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Introduction

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LEAD ARTICLES II
U.C.C. REVISIONS: PROMISES AND PITFALLS

Introduction

by Michael D. Sabbath*

These are challenging times for teachers and practitioners of commercial law. Many changes have taken place and continue to take place in the Uniform Commercial Code ("U.C.C."). Evolving business practices, technological advances, and developments in related areas of both national and international law make these changes necessary.

I. New Articles 2A and 4A

The American Law Institute ("A.L.I.") and the National Conference of Commissioners on Uniform State Laws ("NCCUSL") have promulgated several entirely new articles. Article 2A brings the personal property leasing transaction within the scope of the U.C.C. In the past, personal prop-

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erty leases have been relegated to the relatively obscure and ancient law of bailments and to the common law of contracts. Courts sometimes analogized to real property leasing rules or applied the rules of the U.C.C. (particularly Article 2) either outright or by analogy.[1] This ad hoc approach led to a lack of uniformity from state to state and to the inability to accurately predict the outcome of any particular leasing issue.[2] There certainly is a need for Article 2A and, as of December 1991, it had been enacted in twenty states. Within the next few years, other states, including Georgia, will enact new Article 2A.

The other new article recently promulgated, Article 4A, governs wholesale wire transfers of funds. More credit is transferred by wire than by check or bank credit card,[3] with daily volume in the United States commonly exceeding one trillion dollars.[4] Nevertheless, nonconsumer funds transfers[5] remain largely unregulated. Limited aspects of wholesale wire transfers are governed by the rules of the applicable funds transfer system (*e.g.*, CHIPS rules, Federal Reserve Regulation J, Federal Reserve operating circulars, and National Automated Clearing House Association ("NACHA") rules). These rules, however, are not comprehensive and do not resolve many of the issues that may arise out of a wire transfer. With no comprehensive law governing this area, banks try to negotiate contracts with their customers on their terms. Similarly, corporate users attempt to negotiate contracts with terms more favorable to them. In many cases, neither party can get the other to accept its terms, so transfers often are made with no provision for the significant problems that may arise.[6] The courts then must resolve the issues that arise by resort to common law tort and agency principles or by analogy to Articles 3 and 4 of the U.C.C. Article 4A provides a comprehensive body of law to govern wholesale wire transfers, eliminating much of the uncertainty with regard to these transactions. As of December 1991, thirty-two states have enacted Article 4A. The Georgia House of Representatives passed Georgia's

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1. *See* Amelia H. Boss, *Panacea or Nightmare? Leases in Article 2*, 64 B.U.L. REV. 39, 48-49 (1984); Comment, *The Extension of Article 2 of the Uniform Commercial Code to Leases of Goods*, 12 TULSA L.J. 556 (1977).

2. *See* Amelia H. Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar Alike*, 39 ALA. L. REV. 575, 578-79 (1988).

3. Hal S. Scott, *Corporate Wire Transfers and the Uniform New Payments Code*, 83 COLUM. L. REV. 1664 (1983).

4. *See* U.C.C. Prefatory Note to Article 4A (1990).

5. The Electronic Fund Transfer Act of 1978, 15 U.S.C. § 1693 (1988), deals with consumer electronic fund transfers and proposes "a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems." *Id.* § 1693(b).

6. *See* Fred H. Miller & William B. Davenport, *Introduction to the Special Issue on the Uniform Commercial Code*, 45 BUS. LAW. 1389 (1990).

version of Article 4A (H.B. No. 762) on February 7, 1992 (by a vote of 113 to 1) and the Senate passed it on March 11, 1992 (by a vote of 50 to 0). It will become law on July 1, 1992.

II. Repeal or Revision of Article 6

The U.C.C.'s sponsors, the A.L.I. and NCCUSL, also recommend the repeal of Article 6, or, if that cannot be done, its replacement with a revised Article 6. Article 6 (and earlier bulk sale legislation) was enacted in response to a perceived "bulk sale risk." A merchant might acquire his entire stock in trade on credit, then sell his entire inventory "in bulk" and abscond with the proceeds, leaving creditors unpaid.[7] Unless the purchaser of the business assets affirmatively assumes the debts owed to the merchant's creditors, the purchaser is not obliged to pay the merchant's debts. Of course, the merchant's creditors could sue the merchant on the unpaid debts, assuming the merchant could be found and that jurisdiction over him was available. However, judgments obtained often went unsatisfied because the seller had spent or hidden the sale proceeds. In addition, the transfer of the inventory to an innocent purchaser effectively immunized the goods from the reach of the seller's creditors. Thus, creditors of a bulk seller might be left with no means to satisfy their claims.[8] Where the bulk buyer was in league with a defrauding seller or paid less than a fair price, fraudulent conveyance law allowed defrauded creditors of the seller to avoid the sale and apply the goods towards satisfaction of their claims. But where the buyer gave adequate value in good faith, with no notice of the seller's intent to disappear with the proceeds, the seller's creditor had to look to the absconding seller for a remedy.

Article 6 minimizes the risk of a bulk sale by an absconding seller. It requires the prospective transferee to notify the transferor's creditors of the impending sale in advance and also requires the parties to provide certain information regarding the property transferred.[9] If the transferee fails to comply with these requirements, the resulting bulk transfer is "ineffective against any creditor of the transferor."[10]

Article 6 has been criticized. Poorly drafted, it contains numerous vague provisions that leave many "open questions."[11] Even where a credi-

7. *See* U.C.C. Prefatory Note to Article 6 (1990). *See also* Idon Indus., Inc. v. Charles S. Martin Distrib. Co., 234 Ga. 845, 847, 218 S.E.2d 562, 563-64 (1975).

8. *See* U.C.C. Prefatory Note to Article 6 (1990).

9. *See* U.C.C. §§ 6-104, 6-105, 6-107 (1990).

10. U.C.C. § 6-104(1) (1990).

11. *See generally* Daniel E. Johnson, *The Bulk Sales Act—Revision or Repeal*, 21 Res Gestae 16 (1977); Donald J. Rapson, *Article 6 of the Uniform Commercial Code: Problems and Pitfalls in Conducting Bulk Sales*, 68 Com. L.J. 226 (1963).

tor has received the notice required by Article 6, this notice affords the creditor little or no practical remedies, absent grounds for extraordinary relief.[12] Where there has been compliance with Article 6, a creditor can only show up at the closing and demand payment.[13] By contrast, if the bulk purchaser fails to notify a creditor who was listed by the transferor, or who was known by the purchaser, the sanctions can be quite drastic. As mentioned above, the sale is "ineffective" as to that creditor, and it can enforce its claim by resorting to the purchased assets, even though the purchaser has paid the purchase price in full.[14] The consequences of noncompliance are particularly harsh when the transferor files for bankruptcy before the statute of limitations has run.[15]

Moreover, the parties to a sale of a business often are reluctant, for valid business reasons, to disclose the fact of the transfer or the details of the transaction. In addition, the parties may want to avoid all of the paperwork and delay required by Article 6. Accordingly, many transferees make a conscious decision not to comply with Article 6. Instead, sales of businesses are structured with combinations of escrow arrangements, indemnification agreements, security agreements, or setoff provisions

12. *See generally* Steven L. Harris, *Practicing Under Existing Bulk Sales Law—And a Look at the Future of Article 6*, 22 UCC L.J. 195 (1990); William D. Hawkland, *Remedies of Bulk Transfer Creditors Where There Has Been Compliance with Article 6*, 74 COM. L.J. 257 (1969).

13. A minority of jurisdictions (not including Georgia) have enacted an optional U.C.C. § 6-106 that requires a transferee to apply the purchase price to the debts owed to creditors. Where the purchase price is inadequate to pay all creditors, the proceeds must be applied pro rata.

14. Georgia courts have held that Article 6 permits only an in rem action against the transferred goods or the proceeds therefrom, and not an in personam action against the transferee. *See* American Express Co. v. Bomar Shoe Co., 127 Ga. App. 837, 195 S.E.2d 479 (1973) (no action for fraud against transferee under the bulk transfer law); American Express Co. v. Bomar Shoe Co., 125 Ga. App. 408, 187 S.E.2d 922 (1972) (no contract action on an open account against transferee under the bulk transfer law). However, the availability of an action under the bulk transfer provisions of the U.C.C. does not preclude a creditor from pursuing any other common law or equitable cause of action he may have against the transferee. *See* Boss v. Bassett Furniture Indus., Inc., 249 Ga. 166, 288 S.E.2d 559 (1982).

15. Section 544(b) of the Bankruptcy Code, 11 U.S.C. § 544(b) (1988), gives the transferor's bankruptcy trustee the rights of any unsecured creditor of the transferor who could avoid a pre-bankruptcy transfer under nonbankruptcy law. Thus, the trustee can step into the shoes of any unsecured creditor of the bankrupt seller who can avoid a noncomplying bulk sale. While a creditor may avoid the transfer only to the extent necessary to recover its claim against the transferor, it should be noted that the trustee acts as the representative of all creditors. Therefore, pursuant to Moore v. Bay, 284 U.S. 4 (1931), if there is one omitted creditor, no matter how small its claim, the trustee can avoid the entire sale if complete avoidance is necessary to pay creditors of the transferor.

designed to facilitate noncompliance with Article 6 and to protect the buyer against potential claims by the seller's creditors.[16]

The U.C.C.'s sponsors, the A.L.I. and the NCCUSL, considered the various criticisms of Article 6 and decided to recommend that article's repeal. The sponsors recognized that creditors are able to make informed decisions about extending credit through use of credit reporting services, certified financial statements, and searches of public records to disclose encumbrances on the debtor's real and personal property. In addition, they noted that changes in the law, such as the development of "minimum contacts" with the forum state as a basis for in personam jurisdiction and the promulgation of state long-arm statutes, now afford creditors with greater opportunities to collect their debts from a debtor who flees to another state. They also recognized that a creditor who is reluctant to extend unsecured credit can, in a relatively simple and inexpensive manner, proceed under Article 9 to retain a security interest in inventory to secure its price. Finally, the sponsors could find no evidence that, in today's economy, the problem of fraudulent bulk sales is significant enough to require the regulation of all bulk sales, the vast majority of which are conducted in good faith.[17]

While encouraging the repeal of Article 6, the A.L.I. and NCCUSL recognized that some state legislatures might wish to continue to regulate bulk sales. There are still those who believe that some form of bulk transfer law is desirable.[18] There also is concern that if Article 6 is repealed, it may be replaced by even less satisfactory legislation that will not have the benefit of uniformity among the states.[19] Of course, one can anticipate considerable "political pressure" to retain some form of bulk sales legislation. For those states that do not wish to repeal Article 6, the A.L.I. and NCCUSL promulgated a revised version of Article 6 designed to afford better protection to creditors while minimizing the impediments to good faith transactions. As of December 1991, nine states repealed Article 6 and four states adopted the revised version. The Georgia General Assembly soon should introduce some form of Article 6 legislation.

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16. *See* Donald J. Rapson, *U.C.C. Article 6: Should It Be Revised or "Deep-Sixed?*, 38 Bus. Law. 1753, 1756 (1983). In fact, avoiding compliance with Article 6 has been judicially recognized as a standard business practice. *See* Mercantile Fin. Corp. v. P & F Indus., Inc., 406 N.Y.S.2d 357, 358 (2d Dept. 1978).

17. *See* U.C.C. Prefatory Note to Article 6 (1990).

18. *See, e.g.*, Don L. Baker, *Bulk Transfers Act—Patch, Bury or Renovate*, 38 Bus. Law. 1771 (1983).

19. *See* William D. Hawkland, *Proposed Revisions to U.C.C. Article 6*, 38 Bus. Law. 1729, 1731 (1983).

III. Revised Articles 3 and 4

The NCCUSL and the A.L.I. have approved comprehensive changes to Articles 3 and 4. These revised articles were initially presented to the various states for their approval in early 1991, and as of December 1991, they had been adopted in ten states.

While the basic rules of negotiable instrument law remain intact, the structure and language of Article 3 have been revised. Some of these revisions are designed to accommodate current business practices.[20] For example, under the original version of Article 3, a number of courts found that variable rate notes, which are now commonly used, do not contain a "sum certain" and so are not negotiable.[21] The revision clearly permits variable interest rates.[22]

Other revisions were made to accommodate modern check processing practices. For example, because of mechanical check processing, revised Article 4 eliminates all references to the process of posting. With increased check truncation (the physical item is retained by the depositary bank or other collecting bank while presentment is made electronically), various revisions had to be made to Article 4.[23]

The revision also clarifies the law in a number of areas. For example, the revision provides a more detailed treatment of suretyship defenses in revised section 3-605 clarifying, among other things, that a joint obligor can assert the impairment of collateral defense. Under current law, an incomplete or irregular instrument may provide notice of a claim or defense thus depriving a purchaser of holder in due course status.[24] It is unclear under current law whether the claim or defense must be related to the specific irregularity or incomplete nature of the instrument. Revised Article 3 makes clear that the claim or defense need not be so related.[25]

Some of the revisions resolve conflicting lines of authority. For example, the courts have been divided on whether U.C.C. section 1-207 dis-

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20. *See generally* Robert G. Ballen, Tony M. Davis, Joseph P. Savage & Stephen C. Veltri, *Commercial Paper, Bank Deposits and Collections, and Other Payment Systems*, 46 Bus. Law. 1521, 1539-40 (1991).

21. *See, e.g.*, Doyle v. Trinity Sav. & Loan Ass'n, 869 F.2d 558 (10th Cir. 1989); Northern Trust Co. v. E.T. Clancy Export Corp., 612 F. Supp. 712 (N.D. Ill. 1985); Taylor v. Roeder, 234 Va. 99, 360 S.E.2d 191 (1987). *But see* Tannenbaum v. Agri-Capital, Inc., 885 F.2d 464 (5th Cir. 1989) (holding a variable rate note to be negotiable).

22. *See* revised U.C.C. § 3-112(b) (1990).

23. For example, revised § 4-110(a) (1990) expressly provides for a "presentment notice" pursuant to an "agreement for electronic presentment." *Id.*

24. *See* U.C.C. §§ 3-302(1)(c), 3-304(1)(a) (1962) (amended 1990).

25. *See* revised § 3-302(a)(1) (1990).

places the law of accord and satisfaction.[26] The revisions make clear that no such displacement is intended.[27]

Revised Article 3 does, in some regards, expand upon and change the law of negotiable instruments. For instance, the definition of "good faith" is expanded beyond the current standard of "honesty in fact"[28] to include the observance of "reasonable commercial standards of fair dealing."[29] In the area of impostors, the revisions change the law by enabling an impostor to negotiate a check by impersonating not only the payee of that check, but also by impersonating a person authorized to act for the payee.[30]

While one certainly could question the wisdom of some of the particular revisions, there is little doubt that Articles 3 and 4 are in desperate need of modernization. It has been noted that the provisions of Article 3 and its approach "date back to nineteenth or eighteenth century common law" and that "[t]he statute is a genuine relic and a sort of sanatorium for some grizzled, foggy legal rules whose function has long been forgotten."[31] The revised articles must be adopted to accommodate modern practices.

IV. Revised Article 8

Revised Article 8 had its genesis in the "paperwork crisis" of the late 1960s that seriously threatened the orderly function of the national securities markets.[32] With the increased volume of securities transactions, brokerage firms were finding it impossible to transfer stock certificates fast

26. *Compare* Anderson v. Rosebrook, 737 P.2d 417 (Colo. 1987) (section 1-207 does not alter the common law doctrine of accord and satisfaction as applied to "full payment" or "conditioned" checks) *and* John Grier Constr. Co. v. Jones Welding & Repair, Inc., 238 Va. 270, 383 S.E.2d 719 (1989) (section 1-207 does not operate to supplant the common law doctrine of accord and satisfaction) *with* Horn Waterproofing Corp. v. Brunswick Iron & Steel Co., 66 N.Y.2d 321, 497 N.Y.S.2d 310, 488 N.E.2d 56 (1985) (the common law doctrine of accord and satisfaction was changed with the adoption of section 1-207) *and* Robinson v. Garcia, 804 S.W.2d 238 (Tex. Ct. App. 1991) (section 1-207 overrides the common law doctrine of accord and satisfaction).

27. *See* revised § 3-311 (1990) and revised § 1-207(2) (1990). *See also* revised § 1-207 cmt. 3 (1990).

28. *See* U.C.C. § 1-201(19) (1989).

29. *See* revised § 3-103(a)(4) (1990).

30. *See* revised § 3-404(a) (1990).

31. *See* Robert G. Ballen, Thomas C. Baxter, Jr., Timothy R. McTaggart, Curtis W. Nyquist & Edward L. Rubin, *Commercial Paper, Bank Deposits and Collections, and Other Payment Systems*, 44 Bus. Law. 1515, 1539 (1989).

32. *See* Reporter's Introductory Comment to Revised (1977) Article 8 of the Uniform Commercial Code; Peter F. Coogan, *Security Interests in Investment Securities Under Revised Article 8 of the Uniform Commercial Code*, 92 Harv. L. Rev. 1013, 1017 (1979).

enough to keep pace with the trading. In addition, the use of paper certificates contributed to an alarming growth of securities thefts. This paper crisis caused those in the securities industry to search for ways to reduce the importance of stock certificates and other investment security instruments.

In response to this situation, the American Bar Association Committee on Stock Certificates was formed and was charged with evaluating the possible elimination or reduction of the use of stock certificates in paper form. This Committee recommended, among other things, that Article 8 of the U.C.C. (and related sections of other articles) be revised to provide rules to regulate the rights, duties and obligations of issuers of, and persons dealing with, uncertificated investment securities. The NCCUSL and the A.L.I. produced a revised Article 8 that was recommended for adoption in 1977 by the Permanent Editorial Board for the Uniform Commercial Code.

As of September 1991, forty-five states had adopted revised Article 8. It was introduced in the Georgia General Assembly in February 1991 (H.B. 761) and is now the law in this state.[33] Revised Article 8 provides a coherent set of rules for those dealing with uncertificated securities, to the same extent that present Article 8 deals with the same matters with respect to certificated securities. In order to encourage issuers to choose to issue uncertificated securities, and thus to help alleviate the "paper crisis," such a coherent set of rules is necessary to make the consequences of transactions predictable so that the constituents of the industry—brokers, buyers, sellers, and others—feel comfortable about holding and dealing with such securities.

It should be noted that recently an American Bar Association Committee has recommended further revisions to Article 8. A drafting committee was created by the NCCUSL in February 1991.

V. Other Changes

A number of other changes are likely to take place in the next few years. A drafting committee is working on a revised Article 5 (Letters of Credit);[34] a Study Committee of the Permanent Editorial Board ("PEB")

33. On May 4, 1992, Zell Miller, Governor of Georgia, signed House Bill 761 making the 1977 Official Text of U.C.C. Article 8 the law in Georgia with only minor variations from the uniform version.

34. *See generally* Albert J. Givray, Cornelius J. Chapman, Jr., James C. Doub, Henry D. Gabriel, George A. Hisert, Robert T. Luttrell, III & Brooke Wunnicke, *Letters of Credit*, 46 Bus. Law. 1581, 1581-87 (1991).

of the U.C.C. has recommended that Article 2 (Sales) be revised;[35] and a PEB Study Committee has been reviewing potential revisions to Article 9 (Secured Transactions). In addition, an American Bar Association ("ABA") Advisory Committee recommended revisions to Article 8 and is forming a drafting committee; other ABA Study Committees are considering amendments to and revisions of Article 1 and reviewing the laws governing intellectual property financing.

There are also some related developments. Federal enactments such as the Expedited Funds Availability Act of 1987[36] affect and even preempt parts of the U.C.C. The Environmental Protection Agency drafted a proposed rule concerning the liability of secured lenders.[37] The NCCUSL has established a Study Committee on Software Contracting. That committee recommended that a uniform statute be prepared.[38] A *Restatement of Suretyship* is in the drafting stages.[39]

V. THIS SYMPOSIUM

The articles in this Symposium do not attempt to provide an in depth analysis of all the developments that have taken place and continue to take place in the U.C.C. There is, however, some discussion of the Code's substantive provisions. In his article, Robert (Bo) Strauss does analyze various provisions in new Article 2A, and offers some practice suggestions. Professor Donald King's article focuses on several provisions of Article 2A and suggests that they pose major difficulties that need to be resolved before that article is adopted throughout the United States. Professor Mark Budnitz discusses several sections of revised Articles 3 and 4, arguing that, except in a few instances, the consumer is worse off under the new articles than she was under the old. In their piece, Albert Conrad and Richard Kessler provide an overview of the new articles and the revisions to existing articles. They highlight many of the major changes in the Code's provisions.

But in addition to this discussion of substantive changes to the Code, a major focus of this Symposium is on "process." In his article, Professor Fred Miller discusses NCCUSL procedures, pointing out that "NCCUSL is an organization that conducts business in the sunlight." He briefly dis-

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35. *See generally* Alex Devience, Jr., *The Recommendations to Revise Article 2,* 24 UCC L.J. 349 (1992).

36. 12 U.S.C. §§ 4001-4010 (1988).

37. *See generally* Owen T. Smith, *Secured Lenders' Liability Under CERCLA: The Effect of the EPA's Proposed Regulations,* 24 UCC L.J. 261 (1992).

38. *See* Amelia H. Boss, *Developments on the Fringe: Article 2 Revisions, Computer Contracting, and Suretyship,* 46 BUS. LAW. 1803, 1811-16 (1991).

39. *See* Boss, *supra* note 38, at 1816-23.

cusses the NCCUSL process, emphasizing that, in addition to careful preliminary groundwork, an opportunity to participate must exist for all but the narrowest efforts to add to and revise the Code rules. Professor Miller also stresses the importance of *actual* participation by all interested parties at an early stage and attributes some of the problems in getting Article 2A enacted to a lack of this participation. It is apparent that Professor Miller believes that the process, while not necessarily perfect, does work pretty well.

Professor Miller questions the wisdom of urging federal legislation on matters covered by the U.C.C. He notes that Congress is not particularly adept at formulating the details and drafting legislation, that it is often influenced by special interests and generally is slow to act. He also questions the appropriateness of federal legislation on the more philosophical grounds as reflected in the Tenth Amendment to the federal Constitution.

Professor Miller also offers some advice on the function of a legislative or bar study committee or a law revision commission with respect to a uniform law. While suggesting various functions, he discourages nonuniform changes that destroy the national consensus reached.

Not all of the authors writing for this Symposium are pleased with the NCCUSL procedure. Professor Donald King believes "state by state enactment takes time, creates non-uniformity, and makes the law a less effective instrument for dealing with the changes which are constantly occurring." He urges the enactment of Article 2A on leasing, as well as other commercial law, on a federal basis.

Professor Mark Budnitz claims that the revisions to Articles 3 and 4 "represents a major failure in process." He believes that a process was adopted by the drafters of new Articles 3 and 4 which resulted in a law that affects all consumers using checking accounts and money orders, but which intentionally excluded consumer concerns. Professor Budnitz questions whether the uniform state laws approach is a viable method for future legislative action in regards to payment systems law that affects consumers and urges "a comprehensive national examination of consumer payment systems."

The Symposium also contains a brief article by Richard Kessler that focuses specifically on the State Bar of Georgia legislative process.

In short, the articles in this Symposium discuss interesting issues of both "substance" and "process." It should help the reader better understand some of the substantive changes in the U.C.C. that have been made or that will soon be made and also the process by which these changes come about.