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Security Law, Formalism, and Article 9

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SECURITY LAW, FORMALISM AND ARTICLE 9

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The history of personal property security law in this country has been not unlike the history of a protracted guerrilla war. Right-thinking people seem always to have felt that there was something vaguely dishonorable, if not outright dishonest, about transactions in which a loan is secured by a debtor's personal property—particularly about transactions in which the debtor is allowed to remain in possession of the property and to enjoy its full use during the loan period. Exactly what it is that is dishonorable or dishonest about such transactions has never been made clear. Right-thinking people have usually found "fraud" the most helpful debating term—the transaction in question is constructively, even if it is not actually, fraudulent. And of course once you have characterized anything as "constructive fraud," the possibility of further rational argument is at an end.

For over a hundred and fifty years—which is as far back in time as our subject takes us—the forces of the Establishment, led by the judiciary, black robes flying and pens at the ready, have campaigned against the guerrilla bands of the personal property security people. The judicial literature is a long paean of denunciation in which the constructive fraud inherent in superficially innocent transactions is astutely detected and relentlessly laid bare. But the guerrillas, worsted at each encounter, always fled to fight another day. And from time to time the guerrillas managed to establish a beachhead, to occupy an enclave, to settle down on some bit of unwanted territory—either because the Establishment was momentarily distracted by affairs of greater moment or because the guerrillas had cleverly disguised themselves in the armor of the righteous, or because, in the long run, even the most gallant defender of the faith will have his moments of weakness.

We are all familiar with the principal engagements of our Hundred Years War. There were the battles of the after-acquired property clause and of its disreputable twin, the future advance clause. There were the campaigns of the stock-in-trade mortgage and other types of inventory financing. There was the short,

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savage infighting over accounts receivable financing. And so on.[1]

Eventually, of course, the personal property people had their way—but the point of enduring consequence is that they had their way in a complicated, devious, even underground fashion. In time it became possible, throughout the country, to finance on the security of inventory and receivable, to cover after-acquired property and to provide for future advances. What did not become possible—we are still talking of the pre-Code law—was to do any of these things simply.

Each new extension of the area of personal property security was achieved after a prolonged resistance had been overcome and was regarded with a general suspicion and distrust. We have come to speak of the several new types of security arrangements which appeared during the latter part of the nineteenth century and the early part of this century as "devices." The trust receipt was a "device." The factor's lien was a "device." The field-warehousing arrangement was a "device." The common usage of the word "device" in this context is not without interest. "Device" connotes ingenuity, cleverness, trickery; a legal device is a gimmick for getting around some prohibition imposed by the substantive law. As indeed all our new-fangled security devices were. Their proponents sought to validate previously invalid transactions by the simple expedient of calling the prohibited transactions by new names. Frequently their attempts were frustrated by the courts; occasionally—most dramatically in the case of the trust receipt—they were successful.

The uncomfortable aura of deception, which has from the beginning emanated from the various personal property security devices, explains the quite extraordinary degree of complexity which came to be the leading characteristic of security law in its intermediate, or pre-Code, phase. A new device had, let us assume, won some degree of judicial recognition. The recognition was, however, a grudging one. The one thing that everyone agreed on was that, even assuming that there was such as thing as a "trust receipt," its use must be kept within the narrowest possible limits. Its boundaries must be precisely mapped and the slightest overstepping of the bounds must lead to disaster—disaster, that is, for the unwary secured lender, whose misfortune would be, of course, the occasion for jubilation among the debtor's other creditors. Each new device

[1] I have dealt at length with many of the matters which are referred to in the following discussion in my book, G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY (2 vols. 1965). I shall not attempt in the paper to document all the statements that are made. The curious reader can find documentation in the relevant chapters of the book.

promptly developed its own ritual, its own elaborate system of necessary formalities.

Personal property security law thus became, in this century, one of the most highly formalized bodies of law of which we have record. In Anglo-America law its formalism can be matched, or perhaps surpassed, only in the law of negotiable instruments where, as we have often been told, form quite triumphed over substance. Form, of course, never triumphs over substance; substance occasionally finds an appropriate expression for a time in a highly formal dress. Negotiable instruments formalism established itself the better part of a century before security formalism. It is a plausible hypothesis that, in the two cases, like causes led to like results. If the formalism, in both areas of law, is currently in process of breakdown—which seems to be the case—it should also be possible to assign like causes, or identical causes, for the breakdown.[2]

Formalities with respect to the execution of documents had been with us, in security law, since the earliest chattel mortgage acts. Requirements that all signatures be acknowledged or verified may have been merely reflections of the stately ceremonial which had become traditional in real estate transactions. But it should not be forgotten that the chattel mortgage, which later achieved a sort of respectability, was, in the early days, thought to be just this side of fraudulent conveyance. Thus, the chattel mortgagee was typically required to swear, in all solemnity, to his own good faith and lack of fraudulent intent—an early version, we might say, of current loyalty oaths and, no doubt, equally effective.

The formalities or rituals which were developed in connection with the later devices went well beyond the documents.

The essential article of faith in the theology of the common law trust receipt had to do with the passage of title to the goods whose sale was being financed. Title had to pass from *A* (an exporter, manufacturer or other seller) to *B* (a bank or other financing agency) to *D* (the ultimate buyer) without ever having been, even for an instant of time, in *C* (the security "trustee," a dealer, broker or other purchaser for resale). Title in *C* at any point meant that the "trust receipt" was void as a disguised (and in any case unrecorded) chattel mortgage. Under this formulation the trust receipt became a useful device—principally in a few seaboard states

[2] I shall not further pursue in this paper the problem of the growth and current breakdown of formalism in negotiable instruments law. The parallel developments in that field are discussed, from a somewhat different point of view, in Gilmore, *On Statutory Obsolescence*, 39 U. Colo. L. Rev. 461 (1967).

—for the short-term financing of imports into the United States. When, during the 1920's, the trust receipt was sought to be put to use in wholesale automobile distribution in this country, the experiment ran into trouble almost everywhere, principally for the reason that it proved impossible to keep title out of *C* (the automobile dealer). The sales finance companies, which had been almost forced into the financing of automobile distribution, undertook the desperate gamble of a codifying statute—a gamble which eventually paid off in the widespread enactment of the Uniform Trust Receipts Act.[3] The Trust Receipts Act deleted from the formal requisites of trust receipt financing the common law requirement of "no title in C" and stated its own formal requisites in a section captioned "What Constitutes Trust Receipt Transaction and Trust Receipt" (UTRA §2). You may have escaped the necessity of studying the provisions of UTRA §2. If so, I congratulate you—that way madness lies. The statutory formulation of trust receipt theology had effortlessly achieved the apparent impossibility of being even more impenetrably obscure than the common law formulation. There is, however, a further point to which we shall return in due course: in the fields they were designed to serve, both formulations—common law and statutory—worked extremely well.

Field-warehousing, which developed almost simultaneously with the trust receipt as an alternative method of inventory financing, never claimed to be a new "device," just invented and hot off the griddle. On the contrary, field-warehousing presented itself as just another old-fashioned common law pledge, exactly like any other old-fashioned common-law pledge. Sceptical observers were not overwhelmed by the presentation and, as the price of survival, the field-warehousemen were driven to invent some novel trappings for their "device." Trust receipt formalism had emphasized dogmatic theology—title-passing and all that. Field-warehousing formalism, which developed under somewhat different circumstances, emphasized liturgy more than dogma—the ritual performance of magic acts.

The stage was set for the field-warehousing breakthrough by two decisions of the United States Supreme Court. In 1905 the Court held that a trustee in bankruptcy could not set aside the security interest of a bank which held in pledge field warehouse

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[3] The Trust Receipts Act was promulgated by the Conference of Commissioners on Uniform State Laws in 1933. By 1940 it had been enacted in ten states, including California, Illinois, Massachusetts, and New York. Ultimately, before being replaced by Article 9 of the Code, it was enacted in thirty-eight states.

receipts issued by the Security Warehousing Company.[4] In 1907, on apparently indistinguishable facts and with respect to receipts issued by the same company, the Court held the receipts void and the attempted pledge of inventory a fraudulent conveyance.[5] Since the second case did not purport to overrule the first case, the upshot seemed to be that there were "good" field-warehouses and "bad" field-warehouses, although neither Justice Holmes' opinion in the first case nor Justice Peckham's opinion in the second case even hinted at what the distinguishing difference could be.

Out of this apparently unpromising situation, the field-warehousemen promptly created a large flourishing industry. It seems to have been assumed that the distinction between a Holmesian or good warehouse and a Peckhamite or bad warehouse lay in the ritual. At all events the ritual was laid on with a trowel—leases, signs, chicken-wire, "independent custodians" and all the other conventional signs by which a properly run-field-warehouse is distinguished from a fraudulent conveyance. The lower courts, in the absence of further oracles from the Supreme Court, went along with the assumption that the ritual was all-important. And it is to be noted that the field-warehousing formalities, like the somewhat different trust receipt formalities, worked. If you were to read through the dreary catalogue of field-warehousing litigation between 1910 and 1950, you would discover that, by the 1940's, the improperly run field-warehouse had all but disappeared. The Lawrence Warehouse Company and its competitors had become past masters at performing the tricky ritual which they had, after all, invented. Of course, to say that a field-warehouse is properly run is not quite the same thing as to say that the goods will be in the warehouse when they are needed—as lenders on the security of soy-bean oil and other interesting commodities have not infrequently learned.

The field-warehousing experience was duplicated, a generation later, in the area of non-notification accounts receivable financing. This time only one Supreme Court decision was needed and the receivables financiers learned their lesson much more quickly than the field-warehousemen had. Thus, it may be, we learn from experience.

In *Benedict v. Ratner*[6], the Supreme Court dealt with a financing arrangement under which the assignor went on making collections from the account debtors (who were not notified of the assignment)

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4 Union Trust Co. v. Wilson, 198 U.S. 530 (1905).
5 Security Warehouseing Co. v. Hand, 206 U.S. 415 (1907).
6 268 U.S. 353 (1925).

and used the proceeds of the collections in the ordinary course of his business without accounting for them to the assignee. The Court held, in an opinion by Justice Brandeis, that the arrangement was void against the assignor's trustee in bankruptcy as a fraudulent conveyance under New York law. Justice Brandeis may or may not have read his New York law correctly but, at all events, the rule in *Benedict* soon acquired a sort of federal aura. There were suggestions in Massachusetts and Michigan that the rule was not, as a matter of state law, in force in those states but everywhere else the courts, both state and federal, found or assumed that the Brandeis version of New York fraudulent conveyance law was of universal validity.

Financing arrangements of the type so summarily disposed of in *Benedict* were not in wide use in 1925 when the case was decided. After having read Justice Brandeis's stern and uncompromising opinion, a student, ignorant of the history of this peculiar field, might reasonably have assumed that *Benedict* had dealt such arrangements their death blow. The truth of the matter is that, within ten years after *Benedict* and indeed as the direct result of *Benedict,* there had been a sensational increase in the volume of receivables financing arrangements under which the account debtors were not notified of the assignment and the assignor made collections which he then used in the ordinary course of his business.

The techniques which were promptly worked out for complying with the rule in *Benedict* were, as we might expect, remarkably complex. Justice Brandeis had suggested that the essential vice of the financing arrangement in *Benedict* was that the assignor had "unfettered dominion" over the assigned accounts. The answer, it appeared, was for the assignee to assert "dominion" as a matter of substance, to go on using the proceeds of the accounts which he collected. Indeed the whole point of such arrangements was that the proceeds should be available for use in the business until such time as the assignors improving financial circumstances might make it possible for him to reduce or retire his working capital loan. Under *Benedict*-type receivables arrangements, the assignor was required to remit all proceeds, as received, to the assignee. The assignee then immediately "re-remitted" the proceeds to the assignor. Thus "dominion" had been triumphantly asserted without interfering with the basic features of the financing arrangements. Another customary provision in *Benedict*-inspired loan agreements required the maintenance of a fixed ratio between the outstanding balance of the loan and the aggregate value of the assigned receivables. If their value fell below the agreed ratio, the assignor had to pay down on the loan until the ratio was restored; to the extent

that their value exceeded the ratio, he was entitled to draw down further advances. In post-*Benedict* receivables financing, revolving credit arrangements of this type became universal and the simple term loan disappeared. As a matter of logic, it is hard to see why the use of a revolving credit followed directly, or for that matter indirectly, from anything Justice Brandeis had said in *Benedict*. Nevertheless, on a formal level, the provision for a revolving credit could be put forward as another instance of the assignee's unrelenting assertion of dominion over his security. On a practical level the provision, with its requirement of frequent checks of the ratio of assigned accounts to loan, insured that the assignee kept a close watch on his debtors affairs and became, in the phrase which presently came into use, his policeman.

As had been true in the field-warehousing sequence, the Supreme Court, after its first pronouncement, never had any more to say about the issue. The lower courts, in the later case as in the earlier one, agreed that a proper performance of the ritual immunized the lenders from the fraudulent conveyance attack. Improperly run field-warehouses, as we noted earlier, had quite disappeared from the scene by 1940. Receivables arrangements which did not comply with the rule in *Benedict* had disappeared even earlier.

We have now traced, in three related areas of inventory and receivables financing, the remarkably rapid growth of an extreme type of dogmatic or ritualistic formalism. In each case the financing arrangement in question, after having been apparently at the point of death, went on in its new armor to an extraordinary success. Before passing on, we will do well to inquire what results these developments had on the general pattern of pre-Code financing practices.

I suggest that there were two results of prime importance.

In the first place, the formalism resulted in a high degree of professionalization or specialization in these areas of financing. Only professionals could accomplish the tricky rituals of field-warehousing or comply with the rule in *Benedict* or cope with the almost incomprehensible metaphysics of trust receipt financing. Widows, orphans and country bankers would be well advised to stay away from such mysteries. And in fact they did stay away. In time, the carrying on of these involved operations became the quasi-monopoly of a few large financing enterprises—they were the only ones who had, through painful experience, acquired the necessary expertise. In field-warehousing, for example, it is clear from the case reports that in the early days there were a great many outfits which had

gone into the business of setting up field-warehouses and issuing receipts. By 1960 almost all the field-warehouses then in operation were run by six large companies[7] and, since 1960, at least one of the six has fallen by the wayside. The use of the trust receipt in financing import transactions has always been restricted to a few of the largest metropolitan banks—the same banks which have been the exclusive issuers of international letters of credit: typically, the import trust receipt proceeds from an antecedent letter of credit. When the trust receipt was domesticated for use in automobile and apppliance distribution, the handfull of national sales finance companies, which had pioneered the financing of automobile distribution, were, for a generation or more, almost the only practitioners of the UTRA mystery. And the same sales finance companies, which after 1930 diversified their business by going largely into commercial receivables financing, were, during the 1930's and 1940's, the exalted grand masters of the order of the Rule in *Benedict*.

Formalism in the law leads inevitably to this sort of professionalization. In turn, the resulting professionalization is what makes the formalism work. So long as the amateurs can be kept out and only the professionals play, the rules of the game, however tricky they may be, will be punctiliously observed. It is indeed striking how few transactions, in the areas we have been discussing, were ever upset, once the professionals had taken over. The professionals are both victims and beneficiaries of the system: victims in that they must go on meticulously observing their elaborate, cumbersome and costly formalities; beneficiaries in that they are the only ones who know how to do so, so that they enjoy a profitable monopoly. The point of breakdown comes when the monopoly appears to have become to profitable that the amateurs can no longer be kept out. Rushing in with foolish tread, the amateurs can destroy overnight the delicate balance which has been established with such difficulty and maintained with such skill.

The second important result of formalism in security law was closely related to the first. The formalism, as I have suggested, became most extreme in the areas of inventory and receivables financing. A business enterprise which needs more working capital may seek to raise it through private loans from banks or other financing institutions or through a public issue of securities. In either case, it can put up some or all of its assets as security for the loan or for the debentures or bonds. The assets available for use as security are typically the plant and equipment, inventory and present and future receivables. To judge by the case reports, up to

7 Comment, *Financing Inventory Through Field Warehousing*, 69 YALE L. J. 663, 681-82 (1960).

1920 or so it was common for all these assets to be pledged or hypothecated *en bloc*. After 1920—and particularly after the crash of 1929—the pattern changed significantly. The inventory and receivables no longer formed part of the security package for the long term capital financing, which now was arranged on the security of the plant and equipment alone. Why this change should have taken place is easy to understand. The institutions or individuals who provided the long-term capital were simply not in a position to cope with the formalities required to make security arrangements in inventory and receivables proof against attack. Furthermore, the most paralysing aspect of the *Benedict* rule, as the courts worked it out, was that a transaction which offended the rule in the slightest degree, with respect to an infinitesimal amount of the security, was subject to avoidance *in toto*.[8] Thus, hypothetically, a $50,000,000 loan, secured by plant and equipment worth $100,000,000 as well as by a few dollars worth of receivables thrown into the package for good measure, would lose all the security if it turned out that the receivables had not been handled in strict compliance with the rule in *Benedict*. Under these circumstances the professional draftsmen of corporate indentures and loan agreements soon learned to restrict themselves to the plant and equipment as security, leaving the inventory and receivables as a base for separate financing by the newly emerging groups of professionals in those fields. Thus there came to be a division of labor among the two professional groups who specialized in working out the details of these financing arrangements. Long term financing on the security of the fixed assets of a business enterprise was divorced from financing on the security of the enterprise's most liquid and volatile assets—its inventory and receivables.

This line of division made a good deal of sense, no matter how obscure or absurd the reasons for it may have been in the first place. Inventory and receivables are, by their nature, in a constant state of flux; they may be subject to abrupt seasonal variations and market fluctuations; as a doomed enterprise approaches its final agony, the inventory and receivables are, with disturbing frequency, apt to disappear, as the result of overt fraud or through the gradual attrition of decreasing sales. Inventory and receivables financing is high-risk financing. Lenders who rely on such quicksilver security will, if they are wise, devise techniques for control or policing of the debtor's affairs which would be unnecessary and even grotesque in the altogether more stable world of fixed asset financing. The enforced separation of the two types of financing may have been, in

[8] Lee v. State Bank & Trust Co., 38 F.2d 45 (2d Cir. 1930) became the leading case on this aspect of the *Benedict* rule.

the first instance, a purely legal response to the conceptual complexities of trust receipt theory or to the involutions of the rule in *Benedict*. But, in the world of practical affairs, there was, as the professionals gradually came to see, much to be said for the separation, quite without regard to the legal formalisms.

In the late 1940's the Article 9 draftsmen (I was one of them) set to work, bearing a banner with the strange device: *Simplify*. They argued *from* an unquestionably correct premise: the end result of a hundred years of security law was that, almost everywhere, it had become possible for a secured lender to cover all of his debtor's present and future personal property with valid and enforceable security arrangements. From that premise, the draftsmen argued *to* a possibly questionable conclusion: what could in fact be done should be capable of being done simply. The extraordinary confusion which personal property security law had achieved, its subtle doctrines and involved rituals, were, they explained, merely hangovers from the Hundred Years War. Those memorials of ancient battlegrounds should be torn down and scrapped. Security law should cease to be a paradise for specialists and should become a playground for all the people—small town practitioners, country bankers, even widows and orphans. Taking a personal property security interest should be made as simple and easy as rolling off a log. But what is it, exactly, that happens *after* you have rolled off a log?

I suggested earlier that the principal beneficiaries of the complexities of pre-Code security law had been the professionals—the large metropolitan banks, the finance companies and so on who, with the advice of counsel, were the only ones who knew how to operate the machine. One would assume, therefore, that the simplifying approach of the Code draftsmen would have met with massed opposition in these quarters. My own best memory is that there was, indeed, during the early years of work on the drafting of Article 9, a certain ambivalence toward the project on the part of counsel to the large banks and finance companies. Eventually, however, most of these gentlemen became, and persuaded their clients to become, supporters of Article 9 and of the Code. Perhaps this teaches us that man does not live by bread, or even by logic, alone. Or that all lawyers, even the most devoted representatives of the most predatory of vested interests, are, beneath their wolf's clothing, sheepishly *pro bono publico* at heart. But why should they have identified the public interest with a simplification of a state of law whose preservation, it would seem, was required by their private interest.

We have been told on good authority that ideas have their time: when the time has come, the idea proves irresistible. In this connection, it is worth recalling that Article 9 was by no means the first attempt to codify, and thus simplify, security law. The Conference of Commissioners on Uniform State Laws had prepared several security statutes. Of these the Trust Receipts Act, which can hardly be described as an essay in simplification, was, in terms of the number of enacting states, the only successful one and its success was the result of a number of special and peculiar circumstances. The Conditional Sales Act (1918) was enacted in a handfull of states and then faded from sight. The Chattel Mortgage Act (1927) was never enacted anywhere: its failure is of particular interest since, in its structure and in the underlying policy which it adopted, the Chattel Mortgage Act was a blood-brother of Article 9. We can say that the time for simplification of security law through a general codification, which had not arrived in 1930, had, quite obviously, arrived in 1960. Can we say anything more?

I have made the point that the extreme formalism of security law went hand in hand with its professionalization and that, once the professionals had taken over, noncomplying or amateurish transactions disappeared, for all practical purposes, from the case reports. This state of affairs seems to have obtained through the 1940's. A striking feature of the case law since 1950 is the reappearance in litigation of amateurish transactions of a type which had not been seen since the 1920's and early 1930's.[9] Evidently after World War II, the amateurs had decided to play. In this context the amateurs were the small or country banks—and, for that matter the small or country finance companies—which had not previously engaged in inventory or receivables financing. It is a reasonable hypothesis that such lenders were alerted to the profitable possibilities of such financing during World War II when the demand for private capital to finance war production was insatiable and when, in fact if not in theory, the federal government stood ready to absorb all losses. Such a banker's paradise, of course, could not, and did not, long endure. But the wartime revelation of the possibilities of inventory and receivables as security seems to have stimulated a good deal of post-war financing of this type in siutations where neither the lenders nor the borrowers (who were mostly small, and presumably undercapitalized, businesses) nor the lawyers who advised them had more than the vaguest understanding of either the legal formalities or the

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[9] For such cases, see the discussion of recent litigation in 1 G. Gilmore, Security Interests in Personal Property ch. 4 (The Trust Receipt), ch. 5 (The Factor's Lien), ch. 6 (Field Warehousing) and ch. 8 (Accounts Receivable Financing). There was a particularly interesting series of New Hampshire cases, decided in both state and federal courts.

practical realities. Even without a major depression, there was after 1950 a surprising amount of litigation involving security transactions which, from the professional point of view, had been conceived in ignorance and brought forth with fumbling incompetence. With a major depression, God only knows what would have happened.

The successful maintenance of a formalized system of law depends, as was suggested earlier, on professionalization. When the amateurs come in, the system will break down; the tight, rigid rules of the formal period will be in time replaced by broader and looser categories. Maintenance of the system requires that those who break the rules be penalized—in the context of our discussion, that the lenders be stripped of their security. The courts will do this so long as there is only an occasional noncomplying transaction. But when the amateur transactions multiply, the courts will temper the wind to the shorn lamb—the lender will not be stripped naked even though it is clear as a crystal that he has failed to understand the intricacies of §2 of the Uniform Trust Receipts Act or of the rule of *Benedict v. Ratner*. In the process of dismantling a formal system, there will be a considerable sacrifice of certainty and predictability: the great virtue of such a system is that, for those who understand it, you know where you are and what happens next.

I suggest that a fair reading of the pre-Code case law of the 1950's and early 1960's is that the dismantling process which I have just hypothesized was in fact going on—or at least beginning. The evidence stops well this side of scientific, or even legal, proof. There were not enough cases to allow anyone—even a law professor—to talk confidently and dogmatically of a change or a new direction or even a trend. It is, I think, true that in a surprising number of cases the amateur lenders were not penalized for their transgressions by being stripped of their security as their predecessors would have been, routinely, thirty years earlier. These cases can, of course, be put down to judicial ignorance—perhaps there are country judges as well as country bankers—but judicial ignorance is, after all, one of the prime causes of growth in the law.

From the hypothesis just suggested I would argue that the lesson of the case law of the past twenty years is that, quite without regard to Article 9, security law was beginning to simplify, or purify, itself. The formal system was in process of breakdown on the almost instinctive level of case law. If the case law process had been allowed to continue through the 1960's and 1970's, the breakdown might, in the light of our hypothesis, have been complete. That process was abruptly terminated by the general enactment of Article 9 and the Code. But the forces which were finding one

expression in the surprising case-law harvest of the 1950's may well have found another expression in Article 9 itself. The time having come for the dismantling of the earlier formal system, there was much to be said for carrying out the demolition job as cleanly as possible by way of a general codification instead of attacking it by way of the hit-or-miss disorder of a case-law revolution. What the spirit of the times required was that the job be done, one way or the other. By good fortune Article 9 happened to become available just at the time it was needed.

None of the post World War II developments which had been rehearsed had anything to do with Article 9. Nor, if I may be permitted to bear testimony, were they in any sense foreseen by the draftsmen or their professional advisers. Perhaps the draftsmen were obscurely in touch with the shape of things to come—since the future is, by necessary hypothesis, unpredictable, it is entirely possible, if you are lucky, to be right, albeit for the wrong reasons. Perhaps the professionals, who supported a statutory simplification of security law which ran counter to their own apparent interests, were wiser than they knew. And perhaps we have a tenuous beginning of an explanation of the curious fact that the time for simplification of security law through a general codification, which had not come in 1930, had come in 1960.

In carrying out their self-proclaimed mission of simplification, the Article 9 draftsmen worked, of necessity, out of the past. Draftsmen do not have a crystal ball for peering into the future. What they can do, in a legal context, is to read the old cases and the existing statutes and reduce the past to a sort of order. Article 9 can best be described as an anthological collection of the most celebrated security law controversies of the preceding forty years. Inventory financing and the security devices which it generated, receivables financing and the rule in *Benedict*—these are anthologized at length. But lesser controversies are not neglected—such as those which had arisen in connection with the validity of after-acquired property interests and of arrangements for future advances.[10] For an understanding of Article 9 it is essential to realize that almost all of its specific content—the detail and verbiage of its fifty sections—was a faithful copying-out of historical models. Almost nothing new was added.

[10] With exception for crops and consumer goods, UNIFORM COMMERCIAL CODE §9-203(3) provides that: "[A] security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement." UNIFORM COMMERCIAL CODE §9-204(5) provides that "Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment."

It was suggested earlier that the Article 9 draftsmen argued from the premise that, under existing security law, a lender could take an enforceable interest in all of a debtor's present and future personal property to the conclusion that the new statute should provide for the accomplishment of this result in the simplest possible fashion. Their quest for simplicity led them to a solution which seemed to have a certain novelty, at least of form and language: all the security "devices"—pledge, mortgage, conditional sale, trust re-receipt, factor's lien and so on through the lengthy list—were to be abolished; in their place was substituted the concept of a unitary "security interest".[11] Thus, at a single stroke, all the involved metaphysical speculations about the "true nature" of a conditional sale or a trust receipt transaction or what not were rendered meaningless. There was no need in Article 9 for any analogue to the horrid complexities of UTRA §2. The concept of the unitary security interest also led naturally to the substitution of a single and considerably simplified filing system for the half-dozen different systems, kept in different books at different places by different officials operating under different theories, which successive pre-Code security statutes had established. There can be no doubt that these were the two major contributions which Article 9 made to the simplification of security law.

The draftsmen also set out to eradicate what they considered to be the meaningless formalism which had grown up in such areas as receivables financing and field-warehousing. In the first instance they were successful; in the second they ran into an effective roadblock set by the field-warehousemen themselves and were defeated.

Code §9-205 is a thorough-going and explicit repealer of the rule in *Benedict*, at least of the formal aspects of the rule. Gone is any vestige of the requirement that the assignee somehow assert dominion over the assigned accounts; a Code security interest is a security interest still although the assignor's dominion is absolute, without remittances or even any accounting for the proceeds of collections. An attempt was, however, made to preserve what were considered to be the substantive, as distinguished from the formalistic, aspects of the rule. Thus, under §9-306 (4) the Code assignee who does police his debtors affairs according to the time-honored *Benedict* technique is given, in the event of the debtor's insolvency, a right to proceeds which the non-policing assignee does not have. It is worth noting that the professionals in receivables financing who advised the draftsmen enthusiastically supported this resolution of the *Benedict* problem.

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[11] UNIFORM COMMERCIAL CODE §9-102.

The draftsmen also proposed to scrap the rituals of field warehousing. This was to have been done by treating field warehousing like any other method of inventory financing and imposing a filing requirement for perfection of the interest. Since the filing would constitute perfection, the details of the operation of the warehouse would no longer have any legal, although they would obviously continue to have great practical, significance. No representatives of the field warehousing industry, as it happened, had taken any part in the drafting of Article 9. When they learned of the proposed disestablishment of their mystery, they protested vigorously, indeed violently and, as it proved, effectively. It may be that the almost mystical devotion of the field-warehousing professionals to the ritual of their role as common law pledgees is to be explained by the accident of their non-participation in the drafting. Having escaped the indoctrination or brainwashing which had led the other professionals to their surprising support of the Article 9 proposals, the field warehousemen naturally reacted in defense of their own position and their own immediate interests. After a protracted controversy the proposed filing requirement was deleted; in its place there was added to the final draft of Article 9 a stern admonition which provided in substance that nothing in the Article should be taken to "relax" common law requirements for the validity of field-warehousing arrangements.[12]

The failure to free field-warehousing from its self-imposed rituals leaves us in a situation which should be of interest to future historians. Here is one enclave in which, so far as the statutory formulation of Article 9 goes, the pre-Code formalism is to be maintained in all its ancient rigor. We have hypothesized that there would have been in any event and without regard to Article 9 a gradual breakdown of the pre-Code formalism. The status of the field warehousing enclave is of course not exactly what it would have been without Article 9 since the courts in Code states are admonished to preserve the formalism and to penalize any amateur who rashly undertakes to operate a field-warehouse without having the awesome expertise of the Lawrence Warehouse Company. In twenty years or so we shall be able to see how the courts have carried out the curious legislative mandate that they should preserve one strip of formal garden within the area where nature is otherwise allowed to have its way. In this connection it is worth

[12] UNIFORM COMMERCIAL CODE §9-205 (second sentence). The first sentence of UNIFORM COMMERCIAL CODE §9-205 is the repealer of the rule in *Benedict* previously mentioned. The two sentences of UNIFORM COMMERCIAL CODE §9-205, read together, can be taken to mean that the rule of *Benedict* is still in force for field-warehousing transactions although abolished for all other transactions.

noting that there has been a great deal of field-warehousing litigation since 1950 which has raised novel issues whose existence had not even been suspected in the earlier period when the only litigable issue had seemed to be whether or not the rituals had been observed.[13] It may be of course that the field-warehousemen, abandoning their traditional mysticism, will decide to accept in the 1970's the simplification which they rejected in the 1950's—but that speculation need not be further pursued.

Even when they were not overborne by political pressures, the Article 9 draftsmen were not always successful in achieving the simplification which they were in quest of. Occasionally they stumbled over their own feet. This was notably true in their classification of property which not only divided goods into four classes[14] but went on to divide intangibles into six more classes,[15] it is hard not to see, retrospectively, that the elaborateness of the classification was unnecessary. At other times the draftsmen seem to have been carried away by their own enthusiasm: the priority provisions of the Article purport to solve not only all the priority problems that had even been heard of in the real world but also a good many more that had never existed except in the imagination of the draftsmen. This part of the Article does not lack for subtle complexity.[16]

Even on its own terms, then, Article 9 does not reduce security law to the kindergarten level. Lawyers who enjoy the puzzle-solving aspect of law will find plenty to sharpen their wits on in the statutory text. Furthermore it is true that in the fifteen years or so since the Article, except for a few details, reached its final form, events have overtaken it. I made the point earlier that the specific content of the Article stands rooted—necessarily—in the past. We can now begin to see the shape of current controversies which the Article 9 draftsmen did not foresee. Thus there has been, during the past few years, a great deal of anxious discussion about subordination agreements and negative covenants.[17] A great many

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13 The recent field warehousing litigation is discussed in I G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§6.5-6.8.2 (1965).

14 UNIFORM COMMERCIAL CODE §9-109 ("consumer goods", "equipment", "farm products", "inventory,").

15 UNIFORM COMMERCIAL CODE §9-105 ("chattel paper", "document", "instrument",); UNIFORM COMMERCIAL CODE §9-106 ("account", "contract right", "general intangibles",).

16 In general, Part III UNIFORM COMMERCIAL CODE §§9-301—9-318) is devoted to the resolution of priority problems. The heart of the matter is UNIFORM COMMERCIAL CODE §9-312.

17 *See particularly* Coogan, Kripke, and Weiss, *The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements,* 79 HARV. L. REV. 229 (1965).

questions have been asked but the only thing that is clear is that the answers are not in Article 9. There will in time be other examples of unforeseen and indeed unforeseeable problems.

The fact that Article 9 has, in its short life span, already been caught short or found wanting does not differentiate it from the rest of the Code or from earlier codifying statutes. Indeed the possibility of a successful codification depends in great part on what might be called the principle of statutory obsolescence.[18] The great bulk of any codifying statute will be obsolete by the time the statute is enacted. This apparently unhappy fact of life is indeed what makes it possible for us to live with such statutes, despite inevitably changing circumstances, without being intolerably burdened by their freight of antiquarian detail. Fifty years ago the questions unanswered by Article 9 would have been left for solution to the leisurely tempo of case law approximation. It is too early to tell whether that will continue to be the case or whether, in this half of the century, the basic codifying statute will be kept up to date—or as close to date as the principle of obsolescence permits—by a continuous process of amendment.

Despite its own complexities and despite the additional complexities introduced by unforeseen change, Article 9 must be credited with having in fact achieved a dramatic simplification of security law. It can be said, without too much exaggeration, that an Article 9 secured party can take a blanket security interest in all his debtors present and future assets almost as easily as he could roll off a log. Which brings us back to the question which was earlier left unanswered: what is it, exactly, that happens *after* you have rolled off a log?

The answer, I am inclined to think, is that you get your fingers burnt. The more you give in to the temptation of taking the greatest possible advantage of the Article's permissive provisions, the greater the danger that you will end up getting burnt. The simpler you can make your transactions, the safer you will be. Unless there is some compelling reason why you must include an after-acquired property clause in your security agreement or provide for future advances or take inventory or receivables as collateral, the best advice is: *Don't.* For this depressing bit of advice, there are several excellent reasons.

One is that Article 9 simplifies only the legal concepts and formalities. The dangers inherent in high risk financing are exactly

[18] I have developed this idea at greater length in Gilmore, *On Statutory* Obsolescence, 39 U. COLO. L. REV. 461 (1967).

what they always have been. If you must fool with such doubtful security as inventory and receivables, you will do well to learn and practice the techniques of control and policing which the professionals have always practiced. There are no indications that the professionals themselves have in any way relaxed their pre-Code techniques.

A second reason is that after-acquired property clauses, future advance arrangements and security agreements which cover inventory or receivables will bring you to grips with the Article 9 priority provisions. These, as has been pointed out, do not lack for complexity. You can avoid most priority problems by avoiding the refinements I have just mentioned. If you do not, you had best set aside a good part of your time over the next year or two for turning yourself into an Article 9 specialist.

A third reason is that the same refinements may get you into trouble on the vaguely mapped frontier where inconsistent bodies of state and federal law come into conflict. Such security arrangements, entirely valid, let us assume, and properly perfected under Article 9, may nevertheless be subject to avoidance as preferences under §60 of the Bankruptcy Act or subject to subordination, outside of bankruptcy, to federal tax liens as well as to non-lien federal claims under §3466 of the Revised Statutes, the so-called priority statute.

With respect to the problems created by the intersection of Article 9 and the Bankruptcy Act, there has been so far almost no litigation[19] but there has already come into being a monumental literature on the subject. The principal difficulty is that §60, most recently revised in 1950, speaks the language of pre-Code security law and not the language of Article 9. Arguably, the differences are merely semantic; arguably—at least there are respectable lawyers who have so argued—they are more than semantic and more than one provision of Article 9 is invalid as being in conflict with the overriding policy of the federal Bankruptcy Act. For example, one Article 9 provision which has frequently come under attack is §9-108, which purports to give new value status to certain interests in after-acquired property; according to its critics, §9-108 vainly attempts to convert transfers for antecedent debt into transfers for a present exchange and is therefore invalid in a proceeding governed by federal law, which makes its own determination about such matters. The National Bankruptcy Conference is currently studying proposals for reconciling Article 9 and the Bankruptcy Act. If that

[19] One widely discussed case is In re Portland Newspaper Publishing Co., 271 F. Supp. 395 (D. Ore. 1967).

project is successful, a great deal of unnecessary doubt and confusion will be put to rest. But the doubt and confusion will, at best, be with us for at least the next few years.

With respect to the priority of federal claims for debts and taxes, we have a brand-new statute—the Federal Tax Lien Act of 1966 (which does not, it should be noted, say anything about the federal priority under §3466). One of the main purposes of the draftsmen of the Tax Lien Act was to give protection to certain types of secured financing against the doctrine of virtually absolute federal priority which, since 1950, the Supreme Court had been elaborating both under the earlier tax lien statute and under §3466. The Tax Lien Act rivals even the Uniform Trust Receipts Act for the obscurity of its language and the subtlety of its concepts.[20] It also appears that one provision of the Act,[21] which was designed to give lenders who are committed to make future advances a degree of protection against the federal lien, may not have achieved its intended result: the federal draftsmen, it seems, were not entirely conversant with some of the more obscure Article 9 priority provisions and, as a result, may have made the Act say the opposite of what it was meant to say.

These brief references to federal law suggest, by way of conconclusion, the gloomy though that confusion and a state of extraordinary complexity in security law may be inherent in the nature of things and that the simplification of the law which Article 9 achieved on the state level was merely an illusory triumph and a passing episode. Perhaps the long guerrilla war is not really over and all that has happened is that the battle-lines are reforming, as they have so many times in the past, to fight over new ground. It is at all events a fair guess that security law will continue to be, over the next fifty years, as quirky and unpredictable in its development, as fascinating to the legal historian and as frustrating to the practicioner, as it ever has been in the past.

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[20] For an admirable discussion of the Tax Lien Act, *see* Plumb, *Federal Liens and Priorities—Agenda for the Next Decade,* 77 YALE L.J. 228 (1967) (the first installment of a three part article).

[21] INTERNAL REVENUE CODE of 1954, § 6323(c) (1) (B).