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Code Arrogance and Displacement of Common Law and Equity: A Defense of Section 1-103 of the Uniform Commercial Code

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CODE ARROGANCE AND DISPLACEMENT OF COMMON LAW AND EQUITY: A DEFENSE OF SECTION 1-103 OF THE UNIFORM COMMERCIAL CODE

Robyn L. Meadows*

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I. INTRODUCTION

AS Code commentators, we frequently extol the virtues and polices of the Uniform Commercial Code (the Code or U.C.C.) over other law.¹ The Code is predictable;² it is uni-

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1. See David G. Carlson, *Rationality, Accident And Priority Under Article 9 of the Uniform Commercial Code*, 71 MINN. L. REV. 207, 235 (1986) (noting that the U.C.C. was drafted to provide businesses what they are seeking in commercial transactions: simplicity, uniformity, and predictability). See generally Sarah Jenkins, *Preemption & Supplementation Under Revised 1-103: The Role of Common Law & Equity in the New U.C.C.*, 54 SMU L. REV. ____ (2001); Howard Ruda, *Article 9 Works—How Come?*, 28 LOY. L.A. L. REV. 309 (1994) (discussing how Article 9 improved commercial law by decreasing transaction costs and promoting certainty in secured transactions); Robyn L. Meadows, *A Potential Pitfall for the Unsuspecting Purchaser of Repossessed Collateral: The Overlooked Interaction Between Sections 9-504(4) and 2-312(2) of the Uniform Commercial Code*, 44 AM. U. L. REV. 167 (1994) (arguing that the Code should be redrafted to protect purchasers of repossessed collateral whose rights at common law or equity are inadequate).

2. See U.C.C. §§ 1-102(2)(a), 9-101 cmt. (1995); Carlson, *supra* note 1, at 235 (explaining that one purpose of the U.C.C. is to provide as much certainty as possible in

form;³ it was drafted by commercial law experts.⁴ Common law and equity, on the other hand, are untidy: they vary from jurisdiction to jurisdiction, are developed through the courts, and can be anything but predictable. Therefore, the argument goes, the Code should reign supreme in the commercial world.

While the Code does have many benefits, including increased uniformity and certainty, we should not lose sight of the goals and policies of other laws, which are frequently not furthered by the Code.⁵ This recognition of other law is precisely the purpose of Section 1-103 of the Code.⁶ Section 1-103 provides: "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."⁷ This section not only recognizes the continued viability of other sources of

commercial transactions); Grant Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 LAW & CONTEMP. PROBS. 27, 36 (1951) (noting that the purpose of Article 9 is to make secured lending "easy, cheap and certain"); Ruda, *supra* note 1, at 319 (noting that predictability is a goal of the Code and Article 9); *see also* Ninth Dist. Prod. Cred. Ass'n v. Duggan, 821 P.2d 788, 797 (Colo. 1991) (noting that the primary purpose of Article 9's priority scheme is to provide stability and certainty). *But see* James J. White, *Evaluating Article 2 of the Uniform Commercial Code: A Preliminary Empirical Expedition*, 75 MICH. L. REV. 1262, 1278-82 (1977) (arguing that the Code has neither reduced uncertainty nor enhanced predictability).

3. *See* U.C.C. § 1-102(2)(c) (1995). Of course, the goal of uniformity cannot be perfectly attained. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE §§ 4, 7 (5th ed. 2000) (explaining that the U.C.C. is not uniform in enactment or in interpretation among the states and recognizing that uniformity cannot be attained under our system); *see also* John L. Gedid, *U.C.C. Methodology: Taking a Realistic Look at the Code*, 29 WM. & MARY L. REV. 341, 341-44 (1988) (suggesting that the U.C.C. fails to meet its goal of uniformity due to the failure of courts and commentators to utilize an appropriate Code methodology in interpreting and applying it); E. Hunter Taylor, Jr., *Uniformity of Commercial Law & State-by-State Enactment: A Confluence of Contradictions*, 30 HASTINGS L.J. 337, 343 (1978) (noting non-uniformity in commercial law despite adoption of the U.C.C.).

4. The National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) promulgated the Code for adoption with input from the American Bar Association (ABA). *See* Kathleen Patchel, *Interest Group Politics, Federalism and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83, 84-88 (1993); William J. Woodward, Jr., *The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process*, 82 CORNELL L. REV. 1511, 1514 (1997) (noting that the drafting process of the U.C.C. involved a group of legal experts who established rules in areas covered by the Code). Uniform laws, such as the U.C.C., depend for their legitimacy not on the democratic process, but on the expertise of their drafters. *See id.* at 92-93; *see also* WHITE & SUMMERS, *supra* note 3, §§ 1-2 (explaining the drafting history of the U.C.C. and its revisions); James J. White, *Ex Proprio Vigore*, 89 MICH. L. REV. 2096, 2097 (1991) (noting that "the principal argument that the Commissioners can make on behalf of a uniform law when it is considered by a state legislature is its technical and substantive superiority over a law born in the back room of a state legislature and sired by a lobbying organization.").

5. *See infra* Part IV.

6. *See* Robert S. Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 Nw. U. L. Rev. 906, 908-13 (1978) (discussing that the rationale of section 1-103 is to incorporate into commercial law equitable principles that are not reflected in the Code).

7. U.C.C. § 1-103 (1995).

law, but it also acknowledges that commercial law relies on other areas of law that the Code does not address.⁸ This section's incorporation of the principles of common law and equity with the Code into commercial law is arguably one of the most important sections in the Code.⁹

Yet there is some concern that this section goes too far in permitting the coexistence of common law and equitable principles with the Code.¹⁰ Currently, Section 1-103 is seen as only permitting the provisions of the Code to displace common law or equity if the provision does so explicitly,¹¹ or, at most, by necessary implication.¹² During the revision process of Article 1, there has been some consideration given to broadening the Code's displacement power either by deleting references to explicit displacement, thus permitting displacement by implication,¹³ or by redrafting the comments to permit broader preemption.¹⁴ The purpose of this article is to argue that broadening the preemptive scope of the Code is not only unnecessary, but ill-advised.

The Code, and commercial law in general, need these other sources of law. Because the Code is not a comprehensive code that fully addresses all areas within its scope or covers all areas of commercial law,¹⁵ many

8. See U.C.C. § 1-103 cmt.; see, e.g., U.C.C. § 3-420(a) (applying the law of conversion to negotiable instruments); U.C.C. § 1-201(44) (incorporating the contract law of consideration into the Code's definition of "value"); U.C.C. § 9-203 cmt. 6 (1999) (requiring a debtor to have rights or the power to transfer rights in the collateral before a security interest can attach, yet requiring reference to other property law for a determination of the debtor's rights in the collateral).

9. See WHITE & SUMMERS, *supra* note 3, § 3 (noting that section 1-103's continuation of the general principles of law and equity make it "probably the most important single provision in the Code").

10. See Jenkins, *supra* note 1, at ___; U.C.C. § 1-103, Reporter's Notes (Annual Meeting Draft 2000) (noting that some courts have, at times, supplemented the Code with other law when the other law was inconsistent with the Code's policies).

11. U.C.C. § 1-103 cmt. 1 (1995). See, e.g., *Aceirno v. Worthy Bros. Pipeline Corp.*, 656 A.2d 1085, 1090 (Del. 1994) (requiring explicit displacement by the Code); *Hechter v. New York Life Ins. Co.*, 412 N.Y.S.2d 812, 815 (1978) (holding that nothing short of an express Code provision results in the displacement of common law action).

12. See, e.g., *Berthot v. Sec. Pac. Bank*, 823 P.2d 1326, 1331 (Ariz. Ct. App. 1991) (explaining that the Code only displaces common law when the statute does so expressly or by necessary implication); *United States Nat'l Bank v. Boge*, 814 P.2d 1082, 1090 (Ore. 1991) (finding that the Code's definitions of "good faith" displaced the common duty of good faith because the existing structure of the Code's provisions necessarily required such displacement).

13. See U.C.C. § 1-102, Revision Note (Tentative Draft Apr. 1997) (explaining that the 1997 draft's reworking of current section 1-103 was intended to strengthen the preemptive nature of the U.C.C.).

14. See U.C.C. § 1-102, Reporter's Notes (Annual Meeting Draft 2000) (retaining the language of the current section 1-103, but recommending that the comments be redrafted to extend the displacement of other law and equity to principles that are inconsistent with the Code's policies and purposes). The comment to U.C.C. section 1-103 currently provides that displacement of other law occurs only if the other law is explicitly displaced by a provision of the Code. See U.C.C. § 1-103 cmt. (1995).

15. See, e.g., U.C.C. § 9-109 (1999) (excluding certain liens on property from the scope of Article 9); U.C.C. § 3-402 (1995) (providing that the laws of agency are applicable to contracts governing the liability of a represented party on a negotiable instrument signed by a representative); U.C.C. § 1-201(44) (1995) (incorporating general contract law governing consideration into the Code's definition of "value"); U.C.C. § 2-402 cmt. (1995) (explaining that the local law on hindrance of creditors by a seller's retention of goods and

commercial disputes cannot be decided without resort to common law and equity. The principles of the Code, in particular, predictability, modernization of commercial law and uniformity,¹⁶ are not the only, or at times even the most important, goals commercial law should further.¹⁷ Finally, there is no evidence that the courts have abused the use of Section 1-103.¹⁸ Therefore, Section 1-103 should not be redrafted to increase the displacement of other law.

II. HISTORY AND DEVELOPMENT OF SECTION 1-103

Section 1-103 is based on a comparable provision in the Revised Uniform Sales Act (the Act).¹⁹ In fact, Section 1-103 is worded identically to the same provision in the 1944 draft of the Act.²⁰ Section 1-103 continues the purpose of that original section: to bring the general principles of law and equity into commercial law.²¹ One purpose of Section 1-103, as well as its predecessor from the Act, is to recognize that equitable principles continue to apply to sales transactions.²² This incorporation of equitable doctrines into commercial law is important because of the inability of legislators to draft rules that take into account the equities in every possible

the law's policy on improper preferences are outside the scope of Article 2, and therefore, left to other law); *see also* WHITE & SUMMERS, *supra* note 3, §§ 1-3 (noting that, although the Code was originally envisioned as being comprehensive, it is not); Robert A. Hillman, *Construction of the Uniform Commercial Code: UCC Section 1-103 and "Code" Methodology*, 18 B.C. INDUS. & COM. L. REV. 655, 657 (1977) (discussing the attributes of true code, which include comprehensive coverage of an entire field of law); Mark D. Rosen, *What Has Happened to the Common Law?—Recent American Codifications, and Their Impact on Judicial Practice and the Law's Subsequent Development*, 1994 WIS. L. REV. 1119 (discussing different types of codes and determining that the U.C.C., along with other American codes, are not comprehensive). *But see* Gedid, *supra* note 3, at 376 (noting that the U.C.C. possesses characteristics of a comprehensive code).

16. *See* U.C.C. § 1-102 (1995).

17. *See infra* Part IV.

18. *See infra* Part V.

19. U.C.C. § 1-103 cmt. (1995) (recognizing that sections 2 and 74 of the Uniform Sales Act as prior uniform statutory provisions from which U.C.C. section 1-103 is drawn); *see also* UNIFORM REVISED SALES ACT § 2 (1944).

20. *Compare* UNIFORM REVISED SALES ACT § 2 (1944) *with* U.C.C. § 1-103 (1995). *See also* Summers, *supra* note 6, at 933 (comparing provisions of the Uniform Sales Act with U.C.C. section 1-103).

21. U.C.C. § 1-103 (1995).

22. The Comment to section 2 of the Uniform Revised Sales Act provided:

[T]his act has as one purpose to recognize and to further the application of equitable principles to Sales transactions. This Act takes "equity" in all its aspects as inherently a part of "the law" of Sales The commercial adequacy of the law of Sales has been seriously impaired in the past by counsel's tendency to overlook equity in Sales cases and by occasionally consequent unwillingness of courts to allow new counsel to depart from patterns of relief previously built up by such disregard of equitable principles. Subject to commercial standards (as in regard to good faith purchase for value, Sections 58, 60-64) this Act aims to reintroduce the general use of equitable principles into Sales cases

UNIFORM REVISED SALES ACT § 2 cmt. (1994); *see also* U.C.C. § 1-103 cmt. (1995) (explaining that supplemental bodies of law and equity apply to commercial transactions through this section).

case.²³ For instance, the Code does not address equitable issues, such as fraud or estoppel, yet these are important concepts in the commercial arena that few would argue should be completely eliminated.²⁴

This use of equity is consonant with other provisions of the Code, which require a court to include the circumstances surrounding a transaction and the parties in its decision-making process. Course of dealing, course of performance, and usage of trade are used to determine the meaning of the parties' agreement and performance in light of the circumstances involved in the transaction at issue.²⁵ Equitable principles also take into account the circumstances unique to a particular transaction in resolving commercial disputes.²⁶

Use of supplementing equitable principles is also consistent with freedom of contract. The Code gives great weight to freedom of contract.²⁷ The Code generally permits parties to a transaction to contract out of its provisions.²⁸ This contractual freedom permits the parties to establish their own commercial relationship as they see fit, and the courts will enforce it. Use of equitable principles, such as fraud, misrepresentation, and estoppel, furthers this goal of enforcing of the actual relationship between the parties. These types of actions require parties to abide by statements made and actions taken earlier that affected their overall bargain. As in freedom of contract, the party who has committed fraud or made a misrepresentation is thus bound by its words and deeds. Yet fraud, misrepresentation and the like are not generally covered by the Code.²⁹ Without the use of common law or equity to supplement the Code in these instances, the actual deal between the parties could not be enforced.

However, the presence of equity as a supplemental law in a commercial case is not unlimited. When explicitly displaced by a particular provision

23. See Summers, *supra* note 6, at 907.

24. See *id.* at 912-13; see also *Knox v. Phoenix Leasing, Inc.*, 35 Cal. Rptr. 2d 141, 147-48 (Cal. Ct. App. 1994) (noting that fraud, misrepresentation, and estoppel are beyond the scope of the U.C.C., and therefore, require courts to resort to equity); *Ninth Dist. Prod. Cred. Ass'n v. Duggan*, 821 P.2d 788, 797-98 (Colo. 1991) (noting that a secured creditor cannot escape liability for fraud by relying on the priority provisions of Article 9).

25. See U.C.C. §§ 1-205, 2-208 cmts. (1995).

26. See Summers, *supra* note 6, at 911-12.

27. See U.C.C. § 1-102(2)(b) (1995) (stating the policy of permitting the development of commercial law through agreements by the parties); U.C.C. § 1-102(3) (permitting Code provisions, with limited exceptions, to be varied by agreement between the parties); U.C.C. § 1-102(3) cmt. 2 (explaining that section affirmatively provides that freedom of contract is a principle of the U.C.C.); Stephen C. Veltri et al., *U.C.C. Survey: Payments*, 55 *BUS. LAW.* 1981, 1991 (2000) (noting that the Code places a high value on freedom of contract).

28. See U.C.C. § 1-102(3) (1995). Certain Code obligations, however, cannot be waived, such as good faith, diligence, reasonableness, and care. See *id.*

29. See, e.g., *Knox*, 35 Cal. Rptr. 2d at 146-48 (noting that fraud and misrepresentation are not generally covered under the Code). But see U.C.C. § 5-109 (1995) (providing protection for an issuer, under certain circumstances, who honors a forged or materially fraudulent letter of credit); U.C.C. §§ 3-302, 3-305 (providing that a holder in due course of an instrument is subject to the defense of fraud in the factum). Neither provision, however, defines "fraud," leaving the determination of whether fraud occurred to other law.

of the Code, equity must give way.³⁰ For example, the doctrine of equitable mortgage, which, under limited circumstances, recognized a lien on property in the absence of a written agreement between the parties, has been displaced by the formal requirements for creation of a security interest found in Article 9.³¹ When displacing equitable principles, the Code reflects a specific decision that some other principle must override equity in situations governed by the rule.³²

Section 1-103 goes further to include legal principles as well as equitable ones in the body of supplemental law.³³ This supplementation is absolutely necessary in a number of areas where the Code uses common law doctrines in lieu of establishing a Code rule.³⁴ Additionally, some very important commercial matters are simply not covered by the Code.³⁵ Finally, certain issues even within transactions subject to the Code are not addressed in the Code.³⁶

30. See U.C.C. § 1-103 (1995) (providing that the general principles of law and equity supplement the U.C.C., unless they are "displaced by the particular provisions" of the Code); U.C.C. § 1-103 cmt. 1 (explaining that law and equity remain applicable to commercial law except to the extent that it has been explicitly displaced by a provision of the Code).

31. See U.C.C. § 9-203 cmt. 5 (1995) (explaining that the doctrine of equitable mortgage, which permitted creditors to enforce informal, oral security agreements to prevent fraud, is no longer necessary or useful in light of section 9-203's provisions).

32. See Summers, *supra* note 6, at 907.

33. U.C.C. § 1-103 (1995); see Hillman, *supra* note 15, at 658-60 (discussing the Code's incorporation of other law through section 1-103).

34. See U.C.C. § 3-420 (1998) (recognizing the applicability of the common law of conversion to negotiable instruments); U.C.C. § 3-402 (referring to the law of agency to determine when a represented party is bound by a representative's signature on a negotiable instrument); U.C.C. § 1-201(44) (1995) (including the rules governing consideration from general contract law in the Code's definition of "value"); U.C.C. § 9-501 cmt.; U.C.C. § 9-601 cmt. (1999) (explaining that default, for purposes of a secured party's remedies under Article 9, is left to the agreement of the parties as supplemented by other law); U.C.C. § 2-302 cmts. (1995); U.C.C. § 2A-108 cmt. (granting judges the power to invalidate a contract or provision for unconscionability, but leaving the determination of what constitutes unconscionability to other law); U.C.C. § 5-109 cmts. (governing fraud affecting letters of credit if the fraud is material, but leaving the determination of materiality to the courts and other law).

35. For example, bankruptcy, real estate sales, leases and security interests, insurance contracts, and service transactions (such as the provision of construction services or brokerage contracts) are just a few of the important areas of commercial law that are not covered by the Code. See 11 U.S.C. §§ 101-110 (2000); U.C.C. § 2-102 (1995) (limiting the scope of Article 2 to transactions in goods); U.C.C. §§ 2A-102, 2A-03 (1995) (providing that Article 2A only applies to leases and restricting leases, by definition, to transfers of possession and use of goods); U.C.C. §§ 9-102, 9-104 (1995), 9-109 (1999) (extending the scope of Article 9 to security interests and certain other similar transactions in personal property or fixtures, and excluding real estate interests (other than fixtures) from its provisions); see also *Ellefson v. Centech Corp.*, 606 N.W.2d 324 (Iowa 2000) (noting that although security interests in bank accounts are excluded from Article 9's scope, nothing prevents the creation of such interests under common law); WHITE & SUMMERS, *supra* note 3, § 3 (explaining the Code is not comprehensive because it does not cover all important commercial matters); Hillman, *supra* note 15, at 678-79 (explaining that a resort to common law is needed to fill gaps created, intentionally and unintentionally, by the Code's drafters).

36. For example, Article 2 on Sales has no provision on the important issue of capacity to contract, and thus, it is left to other law. See U.C.C. § 1-103 cmt. 2 (1995) (noting that the general law relating to the capacity to contract is applicable to a sales contract under

The importance of this supplemental body of law and equity is made clear by the Section 1-103 requirement that these principles “shall supplement” the Code’s provisions.³⁷ A court has the duty to look to the common law, other statutory enactments, and equity when resolving commercial disputes under the Code.³⁸

As Article 1 reached its turn at revision, the Drafting Committee considered what changes, if any, should be made to Section 1-103 and its supplementary provision. In the April 1997 Draft of Article 1, the Drafting Committee incorporated Section 1-103 into Section 1-102, with its statement of the policies and purposes of the Code, and amended it to read “(b) Principles of law and equity may be utilized to supplement this [Act], except to the extent that those principles are inconsistent with (1) either the terms or the purposes and policies of particular provisions of this [Act]; or (2) the purposes and policies identified in subsection (a).”³⁹

The intent of this proposal was to strengthen the preemptive reach of the Code and reduce courts’ reliance on common law and equity.⁴⁰ In the September 1997 Draft, the section remained basically the same, but the inclusion of the broad preemption language of (2), which permits general policies of the Code to preempt, was questioned.⁴¹ By the November

section 1-103). Article 9 requires a debtor to have rights to collateral before a security interest may attach. *See* U.C.C. § 9-203 (1995); U.C.C. § 9-203 (1999). Yet, Article 9 does not address the crucial issue of when a debtor has sufficient rights, thereby leaving the determination to other law. *See* U.C.C. § 9-203 cmt. (1995); U.C.C. § 9-203 cmt. (1999); *Trust Co. Bank v. Gloucester Corp.*, 643 N.E.2d 16, 17-18 (Mass. 1994) (noting that the U.C.C. does not define “rights in the collateral” for the issue of the attachment of a security interest); *Nat’l Pawn Brokers Unlimited v. Osterman*, 500 N.W.2d 407, 411 (Wis. Ct. App. 1993) (stating that Article 9 does not define “rights in the collateral” for the purposes of section 9-203 and the attachment of a security interest); Margit Livingston, *Certainty, Efficiency, and Realism: Rights in the Collateral Under Article 9 of the Uniform Commercial Code*, 73 N.C. L. REV. 115 (1994) (noting that the drafters of Code left the issue of a debtor’s rights in the collateral to the courts). The law of mistake and its application to Code transactions is another area the Code has left to other commercial law. *See* U.C.C. § 1-103 (1995) (specifically including law of mistake as a supplementing principle); U.C.C. § 2-205 cmt. 5 (stating protection from mutual mistake in the context of a firm offer is provided by the obligation of good faith and the general law of mistake). With respect to the power of an agent to bind a principal to an instrument, Article 3 leaves the issue to general contract law. *See* U.C.C. § 3-402(a) (providing that a represented party bound by signature of representative “to the same extent the represented person would be bound if the signature were on a simple contract.”); *see also* Hilman, *supra* note 15, at 666 (noting that the U.C.C. does not address the rules of agency, thereby leaving the resolution of these issues to common law).

37. U.C.C. § 1-103 (1995).

38. *See* Summers, *supra* note 6, at 908 (arguing that section 1-103 “imposes a duty on judges to interpret and construe the Code to take account of equities in a particular case”).

39. U.C.C. § 1-102 (Tentative Draft Apr. 1997). The policies referred to include those of simplification, clarification, modernization, and uniformity. *Id.*

40. *See id.* Revision Note.

41. The September 1997 Draft read:

(B) Principles of law and equity may be used to supplement [the Uniform Commercial Code], except to the extent that those principles are inconsistent with

(1) either the terms [Alternative A—or the purposes and policies of] [Alternative B—of, or the principles embodied by,] a particular provision of [the Uniform Commercial Code]; or

1999 Draft and continuing in the 2000 Draft, the Drafting Committee had retreated from changing the language of Section 1-103, thereby returning in the draft to the language as found in the current section 1-103.⁴² The Drafting Committee did recognize some concern with courts' perceived difficulty in applying the current Section 1-103 as a result of the current Official Comment's reference to displacement of other law only where it is explicitly done so by the Code.⁴³ The Drafting Committee recommended that the comments be redrafted to eliminate the reference to explicit displacement to permit displacement of other law that is inconsistent with the policies and purposes of Code provisions, as well as the Code's text.⁴⁴ This position was continued in the 2000 Draft.⁴⁵

III. POLICIES OF THE UNIFORM COMMERCIAL CODE

The Code was drafted to modernize commercial law, permit development of commercial law through practices and agreement, increase certainty, and provide uniformity.⁴⁶ The Code is designed to "simplify, clarify and modernize" commercial law.⁴⁷ Article 2 modernized the law of sales—replacing the Uniform Sales Act—by, among other principles, de-emphasizing the importance of title.⁴⁸ Article 9 modernized secured lending by rejecting the importance of title⁴⁹ and incorporating all former security devices within its scope.⁵⁰ These changes also served to simplify

[2] the purposes and policies identified in subsection (a)].

U.C.C. § 1-102 (Tentative Draft Sept. 1997). The Committee Reporter noted the issues raised by increasing the preemptive scope of the Code, and thus, proposed the changed language for the Drafting Committee's reconsideration. *See id.* Reporter's Note.

42. U.C.C. § 1-103(b) (ALI Council Draft 1999); U.C.C. § 1-103(b) (Annual Meeting Draft 2000).

43. U.C.C. § 1-103 Revision Note (ALI Council Draft 1999); *see also* U.C.C. § 1-103 cmt. (stating "this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act").

44. *See* U.C.C. § 1-103 Revision Note (ALI Council Draft 1999).

45. *See* U.C.C. § 1-103 Reporter's Notes (Annual Meeting Draft 2000).

46. *See* U.C.C. §§ 1-102(2), 1-102(3) (1995); *see* United States Nat'l Bank v. Boge, 814 P.2d 1082, 1088 (Ore. 1991) (noting that the policies of the U.C.C. are to simplify, clarify, and modernize commercial law as well as to make it uniform).

47. U.C.C. § 1-102(2)(a) (1995).

48. *See id.* § 2-401 (providing that the provisions of Article 2 regarding the rights, obligations, and remedies of the parties apply irrespective of title unless the provision specifically relates to title); *see also* U.C.C. § 2-101 cmt. (explaining that under Article 2, the legal consequences of a contract and its performance no longer depend on title); National Conference of Commissioners on Uniform State Laws and American Law Institute, *Uniform Commercial Code: Report of Committee on the Proposed Commercial Code, Developments Since September, 1949*, 8 (Sept. 1950) (recognizing that minimization of the Code's reliance on title was a break with tradition, but suggesting that this will result in a more usable body of rules for attorneys and businesses than previous commercial laws).

49. *See* U.C.C. § 9-202 (1995); U.C.C. § 9-202 (1999) (providing that the general provisions of Article 9 apply, regardless of which party to the transaction—debtor or secured party—has title to the collateral).

50. *See* U.C.C. §§ 9-102(1), 9-102(2) (1995); U.C.C. § 9-109(a)(1) (1999) (providing that Article 9 "applies to any transaction, regardless of its form, which is intended to create a security interest" including chattel mortgages, pledges, conditional sales, and other forms that existed under prior law); *see also* U.C.C. § 9-102 cmts. 1-2 (1995).

secured lending.⁵¹ Article 5 sought to modernize letter of credit law by providing a theoretical framework for letters of credit within a statutory enactment for the first time.⁵² Article 2A was designed to modernize personal property leasing law by codifying the law, which had previously been governed by a patchwork of law derived partially from sales and secured transactions law, real estate lease law, and personal property law.⁵³ The purpose of Article 3 was to modernize the law of negotiable instruments, as found in the Uniform Negotiable Instruments Law, in light of the significant changes in commercial practices over the life of that statute.⁵⁴ Each Article attempts to further the goal of modernization for the transactions within its scope. Few deny that the Code has been very successful in meeting this goal.⁵⁵

The Code also seeks to promote the development of commercial practices through custom, usage, and agreements.⁵⁶ It accomplishes this by permitting parties to vary most provisions of the Code by agreement.⁵⁷ The Code's incorporation of the concepts of course of performance, course of dealing, and usage of trade into the courts' dispute resolution process also furthers this goal.⁵⁸ The parties can create their own "commercial law" for a particular transaction by varying the provisions of the Code. This approach also promotes the policy of freedom of contract.⁵⁹ The court's use of this information to interpret the parties' agreement ensures that the court is actually enforcing the bargain the parties struck, and not some "mythical" agreement based on "objective interpretation."⁶⁰ By giving commercial parties the power to control their affairs,

51. See U.C.C. § 9-101 cmt. (1995) (explaining the complexity of pre-Code secured financing devices and the aim of Article 9 to simplify the structure within which the numerous varieties of secured transactions could go forward with less cost and greater certainty); Thomas E. Plank, *Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper Under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle*, 26 CONN. L. REV. 397, 402 (1994) (opining that there is no question that Article 9 simplified the law of secured transactions by bringing all former security devices under one set of rules).

52. See U.C.C. § 5-101 cmt. (1995).

53. See *Foreword* to U.C.C. art. 2A (1995).

54. See U.C.C. § 3-102 cmt. (1989).

55. See Charles A. Bane, *From Holt and Mansfield to Story to Llewellyn and Mentschikoff: The Progressive Development of Commercial Law*, 37 U. MIAMI L. REV. 351 (1983) (reviewing the development of commercial law from law merchant to U.C.C.).

56. See U.C.C. § 1-102(2)(b) (1995).

57. See U.C.C. § 1-102(3) (permitting parties to vary provisions of the Code by agreement, except the obligations of good faith, diligence, reasonableness, and care as well as noting that standards that are not manifestly unreasonable for measuring these obligations may be established).

58. See U.C.C. § 2-208 (providing that the course of performance of the parties to an agreement is relevant to determine the meaning of an agreement); U.C.C. § 1-205 (providing that usage of trade and course of dealing may be used to give meaning, supplement, and qualify the terms of the parties' agreement); U.C.C. §§ 2-202, 2A-202 (providing that written expression of the parties' agreement may be explained or supplemented by course of performance, course of dealing, or usage of trade).

59. See U.C.C. § 1-102 cmt. 2 (stating that section 1-102(3) affirmatively establishes freedom of contract as a principle of the Code).

60. See U.C.C. §§ 1-205, 2-208 cmts. (1995); see also U.C.C. § 1-201(3) (defining "agreement" for purposes of the Code as "the bargain of the parties in fact as found in their language of by implication from other circumstances").

commercial law will encourage the continued expansion of commercial practices.⁶¹

Uniformity, another primary goal of the Code,⁶² may be one of the most difficult goals to achieve. State legislatures enact versions of the Code at different times.⁶³ The legislatures have the power to amend the Code as it is enacted, and sometimes do.⁶⁴ The Code's drafters even offered the states options from which to choose when drafting certain sections.⁶⁵ Additionally, state and federal courts must interpret provisions of the Code when resolving disputes between parties, which can result in varying interpretations.⁶⁶ While commercial law may be more uniform than it was prior to the adoption of the Code, it is far from reaching the goal of uniformity.

Certainty and predictability are two other recognized goals behind the

61. See U.C.C. § 1-102 cmts. 1-2.

62. See *id.* § 1-102(c); Hillman, *supra* note 15, at 655 (describing the view that uniformity increases certainty and efficiency in commercial transactions).

63. See WHITE & SUMMERS, *supra* note 3, § 8 at 23 (demonstrating the varying rate at which states enact articles of the Code in a chart of state adoptions of U.C.C. revisions and amendments as of June 1999). At the time this article was published, New York still had not adopted revised Articles 3 and 4, which were promulgated by NCCUSL and ALI in 1990.

64. See, e.g., MD. CODE ANN. COM. LAW I § 2-316-1 (1999) (adding a non-uniform provision to Maryland's Article 2 on sales limiting Code warranty disclaimer provisions in consumer transactions); MICH. STAT. ANN. § 440.9312 (Michie1994) (extending purchase-money security interests priority in collateral (other than inventory) to purchase-money security interests perfected within 20 days of a debtor's possession, as a change from the uniform version of 10 days); accord TEX. BUS. & COM. CODE ANN. § 9.312(d) (Vernon 1987); 13 PA. CONS. STAT. ANN. § 9-301 (West 1996) (extending uniform laws to purchase-money security interests by granting them priority over lien creditors and transferees in bulk perfected within 20 days of a debtor's possession rather than 10 days); FLA. STAT. ANN. §§ 679.301, .312 (West 1979) (providing purchase-money security interests priority over prior secured creditors in collateral other than inventory and over lien creditors or transferees in bulk if the secured party perfects within 15 days of a debtor's possession).

65. See, e.g., U.C.C. § 2-318 (1995) (providing three alternatives from which an enacting state may choose with respect to the issue of third party beneficiaries of express or implied warranties); U.C.C. § 9-401(1) (giving three alternatives for intrastate filing systems); U.C.C. § 9-401(3) (providing two alternative subsections on the effect a change of a debtor's circumstances has on previous filings). Revised Article 9 even gives the states an option with respect to production-money priority. Revised Article 9 omits the production-money priority contained in current section 9-312(2), but provides optional provisions for states to retain this priority. See U.C.C. art. 9, app. II (2000).

66. See WHITE & SUMMERS, *supra* note 3, §§ 4, 7 (explaining that the U.C.C. is not uniform in enactment or in interpretation among the states); Taylor, *supra* note 3, at 343 (noting that there is non-uniformity in commercial law despite the adoption of the U.C.C.); see, e.g., Knox v. Phoenix Leasing, Inc., 35 Cal. Rptr. 2d 141, 144-45 (Cal. Ct. App. 1994), 35 Cal. Rptr.2d at 144-45 (discussing the split in authority among the courts on the issue of whether an equitable remedy of restitution can be had against a secured creditor with priority under the Code); *Acierno v. Worth Bros. Pipeline Corp.*, 656 A.2d 1085, 1088 (Del. 1994) (noting that there is a split in authority on whether common law accord and satisfaction were displaced by Section 1-207 of the U.C.C. prior to enactment of Section 3-311); U.C.C. § 3-311 cmt. (1995) (noting the difference between courts on the interrelationship between Section 1-207 of the U.C.C. and common law accord and satisfaction, thus necessitating this section). See generally Gedit, *supra* note 3 (arguing that the Code's failure to achieve uniformity is due in part to the failure of courts to utilize appropriate Code methodology when applying and interpreting the Code's provisions).

Code.⁶⁷ Certainty of the law permits parties to structure their transactions with knowledge of the consequences of their choices. Certainty may also increase economic efficiency in the commercial arena. Certainty in secured lending, for example, is believed to reduce the cost and increase the availability of credit.⁶⁸ This policy is clearly more important in some Articles than in others.⁶⁹

These general espoused policies underlie the Code. Obviously, individual provisions will reflect additional policy choices made by the drafters.⁷⁰ These general policies, however, are the ones courts are admonished to consider by the Code when construing its provisions.⁷¹ Thus, the focus in this article will be on these core policies and purposes.

IV. LEGAL AND EQUITABLE NORMS AND THE CODE

The Code does not always reflect policy choices that have been made in other areas of the law or in society, and, in fact, may contradict such

67. See U.C.C. §§ 1-102(2)(a), 9-101 cmt. (1995); see also Carlson, *supra* note 1, at 235 (noting that the purpose of the Code is to provide as much certainty as possible in commercial transactions); William M. Burke et al., *Interim Report on the Activities of the Article 9 Study Committee*, 46 BUS. LAW. 1883, 1884 (1991) (describing the importance of certainty in secured transactions under the Code and its relationship to the availability and cost of credit); Hillman, *supra* note 15, at 655 (noting the need for predictability in business transactions is a major factor in the development of the Code); Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051 (1984) (providing critiques of the goal of certainty underlying the Code and questioning whether certainty is economically efficient for society as a whole); Richard L. Barnes, *The Efficiency Justification for Secured Transactions: Foxes and Soxes and Other Fanciful Stuff*, 42 KAN. L. REV. 13 (1993) (discussing the goal of certainty in the Code).

68. See Burke, *supra* note 67, at 1884; Gilmore, *supra* note 2, at 36 (noting that the purpose of Article 9 was to make secured lending simple, certain, and cheap).

69. Consider the extensive use of reasonableness as a standard in Article 2 sales. Such a standard requires courts and juries to make judgments on issues that are simply not predictable. See, e.g., U.C.C. § 2-305 (1995) (providing that where the parties entered into a contract without agreeing on a price, the price of the goods is a reasonable price); U.C.C. § 2-306 (1995) (placing reasonable limits on output and requirements contracts); U.C.C. § 2-309 (setting the time for shipment at a reasonable time if it is not provided for in a contract). Article 9, on the other hand, uses such language more sparingly; see U.C.C. § 9-203 (setting specific requirements for the creation of a security interest); U.C.C. §§ 9-302 through 9-306 (setting specific requirements for the perfection of a security interest); § 9-301, §§ 9-307 through 9-315 (establishing a specific priority scheme based generally on the timing of filing and perfecting of security interests); see also Peter A. Alces, *Roll Over, Llewellyn?*, 26 LOY. L.A. L. REV. 543, 544-45 (1993) (suggesting that Llewellyn may have realized the nature of sales transactions, and thus, sales law, which required less predictable results than secured transactions).

70. For example, the priority scheme of Article 9 that subordinates unperfected security interests to most other interests in property reflects a choice by the drafters to encourage the perfection of security interests by making unperfected interests subordinate. See U.C.C. § 9-301 (1995); U.C.C. § 9-317 (1999) (subordinating interest of an unperfected secured creditor in collateral to competing perfected secured creditors, lien creditors, including a bankruptcy trustee, and buyers without knowledge of the security interest); see also U.C.C. § 3-302 cmt. (1995) (noting that provision's exclusion from the definition of holder in due course of one who takes an irregular or incomplete instrument reflects a policy choice by the drafters).

71. See U.C.C. § 1-102 (1)-(2) (1995) (providing that the Code is to be liberally construed to further its policies and stating the policies underlying the Code).

choices.⁷² In this section, some representative policies from other law will be considered to demonstrate that other norms exist in the law that the Code does not further and which, at times, should override the Code.

The equitable remedy of estoppel is grounded in reliance.⁷³ A party that makes a promise on which another party reasonably relies to her detriment can be bound by the promise on the basis of promissory estoppel.⁷⁴ This consideration-substitute is based, at least in part, on equitable principles, including fairness to the promisee.⁷⁵ Estoppel can also be used to prevent a party from taking a position during the dispute that is inconsistent with a position previously taken and upon which the other party relied, again furthering the fairness goal.⁷⁶ This principle is not generally incorporated into the Code,⁷⁷ yet remains an important avenue

72. For example, fairness is a norm reflected in other areas of the law and society, but which is not enumerated in the general policy of the Code. See U.C.C. § 1-102 (1995). It is also not always given adequate consideration in the Code's rules. See Aremona G. Bennett, *Diminishing Returns: Doing Without A Separate Provision for Implied Warranty Disclaimers Through Dealing, Performance, and Usage*, 41 CLEV. ST. L. REV. 1, 11 (1993) (noting that fairness was not a consideration in determining warranty disclaimers under Article 2).

73. See Michael Gibson, *Promissory Estoppel, Article 2 of the U.C.C., and the Restatement (Third) of Contracts*, 73 IOWA L. REV. 659 (1988) (discussing estoppel's development as an alternative to the bargained-for consideration requirement in contracts); Charles L. Knapp, *Rescuing Reliance: The Perils of Promissory Estoppel*, 49 HASTINGS L.J. 1191, 1196-97 (1998) (noting the development of estoppel to enforce promises which resulted in discernible injury to a promisee from action taken in reasonable reliance of performance by a promisor in the absence of consideration); L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52 (1936) (suggesting three bases for the enforcement of promises based on estoppel—expectation, restitution, and reliance—with the most significant being reliance).

74. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981).

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

75. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981) cmt. b (noting that under promissory estoppel, a promise is enforced only if it is necessary to prevent an injustice to the promisee); *id.* § 139 cmt. b (noting that the use of estoppel is for the purpose of avoiding an injustice); *First State Bank v. Diamond Plastics Corp.*, 891 P.2d 1262, 1272 (Okla. 1995) (noting that the doctrine of estoppel is designed to prevent unjust consequences); see also Eric Mills Holmes, *The Four Phases of Promissory Estoppel*, 20 SEATTLE U. L. REV. 45 (1996) (discussing the equitable, contractual, and tort basis for promissory estoppel).

76. See RESTATEMENT (SECOND) OF CONTRACTS § 90 cmt. a (1998) (explaining that "[e]stoppel prevents a person from showing the truth contrary to a representation of fact made by him after another has relied on the representation"); see also RESTATEMENT (SECOND) OF AGENCY § 8B (1998); RESTATEMENT (SECOND) OF TORTS §§ 872, 894 (1998); RESTATEMENT (SECOND) OF RESTITUTION § 55 (1998).

77. See Richard L. Barnes, *Toward A Normative Framework For The Uniform Commercial Code*, 62 TEMP. L. REV. 117, 159 (1989) (arguing that, for the most part, Article 9 is "unconcerned with chicanery and fundamental unfairness"); Gibson, *supra* note 73 (suggesting that Llewellyn rejected the theory of promissory estoppel as a principal basis of contracting in drafting Article 2); Summers, *supra* note 6, at 913-19 (noting that estoppel, among other equitable principles, is not reflected in the provisions of Article 2, Article 3, or Article 9, but is needed for the appropriate resolution of some commercial transactions). A related concept, waiver, is included in at least one provision of the Code that addresses modification. See U.C.C. § 2-209(4), (5) (1995).

for the resolution of commercial disputes.⁷⁸

Estoppel can ameliorate the harshness that a literal application of a rule can create. For example, assume a buyer and seller enter into a contract for the sale of a good.⁷⁹ The buyer represents to the seller that the buyer has the good insured. The seller does not insure the good based on the buyer's representation and the good is destroyed. Under the Code, risk of loss remains with the seller.⁸⁰ Unless the court finds that the parties agreed the buyer would assume the risk of loss earlier than the Code provides, the seller would be left with the uninsured loss. The court, however, could use the doctrine of estoppel to prevent this harshness and do justice between the parties. The court could find that the buyer was estopped from denying it had insured the property and essentially shift the risk of loss to the buyer.⁸¹ This is more consistent with the Code's goal of enforcing the actual agreement between the parties, rather than the mechanical application of the risk of loss section.⁸² Such an approach also recognizes that the predictability furthered by the application of Section 2-509's risk of loss rules should, when appropriate, give way to the fairness concerns embodied by other law.⁸³

A similar situation may arise under Article 9. In the case of *Citizens State Bank v. Peoples Bank*,⁸⁴ a secured creditor with Article 9 priority (Peoples Bank) made both oral and written representations to a junior creditor (Citizens State Bank) that the senior creditor would release its security interest in the debtor's equipment.⁸⁵ Relying on these representations, Citizens renewed its loan with the debtor, taking a security interest in the equipment.⁸⁶ Peoples did not release its security interest and when the debtor defaulted to both lenders, Peoples tried to assert priority. Finding that Citizens reasonably relied on Peoples' representations and would suffer substantial economic loss if Peoples were permitted to disavow its earlier representations, the court found that Peoples' security

78. See, e.g., *Potter v. Hatter Farms, Inc.*, 641 P.2d 628, 633 (Or. Ct. App. 1982) (noting that the use of promissory estoppel in commercial law is consistent with the Code's obligation of good faith); *Citizens State Bank v. Peoples Bank*, 475 N.E.2d 324, 327 (Ind. Ct. App. 1985) (holding that promissory estoppel is applicable to commercial cases under the U.C.C.); *Mercanti v. Persson*, 280 A.2d 137 (Conn. 1971) (holding that the defense of estoppel is applicable in sales transactions governed by Article 2); see also Knapp, *supra* note 73, at 1225 (discussing the importance of promissory estoppel as a part of commercial law).

79. This hypothetical, based on *Mercanti*, 280 A.2d at 137, was first suggested by Professor Summers. See Summers, *supra* note 6, at 909.

80. See U.C.C. § 2-509-10 (1995) (stating the rules by which it is determined which party has the risk of loss).

81. See *Mercanti*, 280 A.2d at 141-43.

82. See Alces, *supra* note 69, at 549 (suggesting that Article 2 reflects an approach that prefers "factual analyses in terms of fundamental principles" rather than to fix certain rules that would permit contortion of the spirit of the law for the sake of the letter of the law).

83. *Id.* (suggesting that an appropriate balance in commercial law is between rules that further predictability with those that provide the best result, and that Llewellyn recognized this in Article 2, in particular).

84. 475 N.E.2d 324, 324 (Ind. Ct. App. 1985).

85. *Id.* at 326.

86. See *id.*

interest in the equipment was subordinate to that of Citizens.⁸⁷ The court based its decision on the doctrine of promissory estoppel.⁸⁸ By using estoppel to supplement the Code under Section 1-103, the court was able to prevent Peoples from working an injustice on Citizens, something the Code would not have done.⁸⁹

Recovery for fraud rests on the principle that one party should not be permitted to take advantage of another through fraudulent actions or words.⁹⁰ The doctrine of fraud rests in not only fairness to the innocent party, but also in preventing the wrongdoer from benefiting from its false statements.⁹¹ Fraud is an area the Code generally does not address, leaving the appropriate remedies for fraud to other law.⁹² These principles underlying fraud are important legal and societal norms, which are not generally furthered by the Code, but rather left to other law. The Code's policies, such as predictability, should not automatically override these important goals.⁹³

Fraud can occur in many different ways in a commercial transaction. A debtor may fraudulently convey collateral to avoid repossession.⁹⁴ Despite a written contract disclaiming all warranties, a seller may make

87. *See id.* at 328.

88. *See id.* at 326-28.

89. *But see* Daniel v. Stevens, 394 S.E.2d 79, 87 (W. Va. 1999) (rejecting the use of equitable estoppel as a defense to avoid the Article 9 priority system where a senior creditor denied making a statement and a junior creditor did not wait until the senior creditor filed a termination statement or sent a written release of the security interest).

90. *See* Moore v. Crawford, 130 U.S. 122, 128 (1889) (defining "fraud" to include an act, omission, or concealment that results in "undue and unconscientious advantage" taken by one party or another and holding that a court in equity will intercede in such a case); Murray v. D & J Motor Co., 958 P.2d 823, 830 (Okla. Ct. App. 1998) (explaining that fraud includes any method to gain unfair advantage over another, including surprise, trick, cunning, dissembling, or any unfair means by which another is cheated).

91. *See* Moore, 130 U.S. at 128; Detroit Edison Co. v. NABCO, Inc., 35 F.3d 236, 239 (6th Cir. 1994) (noting that tort law protects society's interest in person's freedom from harm); Khan v. Shiley, Inc., 266 Cal. Rptr. 106, 112 (Cal. Ct. App. 1990) (noting that action for fraud impugns the defendant's conduct); RESTATEMENT (SECOND) OF CONTRACTS § 164 cmt. a (noting that fraudulent misrepresentation to render a contract voidable need not be material because the maker of a fraudulent misrepresentation may not insist on its bargain).

92. *See* U.C.C. § 1-103 (1995) (providing that the law of fraud supplements the Code); Knox v. Phoenix Leasing, Inc., 35 Cal. Rptr. 2d 141, 147 (Cal. Ct. App. 1994) (noting that fraud is beyond the scope of the Code); Chittenden Trust Co. v. Andre Noel Sports, 621 A.2d 215, 220-22 (Vt. 1992) (holding that a creditor, although barred by the Code from recovering a deficiency judgment against a debtor, could maintain a common law action for fraud on an allegation that a debtor fraudulently conveyed collateral to avoid repossession); Streeks, Inc. v. Diamond Hill Farms, Inc., 605 N.W.2d 110, 123 (Neb. 2000) (holding that fraud and deceit provide grounds for recovery independent of the Code); *accord Murray*, 958 P.2d at 831; *cf.* U.C.C. § 3-305 (1995) (providing that even a holder in due course of an instrument is subject to the defense of fraud in the factum).

93. *See* Alces, *supra* note 69, at 546 (suggesting that a commercial statute that accommodates better results and not just predictability is preferable); PETER A. ALCES, THE LAW OF FRAUDULENT TRANSACTIONS § 3.303(1), at 3-5 (1989) (noting that fraud unravels everything in a transaction).

94. *Chittenden Trust Co.*, 621 A.2d at 220-22 (holding that, although barred by the Code from recovering a deficiency judgment against a debtor, a creditor could maintain a common law action for fraud on the allegation that a debtor fraudulently conveyed collateral to avoid repossession).

fraudulent oral misrepresentations about a good.⁹⁵ While the relevant Code provisions would not consider the fraud in resolving these types of disputes, the common law of fraud would permit a court to do justice between the parties by taking into account the fraudulent actions or words of a party.

Distributive fairness is a further norm reflected in another area of commercial law that is outside of the Code in bankruptcy law. One aim of bankruptcy law is to distribute an insolvent debtor's assets equally among similarly situated creditors.⁹⁶ Such a policy does not equate with absolute equality among creditors. For example, secured creditors receive compensation on their debts prior to unsecured creditors, and certain unsecured creditors have priority over others. The policy of distributive fairness, however, is one goal that is reflected in the bankruptcy code.

The Code, through Article 9, takes the opposite approach. It is structured so that one particular creditor can acquire priority in the debtor's assets over all other creditors of the debtor.⁹⁷ In fact, during the recent revision process, it was suggested that Article 9 adopt a carve-out provision that would reserve a portion of the debtor's assets for payments to other creditors.⁹⁸ Such a provision would have been more consistent with the distributive fairness policy of bankruptcy law. This approach, however, was rejected by the drafters of revised Article 9 and the existing priority system was maintained.⁹⁹

Both bankruptcy law and Article 9 deal with competing claims of creditors to a debtor's assets. Unlike bankruptcy law, however, Article 9's fo-

95. See *Glenn Dick Equip. Co. v. Galey Constr., Inc.*, 541 P.2d 1184, 1191-92 (Idaho 1975) (holding that the parol evidence rule, when supplemented by U.C.C. § 1-103, did not exclude such evidence); cf. *King v. Fordice*, 776 S.W.2d 608, 610-11 (Tex. App.—Dallas 1989, writ denied) (noting evidence of fraud which goes to the issue of whether a binding contract was entered into is admissible under the parol evidence rule).

96. See Steve H. Nickles, *Consider Process Before Substance, Commercial Law Consequences of the Bankruptcy System: Urging Merger of the Article 9 Drafting Committee and the Bankruptcy Commission*, 69 AM. BANKR. L.J. 589, 590 (1995) (explaining that bankruptcy law aims at distributive fairness to creditors).

97. See generally U.C.C. §§ 9-301 through 9-315 (1995), U.C.C. §§ 9-317 through 9-339 (1999) (establishing a hierarchical priority system for disputes between secured creditors and third parties claiming interest in collateral).

98. See Lynn M. LoPucki, *Should the Secured Credit Carve Out Apply Only in Bankruptcy? A Systems/Strategic Analysis*, 82 CORNELL L. REV. 1483, 1495 (1997) (discussing different proposals for carve-out provisions and whether such proposals should be incorporated into either bankruptcy law or Article 9); Woodward, *supra* note 4, at 1511-12 (discussing Professor Elizabeth Warren's carve-out proposal and suggesting that enactment of such a proposal is unlikely in the Article 9 revision process); see also Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996) (discussing a carve-out to protect unsecured creditors from secured claims in bankruptcy); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887 (1994) (questioning the legitimacy of permitting a secured credit to encumber all of a failing debtor's assets to the detriment of unsecured creditors).

99. See Alvin C. Harrell, *Article 9 Drafting Committee Considers Consumer Issues Subcommittee Report*, 50 CONSUMER FIN. L.Q. REP. 189, 193-94 (1996) (describing the Article 9 Drafting Committee's unanimous rejection of a proposed carve-out provision); see also U.C.C. §§ 9-317 through 9-339 (1999) (continuing the general structure of the Code's priority system).

cus is on disputes between specific parties and not necessarily on the interests of other creditors or third parties not immediately involved in the dispute. This myopic focus is one of Article 9's limitations. This limitation, however, can be minimized by the use of Section 1-103 and the supplemental body of law and equity without doing unwarranted violence to Article 9's established priority scheme.

When a secured creditor, even one with Article 9 priority, commits a fraud upon other creditors, the secured creditor should not be permitted to shield its actions by use of the Article 9 priority system.¹⁰⁰ Similarly, a secured creditor who, through affirmative conduct, induces another to improve or supplement the collateral on the expectation of future payment from the collateral should not be permitted to rely on its priority to the collateral under Article 9 to defeat the other claim.¹⁰¹ Yet, neither of these situations are addressed within Article 9 and a strict reading of Article 9 would permit the offending creditor to prevail. Without the equitable doctrines of fraud, estoppel, and unjust enrichment, secured creditors would be free to take actions that the law generally considers objectionable.

By permitting equitable doctrines to supplement the Code in these instances, Article 9's established priority scheme, which generally disregards knowledge and culpability, will unquestionably be altered. But it will be altered to prevent one culpable party to work an injustice on other innocent parties. Perhaps such an occasional result makes the priorities of secured claims less predictable. The question becomes: should predictability trump fairness? Should slavish adherence to Code rules permit and, in fact, foster fraud and misrepresentation? Currently Section 1-103 answers this question in the negative.¹⁰² Unless equitable actions, such as fraud and misrepresentation, have been explicitly displaced by the provi-

100. See *Knox v. Phoenix Leasing, Inc.* 35 Cal. Rptr. 2d 141, 147 (Cal. Ct. App. 1994) (noting that the fraud of a secured creditor is beyond the scope of the Code); *Peerless Packing Co. v. Malone & Hyde, Inc.*, 376 S.E.2d 161, 161-65 (W. Va. 1988) (noting that although the priority system of Article 9 generally prohibits the equitable remedy of restitution against a secured creditor, a secured creditor cannot escape liability for fraud). *But see* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER'S EDITION § 26-20 (3d. ed. 1988) (suggesting that it is "better to leave an occasional widow penniless by the harsh application of the law than to disrupt thousands of other transactions by injecting uncertainty").

101. See *Ninth Dist. Prod. Credit Assoc. v. Duggan, Inc.*, 821 P.2d 788, 797-98 (Colo. 1991) (stating that where a secured creditor initiates or encourages a transaction between a debtor and suppliers of goods or services to preserve collateral and the creditor benefits therefrom, equity requires the secured creditor to compensate the other creditor to avoid unjust enrichment); *Producers Cotton Oil Co. v. Amstar Corp.*, 242 Cal. Rptr. 914, 927 (Cal. Ct. App. 1988) (relying on Section 1-103, finding equitable principles permitted a harvester and a buyer of crops to deduct the cost of harvesting from the proceeds of the sale despite the creditor's security interest because the secured party knew of and acquiesced in the expenditures and benefitted from them). *But see Knox*, 35 Cal. Rptr. 2d at 144 (explaining that the majority of courts do not permit equitable restitution against a secured creditor in the absence of fraud).

102. See *Alces*, *supra* note 69, at 546 (suggesting that the proper balance in commercial law weighs predictability and best results thereby making commercial law that accommodates the best answer better than commercial law that is merely predictable).

sions of Article 9, which they have not, a court must consider equitable principles and remedies as well as Code solutions. This permits courts to strike a balance in those rare cases where culpable conduct on the part of a secured party results in unjust enrichment of that creditor.¹⁰³

Strict adherence to Code rules without concern for the improper actions of a party, such as a secured creditor, suggests a return to legal formalism—an approach the Code has rejected.¹⁰⁴ Legal formalism relied on concrete, inflexible rules to resolve disputes.¹⁰⁵ As contract law developed, it moved away from this strict, unquestioning adherence to rules toward a more flexible approach to commercial dispute resolution.¹⁰⁶ Restriction of the courts' ability to use flexible principles of law and equity reverts back to legal formalism and its slavish adherence to rules. This formalistic approach, in itself, is inconsistent with the policies and purposes of the Code.

These examples are meant to be illustrative, not exhaustive.¹⁰⁷ Their significance is to demonstrate that there are other policies of the law and society, which are equally, if not at times more important, than the goals of the Code. Section 1-103 permits courts to balance these different purposes and policies, when necessary, to resolve disputes between commercial parties.

V. SECTION 1-103 IN THE COURTS

It has been suggested that Section 1-103 must be clarified and that the courts' use of it should be limited, because courts overuse common law and equity by applying it when they should not.¹⁰⁸ A review of a number

103. This is not to argue that courts should disregard the Code's priority scheme to do justice as they see it. *See, e.g., In re Samuels & Co.*, 526 F.2d 1238, 1241-42 (5th Cir. 1976) (discussing and rejecting the dissent's attempts to do what it perceives as justice between the parties by disregarding the clear language of the Code). Section 1-103 does not permit courts to disregard provisions of the Code. Its provisions merely incorporate established equitable remedies into commercial law.

104. *See, e.g.,* U.C.C. § 1-102(1) (1995) (providing that the Code "shall be liberally construed and applied to promote its underlying purposes and policies."); U.C.C. § 1-102(1) cmt. 1 (noting that the Code is drafted to provide flexibility); U.C.C. §§ 1-205, 2-202(a), 2-208 (incorporating course of dealing, usage of trade, and course of performance into contract interpretation to permit the court to ascertain the meaning of the agreement between the parties); U.C.C. § 2-204 (permitting a contract to be formed in any manner sufficient to show an agreement; dispensing with the common law of determining the moment of the making; and preventing a contract from failing for indefiniteness if the parties intend to be bound and there is a reasonably certain basis for providing a remedy); *see* Livingston, *supra* note 36, at 182-83 (noting Llewellyn's legal realist view and its effect on the U.C.C.); Karl N. Llewellyn, *Some Realism About Realism—Responding to Dean Pound*, 44 HARV. L. REV. 1222 (1931) (suggesting that law is more than rules and principles, and some social good should derive from law).

105. *See* Michael B. Metzger & Michael J. Phillips, *Promissory Estoppel and the Evolution of Contract Law*, 18 AM. BUS. L.J. 140, 149 (1980).

106. *See id.* at 159-62.

107. *See* Summers, *supra* note 6, at 913-23 (providing additional examples of equitable doctrines that serve purposes not furthered by the Code).

108. *See* U.C.C. § 1-103, Reporter's Notes (Annual Meeting Draft 2000) (noting that some courts have, at times, supplemented the Code with other law when the Code's displacement should have been found); Hillman, *supra* note 15, at 656.

of issues that courts have addressed on the interaction between the Code, common law, and equity, however, leaves one questioning whether such abuse actually exists.

In the 1972 version of Article 9, when there is disposition of the collateral subject to a security interest, the security interest continues in the identifiable proceeds realized from the disposition.¹⁰⁹ Neither the text of the Code nor the comments defined "identifiable proceeds." An issue would frequently arise when a debtor sold collateral, received cash proceeds,¹¹⁰ and deposited those proceeds into a bank account. Literally, those proceeds were no longer identifiable; they had been commingled with other fungible money and had lost their identity. If, however, a creditor's security interest in cash proceeds could not follow the money into the bank account, it would be relatively easy for a debtor to defeat a creditor's proceeds security interest, either intentionally or unintentionally, by receiving cash or check payments and depositing them into the debtor's general bank account.

Faced with this possibility, courts resorted to common law tracing rules to permit creditors to trace cash proceeds into a debtor's bank accounts.¹¹¹ This common law rule benefited creditors by extending the definition of "identifiable proceeds" to include "traceable proceeds." Little complaint has ever been made about the courts' "abuse" of Section 1-103 in this instance. Revised Article 9 adopted this approach by providing that proceeds are identifiable if they are traceable under other legal or equitable principles.¹¹² The courts, in deciding this issue and the inter-

109. See U.C.C. § 9-306(2) (1995). Proceeds are "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." *Id.* § 9-306(1).

110. Cash proceeds are "[m]oney, checks, deposit accounts, and the like." U.C.C. § 9-306(1) (1995).

111. See *Bombardier Capital, Inc. v. Key Bank*, 639 A.2d 1065, 1066-67 (Me. 1994) (noting that the majority of courts have applied by analogy the lowest intermediate balance rule from trust and estate law to permit a secured creditor to trace proceeds into a debtor's bank accounts); *Gen. Motors Acceptance Corp. v. Norstar Bank*, 532 N.Y.S.2d 685 (N.Y. Sup. Ct. 1988) (explaining that a secured creditor could trace cash proceeds into a debtor's bank account under the principles of trust accounting even though commingled and the lowest intermediate balance method of accounting are proper methods to use in this instance); *C.O. Funk & Son, Inc. v. Sullivan Equip., Inc.*, 415 N.E.2d 1308 (Ill. App. Ct. 1981) (noting that the cash proceeds from a sale of collateral did not automatically become unidentifiable when a debtor deposited the proceeds into a general bank account); *Brown & Williamson Tobacco Corp. v. First Nat'l Bank*, 504 F.2d 998 (7th Cir. 1974) (explaining that proceeds remain identifiable if traceable); *Domain Indus., Inc. v. First Sec. Bank & Trust Co.*, 230 N.W.2d 165 (Iowa 1975) (holding that cash proceeds do not become unidentifiable because they were deposited into a general bank account); see also Robert H. Skilton, *The Secured Party's Rights in a Debtor's Bank Account Under Article 9 of the Uniform Commercial Code*, 1977 S. ILL. U. L.J. 120 (discussing the courts' use of equitable tracing principles to permit a secured creditor to trace cash proceeds into a debtor's bank accounts).

112. See U.C.C. § 9-315(b)(2) (1999).

(b) [WHEN COMMINGLED PROCEEDS IDENTIFIABLE.] Proceeds that are commingled with other property are identifiable proceeds:

(2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

relationship between equitable tracing principles and Article 9, must have done it correctly, at least in the view of the drafters of the revision, as reflected by their adoption of the courts' approach into the revision.

Another frequently litigated area involving the interaction between common law and the Code deals with full payment checks. At common law, if a check with a notation that represented payment in full of a disputed claim was accepted and collected by a party having a claim against the drawer of the check, the underlying claim was discharged.¹¹³ The doctrine of accord and satisfaction prevented the claimant from striking out the restrictive language, collecting on the check, and then seeking the balance of the disputed claim in an action against the other party.¹¹⁴ The full payment check represented an offer to enter into a separate contract to settle the disputed claim that was deemed accepted by the collection of the check.¹¹⁵

After the adoption of the Code, an issue arose as to whether the provisions of section 1-207 altered this common law rule. Section 1-207 permits continued performance of a contract despite a dispute between the parties.¹¹⁶ Section 1-207 permits a party who is offered performance in a manner other than that which the party claims it is entitled to reserve explicitly its rights to dispute the appropriateness of the performance and still accept the performance.¹¹⁷ Prior to the revision of Article 3, the courts had to decide whether this section displaced the common law rules on accord and satisfaction as applied to full payment checks. The majority of the courts that addressed the issue held that it did not.¹¹⁸ The tender of the full payment check was deemed to create a new contract

Id.; see also *id.* cmt. 3.

113. See *Am. Ins. Union v. Wilson*, 291 S.W. 417 (Ark. 1927) (stating the well-established common law rule that where a debtor sends a check as full payment of a disputed claim, receipt and collection of the check by a creditor results in accord and satisfaction of the claim). For general discussion of doctrine of accord and satisfaction and full payment checks, see RESTATEMENT (SECOND) OF CONTRACTS § 281 (1981) and 1 AM. JUR. 2D *Accord and Satisfaction* § 18 (1999).

114. See *Acierno v. Worthy Bros. Pipeline Corp.*, 656 A.2d 1085, 1088 (Del. 1994) (explaining that under common law, words of protest added to a full payment check did not prevent accord and satisfaction of the disputed claim).

115. See *id.* at 1089 (noting that courts have reasoned that accord and satisfaction creates a new contract by acceptance of the check, including its condition of full payment).

116. U.C.C. § 1-207 cmt. 1 (1995).

117. U.C.C. Section 1-207 provides: "A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as 'without prejudice', 'under protest' or the like are sufficient." U.C.C. § 1-207(1) (1995). This subsection is identical to the original section 1-207 in effect prior to the revision of Article 3. *Id.* § 1-207 cmt. 3; see also U.C.C. § 1-207 (1989).

118. See *Robinson v. Garcia*, 804 S.W.2d 238, 245-47 (Tex. App.—Corpus Christi 1991, writ denied) (noting that the majority of courts that addressed the issue had held that Section 1-207 did not preempt common law accord and satisfaction, but decided to follow a "better-reasoned" minority view); see also Annotation, *Application of UCC § 1-207 to Avoid Discharge of Disputed Claim Upon Qualified Acceptance of Check Tendered as Payment In Full*, 37 A.L.R. 4th 358 (1985) (outlining a split in the courts on the issue of whether section 1-207 displaced the common-law doctrine of accord and satisfaction).

and not simply an offer of disputed performance.¹¹⁹ Because the Code did not explicitly displace the common law, the courts found that the common law rule of accord and satisfaction survived to supplement the Code.¹²⁰

A meaningful minority of courts held that the term performance in section 1-207 included payment, and thus, a recipient of a full payment check could strike the full payment restriction from the check or otherwise protest its character and retain its rights to sue for the disputed balance.¹²¹ These courts found that the common law rule of accord and satisfaction had been displaced by the Code.¹²²

When Article 3 was redrafted in the 1980's, the drafters addressed the issue. Again accepting the majority rule, the drafters revised Section 1-207 by adding a subsection which explicitly states the section does not apply to accord and satisfaction.¹²³ Section 3-311 was also added to Article 3 to address directly the finality of such full payment checks and other instruments tendered as full payment.¹²⁴ In the comments to Section 3-

119. See *Acierno*, 656 A.2d at 1089 (explaining that courts that have found that section 1-207 did not preempt the doctrine of accord and satisfaction have, in part, based their decisions on the finding that tender of a full payment check in payment of the disputed claim constitutes an offer for a new contract).

120. See, e.g., *Marton Remodeling v. Jensen*, 706 P.2d 607 (Utah 1985); *Stultz Elec. Works v. Marine Hydraulic Eng'g Co.* 484 A.2d 1008 (Me. 1984); *Flambeau Prods. Corp. v. Honeywell Info. Sys., Inc.*, 341 N.W.2d 655 (Wis. 1984); *Air Van Lines, Inc. v. Buster*, 673 P.2d 774 (Ala. 1983); *Hixson v. Cox*, 633 S.W.2d 330, 331 (Tex. App.—Dallas 1982, writ ref'd n.r.e.) (noting that at that time, no Texas court had applied Section 1-207 to a full payment check); *Pillow v. Thermogas Co.*, 644 S.W.2d 292 (Ark. Ct. App. 1982) (holding that Section 1-207 did not displace the common law rule of accord and satisfaction and noting that to hold otherwise would seriously circumvent the accepted business practice of settling disputes using full payment checks); see also *RESTATEMENT (SECOND) OF CONTRACTS* § 281 cmt. d (1981) (stating that Section 1-207 "need not be read" as altering the common-law rule that a creditor may not avoid discharge of a disputed obligation by accepting a full-payment check under protest or with a reservation of rights).

121. See, e.g., *Robinson*, 804 S.W.2d at 238-41 (detailing the majority and minority approaches and the jurisdictions adopting each).

122. See, e.g., *id.*; *Ditch Witch Trenching Co. v. C & S Carpentry Servs., Inc.*, 812 S.W.2d 171 (Ky. Ct. App. 1991); *In re Broadview Lumber Co.*, 137 B.R. 775 (Bankr. D. Mo. 1992); *Kroulee Corp. v. A. Klein & Co.* 426 N.Y.S.2d 206 (N.Y. Sup. Ct. 1980) (holding that where a recipient seller of a full payment check noted a reservation of rights on the back of the check and immediately informed a buyer of reservation, Section 1-207 avoided discharge of the obligation); *Bivins v. White Dairy*, 378 So.2d 1122 (Ala. Civ. App. 1979) (holding that an explicit reservation of rights on a full payment check is effective under Section 1-207 to avoid accord and satisfaction on a disputed claim). For discussion of the interaction of U.C.C. Section 1-207 and common law accord and satisfaction prior to revision of Section 1-207, see Albert J. Rosenthal, *Discord and Dissatisfaction: Section 1-207 of the Uniform Commercial Code*, 78 COLUM. L. REV. 48 (1978) and Patricia B. Fry, *You Can't Have Your Cake and Eat It Too: Accord and Satisfaction Survives the Uniform Commercial Code*, 61 N.D. L. REV. 380 (1985). See also Paula G. Walter, *The Rise and Fall of U.C.C. Section 1-207 and the Full Payment Check-Checkmate?*, 21 LOY. L.A. L. REV. 81 (1987).

123. U.C.C. § 1-207(2) (1995) ("Subsection (1) does not apply to accord and satisfaction."); see also *id.* § 1-207 cmt. 3.

124. Section 3-311, entitled "Accord and Satisfaction by Use of Instrument," generally continues the common law rule that a claimant who obtains payment of an instrument with a notation that it is full payment of a bona fide disputed claim releases the obligor on the claim. See U.C.C. § 3-311. This section provides a method by which a corporation can

311, the drafters acknowledged that prior to the enactment of this section the issue of accord and satisfaction through the use of a full payment instrument was governed by common law. They noted, however, some courts had held that Section 1-207 altered that rule.¹²⁵ By amending Section 1-207 and adding Section 3-311, the drafters acknowledged that the courts that had continued to apply the common law rule of accord and satisfaction were, in fact, correct.

Under former Article 3, the Code was silent as to whether actions that existed under common law when an instrument was paid on a forged indorsement continued to be viable.¹²⁶ Courts were then faced with the issue when parties sought recovery for improper payment under common law conversion. A majority of courts that addressed the issue held that common law actions survived the enactment of the Code because the provisions of Article 3 did not specifically displace the common law.¹²⁷ When Article 3 was revised, this majority rule was adopted and the Code now expressly provides that common law conversion applies to instruments.¹²⁸ This is another example of the majority of the courts correctly interpreting the Code's interaction with common law, as reflected by the Code's drafters' later adoption of the courts' position.

Article 9's established, inflexible priority system is an area ripe for equitable claims. Priorities under Article 9 are based on the timing of the

ensure that such full payment checks are tendered to an appropriate person and office before such check can serve as a discharge of the obligation. *See* U.C.C. § 3-311(c)(1). It also provides that a person who did not know within a reasonable time before collection that the instrument was tendered in satisfaction of the obligation, can tender repayment of the instrument within 90 days payment of the instrument to preserve its rights to the claim. *See* U.C.C. § 3-311(c)(2) through (d) (providing that the claim of a claimant that tenders repayment within 90 days is not discharged, but the claim is discharged if the claimant, within a reasonable time before collection of the instrument, knew it was tendered in full satisfaction of the disputed claim).

125. *See* U.C.C. § 3-311 cmt. 1.

126. Former U.C.C. Section 3-419, provided:

- (1) An instrument is converted when
 - (a) a drawee to whom it is delivered for acceptance refuses to return it on demand; or
 - (b) any person to whom it is delivered for payment refuses on demand either to pay or to return it; or
 - (c) it is paid on a forged indorsement.

U.C.C. § 3-419 (1989) (making no reference to common law remedies).

127. *See, e.g.,* Hecker v. Ravenna Bank, 468 N.W.2d 88 (Neb. 1991) (holding that section 3-419, which listed ways under the Code an instrument could be converted, did not explicitly displace the common law action for conversion of an instrument, and thus, coexisted with it); Leaksealers, Inc. v. Conn. Nat'l Bank, 1995 WL 384611 (Conn. Super. Ct. June 20, 1995) (holding that section 3-419 did not preempt common law action because it did not state that the common law had been displaced). *But see* Berthot v. Sec. Pac. Bank, 823 P.2d 1326 (Ariz. Ct. App. 1991) (noting that while other courts had permitted common law actions to continue despite the enactment of U.C.C. Section 3-419, a common law negligence claim in this instance is inconsistent with provisions of Section 3-419, and thus, is displaced by necessary implication). *See also* Peerless Ins. Co. v. Tex. Commerce Bank, N.A., 791 F.2d 1177, 1177 (5th Cir. 1986) (holding that a common law action for money had and received due to the bank's payment on a forged endorsement is not displaced by the provisions of Article 3).

128. *See* U.C.C. § 3-420 (1995) ("The law applicable to conversion of personal property applies to instruments.").

filing and perfection by secured creditors and not on secured creditors' knowledge or lack of knowledge of competing claims.¹²⁹ This type of "race" priority system can lead to hardship when a creditor reaps the benefits of another party's dealings with the debtor. A typical example is when a supplier provides the debtor with services or materials that are necessary for the debtor to maintain or enhance the collateral on the expectation of being paid when the collateral is ultimately sold.¹³⁰ If this party does not follow the requisite steps in Article 9 to attach and perfect a security interest and take action to insure that this interest has priority over an existing secured creditor,¹³¹ it will lose in a dispute over the proceeds from the sale to an existing secured creditor.¹³²

Parties who have been faced with this situation have brought actions in equity for unjust enrichment on the theory that the creditor is unjustly enriched by the increase in the value of the collateral attributable to the party's performance on the contract with the debtor.¹³³ When faced with these situations, a large majority of courts found that these equitable actions had been displaced by the Code.¹³⁴ The courts reasoned that Article 9's established priority scheme is premised upon predictability in secured transactions and any attempt to impose equity in this system would unduly disrupt its structure.¹³⁵ Therefore, the courts found that, by necessary implication, the provisions of Article 9 displaced the common law or equitable actions that would hold a secured creditor with priority

129. See generally U.C.C. §§ 9-301 through 9-315 (1995); U.C.C. §§ 9-317 through 9-339 (1999) (establishing a hierarchical priority system for disputes between secured creditors and third parties claiming interest in collateral).

130. See, e.g., Ninth Dist. Prod. Cred. Ass'n, 821 P.2d 788, 797-98 (Colo. 1991) (holding that the provider of feed to a livestock company could assert an equitable claim against a secured creditor who encouraged the provider's dealings with the debtor that enhanced the value of the collateral); Producers Cotton Oil Co., 242 Cal. Rptr. 914, 914 (Cal. Ct. App. 1988) (permitting the harvester of a crop to offset the harvesting expenses from the proceeds of the sale of crop despite the secured creditor's statutory priority when the creditor had acknowledged and acquiesced in the expenditures for the development of the crop). But see Knox v. Phoenix Leasing, Inc., 35 Cal. Rptr. 2d 141, 144 (Cal. Ct. App. 1994) (explaining that the majority of courts do not permit an equitable restitution against a secured creditor in the absence of fraud).

131. If the party is supplying goods, it may qualify as a purchase-money security interest and can gain priority by meeting the requirements of U.C.C. Section 9-312 (3), or (4), or revised Section 9-324. If the party provides new value for the production of crops, the party can acquire priority by qualifying under U.C.C. Section 9-312(2) or under revised Article 9, where adopted, the Model Provisions for Production Money Priority. In the absence of priority under these sections, a party could obtain a subordination agreement from the existing secured creditor prior to providing the goods or services to the debtor. See U.C.C. § 9-316 (1995); U.C.C. § 9-339 (1999).

132. See U.C.C. § 9-201 (1995); U.C.C. § 9-201 (1999) (providing that, except where provided in the Code, a security agreement is effective against creditors of the debtor); U.C.C. § 9-301(1)(a) (1995); U.C.C. § 9-317(a)(1) (1999) (providing that a perfected secured creditor has priority over an unperfected secured creditor).

133. See Knox, 35 Cal. Rptr. 2d at 144-47 (discussing numerous cases in which other creditors made equitable claims for unjust enrichment against a secured creditor).

134. See *id.* at 144 (noting that the substantial majority of courts have rejected equitable claims for unjust enrichment against a secured creditor with statutory priority).

135. See *id.*; see also Daniel v. Stevens, 394 S.E.2d 79, 85-86 (W. Va. 1990) (noting that courts generally do not utilize equitable estoppel to disrupt the Code's filing system).

liable to a debtor's subordinate creditor.¹³⁶

Only in egregious situations involving fraud or misrepresentation on the part of the secured creditor that directly resulted in the other party's loss would these courts permit an equitable action against the secured creditor outside of the Code.¹³⁷ The courts took very seriously the specific provisions and goals of the Article 9 priority system and correctly decided that this system, which was adopted based primarily on timing of an interest and with specific requirements for attaining priority, supplanted an equity based system for resolving disputes over the debtor's assets in the absence of compelling circumstances.

Courts are just as likely to find incorrectly that the Code supplants common law and equity as they are to incorrectly apply supplemental law in contradiction to the Code in a commercial dispute. In the areas just discussed—tracing, accord and satisfaction, and conversion of an instrument—the minority of the courts that addressed each case prior to the revisions of the Code had incorrectly, at least in the opinion of the drafters, failed to apply common law or equity when they should have.

Another example of a potential over extension of the Code's preemption powers is *AKA Distributing Co. v. Whirlpool Corp.*¹³⁸ The contract, involving arrangement for the distribution of vacuum cleaners, was for a period of one year. The plaintiff alleged that the defendant fraudulently misrepresented that the distribution relationship would last for many years, while concealing an intent to develop a relationship with another party.¹³⁹ The plaintiff sued in tort to recover for the fraudulent misrepresentation. The court found that the applicability of Article 2 to the transaction precluded the tort action for the fraudulent misrepresentation.¹⁴⁰ The plaintiff was left solely with its contract remedy, which in this instance was barred by the statute of limitations.¹⁴¹ The difficulty with this court's refusal to permit the common law action is that actions for fraud are generally outside the scope of Article 2 and are the type which traditionally fall within the area of common law.¹⁴² Furthermore, Section 1-103 specifically recognizes fraud as a common law principle that supplants the Code "unless displaced by the particular provisions" of the

136. See *Knox*, 35 Cal. Rptr. 2d at 144 (explaining that occasional harsh results caused by the Code's displacement of equitable remedies is acceptable to the majority of courts to preserve the Code's predictable system of priority).

137. See *id.* at 147; *Peerless Packing Co. v. Malone & Hyde, Inc.*, 376 S.E.2d 161, 161-65 (W. Va. 1988) (noting that although the priority system of Article 9 generally prohibits the equitable remedy of restitution against a secured creditor, a secured creditor cannot escape liability for fraud).

138. 137 F.3d 1083 (8th Cir. 1998).

139. See *id.* at 1085.

140. See *id.* at 1085-87.

141. See *id.*

142. See *Knox*, 35 Cal. Rptr. 2d at 147 (stating that fraud is expressly beyond the scope of the Code, relying on U.C.C. section 1-103); John D. Wladis et al., *Uniform Commercial Code Survey: Sales*, 54 BUS. LAW. 1831, 1851 (1999) (suggesting that an action in tort is appropriate for fraudulent misrepresentation).

Code.¹⁴³ For each case in which a court permitted a common law or equitable action to go forward when it should not have, a case can be found where another court did the contrary. A few courts' misconstruction of Section 1-103 is no justification for a broader, even vaguer, rule.

A redrafting of even the comments to Section 1-103, which suggests that the standard for finding displacement should be broadened to permit displacement by the policies of the Code, is likely to result in more litigation and less certainty. The same courts that have been criticized for misapplying Section 1-103 when it established a reasonably specific rule, allowing displacement only when done so by provisions of the Code, will now be invited to determine if the policies or purposes of the Code supplant other law. Trying to determine displacement not by text but by policy will result in less uniformity among the courts and less predictability than the current rule. The courts have done as well as can be expected when hundreds of courts attempt to interpret the same statute. Section 1-103 has worked reasonably well for the past four decades with the majority of the courts "getting it right." No redrafting will ever result in perfect application by all courts and will only guarantee that some courts will continue to "get it wrong." Undoubtedly, we will be having this same discussion the next time Article 1 is revised.

VI. CONCLUSION

Amending section 1-103's language to permit displacement where not explicitly required will result in less uniformity and predictability, not more. If the provision is redrafted to permit displacement by implication, courts will be required to determine where this displacement is implied. Displacement will depend on a particular court's view of the policies of the Code implicated in the transaction and to the extent those policies should be given priority over equally important policies found in general law and equity. The likelihood that courts as diverse and widespread as the states will have a uniform interpretation of when a Code provision (or provisions or its policies by implication) should displace general legal and equitable principles is very small indeed. This approach will increase litigation—not minimize it. Moreover, it will provide less certainty as to the applicable law governing a transaction and create less uniformity among the states.

The Code policies of uniformity, certainty, and modernization may be important in an economic sense, but they do not necessarily reflect other important social and legal policies, such as fairness, justice, and prevention of fraud. The limited policies reflected in the Code, while important, should not be permitted to unquestioningly reign supreme when other equally important norms are implicated. In the rare cases where other legal and equitable principles are implicated and not specifically displaced, courts should be free to weigh the Code's provisions and policies

143. U.C.C. § 1-103 (1995).

against other law and equity to reach a just result in the particular circumstances of the parties' dispute.

The Uniform Commercial Code is not comprehensive. It leaves untouched numerous major areas of commercial law. It needs supplemental law and equity to complete even the areas of commercial law it covers. Because the Code is not comprehensive and so heavily relies on common law and equity, it should not be granted the presumption of preemption to which a truly comprehensive Code might be entitled.

There is no need to restrict the courts' ability to resolve commercial disputes in light of the Code's provisions, policies, and purposes as supplemented by the more general principles of law and equity. The Code, common law, and equity can peacefully coexist, and should be permitted to continue to do so.

