer, which was considered desirable because the proposed expansion of the concept of "broker," see id. § 8-313(f), includes financial intermediaries that, unlike clearing corporations, may be beneficial owners of securities not held in account for their customers. See id. at 49.
116. The procedure, which corresponds to that now used to register transfers of ownership, is spelled out in id. §§ 8-401, 8-402.
when the pledgee takes delivery but allows the securities pledged to remain registered in the name of the pledgor.\textsuperscript{117}

The new concept of an uncertificated security and the mechanisms that attend it thus pay more than lip service to the law of pledge. The secured party, the debtor, and third parties would be placed in positions designed to resemble as closely as possible those that they would have occupied had there been a physical pledge. The registered pledgee would acquire exclusive power over further transfers of the pledged security,\textsuperscript{118} just as though he had physical possession of a stock certificate. He could transfer ownership of the uncertificated security outright, free from or subject to his pledge, or transfer his security interest to another secured party.\textsuperscript{119} In a further effort to duplicate the results of physical transfer, proposed section 8-313(h)(iv) provides that a junior pledge is effected by notification to the registered pledgee, rather than by notification to the issuer. The junior pledge, unlike the registered pledge or a lien obtained through legal proceedings, would not necessarily be reflected on the issuer's records.\textsuperscript{120} Thus the registered pledgee, like a pledgee under existing law, could sell the uncertificated security to a bona fide purchaser who would have no notice of the junior pledge; presumably, the junior pledgor would have only his present remedy of a claim against the first (registered) pledgee.\textsuperscript{121} This undesirable result is a regrettable incident necessitated by the supposed importance of possession of the stock certificate; here, of course, there is no certificate. It might be argued that the issuer should not be required to take the trouble to register junior pledges, even though junior pledges of stock are thought to be rare. Nonetheless, there seems no reason to fall back on the rules of the pledge; some other method, one that would in fact give public notice of the junior pledge, would be preferable.

\textsuperscript{117} Id. §§ 8-313(1)(b); id. at xx-xxii (Reporter's Introductory Comment explaining proposed changes). Two additional provisions, which would apply to both certificated and uncertificated securities, would complete the preemption of Article 9 as to investment securities by providing mechanisms that correspond to § 9-305 (perfection through notification of bailee) and § 9-304(4) (automatic perfection of security interest in instrument for 21 days when new value is given pursuant to existing security agreement). See Proposed Revision of Article 8 §§ 8-313(h), (i); id. at 49-50.

\textsuperscript{118} See id. §§ 8-207(3), (4) (power to order transfer); § 8-308(7)(b), (8) (power to originate “instruction” to issuer to register transfer, pledge, or release from pledge).

\textsuperscript{119} Id. § 8-207(4); id. at 24-25.

\textsuperscript{120} Id. § 8-403(4)(a) (duty of issuer to note adverse claims embodied in legal process). The issuer is not under a duty to note other claims unless notified in writing by the registered owner or registered pledgee. Id. § 8-403(4)(b); cf. id. § 8-403(4)(c), (d) (limited exceptions).

\textsuperscript{121} See id. at xxxi-xxxii (Reporter's Introductory Comment explaining proposed changes), 72-73.
No doubt there is merit in attempting to provide for identical results regardless of whether an investment security subject to a security interest is certificated and hence an "instrument" or uncertificated and hence a "general intangible." But, although a decade of experience with the new Article 8 could demonstrate otherwise, there seems to be little logic in basing results on the concepts and assumptions of "possession" despite the fact that no item exists to possess. Professor Gilmore once submitted that one should look to commercial practice to determine whether a piece of paper falls within the "exclusively pledgeable" category: if the commercial world attaches great symbolic significance to possession of the paper in question, as with the classic negotiable instrument, the rules of pledge should apply.\textsuperscript{122} The mutation of Article 8 indicates that the modern commercial world not only cares little about possession but also must function without regard even to the existence of the representative paper. The 1988 Committee to Review Article 9 should consider whether the pattern of the traditional pledge belongs in such a world at all and, if not, whether filing as to all general intangibles or some other notice method would be the most appropriate solution.

C. Some Thoughts on Possible Revisions

Awkward or complicated mechanisms can be borne, at least in isolated areas. But if they are out of accord with commercial needs, they are unlikely to be tolerated very long. Moreover, they undermine the U.C.C.'s stated purposes of simplifying, clarifying, and modernizing the law and of permitting the development of new commercial practices.\textsuperscript{123} To the extent that they do not fit the nature of the transactions they govern, there is also good potential for undermining the uniformity, either in statutory language or in court decisions, that the U.C.C. seeks to achieve.\textsuperscript{124} This is especially true if solutions are devised by persons other than the sponsors of the U.C.C. Adjusting the statute to developments such as those sketched above should be a major goal of the 1988 Committee to Review Article 9. The task will not be an easy one, but the need, which is pressing even now, is sure to expand beyond its present bounds.

For clear evidence that the diminishing importance of "paper" and, generally, of physical evidence of claims to or rights in property as necessary accompaniments to commercial transactions, one need only

\textsuperscript{122} Gilmore at 379.
\textsuperscript{123} Section 1-102(2)(a), (b).
\textsuperscript{124} Section 1-102(2)(c).
look at the burgeoning field of electronic fund transfers (EFT). EFT transactions encompass a variety of issues, including transactions by point-of-sale and automatic teller machines, check guarantee transactions, pre-authorized debit and credit transactions conducted through automated clearing houses, credit card transactions, and wire and telephone transfers. The field is under intense study by the U.C.C.'s "3-4-8" Subcommittee and has recently been the subject of reports by the National Commission on Electronic Fund Transfers, which for several years explored ways of developing rules to govern payments and transfers made without using the kinds of commercial paper now regulated by Articles 3 and 4. The import for Article 9 is less obvious at present, but as EFT practices expand, secured transaction problems are certain to arise. Moreover, one can predict with some confidence that EFT will not be the only technological advance that will jeopardize old customs and old assumptions, particularly those based on the notion that certain claims or rights depend on "possession" of a particular item of collateral—an idea that presupposes the existence of something tangible to possess.

125. The 3-4-8 Subcommittee of the U.C.C.'s Permanent Editorial Board is so called because EFT transactions primarily implicate Articles 3, 4, and 8 of the U.C.C. The Subcommittee has not yet issued a report on EFT, but its Reporter recently delivered a proposed report, which is scheduled for public discussion by interested parties at an ALI-ABA Conference in Williamsburg, Virginia, April 8-10, 1978. The Subcommittee probably will not issue an official report on EFT at least for some time after the ALI-ABA Conference. The Chairman indicated in 1976 that thorough study might require four or five years before the Committee could propose amendments to the Code. See NATIONAL COMMISSION ON ELECTRONIC FUND TRANSFERS, EFT AND THE PUBLIC INTEREST 16-17, 17 n.16 (interim report Feb. 23, 1977) (citing testimony of Robert Haydock, Jr., chairman of 3-4-8 Subcommittee, before National Commission on Electronic Fund Transfers, Oct. 26, 1976).


127. For confirmation of the logic of this assertion, see GILMORE at 439 (footnote omitted):

In the nature of things possession can be available as a perfection device only where the collateral has, at least in contemplation of law, a tangible existence. . . . [P]ossession is a meaningless concept when applied to an intangible claim not evidenced by a writing which represents the claim. A purely intangible claim . . . [has] nothing visible which can be transferred in possession; thus it cannot be pledged. Nevertheless, security agreements relating to such intangibles frequently use language of pledge; the language is sometimes meaningless, is sometimes . . . an indication that the transaction is a transfer for security rather than a sale . . . , and is sometimes, in the case of novel types of intangible collateral, an attempt to make clear that some kind of security arrangement is being set up in a situation where nobody knows what the rules of the game are.
Article 9—An Agenda for the Next Decade

The sponsors of the Code could choose from a number of alternatives for dealing with these new challenges. They could, of course, decline to take up the gauntlet. This would lead to a scattered farming out of responsibility: to federal authorities, as occurred with the United States bonds crisis and may occur with EFT;128 or to state legislatures and courts, as with motor vehicle certificate of title laws129 and the confusion of leasing law.130 They could create new classes of collateral and attendant rules, as is somewhat true of the new Article 8 approach;131 or they could studiously attempt to adapt old categories and rules, as is certainly true of the new Article 8 approach.132 The latter two alternatives do not seem to be the most logical and efficient that could be devised, and they might force courts to solve difficult conceptual problems resulting from overlaps or gaps among various sets of rules. None of these approaches seems likely to promote the U.C.C.'s purposes. Instead, our future revisers of Article 9, who will have the valuable aid of hindsight in evaluating the alternatives sketched above, should rethink the statutory framework from a fresh perspective. If public notice is to be required for most security interests, should the means of giving it vary with the nature of the collateral? Or is there a better way? Here, the history

128. The National Commission on Electronic Fund Transfers has already recommended congressional action in certain areas. See National Commission on Electronic Fund Transfers, supra note 126, at 6-17 (final report Oct. 28, 1977). As noted at pp. 1038-40 supra, however, federal preemption may not be an alternative when federal fiscal interests are not involved. Indeed, I was once asked whether something similar to federal book entry for United States bonds might be devised as a mechanism for allowing savings and loan associations to perfect security interests in batches of mortgages without actually taking possession of the pieces of paper. I concluded that, under the present law, see notes 92 & 93 supra, this could not be accomplished under federal law.

129. Most states require notation of security interests on motor vehicle certificates of title, and Article 9 explicitly defers to this alternative method of public notice. See § 9-302(3)(b); cf. id. § 9-103(2) (special conflicts-of-law rules respecting goods covered by certificates of title issued by states that require notation of security interests on such certificates). The certificate of title mechanisms have not proved easy to live with. See pp. 1049-50 & notes 142-143 infra.

130. Leases intended as security arrangements are subject to Article 9, §§ 1-201 (37), 9-102(2). "True" leases are not. The distinction is absurdly elusive under the present Code provisions, but it could be quite simply stated. See Coogan, Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1-201(37) and Article 9—Sales of Accounts and Chattel Paper—Consignments—Buyer's Security Interest, 1973 Duke L.J. 909, reprinted with additions in 1 COOGAN, HOGAN & VAGS §§ 4A.01-.08. Leasing has become a very large area of commercial transactions; no uniform law governs the rights and duties of the parties. If, for good reasons or bad, businessmen choose to acquire the use of billions of dollars' worth of equipment through leases rather than sales, should not the field be brought under the aegis of the U.C.C.?

131. As noted at p. 1043 & note 111 supra, the proposed Article 8 would create the new "uncertificated security" but would classify it as a general intangible.

132. See pp. 1043-45 supra (describing manner in which proposed Article 8 would contort pledge model to fit problem of uncertificated securities).
of the statute offers instruction that, even at present, suggests at least a first step in improving Article 9.

The original idea of the draftsmen was that formal differences among the various pre-Code security devices should be abandoned; they initially assumed, however, that then-current financing transactions were "so diverse" that different statutes, separated along functional (as opposed to formal) lines, would be required.\textsuperscript{133}\ The scheme ultimately proved unnecessary; the perceived differences dissolved before the drafters' eyes, and the different statutes became more and more the same. Hence, the article was reorganized into a single statutory scheme.\textsuperscript{134}\ This "made largely irrelevant the painstakingly precise definitions" of the types of collateral that were to have fallen within the contemplated categories of financing transactions; nonetheless, the draftsmen "[u]nfortunately . . . never [thought] to see whether the classifying definitions could not usefully be consigned to oblivion. The Article in its final form clung grimly to its four-fold classification of goods and its six-fold classification of intangibles."\textsuperscript{135}\ Folded into the classifications was the supposedly basic functional distinction between possessor and nonpossessor interests, pledgeable and non-pledgeable collateral.

These classifications have never been of paramount importance for most purposes,\textsuperscript{136}\ with the exceptions of the statute of frauds requirement and the method of giving public notice. They now appear to be less significant than ever. It has always been the case that an Article 9 security interest need not be tied to an exclusive category of collateral; "fluid" or interchangeable collateral is an underlying concept of the statute, as witnessed by its "floating lien" and by its provision for automatic transformation of a security interest from one in specified tangible property to one in tangible or intangible proceeds.\textsuperscript{137}\ This concept is now commercially legitimate, as confirmed by its utilization in the proposed new Bankruptcy Act. Never have the categories of collateral been absolute, as evidenced by the familiar transformation of "nonpossessor" accounts into "possessor" instruments.\textsuperscript{138}\ 

\textsuperscript{133}\ \textsc{Gilmore} at 290.
\textsuperscript{134}\ \textit{Id.} at 292.
\textsuperscript{135}\ \textit{Id.}
\textsuperscript{136}\ \textit{Id.} at 293.
\textsuperscript{137}\ \textit{See} pp. 1016-17 & notes 21, 22 \textit{supra} (describing floating lien); § 9-306(2), (3) (temporary automatic perfection of security interest in proceeds).
\textsuperscript{138}\ The "mutation" of collateral, including that of accounts into instruments or general intangibles, is discussed briefly in \textsc{Gilmore} at 386-87. Professor Gilmore's foresight here proves to have been faulty; he speculated that

\textbf{1048}
and now they at times approach fungibility, as indicated by the new uncertificated security (a general intangible), which can become, at corporate or shareholder whim, a certificated security (an instrument). EFT, and “paperless” transactions generally, further jumble the categories and further undermine the distinction between possessor and nonpossessor interests and its attendant classes of pledgeable and nonpledgeable collateral.

Although Article 9 could now be written without distinguishing among so many kinds of collateral, the distinctions have usually done little harm and may at times be useful. Workable rules to govern, for instance, rights of the parties upon default or priorities may have to vary according to the nature of the collateral, though future draftsmen may well conclude differently. But the distinctions based on “possession” seem to be losing their utility and should be reconsidered with an eye to their abolition, especially in the provisions for public notice and for exemption from the statute of frauds. It would seem that the purposes of giving notice are the same regardless of the nature of the collateral, even though the amount of information that can be placed on public record and the location of the record may vary. Future draftsmen may be able to devise a single, comprehensive means of satisfying the public notice requirement. If they can, they will have taken a long step toward adapting Article 9 to the demands of the modern commercial world. Nor would they be without guidance in searching for an appropriate mechanism, for the various existing methods of giving notice all point toward centralized filing, or recordation, as the best choice: efforts to dispense with the pledge without relying on filing have had questionable results, and more recently devised systems all attempt to set up a sort of “notice filing” mechanism.

One of the best examples of an attempt to devise a notice system that relies neither on filing nor on possession is the established practice of noting security interests in automobiles on the vehicles’ certifi-

market-place evidence that one has occurred usually becomes overwhelming in a short period of time. It seems unlikely that this theoretical problem will ever become a real source of trouble.

Id. at 386. We might query whether, even in the brief period since this was written, the trend has not reversed—e.g., stock certificates (instruments) have become general intangibles.

139. A shareholder would be allowed to elect to have a certificate issued for his uncertificated stock, and vice-versa. See Proposed Revision of Article 8 § 8-407(2)-(4). Presumably, a corporation would be free to issue whatever type of shares it wanted; if it regularly issued both types, however, it would have to fulfill the “exchangeability” requirements. Id. § 8-407(1).

140. GILMORE at 291-92: “Acceptance of the distinction between the possessor and nonpossessor interest ... required definitions of intangibles which could be pledged ....”
icates of title, which were originally required as an antitheft measure.\textsuperscript{141} This method is specifically tailored to the nature of the collateral. The practice was a response to the inappropriateness of other conventional notice systems: a motor vehicle is too likely to move from the place of filing for that method to be effective and too mobile for perfection through possession to have even surface logic. But the system has not worked well, primarily because of the importance of the piece of paper involved,\textsuperscript{142} and at least one experienced practitioner recently concluded that the system should be scrapped in favor of what amounts to a computerized federal filing system.\textsuperscript{143} Federal book entry for United States bonds and registration of some transfers of investment securities both rely on a sort of centralized recordation, although neither divorces its system from the pattern of pledge nor provides all creditors with a means of obtaining information. A 1966 French statute on leasing demonstrates a mixed approach; it subjects companies that habitually lease their equipment or machinery to the reporting requirements of the \textit{banking} laws. The debtor (lessee) must file both his annual and his more frequent periodic accounting records in a public office; the obvious intent is that the notice that certain items possessed by the debtor are leased rather than owned appear both on the public record (as with an Article 9 filing) and on the debtor's own financial statements.\textsuperscript{144}

These different public notice mechanisms all imply that recordation in some designated place (usually a public office) is the most desirable method of ensuring that potential creditors can discover the state of their prospective debtors' affairs or at least obtain enough information to guide further inquiries. This sounds quite familiar, for

\textsuperscript{141} See \textit{Gilmore} at 550-52.

\textsuperscript{142} See \textit{Meyers}, \textit{Multi-State Motor Vehicle Transactions under the Uniform Commercial Code: An Update}, 30 \textit{Okla. L. Rev.} 834 (1977). Mr. Meyers sets forth the history of title certificate laws and discusses in detail the numerous problems created by interstate movement of vehicles covered by a certificate or--more problematically--by more than one certificate. \textit{See, e.g., id. at 855-57.}

\textsuperscript{143} \textit{Id. at 887-90.} Mr. Meyers' proposal would not dispense with the physical certificate but emphasizes that "transfer of ownership or perfection of liens would be accomplished only on the [federal] records . . . not by notation or delivery of the certificate." \textit{Id. at 889.}

\textsuperscript{144} Loi n° 66-455 du 2 juillet 1966, [1966] D.S.L. 305. The banking statutes made applicable by this law are Loi du 13 juin 1941, [1941] D.A.L. 333, and Loi du 14 juin 1941, [1941] D.A.L. 337. The first contains the most relevant provisions. \textit{See, e.g., Loi du 13 juin 1941, art. 16, [1941] D.A.L. 334 (recording of accounting statements); art. 17, id. (power of commission de contrôl to require additional information); art. 18, id. (official publication of all recorded statements); arts. 19 & 22, id. (civil and penal sanctions for noncompliance or submission of inaccurate information). The idea of requiring notation of security interests on a business's accounting statements deserves exploration, for most potential creditors consult their prospective debtor's financial statements, \textit{see note 84 supra}; accounting statements quickly become dated, however, so some additional regulation, as well as public filing, would seem a necessary corollary. This is the thrust of the French statutes.
such reasoning is the basis for Article 9's provision for filing as the notice mechanism for most types of collateral. But the current filing system might never be able to serve as a single means of notice for all security interests regardless of the nature of the collateral. The system is not truly centralized; it is organized by state, and most states require local (rather than statewide) filing for at least some types of collateral. A prospective creditor may therefore have to "search" a number of filing offices—a time-consuming task that, when completed, may still leave some doubt as to whether every office that might contain relevant information has been checked. And since filings generally remain effective for five years, the mechanism seems unsuited for frequent, short-term transfers between a single creditor and a variety of debtors, particularly if the transactions would often implicate filing systems in more than one state.145 This is why, under the present system, the Ninth Circuit's holding that uncertificated stock is a general intangible seems at first blush anomalous. But it is not the notion of filing as to "possessory" collateral that is strange; after all, filing, even now, is permitted as to chattel paper, which may include a negotiable instrument, and as to negotiable documents.146 The idea of filing as to investment securities or other instruments seems strange only because the current filing system is too clumsy an animal: at present, it seems unsuited for all types of collateral.

But perhaps present difficulties could be remedied by even moderately creative draftsmen and technicians. Computerization is a reality, and the notion of a nationwide, computerized filing system, organized by name of debtor rather than type or location of collateral, is an alluring possibility.147 If a lender could almost instantly obtain

145. See note 106 supra.
146. It was natural for the drafters to assume that when tangible or intangible rights have been embodied in a necessary piece of paper, a security interest or other transfer of those rights must require a transfer of that piece of paper—that is, perfection through possession. This, of course, is the general rule for Article 9 instruments (such as stock certificates or negotiable notes). See p. 1032 & notes 79 & 80 supra. But the drafters departed from this thinking in allowing perfection through filing for chattel paper, which may include a negotiable instrument, and as to negotiable documents. Further exceptions to the rule that transfers of possession are required for necessary pieces of paper are the temporary perfection provisions of §§ 9-104(4), (5) and 9-306(3). And, of course, the role of possession has been reduced with respect to investment securities by § 8-320, and the proposed new Article 8 would continue the trend, albeit by adhering to the pattern of pledge. See pp. 1043-45 supra.
147. The suggestion in the text conjures up the old conflicts-of-law debate over whether the "situs" of particular things or events or the "domicile" of a party should control the application of legal rules. For a brief summary, see GILMORE at 599-605. Interestingly, § 9-103, which states conflicts-of-law rules for perfection of security in-
from a computer file even the names of his debtor's secured parties, he would at least be on notice and would be in a position to ask the right questions of his prospective debtors. Because of its speed and efficiency, such a system could be used regardless of the nature of the collateral, even if the nature of the filings and of secured obligations would require the searcher to proceed further. And if the requirement of public notice could be so simply satisfied, a number of problems might be ameliorated. Obvious examples are the complex conflicts-of-law difficulties that result from the ill-correlated notice systems of different states and, of course, puzzles such as those posed by nonexistent yet exclusively pledgeable collateral. It is quite important to note that the creation of a single system or mechanism for purposes of public notice would not prevent the formulation of different rules based on the nature of the collateral in other contexts.

The new personal property security acts of several Canadian provinces are modeled after Article 9 but contemplate central filing with complete computerization of the filing records. By 1988, the ad-

The "domicile" rule, or, as the text suggests, the "name of debtor" rule, has—rather obviously—greater merit as to intangible or mobile collateral than does the "situs" rule. For a discussion of the relative merits of the two approaches, see Gilmore at 502-05. As Professor Gilmore notes, residence (or "domicile") generally "gives a more stable filing base." Id. at 503. With advanced technology, there may yet be a way to centralize at least the public notice aspects of the problem.

148. If centralized, nationwide filing were the exclusive means of satisfying the public notice aspect of "perfection," the horrors of § 9-103, the section that spells out conflicts-of-law rules to govern "perfection," would diminish significantly, for "domicile" and "situs" would become irrelevant with respect to public notice. On § 9-103 and its current problems, see note 147 supra (citing sources). With public notice out of the picture, only the attachment requirements of § 9-203(1) would be relevant to choice of law, and they seem much more manageable than the present public notice rules.

Convincing state legislatures to adopt such a proposal might, of course, prove quite difficult, though it is possible that centralization could be achieved by computerizing and consolidating (rather than eliminating) individual state filing systems. In any event, "If the now unconscionable distance between what is the law and what ought to be the law is to be traveled, the legal profession had better have as its lodestar, not 'political reality,' but the best and fairest [approach]." Weintraub, Choice of Law in Secured Personal Property Transactions: The Import of Article 9 of the Uniform Commercial Code, 68 Mich. L. Rev. 684, 718 (1970).

149. Goode & Gower, Is Article 9 of the Uniform Commercial Code Exportable? An English Reaction, in Aspects of Comparative Commercial Law 298, 335 (J. Ziegel & W. Foster eds. 1969) (footnote omitted): "[L]ocal filing with electronic transmission to a central registry . . . is being set up at present in Ontario [.] and it will combine all the advantages of local and central filing and eliminate most of the problems that have arisen under the present alternative options allowed by [the United States' Article 9]." The footnote omitted from the quotation notes that the province of Alberta, which
vantages and disadvantages of the Canadian system should be evident enough for future draftsmen to explore my idea in more concrete fashion than is now possible. Perhaps they will be able to devise a public notice system that will be independent of old categories, especially of the antiquated notion that “possession” has some almost magical significance. This independence, in any event, should serve as a goal, even if it cannot be fully implemented and even if the draftsmen reject computerized filing in favor of some other mechanism, divorced from “possession,” that does actually perform a public notice function.

Conclusion

My suggestion that it may be time to recognize the declining importance and increasing problems of perfection through possession is impelled by the contrived attempts to “deem” possessory rules applicable in situations where there is nothing left to possess—for example, uncertificated stock and federal book entry securities. The suggestion grows neither out of a disparaging opinion of Article 9 nor out of ignorance of the extent to which it has furthered the goals that its draftsmen set out to accomplish. That forty-nine states now follow the rules of Article 9 is indisputable and unimpeachable testimony to its success in transforming true chaos into something approaching uniformity.150 There have been failures,151 and there are yet omis-


150. The chaotic state of pre-Code chattel security law is well documented in GILMORE at 27, 288-90; see generally id. at 5-286; pp. 1015-16 supra.

151. One of the most serious failures to achieve uniformity has been the provision on fixtures, § 9-313. Fixtures are hybrids, partly personal property and partly real estate; even after adoption of § 9-313, their legal definition and treatment varied enormously from state to state. Any statute providing for chattel security interests in fixtures was bound to threaten real estate interests in the same property. For discussions of the difficulties encountered by the 1962 version of § 9-313, see Coogan, Fixtures—Uniformity in Words or in Fact?, 113 U. PA. L. REV. 1186 (1965), reprinted in 1A COOGAN, HOGAN & VATS §§ 17.12-14; Coogan, Security Interests in Fixtures Under the Uniform Commercial Code, 75 HARV. L. REV. 1319 (1962), reprinted in 1A COOGAN, HOGAN & VATS §§ 17.01-11. Section 9-313 was entirely rewritten during the 1972 revisions and should prove more palatable to real estate representatives in various state legislatures than did its predecessor. New § 9-313 provides for “fixture filing” in the office in which a real estate mortgage would be
sions, but anyone would have to acknowledge that Article 9 has made uniform the core of the law with which it deals. The parties to a transaction at least know the relevant questions, even if they cannot always know of statutory variations or know how a court in a particular state is likely to answer unless they take local idiosyncracies into account. This, perhaps, is all that can be expected in a federal system such as ours. Even more impressive is Article 9's success in simplifying, clarifying, and modernizing pre-Code chattel security law, within as well as among the adopting states. To the great credit of the draftsmen, their product has become a model for those seeking to achieve similar goals in Canada, Great Britain, and non-Anglo-American jurisdictions.

recorded and provides a better tie-in with realty records; this makes it easier for a potential mortgagee to discover the existence of chattel security interests in property that is or may become a fixture. In addition, the “construction mortgage” concept of new § 9-313(6) gives the mortgagee a means of protecting himself against many secured claims; it provides that a security interest in fixtures is generally “subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction.” It might be thought that this is undercut to some extent by § 9-313(4)(c), which subordinates the construction mortgage to a vague category of chattel security interests in “readily removable . . . machines or . . . replacements of domestic appliances which are consumer goods” (emphasis added). For discussion of the new § 9-313, see Coogan, supra note 99, at 483-505, reprinted in 1 COGAN, HOGAN & VAGIS § 3A.02.

152. See note 130 supra (discussing leases).

153. Professor Fairfax Leary once remarked that this was the critical test of the success of any uniform statute.

154. The pressures of local politics, as well as of special interest groups, and sometimes disagreements among the draftsmen themselves (often induced by political or other special influences), make true uniformity a near impossibility in a statute subject to scrutiny and debate by numerous state legislatures. These factors, for example, are responsible for the lack of uniformity in § 9-401(l), which specifies where to file and for which three alternatives are available. GILMORE at 517-18. See id. at 524 (footnote omitted):

Our discussion has assumed that the decision between exclusive and double filing will be made on what may be called its commercial merits. This assumption is to a degree unrealistic; experience to date suggests that the issue is quite likely to become entangled in local politics. The town and county clerks are naturally disinclined to lose the business on which their jobs depend. Their association will typically insist at legislative hearings on the maintenance of an exclusively local filing system or, as a reluctant compromise, on the addition of local to state filing. Anyone who scoffs at the political influence of the county clerks on state legislatures will in due course become a sadder but wiser man.

There are other examples as well. Certain of the transactions that § 9-104 excludes from the requirements of Article 9 were exempted more because of the opposition of pressure groups than because of any particular logic. One of the more egregious of these, § 9-104(c) (equipment trusts covering railroad rolling stock), was eliminated in 1972; no one in the railroad industry was able to give the 1972 draftsmen a convincing reason for continuing the exemption, which railroad interests in the 1950s had successfully championed. Perhaps subsections (g) and (l) (exempting transfers of interests in most insurance policies and deposit accounts) can be likewise eliminated in 1988.

155. Article 9 codified the numerous state laws relating to chattel mortgages, conditional sales, trust receipts, factor’s liens, and financing on accounts receivable. See generally GILMORE at 5-301; pp. 1015-16 & note 16 supra.

156. See Abel, Is Article 9 of the Uniform Commercial Code Exportable? The Ontario Experience, in ASPECTS OF COMPARATIVE COMMERCIAL LAW, supra note 149, at 291, 292
But a statute cannot rest on its laurels, as Grant Gilmore would be the first to concede. Indeed, any commercial statute that proposes "to permit the continued expansion of commercial practices" in a rapidly changing commercial world must ever be ready to adapt to new developments and new needs. I hasten to add that the sponsors of the U.C.C., far from being oblivious to this fact, have recognized, perhaps for the first time in the movement for uniform laws, that commercial law can never remain frozen for any length of time. In 1961, at an early stage after the first states had adopted the U.C.C., the sponsors saw the need for a continuing body to pass on suggested changes; they enlarged the Permanent Editorial Board, making it an ongoing body with power to suggest changes to the sponsors. The Board’s recent appointment of the 3-4-8 Subcommittee indicates a continued willingness to explore new problems and to face new challenges. It is in that spirit that I have endeavored here to unearth some fundamental issues that may face future draftsmen. And it is singularly fitting that I should undertake such an inquiry in honor of Grant Gilmore, who will no doubt find my critique of the product of his labors a truer compliment than any of my words of praise.

(Article 9 was “basic guide” for draftsmen of Canada’s Uniform Personal Property Security Acts); 1 GREAT BRITAIN DEPT OF CONSUMER CREDIT, supra note 149, at 182-230 (describing proposed Lending and Security Act explicitly modelled on Article 9); BANKING LAWS COMMITTEE (GOVERNMENT OF INDIA), PROJECT STUDY ON PERSONAL PROPERTY SECURITY LAW—PROJECT REPORT 4-5 (1976) (acknowledging benefit from Article 9’s “conceptually comprehensive scheme” and noting that Article 9 has served as model for proposed legislation in Canadian provinces and United Kingdom).

157. Section 1-102(2)(b).

158. It has been nearly four decades since the drafting of the U.C.C. was begun. The human mind works slowly, and, when changes in accustomed ways of thinking are involved, the collective human mind works at a glacial pace. It is not too early to begin thinking about 1988 changes.
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1056