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Volume 26  
Number 3 *Is the UCC Dead, or Alive and Well?*

Article 5

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4-1-1993

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### Recommended Citation

John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 Loy. L.A. L. Rev. 579 (1993).

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# CHANGING COMMERCIAL PRACTICES AND THE UNIFORM COMMERCIAL CODE

*John F. Dolan\**

## I. INTRODUCTION

There is currently afoot considerable effort to fashion a new Uniform Commercial Code. Article 3 is revised; Article 4 amended; Articles 7, 8, and 9 the object of studies that typically precede revision; and Articles 2 and 5 in the revision process. The sponsors recommend the dustbin for poor old Article 6. Leasing and wholesale wire transfers have new articles to govern them.

The drafting of the Uniform Commercial Code in the 1940s and 1950s and its adoption in the 1960s was a signal event in U.S. law. The Code enterprise transformed sales law and rationalized secured transactions law. It codified payments and bailment law with some modernization. Since that time, commercial practices have undergone significant change, and the agencies that have sponsored the Code rightly conclude that it is time for its revision.

This Essay reviews the commercial innovations that have arisen since the adoption of the Code. Those changes result from a number of commercial innovations of which three are paramount: (1) the revolution in information technology; (2) the expansion of international trade; and (3) the rise of the service sector. With quick, inexpensive credit information at hand, sellers have dramatically revised the way they sell to merchants and to consumers. Rapid and reliable methods of transmitting information have fostered change in the way banks transfer credit through the payment system. The ability to track sales and manage cash needs and to evaluate consumer credit worthiness has had an impact on secured lending, especially inventory lending and consumer finance. The relative decline of the manufacturing sector and the rise of intellectual property as an important commercial asset also have had their impact on secured lending. The information age also has transformed the way sellers and buyers use transport and storage documents to market and finance their transactions.

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\* Professor of Law, Wayne State University Law School. Thanks with the customary disclaimer to Stephen Calkins, Jessica Litman, and Michael McIntyre.

The following discussion examines, then, not changes in law but changes in commercial practices, the commercial innovations that have arisen or gained prominence since the drafting of the Code.

## II. SALES

### A. *On Horseback*

Much of our sales law evolved out of the English fairs and markets. In these settings, buyers and sellers generally knew each other. As late as the eighteenth century, the reports indicate that merchants knew the signatures of other merchants, knowledge that was essential to the circulation of the payments system's paper. During the colonial period, U.S. domestic commerce mirrored that of England; but with the opening of the interior, everything changed.

The geography of the United States and the sheer number of participants prevented buyers and sellers in the domestic economy from knowing each other. Distances, moreover, delayed purchase transactions and payment. The Baltimore importer that sold worsted products to Kentucky buyers faced the same problems that Belgian sellers of tapestry faced when they sold to merchants in Bristol. The nineteenth century American seller marketing goods in the interior was essentially an international trader. The seller did not know the buyer and could not obtain payment against delivery of the goods.

The Baltimore seller, then, resorted to practices that international traders had used to deal at long distances with often unknown buyers. International traders had relied on the supercargo, an intermediary that acquired goods from sellers, transported them over long distances—first by sail, later by steam—and sold them. In domestic trade, the nineteenth century equivalents of the supercargo were the "old" factor and the commission merchant. They performed the same function, sometimes by mule-drawn barge or wagon and side-wheel paddler rather than sloop or steamship.

Other sellers, commodities brokers, adapted to interstate sales two favorites of international trade, the document of title and the draft. The courts hampered this practice some, but the documentary draft—sometimes with a letter of credit—supported interstate sales of cotton, grain and other agricultural commodities. Thus in the nineteenth century as U.S. domestic commerce expanded dramatically, goods moved from the eastern importer and manufacturer to the distribution centers on the other side of the Appalachians.

*B. In the Llewellyn Era*

Karl Llewellyn characterized these practices as sales on horseback and rightly complained that the law governing them was ill-fitted for the twentieth century. For by the time Llewellyn came to commercial law in the 1920s, the railroad had changed sales practices dramatically. The era of horseback sales was over. The steam engine of the plains had made the old factor and the commission merchant relatively unimportant. By the beginning of the twentieth century, sellers could do business directly and avoid the transaction costs of the documentary sale and the commission of the factor and other middlemen. This was the age of the drummer.

We sometimes think of the drummer as a salesman, as indeed the drummer was. Yet, the drummer, and to some extent the commission merchant before him, performed another important commercial function for the distant seller. The drummer visited the premises of the buyer. He looked at the buyer's stock in trade to determine its volume and its quality. He sipped coffee (and other beverages) with the buyer's creditors. The drummer was a credit reporter. The information he brought or telegraphed to New York and Chicago permitted sellers and buyers to devise what may have been the single most important innovation of domestic commerce in the last 100 years—the open-account sale.

The open-account sale significantly reduced transaction costs, as the open-account seller and buyer did not have to pay commissions to middlemen or charges to bankers. They did business on trust, much as their London forbearers had done at a time when sellers and buyers knew each other. The advent of this primitive system of credit reporting effected enormous change in the practice of domestic sellers and buyers.

Among the most important effects of the open-account sale was the opportunity it provided for credit terms. Sellers without credit reporting were captives of the cash sale. For them, credit selling imposed intolerable risk.

Once the seller laid hold of reliable credit information, however, the financially irresponsible buyer could not gain entry to the seller's buyer list. Sellers expanded their market at small risk, increased efficiencies and enhanced credit offerings to the responsible yet traditionally cash-starved buyer.

By the 1950s the open-account sale was the paradigm in merchant-to-merchant sales. Much of the Code's sales law anticipates it and modifies traditional sales law to accommodate it.

By the 1950s merchant-to-consumer sales also had altered. Horseback consumer sales had been primarily low dollar, over-the-counter, cash transactions involving food, clothes and a modicum of services. By the 1950s, while those sales continued to predominate, there had arisen new practices, some of which were areas of considerable consumer peril. These were sales of consumer durables, the new products that transformed the American way of life in the twentieth century. Washing machines, radios, refrigerators and above all the automobile made their way into the consumer sales picture.

These sales were not low dollar. Frequently they required financing; and consumer credit became a social and commercial necessity. There were two additional and regrettable features of these transactions. First, many of them were made door-to-door by travelling salesmen, who were here today with their high pressure and insupportable promises and gone tomorrow with the consumer's funds. The second regrettable feature of these sales was that in order to finance them, the merchants and financial institutions borrowed a commercial device from the merchant sale. They borrowed the negotiable instrument in order to render the financial institution free from the claims of the consumer against the travelling seller.

In retrospect it is clear that the peculiarly commercial negotiable instrument device was wholly unsuited for the consumer sale. Its introduction excited animus toward the device, the consequences of which are, unfortunately, still with us. Gilmore was unable to overcome statutorily the baleful consequences of this consumer sale, though Llewellyn succeeded grandly in fashioning warranty rules that, absent the negotiable instrument, largely reordered the consumer sale to effect an efficient balance.

### *C. Today*

Four changes in the sale transaction since the 1950s render many concerns of the 1950s out of date. Two of them, still incipient, suggest further dramatic change.

The first change relates to credit information on the merchant buyer. By virtue of refinements in merchant credit reporting, the open-account sale now dominates the merchant-to-merchant sales transaction. The second involves credit information on the consumer buyer. The advent of reliable and widely available consumer credit information has made credit available in retail sales. The third, still a fledgling commercial device, involves information on sales and its effect on inventory control and ultimately on marketing. By virtue of point of sale inventory control in some trades, manufacturers and retailers can eliminate guess-

work in or even the need for sales projections. They can now predict with considerable accuracy what their inventory requirements will be. Given that information, they now wonder how crucial the distributor and its warehousing function will be in the future. The fourth development, also still in its early stages, is in the area of data transmission. Telemarketing permits retail sales without a retail establishment and reduces the need for distribution centers and warehousing. Electronic data interchange renders obsolete not only many of the purchase orders and invoices that have long characterized the merchant sale but also threatens to push to the perimeter of sales law the grand battle of the forms.

### 1. Merchant credit availability

Merchant sellers and the national reporting agencies have refined credit reporting to the point that it is now ubiquitous and virtually instantaneous. It is not necessary for a merchant seller to maintain a stable of drummers with territories. Commercial reporting services now provide on-line access to their credit databases. Credit departments in any area of the country can receive instant and reliable reports concerning potential accounts in any other area. The open-account seller can acknowledge purchase orders in a matter of minutes. Sellers out of inventory can initiate performance with orders to the shipping department with equal dispatch. These developments have opened credit to credit-worthy accounts.

The standby letter of credit, a mercantile device largely confined to the automobile industry in the 1950s is a refinement that has vastly increased the availability of open-account credit for merchant buyers. Accounts that cannot satisfy the reporting agencies' requirements for favorable ratings can now enhance their own credit worthiness by virtue of the credit of their bank. Those with financial backing not reflected on their own balance sheets can use that backing to obtain the standby. The arrangement entails transaction costs that the traditional open-account sale avoids; but the costs are low; and the standby in the open-account context has the effect of elevating the new entrant and the weak buyer to the rank of good credit risk.

### 2. Consumer credit availability

Credit reporting has had perhaps greater impact in the consumer sale setting. Formerly, retail sellers could not take the risk of selling on credit to consumers, at least not without the negotiable instrument that they could readily discount by virtue of its ability to cut off consumer

defenses. The same danger that lurked in the nineteenth century merchant-to-merchant sale haunted the retail sale. The seller could not distinguish the good credit risk from the bad, and the bad risk drove out credit sales.

All of that has changed. Credit information on consumers is now as reliable as merchant credit reporting and as available as the nearest telephone line. Point of sale devices permit merchants to check on credit histories. Financial institutions now claim that they can make significant credit commitments in a matter of hours.

Nothing can be more important to the transformation of the retail sale, however, than the introduction of bank credit into that transaction. Retail merchants now sell without credit inquiry to consumers holding the plastic standby letter of credit that virtually every consumer now carries—the bank credit card.

### 3. Data transmission and manipulation

The full effect of innovations in inventory control remain to be seen, but they too suggest that sales in the next four decades will differ from sales in the last four. Since the 1950s, manufacturers and retailers have devised ways of reducing the cost of marketing goods. Of particular concern over this period was the cost of holding inventory. Inventory is obviously costly. It ties up funds, and it requires storage and insurance. It also has the nightmarish tendency to become obsolete. In 1920, and even 1950, a large inventory was a sign of fiscal strength. Today it is often a sign of poor planning, a sign that the merchant is paying high loan carrying charges and is risking serious loss if or when the merchant's suppliers develop newer and better products, as they do with regularity. Sellers do not need drummers anymore; sellers that rely on the information drummers give them would be extending credit to the wrong parties.

Trade creditor practices reflect this development. Trade creditors no longer rely on a buyer's stock in trade. They have, it is worth noting, made little fuss over the recommendation that the Bulk Sales Article be repealed. That article is a monument to a past practice—trade creditor reliance on buyers' inventories.

## III. PAYMENTS

The most profound change in the payments system has been the replacement of paper with newer methods of transferring bank credit. Those innovations fall under two broad and sometimes overlapping headings: (1) wire transfers; and (2) credit and debit cards.

For a long time, some commentators insisted that the payment system was on the verge of becoming paperless. That prediction has proved hollow. The number of negotiable instruments in the bank collection system continued to grow into this decade, though it now appears to have peaked. It is clear, nonetheless, that growth is no longer in paper but in non-paper transfers. The use of credit and debit cards in the consumer setting and the use of wire payments in merchant transactions and, to a lesser extent, in consumer transactions is the locus of growth. By 1992 wire transfers and credit card sales effected payments that surpassed the fifty billion checks handled annually by the bank collection system. These new payment media, moreover, have been the subject of innovation. Payment system efficiencies arise in connection with these innovations, not in connection with paper.

### *A. History*

Negotiable instruments (drafts and notes) were the chief innovation of U.S. commerce in the payments area. A replacement for scarce specie that was so vulnerable to the appetites of brigands and pirates, the negotiable instrument facilitated the transfer of credit and the exchange of currencies. Initially a product of international trade, the draft and later the promissory note also became vehicles for creating credit, usually in connection with the sale of goods or commodities. In international sales, foreign buyers used trade acceptances, which merchant houses held or took at discount, to finance their purchases. Similarly, buyers in the American interior could pay for their purchases with promissory notes, which the banking system discounted for the credit seller. The draft, of course, played a significant role in the domestic documentary draft transaction under which eastern and big city sellers sold merchandise on credit. In short, by the middle to late nineteenth century, promissory notes and drafts were important commercial devices that played the dual role of facilitating credit and payment.

Accommodation parties appear in these transactions. Merchant buyers that were not well established found their paper unacceptable in the market and sought to enhance that paper (their promissory notes and accepted drafts) with the signature of a co-maker or endorser whose credit standing was recognized and whose signature on the paper rendered it more acceptable and less subject to steep discount.

Checks made their appearance in the nineteenth century as well, though they were and still are limited primarily to a payments function, having less of a credit function than the draft and the promissory note.



### *B. Effect of the Open-Account Sale*

With the advent of credit reporting and the efficient open-account sale that credit reporting makes possible, the promissory note and the draft met their demise in domestic sales. Today, drafts play a distinctly minor role as credit instruments, usually in sales to buyers with marginal credit standing. Promissory notes play a role in the syndication of limited partnerships. In these instances they are vehicles for investors. Notes also appear in forfaiting transactions, a practice that is not prominent in the United States. Generally, promissory notes are now simply records of loans. The note usually sits in the vault of the commercial lender from the time of utterance until the time it is satisfied and stamped "paid." It is true that at times the note and the draft make their appearance in domestic commerce. Transactions fashioned at the kitchen table may yield a note that passes from one hand to another. Some drafts arise when marginal credit standing renders the open-account sale inconvenient. Generally, however, in domestic commerce and especially in domestic sales, the promissory note and the draft no longer play any significant role.

The open-account sale and the advent of consumer credit have dramatically enhanced the role of checks in the payments system, to the point that each year the bank collection system handles as many as fifty billion of them. The thrift and mutual fund industries have availed themselves of checking facilities. Under the documentary sale, the bank collection system effected payment as the draft passed from bank to bank. The demise of that transaction in domestic commerce necessitates the check, which now initiates payment of the invoice that the open-account seller sends to its credit buyer.

Similarly, the consumer buyer on credit, either through bank credit cards or store credit, must use the check in lieu of the cash the consumer formerly used to pay retailers. The check is in many respects an efficient payment mechanism. It has the supreme advantage of replacing cash, which imposes serious costs on both consumer and retailer. Cash can be lost, stolen or embezzled easily. Checks are much more difficult to steal or embezzle, and lost checks can be replaced.

Checks, however, can be forged by drawers and endorsers; and the cost of moving checks through the collection system, even with modern truncation, is significant. The negotiation of checks, furthermore, is less apparent than formerly when the check sometimes moved outside the banking system—a practice now rapidly disappearing. In short, the check rarely appears in commerce outside the bank collection system, and the prospects are that it will appear even less often in the future.

There are also signs that the check itself will appear less often, as merchants and consumers avail themselves of wire transfers of one kind or another.

In the merchant context, electronic innovations now permit the transfer of bank credit by reliable and inexpensive means at high speed. Wire payments permit same day credit transfers. Credit and debit cards and payments through the automated clearinghouse permit merchants and consumers to effect payment with no checks or with one check for a month's worth of purchases.

Checks are, after all, substitutes for cash; and as the need for cash diminishes, the need for the check is likely to diminish. It is too soon to predict the demise of the check from the payments system, but it now appears that its numbers have peaked. As merchants become more familiar with and recognize the efficiencies of the wire payment, they will be inclined to move from the check to the wire transfer. Transactions effected through electronic data interchange will almost certainly result in payment by wire. As such transactions grow, then, the use of the check will diminish.

Consumers are beginning to accept the debit card, now largely confined to automated teller machine use. The costs merchants incur with credit cards render them unsuitable for low-dollar sales, those at the fast food restaurant, the supermarket and the gas station. The debit card entails fewer charges and avoids credit costs. It is attractive to the merchant. Its easy substitutability for cash and the check makes it attractive to consumers. The debit card appears poised for a greater role in the payments system.

The automated clearinghouse has already displaced checks by the millions when employers pay salaries, governments distribute welfare and social benefits, and corporations consolidate cash or distribute dividends. Home banking, which is enjoying growth after a period when its success was in question, may effectively induce consumers to use the automated clearinghouse to pay their creditors. All of these innovations will be at the expense of the check.

Checks and wire payments require liquid deposits. The check collection system is, in effect, the transfer of credit from one customer to another by depository institutions—banks, thrifts and mutual funds. The system works by virtue of the fact that there are corresponding deposits, usually in federal reserve banks, against which the parties can net their respective claims. Netting is the key, and some payors and payees are experimenting with netting arrangements outside the banking system. International currency traders, for example, can maintain balances in a

securities mutual fund and net their claims periodically during the day or at the end of the day, all by wire and at little cost. These arrangements, if they prove efficient, are bound to grow, and the banking system may witness the advent of other new competitors in the payment system.

### *C. International Payments*

The draft survives in international sales in much the same role it formerly played in domestic sales. More than eighty percent of U.S. imports and exports are supported by commercial letters of credit that usually involve the draft. As international trade grows, use of the negotiable draft grows with it. Yet, innovations in international trade suggest a diminished role for the draft, for as international traders come to know and rely on each other's credit, they will remove the letter of credit and the draft it entails from the international sale transaction. Indications are that the international merchant community is making efforts to promote open-account sales with all of the efficiencies that attended the rise of the open-account sale in domestic commerce.

Many foreign buyers are familiar to their domestic sellers, who can be relatively comfortable that payment will ensue. There are risks in shipping a supertanker of petrochemicals from Texas to Rotterdam, however; and the seller of a cargo worth in excess of \$100 million still wants assurances. The invoice standby arrangement permits the parties to operate on an open-account basis and to invoke the standby in the event the buyer does not satisfy the invoice. The arrangement is becoming increasingly common, as buyers and sellers attempt to avoid bank charges in sales for which payment is usually automatic. The draft still appears, but only in the unlikely event that the buyer defaults. Thus, even in the international sale the draft may relinquish some of its importance.

Bank drafts that formerly moved bank credit still appear in international trade but with decreasing frequency. Bank wire transfer arrangements for international payments, such as the New York Clearinghouse Interbank Payment System (CHIPS), now dominate international bank credit transfers.

At the same time, the role of the promissory note has assumed a minor degree of importance in international trade. Forfeiting involves the use of negotiable promissory notes in international sales between sellers that must grant credit terms to financially strong buyers. The sellers discount the buyers' notes with a local bank, which may, in turn, sell the notes in the money market, just as the Baltimore seller of the nineteenth century and his bank used the promissory note of the Kentucky buyer of

that era. Negotiability is essential in these transactions, which are easily adapted to sales in proximate international markets. European sellers have used the device with success, and its advantages in some U.S. export markets may foster its growth domestically. Thus, the promissory note could enjoy a modicum of resurgence in international sales.

#### IV. TRANSPORT AND STORAGE

Changes in bailment practices since the drafting of the Code have been no less significant than those in other areas of commercial practice. There has been significant change in transport as the non-negotiable waybill appears more frequently, and containerization displaces break bulk cargoes. In warehousing, the revolution in information technology has completed the demise of the field warehouse that had begun its decline by the 1950s and has witnessed the same gradual decline in the negotiability of receipts that has attended negotiable drafts and promissory notes.

##### *A. History*

The chief benefit of the negotiable document is its reification effect. The negotiable document stands for the goods, and during the pre-Code era when domestic buyers and sellers were unfamiliar with each other, that reification feature enabled them to market and finance goods in storage or transport. With the rise of federal farm programs in the 1930s, the negotiable warehouse receipt allowed banks and agencies of the federal government to take a pledge of commodities stored in distant locations. While the commodities rested in a safe environment awaiting rail or barge transport and consumer calls for delivery, lenders could hold and transfer negotiable receipts with a marked degree of reliability. Those practices survived the drafting of the Code, which largely validated them; and they survive today.

In colonial times and later, the delivery order was an efficient commercial document. Especially in ports and to some extent in seaboard/interior commerce, sellers and buyers used delivery orders to instruct bailees as to the change in ownership of stored commodities. The Code recognized the delivery order, but at some point, perhaps before the Code's adoption, commercial parties appear to have forgotten about it. There is evidence, for example, of agricultural commerce's attempts to reinvent it as a commodity "draft." The bill-and-hold practices of the textile industry seem to be made for the delivery order as a negotiable document of title; but it does not appear to play the role it was originally fashioned to play.

The negotiable bill of lading was and still is an integral part of the documentary draft transaction. By virtue of its reification feature, the bill permitted banks to extend credit to buyers and sellers while the goods were in transit and allowed the buyer to pay a sight draft before the goods arrived at their destination.

### *B. Current Developments*

The demise of the documentary sale in domestic commerce has diminished the need for domestic negotiable bills of lading. Rail bills and truck bills for domestic transport are almost always non-negotiable, though the transport industry has wisely retained the capacity and protected the legal effect of domestic negotiable bills. The domestic documentary sale survives but as a marginal practice.

In international sales the documentary draft transaction is very much alive and growing in real terms but not as a percentage of those sales. Current efforts to subject the bill of lading to electronic innovation have met the largely unanimous view that a paper bill is essential to the documentary sale, which is still a staple of the marketing and financing of international shipments.

The Code's bailment article, of course, plays no role in these transactions, limited as it is to intrastate transport. The Federal Bills of Lading Act and the Carriage of Goods by Sea Act govern interstate shipments and transport from the United States to foreign ports.

Two further bailment developments merit discussion. The first is the rise of the non-negotiable bill; the second is the specialization of the transport industry.

With the advent of the open-account sale, the negotiable bill became an impediment. Buyers could not take possession of merchandise without surrendering the bill. Delay in the mails, and loss or theft of the bill created the need for expensive bonds to protect the carrier against potential claims. The non-negotiable bill, then, suits the open-account sale. The non-negotiable bill need not be surrendered to the carrier. That bill, however, is less a document of title than a shipment contract. Internationalists call the non-negotiable bill a "waybill." It has appeared in North Atlantic transport, and the British have had to amend their version of the Carriage of Goods by Sea Act to accommodate it. English commentators treat the notion with a measure of disdain. The idea of a non-negotiable bill, in their view, is inconsistent with the document of title concept.

Use of the non-negotiable bill is increasing in international trade, however, for the same reason that it has come to dominate domestic

trade. When international traders ship on open account under the invoice standby letter of credit, the negotiable bill becomes a liability. A shipper that suffers the loss or theft of a negotiable bill covering a supertanker cargo of petrochemicals faces significant costs for a bond to indemnify the carrier. The shipment under a non-negotiable bill does not entail those costs. The negotiable bill, of course, is still efficient if the parties desire to finance the goods or commodities while they are in transport. Banks are less inclined to make advances without security than when they have it. The negotiable bill gives it to them. For transport of commodities that are traded while in transit, such as crude oil and ores, the negotiable bill appears to be essential. Thus, for the moment, the future of the negotiable bill in international trade seems to be assured. At the same time, the shortening of transit time, especially in air transport, and the open-account practices that are incipient in international sales make the non-negotiable bill, the waybill, essential too.

The non-negotiable warehouse receipt played something of a role in field warehousing, but otherwise is less commercially important than its transport analogue. Parties that store goods use the non-negotiable receipt, but it seldom affects the rights of the parties except as a contract covering matters such as storage charges, risk of loss and the like. Today, computerized record keeping has replaced the field warehouse.

The second development in transport that affects bailment law is specialization. As international sales of goods become more significant in the U.S. economy, more U.S. sellers enter the field; but indications are that they quickly avail themselves of the expertise of freight forwarders and the international departments of banks to arrange the export transaction and the export shipment itself and to issue the export letter of credit. Similarly, importers are multiplying, but they seem to be availing themselves of the freight forwarder in its customs broker role and of the international banker as advisor or confirmor of the import letter of credit. The expertise of these parties renders law less important. Disputes are fewer. Arbitration, without lawyers and in a setting in which business practices tend to trump legal rules more effectively than in the alien setting of the courtroom, is a favored alternative to litigation for this industry.

### *C. Conclusion*

Documents of title are important commercial instruments only when they retain features of negotiability, that is, only so long as they reify the goods in the document itself. The demise of negotiable documents in domestic commerce effects a parallel demise in the importance

of negotiability rules found in Article 7, and with analogous rules in Articles 4 and 9 that deal with these once but now less important commercial devices.

## V. SECURED LENDING

There have been four major developments in the landscape of secured lending: (1) the rise of equipment leasing; (2) the demise of secured consumer sales; (3) the diminishing role of inventory as security; and (4) the increase of non-asset based lending in the middle market.

### A. History

Until the end of the last century or the beginning of this one, commercial bankers thought all loans should be self liquidating. A banker might finance a merchant-to-merchant sale on a secured basis, but the loan related to that discrete sale usually was against assets generated by the sales transaction. First came the negotiable document representing the goods sold. Next came the negotiable instrument—the buyer's promissory note or trade acceptance.

This was the real bills theory of banking, and it gradually gave way to the realization that collateral, especially inventory and accounts, could revolve. The open-account sale provided significant credit for the buyer, but it was short term credit, and it was sometimes insufficient for the buyer to turn over the merchandise. Buyers, furthermore, needed working capital; and the discrete loan did not accommodate it.

Thus developed the concept of the working capital loan, which was not discrete or self liquidating in any way but was usually secured by revolving collateral and was evidenced by a demand, not a time note. Under the revolving loan, the borrower granted the lender security in a variety of assets and made payments as it suited the borrower's cash flow and the lender's patience.

Originally, trust companies made these daring loans that challenged commercial banking orthodoxy, but eventually the commercial banker saw their attractiveness and ventured into secured lending. As this new brand of secured commercial lending commenced, the borrower was the marginal operation or at least the new one. Borrowers longed to borrow on the credit of their reputation and their history of profits rather than on the marketability of their assets. As Homer Kripke put it, they wanted to get out of the finance companies and into the banks.<sup>1</sup> Com-

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1. Homer Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929, 970 (1985).

mercial bankers were more inclined to lend to the enterprise that was at minimal risk of default and, therefore, did not need to post collateral; it was the finance company that made the asset-based loan.

By the 1950s, the picture had begun to change, as the good credit risks, in order to avoid bank charges, moved out of the banks and directly into the money markets. At the same time the asset-based borrower moved to the banks. Clearly, one of the objects of the Code was to validate in all respects loans secured by revolving inventory and accounts. Article 9 faced two challenges to that loan concept, one a Supreme Court opinion by Justice Brandeis,<sup>2</sup> another the anti-preference rule of the Bankruptcy Act. The drafters successfully overturned the first, a matter of state law, but failed as to the second, a matter of federal law. The courts relieved the pressure from the second challenge until Congress itself refashioned the bankruptcy statute in a way that renders it hospitable to these revolving loans.

Secured lending has played a major role in consumer finance. The middle of this century witnessed the rise of consumer credit. Unfortunately for all involved, the consumer credit transaction initially drew its form from the merchant credit sale and involved negotiable instruments and their holder-in-due course feature. The effect of these rules was to force consumers to pay for goods that failed to conform to reasonable expectations.

With the end of the Second World War and the burgeoning sales of consumer durables, consumer credit virtually always entailed a purchase money security interest in the durables. By dint of that security interest, the consumer not only had to pay the holder of his paper but faced loss of the goods in case of default. This double threat admitted no commercial defenses, because the holder of the paper took it free of defenses.

The Code drafters' successful attempts to fashion strong warranty terms in the sales transaction did not completely avail the consumer because the negotiability rules of Article 3 and the imputation doctrine of Article 9 rendered the consumer defenseless in the event institutional lenders entered the transaction.

### *B. Today*

Developments since the 1950s alter the picture. First, in both the consumer and the commercial setting, unsecured credit has grown and secured credit has diminished markedly. Second, equipment leasing has become, in its true lease form or its disguised sale form, a critical source

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2. *Benedict v. Ratner*, 268 U.S. 353 (1925).



of credit in the equipment trade. Third, inventory has become relatively less important as collateral. Fourth, intellectual property, currently the subject of federal law, has become an important, valuable commercial asset.

Today most consumer credit, except for automobile or mobile home transactions, is unsecured. Quick, reliable credit reporting has once again considerably changed the face of commerce. Credit card issuers can rely on those reports when they issue the card, increase its limits and honor merchant charges. Except for the automobile or mobile home transaction, the chattel paper that has been such a source of consumer credit, and consumer dissatisfaction, has assumed a much more modest role in the consumer credit picture. The Code, of course, does not govern credit card transactions, which are largely the domain of federal law or of the contracts between the various parties to the credit card transaction.

Since the 1950s, furthermore, many business enterprises that formerly obtained credit from banks now seek it in the money markets. It is true that some of those enterprises would have borrowed from banks on an unsecured basis, but others would have had to grant security interests in assets in order to secure their loans. Today, larger businesses are obtaining credit via commercial paper, much of it enhanced by guarantees of one sort or another, including the bank-issued standby letter of credit. Commercial paper borrowing is unsecured and is not within the province of the Code. Even smaller businesses, the classic asset-based borrowers, are avoiding collateralized loans. Some of them reduce inventory through various mechanisms. They use just-in-time inventory planning and point-of-sale inventory control; and they bargain vigorously for longer credit terms from their larger suppliers, using them as sources of credit. The credit crunch of the 1970s taught some hard lessons. Borrowers became wary of credit charges and of bankers that suddenly demanded payment of notes that in the past had been refinanced with regularity. Some finance companies have responded to business wariness of asset-based lending and its transaction costs by making unsecured advances, though usually on the very shortest of terms.

Leasing is probably still a growth industry. It is an industry, however, characterized by adhesion contracts, large merchant lessors and large merchant lessees. The leasing article codifies the best of the cases and provides what amounts in some instances to regulations for the gray areas of leasing law, not the least of which is the law that determines whether a transaction is a sale or a lease. One suspects that the number of leasing cases will be quite small and that the impact of Article 2A will

be largely reflected or deflected in the drafting of the lease forms that the industry is and will continue to use.

Durable assets characterize the balance sheet of the manufacturing sector. The 1990s are witnessing the relative decline of that sector and the corresponding growth of the service sector. Service industries are not durable asset rich. The great increase in assets over the last decade and the growth that one would expect will continue into the next decade has been in the area of intellectual property. With the relative decline in manufacturing and the relative rise in services has come a dramatic increase in the economy's intellectual property. Durables, then, as inventory and as consumer goods comprise a relatively less important part of the lending picture; and with their demise has come the spectacular rise of intellectual property assets.

## VI. SUMMARY

A Uniform Commercial Code drafted in the 1950s cannot serve commerce in the 1990s. When the American Law Institute and the National Conference of Commissioners on Uniform State Laws fashioned the Code, credit reporting was inefficient and hardly universal. Today it is instantaneous and evident in the smallest enterprise. The service sector of that era was nascent, the manufacturing sector dominant. Today service is ascendant, and manufacturing is in relative, if not actual, decline. The explosion of international trade and international conventions and the like and of federal statutes and regulations provide competition for the Code as the premier source of U.S. commercial law.

The invention of new payment and guaranty mechanisms has rendered promissory notes, accommodation parties and domestic documentary collections quaint artifacts analogous to the allonge of which Grant Gilmore made fun. On an average day CHIPS will clear more than \$600 million using technology unknown in 1950.

That is not to deny that the drafting and adoption of the Code was a signal achievement in the history of U.S. commercial law. But just as Llewellyn lamented that merchants of the 1940s were forced to deal with sales law made for sales on horseback, so today commercial parties must be aware of the fact that their transactions are governed by law made when the telegraph, the international bank draft and the traveller's letter of credit were important adjuncts to commercial activity. In 1993 they are curious anachronisms.

The Code of the 1950s was a Code for distant sellers and buyers contracting by mail, consumers signing or co-signing promissory notes, domestic documentary sales, clearinghouses choking on scraps of paper,

negotiable rail or truck bills, trade creditors that relied on a customer's stock in trade—all largely gone and the commercial world they characterized largely gone with them.

Those who face the task of writing the new Code are conscious of this new commercial world and its requirements. There is still much for the Code to govern. It is a major source of commercial law. Its careful revision will give rise to great efficiencies. Its thoughtful revisers have shaped and undoubtedly in their future efforts will shape a climate hospitable to further commercial growth, for that is the Code tradition. But they will not work in an environment similar to that of Llewellyn and Gilmore. Their task is as daunting and will call for just as much resourcefulness and knowledge of law and commerce, and the commercial prize for the economy in real dollars may be as great. Their Code, however, will operate in a different environment. The Llewellyn commercial code has been circumscribed by commercial events.