THE REFORM OF ENGLISH PERSONAL PROPERTY SECURITY LAW

This article focuses upon aspects of title financing in personalty under English Law. Article Nine of the American Uniform Commercial Code is often regarded as a model for solving credit and security problems and has been adopted in some Commonwealth jurisdictions, most notably, in Canada. The article considers some of the difficulties, in the light of the North American experience, associated with an English project for reform. A wider problem here concerns the deficiencies in codification as a successful mechanism for reform in Commercial Law.

THE traditional approach to the legal treatment of security concentrates upon the extent of the financier's capability, as a matter of law, to effectively lend on a gone concern as distinct from a going concern basis. From the financier's point of view, the value of taking security is considered both axiomatic and an aspect of the model financing transaction. An important argument that is often rehearsed in the context of the creation of security interests is that precise entitlements facilitate the efficient allocation of goods and that it is easier to live in a commercial world with a few simple rules such as the first-to-file principle encapsulated in Article Nine of the U.S. Uniform Commercial Code (the UCC).[1] Underlying this approach is that rules ought to be clear *ex ante* so that they can influence behaviour.[2]

The principal draftsman of Article Nine, Professor Gilmore, explains the statute as presenting a rational curative for the difficulties presented by the disparate common law and statutory security interests of the past.[3] With this in mind, at least in the context of Article Nine, it is fallacious to argue that the UCC is characterised by law *stating (e.g. lex mercatoria)* rather than law *making.* This might explain why English commercial law has failed to address the transformation of commercial transactions over the twentieth century. In the words of Professor Goode:

> "If it be right that commercial law is rooted in the customs and practices of merchants we could reasonably expect to find a parallel

[1] See generally Davies, "The Reform of Personal Property Security Law: Can Article 9 of the U.S. Uniform Commercial Code be a Precedent?" (1988) 37 I.C.L.Q. 465.
[2] See Baird and Jackson, "Information, Uncertainty and the Transfer of Property" (1984) 13 J. Legal Studies 299.
[3] See Gilmore, *Security Interests in Personal Property* (1965).

> transformation in English commercial law [referring to new contract structures and financing techniques which have developed during the twentieth century], a reappraisal of fundamental concepts, a wholesale jettisoning of nineteenth century statutes and case law. It is a matter of astonishment that this has not occurred.... We have not sought to emulate the United States in formulating a commercial code, and our principal commercial law statutes have remained substantially in the form in which they were enacted a century ago."[4]

The failure of English commercial law is not that of omission in statutorifying a more contemporary *lex mercatoria* but rather its inability to present a remedial formulation for the inadequacies of current law, especially security interests law. The recent DTI Report "A Review of Security Interests In Property" prepared by Professor Diamond attempts to specifically address this problem. The main recommendation is that legislation should be introduced in Great Britain closely based on Article Nine of the UCC which also provided the model for the Personal Property Security Acts (PPSAs) adopted in several Canadian provinces.[5]

In this article we shall consider, in the light of North American experience, the inherent difficulties associated with an English project for the reform of personal property security law.

ARTICLE NINE OF THE UNIFORM COMMERCIAL CODE AS A MODEL FOR REFORM

There is no doubt that Article Nine of the UCC has influenced the debate over reform of personal property security interests in England.[6] In 1971 the proposed Lending and Security Act suggested by the Crowther Committee[7] leaned very heavily on Article Nine which was considered to be "in concept and in structure an admirable prototype for a modern law of personal property security."[8] The DTI Report prepared by Professor Diamond reflects post-Crowther developments in English law which were highlighted by the Cork Committee on Insolvency[9] in the following way:

> "There can be no doubt, however, from the force and weight of the submissions made to us that there is a considerable body of informed opinion which supports the recommendation of the Crowther Committee and believes that the problems arising in relation to the impact of reservation of title clauses on insolvency are only part of more extensive problems deriving from the unsatisfactory laws concerning security interests in personal property."[10]

4 Goode, "Twentieth Century Developments in Commercial Law" (1983) 3 Legal Studies 293.
5 Diamond, *A Review of Security Interests in Property* (1989) at 9:2:2.
6 See especially Goode and Gower "Is Article 9 of the Uniform Commercial Code Exportable?" in Ziegel and Forster (eds.) *Aspects of Comparative Commercial Law* (1969) 298.
7 *Consumer Credit Report of the Committee* (the Crowther Committee) Cmnd. 4596 (1971).
8 *Supra,* at Chapter 5.5.6.
9 *Insolvency Law and Practice Report* (the Cork Committee) Cmnd. 8558 (1982).
10 *Ibid,* at para. 1623.

The adoption of the Crowther scheme would involve a register of security interests of all types, in property corporeal and incorporeal of all kinds except land, whether granted by a corporation, a partnership or an individual. However, the Diamond Report suggested as an alternative a limited reform of the present registry of company charges[11] much of which has been accommodated under the Companies Act 1985 as amended. Such limited reform by itself fails to address some fundamental issues so that the difficulties associated with reconciling the effect of registration on different registers such as shipping, aircraft and patents with the Companies Register still persist. There are also problems concerning the scope of registrable charges;[12] should there be registration of a charge over unascertained chattels and, if so, what description of the property should suffice? To the extent that any security is exempted from registration in the Companies Register, the intending creditor's search will be incomplete and multiple searching is required if there are other registers which may contain information in order for the intending creditor to get the full picture concerning the debtor's position.[13] This approach contrasts starkly with the conceptual unity seen in an Article Nine-type of regime so that Professors Ziegel and Cuming have said: "The genius of Article Nine, which has no parallels in prior law, is the conceptual unification brought about by the adoption of the 'security interest' as the essential factor identifying those transactions to which the legislation applies."[14]

A distinction is drawn under Article Nine of the UCC between the enforceability of the security interest *inter se* and as against third parties. As between the parties, an agreement which creates or provides for a security interest together with "attachment" of the security interest are all that is required.[15] Normally three conditions have to be fulfilled for attachment to occur, namely the parties must intend attachment; value must be given; the debtor must have rights in the collateral.[16] In order to obtain priority as against third parties on the other hand, it is necessary to "perfect" the security interest. This occurs when the security interest has attached and all the steps required for perfection have been completed which means either possession[17] or registration of a financing statement.[18]

11 *Supra,* at fn.5 Chapter 1:17.

12 See especially Companies Act 1989 ss.395-407.

13 A distinction should be drawn between the "public" and "notice" element of filing. See Davies, *supra,* at fn. 1.

14 Ziegel and Cuming, "The Modernisation of Canadian Personal Property Security Law" (1981) 31 Univ. of Toronto L.J. 248 at p.232.

15 See Uniform Commercial Code (UCC) Art. 9:203(1); Ontario Personal Property Security Act (OPPSA) s.12; Saskatchewan Personal Property Security Act (SPPSA) s.12; Model Uniform Personal Property Security Act (MUPPSA) s. 11.

16 *Supra.*

17 It could be argued that under a system which has a sophisticated filing mechanism, the centrality accorded to possession as a "perfecting" mechanism is anomalous which is compounded by the fact that Article Nine does not attempt to define what is meant by possession.

18 In order to determine what is meant by "perfection" under the UCC it is necessary to unravel the awkward semantics in Article 9:303. The first two sentences of 9:303(1) state that "perfection" consists of *all* of the steps specified in 9:203(1) to cause a "security interest" to "attach" plus one or more of the steps specified in 9:302, 304, 305 and 306. However, 9:303(2) uses the term "perfect" to cover both of these requirements and this must be the meaning of "perfection" although, unfortunately, 9:302,304, 305 and 306 which specify when certain steps such as filing are required for "perfection" do not mention the co-requirement of attachment. See Coogan, "Article Nine - An Agenda for the Next Decade" (1978) 87 Yale L.J. 1012.

There is no doubt that Article Nine, more than any other part of the Code is new law as its aim was to provide a "simple and unified structure" to secured transactions. This provides a striking contrast to the present English position where the law lacks a functional basis in that "[t]ransactions essentially similar in nature are treated in very different ways."[19] It is true that Professor Gilmore reported that Article Nine was in "no sense" a complete Code[20] but this was written before the substantial revisions in 1972 which centred principally upon amendments to Article Nine.[21] Furthermore, the nature of pre-Code law on secured transactions lent itself to repeal since it was mostly statute law which included chattel mortgage and conditional sale legislation:

> "Except for the law of pledges, however, secured transaction law is, and always has been, mainly a [legislative] creation. Thus, when Article 9 was adopted, most of the law formerly controlling secured transactions was cleanly washed away through explicit statutory repeal. Article 9 was thereby given a fresh conceptual bed, and there it rests with no bubbling substratum of common law threatening to rush in whenever and wherever there is a fissure of some sort."[22]

Thus the UCC is often portrayed as an essential repository of law and not merely a collective statement of legal standards.[23]

The draftsman who was responsible for the codification of early twentieth century U.S. sales law, Professor Williston, basically disapproved abandonment of the generalisation and inclusiveness which he considered characterised the Uniform Sales Act and its replacement by far greater particularisation of rules.[24] The learned draftsman indignantly pointed out that the UCC eschewed language honoured by legal usage.[25] What Professor Williston considered a "seamless web", for example the concept of title, the Code draftsmen saw as a "tangled web", better boldly jettisoned where necessary than tinkered with.[26] With this in mind, Pro-

[19] Diamond *supra,* fn.5 at Chapter 8:2:4. The reference here is to hire purchase, conditional sale, finance leasing and retention of title clauses. These are all examples of unconventional security devices.

[20] See Gilmore, *Security Interests in Personal Property* Vol I (1964) at viii.

[21] It was recognised that periodic review of the UCC was important if the latter was to stay current and vigorous and this is the charge of the editorial board of the UCC. Amendments to the Code do however lead to non-uniformity. See Carroll, "Harpooning Whales of which Karl N. Llewellyn is the Hero of the Piece" (1970) 12 Boston College Indus. and Comm. L.R. 139.

[22] *Hillman,McDonnell and Nickles,CommonLaw and Equity under the UCC* (1985)*at s.106[3][a].*

[23] It may be that the UCC can be seen as an example of the "civilisation of commercial law". For classical discussion here under the UCC see King, "New Conceptualism of the UCC: Ethics, Title and Good Faith Purchaser" (1966) 11 St. Louis L.T. 15; Farnsworth, "Good Faith Performance and Commercial Reasonableness under the UCC" (1963) 30 University of Chicago L.R. 666; Carroll, "Harpooning Whales of which Karl N. Llewellyn is the Hero of the Piece" (1970) 12 Boston College Industrial and Commercial L.R. 139. In those systems with separate civil and commercial codes neat lines of differentiation or scope criteria have proved very difficult. See Kozolchyk, "The Commercialisation of Civil Law and the Civilisation of Commercial Law" (1979) 40 La. L.R. 3; Dominguez, "Interaction of Civil Law and Commercial Law" (1982) 42 La. L.R. 1629.

[24] See Williston, "The Law of Sales in the Proposed Uniform Commercial Code" (1950) 63 Harv. L.R. 561.

[25] *Ibid*., at pp. 566-569.

[26] Compare Beutel, "The Proposed Uniform [?] Commercial Code Should Not Be Adopted" (1952) 61 Yale L.J. 334.

fessor Llewellyn rejected title[27] precisely in order to replace an over broad category with a number of smaller categories. As a Realist, he reacted against the Willistonian attempt to derive all rules of sales law from a few "universally applicable" general principles. In his endeavour to replace artifical distinctions with functionally based distinctions, Professor Llewellyn searched for narrow categories based upon commercially significant type-fact patterns.[28] Indeed as Professor Gilmore has pointed out: "Llewellyn's atomization of sales law, like Corbin's atomization of contract law, was the opposite pole from the Langdellian attempt to reduce all principles of liability to what Holmes has called a 'philosophical continuous series'...."[29]

Even with regard to the values of codification, Professor Williston disagreed sharply with Professor Llewellyn. Professor Williston considered the UCC as being unwise and iconoclastic and he favoured piecemeal amendment over comprehensive codification.[30] This is significant in the light of Professor Gilmore's later "repentance"[31] as a draftsman of Article Nine by echoing Savigny's opposition to the idea of codification on the basis that it entails, of necessity, an unhealthy crystallisation of the law.[32] In the light of this, it is appropriate to consider the incompleteness of Article Nine especially since it is held out as a model for the reform of English personal property security law.

DEFECTS IN ARTICLE NINE AS A MODEL OF REFORM

The architects of the UCC were concerned with expanding the pool of assets available for security through the recognition of the "floating lien".[33] The theory is that this will reduce the cost of initial and long term credit[34] so that the UCC has warmly embraced the after-acquired property interest.[35] Inevitably this involves granting a situational monopoly[36] to a

[27] However "title" has not been wholly extirpated from the UCC and even Llewellyn saw title as performing a continued residual function.

[28] See Llewellyn, "Through Title to Contract and a Bit Beyond" (1938) 15 N.Y.U.L.R. 159 especially at pp.169-170.

[29] Gilmore, *The Ages of American Law* (1977) at p.85.

[30] See Twining, *Karl Llewellyn and the Realist Movement* (1973).

[31] Gilmore, "The Good Faith Purchase Idea and the UCC: Confessions of a Repentant Draftsman" (1981) 15 Georgia L.R. 605.

[32] Savigny, Of the Vocation of our Age for Legislation and Jurisprudence (Hay ward A. transl. 1831).

[33] Compare Gilmore, "The Purchase Money Priority" (1962-63) 76 Harv. L.R. at p.1333:
> "We have passed from wholehearted acceptance of the self-evident proposition that a man cannot transfer property he does not own... to a somewhat grudging acceptance of the much less evident proposition that, for reasons which are no doubt sufficient even though they are rarely articulated, a business enterprise should be allowed to make an irrevocable commitment, for the benefit of its creditors, of all its future property."

[34] It is not self-evident that the gains from giving the floating lien priority exceeds the extra cost of unsecured credit. See Diamond *supra,* fn.5 at Chapter 8.1.8.

[35] Article 9:204(1) of the UCC envisages that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral", whilst Article 9:204(3) provides that "obligations ... may include future advances...."

[36] Difficult policy considerations are posed by the after-acquired property clause which centre around the lending monopoly danger. It is sometimes assumed that a creditor with a security interest in after-acquired property enjoys a special competitive advantage over other lenders in all his subsequent dealings with the debtor in that the clause could, if unchecked, effectively tie the debtor's hand to an existing and often exhausted line of credit thereby making it impossible to obtain fresh capital. See Goode, "Is the Law too Favourable to Secured Creditors?" (1983-84) 8 Can. Bus. L.J. 53.

secured creditor with an after-acquired property clause and in this respect, the importance of a subordination arrangement in breaking down such monopoly cannot be over-emphasised. Despite this, the legal treatment of a subordination agreement is not governed by the UCC[37] which can only be elicited through examination of the non-code law. It would seem that even with a comprehensive system like Article Nine there remain considerable ambiguities. Thus Professors Googan, Kripke and Weiss[38] have distinguished between original and subsequent subordination agreements on the basis that with regard to the former, the junior creditor "grants" no rights when it *(in the case of a company)* first creates a subordination since the junior creditor has *always* entered into a "limited debt". In contrast, a subsequently entered into subordinated agreement constitutes a property transfer[39] to which the security interest can attach. The difficulty with this argument is that it seems to defeat the policy of Article Nine which is to apply to any transaction regardless of the form[40] in which a security interest is created. As Professor Gilmore has said:

> "The whole point and purpose of Article 9 was to bring to an end the pre-Code proliferation of 'independent' security devices. A creditor who wants to claim priority over other creditors in specific assets should no more be able to avoid the perfection requirements of the Article by calling his arrangement 'subordination agreement' than he could by calling it 'consignment', 'lease', 'trust' or whatnot."[41]

From this approach it is clear that *ab initio* and subsequent subordination agreements are essentially the same thing. Article Nine of the UCC extends not only to *in futuro* security interests, as in the classic example of an after-acquired property clause, but also to the instantaneous encumbrance of newly obtained property.

The scenario described by Professors Coogan, Kripke and Weiss is similar to that envisaged in the existing priority conflict under English law between the holder of a proceeds *Romalpa* clause and a credit factor-

37 Article 1:209 of the UCC expressly provides for this:
"An obligation may be issued as subordinated to payment of another obligation of the person obligated, or a creditor may subordinate his right to payment of an obligation by agreement with either the person obligated or another credit of the person obligated. Such a subordination does not create a security interest as against either the common debtor or a subordinated creditor. This section shall be constructed as declaring the law as it existed prior to the enactment of this section and not as modifying it."

38 Coogan, Kripke, Weiss, "The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money Deposits, Negative Pledge Clauses and Participation Agreements" (1965) 79 Harv. L.R. 229.

39 This approach is typified *ibid*., at p.238.
"In subordinated debentures individual senior and junior creditors typically do not even know each other, much less intend to create a security interest. Each has made his bargain with the common debtor: the senior creditor's has purchased a note or debenture that is payable in full out of the common debtor's assets in liquidation prior to the time that any dividend is payable to the junior creditor; the junior creditor's *rights from their inception* have been limited to the right to collect from the liquidating assets only after such prior payment to the senior."

40 Article 9:102(l)(a) provides that it applies "to any transaction (regardless of its form) which is intended to create a security in personal property...."

41 See Gilmore, *Security Interests in Personal Property,* Vol. II (1965) s.37:3.

ing company.[42] The argument centres around the issue whether the seller's equitable interest under a valid proceeds clause[43] will be first in time, as distinct from the rule in *Dearie* v. *Hall,*[44] thereby relegating the priority of a credit factoring company to the proceeds in the form of book debts. As McLauchlan has put it:

> "A pre-condition to the vesting of the [factor's] equitable interest is the passage of legal title to [the buyer's]. There must be a momentary time-gap between [the factor's] acquisition of legal title and the creation of [the factor's] equitable interest. Whereas [the buyer's] legal title is never free from [the seller's] equitable interest. Title passes already impressed with a trust in favour of [the seller]. In this game of snap, the seller wins by a whisker!"[45]

The adoption of an Article Nine-type of regime would not prevent a similar priority dilemma at least in the field of subordination arrangements.

A further important difficulty is that Article Nine does not in all cases produce hard-edged rules as seen in some of the exceptions to the filing requirement. Perhaps one of the most interesting examples of this is Article Nine's treatment of set-off which is particularly pertinent in the light of the English experience in *Re Charge Card Services Ltd*[46] In this case it was held at first instance to be 'conceptually impossible"[47] for a creditor to charge back a debt owing by him to his debtor by way of security. Much academic debate has ensued from this and it is still open to argument and considerable uncertainty[48] whether a charge back can constitute a valid security device.[49] Under the UCC however, a bank's right of set-off like security interests in deposit accounts is excluded from Article Nine by virtue of section 104(1). The Official Comments to Article 9:104 states that security interests in deposit accounts are excluded because: "... such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law."[50]

42 *AlV* v. *Romalpa Aluminium Ltd.* [1976] 1 Lloyd's Rep. 443. The literature on this case is substantial. For an up to date treatment see Jones, "Retention of Title Clauses 10 Years from *Romalpa"* (1987) 7 Co. Law 273.

43 Compare *PfeifferGmBH and Co. v.Arbuthnot Factors Ltd.* [1988] 1 W.L.R. 150. See generally Whitehouse, *"Romalpa* Clauses and Factoring" [1986] Law Soc. Gazette 1128.

44 *Dearie* v. *Hall, Loweridge* v. *Cooper* (1828) 3 Russ. 1.

45 McLauchlan, "Priorities - Equitable Tracing Rights and Assignment of Book Debts" (1980) 96 L.Q.R. 90 at p.91.

46 [1986] 3 All E.R. 289 (Millet J.), [1988] 3 All E.R. 702 (Court of Appeal).

47 *Per Millett J. ibid*., at p.308. The Court of Appeal focused solely on the issue of whether there is a general principle of law that whenever a method of payment is adopted which involves a risk of non-payment by a third party, there is a presumption that the acceptance of payment through a third party is conditional on the third party making the payment.

48 Insofar as a charge back is not available, a creditor bank may apply artificial techniques in an attempt to secure priority, for example, the flawed asset device. See generally Wood, *English and International Set-Off (1989)* at Chapter5:13.1-197.

49 See generally Goode, *Legal Problems ofCredit and Security* 2nd ed. (1988) at p. 152. Compare Wood, *ibid*., at Chapter 5.13.1-197.

50 Article 9:104(1) Official Comment 7.

This approach is odd especially in view of the fact that a deposit account is valuable collateral and to the extent that a deposit account cannot be used as collateral, the debtor is deprived of a major asset on which to borrow.[51]

It appears that Article Nine's exclusion of set-off[52] is based upon the premise that set-off is not a security interest.[53] However, the line between set-off and security interests is increasingly fuzzy and it is in this vein that Murray[54] has argued:

> "The set-off principle when confined to two parties who are both creditors and debtors of each other is most logical because it facilitates the quick and economic adjusting of their affairs.... When rights of third parties arise, the answer seems less clear.... reduced to its basic terms: Why should any unsecured creditor (banker or non-banker) receive more than his *pro rata* sharing of loss is the touchstone of creditor's rights, set-off seems to be an aberration."[55]

The difficulty with this argument is that there is no notice mechanism for the bank to perfect its security interest. Furthermore, U.S. courts have adopted a narrow interpretation of Article 9:104 advocated by Professor Gilmore,[56] namely that a bank that merely has general creditor status cannot defeat a perfected security interest in deposited proceeds simply by having a right of set-off.[57] Some courts interpret Article 9:104(1) broadly to exclude both the creation of set-offs and priority rules for resolving set-off disputes under Article Nine. To unravel set-off priority disputes such courts refer to the law and equity. Under the "legal rule", if before the bank exercises set-off it has knowledge of facts sufficient to necessitate inquiry whether a third party interest exists it cannot claim set-off, as in the case of a perfected security interest.[58] In contrast, under

51 Article 9 is not consistent in this respect because some security interests in deposit accounts are included under Article 9 if their contents include "identifiable proceeds ... received by the debtor". [S306(2)] Article 9 does not itself specify the means of identification.

52 It has been argued that the banker's set-off right in the U.S. is an unconstitutional taking of the customer's money without due process. See Comment, "Banking Set-Off: A Study in Commercial Obsolescence" (1972) 23 Hastings L.J. 1585. Subsequent cases have held that the exercise of the right of set-off by a bank against its customer's accounts does not involve significant state involvement and a consequent taking of property without due process under federal and state constitutions. See for example *Meyer v. The Idaho First National Bank* (1974) 96 Idaho 208, 525 P.2d. 990.

53 See Gilmore, *Security Interests in Personal Property,* Vol. II(1964) at p.315:
"[O]f course a right of set-off is not a security interest and has never been confused with one: the statute might as appropriately exclude fan dancing."

54 Murray, "Banks versus Creditors of their Customer: Set-offs against Customers' Accounts" [1977] Commercial L.J. 449.

55 *Ibid.*, at p.464.

56 *Supra,* fn.52.

57 See for example *First Nat' I Bank and Trust Co.v. Iowa Beef Processors Inc.* 626 F.2d 764 (10th Cir. 1980); *Universal C.I.T. Credit Corp.* v. *Farmers Bank of Portageville* 358 F. Supp. 317 (ED Mo. 1973). See generally Note, "Commercial Law - Problems with Identifiable Proceeds and Transfers in Ordinary Course in Floor Plan Financing" (1982) 30 Univ. of Kansas L.R. 478.

58 See Skilton, "The Secured Party's Rights in a Debtor's Bank Account under Article 9 of the UCC" [1977] So. Il1. U.L.J. 120; Henning, "Article Nine's Treatment of Commingled Cash Proceeds in Non-Insolvency Cases" (1982) 35 Arkansas L.R. 191.

the "equitable rule", even if a bank lacks notice, it cannot set-off against the account unless it has changed its position or has superior equities in the deposit, *i.e.* reliance.[59] In applying these rules it would appear from the case-law that banks lose consistently.[60]

It could be argued that the approach considered above is consistent with the principle where the set-off is not first in time.[61] The reasoning here is that banks can constantly monitor the debtor's account. On the other hand, where banks are first in time[62] they will risk losing out. To protect itself, the bank must monitor other claims after it has extended credit to the debtor and there is risk of exposure to an indefinite number of later creditors. What reason is there in policy for distinguishing the position of a bank (first in time) and the holder of a first in time security interest? This divergence in approach demonstrates a failure to address a major policy objective of the UCC which is to minimise the total cost of credit. As Phillips[63] has pointed out:

> "Any exclusion from Article 9 destroys the unity of secured transactions. Subjecting the credit transaction to more than one body of law increases the transaction costs in extending credit. *The indefiniteness of the body of law that pertains to deposit accounts in contrast to the greater definiteness of Article 9 when filing is employed, quite unnecessarily increases the risk."*[64]

Insofar as there are "blind spots"[65] in Article Nine of the UCC this must invite scrutiny of the wider question concerning the appropriateness or otherwise of codification as a reforming mechanism of personal property security law.

The rise of U.S. statutorification[66] in commercial law during the twentieth century is often portrayed[67] as the legislature's concern with efficiency to replace the inefficient common law. Such an approach does beg the

59 See Skilton *ibid*., at pp. 191-196.
60 See generally Rauer, "Conflicts Between Set-offs and Article 9 Security Interests" (1986) 39 Stanford L.R. 235.
61 The first in time principle "runs like a gold thread through virtually all priority schemes". See White and Summers, *Handbook for the Law under the UCC* (2nd ed., 1980) at p.1036.
62 The first in time rule allocates the burdens of risk and monitoring to later parties because it is argued that the latter will have knowledge of the earlier creditors. There are some important exceptions, *e.g.* Art. 9:309 holders in due course; Art. 9:307(1) buyers in ordinary course; Art. 9:312(4) purchase money security interest.
63 Phillips, "Flawed Perfection: From Possession to Filing Under Article 9" (1979) 59 Boston Univ. L.R. 1.
64 *Ibid*., at pp. 50-51. Emphasis added.
65 See Skilton, *supra,* fn.58 at p.207.
66 See Calabresi, *A Common Law for the Age of Statutes* (1982).
67 *See e.g.* (1983) 92 Yale L.J. 862 at p.885.

question whether *in fact* the common law is inefficient[68] especially in view of Professor Gilmore's observation[69] that Article Nine permitted nothing that could be done without it. Moreover, Professor Llewellyn himself understood the significance of case law[70] and would probably have concurred with Portalis, the chief drafter of the Code Napoleon, who in response to the charge that the Code Napoleon was not entirely new and revolutionary said that: "['N]o nation has ever indulged in the perilous undertaking of suddenly cutting itself off from all that has civilised it, and of remaking its entire existence".[71]

Nevertheless, the drafter of Article Nine of the UCC adopted the term "security interest" as the linchpin to the notice filing mechanism because it did not signal a well-established concept or set of concepts.[72] One of the policy objectives underlying Article Nine, the Canadian Personal Property Security Legislation and the Diamond Report,[73] was to jettison the conceptual and administrative structure that had come to characterise the legal regulation of secured financing prior to the enactment of the legislation. Despite this, echoes of the common law have permeated the outer fringes of Article Nine in a significant way which we shall now proceed to discuss.

The extended type of retention of title clause which anticipates that the finished product "remains" in the ownership of the supplier has proven especially problematic under English law[74] and has provided a great impetus to the call for reform.[75] It is surprising, therefore, that similar dilemmas can still subsist even under an Article Nine-type of regime especially if the relationship between the supplier and the buyer is analysed in bailment terms *i.e.,* a bailment *locatio operisfaciendi* or commodity processing. Such a phenomenon occurs in many different areas, typically, where a party performs the processing, converting or finishing material supplied by shippers and then "returns" the finished or semi-finished material or

68 This question is beyond the scope of the article although there exists a significant band of literature which has argued that the common law is composed of economically efficient rules. See Rubin, "Why is the Common Law Efficient?" (1977) 6 J. Leg. Stud. 51; Priest, "The Common Law Process and the Selection of Efficient Rules" (1977) 6 J. Leg. Stud. 65; Goodman, "An Economic Theory of the Evolution of the Common Law" (1978) 7 J. Leg. Stud. 393; Cooter, Kornhauser & Lane, "Liability Rules Limited Information and the Role of Precedent" (1979) 10 Bell J. Econ, 366; Landes and Posner, "Adjudication as a Private Good" (1979) 8 J. Leg. Stud. 235; Cooter and Kornhauser, "Can Litigation Improve the Law without the Help of Judges" (1980) 9 J. Leg. Stud. 139; Terrebone, "A Strictly Evolutionary Model of Common Law" (1981) 10J. Leg. Stud. 397. Terrebone has argued (p.405) that statutory intervention has reduced the ability of the common law system to adopt rules that promote economic efficiency, whereas Posner has argued that legislatures do little else than redistribute wealth to politically effective interest groups. See Posner, "An Economic Approach to Legal Procedure and Judicial Administration" (1973) 2 J. Leg. Stud. 399-414.

69 Gilmore, "The Purchase Money Priority" (1976) 76 Harv. L.R. 1333 at p. 1334.

70 See Llewellyn, *Cases and Materials on the Law of Sales* (1930).

71 Herman, "Excerpts from a Discourse on the Code Napoleon by Portalis and Case Law and Doctrine by A Esmein" (1972) 19 Loy. L.R. 23 at p.26.

72 See Diamond *s72upra,* fn.5 at Chapter 3.

73 See Diamond *supra,* fn.5 at Chapter 9.

74 See for example *AIV v.Romalpa Aluminium Ltd.* [1976] 1 W.L.R. 676; *Re Bond Worth* [1980] Ch. 228; *Borden* v. *STP* [1981] Ch. 25; *Clough Mill Ltd.* v. *Martin* [1983] 1 W.L.R. 111. See especially Goodhart, "Comment on *Clough Mill"* (1986) 49 M.L.R. 96.

75 See *e.g. Cork Committee Report, ibid.*, at fn. 10.

an agreed quantity of equivalent material in exchange for a fee. An example of this can be seen in the U.S. case of *Re Medomak Canning* Co,[76] where a bailment for processing was upheld in the context of a co-packing arrangement. Although Judge Cyr recognised the potential for abuse posed by a retention of possession in circumstances indicating ostensible ownership, his characterisation of the transaction as a "bailment of entrustment" rather than a secured transaction recognised under Article Nine of the UCC, represents a departure from the anti-secret lien policy anticipated under the UCC. No attempt was made to consider the underlying credit and security issues posed by the economic realities of the matter.

There are similarities between commodity processing and "consignments" or "sale or return". Both transactions involve delivery of goods to a second party; with consignments, the delivery is for redistribution to third parties while in the processing case, the model calls for the delivery of raw material by the shipper and the delivery by the processor of upgraded and hence related material to the shipper. The essence of both models calls for retention of title – by the consignor until his agent consignee sells the goods for the consignor, and by the shipper throughout performance of the entire transaction. In addition, both transactions fulfil as part of their essential purpose a financing function. Despite this, the idea of a "consignment sale" is self-contradictory[77] because one part of the phrase is assuming what the other contradicts. Nevertheless, the position becomes clear if one keeps in mind the distinction between wholesale and retail financing since the consignment is a transaction in which the consignee/bailee carries out the sale on the basis of principal and agent. As an agency arrangement, the consignment is outside the scope of the Sale of Goods Act 1979[78] which fails to deal with the distinction between wholesaler and retail financing. Indeed, Colburn[79] has remarked:

"Little thought was then [referring to the drafters of the Sale of Goods Act and the Factors Act] paid to the commercial difference between sales at retail and sales at wholesale level because business did not at that time need to differentiate between the two. The [Factors] Act was developed to regulate the relationships of mercantile agents and their principals at the retail level and was 'designed to protect the buying public'."[80]

The English Sale of Goods Act in section 18 rule 4 fails to distinguish between "sale on approval" and "sale or return"[81] whereas in the U.S. such a distinction is fundamental.[82] Under the UCC, a "sale on approval"

76 25 UCC Rep. Serv. (Callaghan) 437 Bankr. D. Me.) aff'd 588 F.2d (1st Cir. 1978).

77 Compare *AIV* v. *Romalpa Aluminium Ltd.* [1976] 1 W.L.R. 676.

78 The Factors Acts did not address the problem since the policy behind this legislation was not the regulation of the agency relationship between the factor and his principal but rather protecting innocent third parties. Compare Consignment Sale Legislation in Canada which deals with the relationship between the consignor and consignee *e.g.* Saskatchewan Sales on Consignment Act, R.S.S. 1978 c. 5-4.

79 Colburn, "Consignment Sales and the Personal Property Security Act" (1981-82) 6 Can. Bus. L.J. 40.

80 *Ibid.*, *at p 41.*

81 The crucial question here is whether the buyer has engaged in an "act adopting the transaction". See *Kirham* v. *Attenborough* [1897] 1 Q.B. 201.

82 For a criticism of this see Adams, "Sales 'On Approval' and 'Sale or Return'" in Adams (ed.), *Essays for Clive Schmitthoff* (1983).

is a special form of contract for sale.[83] The most significant aspect of sale on approval for our purposes is that the buyer's creditors have no claims to the goods until acceptance and the seller bears the risk and expense of the return of the goods.[84] In the case of a sale or return, the UCC treats this as functionally similar to consignment.[85] The buyer takes the goods primarily for resale and in most cases is a merchant. Unless otherwise agreed, the buyer will bear the risk of loss and expense when exercising his option to return the goods,[86] and while the goods are in his possession they are subject to the claims of his creditors in accordance with Article 2:326(2). The scenario anticipated here is summarised in the Comment to Article 2:326: "The type of 'sale or return' involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold."

If despite the delivery to the buyer the supplier retains title, this is treated as a reservation of a security interest which attaches and is perfected pursuant to Article Nine.

The UCC fails to distinguish between a "true" consignment and one intended as a security. The definition of "security interest" in Article 1:201(3) refers to consignments: "Unless a lease or consignment is intended as security, reservation of title thereunder is not a 'security interest' but a consignment is in any event subject to the provisions on consignment sales (Section 2:326)."

Article 2:326(3) provides:

> "Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as 'on consignment' or 'on memorandum'. However, this subsection is not applicable if the person making delivery

[83] See Art. 2:326. A "sale on approval" is a special form of sale under the UCC and differs from a regular contract for sale in that: (a) the buyer in a sale on approval takes goods primarily for use, whereas a buyer in a regular sale is not so limited; (b) the buyer on approval may return the goods after trial even if they fully conform to the contract description; (c) the sale on approval is subject to the special incidents of Art. 2:327.

[84] The UCC's emphasis on title here is odd given the de-emphasis on title generally under the Code. The original Uniform Sales Act 1906 dealt with 'sale or return' and 'sale on approval' by reference to title. Title passed immediately in the former whereas in the case of 'sale on approval' the buyer only got title when he accepted the goods after a trial period.

[85] Compare the Sale of Goods Act 1979 section 18 rule 4 which does not refer to goods as being "sold" but rather refers to delivery. It is clear that through this method Chalmers accommodated both "a contract of sale" and an "agreement to sell". The latter analysis does not entirely fit conceptually the 'sale or return' transaction, i.e. here there is an agreement to sell subject to the buyer adopting the transaction. Moreover, in the case of 'sale on approval' many of these are "sales" (property passing) subject to a right of rescission.

[86] UCC Art. 2:327(b).

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9)."

It would seem from this that even a true consignment[87] requires notice to be given to creditors. This approach reflects the criticism of the pre-UCC position, namely, consignment arrangements were functionally similar to conditional sales[88] but where conditional sales had to be recorded publicly, the consignor's claims to the goods had to be recorded in only a few states.[89] Certainly in Canada, consignment sales did not require any of the registration technicalities associated with the conditional sales legislation.[90] Indeed, Professor Ziegel has pointed out: "As a method of inventory financing a sale on consignment has much to commend it.... Above all, it enjoys the supreme advantage of being free from all registration requirements."[91]

The UCC aimed to cure the ostensible ownership problems through the insertion in Article 2:326(3) of the three conditions. If condition (c) is relied upon, Article 9:114[92] of the 1972 UCC revision provides that a "true" consignor's interest will be subordinated to a secured party who would have a perfected security interest in the goods if they were the property of the consignee, unless the consignor files before the consignee receives possession of the goods and gives written notification to the prior secured party.[93] However, the "true" consignor is not obliged to file under Article Nine and he can rely instead on the "sign law" anticipated

87 The courts have adopted a wide approach to the definition of consignee for sale under 2:326(3). Thus, in *General Electric Co.* v. *Pettingell Supply Co.* 347 Mass. 631,199 N.E. 2d 326,2 UCC Rep. Serv. 184 (1964) it was held that a consignee who primarily distributed goods to other retailers but who also sold some of the goods was found to be within the scope of 2:326(3). Furthermore "goods of the kind involved" is a highly fluid concept so that a retailer of floor coverings who took a consignment of expensive oriental rugs was found to be dealing in similar goods (i.*e.* floor coverings) without inquiry having been made whether or not creditors could be misled. See *In re Fabers Inc.* 12 UCC Rep. Serv. 126 (D. Conn. 1972).

88 Compare *Liebowitz* v. *Voiello* 107 F.2d 914 (2nd Cir. 1939) 916:

"It is not readily apparent why any consignment arrangement is not a secret lien against creditors of a shaky consignee, as harmful as an unfiled chattel mortgage or conditional sale...."

See Shinberg, "Consignment Sales in Bankruptcy" (1958) 63 Commercial Law Journal 93.

89 The draftsman contemplated the "Traders Acts" of which the Virginia statute was the most well known. Since then much of this legislation has been repealed so that, for example, the Virginia Act was repealed in 1973. See Winship, "The 'True' Consignment Under the Uniform Commercial Code and Related Peccadilloes" (1975) 29 Southwestern L.J. 825 at p.853.

90 See Ziegel, "The Legal Problems of Wholesale Financing of Durable Goods in Canada" (1963) 41 Can. Bar Rev. 54.

91 *Ibid*., at pp.57-58.

92 The placing of UCC Art. 9:114 is odd given that it is only Article 2 which is concerned with "true" consignments.

93 This is similar to the purchase money security interest recognised under the UCC. See Diamond *supra*., fn.5 at Chapter 11.

in condition (a). This is the U.S. equivalent of the reputed ownership provision well-known to English bankruptcy law, the scope of which was notoriously uncertain.[94] In addition, the notoriety exception in condition (b) can also be criticised not least because the creditors of the debtor will fluctuate and may not know of the bankrupt's business methods.[95] Be that as it may, no notice[96] provisions are anticipated under the English Sale of Goods Act 1979 which is an important omission from any proposals for the reform of English personal property security legislation.

An ostensible ownership problem exists whenever there is a separation of ownership and possession.[97] Article Nine of the UCC sets up a priority system based upon notice filing. In theory, if a creditor after checking the appropriate file and his debtor's possession still bears the risk of losing to earlier claimants then this risk will reflect itself in the higher interest rate charged to the debtor. Despite this, in setting forth the scope of Article Nine before the 1987 amendment, section 102 referred to leases and other transactions "intended as security" as being included within its provisions whilst Article 1:201(37) drew a distinction between a "true" and a "non-true lease". This distinction was one of the most frequently litigated is-

94 With the repeal of the Bankruptcy Act 1914 the reputed ownership clause for personal bankruptcy has now ceased to exist. See Insolvency Act 1986. The doctrine of reputed ownership never applied to companies in liquidation.

95 Some commentators have argued for a "consumer" exception to the consignment rule under Article 2 on the basis that the non-merchant consignment is as unlikely to mislead anyone as a transaction could be. See Dolan, "The UCC's Consignment Rule Needs an Exception for Consumers" (1983) 44 Ohio St. L.J. 21; Bruckel, "Consignments Under UCC Articles 2 and 9" Chapter 18 Bender Series on the Uniform Commercial Code:

> "... the easiest cases to identify as 'true consignments' are those in which the consignor is a consumer. These cases bear little resemblance to floor-planning arrangements because the goods are usually few in numbers, and often are not new; consequently there is little opportunity for confusion. Although a consumer might consign a modestly large quantity of antiques or jewelry, such a consignment is unusual, likely a once-in-a-lifetime arrangement, probably a consequence of a death or the breaking up of housekeeping, and unlikely to mislead sophisticated creditors of the consignee."

Bruckel *ibid*., s.18.03[2][a].

96 The doctrine of constructive notice is not usually extended to commercial transactions. See *Manchester Trust v.Furness* [1895] 2 Q.B. 539. But see now *Re Montagu's Settleme/it Trusts* [1987] 2 W.L.R. 1192.

97 Interestingly in its approach to leasing rules in international transactions, the UNIDROIT Committee of experts recognised the ostensible ownership issue as being especially problematic. They considered the requirement of plaques on leased equipment, or notation of lessee's balance sheet of the existence of the lease, but rejected these ideas as of limited use. Although they recognised the need for a system of registration, such as that contained in Article 9 of the UCC, they realised that to include such a notice system in the UNIDROIT Leasing Rules would be difficult, particularly since only a few States have such a system. Ultimately the decision was to defer to the domestic law on the issue of public notice. See Article 5(2) *Draft Convention on International Financial Leasing* as adopted by a UNIDROIT committee of Governmental Experts at its 3rd session held in Rome from 27 to 30 April 1987. Under the *UNIDROIT Convention on International Financial Leasing* done at Ottawa on May 28, 1988, Art. 7(2) provides that where by the applicable law the lessor's real rights in the equipment are valid against such a person only on compliance with rules as to public notice, those rules must be complied with. Article 7 preserves the efficacy of other Conventions, such as the Geneva Convention on Recognition of Rights in Aircraft.

sues under the UCC[98] although it is now alleviated somewhat under the new Article 2A of the UCC[99] as well as in some Canadian Provinces. Thus, under the Saskatchewan Personal Property Security Act (SPPSA) a commercial lease for more than one year is subject to the perfection and priority structure of the Act. There was no empirical basis for excluding leases of less than one year as it was merely perceived as an arbitrary time period to relieve lessors from the administrative costs involved.[100] Significantly, under the Diamond proposals[101] although the Canadian precedent is adopted the appropriate period is extended from one year to at least three years. Even so, it is clear that an extension of the generic approach to legal categorisation of secured financing transactions so as to encompass simple bailment agreements is not intended.[102] Nevertheless, the Diamond cut off point of at least three years does raise more signi-ficant ostensible ownership problems as well as the determination of the lease versus security issue.[103]

One of the most curious omissions from the debate over reform of personal property security legislation has been the doctrine of tracing. This is essentially a rough doctrine of causation and the assumption is that the defendant has benefitted at the claimant's expense in that the amount of the benefit is the value of the traceable product. In contrast, if tracing is not available, the court assumes that a wrongdoer has not benefited beyond receiving the value of the misappropriation. The dilemma of course is that essentially the inequity occasioned to victim one and victim two is the same, but the remedy depends upon the whim of the wrongdoer, *i.e.,* whether he decided to use the proceeds to "consume"

98 The literature here is immense. See *e.g.* Hawkland, "The Impact of the UCC on Equipment Leasing" [1972] Univ. of Illinois L.F. 446. Gilmore, *Security Interests in Personal Property* (1965), Vol. II, pp.337-9; Stroh, "Peripheral Security Interests - The Expanded Net of Article 9" (1967) 22 U. Miami L. Rev. 67; Leary, "Leasing and Other Techniques of Financing Equipment under the UCC" (1969) 42 Temp. L.O. 217; Peden, "The Treatment of Equipment Leases as Security Agreements under the Uniform Commercial Code" (1971) 13W.&M.L.Rev. 110;Coogan, "Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1:201 (37) and Article 9" *Bender's Uniform Commercial Code Service,* Vol 1, Chapter 4A; P.L.I., *Equipment Leasing - Leverage Leasing,* (1st ed. 1977) Chapter 6, and (2nd ed. 1980) Chapter 1; Mooney, "Personal Property Leasing; A Challenge" (1981) 36 Bus Lawyer 1605; Coogan, "Is There A Difference Between a Long-Term Lease and an Instalment Sale of Personal Property?" (1981)56 N.Y.U.L. Rev. 1036.

99 The effect of the amended definition of sl-201(37) and s2A-301 is that they clearly delineate leases and leases intended as security and thus signal the need to file.

100 The SPPSA contains an elaborate definition of "a lease for more than one year" designed to ensure the inclusion of leases which are initially or ultimately will turn out to be leases of more than one year. There was no empirical basis for excluding leases of less than one year, it is merely an arbitrary time period to relieve lessors from the administrative costs involved.

"Lease for a term of more than one year" is extensively defined in s.2(W). It includes a lease for an indefinite term or a lease for one year or less that is automatically renewable or renewable at the option of one of the parties. The expression does not include a lease transaction involving a lessor who is not regularly engaged in the business of leasing goods. Also excluded is a lease of prescribed goods regardless of the length of the term of the lease. This provision was designed to obviate the need to register and perfect leases involving public utility items like telephones that are commonly and notoriously held on a rental basis. See Law Reform Commission of Saskatchewan, *Proposals for a Sakatchewan PPSA* (1977) p.8.

101 See Diamond *supra,* fn.5 at Chapter 9.7.16.

102 See Diamond *supra,* fn.5 at Chapter 9.7.11.

103 See Diamond *supra,* fn.5 at Chapter 9.7.17.

or to "invest". It may be that, as Professor Gilmore has argued,[104] the victim who cannot trace could maintain that the misappropriation enabled the wrongdoer to free-up and use other funds or assets to purchase a product.[105] At least this approach goes some way to addressing the arbitrariness involved in tracing which overcompensates one victim but creates distinctions between claimants on, for example, the basis of "identifiability". There may be force, therefore, in the argument that because tracing depends upon select transactional links rather than concentrating upon causal links,[106] the tracing remedy is not an acceptable means of determining whether the wrongdoer's creditors are in fact benefiting from the victim's loss. In the light of this, it is odd that the Crowther Report[107] and the Diamond Proposals[108] merely call for a declaration of the established principles of tracing proceeds, whilst the Cork Committee did not wish there to be any reform of the law of tracing.[109] The Halliday Committee[110] did not consider the matter in detail preferring to leave the issue of identifiability by regarding it as a "practical question" drawing heavily on the Canadian approach.[111]

Unlike U.S. law, the Canadian Personal Property Security Acts expressly did not adopt the rules of tracing in determining what constitutes proceeds. [112] Article 9:306 of the Uniform Commercial Code only used the word "identifiable" and this it would appear is intentional in order to avoid equitable tracing.[113] However, if this indeed was the intention of the draftsmen then it was not successfully expressed since "identifiability" lies at the heart of the tracing remedy. Given the inclusion of Article 1:103 which expressly retains the principles of law and equity unless they are despatched by the Code's provisions, American courts have concluded that the UCC

104 Gilmore, *Security Interests In Personal Property* Vol II, s.45:9 at pp.1338-1339.

105 See *In re Transport Clearings - Midwest Inc.* 16 Banks 890 (W.D. Mo. 1979) and the U.S. Bankruptcy Reform Act 1978, s.523(a)(2).

106 See, *e.g., Devaynes v. Noble* (Clayton's Case) (1817) 1 Mer. 572.

107 *Report of the Committee on Consumer Credit* (1971) Cmnd. 4596 at Chapter 5.7.63-64.

108 *Supra,* fn.5 at Chapter 15.2.3.

109 See Report of the Review Committee (the Cork Committee) on *Insolvency Law and Practice* (1981) Cmnd 8358 at para. 1643. The Report also recommended that there should be no attempt to introduce a Code to determine priorities of claims of suppliers *inter se* or of suppliers and chargees. Somewhat inconsistently in para. 1650 there is a proposal to the effect that the claims of each supplier in a moratorium will be satisfied proportionately in relation to the cost of the goods to the buyer company, when the proceeds of the sale of the product are insufficient to meet the suppliers' claim.

110 *Report by the Scottish Law Commission Working Party on Security Over Movable Property* (the Halliday Committee) March 1986.

111 Thus, *e.g.,* at para. 62(2)(c) *ibid*., there is a provision that:

> "[S]o long as the other goods so acquired are within the description of the security subjects in the financing statement relative to the filed interest, the replacement goods would be covered by the security."

There is also a *pro rata* approach with regard to identifiable proceeds in a perfected security which is commingled in an account with other such security interests so that the proportion referable to the item covered by each of the file security interests is not ascertainable. Each of the security holders would have an interest in the total proceeds *pro rata* to the amount of principal (excluding interest) remaining due to him under his security after the deduction of the value of other proceeds and unsold goods which are identifiable as covered by his security (para 62(2)(e)).

112 Ontario Personal Property Security Act s.27(2) (OPPSA); Manitoba Personal Property Security Act s.27(3) (MPPSA); Saskatchewan Personal Property Security Act ss.2(ee), 28 (SSPSA).

113 See Gilmore, *Security Interests in Personal Property,* Vol. II (1965) at pp.735-736.

intended to permit tracing principles.[114] In Canada on the other hand, there is express provision for the equitable tracing rules and this will include the right to follow at common law if the expression "traceable personal property" is read literally.[115] Thus, if a trustee in bankruptcy has disposed of property to a *bona fide* purchaser of the legal estate for value without notice thereby frustrating the equitable remedy *in rem,* the common law will permit the owner to sue the trustee in his personal capacity for wrongful interference with goods and so produce an effect similar to a tracing order in equity.

One important feature of more recent Canadian personal property security legislation *vis-a-vis* the effect of tracing and third parties is that a secured party cannot have a perfected security interest in proceeds, other than cash proceeds,[116] unless he has registered a financing statement describing the proceeds by type or kind.[117] To a large extent this approach cures the ostensible ownership problem. Despite this, there are significant difficulties with the importation of an external body of rules, *i.e.* tracing rules, into the priority structure of a Personal Property Security Act[118] where registration normally assures priority. Thus, according to equitable tracing principles, a good faith purchaser would be protected even though

114 The case law is discussed by Henning, "Article Nine's Treatment of Commingled Cash Proceeds in Non-Insolvency Cases" (1982) 52 Arkansas L.R. 191.

115 In *Prince Albert Credit Union Ltd.* v. *Cudworth Farm Equipment Ltd.* (1985) 45 Sask. R. 67 (QB), Matheson, J. held at p.71:

> "Although the right to trace is implicit in the definition of 'proceeds', there are no rules in the Personal Property Security Act delineating the extent to which proceeds may be traced. It must, therefore, be assumed that it was the intention of the Legislature that the *common law and equitable rules relating to tracing would be invoked."*

116 The assumption here is that third parties searching the registry will know that cash proceeds are being claimed by a secured party who has registered a financing statement. See SPPSA s.28(a).

117 See Model Uniform PPSA ss.l(24), 25(1); SPPSA ss.2(ee) 28. There is some difficulty under OPPSA as to whether perfection of proceeds (defined in s.l(r) as "personal property in any form ... derived directly or indirectly from any dealing with collateral or proceeds or that indemnifies or compensates for collateral destroyed or damaged") requires a further financing statement. The problem arises with the ambiguous wording in s.27 OPPSA. Thus s.27(1)(a) & (b) provides for security interest continuing into proceeds but at the same time s.27(2) provides that a security interest in proceeds only remains effective for 10 days after receipt of the proceeds unless a new financing statement is registered. The Ontario courts have however interpreted these two provisions as meaning that no further act of perfection is required if in the original financing statement referring to the original collateral reference is made to a security interest in proceeds which McLaren has suggested can be achieved by having an "x" placed in the "other" box in the financing statement. See McLaren, *Secured Transaction in Personal Property in Canada* (1979) Vol. 1 as 4.02[3]. This has found judicial support in *Massey-Ferguson Industries Ltd. v.Bank of Montreal* (1983) 4 D.L.R. (4th) 96. It would seem then that s.27(2)'s purpose is to provide a perfection mechanism for collateral under OPPSA that cannot be perfected by registration as listed in s.24 OPPSA.
Under the Manitoba Act the financing statement contains a box unlike OPPSA, which permits the secured party to designate whether he is claiming a security interest in proceeds. See generally Alpert, "Perfection and Tracing of Proceeds under the PPSA" (1984) 9 Can. Bus. L.J. 467.

118 Compare Waters, "Trusts in the Setting of Business, Commerce and Bankruptcy" (1983) 21 Alberta L.R. 395 at p.434:

> "[T]he PPSA already defines the meaning of 'proceeds' in very exact terms. If the task were completed, the legislation could then expressly exclude the applicability of the tracing remedy. For the purposes of personal property security law the controversies associated with that remedy would then in future be avoided. Indeed, it is difficult to resist the conclusion, admittedly with the benefit of a thirty year hindsight, that the draftsmen of the Uniform Commercial Code might usefully have taken this course."

the sale is made *out of the ordinary course of business,* whereas the relevant criterion under Canadian personal property security legislation is the ordinary course of business. This invites scrutiny of the wider issue namely the inter-relationship between the legislative policies of Article Nine and the common law and equitable environment in which it must operate.

CODIFICATION AS A MECHANISM OF REFORM IN COMMERCIAL LAW

Legislation is bifocused in the sense that some laws are intended to provide specific instructions about particular conduct whilst other legislation may be more broadly rulemaking, providing guideposts for reasoned decision-making by the judges. The English Sale of Goods Act 1979 is drafted in the latter style as was the U.S. Uniform Sale Act 1906[119] and, as such, they constitute an open-ended restatement of common law sales principles. In contrast, the Bills of Exchange Act 1882 and the U.S. Uniform Negotiable Instruments Law contain detailed commands about the determination of negotiability. The UCC continues both patterns as its different articles have markedly divergent styles. Thus Article Two, which was drafted by Llewellyn, is characterised by statements of principle and presumptive guidelines, whereas Article Nine leans heavily to positivist prescription of rules that dictate outcomes.[120]

We have already identified "gaps" in the UCC and the question then is to determine the methods for resolving such doubtful cases. The UCC itself lays down a mechanism for resolving doubtful cases so that Article 1:102 and its commentary provide:

> "SECTION 1-102. (1) This Act shall be liberally construed and applied to promote its underlying purposes and policies."
>
> * * * * * *

[119] The history of the U.S. Uniform Sales Act has been described as follows:

"In 1888, Mackenzie D. Chalmers was commissioned to codify the law of sales in Great Britain. He was instructed in this effort to 'reproduce as exactly as possible the existing law'. See Chalmers, "Sale of Goods Act" (12th ed., 1945) viii; see also, 1 N.Y. Law Rev. Comm. Report on Art. 2, 347 (1955). In spite of this instruction, Chalmers in his work relied heavily on sales concepts and rules which had developed in the late seventeenth and early eighteenth centuries. As a consequence, his efforts, which culminated in the British Sale of Goods Act in 1893, represented a codification of norms which probably lagged behind the then current commercial law and practice.

In the United States, codification of the sales law was assigned in 1902 to Professor Samuel Williston of the Harvard Law School. Williston was impressed with Chalmer's work in England, and he considered it advisable to follow it closely. Consequently, his Uniform Sales Act, with a few important exceptions, turned out to be almost identical with the British Sale of Goods Act in both substance and expression.

It can be said, therefore, that the Uniform Sales Act... represented 'old law' at the time it was officially promulated in 1906 by the National Conference of Commissions on Uniform State Laws." See *Second Report of the New Jersey Commission to Study And Report Upon the Uniform Commercial Code* at p. 18.

[120] Professor Gilmore's account of the drafting history of the UCC indicates that practising attorneys who participated in drafting the Code became more influential as the document reached its final stages. The practitioners allegedly used their influence to restrict opportunities for courts to create innovative commercial obligations. The Code instead, was to employ language that would "control the courts and compel the decision". See Gilmore, *The Ages of American Law* (1977) at p.85.

> "OFFICIAL COMMENT 1. This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in light of unforeseen and new circumstances and practices.... Courts have been careful to keep broad acts from being hampered in their effects by later acts of limited scope.... They have recognised the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act.... They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general.... They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply.... Nothing in this Act stands in the way of the continuance of such action by the courts."

In its next section however, the UCC sanctions the continuation of the common law as a source of commercial law:

> "SECTION 1-103. Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions."
>
> * * * * * *
>
> "OFFICIAL COMMENT ... [T]his section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act...."

There is an inherent ambiguity here concerning which source is to be applied in resolving cases that do not expressly fall within the letter and purpose of its provisions. It is clear that Professor Gilmore in his classic work, *Security Interests in Personal Property,* preferred the first source as it fills in the fissures in Article Nine's comprehensiveness by "cast[ing] about for an analogy to another section or article of the Code."[121] More recently,[122] emphasis has been placed upon Article 1:103 which represents a resurgence of common law and equity. This tension translates itself into a dispute over the hierarchy of *sources* of law in deciding commercial law cases.[123] In resolving this question, it is necessary to look at the background of the Code.

[121] See Young, "Book Review" (1966) 66 Colum. L.R. 1571 at p.1574.
[122] See generally Hillman, McDonnell and Nickles, *Common Law and Equity under the UCC* (1985).
[123] The issue quite simply is whether intra-code concepts or metacode concepts such as the common law should apply.

The interaction of legislation and the common law under Anglo-American uniform acts is a comparatively recent phenomenon. In contrast, civilian lawyers have been debating for centuries the relationship between enacted and other sources of law. The civilian code is seen as the primary authoritative source of law[124] in the sense that it is an ideological expression which recognises the power of the centralised state as the unique originator of the law.[125] This demonstrates the essential difference between the civilian and common law traditions. Ever since Justinian, civilians have developed and refined techniques for extending the scope of rules beyond their literal wording principally through *a fortiori, a pari,* and *e contrario* meaning.[126] This approach was necessitated under a continental tradition which assumed codes to be gapless[127] because theoretically, civilian courts merely apply the written law. Of course, as a practical matter, prior decisions are indispensable to the civilian lawyer on points of interpretation of the written texts.[128]

There is a critical difference between codified and case law systems on the basis of the relative priorities accorded to judicial decisions. In discussing the political difficulty of complete codification in England in the style of Bentham, Holdsworth points out[129] that the civilians of Europe historically distrusted judges in administering law[130] but in England, the courts traditionally have been institutions commanding great respect. Civilians looked to the legislative bodies as the protectors of freedom and liberty. This was not considered necessary nor desirable in the Anglo-Saxon tradition.[131] Although the civil method clearly recognises the exis-

124 Compare Smith, "The Common Law Cuckoo: Problems of Mixed Legal Systems with Special Reference to Restrictive Interpretations in the Scots Law of Obligation" [1956] S. African L.R. 147; Deak, "The Place of the 'Case' in the Common and the Civil Law" (1934) 8 Tul. L.R. 337; Tate, "Civilian Methodology in Louisiana" (1970) 44 Tul. L.R. 673.

125 See generally Schwartz (ed.), *The Code Napoleon and the Common Law World* (1956). The different types of codification are discussed by Donald, "Codification in Common Law Systems" (1973)43Aust. L.J. 160.

126 See Stein, *Regulae luris* (1966).

127 Compare Story, *The Miscellaneous Writings ofJoseph Story* (1852) at p.238:

> "We ought not to permit ourselves to indulge in the theoretical extravagances of some well meaning philosophical jurists, who believe that all human concerns for the future can be provided for in a code, speaking in a definite language."

128 See *e.g.,* Loussouarn, "The Relative Importance of Legislation, Custom, Doctrine and Precedent in French Law" (1958) 18 La L.R. 235; Nickles, "Problems of Sources of Law Relationships under the UCC - Part I: The Methodological Problems and the Civil Law Approach" (1977) 31 Arkansas L.R. 1 at p.44:

> "The codes of Europe are dated, but they continue to govern the modern legal affairs of Europeans. The process of modernising the codes to meet contemporary needs and to accommodate present values has been effected and is continuing primarily by a process of judicial interpretation which reflects a modern conception about the nature of its function. This conception recognises the importance to decision-making of policy considerations not purely legal and which are not discoverable merely by the elaboration of codified texts through grammatical and logical interpretation emphasising intra-code linguistics and geometric reasoning."

129 Holdsworth, *A History ofthe English* Law (1938) vol. XI at pp. 18-21.

130 Distrust of the judiciary is a common rationale for preferring formal rules over more flexible standards or principles for legal decision making. See Wasserstrom, *The Judicial Decision* (1961) pp.75-79; Kennedy, "Form and Substance in Private Law Adjudication" (1976) 89 Harv. L.R. 1685.

131 See Judson, "A Modern View of the Law Reforms of Jeremy Bentham" (1910) 10 Colum. L.R. 41.

tence of sources of law in addition to codified texts,[132] its strict hierarchical arrangement of these sources just as clearly prescribes that every effort must first be made to reach a legal decision upon the basis of the rules and principles contained within the four corners of the relevant code. Civilian interpretative methodology applicable to codes reinforces the supremacy of enacted law as the primary source of law.[133] This ex-plains Professor Llewellyn's approach to the UCC when he anticipated that it would be a "case law code"[134] but insisted that the only part of precedent that should stand for future decisions is that which could be justified as a matter of reason, *i.e.,* a reference to *jurisprudence constante*[135] rather than *stare decisis.*[136]

In an early article, Professor Hawkland argued[137] that the proper methodology for deciding doubtful cases under the UCC should be patterned on the methods and techniques commonly applied to civil law codifications.[138] This process of reasoning analogically is based upon Article 1:102 and

[132] An important exception to this is the French Code Civil (1804) which sets out in its text no theory of sources of law. See Ramos, "Equity in the Civil Laws: A Comparative Essay" (1970) 44 Tul. L.R. 720. An explanation for this lack was that it was considered unnecessary to have other sources because the positive law contained in the codes was supposed to have an answer to every legal problem.

[133] It is not intended to trace the historical development of civilian sources of law or detail the factors which have contributed to the relative priorities assigned to these sources. See generally Morrow, "Louisiana Blueprint: Civilian Codification and Legal Method for State and Nation" (1943) 17 Tul. L.R. 351. For the classic description of the methods of statutory interpretation in a civil system see *Geny,MethodeD'Interpretation et Sources enDroitPrivePositif(Mnyda* J.*transl.* 1963). For a recent comparative discussion see Dale (ed.), *British and French Statutory Drafting* (1987).

[134] Llewellyn, "A Realistic Jurisprudence - The Next Step" (1930) 30 Colum. L.R. 431 at pp.464-465.

[135] This is where a pattern of decisions as opposed to a single case could be persuasive for future decisions.

[136] The difference between *stare decisis and jurisprudence constante:*

> "... is of such important that it may be said to furnish the fundamental distinction between the English and the Continental Legal Method".

See Goodhart, "Precedent in English and Continental Law" (1934) 50 L.O.R. 40 at p.42. However, there is no reference *to jurisprudence constante* in the UCC.

[137] Hawkland, "Uniform Commercial 'Code' Methodology" [1962] Univ. Il1. L.R. 291.

[138] Hawkland concludes on the basis of the UCC being a "true code" that courts in construing it should make three changes in their standard legal method:

> "They should: (1) use analogy, rather than 'outside' law to fill code gaps; (2) rely somewhat more heavily on the decisions of other code states in making their own decisions; and (3) give their own decisions somewhat less permanent precedential value." *Ibid*., at p.313.

He justifies the use of analogy alone to fill gaps in the code not only because that technique is "standard code methodology" under a true code but, also, because he believes that the analogical approach will enhance uniformity of decisions among jurisdictions. On the other hand, he believes that "[f]ree resort to outside law ... not only makes possible the utilisation of different analogies, but brings into play different rules of law and social policies, inevitably reducing the chances of uniform decisions." *Ibid*., at p.314. This argument overlooks the fact that techniques of analogy are in themselves neutral devices, *i.e*., they do not assist in deciding when an analogy properly is to be drawn from a text or what considerations should influence the development of the analogy. The court in any case will be influenced by factors which are as peculiar to its jurisdiction as are the different rules of law and social policies which Hawkland indicates are brought into play by resort to outside law to fill gaps. He admits that it is "too much to hope that all courts will use the same approach in developing the Code analogically." *Ibid.* It seems that uniformity remains an equally elusive goal whether gaps are filled by applying civilian methodology or by having "free resort" to outside law. A "good" decision by any court will have as much persuasive value in a sister jurisdiction regardless of its having been reached on the basis of analogy or meta-Code concepts of the common law. See also Franklin, "On the Legal Method of the UCC" (1951) 16 Law and Contemp. Prob. 330.

no reference was made to Article 1:103. Interestingly, Professor Gilmore adopts a similar approach:

> "A statute, let us say, is a legislative enactment which goes as far as it goes and no further: that is to say, when a case arises which is not within the precise statutory language, which reveals a gap in the statutory scheme or situation not foreseen by the draftsmen (even though the situation is within the general area covered by the statute) then the court should put the statute out of mind and reason its way to decision according to the basic principles of the common law. A "code", let us say, is a legislative enactment which entirely pre-empts the field and which is assumed to carry within it the answers to all possible questions: thus when a court comes to a gap or unforeseen situation, its duty is to find, by extrapolation and analogy, a solution consistent with the policy of the codifying law; the pre-Code common law is no longer available as an authoritative source.[139]

The difficulty with these approaches is the failure to accommodate the differences in *ideology* between codification under civil law and that seen by the UCC. The methods of interpretation of civil codes reflect the fact that the purpose of such codes is to provide "a complete legislative statement of principles" rather than to prescribe rules.[140] In contrast the UCC, especially Article Nine, is characterised by rigid formalism.[141]

One of the criticisms of the UCC has been that it is a "common law code" and that not enough systematic comparative study was undertaken in respect of the continental experience of codification in commercial law.[142] The UCC is not like a civil code so that Herman could say:

> "No feature of the Uniform Commercial Code disturbs a civilian ear more than its verbosity. The Uniform Commercial Code would be more aesthetically pleasing if its style were more terse. Its detail is probably attributable to a real fear that lawyers, because they are unskilled in analogical interpretation of legislation, need the guidance of specific details...."

[139] Gilmore, "Legal Realism: Its Cause and Cure" (1961) 70 Yale L.J. 1037 at p. 1043.

[140] See Pound, "Codification in Anglo-American Law" in *The Code Napoleon and the Common Law World supra,* fn. 20 at p.282.

[141] Llewellyn favoured a uniform, flexible, clear and long-lived legislation but his dream of a single small volume replacing a large law library was crushed in the early drafts. Some of his writings indicate some disappointment with the final draft:

> "A great deal of what is wrong with it now has been put in during the past three years in an effort to pacify the bar; but on the whole just between ourselves, they really aren't quite ready for the best kind of law. That is a fair statement and all of you know it down in your own souls. You all have a hangover from law school; you feel that the proper way to draw a statute is to mark it out as if it was written for dumbbell judges whom you are trying to corral. Of course, that isn't the way to write good law. The way to write good law is to indicate what you want to do, and you assume within reason that the persons the law deals with will try to be decent; then after that you lay down the codes to take care of the dirty guys and try to hold them in, which means that every statute ought to have two essential bases, one to show where the law wants you to go, and one to show where we will put you if you don't."

See Llewellyn, "Why A Commercial Code?" (1953) 22 Tenn. L.R. 779.

[142] See Twining, *Karl Llewellyn And The Realist Movement* (1973) at p.312.

This phenomenon is clearly illustrated by the fact that although Article 1:103 in its last phrase provides that the common law is a "supplement" to the Code implying the pre-eminence of the Statute, in the first phrase of the section this implication is reversed: "[U]nless displaced by the pro-visions of this Act...."

If this is construed narrowly, Article Nine will be effective to displace the common law only when particular provisions supersede legal and equitable principles and not when provisions can be read collectively to supply a solution by analogy. Furthermore, Article 1:103 is strikingly similar to the "saving provisions" of the common law found in the nineteenth century English Commercial Codes.[143] Here parity between the statute and the common law is ensured since the major premise (the code provision) in the legal syllogistic exercise is no more than a restatement of common law principle. In this respect Chalmers, the principal legal personality and draftsman behind the English Codes, insisted that each provision should have a common law history.[144] Consequently, when subsequent to the passage of the Acts Chalmers wrote his various "digests", his purpose was not merely to annotate the Codes with cases decided under them: "Our common law is rich in the exposition of principles, and those expositions lose none of their value now that the law is codified. A rule can never be appreciated apart from the reasons on which it is founded."[145]

The main difficulty with this approach in the context of Article Nine is that it precisely is *not* a mirror image of the common law. In substantial part, Article Nine declares fresh policy and new principles evidenced in the notice filing mechanism. To the extent that the UCC reflects legislative innovation its provisions must constitute sources as well as statements of law.

A careful reading of Article 1:103 reveals that only *principles* of law and equity are preserved and not specific cases, thereby, contrasting with the saving clauses under nineteenth century English legislation. Indeed, Professor Summers[146] has argued that this Article: "... imposes a duty on judges to interpret and construe the Code to take account of equities in the particular case, except insofar as equitable principles are 'displaced'."[147]

As a phenomenon this provides a striking difference to the English position epitomised by Lord Atkin in *Re Wait.*[148] In essence, the approach of Professor Summers is unwieldy in view of the fact that he fails to provide a formula for determining when the equitable principles have

[143] The Bills of Exchange Act 1882; The Partnership Act 1890; The Sale of Goods Act 1893; The Marine Insurance Act 1906.

[144] This also influenced the approach to the implied terms in contracts of hire under the Supply of Goods and Services Act 1982. See *Implied Terms in Contracts for the Supply of Goods,* Law Commission No 95 (1979); Palmer, *Bailment* (1979) especially at p.724.

[145] Chalmers, *The Sale of Goods Act 1893* (4th ed., 1899) at p.x.

[146] Summers, "General Equitable Principles under Section 1-103 of the UCC" (1978) 72 Nw. U.L.R. 906.

[147] *Ibid.*, at p.908.

[148] [1927] 1Ch. D. 606.

been "displaced".[149] This factor is highlighted due to the tendency in the U.S. courts to construe statutes in a non-formalistic[150] way and they have, in compelling circumstances, limited, reformed, or even refused to apply statutes.[151] Moreover, a major factor in the rise of legal realism in the U.S. was that the case law system had become "intolerably overburdened and unworkably complex."[152] The problem of weight of precedent was one of the major influences behind the codification movement.[153] Even after the UCC, one French commentator has noted recently that the U.S. judge is "fed up" with precedents and refused to discuss their authority in relation to the facts before him.[154]

Since Article Nine more than any other part of the UCC is new law in the sense that its aim was to provide a "simple and unified structure"[155] to secured transactions, Article 1:103 could present an obstacle to furthering the UCC's purposes and policies. With this in mind, a more sound approach would be to concentrate upon the explicit language of the Code supplemented by a recognition of its purposes and policies.[156] This suggestion accommodates the legislative history of the Code together with the Official Comments.[157] At the same time, the emphasis upon the Official Comments also reflects the continental tradition in that they make the Code a major premise for judicial reasoning.

The role of Official Comments under the UCC is in direct contrast to the old methods of publishing commentaries on the text manifested,

[149] A further difficulty with this approach is that it fails to take fully into account that the impact of the decision in the case is not confined solely to the particular litigants before the court but the rule will also affect the class of cases represented by the one before the court.

[150] Professor Posner in describing the approach taken by a U.S. judge has said:

> "[H]e rarely starts his inquiry with the words of the statute, and often if the truth be told, he does not look at the words at all."

See Posner, "Statutory Interpretation - In the Classroom and in the Courtroom" (1983) 50 Univ. Ch. L.R. 800 at pp.807-808. Compare English courts who are not perceived to depart often from a literal approach to statutory interpretation. See *Halsbury's Laws of England* (4th ed.) Vol 44 at para 856 stating the requirement that the court should try to interpret statutory provisions in accord with the literal or plain meaning unless the statute is unclear. See also the Report of the Law Commission and the Scottish Law Commission *The Interpretation of Statutes* (No.21, 1969). Compare Bennion, *Statutory Interpretation* (1984) pp. 199-222; Renton, "The Interpretation of Statutes" (1982) 9 J. of Legislation 232; Atiyah, "Common Law and Statute Law" (1985) 48 M.L.R. 1.

[151] See Calabresi, *A Common Law for the Age of Statutes* (1982).

[152] See Gilmore, "Legal Realism: Its Cause and Cure" (1961) 70 Yale L.J. 1047.

[153] In the USA the federal circuit courts have promulgated rules giving them the power to issue decisions which are not published or citable as precedents. See Reynolds and Richman "The Non-Citable Precedent: Limited Publication and No Citation Rules in the US Courts of Appeal" (1978) 78 Col. L.R. 1167.

[154] Tune, "The Not So Common Law of England and the U.S." (1984) 47 M.L.R. 150.

[155] UCC Article 9: 101 Official Comment.

[156] See Hillman, "Construction of the Uniform Commercial Code: UCC Section 1:103 and 'Code' Methodology" (1977) 18 B.C. Indus. and Com. L.R. 655. The main burden of the approach advocated here is for the U.S. courts to establish a "priority system" whereby they are:

> "... to look first at the explicit language of the Code, next to the Code's purposes and policies, and finally to the common law."

Ibid., at p.678.

[157] See also Nickles, "Rethinking Some UCC Article 9 Problems" (1980) 34 Arkansas L.R. 1. The approach advocated here is to unify the different methods of interpetation suggested by Article 1:102 and 103 and is designed to focus upon commercial practise and circumstances in deciding doubtful cases.

for example in the work of Chalmers. This explains the undoubted sense of academic isolation in the U.S. in the immediate aftermath of the UCC.[158] However, over the last 15 years it is noteworthy that substantial commentaries on the UCC have emerged.[159] Under the Canadian PPSAs, on the other hand, there have been no attempts to include such official comments attached to the legislation. Significantly, it is often the case that the views of the draftsmen in learned articles are taken into account by the Canadian courts.[160] As such the Canadian approach coheres with the tradition of Chalmers[161] so that the draftsman of the Saskatchewan Personal Property Security Act, for example, has produced a commentary on the Act which not merely evaluates and reports on the judicial treatment of the law but is rather an elaboration of doctrine.

CONCLUSION

The conventional wisdom concerning the need for a system of secured credit involves the idea of security as a bargained – for right which justifiably, in the absence of fraud, supersedes the *pari passu* principle of distribution. In addition security is conceived as being desirable *per se* as it stimulates economic growth and modernisation of business. It could be argued that the legislature should promote the low-cost granting and taking of security by, for example, ensuring that accurate information is available about the status of the property to be secured, by allowing ease of documentation for the transaction, and also enabling the creditor to enforce his security as cheaply as possible. If all this is achieved then it may be that transaction and monitoring costs are reduced enabling the debtor to enjoy the maximum interest rate reduction which efficiency allows.[162]

There is no doubt that Article Nine of the UCC is new law as its aim was to provide a "simple and unified structure" to secured transactions.[163] Even if the benefits of secured credit are ambivalent,[164] it may nevertheless be possible to justify a filing mechanism on the basis that monitoring is *itself* costly and that filing on a legal rule can make relevant information available at low cost. The point here is that a risk-averse creditor will provide credit only if he has priority. He is necessarily interested in

158 See *e.g.,* Skilton, "Some Comments on the Comments to the Uniform Commercial Code" [1966] Wis. L.R. 597

159 See for example, White and Summers, *Uniform Commercial Code* (2nd ed., 1980).

160 See for example *Touche Ross Ltd.* v. *Royal Bank of Canada* [1984] 2 W.W.R. 259.

161 Cuming and Wood, *A Handbook on the Saskatchewan Personal Property Security Act* (1987).

162 The most notable articles in this growing field include the following: Jackson and Kronman, "Secured Financing and Priorities Among Creditors" (1959) 88 Yale L.J. 1143; Schwartz, "Security Interests and Bankruptcy Priorities: A Review of Current Theories" (1981) 10 J. Leg. Stud. 2; Levmore, "Monitors and Freeriders in Commercial and Corporate Settings" (1982) 92 Yale L.J. 49; White, "Efficiency Justifications for Personal Property Security" (1984) 37 Vand. L.R. 473; Schwartz, "The Continuing Puzzle of Secured Debt" (1984) 37 Vand. L.R. 1051; Kripke, "Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact" (1985) 133 U.Pa.L.R. 929; Jackson and Schwartz, "A Vacuum of Fact or Vacuous Theory" (1985) 133 U.Pa.L.R. 987; Scott, "A Relational Theory of Secured Financing" (1986) 86 Columbia L.R. 901.

163 Article 9:101 Official Comment.

164 See fn. 162 supra.

discovering which asset(s) a debtor owns and what claims others might have on those assets(s). A filing mechanism cuts down debtor misbehaviour because the availability of *reliable* information about the debtor's property reduces the debtor's incentive to misbehave by removing the opportunity to do so. The adoption of the UCC made filing generally more rational since one set of filing rules replaced so many different pre-Code chattel security files as is currently the position in England. Furthermore, the UCC eliminated the old requirements of unduly particularised descriptions and other formalities such as acknowledgements or affidavits of good faith and thereby allows for secured financing of inventory through the simple priority rule of first-to-file.

This is not to say that there are no gaps. In particular, there are difficulties associated with the derivation principle *(nemo dat)* and the definition of possession as well as its function under a sophisticated filing mechanism. Many of the different articles in the Code were not co-ordinated so that frequently Article Two will point in one direction, while Article Nine will point in the opposite direction. Moreover, the choice of which Article to apply is not an easy one especially when there are many transactions involving both security interests and sales. These problems still persist under the present proposals for reform of English personal property security law.

The common law environment of Article Nine of the UCC should not be underestimated. This is significant in the light of Professor Gilmore's observation that Article Nine permits nothing that could be done without it.[165] Whilst it is clear that the concept of a "security interest" under Article Nine is rooted in common law and equitable principles, the drafter adopted this term precisely because it did not signal a well established concept or set of concepts. In this respect, codification and the introduction of a modern personal property security legislation based on Article Nine will lead to litigation especially in order to define its scope and the terminology used. At least in the short term, the argument based upon the uncertainty of the present law cannot be used as a platform for the introduction of an Article Nine type of regime. The true significance of Article Nine is that we do not approach the task of reforming English Personal Property Security Law with a blank sheet. It is well to recall the approach of Chalmers who did not seek after an impossible perfect Code as this would deter the application of a legal initiative that was within reach:

"Le mieux est l'ennemi du bien."[166]

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[165] Gilmore, "The Purchase Money Priority" (1976) 76 Harv. L.R. 1333 at p.1334.
[166] See Chalmers, "Codification of Mercantile Law" (1903) 19 L.Q.R. 10 at p.17.

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