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Article 9 Works—How Come

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ARTICLE 9 WORKS—HOW COME?

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I. INTRODUCTION

In 1990 the Permanent Editorial Board for the Uniform Commercial Code[1] (PEB) established a study committee to consider whether Article 9 of the Uniform Commercial Code (UCC) should be revised, and if so to recommend the nature and substance of the revisions. At the end of 1992 the committee issued its report,[2] concluding that some revisions would be desirable. The recommended revisions, however, are generally in the nature of the incremental changes that one would expect the passage of time to require.[3] The committee concluded that "Article 9 is fundamentally and conceptually sound,"[4] and the proposed revisions do not alter the Article's structure or principles.

The study committee's judgment that Article 9 is fundamentally sound is widely shared by experienced lawyers.[5] "Article 9 generally has provided a sound set of rules governing attachment, perfection, priority, and enforcement of security interests in personal property."[6] More than thirty years of personal experience with the application of Article 9 to commercial transactions leads me to concur in this view.

This article considers how Article 9 "works" when applied to commercial transactions. While Article 9 also applies to consumer transactions, a wide array of federal and state consumer protection

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1. The PEB functions under authority of the American Law Institute and the National Conference of Commissioners on Uniform State Laws, the two organizations that promulgated the UCC.

2. Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group, *Uniform Commercial Code Article 9 Report* (Dec. 1, 1992) [hereinafter Study Group Report]. Copies of the report are available from: Order Department, The American Law Institute, 4025 Chestnut Street, Philadelphia, PA 19104-3099.

3. Fifty years have passed since Article 9 was first enacted, and over 20 years since it was last revised.

4. Study Group Report, *supra* note 2, at 6 ("General Recommendation of the Committee").

5. *See, e.g.*, Carl Felsenfeld, *But the Proposed Uniform [?] Commercial Code Was Adopted*, 26 LOY. L.A. L. REV. 597, 605-06 (1993) ("Article 9 is generally perceived as a legislative triumph.").

6. Steven L. Harris & Charles W. Mooney, Jr., *The Article 9 Study Committee Report: Strong Signals and Hard Choices*, 29 IDAHO L. REV. 561, 569 (1992-1993).

laws override its provisions.[7] Any analysis of how Article 9 operates in a consumer context largely turns on the efficacy of these consumer laws. Therefore, I am only considering the Article's operational qualities in relation to business credit transactions.[8]

I am not addressing the extensive academic literature discussing whether secured financing is economically efficient.[9] However, I believe it is efficient insofar as it enables persons to receive funding upon terms that would not be available to them but for the grant of security. The long-standing, widespread use of secured credit throughout the United States, as well as in other economically developed nations, suggests that my view is widely shared. In any event, whatever the merits of secured financing, Article 9's purpose is to provide an efficient set of rules to facilitate utilization of personal property for such financing.

I believe Article 9 accomplishes its purpose, in that:

1. It enables credit seekers to receive the maximum amount of credit rationally justifiable, upon the most favorable terms economically available;
2. It enables credit grantors to meet the needs of credit seekers, that is, the credit grantors' customers, while providing credit grantors maximum certainty that they will have the first priority security interest upon which they are relying;
3. Transactional costs, whether in money, time, stress, or uncertainty, are kept to a minimum;
4. There is minimal cost, uncertainty, or risk to third parties in the conduct of their relationship with the credit seekers;[10] and
5. No class of persons is systemically exposed to "unjust," but unavoidable, consequences.[11]

Article 9's unduly complex filing system may be viewed as the exception that proves the rule.

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7. Federal law preempts state law, and UCC § 9-203(4) provides that provisions of state regulatory statutes covering the field of consumer finance prevail over the provisions of Article 9 in case of conflict. *See* U.C.C. § 9-203 cmt. 6 (1990).

8. The Uniform Consumer Credit Code was promulgated to provide a consumer credit balance to the UCC. It has been enacted in less than a dozen states, often in nonuniform versions.

9. In evaluating the utility of security there is no reason to distinguish Article 9 security interests from security interests generally.

10. I am not addressing the economic benefits and detriments to third parties resulting from secured financing, although I believe there is a strong net benefit.

11. Individual persons may experience "unjust" outcomes, as where an innocent and understandable perfection error results in a complete loss of perfected status.

Having stated, in conclusory terms, that Article 9 serves an economically useful purpose, and that it does so efficiently, I turn to considering how it achieves that efficiency. Since the Article can only be evaluated in relation to the transactions to which it applies, my approach is transactional. I focus on those operative principles that largely account for *why* Article 9 "works." Implicit in the "why" is my conclusion that the Article does, in fact, work. If one differs with that conclusion, then my observations can be read as describing *how* the Article works.

II. ARTICLE 9'S INTERNAL DEFICIENCIES

Article 9's effectiveness does not derive from internal strengths. For example, its definition of key terms, such as "collateral," "debtor," and "secured party,"[12] as including the sale of accounts and chattel paper, results in the terms having meanings inconsistent with ordinary usage. The default rules (Part 5 of Article 9), although definitionally applicable to sales of certain receivables, make no sense when so applied.[13] Important terms are not defined, and their meanings may change from one section to another.[14]

There is no internal logic to explain Article 9's rules. These rules often turn on the characterization of the collateral, the debtor, or the credit transaction. These are fact-driven determinations. Are the goods equipment or inventory?[15] Is the debtor engaged in a farming operation?[16] Does the transaction constitute purchase money financing?[17] More than one characterization may apply. Error is possible, and the consequences of error, such as loss of perfected status, are potentially catastrophic to the creditor.

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12. U.C.C. § 9-105(1)(c), (d), (m) (1990).

13. Part 5 of Article 9 largely deals with postdefault remedies that are inherently inapposite to a sale. However, sales are definitionally encompassed within Part 5. The same definitional inapplicability arises elsewhere in Article 9, for example, at § 9-207.

14. *See, e.g.*, U.C.C. § 9-318(3), where assignment encompasses both sales and security interests, and § 9-318(4), where assignment is referenced separately from security interest. For a thoughtful discussion of Article 9's definitional inadequacies see Thomas E. Plank, *Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper Under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle*, 26 CONN. L. REV. 397 (1994).

15. U.C.C. § 9-109(2), (4).

16. *Id.* § 9-109(3).

17. *Id.* § 9-107.

The UCC Official Comments go a long way towards remedying the internal deficiencies of Article 9.[18] Indeed, their existence contributes significantly to the Article's functional utility. They often provide a clarification that no amount of statutory drafting could accomplish. This clarification is effected by such mechanisms as providing an example,[19] a description of transactional practice,[20] case-law precedent,[21] or legislative history.[22] However, if "clarity, uniformity, and elegance . . . in commercial law"[23] is the goal, Article 9 fails the test. It is not internally uniform and its structure and phrasing are neither clear nor elegant. And yet, experience shows that the Article works. Article 9 succeeds because it is well attuned to the commercial logic of the transactions to which it applies. It succeeds for reasons largely extrinsic to its internal qualities.

III. ARTICLE 9 TAKES ACCOUNT OF ALL AFFECTED PERSONS

There are at least two consensual parties to an Article 9 transaction, the debtor[24] and the credit-granting secured party.[25] In some measure, other persons, such as sureties for the debtor, may be parties to the transaction. As between the creditor and the debtor, their security agreement is a wholly private contract, as is true of agreements between the creditor and other persons, such as sureties. Article 9, with only minor exceptions,[26] allows the consensual parties full freedom of contract. "This primacy given by the UCC to the agreement between the parties (and therefore inferentially to usages of trade) allows the UCC to adapt easily to new marketplace practices."[27] Article 9 provides the contracting parties with gap-filling or default rules that govern in the absence of contrary terms. Its goal is to facilitate and support the transaction, not to regulate it.

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18. The PEB Commentaries, a recent innovation, are another helpful source of guidance, particularly as they respond to newly arising "glitches."

19. U.C.C. § 9-102 cmt. 4 (1990).

20. *Id.* § 9-102 cmt. 2.

21. *Id.* § 9-205 cmts. 1-4.

22. *Id.* § 9-302 cmt. 5.

23. Corinne Cooper, *The Madonnas Play Tug of War with the Whores or Who is Saving the UCC?*, 26 LOY. L.A. L. REV. 563, 568 (1993).

24. The debtor may be comprised of more than one person.

25. The creditor may be comprised of more than one person, who may have the same, or more often different, priority status.

26. The exceptions are appropriate and are not unduly burdensome; for example, notification of collateral disposition by the secured party. U.C.C. § 9-504(3) (1990).

27. Gerald T. McLaughlin, *The Evolving Uniform Commercial Code: From Infancy to Maturity to Old Age*, 26 LOY. L.A. L. REV. 691, 699-700 (1993).

One reason Article 9 advances this goal is that it permits the parties to do the deal that they are led to by their economic bargaining. If, instead, the Article intruded on the parties' bargain, the results would often be unsatisfactory. Since Article 9 covers an infinite range of transactions, involving all types of persons, no statute could sensibly regulate how these private dealings should be done, nor is there any reason to impose such regulation in a commercial context.

Apart from the contracting parties, all security agreements may be viewed as including an indeterminate group of nonsignatory third parties, that is, each creditor of the debtor, including its potential trustee in bankruptcy. The debtor's grant of a security interest to the creditor impacts these persons, but they have not assented to the creditor's priority interest in the collateral. The creditor's priority derives entirely from statute. Therefore, as to the debtor's creditor body, Article 9 fills a central, not merely gap-filling, role.

In the commercial world, if a debtor can pay, it does so. If the debtor is financially capable of paying, yet fails to do so, the creditor can enforce its claim against the debtor or any of the debtor's assets. Therefore, to the debtor and creditor, their contract and the general law of creditors' rights is of more importance than Article 9. The real efficacy of the Article is tested by the enforceability of the rights and priorities of the secured creditor as against the debtor's other creditors. In practice, this test takes place when the debtor is unable to pay its debts generally. The acid test occurs in the debtor's bankruptcy, where the creditor's secured position is subject to an overriding federal law that is more oriented towards equality of distribution and debtor rehabilitation than to preservation of security interests.

Article 9 has been crafted with a regard to conflicting creditors' rights law, including the Bankruptcy Code.[28] The transaction between the parties is primarily preserved by validating freedom of contract. The priority of the secured creditor over other creditors is substantially preserved, even in a bankruptcy setting,[29] by an unexpressed but nonetheless present integration of Article 9 with bankruptcy law and policies. The Article provides for basic creditors' rights principles, such as an abhorrence of secret liens. Consequently, the Article satisfies both the private agreements between the parties and the requirements of the creditor community at large.

28. *See* 11 U.S.C. §§ 101-1330 (1988).

29. The Bankruptcy Code does override some of the secured party's contract rights, as by the automatic stay, but the creditor's priority is preserved. 11 U.S.C. § 362.

IV. TRANSACTIONAL LOGIC OF ARTICLE 9

Much of Article 9's effectiveness derives from the fact that its rules follow the transactional realities that exist independently of the Article. Unavoidably, this means that the logic of the rules is to be found in the transactions, and not within Article 9 itself. Someone unfamiliar with secured transactions has difficulty understanding the "how and why" of the Article. A transactional lawyer, however, finds the Article's rules understandable and predictable. Three examples of this proposition follow.

A. *Purchase Money Priority Notice Requirements*

Article 9 permits floating liens, thereby providing a simple mechanism for collateral and debt to revolve.[30] The priority of the floating lienor, however, could frustrate the debtor's ability to get the purchase money financing that is often available for purchasing inventory or equipment. Article 9 pragmatically resolves this uneconomic circumstance by providing a "super-priority" to purchase money liens that primes the floating lienor. The preconditions for such priming differ as between equipment and inventory. The explanation for the difference is found in the transactions themselves.

As to equipment, the purchase money claimant need only perfect within a prescribed time period.[31] Since equipment loans are not made in reliance on equipment to be acquired at unknown, and unknowable, future times, no notice to the equipment floating lienor is required.

In contrast, the rule permitting purchase money priority over a floating inventory lien requires prior notice.[32] Since inventory lending often contemplates that the inventory collateral will revolve, with new inventory automatically substituted for old, the purchase money claimant is required to give prior notice to the inventory lender of its purchase money interest. Having received such notice, the inventory lender can protect its interest by excluding the purchase money inventory from the borrowing base.

This example illustrates Article 9's orientation to protecting the reliance creditor. The equipment financer does not rely on future acquired equipment. The inventory financer does rely on future ac-

30. U.C.C. § 9-204 (1990).
31. *Id.* § 9-312(4).
32. *Id.* § 9-312(3).

quired inventory. Accordingly, notice of the purchase money interest must be given to the latter, but not the former.

B. Accounts and Chattel Paper Perfection Differences

Filing achieves perfection against accounts and chattel paper.[33] However, perfection against chattel paper can also be effected by taking possession of the paper, and such perfection may prime an earlier interest perfected solely by filing.[34] The possession alternative reflects the fact that financers of chattel paper tend to do so in reliance on specific identifiable items of paper. Moreover, financers of inventory do not automatically finance the chattel paper arising from the inventory. In contrast, accounts receivable financers tend to finance the accounts as a pool, with new accounts replacing the paid accounts, and with any inventory loan often rolling into an accounts receivable loan. Therefore, it is both desirable and practical to provide for chattel paper being financed independently of a prior interest. Conversely, it is not economically desirable or practical for accounts to be open to financing by a multiplicity of lenders.

This example illustrates Article 9's adaptation to the operational realities of the transactions. The potential for possession of chattel paper priming a perfected filing certainly adds transactional cost, as compared to the exclusive filing regime applicable to accounts. This cost, however, is well justified by the value of facilitating chattel paper financing alternatives, alternatives that would not be operationally practical with respect to accounts.

Since financers of accounts and chattel paper are virtually always professional credit grantors, they can be expected to know the rules and function within them. Even an "amateur" receivables financer can be expected to consult with counsel, since structuring, documenting, and implementing accounts or chattel paper financing is inherently complex. In contrast, Article 9 is more solicitous of the equipment financer, recognizing that equipment financing often takes the form of vendor installment sales credit. Vendors are not necessarily financing sophisticates. Their transactions are simple, one-time credit extensions that can be documented with standardized forms. These transactions are often consummated quickly to meet the needs of buyer and seller, and counsel is generally not consulted, nor need it be.

33. *Id.* §§ 9-302(1), 9-304(1).
34. *Id.* § 9-308.

C. Purchaser vs. Secured Party

Inventory is intended to be sold. Buyers of inventory must be able to rely upon their sellers' ability to deliver goods free of conflicting interests. Accordingly, section 9-307(1) provides that a "buyer in ordinary course of business"[35] takes free of a security interest created by its seller even though the security interest is perfected and the buyer knows of its existence. Inventory lenders know that they are exposed to having their inventory collateral removed from their security interest and therefore protect themselves by such monitoring as they deem necessary with respect to the particular debtor. In the ordinary course they look to the proceeds of the sold inventory as substitute collateral and their ultimate source of payment.[36]

Equipment, unlike inventory, is held for use, not sale. A purchaser from an equipment user has no reason to assume that the equipment can be sold free of a security interest. Conversely, an equipment lender has no reason to assume that the equipment will be sold. Compelling the equipment financer to police equipment collateral would impose transactional costs out of proportion to any commercial need. Similarly, the equipment financer does not contemplate monitoring, much less financing, the proceeds of equipment sales. Accordingly, a security interest in equipment continues notwithstanding its sale or other disposition unless the secured party has authorized such disposition.[37]

This example illustrates Article 9's accommodation to the needs of third parties, such as inventory purchasers. As between bona fide purchaser and inventory financer, the Article allocates the risk to the latter as the person better able to deal with it. As between equipment financer and purchaser, the Article reverses the risk allocation.

Certainly, the rules do not well apply to all fact patterns. However, they are atypical patterns. One of Article 9's strengths is that it effectively deals with the generality of transactions. Its rules are intuitively what one would expect, once transactional realities are recognized. It places burdens on the party who, as a commercial matter, can best bear the burden at the lowest transactional cost.

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35. *Id.* § 1-201(9).

36. Proceeds of inventory are both the ultimate payments by the account debtors and the purchase price or advance of a third party assignee of the receivables. I do not here address the extent to which an inventory financer, having received the latter, can also claim priority in the former.

37. U.C.C. § 9-306(2).

V. Problem Solving, and Its Limits

Because of its transactional orientation the application of Article 9 to specific credit extensions is not always clear. For example, compliance with such fundamentals as perfection depends upon proper characterization, but in a particular fact setting characterization is not always free of doubt. Key definitions may have counter-intuitive meanings. The Article, even when read with the official comments, may not provide guidance.

Article 9's solution to many potential problems is to permit a "belt and suspenders" approach. For example, filings can be made, with minimal cost, in every likely jurisdiction. Similarly, perfection can be accomplished in concurrent alternative modes by filing and taking possession. If unsure whether a security interest should be perfected under or outside of Article 9, the creditor can always resolve the Article 9 component by perfecting under Article 9.[38] Similarly, if unsure whether equipment constitutes a fixture, the ready answer is to file both fixture and nonfixture filings.[39]

This is not to say that potential for error does not exist. Professor James White has identified over 300 reported bankruptcy cases involving Article 9 perfection issues from the beginning of 1980 through the end of 1990.[40] However, my reading of perfection cases indicates that the secured party could have avoided loss, or even litigation, if it had correctly searched and timely filed proper financing statements, all in the correct places. In almost all cases, the secured party could easily have done so, resolving uncertainties by perfecting in alternative ways and places. A reasonably careful lawyer, taking advantage of Article 9's potential for achieving certainty by "precautionary" and "redundant" perfection, can practice for years without a perfection challenge, much less a loss.

Potential for fraud is inherent to personal property financing. For example, the debtor can sell inventory for cash, and retain the proceeds. The debtor can claim to have more inventory than it in fact has, or that its inventory is marketable when it is not. Similarly, the debtor can divert receivables collections, create fictitious paper, sell on consignment or bill-and-hold terms, pre-bill, secrete equipment, or misrepresent its ownership status.

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38. *See id.* §§ 9-302(3)-(4).

39. *See id.* U.C.C. § 9-313.

40. *See* James J. White, *Revising Article 9 to Reduce Wasteful Litigation*, 26 Loy. L.A. L. Rev. 823, 830-41 (1993).

Creditors understand that they ought not to knowingly extend credit to a morally defective debtor.[41] Their protection against unknowingly doing so is by policing, monitoring, and auditing the debtor, the collateral, and contractual compliance.

Article 9 deters some potential frauds, such as double financing. However, unlike the motor vehicle title acts, fraud prevention is an incidental, rather than primary, purpose. This limitation upon Article 9's utility is responsive to the impracticality of designing a statute that will effectively deter most types of misconduct or fraud. Any attempt to do so would produce a cumbersome set of rules that would frustrate some transactions, materially burden all of them, and still fail to accomplish its goal. This is not a case where something is better than nothing. Barring only one window of my home is no better than barring none.

The foregoing illustrates that one element of how Article 9 works is that it does not undertake more than it can efficiently achieve.

VI. Substance over Form

The application of Article 9 turns on the substance, rather than the form, of the transaction.[42] Thus, the sale of accounts and chattel paper are brought within the ambit of the Article. This provides certainty to the record searcher. Of no less importance, it provides certainty to the party claiming an interest in the accounts or chattel paper.[43] Similarly, transactions cast as leases may be subject to Article 9 if they are functionally the grant of a security interest.[44] If the "lessor" is in doubt it can perfect, with no implication that the transaction is not a true lease.[45] Article 9 likewise covers consignment sales.[46]

Since the requirements and costs of perfection are minimal, potential problems are easily resolved. Litigation tends to arise from a noncompliance that had no legal, economic, or practical justification.

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41. A pledge is effective to prevent fraud since the pledgee has possession of the collateral and, assuming the collateral value exceeds the debt, the pledgee need not concern itself with the character of the pledgor, beyond confirming the pledgor's title.

42. U.C.C. § 9-101 cmt. (1990).

43. The absence of such certainty with respect to general intangibles has led the PEB Study Group to recommend inclusion of the sale of general intangibles within the scope of Article 9. Study Group Report, *supra* note 2, at 43.

44. *Id.* §§ 1-201(37), 9-102(2).

45. *Id.* § 9-408.

46. *Id.* §§ 1-201(37), 9-114.

From a business perspective, it is often more important that a rule be certain, than "equitable." Often, the mere fact of certainty makes the rule equitable. Transactions can be structured to accommodate known rules, and priced to reflect costs imposed by the rules.

Article 9 takes full advantage of this principle. Under its regime, millions of transactions have taken place without contest or cost. The price of certainty is an occasional harsh result. This price is well worth paying since it can be recognized, quantified, and, in most situations, avoided, while the costs of uncertainty are immeasurable and insoluble—except by not doing the deal.

VII. Remedies Are Designed to Maximize Economic Values

Article 9 default rules may be phrased in subjective terms. For example, the disposition of collateral "must be commercially reasonable."[47] The Article neither defines "commercially reasonable" nor does it spell out the criteria of reasonableness. However, the uncertainty that this would seem to engender does not exist in practice.

A secured party can avoid attack by behaving in a way that is unarguably reasonable. In a given fact situation, the proper course of action is not hard to identify. The creditor only runs into problems if it is seeking to cut as close to the line of reasonableness as possible, and there is rarely a legitimate commercial purpose to do so. To the contrary, compliance generally involves no incremental cost because the creditor's own interest is to realize the best possible recovery. Even when some incremental compliance cost is entailed, the cost is almost always immaterial in relation to avoiding litigation, preserving deficiency claims against the debtor and third parties, and satisfying the societal value of protecting the debtor's legitimate interest in the collateral. Since the creditor's conduct is tested by the objective facts of its procedural compliance,[48] and the creditor can make a record of its conduct, avoidance of litigation, much less loss, is almost always achievable.

A commercial debtor who has an equity in the collateral generally arranges for its disposition, repaying its creditor and retaining the surplus. Creditors typically cooperate with such debtors, since the creditor has no reason to expose itself to costs and litigation risks that can be avoided by economic means. Therefore, if it is the creditor

47. *Id.* § 9-504(3).

48. *See id.* § 9-507(2).

who is liquidating the collateral, that almost always means the creditor is facing a deficiency.

Recognizing that creditors and debtors share an economic interest in maximizing collateral values, Article 9's disposition rules are designed to facilitate maximum recovery. For example, the Article permits private sale by the creditor because such a sale often results in higher collateral realization than would public sale.[49] Similarly, retention of collateral by the creditor is permitted since "[e]xperience has shown that the parties are frequently better off without a resale of the collateral."[50]

The Article protects debtors by application of commercial reasonableness standards, and it does not allow disclaimer of the UCC's overriding obligations of "good faith, diligence, reasonableness and care."[51] Also, commercial debtors are capable of protecting their interests, most often knowing more about the collateral and its potential for disposition than do its creditors. Therefore, Article 9 looks to prior notice of disposition[52] as the means for debtors to protect themselves.

VIII. ARTICLE 9 STRIKES A PROPER BALANCE BETWEEN CREDITOR AND DEBTOR

By its terms, Article 9 appears skewed towards the protection of creditor rights and remedies. A balance between debtor and creditor interests cannot be found within the four corners of the Article. However, I believe the Article does strike a fair balance. This balance comes from the fact that the Article is not just an autonomous set of rules. Its impact upon the parties must be measured in a total transactional context.

Article 9 is only one element in the transactional balance. When the credit extension closes, the debtor is funded. Typically, the funds are immediately disbursed by the debtor, or applied for the debtor's account, for such purposes as paying outstanding debt or acquiring assets. The funds having been spent, if default occurred the next day, the debtor would rarely be able to repay the accelerated debt. This is not always the case, but most often it is.

On default, the creditor has recourse to the collateral. The debtor, however, usually has dominion over the collateral. Rarely are

49. *Id.* § 9-504 cmt. 1.
50. *Id.* § 9-505(2) cmt. 1.
51. *Id.* § 1-102(3).
52. *Id.* § 9-504(3).

the creditor's rights self-executing. Debtors can, and often do, obstruct and delay enforcement. When the creditor gets judicial relief, if not sooner, the debtor can, and often does, go into bankruptcy. At that point the automatic stay,[53] cash collateral,[54] and similar provisions of the Bankruptcy Code usually preclude effective creditor action. The debtor has use of the collateral, and the creditor faces a new round of negotiations and proceedings. The law provides no fully effective recourse for the loss of collateral values and the expenses—including money cost—the creditor may suffer.

The typical loan and security agreement includes a litany of debtor representations, warranties, and covenants. For example, the debtor represents that its inventory is marketable, that its receivables are collectable, that its equipment is operable, and that these conditions will continue to exist. It covenants that it will maintain, safeguard, and insure collateral; it will comply with all laws, including health and safety standards that apply to the collateral; it will maintain its financial and business condition; and so on. The creditor is rarely able to ascertain the continuing truth of all these assurances. Moreover, circumstances may lead to the statements being, or becoming, false through no fault of the debtor. Equipment may become technologically obsolete, inventory may become unmarketable, account debtors may become unable to pay receivables, and so on. While the debtor's breach constitutes an event of default, all that such event means is that the creditor can start enforcement proceedings. Insofar as the harm has been done, for example, the collateral has not been maintained, the inventory does not conform to safety standards, the receivables are not collectable, the creditor has no effective remedy.

Viewed as a whole, the transaction results in the debtor having the money and the collateral, while the creditor has a set of contractual and statutory rights that are not self-executing and are subject to an array of practical and statutory constraints. The creditor has no inherent reason to abuse its powers. Its only goal is to be repaid, and it cannot realize any greater profit or gain by being heavy handed. To the contrary, such behavior results in increased transactional costs, diminution in collateral value, loss of market reputation, and possible lender liability claims. In contrast, because the debtor wants funding, and wants to retain the funding, it has a rational incentive to misrepresent, breach, and, in the worst case, defraud. If a creditor misbehaves, it is usually financially capable of responding to its debtor's damage

53. 11 U.S.C. § 362 (1988).
54. *Id.* § 363(c)(2).

claim. The converse is rarely true if the creditor is the claimant against the debtor.

One reason Article 9 works is that it takes into account the overall position of the parties. It recognizes that debtors have "leverage" based on legal rights and economic positions that exist outside of the Article's confines. The balance Article 9 strikes between debtor and creditor reflects their overall positions.

IX. CONCLUSION

Article 9 does not work perfectly. Compliance with its perfection rules is unduly complicated, and the adverse consequences of error are often disproportionate to any harm in fact done.[55] Difficulties arise where Article 9 intersects with other bodies of law. For example, security interests in fixtures are unavoidably subject to real estate law, as well as to Article 9. States have lien laws that favor particular classes of debtors, such as farmers, mechanics, materialmen, and processors, and those laws are not necessarily integrated with Article 9. These "secret liens" are a potential trap for even well-informed, diligent creditors. Federal law preempts Article 9 with respect to certain collateral, including vessels, aircraft, patents, or certain classes of debtors, such as farmers.[56] Although the Bankruptcy Code was integrated with Article 9 when it was enacted in 1978, and Article 9 was drafted with bankruptcy principles well in mind, the fit is not perfect. Moreover, it is not practical to amend the state-enacted UCC to respond to the all too frequent Bankruptcy Code amendments.[57]

In addition, there are internal weaknesses to be corrected,[58] judicial misconstructions to be cured, newly arisen needs to be met,[59] and inconsistent non-Article 9 laws to be reconciled. The revisers of Article 9 are addressing this task and, insofar as extrinsic law permits, it can in large measure be accomplished.

55. One purpose for revising Article 9 is to cure at least some of the perfection difficulties.

56. *See, e.g.*, Packers and Stockyards Act of 1921, 7 U.S.C. §§ 181-231 (1988); Perishable Agricultural Commodities Act of 1930, 7 U.S.C. § 499(e)(C) (1988 & Supp. V 1994).

57. Aside from perfection infirmities, the major weaknesses of Article 9 largely derive from state or federal law extrinsic to the Article.

58. *See* C. Edward Dobbs, *Enforcement of Article 9 Security Interests—Why So Much Deference to the Junior Secured Party*, 28 LOY. L.A. L. REV. 131 (1994) for a discussion of the imperfect statutory balance between senior and junior security interests.

59. See Edwin E. Smith, *Article 9 in Revision: A Proposal for Permitting Security Interests In Nonassignable Contracts and Permits*, 28 LOY. L.A. L. REV. 337 (1994) for a discussion of Article 9's failure to effectively facilitate security interests in certain nonassignable intangible assets.

A successful revision can only be one which enhances the effectiveness of Article 9 in meeting the needs of the affected persons. If the goal is internal elegance, this success will not be realized. Article 9 is not a work of art, a painting whose beauty is to be found solely within its frame. To the contrary, Article 9 is one component of a far larger commercial "organism"—that is, the entire national personal property financing market—of which it is itself a vital part. Like my liver, it must be judged by how well it works, not how beautiful it looks.

In this article, I have identified operational qualities that enable Article 9 to accomplish its task. These qualities derive from the synthesis of the Article with commercial dynamics. Article 9 is, in fact, elegant, but the elegance is in this synthesis; its genius is found in its transactional logic. As the Article 9 revision process moves forward, the drafting committee will do well to preserve that synthesis and logic.