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Contracts Jurisprudence and Article Nine of the Uniform Commercial Code: The Allowable Scope of Future Advance and All Obligations Clauses in Commercial Security Agreements

By Bruce A. Campbell*

Many commercial security agreements under Article Nine of the Uniform Commercial Code¹ provide that payment or performance of all the debtor's obligations to the creditor is secured.² Such agreements purport to secure not only the debtor's primary obligation³ to repay the creditor's first advance, but in addition all of the debtor's secondary obligations⁴ to the creditor, including, among others, the obligation to repay


1. This Article is confined principally to commercial security agreements under Article Nine of the Uniform Commercial Code. U.C.C. §§ 9-101 to -507 (1978) [hereinafter cited to the 1978 version of the U.C.C. unless otherwise noted]. This Article does not discuss, except incidentally, security agreements in which the debtor is a consumer. The law of real estate mortgages is sometimes discussed as the source of principles applicable to Article Nine, but the principal focus is on security interests in personal property.


3. A primary obligation is the obligation or obligations in connection with which the security agreement is originally executed. The primary obligation is usually the debtor's obligation to repay the first loan or extension of credit, and is usually specifically identified in the security agreement.

4. A secondary obligation is any secured obligation which is not a primary obligation. A secondary obligation arises separately from the execution of the original security agreement and the incurrence of the primary obligation. A secondary obligation may be an antecedent debt or may arise after the execution of the original security agreement.
any future advances which the creditor may make.

The commercial utility and validity of future advance security arrangements have long been recognized in real and personal property law. Consolidating almost a century of development, the New York Court of Appeals stated in 1881:

There is no question as to the validity of mortgages to secure future advances or liabilities. They have become a recognized form of security. Their frequent use has grown out of the necessities of trade, and their convenience in the transactions of business. They enable parties to provide for continuous dealings, the nature or extent of which may not be known or anticipated at the time, and they avoid the expense and inconvenience of executing a new security, on each transaction. It is well known that such mortgages are constantly taken by banks, and bankers, as security for final balances, and banking facilities are extended, and daily credits given, in reliance upon them.

Although today's financial institutions are much different from those of the nineteenth century, the commercial utility of future advance security arrangements remains constant. From the creditor's perspective, a future advance arrangement ordinarily allows additional loans or credit to be extended only at the creditor's option, and provides that any advance made will be secured under the original agreement. An all obligations clause is intended to go even further to place the whole continuing debtor-creditor relationship on a secured basis. From the standpoint of the debtor, a comprehensive security arrangement may be the sine qua non of receiving loans or credit, and may liberalize interest or repayment terms. The future advance component allows the debtor to receive loans or credit only as needed, thus delaying the incurrence of interest.

Difficult problems can arise when a creditor claims that a secondary obligation which differs in some respect from the specific primary obligation is secured under a broad future advance or all obligations clause in the original security agreement. For example, a bank enters into an

5. The Code defines neither "advance" nor "future advance." For the purposes of this Article, an "advance" is any extension of value by the creditor to or primarily for the benefit of the debtor, and a "future advance" is any such extension of value which is made after and which is functionally separate from the execution of the original security agreement. A future advance will usually be a secondary obligation. If the owner of the collateral is not the principal debtor, but functionally a surety to the extent of the collateral, an "advance" is an extension of value by the creditor to or primarily for the benefit of the principal debtor. These definitions should apply to the terms "advance" and "future advance" when used in Article Nine. See, e.g., U.C.C. §§ 9-204(3), -301(4), -307(3), -314(3). Most commentators and cases, and even the Code itself, do not distinguish adequately between future advance and all obligations clauses. The all obligations clause may cover all forms of secondary obligations, including both antecedent debts and the obligation to repay future advances. This Article maintains the distinction by referring to both future advance and all obligations clauses.

agreement with a car dealership by which the bank regularly extends credit against new car invoices and certificates of manufacture. The original security agreement provides that a security interest in the dealership’s inventory will secure all obligations of the dealer to the bank. When the dealership encounters financial difficulties, the bank allows the dealer to make substantial overdrafts in his checking account, and then claims that the dealer’s secondary obligation—to repay the overdrafts—is secured under the original security agreement’s all obligations clause. Such a claim raises four fundamental questions: 1) Intention: Did the parties intend that the original agreement would secure the secondary obligation? 2) Validity: If so, is the securing of the secondary obligation legally permissible under Article Nine? 3) Good Faith: Has the secured creditor acted in good faith? 4) Priority: If the obligation is within the allowable scope of the security agreement and the creditor has acted in good faith, what is the extent of the secured creditor’s priority for the interest securing the obligation vis-a-vis competing claimants to the debtor’s collateral?

Unfortunately, most cases addressing the problem of the allowable scope of a future advance or all obligations clause are an analytic wasteland. Opinions fail to distinguish issues of contractual interpretation (intent) from those of validity and policing creditor behavior, fail to reason persuasively, and are divided in rationale and results. In the absence of special circumstances, such as language in the security agreement precisely identifying the category of secondary obligation in question as secured, many courts, influenced by the late Professor Grant Gilmore, apply the following rule of construction to determine the allowable scope of the agreement: the only secondary obligations intended by the parties to be secured are those of the same class as the primary obligation and so related to it that the consent of the debtor to its inclusion as a secured obligation may be inferred. Some courts applying this “same class-relatedness” rule of construction find that almost any difference between the primary and secondary obligations places the secondary obligation in a different class, with the result that the parties are held not to have

7. This example is suggested by Community Bank v. Jones, 278 Or. 647, 566 P.2d 470 (1977).

8. The “allowable scope” of a future advance or all obligations clause refers to both intention and validity. The intended scope of the security agreement is technically a question of fact. The validity of what the parties originally intended is a question of law.

9. See R. HILLMAN, supra note 2, §§ 35.2, .5.

intended to secure the secondary obligation.11 Other courts find the "same class-relatedness" test to be met despite differences between the primary and secondary obligations.12

At the other end of the spectrum, many courts apply no rule of construction but simply hold, often without much analysis, that the parties intended what the language in their written agreement would generally be taken to express.13 If a written security agreement provided that all obligations of the debtor to the creditor would be secured, such a court would ordinarily hold that a secondary obligation was intended to be secured without inquiry as to whether the subsequent obligation was of the same class as or related to the original. Along the same lines, when the language of a future advance or all obligations clause appears unambiguous on its face, some courts will apply the plain meaning rule,14 excluding evidence of the subjective intent of either party which conflicts with the plain meaning of the clause.15 Although the exclusion of evidence of subjective intent does not necessarily preclude the application of the "same class-relatedness" rule of construction, a restrictive ruling on the parol evidence question usually presages the enforcement of the plain meaning of the all obligations clause. Finally, the legislature of the State of Tennessee, apparently exasperated with a line of cases by the local bankruptcy courts applying the "same class-relatedness" rule to restrict priority claims of secured creditors,16 passed a remarkable statute providing that any written, signed security instrument containing a future advance or all obligations clause "shall be deemed to evidence the true intentions of the parties, and shall be enforced as written . . . regardless of the class of the other indebtedness, be it unsecured, commercial, credit

13. E.g., In re Public Leasing Corp., 488 F.2d 1369, 1377-78 (10th Cir. 1973); In re Iredale’s Ltd., 476 F.2d 938, 939 (9th Cir. 1973); In re Riss Tanning Corp., 468 F.2d 1211, 1213 (2d Cir. 1972).
16. E.g., In re Blair, 26 Bankr. 228, 229-30 (Bankr. W.D. Tenn. 1982) (secondary business obligations not of the same class and unrelated to primary personal obligations); In re Johnson, 9 Bankr. 713, 716-17 (Bankr. M.D. Tenn. 1981) (lender made no showing that second loan was in same class as first).
What the cases lack and what the commentators have failed to provide is an adequate theoretical framework for resolving the interpretive and policing issues raised by broad future advance and all obligations clauses under Article Nine. Such a framework must have three elements. The first is a working theory of the obligational side of secured transactions, a theory, that is, of the general validity, under Article Nine, of agreements securing various types of obligations. The second element is a working theory of contract interpretation adapted to the specific context of Article Nine. The final element is a set of standards derived from Code and non-Code sources for policing secured creditors’ overreaching or other abuses.

This Article begins to construct such a framework. Part I discusses the Article Nine revolution. Replacing a functionally restrictive pre Code system, Article Nine was intended to encourage the extension of credit to small businesses on a secured basis in the belief that additional credit would spur economic growth and that the overall benefits of the new system would exceed the costs. Part II discusses Article Nine’s partial conceptualization of a security agreement as a contract, and its initial validation of future advance and all obligations clauses. Part III further discusses the security agreement as a modern contract. In the absence of special circumstances, most commercial security agreements are both relational and adhesive contracts and should be approached with doctrinal tools suitable for working with these modern phenomena. In general, Part III proposes that the intended scope of such a security agreement can be found in the objectively reasonable expectations of the parties as to the scope of their ongoing debtor-creditor relationship. Part IV discusses mechanisms for identifying and redressing secured creditor abuses of future advance and all obligations clauses. The section proposes that secured creditor behavior be regulated principally through the requirement that creditors perform and enforce their security agreements in good faith, defined broadly to include not merely faithfulness to common purposes and justifiable expectations, but also compliance with community standards of decency, fairness, and justice. In addition, a specific clause within a detailed list of secured obligations in the original printed-form security agreement may be denied enforcement because it is unconscionable. Part V argues that the “same class-relatedness” rule is inappropriate under Article Nine for several reasons: it is indeterminate in content; it is, as a rule of strict construction, inconsistent with the pur-

poses and language of the Uniform Commercial Code; it leads to unfortunate counter-measures; and it is not warranted by pre-Code law. Part VI applies the general interpretive and policing standards developed in Parts II-IV to some test cases. Part VII is a summary conclusion.

This Article makes two assumptions. First, the Article assumes that Article Nine grants the secured creditor substantial priority for interests securing secondary obligations over rival interests in the same collateral. Second, the Article assumes that federal bankruptcy law for the most part respects the asset distribution scheme of Article Nine. Discussion of the priority under Article Nine of interests securing secondary obligations and of the survivability of such priority interests in bankruptcy are left for another day.

The Article Nine Revolution: A New Systemic Norm

The New Systemic Norm: Encouraging Secured Credit by Favoring Secured Creditors

An understanding of Article Nine begins with a knowledge of the contours of pre-Code personal property security law. The early modern common law was hostile to nonpossessor chattel security, which it tended to regard as a fraudulent device to lure the debtor's third-party creditors into improvident extensions of credit. Beginning in the early nineteenth century, the law gradually responded to economic pressures created by the accelerating industrial revolution, as legislatures and courts moved fitfully to accommodate an ever wider variety of nonpossessor commercial security devices. The process of legal change was not yet complete during the immediate post-World War II period. The law of chattel security was a numbingly complex mixture of common law and statutory provisions defining and limiting chattel mortgages, conditional sales, trust receipts, factor's liens, assignments of accounts receivable, and other devices.

18. U.C.C. §§ 9-301 to -308.
21. This paragraph is derived from 1 G. Gilmore, supra note 2, §§ 1.1-9.2.
The pre-Code system of secured credit had a certain operational balance, with both negative and positive aspects. On the one hand, the availability of secured credit, and perhaps of credit generally, to small businesses was effectively restricted. Because of the costs, complexities, and risks involved, commercial finance companies and a few large banks were the only large-scale lenders which would extend credit on the basis of collateralized inventory and accounts receivable. Many banks simply did not engage in asset-based financing at all. To acquire valid, enforceable liens against all of the debtor's present and future assets was technically possible in many and perhaps most jurisdictions, but it was so difficult to do that "only the most expert lawyers [could] hope to avoid the many hidden pitfalls." As a result, few such comprehensive liens were created.

On the other hand, there were some apparent advantages to a system which effectively restricted personal property security. Where small business assets were not effectively encumbered by security interests, they were available to satisfy the claims of the debtor's unsecured creditors, chiefly trade creditors and employees. While Article Nine was under consideration in California in the early 1960's, representatives of unsecured creditors' trade associations complained that the new Code would give too much power to the first lender at the expense of furnishers of labor and materials on unsecured credit and that it would be "detrimental to the wholesalers, manufacturers, distributors, and others selling on an unsecured basis." Since trade creditors and employees are generally less able to bear losses than are large-scale financers, the de facto preservation of a "cushion of free assets" appeared to result in a more equitable division of a bankrupt debtor's assets than if all assets were allocated to the primary secured creditor.

It was in this context that the movement for a Uniform Commercial Code combined state common and statutory law. The details varied from state to state, and the balance struck likewise varied within a fairly broad range.

22. The pre-Code system of secured credit combined state common and statutory law. The details varied from state to state, and the balance struck likewise varied within a fairly broad range.
25. Kripke, Reflections, supra note 24, at 578.
26. 1 G. Gilmore, supra note 2, § 11.7, at 360; see also Gilmore, supra note 24, at 11.
27. Hearing on Uniform Commercial Code (Senate Bill 1093) Before California Senate Comm. on Judiciary 12-17 (1961) (testimony of Martin Gendel, representing five credit associations).
28. Id. at 18 (testimony of James M. Conners, representing five credit associations).
29. The phrase is from U.C.C. § 9-204 comment 2.
Code came to fruition in the late 1950's. A system of personal property security which appeared to restrict the availability of secured credit to business, and thus to impede economic growth, did not commend itself to a country recently emerged from the Depression and embarking upon a period of prolonged economic expansion.\textsuperscript{30} The operational balance inherited from the past would no longer do. What was needed was a system which would give free play to the expansive forces of American capitalism.

Article Nine became not another modest step along the evolutionary path of traditional personal property security law, but a qualitative alteration of the path itself—a new way,\textsuperscript{31} built of both new and salvaged materials, designed to encourage the extension of credit on a secured basis, with the immediate goal of expanding the availability of commercial secured credit, and the ultimate goal of promoting economic growth.\textsuperscript{32} The new Code would liberalize the law of secured credit from the restrictions of the past, democratizing it so that virtually all financers and small businesses could easily, cheaply, and safely engage in secured transactions. The new Code would also destroy the old operational balance between secured and unsecured creditors.

The innovations made by the Code are not minor. First, and above all, Article Nine is a paean to freedom of contract, private property, and free enterprise. Abolishing old legal restrictions based on the type of col-

\textsuperscript{30} Kripke, \textit{Reflections}, supra note 24, at 603.

\textsuperscript{31} Some do not agree that Article Nine was revolutionary. "[A]rticle 9 ... is not a revolution. It marks but the culminating step of an evolution in which techniques developed in the more modern and sophisticated forms of financing are applied to their older and more backward cousins." Leary, \textit{Secured Transactions—Revolution or Evolution}, 22 U. MIAMI L. REV. 54, 66 (1967). "[T]he UCC merely codifies and simplifies prior commercial practice. There is nothing that the UCC permits that could not be done without it." Kripke, \textit{Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact}, 133 U. PA. L. REV. 929, 975 (1985). These authors focus on legal technique—process—rather than Article Nine's radical substantive shift in priorities favoring the primary perfected secured creditor and against secondary secured and general creditors. Professor Gilmore vacillated. In 1951, he wrote of Article Nine, "No other Article of the Code proposes so radical a departure from prior law." Gilmore, \textit{The Secured Transactions Article of the Commercial Code}, 16 LAW & CONTEMP. PROBS. 27, 27 (1951); see also id. at 28 ("Article 9 ... deliberately cuts loose from all anchorage in the past."). In 1965, he stated in his two-volume treatise: "Article 9 is not so much a new start or a fresh approach as it is a reflection of work long since accomplished." I G. GILMORE, supra note 2, § 9.2, at 290. In 1981, in one of his last articles, Professor Gilmore implicitly conceded that the issue was not process but substance—the priority given to the primary secured party—and that Article Nine had made revolutionary changes in favor of the secured creditor, changes which he thought were ill-advised. Gilmore, \textit{The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman}, 15 GA. L. REV. 605, 620-28 (1981) [hereinafter cited as Gilmore, \textit{Good Faith Purchase}].

\textsuperscript{32} Kripke, \textit{supra} note 31, at 975; Leary, \textit{supra} note 31, at 55, 57.
lateral and the form of the security instrument, the Code allows the debtor and creditor, in a single agreement, to secure all the debtor's legally enforceable obligations to the creditor with virtually all of the debtor's present and future assets. Second, the Code substantially reduces the primary secured creditor's economic and legal risks by creating a juggernaut of priority in her favor and by leaving few legal barriers which could be set up by those who would block the machine's progress. Third, the Code substantially reduces most secured creditors' monitoring costs, since the focus of insecurity is shifted from the debtor's overall financial position to the status of the particular collateral. Finally, the Code reduces transaction costs relative to the total dollar value of the credit extended.

Although the drafters believed that the new Code would successfully encourage the extension of credit on a secured basis, with the salutary result of promoting economic growth, they never clearly stated the economic assumptions upon which their beliefs rested. The drafters apparently regarded the supply side of the debtor-creditor relationship as crucial. What mattered was, first, the willingness of highly risk-averse financial institutions to lend substantial sums to small businesses and, second, their willingness to make such loans at reasonable rates of interest. Reducing both the legal risks and the overall transaction costs of the highly technical pre-Code system would plainly help, but, standing alone, would have only a minor impact. The key additional elements were the expansion of the allowable scope of the security interest coupled with the allocation of overwhelming priority to the primary secured creditor. By substantially reducing financial institutions' risks through priority secured credit, the Code would attract more capital into the small business sector than ever before.

The new system of secured credit would have both positive and negative effects upon trade creditors—those who sell goods and services to

33. U.C.C. §§ 9-102(1), (2), -102 comment 1, -101 comment.
34. Id. § 9-201.
35. A "primary secured creditor" in this Article is one who has satisfied all the conditions for achieving the maximum possible priority for interests securing both primary and secondary obligations as against rival claimants to the collateral.
36. U.C.C. §§ 9-301 to -318.
37. Id. §§ 9-201, -303 to -305, -401 to -408.
39. U.C.C. § 9-101 comment; Kripke, supra note 31, at 975 & n.166.
commercial debtors on relatively short-term and traditionally unsecured credit. Most positively, the increased availability of secured credit would help trade creditors as a class by increasing the market for their goods and services. But the negative effects were not inconsequential. Some traditionally unsecured trade creditors would begin to require security, resulting in a net increase in transaction costs with little or no increase in the amount of credit. In a market where a debtor's "cushion of free assets" was reduced or eliminated, the remaining unsecured trade creditors' risk of nonpayment would grow substantially, while competitive pressures would limit the extent to which they could raise prices to compensate for the increased risk.

However they thought these matters through, the drafters of Article Nine plainly acted on the assumption—indeed, the faith—that the overall economic benefits of the new system would exceed its costs. This faith, as all others in the twentieth century, has been both questioned and defended, most recently in the court of neoclassical economics.

Whatever the verdict of modern economists as to the efficiency of Article Nine, the systemic assumptions of the drafters and adopting legislators constitute a normative reference for judicial interpretation of the Code. Recognizing that the Code is squarely within the Realist tradition of law as social engineering, courts should interpret and apply the Code to promote economic growth through the specific means chosen by the legislatures: encouraging the extension of secured credit by favoring primary secured creditors over their rivals, and generally reducing primary secured creditors' legal risks and overall transaction costs.

Justifying the Revolution: Efficiency, Distributive Justice, and the Code Comments

Systemic economic efficiency is one thing; distributive justice among the creditors of a common debtor is another. The drafters of Article Nine and the legislators who adopted it assumed not only that the Code is economically efficient, but that the burdens it imposes upon sub-

42. E.g., Jackson & Kroman, supra note 38; Kripke, supra note 31, at 934-55; Levmore, supra note 38; White, Efficiency Justifications for Personal Property Security, 37 VAND. L. REV. 473 (1984).
44. See generally Kroman, Contract Law and Distributive Justice, 89 YALE L.J. 472 (1980).
ordinate creditors when the common debtor fails are justified. The latter conclusion is at least open to question.45 When a debtor goes bankrupt, the secured creditors, who tend to be relatively large institutions, often take most or all of the assets, leaving little or nothing to the unsecured creditors, who tend to be small trade creditors, employees, or even tort claimants.46 It may be that all of us benefit from the system, but it often doesn’t look as though that’s so in particular cases.47

Not surprisingly, there is a continuing tension under the new regime between the presumed benefits to the economy at large of promoting secured credit and the obvious distributional inequality resulting from the allocation in particular cases of substantially all the assets to the rich and strong and all the losses to the poor and weak. Reacting adversely to the Code’s apparent distributional unfairness in individual cases, courts may undertake a sort of counter-revolutionary guerilla action at the margins of the Code by holding that the primary secured creditor and the debtor did not intend to secure a particular secondary obligation.48

The corrosive effects of the tension between systemic requirements and individualized justice are compounded by the failure of the drafters of Article Nine to explain clearly in their Comments the policy basis for discarding the operationally restrictive pre-Code system and adopting Article Nine in its place. The most detailed explanation of the new Code’s comprehensive validation of the floating lien—the creditor’s security interest in the debtor’s after-acquired property, and the cornerstone of the new system—is contained in Comment 2 to section 9-204, which states in part:

The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets


47. Although the law of secured transactions would seem to offer a mother lode for those who would mine the legal system for ideology and facially neutral rules applied in the service of an oppressive class structure, there seems to be no critical legal study of the area. For critical legal studies of contract law suggesting the possibilities of such approaches, see, e.g., Dalton, An Essay in the Destruction of Contract Doctrine, 94 YALE L.J. 997 (1985); Feinberg, Critical Approaches to Contract Law, 30 UCLA L. REV. 829 (1983); Kennedy, Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power, 41 MD. L. REV. 563 (1982); Unger, The Critical Legal Studies Movement, 96 HARV. L. REV. 561 (1983).

present and future, and that for the protection not only of the bor-
rower but of his other creditors a cushion of free assets should be pre-
served. That inarticulate premise has much to recommend it. This
Article decisively rejects it not on the ground that it was wrong in
policy but on the ground that it was not effective. In pre-Code law
there was a multiplication of security devices designed to avoid the
policy: field warehousing, trust receipts, factor's lien acts and so on.
The cushion of free assets was not preserved. In almost every state it
was possible before the Code for the borrower to give a lien on every-
thing he held or would have. There have no doubt been sufficient eco-
nomic reasons for the change. This Article, in expressly validating the
floating charge, merely recognizes an existing state of things.49

This historical analysis of pre-Code law certainly contains a core of
truth. If the policy of the classical common law was to preserve a sub-
stantial cushion of the debtor's assets free from the claims of secured
creditors, the policy had been severely eroded by various statutory de-
vices. Although the cushion of free assets was not entirely eliminated, it
was greatly reduced in those industries whose assets and form of opera-
tions were suited to financing under one of the special statutory forms of
security.

Still, the Comment is seriously flawed in ways which have contrib-
uted to interpretive difficulties. The Comment understates the extent to
which the cushion of free assets was in fact preserved in pre-Code law,
and thus implicitly understates the extent to which Article Nine was a
revolution in favor of secured creditors against the whole class of general
creditors. Before the adoption of the Code, neither state legislatures nor
the courts had deliberately rejected the ancient policy of preserving a
cushion of free assets, nor had they adopted such comprehensive freedom
of debtor-creditor contract in all commercial financing as that embodied
in Article Nine. The use of the pre-Code security devices was so expen-
sive and risky50 that much potential security was not taken and many
assets remained free.51 It is thus highly misleading to say, as does Com-
ment 2, that in pre-Code law the "cushion of free assets was not pre-
served," and that Article Nine, "in expressly validating the floating
charge, merely recognizes an existing state of things."52 In fact, Article
Nine was, and was intended to be, revolutionary.

More serious than the drafters' failure to state clearly what they

49. U.C.C. § 9-204 comment 2.
50. Id. § 9-101 comment. The clear implications of the historical account given in the
comment to section 9-101 cannot be reconciled with the account given in section 9-204 com-
ments 2 and 5. For the reasons stated above, the comment to section 9-101 is, in my opinion,
the more accurate.
51. See supra text accompanying notes 23-26.
52. U.C.C. § 9-204 comment 2.
were doing was their failure to state clearly why they were doing it. Strangely, in Comment 2 the drafters approved the ancient policy of restricting the reach of secured creditors to protect debtors and general creditors. This of course raises the interesting question of why, if the ancien régime was correct in policy, the Code did not restore and strengthen the old restrictions on secured creditors, instead of overthrowing them completely. And why, if the old restrictions were correct in policy, did the drafters not believe that the new Code should be read narrowly by the courts against secured creditors and in favor of general creditors?

Having explicitly praised the policy of the ancien régime which Article Nine proposed at last to bury, the drafters offered only shallow justifications for their revolution. Simplifying the formalities of creation and perfection of a security interest did not justify Article Nine's systemic shift in priorities. It is vacuous to argue, as the drafters did in Comment 2, that Article Nine is correct in policy because the old policy, also correct, was not maintained for unspecified economic reasons. The argument implies that law is determined by impersonal economic forces, which we are powerless to control. In fact, the drafters believed they had substantial control, and that there were good and sufficient reasons for adopting Article Nine. But these reasons were not clearly stated in the Comments.

Just as the drafters failed to justify their full validation of after-acquired property clauses, so they also failed to explain adequately the Code's validation of future advance and all obligations clauses. The Comments simply do not discuss in detail the securing of a performance obligation other than an obligation to pay money. The principal discussion of future advance clauses is in Comment 5 to section 9-204, which states in part:

At common law and under chattel mortgage statutes there seems to have been vaguely articulated prejudice against future advance agreements comparable to the prejudice against after-acquired property interests. Although only a few jurisdictions went to the length of invalidating interests claimed by virtue of future advances, judicial limitations severely restricted the usefulness of such arrangements. . . . In line with the policy of this Article toward after-acquired property, [section 9-204(3)] validates the future advance interest, provided only that the obligation be covered by the security agreement.

Here, again, the historical account given by the drafters is mislead-

53. Id.
54. Id. comment 5.
ing at best. Although there was a concern evident in pre-Code law, as there is under the Code itself, that future advance clauses might be abused to the detriment of both borrowers and third-party creditors, contrary to the impression given by the drafters, pre-Code law generally favored future advance clauses. Professor Gilmore noted the discrepancy in pre-Code law between the favorable treatment given future advance clauses and the hostility directed toward after-acquired property clauses. An influential property law treatise stated that parol evidence could be used to show that future advances were to be secured under a mortgage, and observed that "[t]he courts are liberal in construing the parties' agreement as including future advances." It is difficult to find in this any "prejudice" against future advance clauses.

The drafters' discussion of future advance clauses is not simply misleading history; it also fails completely to state affirmatively the policy basis for the Code's validating of and allocating priority to security interests arising from future advances. Indeed, by its cross-reference to the earlier discussion of after-acquired property clauses, the Comment implies that whatever hostility to future advance clauses did exist in pre-Code law had a sound policy basis, and that the new Code is without adequate justification.

It is probable that the drafters deliberately minimized the extent of the Article Nine revolution and only hinted at the ultimate policy bases for the Code as tactical devices to assist passage of the Code through instinctively conservative state legislatures responding to equally conservative commercial interests. However, as in revolutions since the beginning of time, the means of achieving success compromised the ideals of the revolution and affected the operation of the new regime. In Article Nine, the failure of the drafters to state clearly what they were doing and why they were doing it has left the courts without guidance in answering difficult questions involving future advance and all obligations clauses. This Article shall now try to suggest the missing guidance.


56. 2 G. Gilmore, supra note 2, § 35.3, at 921-22.

57. 4 AMERICAN LAW OF PROPERTY § 16.72, at 136 n.8 (A. Casner ed. 1952). The same liberality was noted in G. Osborne, HANDBOOK OF THE LAW OF MORTGAGES 184 n.7 (1951).
The Security Agreement as Contract: The Validity of Future Advance and All Obligations Clauses

The historical roots of modern personal property security law are found in property law. Although liens and titles, with various procedural appurtenances, run together throughout the long history of security law, the pledgor and mortgagor have always given and the pledgee and mortgagee have always acquired (or retained) legal entitlement in the nature of a property interest. The allowable scope of various security devices was in significant part a function of the law’s regulation of relations among rival claimants to the common debtor's assets—a function, that is, of the property law’s customary office of regulating relations among persons with respect to specific goods and intangible legal entitlements. Under the old regime, a security interest in favor of a creditor often varied in “validity” depending on form, timing, recording, and other circumstances, as a security instrument might be valid against the debtor and some classes of rival claimants, but invalid as to others.

The Security Agreement as Contract

Article Nine is an ingenious compound of traditional property and modern contract law principles. The Code’s priority system is struc-
tured primarily on traditional property law bases. The creation and initial validity of a security interest, however, are largely separated from property principles and are redefined in terms of contract law. Thus, under the Code, a security interest is created by an "agreement" between the debtor and the creditor,\(^{63}\) which is the "bargain of the parties in fact" as found in all the relevant circumstances,\(^{64}\) and which is given legal effect as a "contract."\(^{65}\)

Basing the secured creditor-debtor relationship in contract was in part a legal vehicle for allowing a substantially increased degree of freedom to debtors and creditors in structuring their ongoing commercial relations on a secured basis. At the same time, it was in part an act of creative destruction, freeing the law of secured transactions from conceptual and practical impediments of the past. For example, the old property-based system had conceptual difficulties validating a present security interest in after-acquired property since you generally cannot convey a title which you do not yet have.\(^{66}\) However, the modern conceptions of contract, whether as an enforceable present commitment relating to the future\(^{67}\) or as an exchange projected into the future,\(^{68}\) readily accommodate the idea that a bargain concluded today can include a commitment which will bind you as an encumbrance on property you acquire in the future. Moreover, shifting security law from property to contract removed many of the formal rocks and shoals of conveyancing which in the past had so clogged the streams of asset-based financing as to make passage hazardous for all.


\(63\) U.C.C. §§ 9-201, -203(1)(a).

\(64\) Id. § 1-201(3).

\(65\) Id. § 1-201(11).

\(66\) 1. G. GILMORE, supra note 2, §§ 2.3-.4, 7.10.


The U.C.C., emphasizing commercial context, reasonableness, and flexibility as touchstones, effectively embraces many aspects of the "relational" contract. U.C.C. §§ 1-201(3), 1-205, 2-208, 2-209, 1-201 comment 3, 1-205 comments 1-10. The "relational" nature of an ongoing secured debtor-creditor relationship is discussed infra text accompanying notes 105-07.
Section 9-201: General Validation

Section 9-201 is the provision in Article Nine which generally validates security agreements. It evolved from an uncertain statement in earlier drafts to become a strong substantive provision in later versions. Section 9-201 of the 1952 Code provided:

Except as otherwise provided by this Act or by other rule of law or regulation, a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this Article validates any charge or practice illegal under any rule of law or regulation governing usury, small loans, retail installment sales, or the like . . . .

In this form Section 9-201 was plainly inadequate. It clearly validated only those terms of an Article Nine security agreement which were never invalid under pre-Code law. The whole weight of change in the scope of validation was to be carried by other provisions of Article Nine. To the extent that the other provisions could not carry the burden, the pre-Code rules would remain in place, blocking progress and defeating the purpose of Article Nine. The 1953 version of the Code added to the Comment in section 9-201 the statement that the exception was "not intended to preserve as against this Code any rule of law in direct conflict with a substantive rule stated in the Code." But amending the Comment was not enough. In 1956, the New York Law Revision Commission recommended that the text be changed, noting that "the phrase 'or by other rule of law or regulation' in the first sentence of [section 9-201] raises a question as to the continued operation under Article 9 of common-law rules of consideration, bona fide purchaser, constructive fraud on creditors, and the like." Implementing the suggestion of the New York Law Revision Commission, the drafters of the Code deleted the qualifying phrase and otherwise narrowed the exceptions to section 9-201's validation of security agreements. Section 9-201, which has not been changed since 1957, now reads in part:

Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this Article validates any charge or practice illegal under any statute or regulation thereun-

der governing usury, small loans, retail installment sales, or the like...

Section 9-201, as modified in 1957, became the structural heart of Article Nine. Leaving aside non-Code statutes and derivative rules, section 9-201, without the aid of any other substantive provision of the Code, validates any commercial security agreement between the parties and against third parties. Apart from non-Code common-law policing provisions incorporated generally through section 1-103, the only Code exceptions to validity applicable to all security agreements are contained in section 9-203, which states that for a security interest to attach to collateral and be enforceable, there must be an agreement between the parties meeting certain formalities, the creditor must have given value, and the debtor must have rights in the collateral. The requirement that the security agreement meet certain formalities is in the nature of a statute of frauds. The requirement that the creditor give value, taken with the definition of "agreement," is in the nature of a consideration requirement. The debtor need not be obligated to repay the value given, nor must any particular obligation to repay which does arise be among the obligations secured. Finally, the requirement that the debtor have rights in the collateral is a remnant of traditional property law—whatever your contractual commitments, you cannot actually "convey" an entitlement until you "have" it.

Briefly stated, under section 9-201 alone the parties to a commercial security agreement can effectively secure the payment or performance of any past, present, or future legally enforceable obligation of the debtor to the creditor, and can do so with any of the debtor's existing or subsequently acquired personal property. Section 9-201 thus generally validates future advance and all obligations clauses against both debtors and third parties. Those agreements not meeting the formalities required by section 9-203 and those agreements running afoul of the common-law policing doctrines are the only commercially important exceptions.

Section 9-204: A Substantively Irrelevant Exposition

Section 9-204 specifically addresses after-acquired property and future advance clauses in security agreements. The section has had a checkered career, which it would be more tedious than instructive to re-

72. U.C.C. § 9-201.
73. Id. § 1-103 (principles of law and equity supplement Code provisions).
74. Id. § 9-203(1).
75. Id. § 9-203 comment 5.
76. Id. §§ 1-201(44) (defining "value"), 9-203(1)(b).
77. Id. § 1-201(3) (defining "agreement" as "the bargain of the parties in fact").
count in detail.78 Before the revision of section 9-201 in 1957,79 when the only explicit validation provisions were in sections other than section 9-201, section 9-204 broadly validated future advance and all obligations clauses.80 The Comments to section 9-204, to this extent unchanged from the 1952 version, still indicate that the section "serves to validate the . . . 'cross-security' clause,"81 and "validates the future advance interest."82 However, once section 9-201 became a substantive provision validating security agreements,83 section 9-204 ceased to validate anything.

As applied to commercial financing arrangements, section 9-204 is merely a partial, imperfect, declaratory exposition of section 9-201's general substantive validation. Section 9-204 now provides, in part:

(3) . . . [A] security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement . . . .

(5) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment.84

Section 9-204's exposition of section 9-201 is imperfect because it fails to state explicitly that the parties may validly secure with existing collateral the debtor's performance obligations, that is, the debtor's obligations other than to repay money for value extended by the creditor.85

In the end, the shortcomings of section 9-204 should not, and usually do not, matter much. If section 9-201 is correctly interpreted and applied in commercial cases, section 9-204 is simply irrelevant. Furthermore, most courts at least implicitly recognize that the Code allows the parties to a security agreement to secure payment or performance of all the debtor's legally enforceable obligations to the creditor.

Although the Code allows the parties to secure all the debtor's obligations, questions often arise in particular cases as to whether the parties originally intended to go as far as the Code permits, and, if so, what

79. See supra notes 69-72 & accompanying text.
82. U.C.C. § 9-204 comment 8 (1952), reprinted in 17 U.C.C. DRAFTS, supra note 69, at 220; U.C.C. § 9-204 comment 5.
83. See supra text accompanying note 73.
84. U.C.C. § 9-204(3), (5).
85. For a discussion of performance obligations, see infra note 276 & accompanying text.
restrictions might limit claims which have been enlarged through the creditor's overreaching or abusive behavior. We now turn to these problems.

Security Agreement as Contract: Determining Intent

The freedom of contract which Article Nine embodies leads to difficult problems of interpreting broad future advance or all obligations clauses in security agreements. If an original security agreement contains a clause securing all obligations of the debtor to the creditor, and over time the debtor becomes obligated to the creditor in a number of transactions and in a variety of ways, by what standards do we decide which of these obligations was "intended" by the parties to be secured?

Article Nine, in common with the rest of the Code, embodies a thoroughly modern, contextual theory of contract.\(^8\)\(^6\) There are few specific interpretive rules.\(^8\)\(^7\) A security agreement is first of all an agreement,\(^8\)\(^8\) which is defined in Article One as the "bargain of the parties in fact."\(^8\)\(^9\) The terms of the bargain-in-fact are to be determined from the parties' "language" and from any other relevant circumstances.\(^9\)\(^0\) The meaning of the parties' language and the terms of the bargain are in part functions of reasonableness in the particular circumstances within a larger commercial context.\(^9\)\(^1\) The legal effect of the parties' bargain is determined

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86. On the "contextual approach" to contracts, see Speidel, *An Essay on the Reported Death and Continued Vitality of Contract*, 27 STAN. L. REV. 1161, 1172-77 (1975) (discussing the replacement of the "grand theory" of contracts with a "contextual approach [which] focuses upon particular types of contracts within a relevant business or social setting").

87. If we characterize Article Nine as a purely remedial statute, see supra notes 59 and 62, then the Code may provide, at least inferentially, a rule of liberal interpretation through U.C.C. § 1-106(1), which states, "The remedies provided by [the Code] shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . ." However, the drafters of the Code did not conceive of Article Nine as purely a contract remedy and probably did not intend § 1-106(1) to apply directly to Article Nine. See U.C.C. § 1-106 comments 1-3 (no reference to Article Nine). Nonetheless, § 1-106(1) and the inferences which may be drawn from it are fully consistent with the drafters' approach to Article Nine.


89. Id. § 1-201(3).

90. Id. In Estate of Beyer v. Bank of Pennsylvania, 449 Pa. 24, 27, 295 A.2d 280, 281-82 (1972), the court, citing U.C.C. § 9-105(1)(h) (1962) (9-105(1)(l) in the 1978 version) (definition of security agreement), used a course of dealing between the creditor and debtor over six years as evidence that a form security agreement with a future advance clause was intended to provide continuing security for the creditor's future advances.

not only by the Code itself, but also by the common law of contracts.\textsuperscript{92} The law of contracts includes general interpretive standards which may apply to agreements under the Code, such as the rule that an ambiguous writing is interpreted against the drafter.\textsuperscript{93}

Since standards of interpretation can best be defined and explicated with reference to circumstances, we can focus this discussion with a hypothetical security agreement. Assume a commercial bank is the lender and a small business is the borrower and debtor. After preliminary discussions, the debtor submits a formal request for a substantial secured loan from the bank.\textsuperscript{94} The loan officer and the debtor further discuss terms, focusing on the principal amount, the repayment schedule, interest and other charges, collateral, reporting requirements, and the like. The loan officer and debtor may go even further, specifically discussing all significant parts of the proposed arrangement, including the provision that all obligations of the debtor to the creditor will be secured.

To the extent that the security agreement is actually read, discussed, and understood by both parties at the time of closing, it is largely indistinguishable from a fully negotiated contract even though the agreement is embodied in a printed form. The terms of such an agreement should be determined by much the same process and standards as those of a fully negotiated agreement.

Under both the Code\textsuperscript{95} and the \textit{Restatement (Second) of Contracts},\textsuperscript{96} the process of interpreting a written agreement begins with the language used. Ordinarily, the creditor will contend that a broad future advance or all obligations clause means just what it appears to say, and the debtor or other litigant adverse to the creditor will contend that the clause in question has a narrower meaning. Under these circumstances, the \textit{Restatement (Second)’s} rules in aid of interpretation prefer the "generally prevailing meaning" urged by the creditor unless some special circumstances known to both contracting parties support the narrower interpretation.

\textit{Commercial Code,} 51 OR. L. REV. 269, 276 (1972) (“The underlying philosophy of the changes in contract law effected by Article 2 may be stated as follows: a more precise and fair identification of the actual or presumed assent of the parties.”) (emphasis in original).

\textsuperscript{92} U.C.C. §§ 1-103, -201(3), (11).
\textsuperscript{93} \textit{RESTATEMENT (SECOND) OF CONTRACTS} § 206 (1981).
\textsuperscript{94} R. HAYES, BUSINESS LOANS 153-62 (2d ed. 1980); J. SIMMONS, CREATIVE BUSINESS FINANCING 21-26, 42-69 (1982).
\textsuperscript{95} U.C.C. § 1-201(3) (terms of agreement are found in the language of the parties and other relevant circumstances).
\textsuperscript{96} \textit{RESTATEMENT (SECOND) OF CONTRACTS} § 17(1) (1981) (formation of contract ordinarily requires manifestation of mutual assent); \textit{id.} § 19(1) (manifestation of mutual assent may be by written words).
Moreover, the debtor is presumed to have reason to know the "generally prevailing meaning" attached to the future advance or all obligations clause. Even if the debtor in fact had no reason to know of the prevailing meaning the Restatement (Second) would still prefer the creditor's interpretation over that of the debtor unless the debtor communicated his narrower interpretation to the creditor. Of course, even broad future advance or all obligations clauses should not protect abusive behavior by creditors, and courts should restrain overreaching through enforcement of the creditor's duty of good faith.

Rules of interpretation premised on the parties' actual understanding of the terms of a written agreement at the time of execution are not always applicable. In most commercial loan negotiations involving a professional lender and a small business borrower, the terms of secondary importance, such as a future advance or all obligations provision, are probably not specifically read, discussed, or understood by either the loan officer or the debtor. Probably the loan officer and the debtor discuss the possibility that the bank may make additional loans to the business in the future, particularly if the business succeeds and requires additional capital to expand. Both the loan officer and the debtor understand generally that future loans will be secured. At the final closing, the debtor executes a promissory note and a long printed-form security agreement, with blanks filled in and appropriate boxes checked. The agreement grants the bank a security interest in substantially all the existing and after-acquired personalty of the business. One of the clauses in the agreement states that the security interest specifically secures repayment of the promissory note and any extensions or renewals, and additionally secures all obligations of the debtor to the bank of whatever nature, whenever and however arising or incurred. The printed all obligations clause is not read by the debtor, or, if read, is not fully comprehended.

Examined with reference to modern contract theory, the circumstances under which most commercial non-purchase-money security agreements are concluded suggest at least two characteristics which

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97. Id. § 202(3)(a) ("Unless a different intention is manifested . . . where language has a generally prevailing meaning, it is interpreted in accordance with that meaning . . . ").
98. Id. § 201(2)(b); cf. id. § 20(2)(b) (effect of misunderstanding).
99. See infra text accompanying notes 113-37.
100. A security interest is "purchase money" if it is taken by the seller of the collateral to secure payment of the portion of the purchase price remaining due, or if it is taken by a creditor to secure the debtor's repayment of value extended by the creditor to enable the debtor to purchase the collateral. U.C.C. § 9-107. Most purchase money security agreements concluded by sellers of collateral on credit probably do not have future advance or all obliga-
compound the difficulties of determining which obligations are within the agreement's intended scope. First, the security agreement is from the outset a *relational* contract. The bank or other lending agency and the debtor enter into a long-term contractual debtor-creditor relationship. The elements of the relationship, and in particular the origin, purpose, form, or amount of obligations which may in the future be owed by the debtor to the bank, cannot be stated with precision because they are unknown. The bank is willing to become the debtor's banker, a continuing source of credit and provider of services should the debtor remain worthy, but only if the whole relationship is placed on a secured basis. The debtor expects to continue to need credit and banking services, and understands generally that the bank will require security for any loans and related charges which may become due. But beyond these general understandings concerning an indefinite future, the parties in most cases will have no focused intent as to the secured status of specific obligations which may later arise.

The second complicating characteristic is that the commercial security agreement is often also functionally a *contract of adhesion,* at least as to the standard-form future advance or all obligations clause which is not read or understood by the debtor. The bank, as a professional with money to lend, is plainly the dominant party with the power to offer small business loans on a take-it-or-leave-it basis. The bank has made a policy decision, which the loan officer enforces in particular
cases through her selection of forms, that it will make a relatively large loan against a large portion of a small business debtor's assets only if the total bank-debtor relationship is placed on a fully secured basis. The all obligations clause preserves the bank's freedom of future action and reduces several risks, including the risk of the bank's own bureaucratic failure to execute or file proper security documents in future credit transactions with the debtor. From the debtor's standpoint, the all obligations clause is just not very important, a low-visibility component of the total arrangement. If he thinks much about it at all, he is likely to conclude that the all obligations clause is not unreasonable and at least partly favorable to him, as it seems to complement the bank's suggestion that additional credit may be available in the future. If the debtor should negotiate or shop elsewhere for more favorable terms, he will likely ask for a larger loan, lower interest, and an extended repayment schedule, or for a security interest in less collateral, rather than for a less-than-all obligations clause. Moreover, for a large loan against a large portion of the small business debtor's assets, most, and perhaps all, commercial financers are likely to require an all obligations clause. In the end, if the small business debtor wants all that money on the payment terms ultimately offered, with the prospect of more money later, he just signs what is put in front of him at closing with little or no regard for the printed-form boilerplate.

The interpretive problems created by the relational, adhesive security agreement are severe when, long after the debtor-creditor relationship originated, a court must decide which of the debtor's subsequent obligations to the creditor were "intended" to be secured. Since, at the time the security agreement was entered, the parties had no specific intent as to particular future obligations, and since the small-business debtor merely "adhered to" the creditor's standard-form all obligations clause, the focus of judicial inquiry must shift from ascertaining specific intent, or specific assent, to interpreting the situation. As Karl Llewellyn stated, "the conditions and clauses to be read into a bargain are not those which happen to be printed on the unread paper, but are those which a sane man might reasonably expect to find on that paper."104

Under the Code, the meaning of a broad future advance or all obli-

104. Llewellyn, Book Review, 52 HARV. L. REV. 700, 704 (1939); see also K. LLEWELLYN, THE COMMON LAW TRADITION 370 (1960):

What has in fact been assented to [by an adherent to a standard-form contract], specifically, are the few dickered terms, and the broad type of the transaction, and ... a blanket assent (not a specific assent) to any not unreasonable or indecent terms
gations clause in a standard-form security agreement between a professional lender and small business debtor is found in the parties' objectively reasonable expectations as to the scope of their ongoing debtor-creditor relationship.\textsuperscript{105} The parties use such clauses to put their expected future dealings on a secured basis. What future obligations of the small business debtor would the reasonably prudent bank following generally accepted banking standards and the reasonably prudent small business debtor following generally accepted business practices expect to be secured under the original security agreement? In general, both will reasonably expect the obligations of the debtor to the bank incurred in the ordinary course of the bank-customer relationship to be secured.\textsuperscript{106} These would include at least the debtor's obligation to repay any loans and credits, the debtor's obligation to pay the cost of administering and enforcing the security agreement, and the debtor's obligation to pay for any banking or other financial services received. Such services may include safety deposit boxes, retirement plans, payroll, insurance, purchase or sale of securities, letters of credit, cash transfers, and financial advice.\textsuperscript{107}

Whether the debtor's obligations to the creditor which arise outside the usual course of the relationship will be secured under the agreement will always be a difficult question. On its face, an all obligations clause, interpreted according to its generally accepted meaning, would operate to secure literally all legally enforceable obligations of the debtor to the

\textsuperscript{105} Cf. Slawson, New Meaning of Contract: The Transformation of Contract Law by Standard Forms, 46 U. Pitt. L. Rev. 21, 23 (1984) ("[W]hereas under the old meaning [of contract], the contract is the parties' manifestations of mutual assent, which are interpreted to try to fulfill their reasonable expectations, under the new meaning the reasonable expectations are the contract."). Professor Rakoff's proposal that a form term should be presumptively unenforceable to the extent that it deviates from terms established by background law, Rakoff, supra note 102, at 1242-43, presupposes the existence of legally supplied terms as measures of and alternatives to form terms, \textit{id.} at 1244. Since the Code supplies no such terms to define which of the debtor's obligations will be secured under a security agreement, the proposal seems inapposite in the Article Nine context.

\textsuperscript{106} Gillet v. Bank of America, 160 N.Y. 549, 55 N.E. 292 (1899) (pre-Code law); see \textit{infra} text accompanying notes 174-83.

\textsuperscript{107} Gillet, 160 N.Y. at 556-57, 55 N.E. at 294. The "ordinary course of business" is intended to be functional, and is necessarily imprecise. \textit{Cf.} U.C.C. § 1-201(9) (defining "buyer in the ordinary course of business"). Many banking services or transactions have unusual aspects, but are not as a whole so unusual as to be outside the ordinary course. Other transactions may be so rare or unusual as to be extraordinary for both bank and customer. The bank's motive may be a factor in determining whether a transaction is ordinary or extraordinary. \textit{See infra} text accompanying notes 299-302 (discussion of the secured creditor as assignee of the debtor's unsecured third-party obligations).

\textsuperscript{107} Cooley & Pullen, Small-Business Use of Commercial Bank Services, 162 Bankers \textbf{Mag.} 72, 73 (1979).
creditor, however they arose. But the generality of the clause almost invites the secured creditor to exploit the clause opportunistically by claiming that even an extraordinary obligation of the debtor to the creditor is secured.\textsuperscript{108} The problem of determining the proper limit of the all obligations clause is exacerbated by the relational nature of the contract and the clause’s adhesive origins. In general, courts facing this issue must apply a judicial rule of reason, itself defined through an inquiry into commercial practice and through the application of standards derived from the Code and from the non-Code law of contract, agency, surety, trust, etc. The inquiry may be aided by the Restatement (Second) of Contracts’ general rule that a written standardized agreement “is interpreted wherever reasonable as treating alike all those similarly situated.”\textsuperscript{109}

Although at this stage the inquiry may still nominally be directed toward determining the parties’ intent, functionally the application of a judicial rule of reason will operate as a limit on an all obligations clause in substantially the same manner as the judicial enforcement of the requirement of good faith can operate as a means of regulating secured creditor behavior. It is to this subject that we now turn.

**Regulating Secured Creditor Behavior: The Requirements of Good Faith and Conscionability**

The interests not only of the debtor but also of nonparties are likely to be directly and adversely affected by the terms, performance, and enforcement of a security agreement. Specifically, the interests of rival claimants to the collateral who are subordinated to the secured party are likely to be adversely affected by any expansion in the dollar amount of the secured obligations, and may likewise be affected by the secured party’s foreclosure of the security interest. More generally, the public has an interest in preserving the integrity of the Article Nine system and,

\textsuperscript{108} See generally Muris, Opportunistic Behavior and the Law of Contracts, 65 Minn L. Rev. 521 (1981) (discussing the problem of opportunism when a performing party behaves contrary to the understanding of the other party but not necessarily contrary to the explicit terms of the contract, resulting in a transfer of wealth from the other party to the performing party).

\textsuperscript{109} Restatement (Second) of Contracts § 211(2) (1981). This section is intended to aid courts which “seek to effectuate the reasonable expectations of the average member of the public who accepts [a standardized contract].” Id. § 211 comment (e). Although a business debtor entering into a long-term relationship with a professional lender is not an “average member of the public,” she certainly should be able reasonably to expect the same treatment from the lender as other business debtors similarly situated. In this context section 211(2) seems merely to reformulate the principal problem—determining the objectively reasonable expectations of the parties—by focusing on the secured creditor’s customary commercial practice.
correlatively, in preventing Article Nine from becoming a publicly sanctioned tool of private oppression.

The courts have always regulated the actions of secured creditors to protect the interests of parties, interested nonparties, and the public. In the past, much regulation was simply implicit in the restrictions on the giving and taking of security interests in general. More particularly, pre-Code law usually required that a future advance be made in "good faith" to be secured under a future advance clause.

Apart from some controls on the secured party's foreclosure of the security interest, Article Nine, being principally an enabling statute, has few provisions regulating secured creditor behavior. However, no one has ever suggested that the absence of detailed controls in Article Nine was intended to legitimize secured creditors' actions properly regarded as abusive. Although the scope of legitimate action is necessarily broad, Article Nine is not a blanket license for the secured party to clear the whole forest of the defaulting debtor's valuable collateral under all circumstances and by any means whatsoever.

Good Faith

At least at the present stage of legal development, the doctrine of good faith should be the principal vehicle for defining and applying

110. Early personal property security law regarded a nonpossessory security interest as fraudulent and thus invalid against third-party creditors and purchasers of the collateral. This presumption eroded only slowly. 1 G. Gilmore, supra note 2, § 2.1.
111. 2 G. Gilmore, supra note 2, § 35.2, at 920 ("No matter how all-embracing the [future advance] clause may be, [in pre-Code law] the mortgagor who seeks to assert a claim under it will find himself restricted by a rule of reason and good faith."); 1 G. Glenn, supra note 55, § 372, at 643. A creditor making an advance which expands the dollar value of the secured obligation is, relative to a third-party claimant to the collateral, in some respects analogous to a purchaser of the collateral for value, whose entitlement will depend in part on her bona fides. See generally McDonnell, The Floating Lienor as Good Faith Purchaser, 50 Calif. L. Rev. 429 (1977).
112. E.g., U.C.C. § 9-503 (secured party may repossess collateral "without judicial process" only "if this can be done without breach of the peace"); id. § 9-504 (notification of foreclosure sale must be given to appropriate parties, and every aspect of the sale must be "commercially reasonable"); id. § 9-505 (regulating strict foreclosure); id. § 9-507 (secured party liable to debtor and certain other interested parties for loss caused by failure to comply with required foreclosure procedures).
113. Id. § 1-203 ("Every contract or duty within [the Code] imposes an obligation of good faith in its performance or enforcement."); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."). The leading article on good faith in performance and enforcement is Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195 (1968) (arguing that the doctrine of good faith is best understood as an excluder of various forms of bad behavior). Standards for determining the allowable scope of future advance and all obligations clauses may be drawn from both
standards to regulate secured creditor behavior in performing and enforcing security agreements. The doctrine has been used to regulate secured creditor performance and enforcement under future advance arrangements.114 Moreover, as the doctrine of good faith is well-suited to the regulation of principals in relational agency contracts,115 so the doctrine is appropriate to regulate the behavior of secured creditors relying on broad future advance and all obligations clauses in relational security arrangements.

The language and legislative history of the Code's definition of good faith raise serious questions about the propriety of using the doctrine to regulate secured creditor behavior under Article Nine. The Code states, "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement,"116 but also states that "unless the context otherwise requires . . . '[g]ood faith' means honesty in fact in the conduct or transaction concerned."117 An earlier draft had added, "Good faith includes observance by a person of the reasonable commercial standards of any business or trade in which he is engaged."118 However, on the request of the American Bar Association, the expansive definition of good faith as commercial reasonableness was deleted, leaving only the narrow, subjective definition.119 Certainly the current language of the Code, read with this legislative history, at least suggests that the drafters intended "bad faith" to be confined to "dishonesty." And if "honesty" is given its generally accepted meaning, the Code's doctrine of good faith as honesty, or bad faith as dishonesty, becomes practically useless for regulating secured creditor behavior. Secured creditors may be overreaching, abusive, oppressive, and heedless of the interests of third parties and the public, but they are rarely dishonest in the generally ac-
cepted sense. If the doctrine of good faith is to perform a regulative function under Article Nine, “good faith” must be defined expansively and objectively as, at least, commercial reasonableness and fair dealing.

The problems with the application of an expansive, objective standard of good faith to regulate secured creditor behavior under Article Nine are not as great as they initially appear. The issue is merely one of analytical categories, of rubrics or labels, not policy. The Code does not intend to license all manner of abusive behavior, but, on the contrary, intends that courts continue their traditional regulation of secured creditors. The principal question is thus not whether but how the regulation will be accomplished.

The courts can adequately regulate secured creditor behavior without reliance upon the doctrine of good faith, but they cannot do so without cost. For example, the courts can refuse to accept a secured creditor's particularly outrageous claim that a specific obligation is secured on the grounds that under the circumstances enforcement of the security agreement as requested would violate public policy. They can also apply the restrictive “same class-relatedness” rule of construction or otherwise engage in creative interpretation (or misinterpretation) to find that the obligation in question was never intended to be secured. What would be lost in abandoning good faith as a doctrinal category would be doctrinal integrity and a fruitful connection with modern contract law, a connection which would produce a better understanding and a more precise analysis of the issues.

Fortunately, there is no need to resort to alternative doctrines, because the Code permits application of an expansive, objective standard of good faith behavior to regulate secured creditor behavior under Article Nine. Generally, the use of a broad conception of good faith is consistent with the drafters' expressed intention “to make it possible for the law embodied in [the Code] to be developed by the courts in the light of unforeseen and new circumstances and practices.” More particularly, the Code's definition of good faith as “honesty” is a minimum and not a

120. It has, however, been suggested that “honesty” itself can be read to mean commercial reasonableness and fair dealing. Gillette, supra note 119, at 621-22.
121. U.C.C. § 1-203 (non-Code validating and invalidating causes supplement the Code); RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981) (contract term may be unenforceable on grounds of public policy when interest in enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms).
122. This Article argues that the “same class-relatedness” rule should not be applied under the Code, see infra text accompanying notes 145-227, but that argument rests in part on the assumption that the doctrine of good faith, defined expansively and objectively, may be applied under Article Nine.
123. U.C.C. § 1-102 comment 1.
maximum standard. The Comments state that "'good faith' . . . means at least [honesty]," necessarily implying that the term may mean more. "Good faith" may mean more not only where the Code specifically says so, as in the case of sales of goods by merchants, but also where "the context otherwise requires." The regulation of secured creditor behavior under Article Nine is one "context" which, as a matter of policy, requires the duty of good faith in performance and enforcement to mean not only honesty but also the observance of reasonable commercial standards and fair dealing.

Another context requiring an expansive, objective definition of good faith is the area of overlap between Code and non-Code law. The Code specifically contemplates an accommodation between Code and non-Code law where it authorizes, in section 1-103 and in the definitions of both "agreement" and "contract," derivation of standards for regulating contracting parties' behavior from non-Code law. Thus, at least in Article Nine, when neither policy nor specific provisions direct otherwise, the Code's obligation of good faith should be read together with regulatory principles derived from general contract law.

General contract law embodies an expansive, objective definition of "good faith," which becomes applicable to Article Nine. The Restatement (Second) of Contracts provides, "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement." The Comments explain that "[g]ood faith . . . excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or rea-

124. Id. § 1-201(19) (emphasis added).
125. Id. § 2-102(1)(b) ("'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.").
126. Id. § 1-201 (introductory phrase). For a discussion of the "context" qualification of the U.C.C. definitions, see Summers, supra note 113, at 213-15.
127. U.C.C. § 1-103 provides in part: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law relative to . . . estoppel, fraud, misrepresentation, duress, coercion, mistake, . . . or other validating or invalidating cause shall supplement its provisions." U.C.C. § 9-105(4) refers to Article One as the source of "general definitions and principles of construction and interpretation applicable throughout [Article Nine]." On U.C.C. § 1-103, see generally, Hillman, Construction of the Uniform Commercial Code: U.C.C. Section 1-103 and Code Methodology, 18 B.C. INDUS. & COM. L. REV. 655 (1977).
128. U.C.C. § 1-201(3) ("Whether an agreement has legal consequences is determined by the provisions of [the Code], if applicable; otherwise by the law of contracts (Section 1-103.").
129. Id. § 1-201(11) ("'Contract' means the total legal obligation which results from the parties' agreement as affected by [the Code] and any other applicable rules of law.").
130. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). If "fair dealing" is a requirement separate from "good faith," it could be applied to Article Nine problems through U.C.C. § 1-103 without direct conflict with the Code's narrow definition of good faith.
sonableness.  

Some courts have read the Code's general obligation of good faith expansively in Article Nine cases. For example, in Skeels v. Universal C.I.T. Credit Corp., a secured financer had led an automobile dealer to believe that overdue notes would be renewed, but instead repossessed the dealer's entire inventory without notice. The appellate court stated that the jury could not easily avoid the conclusion that the financer had acted in bad faith. Reading sections 1-103 (non-Code law supplements the Code) and 1-203 (the Code's good faith requirement) together and applying them to Article Nine, the court stated that "[t]hese provisions superimpose a general requirement of fundamental integrity in commercial transactions regulated by the Code."

"Good faith," defined expansively and objectively to include commercial reasonableness and fair dealing, is not sufficiently definite standing alone to resolve individual cases. "Commercial reasonableness" and "fair dealing" are themselves largely indeterminate, and must derive meaning from the context in which they are applied.

Article Nine provides a source of meaning—or standards—of commercial reasonableness, fair dealing, and, ultimately, good faith in at least two ways. First, Article Nine regards the interests of the debtor's third-party creditors and purchasers of the collateral as legitimate and entitled to protection from secured creditor overreaching and abusive behavior. The debtor's third-party creditors and purchasers may be viewed as third-party maleficiaries of the debtor-secured creditor contract, since one major purpose of a security agreement is to subordinate the interests of these third parties to those of the secured creditor. Just as the general law of contracts protects the interests of intended third-party beneficiaries, so the contract law of Article Nine should protect third-party maleficiaries from abusive behavior.

Standards of commercial reasonableness, fair dealing, and good faith

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133. 335 F.2d 846 (3d Cir. 1964).
134. Id. at 851.
135. Restatement (Second) of Contracts §§ 302-315 (1981). The reference to intended third-party beneficiaries is only to suggest very broadly that modern contract law protects the legitimate interests of nonparties intended to be directly affected by a contract, and that protection of the legitimate interests of the debtor's subordinate third-party creditors from the abusive actions of a primary secured party would be consistent with Article Nine's incorporation of contract law's regulative doctrines.
may also be derived from Article Nine by regarding it as a system with its own integrity and limits. Article Nine is designed to encourage the regular extension of commercial credit on a secured basis by reducing both costs and the secured creditor's risks. Thus a large core of commercially legitimate transactions is authorized by Article Nine, and the secured party may take many actions to ensure her priority. But Article Nine is not a secured creditor's license to kill. Some actions by secured creditors will be outside the statutory license granted by Article Nine, and thus taken in "bad faith," because they are highly irregular commercially, or procedurally bizarre, or are taken for questionable motives, as well as being oppressive in their effects on the debtor or third parties. Such extreme actions need not be countenanced to further the basic goals of Article Nine. If allowed, they would have the counterproductive effect of compromising the legitimacy of the whole system.

Finally, standards of commercial reasonableness, fair dealing, and good faith may be drawn not only directly from Article Nine itself but also from non-Code community standards of fairness. The courts have always had a residual power to redress the effects of a creditor's illegitimate actions, and Article Nine expressly reserves that power by its reference to non-Code regulatory principles.

In sum, courts should regulate secured creditor behavior through the enforcement of the Code's obligation of good faith in enforcement of contracts. "Good faith" should be defined expansively and objectively to include commercial reasonableness and fair dealing. Standards of commercial reasonableness, fair dealing, and, ultimately, good faith are derived partly from Article Nine itself, which recognizes as legitimate the interests of the debtor's third party creditors and the interests of the public in the integrity of the Article Nine system. Finally, courts retain under the Code their traditional power to redress outrageous behavior by secured creditors.

Conscionability

One commentator has suggested that the doctrine of unconscionability that is stated in section 2-302 of the Uniform Commercial

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136. Id. § 205 & comment a.
137. U.C.C. § 1-103 (non-Code regulatory principles supplement the Code); id. § 9-105(4) (referring to Article One for principles of construction and interpretation).
138. Justice, supra note 2, at 905-06, 915.
139. The literature on unconscionability is extensive. The leading article is Leff, Unconscionability and the Code: The Emperor's New Clause, 115 U. PA. L. REV. 485 (1967) (critically surveying drafting history of U.C.C. § 2-302, and distinguishing substantive from procedural unconscionability).
Code\textsuperscript{140} and section 208 of the \textit{Restatement (Second) of Contracts}\textsuperscript{141} should be applied to regulate secured creditor behavior under Article Nine. Although no provision in Article Nine specifically requires courts to refuse enforcement of unconscionable security agreements, the provisions authorizing derivation of regulatory standards from non-Code law\textsuperscript{142} plainly allow application of the doctrine of unconscionability to appropriate cases under Article Nine.

Broad future advance and all obligations clauses in commercial security agreements should only rarely be found unconscionable either on their face or as applied in specific cases. The conclusion that a contractual provision is "unconscionable" usually follows from serious defects in the bargaining process, leading to the formation of a contract with terms which are substantively oppressive in their effect.\textsuperscript{143} This situation is usually not present in a commercial contract. Although a commercial security agreement may be substantially adhesive, its terms are not for that reason alone unconscionable. All obligations clauses are commercially reasonable from the financer's point of view, are not unreasonable from the standpoint of commercial debtors, and are generally validated by Article Nine, consistent with its policy of encouraging the extension of credit on a secured basis. An attempt at opportunistic exploitation of such a general provision by a secured creditor should be restrained not by declaring the clause unconscionable\textsuperscript{144} but by declaring the creditor's action to be outside the reasonable expectations of the parties or in bad faith.

\textsuperscript{140} U.C.C. § 2-302 (authorizing courts to refuse to enforce unconscionable terms or contracts in transactions in goods).
\textsuperscript{141} \textit{Restatement (Second) of Contracts} § 208 (1981) (court may refuse to enforce unconscionable contract or term).
\textsuperscript{142} U.C.C. §§ 1-103, -201(3), (11).
\textsuperscript{143} U.C.C. § 2-302 comment 1; \textit{Restatement (Second) of Contracts} § 208 comments c & d (1981). \textit{See generally} Leff, \textit{supra} note 139.
\textsuperscript{144} Similarly, \textit{Restatement (Second) of Contracts} § 211(3) (1981) should not be used to restrain the secured creditor's attempted opportunistic exploitation of a broad future advance or all obligations clause. Section 211(3) provides, "Where the other party has reason to believe that the party manifesting such assent [to a standardized writing] would not do so if he knew that the writing contained a particular term, the term is not part of the agreement." Most general future advance and all obligations clauses are not unreasonable from the standpoint of the business debtor, so the secured creditor ordinarily would not have a reason to believe that the debtor would object to the clause. Section 211(3) has been examined and criticized in Murray, \textit{The Standardized Agreement Phenomena in the Restatement (Second) of Contracts}, \textit{67 Cornell L. Rev.} 735, 762-79 (1982).
How Not To Do It: The "Same Class-Relatedness" Rule

Many courts, as we observed at the outset, do not apply modern interpretive and policing doctrines to determine the allowable scope of a security agreement. Instead, they apply the "same class-relatedness" rule: to be among obligations secured under a broad future advance or all obligations clause, a future advance or other secondary obligation must be of the same class as the primary obligation and so related to it that the consent of the debtor to its inclusion as a secured obligation may be inferred.

For several reasons, the "same class-relatedness" rule is an unsatisfactory test of the allowable scope of a security agreement. The content of the rule is hopelessly indeterminate. The rule is an empty container into which the courts may pour as little or as much as they wish in individual cases. What is meant by "class" of obligations? Is any difference, however trivial, in form, purpose, or mode of incurrence between the primary and secondary obligation sufficient to place the secondary obligation in a different class from the primary, and is this sufficient to render the secondary obligation unsecured? If some differences between primary and secondary obligations are permitted without taking the secondary obligation outside the range of the security, how do we tell which differences are permissible and which are not? Just what does it mean to say that, to be secured, the secondary obligation must be "so related to the original that consent to its inclusion as a secured obligation may be inferred"? How related is that? Do we focus on the nature and degree of relatedness between the primary and secondary obligations, or do we also look at such factors as the commercial context in which the security agreement was intended to operate, the process of bargaining, and the reasonable expectations of the parties? What is the relationship between the "same class" and "relatedness" components of the test? What if a secondary obligation is closely related to the primary one, but of a different "class"? Should we exclude from secured status secondary obligations which are for the same business purpose as, and thus closely related to, the original secured obligation, but which are in a different form and thus (perhaps) in a different class from the original?

Similarly, it is unclear whether the "same class-relatedness" rule is a rule in aid of interpretation or a rule of construction which operates as a rule of law severely restricting the allowable scope of security agree-

145. See supra notes 9-12 & accompanying text.
146. Some writers distinguish between interpretation, which is the process of ascertaining the intent of the parties, and construction, which is the process of determining meaning in order to give a particular legal effect to the language used. 3 A. CORBIN, CONTRACTS § 534
ments. The indeterminate status of the "same class-relatedness" test as a rule of interpretation or a rule of law has on occasion produced substantial confusion.\textsuperscript{147} For example, in denying a secured creditor's motion for summary judgment on its claim that the debtor's secondary as well as primary obligations were secured under a broad future advance clause, a federal district court stated:

[The debtor] has created a material issue of fact as to whether all of the advances were within the same class so that they could all be found to have been within the reasonable contemplation of the parties. Accordingly, even if I were to find that the parties intended that future advances be covered by their agreement, [the secured party's] motion must still be denied.\textsuperscript{148}

The court plainly regarded the "same class-relatedness" test as both a rule of interpretation and a restrictive rule of law, which makes little sense.

The application of the "same class-relatedness" test as a rule of strict construction, that is, as a restrictive rule of law, is wholly inconsistent with the purposes and language of the Code.\textsuperscript{149} As a rule of strict construction, the "same class-relatedness" test operates as an overly exclusive rule of law which renders unsecured secondary obligations which are fully legitimate under the Code. The basic purpose of Article Nine is to encourage the extension of commercial credit by reducing transaction costs and economic and legal risks, especially in long-term commercial relationships.\textsuperscript{150} Application of the "same class-relatedness" test increases transaction costs by requiring new security agreements for each transaction, and also increases the secured creditor's economic and legal risk that secondary obligations will be unsecured. Thus, the text of the Code and Comments implicitly rejects the "same class-relatedness" test as a rule of strict construction. A security agreement is to be "effective

(1960); Patterson, The Interpretation and Construction of Contracts, 64 COLUM. L. REV. 833 (1964). A rule of construction operates as a rule of law when it excludes specific interpretations or outcomes from judicial acceptance or validation.

\textsuperscript{147} For example, the Oregon Supreme Court indicated that the "same class-relatedness" test was a rule of law restricting the allowable scope of a security agreement no matter how a future advance clause in the agreement was drafted. Community Bank v. Jones, 278 Or. 647, 666, 566 P.2d 470, 482 (1977). Perplexed, a lower court in a later case ventured to conclude that "the language of [a security agreement] is... relevant," Credit Alliance Corp. v. Amhoist Credit Corp., 74 Or. App. 257, 264 n.3, 702 P.2d 1121, 1125 n.3 (1985), and that there was evidence that the security agreements at issue were intended to secure the secondary as well as the primary obligations of the debtor. Id. at 265, 702 P.2d at 1126. Although secured creditors will be pleased to know that the language of a security agreement remains at least "relevant" in Oregon, no one can be certain of the status of the "same class-relatedness" test.


\textsuperscript{149} R. HILLMAN, supra note 2, § 21.01[3][a], at 21-9; Justice, supra note 2, at 903-05.

\textsuperscript{150} See supra text accompanying notes 32-39.
according to its terms,"¹⁵¹ which are to be ascertained from the parties' language and all other relevant circumstances,¹⁵² not simply by "class" and "relatedness." Article Nine specifically permits and imposes no restrictions upon future advance, all obligations, and cross-security clauses in commercial security agreements.¹⁵³ The Comments specifically reject pre-Code rules designed to limit commercial security, a rejection which plainly encompasses the restrictive "same class-relatedness" test.

The judicial popularity of the "same class-relatedness" rule of construction is due in part to Professor Grant Gilmore,¹⁵⁴ who claimed that the rule as stated by a federal district court purportedly applying Arkansas law¹⁵⁵ represented the "general" pre-Code law of future advance clauses,¹⁵⁶ and who argued that the rule should continue to be applied under the Code.¹⁵⁷

Although probably no one knew more about the evolution of the common and statutory law of security interests in after-acquired personal property than Professor Gilmore, he should not be taken as a pre-eminent authority on the obligational component of secured transactions, a much different subject. There is evidence that Professor Gilmore neither studied independently nor thought deeply about the pre-Code case law of future advances. For example, Professor Gilmore seems to have regarded the secured construction loan as the commercial transaction giving rise to most early-modern future advance clause problems.¹⁵⁸ However, even a cursory review of the cases in a commercially important jurisdiction such as New York reveals the use of future advance and all obligations clauses in many types of commercial transactions, and a well-

¹⁵¹ U.C.C. § 9-201.
¹⁵² Id. § 1-201(3) (defining "agreement").
¹⁵³ Id. § 9-201 (a security agreement is effective according to its terms); id. § 9-204(1) (all obligations may be secured by after-acquired collateral); id. § 9-204(3) (secured obligations may include future advances or other value).
¹⁵⁴ R. HILLMAN, supra note 2, § 21.01[3][a], at 21-9 ("[O]ne reason for the [same class-relatedness] rule's continued vitality is Gilmore's endorsement of it.").
¹⁵⁵ National Bank v. Blankenship, 177 F. Supp. 667 (E.D. Ark. 1959), aff'd sub nom. National Bank v. General Mills, Inc., 283 F.2d 574 (8th Cir. 1960). The district court stated: The other "indebtedness" secured by a mortgage may be either antecedent or subsequent. Where it is antecedent, it must be identified in clear terms, and where it is subsequent, it must be of the same class as the primary obligation secured by the instrument and so related to it that the consent of the debtor to its inclusion may be inferred.
¹⁵⁶ 2 G. GILMORE, supra note 2, § 35.2, at 921.
¹⁵⁷ Id. § 35.5, at 932.
¹⁵⁸ Id. § 35.3, at 925 ("The institutional transaction out of which future advance law grew was the building construction loan."); see also id. at 922.
developed pre-Code law on the subject. Furthermore, Professor Gilmore's conclusion that the “same class-relatedness” rule of construction was the “general” pre-Code law seems to have been derived not from his own independent analysis of the pre-Code cases, but principally from a 1954 student law review note in which analysis of restrictions on future advance and all obligations clauses was based almost exclusively on cases from Southern, Midwestern, and Western agricultural states.

All of the accumulated evidence indicates that Professor Gilmore was simply wrong in asserting that the “same class-relatedness” test was anything other than a minority rule in pre-Code law. As noted above, even Professor Gilmore observed that future advance clauses received relatively favorable treatment in pre-Code law, and at least two major real property treatises stated that mortgages were liberally construed as including future advances, an approach which implicitly rejected the “same class-relatedness” rule. A recent commentator examined many pre-Code cases and concluded that “Gilmore overstated matters.”

For the purposes of this Article, I have chosen to examine the law of New York, because it was the most significant commercial jurisdiction before 1962, and of Arkansas, because it was apparently the birthplace of the “same class-relatedness” test. A survey of the future advance law in these states reveals that New York never adopted the “same class-relatedness” test, and that the rule was being qualified in Arkansas as Gilmore wrote.


160. Note, Refinements in Additional Advance Financing: The “Open End” Mortgage, 38 MINN. L. REV. 507, 511-15 (1954) (surveying cases and claiming that “the results seem to indicate a general adherence” to the “same class-relatedness” rule of construction). The Note was cited as one of the two “most useful” pre-Code articles on future advances. 2 G. GILMORE, supra note 2, § 35.1, at 916 n.1.

161. Note, supra note 160, at 511-15. Twentieth-century cases cited were from the states of Alabama, Arkansas, Georgia, Iowa, Kansas, Louisiana, Ohio, Oklahoma, Texas, and Vermont.

162. See supra text accompanying notes 56-57.

163. 2 G. GILMORE, supra note 2, § 35.3, at 921-22.

164. 4 AMERICAN LAW OF PROPERTY, supra note 57, at 136 n.8; G. OSBORNE, supra note 57, at 184 n.7.

165. Justice, supra note 2, at 898.

166. Ideally, a complete study would be made of the evolution of each state’s pre-Code law of future advance and all obligations clauses against the changing economic background. Such a complete study is beyond my resources, and most probably would merely confirm the conclusions reached in this Article.
New York

From the beginning of the nineteenth century, New York, an influential, capital-rich, industrial state, has favored all obligations clauses and interpreted them generously in favor of creditors.\(^{167}\) In early New York cases, unsecured and secondary secured creditors frequently challenged future advance clauses as fraudulent or as preferences in per se. Such challenges were almost always unsuccessful, as courts regularly upheld and enforced future advance and all obligations clauses in chattel mortgages.\(^{168}\) Early cases interpreted "future advance" or "all obligations" language liberally in favor of primary creditors. For example, in *Agawam Bank v. Strever*,\(^{169}\) a promissory demand note for $4000 was pledged to secure "all liabilities incurred" by the principal debtor to the bank.\(^{170}\) The makers contended that the note secured only liabilities existing on the date of the pledge, but the appellate court approved the admission and consideration of parol evidence that no liabilities existed at the time the note was pledged,\(^{171}\) and went on to hold as a matter of law that the security of the note extended beyond the single sum of $4000 to secure as "a continuing guaranty" literally all liabilities of the principal debtor to the bank.\(^{172}\)

The early New York cases were consolidated and the contours of the modern New York law of future advance and all obligations clauses were completed in the cases of *Ackerman v. Hunsicker*,\(^{173}\) decided in

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\(^{167}\) On future advances in New York, see S. EAGER, THE LAW OF CHATTEL MORTGAGES AND CONDITIONAL SALES AND TRUST RECEIPTS §§ 41, 42 (1941); Note, Mortgages to Secure Future Advances, 8 ST. JOHN'S L. REV. 340 (1934).


\(^{169}\) 18 N.Y. 502 (1859).

\(^{170}\) Id. at 508.

\(^{171}\) Id. at 509.

\(^{172}\) Id. at 510. Despite their liberal approach to future advance and all obligations clauses, the New York courts occasionally found on the facts that no agreement covered the particular advances in question. See, e.g., Davenport v. McChesney, 86 N.Y. 242 (1881); Duncan v. Brennan, 83 N.Y. 487 (1881); Stoddard v. Hart, 23 N.Y. 556 (1861); Monnot v. Ibert, 33 Barb. 24 (N.Y. App. Div. 1859); Wyckoff v. Anthony, 90 N.Y. 442 (N.Y. C.P. 1882); cf. Truscott v. King, 6 N.Y. 147 (1852).

\(^{173}\) 85 N.Y. 43 (1881).
1881, and *Gillet v. Bank of America*,\(^{174}\) decided in 1899. In *Ackerman*, the Court of Appeals recognized the commercial utility of continuing security arrangements and broadly approved the use of future advance clauses.\(^{175}\)

The crucially important *Gillet* case defined limits on the application of future advance and all obligations clauses in terms of commercial reasonableness. The firm of Dan Talmadge & Sons had pledged certain stock to the Bank of America to secure the payment of a $35,000 note and any other present or future liabilities of the firm to the bank.\(^{176}\) After the firm defaulted on an unsecured promissory note payable to a life insurance company, the bank bought the note from the insurance company and asserted that its security interest in the pledged collateral secured the firm's payment of the purchased note now due to the bank.\(^{177}\)

In a broad and surprisingly modern opinion, the New York Court of Appeals held that the "all liabilities" clause in the original pledge agreement did not extend the bank's security interest to secure payment of the Talmadge firm's note which the bank had purchased from the life insurance company.\(^{178}\) Observing that the security agreement was a printed form prepared by the bank,\(^{179}\) the court held that "the principle controlling as to the construction of insurance policies and other similar instruments is applicable to this agreement, and that [the printed-form security agreement] should be liberally construed in favor of the [debtors]."\(^{180}\) The court examined the "circumstances and transactions existing between the parties" to define the relationship established between the bank

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175. *Ackerman*, 85 N.Y. at 47; see supra text accompanying note 6.
177. *Id.* at 554, 55 N.E. at 293.
178. *Id.* at 559, 55 N.E. at 295.
179. *Id.* at 552, 554, 55 N.E. at 292, 293.
180. *Id.* at 555, 55 N.E. at 293. The rule that a printed-form security instrument should be strictly construed against the preparer quickly became accepted nationally. See, e.g., Hanover Nat'l Bank v. Suddath, 215 U.S. 110 (1909) (language in printed-form pledge agreement between correspondent banks strictly construed against secured party preparer); Heffner v. First Nat'l Bank, 311 Pa. 29, 166 A. 370 (1933); Holston Nat'l Bank v. Wood, 125 Tenn. 6, 16, 140 S.W. 31, 34 (1911) ("[A stock pledge] agreement will not be construed so as to extend the obligation beyond that intended by the pledgor; and, if such agreement is on a printed form furnished by the bank and signed by its customer, and any doubt arises as to its proper interpretation, it will be construed in favor of the customer."). The rule stated in *Gillet* is a lineal antecedent of a modern rule of interpretation applied generally in contract law. RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981) ("[T]hat [reasonable] meaning [of a contract or term] is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds."). It is significant that the adherents in *Gillet* and *Suddath* were not consumers, but a business firm and a bank, respectively, with, it is reasonable to assume, some sophistication.
and the Talmadge firm, and concluded that the pledge "was intended to secure the liabilities of the [debtors] to the bank arising out of the business transactions or relations . . . between them as bank and customer, or which came into [the bank's] hands in the ordinary course of its banking business, whether past, present, or future."\(^{181}\) The court further observed that the opposite construction would allow the bank to transfer all the debtor's property within its reach to such of the debtor's creditors as the bank might wish to prefer, at least to the extent of the bank's ability to purchase the debtor's outstanding liabilities.\(^ {182}\) Such a construction was to be resisted because it "would make the contract unreasonable, and place one of the parties at the mercy of the other."\(^ {183}\)

The *Ackerman-Gillet* axis formed a modern relational law of all obligations clauses which has been consistently applied by the New York courts throughout the twentieth century, both before and after the adoption of the Uniform Commercial Code. Following the early nineteenth century tradition and *Ackerman*, the New York courts have consistently read future advance and all obligations clauses expansively, repeatedly extending the security of real and chattel mortgages and Article Nine security agreements to cover particular obligations incurred after the date of the original agreement.\(^ {184}\) On the other hand, when a creditor claims that an all obligations clause extends to a particular debt arising or acquired outside the ordinary course of dealing and the specific intent of the parties cannot be precisely determined, the courts confine the original security agreement to the commercially reasonable scope of the parties' relationship under all the circumstances.\(^ {185}\) Of course, in a few

\(^{181}\) *Gillet*, 160 N.Y. at 556-57, 55 N.E. at 294.

\(^{182}\) *Id.* at 557, 55 N.E. at 294.

\(^{183}\) *Id.* at 557, 55 N.E. at 295.


cases, neither the language of the security agreement nor the surrounding circumstances support the creditor's claim that the security extends to a particular secondary obligation.\(^\text{186}\)

One thing the New York courts have never done is apply the "same class-relatedness" rule or anything remotely like it to interpret or construe a future advance or all obligations clause in a security instrument. The "same class-relatedness" rule is not, and never has been, a part of the "general" law of New York.

Arkansas

Arkansas was the birthplace of the "same class-relatedness" test, and for that reason its law of all obligations clauses is important.\(^\text{187}\) In the nineteenth and early twentieth centuries, Arkansas was a world away from New York. As late as 1940, about eighty percent of Arkansas' population earned their living by agriculture.\(^\text{188}\) The state was the second or third largest producer of cotton in the United States during the 1930's and cotton produced about half the state's cash farm income.\(^\text{189}\) The price of cotton reached a high in 1920, dropped and fluctuated in the next decade, and collapsed in the 1930's,\(^\text{190}\) the heyday of the "same class-relatedness" test in Arkansas.

The post-Civil War economic history of Arkansas, and the evolution of the law of all obligations clauses, is divided into three overlapping periods. The first is the period of the crop-lien system of agricultural finance which extended from about 1870 until the 1930's. The second is the period between the two world wars, from about 1920 to 1940, when the Arkansas economy was in a state of instability leading to a collapse, and when the state's commercial system was undergoing moderniza-

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188. J. FLETCHER, ARKANSAS 336 (1947).

189. WRITERS' PROGRAM OF THE WORK PROJECTS ADMINISTRATION IN THE STATE OF ARKANSAS, ARKANSAS 59 (1941).

tion.\textsuperscript{191} The third period is that after World War II when Arkansas emerged as a part of the national economic system. I shall consider each of these periods in turn.

The Arkansas law of all obligations clauses in security instruments initially developed within the context of the crop-lien system of agricultural finance in effect throughout the South from about 1870 into the 1930's.\textsuperscript{192} Although there were many variations in this system of agricultural credit, in general a merchant-factor\textsuperscript{193} made an initial advance to the farmer in the spring with the understanding that additional advances might be necessary throughout the season to enable the farmer to harvest the crop. To secure repayment, typically due in November, the farmer mortgaged the crops to be grown (usually cotton and corn), draft animals, tools, and land. The mortgage, executed in the spring, ordinarily contained a future advance or all obligations clause to secure repayment of any future advance which might be made. Occasionally the mortgage also secured, or was claimed to secure, pre-existing debts.

During the period of the crop-lien system, the Arkansas Supreme Court resolved all obligations clause cases according to its understanding of the commercial requirements and reasonable limits of the system of nonbank agricultural credit. Many, and perhaps most, mortgages were individually negotiated, as opposed to being merely adhered to by debtors as in more recent credit systems. The starting point was the language of the security instrument, interpreted in light of what parties at home in the system would reasonably expect. The court regularly held that a mortgage secured repayment of future advances incurred between the parties in the ordinary course of business when the language of the security instrument reasonably comprehended the debt in question.\textsuperscript{194} In the

\textsuperscript{191} See generally G. Wright, \textit{Old South, New South} (1986) (dividing the economic history of the post-Civil War South into these periods).


\textsuperscript{193} So far as observed, a bank was the lender in only one all obligations clause case decided by an appellate court in Arkansas before 1920, Greeson v. German Nat'l Bank, 78 Ark. 141, 95 S.W. 439 (1906). The debtor was a lumber company.

\textsuperscript{194} See, \textit{e.g.}, Price v. Williams, 179 Ark. 12, 13 S.W.2d 822 (1929) (mortgage containing future advance clause secured repayment of advances made to debtor by assignee of mortgage);
absence of special circumstances, the obligations secured would be limited to those reasonably comprehended by the instrument, interpreted in light of the general purpose of the transaction. In a precursor of the "same class-relatedness" cases, one court held that an all obligations clause in a chattel mortgage given to secure a crop loan did not secure the debtor's payment of a third-party judgment which the mortgagee had purchased at face value, because the mortgage was intended to secure only indebtedness "of the same nature" as the original crop loan.

New commercial institutions and practices appeared in Arkansas between the wars. This period was, paradoxically, both a time of transition to a modern commercial economy and a time of economic instability and collapse. At the outset of the period, the Arkansas Supreme Court demonstrated its hostility to modern commercial financing methods when it plainly misinterpreted chattel mortgages given by an automobile dealer to a bank in order to eliminate their cross-security provisions.

As the agricultural depression of the late 1920's deepened into the Great Depression of the 1930's, the Arkansas Supreme Court condemned secured creditors who relied upon broad future advance and all

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Thompson v. B.W. Reeves & Co., 170 Ark. 409, 279 S.W. 1011 (1926); Lines v. Brandon, 129 Ark. 27, 194 S.W. 867 (1917) (mortgage given by husband and wife to secure debts owed to W.P. Brandon and J.D. Baugh also secured debts owed to partnership, Brandon, Baugh & Co., and secured advances after husband's death to enable the wife to gather the crop); Blackburn v. Thompson, 127 Ark. 438, 193 S.W. 74 (1917); Hamilton v. Rhodes, 72 Ark. 625, 83 S.W. 351 (1904); Moore v. Terry, 66 Ark. 393, 50 S.W. 998 (1899); Curtis & Lane v. Flinn, 46 Ark. 70 (1885); Bell v. Radcliffe, 32 Ark. 645 (1878) (equity will extend security of mortgage to secure repayment of advances beyond specific limitation in mortgage if necessary to carry out the purpose of the mortgage); Jarret v. McDaniel, 32 Ark. 598 (1877). For a case holding an antecedent debt to be secured under an "all indebtedness" clause in a livestock mortgage, see Hoye v. Burford, 68 Ark. 256, 57 S.W. 795 (1900).


196. Martin v. Holbrooks, 55 Ark. 569, 571, 18 S.W. 1046, 1046 (1892). The court added, ambiguously, "If the mortgagees expected to acquire a right under the mortgage which was not in the contemplation of the parties at the time of its execution, they should have employed unambiguous language expressing that intention." Id. at 571, 18 S.W. at 1047; see also Lightle v. Rotenberry, 166 Ark. 337, 266 S.W. 297 (1924) (mortgage to secure "all liabilities" of debtor to bank did not secure previously unsecured note of debtor to third party acquired by bank as collateral for third-party debt to bank).

obligations clauses in mortgages as "grasping and unconscionable." The court labelled mortgages containing such clauses "Anaconda mortgages... as by their broad and general terms they enwrap the unsuspecting debtor in the folds of indebtedness embraced and secured in the mortgage which he did not contemplate..." In this context, the "same class-relatedness" test was formulated and applied as a rule of strict construction to limit the reach of secured creditors and to provide some relief to debtors and secondary creditors. In the case of Hendrickson v. Farmers' Bank & Trust Co., the court, rejecting a claim that a real estate mortgage with an all obligations clause secured an antecedent debt, discovered that the "same class-relatedness" rule of construction was derived from natural law:

[I]n order to extend the intention of the parties beyond the primary purpose of the mortgage so as to secure the payment of debts other than those specifically mentioned, from our decisions and principles of natural justice the following rule may be deduced: Where a mortgage is given to secure a specific debt named, the security will not be extended as to antecedent debts unless the instrument so provides and identifies those intended to be secured in clear terms, and, to be extended to cover debts subsequently incurred, these must be of the same class and so related to the primary debt secured that the assent of the mortgagor will be inferred. The reason is that mortgages, by the use of general terms, ought never to be so extended as to secure debts which the debtor did not contemplate.

While relentlessly applying the "same class-relatedness" test to restrict the claims of secured creditors against individual debtors and their third-party creditors, the Arkansas Supreme Court did recognize the legitimacy of future advance arrangements in purely commercial financing, holding, for example, that a financing seller's subsequent advances to a buyer were secured under a future advance clause in a real estate mortgage.

In the most recent period of Arkansas economic history, which began at the end of World War II, conditions have generally been much

199. Id.
200. 189 Ark. 423, 73 S.W.2d 725 (1934).
201. Id. at 433, 73 S.W.2d at 729.
202. E.g., American Bank & Trust Co. v. First Nat'l Bank, 184 Ark. 689, 43 S.W.2d 248 (1931) (future advance clause in mortgage given to secure repayment of loan for purchase of business did not extend security of mortgage to later small loans unconnected with original transaction); Berger v. Fuller, 180 Ark. 372, 21 S.W.2d 419 (1929) (debtor's unsecured obligations did not become secured under all obligations clause in third-party mortgage when creditor took mortgage by assignment).
203. State Nat'l Bank v. Temple Cotton Oil Co., 185 Ark. 1011, 50 S.W.2d 980 (1932); see G. Fite, supra note 190, at 181-83, 207; Parker, supra note 192, at 1045-46.
better than in the 1930's, and the state has joined the mainstream of the American commercial and legal system. Under these circumstances, the economic emergency having passed, the Arkansas Supreme Court no longer applies the "same class-relatedness" rule strictly. Rather, the court applies the test differentially. Sometimes the court relies upon it directly in restricting the extension of a security interest. At other times the court appears to ignore or at least not to rely upon the test in upholding the extension of a security interest to cover particular advances. One interpretation of the modern Arkansas future advance cases is that the supreme court uses the "same class-relatedness" test only to justify the restriction of a security interest, and that the test is not a test at all but simply a sign of a conclusion reached on other grounds. Perhaps a better interpretation is that the court no longer applies the old test as a legal standard controlling decisions, but regards it as highlighting important factors to be considered in resolving difficult future advance cases in a modern commercial context. On balance, it appears that during the modern period Arkansas has returned to its approach under the old crop-lien system: regardless of doctrinal formulations, the Arkansas Supreme Court resolves all obligations clause cases according to its understanding of the requirements and reasonable limits of the existing commercial system, viewed in light of the particular circumstances of each case.

While the Arkansas Supreme Court was abandoning the strict "same class-relatedness" test in the post-World War II period, the federal courts in Arkansas were continuing to apply it. In National Bank v. Blankenship, the case upon which Professor Gilmore relied in rec-
ommending the "same class-relatedness" test, the debtor, who operated a poultry business, received three loans from the bank, each of which was specifically secured by a separate real estate mortgage containing a broad all obligations clause. One mortgage was on the debtor's store, a second on his farm, and a third on his home. The primary issue, litigated by the bank and the debtor's secondary creditors after his bankruptcy, was whether the all obligations clauses extended the security of each mortgage to all the debtor's other obligations to the bank. Surveying the old Arkansas cases, the federal district court restated the "same class-relatedness" test. Specifically relying upon a 1925 case in which the Arkansas Supreme Court plainly misinterpreted auto dealer-bank security instruments to eliminate their cross-security features, the court found that each mortgage was separate and independent, and not intended to secure those debts for which other mortgages had been specifically given despite the fact that all these loans were for the "general business welfare" of the debtor. Similarly, it did not matter that the debtor understood that all of his property was subject to a lien for everything he owed the bank—an understanding which plainly took him out of the category of unsuspecting debtors for whose protection the "same class-relatedness" rule had supposedly been created. On appeal, the Eighth Circuit found the Arkansas law on antecedent debts and future advances to be "in doubt," but nevertheless declined to disturb the district court's statement of Arkansas law, and affirmed the decision.

Since the Arkansas Supreme Court has retreated from a strict use of the "same class-relatedness" test, it is doubtful that Blankenship retains any vitality in Arkansas. The state supreme court, so far as has been observed, has never cited the case. Even the federal district court distinguished Blankenship and refused to apply the "same class-relatedness" test in an Arkansas case involving a detailed future advance clause.

209. 2 G. Gilmore, supra note 2, § 35.2, at 920, § 35.5, at 932.
210. Blankenship, 177 F. Supp. at 673; see supra note 155.
213. Id. at 675.
215. Id.
216. Id. at 580.
A Revised View of the "Same Class-Relatedness" Rule

In short, this survey of both New York and Arkansas law yields little support for Professor Gilmore's contention that the strict "same class-relatedness" rule of construction represented the "general" pre-Code law of future advance and all obligations clauses. The test was born in Arkansas under conditions of economic instability and widespread suffering, and was designed to protect debtors and partially equalize losses among creditors. Once the economic emergency had passed and Arkansas' economy had matured, the state abandoned the strict test and moved toward a standard of commercial reasonableness. New York, a far more important jurisdiction commercially, always applied a standard of commercial reasonableness and never applied rules of strict construction to determine the allowable scope of a future advance or all obligations clause.

Apart from the influence of Professor Gilmore, and despite its manifest deficiencies as a legal rule, the strict "same class-relatedness" test apparently retains much of its strength nationally because it provides a mechanism for limiting the priority claims of primary secured creditors while leaving the heart of the Article Nine system intact. Professor Gilmore himself always thought that the Code went too far in favoring secured creditors, and his advocacy of the restrictive "same class-relatedness" rule of construction is consistent with his general position. Similarly, courts which are reluctant to grant all of a failed debtor's assets to the primary secured creditor can apply the "same class-relatedness" rule to eliminate some or all of the secured creditor's priority claims in favor of interests securing secondary obligations. For example, in the case of In re Eshleman, a bank first made a secured purchase money loan to a debtor for an automobile and later made him a loan for business pur-

218. *Cf.* R. Hillman, supra note 2, § 21.01[3][a], at 21-9 n.24 ("The courts may use [the same class rule], not strictly as an interpretive aid, but as a weapon to guard against overreaching by savvy creditors in cases involving unsophisticated debtors.") These commentators are correct as far as they go, but their statement is too narrow: the courts use the "same class-relatedness" rule to reorder priorities as well as to protect unsophisticated debtors.

219. In 1954, Professor Gilmore told the New York Law Revision Commission that "on grounds of policy" he was "inclined" to choose "a rule under which no after-acquired property interest, no floating charge of any sort would be recognized." *2 New York, Report of the Law Revision Commission and Record of Hearings on the Uniform Commercial Code for 1954*, at 1180 (Legis. Doc. No. 65, 1954) (statement of Grant Gilmore). In 1981, Professor Gilmore argued that assignees of accounts receivable should be required to police their collateral, and that primary secured creditors should not be allowed to take all the debtor's after-acquired property after standing by while the debtor failed. Gilmore, *Good Faith Purchase, supra* note 31, at 627.

poses. When the debtor went bankrupt, the bank claimed that the relatively large amount remaining due on the business loan was secured by the perfected security interest in the car under the future advance clause in the original security agreement. The bankruptcy referee would have none of this. He held that the business loan "was so unrelated to the earlier [automobile purchase money] loan transaction . . . as to negate the inference that the debtor consented to its inclusion" as an obligation secured by the car, notwithstanding the breadth of the original security agreement's future advance clause. Aware that the "relatedness" test was less an aid to discovering the debtor's intention than a restrictive rule of law, the referee explained:

It seems wholly unjust and outrageous for a court of equity, such as a bankruptcy court, where the interests of so many other creditors are concerned in the outcome of a question such as the one before us, to permit the bank to couple to a small remaining balance on an earlier loan a wholly unrelated indebtedness over six times its size and defeat what appears to be a source of funds for general creditors. In our view this would be an impermissible extension of a future advance clause authorized by . . . the Code.

Although the result in Eshleman may have been consistent with the parties' reasonable expectations, the court acted improperly to the extent that it used the "same class-relatedness" test to substitute its particular judgment as to the fair and proper distribution of the debtor's assets for that of the state legislature and Congress. Although the systemic assumptions and wisdom of the legislature and of Congress are open to question, it is improper for courts to invoke the "same class-relatedness" rule of construction to revise national policy under the pretense of interpreting agreements.

The judicial use of the "same class-relatedness" rule of strict construction is not only wrong in principle, but may also be counterproductive in the long run. Secured creditors who wish to be able to continue to establish long-term and multifaceted security arrangements with their

221. Id. at 751.
222. Id.
223. Id. at 753.
224. Id.

Bankruptcy judges, we believe, have no business to compromise the rights of secured creditors in the interests of being "fair." They frequently fail to recognize that while the value of secured credit is a debatable question, it is not a debatable bankruptcy question. Bankruptcy law, on this point, takes—and should take—state law as it finds it.

(emphasis in original).
debtor customers may prevail upon the legislature to revise the rule. This appears to have happened in Tennessee, where in 1983 the legislature specifically abolished the “same class-relatedness” rule and provided that any written security agreement containing a future advance clause “shall be deemed to evidence the true intentions of the parties, and shall be enforced as written.” Although the statute contains a clause saving other statutory and common-law contract defenses, this legislative cure for judicial misconstruction may in the end prove worse for consumers and small secondary creditors than a straightforward judicial approach to interpretation, unencumbered by either artificially restrictive rules or legislative mandates.

In sum, the “same class-relatedness” rule should be rejected as a test of the allowable scope of future advance and all obligations clauses in security agreements under Article Nine of the Uniform Commercial Code. The rule is indeterminate in content and status and produces confusion. As a rule of strict construction, the “same class-relatedness” test is inconsistent with the policy and language of the Code. Professor Gilmore’s claim that the “same class-relatedness” rule of construction was the “general” pre-Code law of future advance and all obligations clauses is probably wrong. The use of the rule by courts to reorder legislative priorities in the distribution of failed debtors’ assets is an improper substitution of judicial for legislative judgment, and can lead to an unfortunate legislative counterattack.

Rejection of the “same class-relatedness” rule will not make the judicial task any easier in future advance and all obligations clause cases. Indeed, application of the “objectively reasonable expectations” test as the principal interpretive standard of adhesive agreements, and of the “good faith” and “conscionability” rules as the principal regulative standards, often depends upon close inquiry into facts and circumstances and the careful weighing of many factors. We turn now to explore some of the problems likely to be encountered.

**Test Cases**

There are no fully typical or paradigmatic problems involving secondary obligations of debtors to secured creditors because such problems arise on the variegated periphery of commercial security arrangements. The best that can be done is to survey some problems which have arisen and suggest how modern contract law, adapted as necessary to the con-

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227. *Id.*
text of Article Nine, might approach their resolution. Because all modern contract cases, including those under Article Nine, are highly fact-specific, we should be wary of mechanical tests which offer certain and principled resolution of all problems of a particular type.

The following discussion is organized into problems arising principally from the wording of the security agreement, parol evidence and interpretation, the nature and timing of secondary obligations, and creditor assignees. Of course, none of these areas is wholly separate from all the others.

The Wording of the Security Agreement

Omnibus Clauses

One of the baleful effects of the application of the “same class-relatedness” rule of strict construction has been the proliferation of omnibus all obligations clauses in which the secured creditor’s form lists nearly every type of legally enforceable obligation known to man. For example, instead of the simple statement, “This security interest secures all obligations of the debtor to the creditor,” one bankers’ form book suggests that a security agreement define the debtor’s “liabilities” which are secured as follows:

The term “Liabilities” shall include the liability evidenced by this note and any and all other of Borrower's liabilities, direct or indirect, absolute or contingent, secured or unsecured, joint, several, or independent, now or hereafter existing, due or to become due to, or held or to be held by, the Bank for its own account or as agent for another or others, whether created directly or acquired by assignment or otherwise.228

Professor Gilmore is at least partly responsible for this drafting elephantitis. Apparently believing that the brief and simple was obscure and misleading, he suggested that the more accurately contemplated transactions were described in the security agreement, the less likely future advances would be held unsecured through application of the “same class-relatedness” test.229

At least in the modern commercial context, Professor Gilmore’s assumption that the brief and simple is obscure seems erroneous. The plain English movement is surely right that the short and simple is more read-

228. 10 J. REITMAN, H. WEISBLATT, J. COOPER, C. SILVER & H. SHAPIRO, BANKING LAW § 251.02[16], ¶ 3(a) (1981) [hereinafter cited as J. REITMAN]. Actually, the quoted clause is one of the shorter and clearer clauses recommended. See id. § 257.04[4].

229. 2. G. GILMORE, supra note 2, § 35.5, at 932-33.
ily comprehended than the long and complex.\textsuperscript{230} Moreover, from the standpoint of the adherent-debtor who signs a standard-form contract, the problem is that he either does not read or does not fully comprehend any clause which is not immediately important. The very length of an omnibus clause may deter even a conscientious debtor from attempting to understand it. Whatever an omnibus clause gains in conspicuousness and specificity due to its length is surely lost to the debtor in the fog of words.

The problem of interpreting and policing omnibus clauses is basically the same as the problem encountered with shorter, simpler all obligations clauses. Since a security agreement establishing a flexible, long-term debtor-creditor relationship is relational, and the precise nature of future secured obligations is unknown at the outset, the list of all types of possible obligations which may arise in the future provides only a specious specificity. An omnibus clause moves the level of generality to a slightly lower plane, but the central problem remains the possibility of the secured creditor’s opportunistic exploitation of the general clause in particular circumstances.

Consider the following example. Mary borrows considerable sums from the bank to open a boutique, signing a blanket security agreement containing the omnibus clause quoted above.\textsuperscript{231} As part of her original financing, Mary also borrows a substantial sum from her aging, sick uncle, giving him an unsecured promissory note. As he advances in age, the uncle creates a trust for his grandchildren, with the bank as trustee, and with Mary’s unsecured promissory note as part of the corpus. When Mary fails to pay the uncle’s note, the bank claims that the note is now secured by her business assets under the clause in the security agreement which secures liabilities “to be held by the Bank . . . as agent for another.”\textsuperscript{232} The effect of upholding the bank’s claim would be to give the trust beneficiaries a windfall priority claim to Mary’s business assets, possibly at the expense of her third-party creditors.

The bank’s claim that Mary’s previously unsecured promissory note


David Melinkoff has written:

With communication the object, the principle of simplicity would dictate that the language used by lawyers agree with the common speech, unless there are reasons for a difference. . . . If there is no reason for departure from the language of common understanding, the special usage is suspect. If, in addition, a special usage works evil, it should be abandoned, and quickly.


\textsuperscript{231} \textit{See supra} text accompanying note 228.

\textsuperscript{232} \textit{Id.}
is now secured should be rejected. Although the trust corpus including the promissory note was acquired in the ordinary course of the bank’s business, it was not acquired in the ordinary course of the bank’s specific business with Mary. The securing of the promissory note under these circumstances is outside the objectively reasonable expectations of the parties as to the scope of their future relationship. Mary could not have agreed to let the bank exploit its position as provider of banking services to the general community to alter disadvantageously her previous financing arrangements. Similarly, to the extent that “good faith” standards of community decency and fairness contemplate protection of the debtor’s third-party creditors, the bank may be said to be acting in bad faith when it effectively gives the trust beneficiaries a windfall at the expense of Mary’s employees and trade creditors. Neither commercial law generally nor the Article Nine system in particular favors windfall gains and unwarranted forfeitures.

**Bad Drafting**

Even a form can be badly drafted. When a standard-form security agreement does not clearly state that future advances or other secondary obligations are to be secured, the court should apply the usual rule that a written agreement should be construed against the drafter and confine the security to the obligations specifically identified as secured. For example, in *Texas Kenworth Co. v. First National Bank*, each of four security agreements specifically secured the payment of the purchase price of each of four trucks. The only clue that the agreements were intended to secure other obligations was in a clause providing that the creditor would retain title to the trucks until the purchase price and related charges “and all other indebtedness from Buyer to Secured Party [was] fully paid.” The court properly found that the language of the title retention clause was insufficient to extend the security beyond the purchase price and related charges for each truck.

Of course, if a printed-form security agreement has boxes to be checked, the box by a future advance or all obligations clause must be

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233. *Restatement (Second) of Contracts* § 206 (1981) (reasonable meaning which operates against drafter generally preferred); *see supra* note 180 (discussion of the origins of section 206); *supra* text accompanying notes 176-83 (discussion of *Gillet v. Bank of America*).

Application of this general rule to security agreements under Article Nine is authorized by U.C.C. sections 1-103 (principles of law and equity supplement the Code), 1-201(3) (definition of “agreement”), and 1-201(11) (definition of “contract”).

234. 564 P.2d 222 (Okla. 1977).

235. *Id.* at 225.

236. *Id.* at 225-26.
checked to extend the security beyond the obligations specifically identified as secured.  

Parol Evidence and Interpretation

The parol evidence rule and its surrounding territory are among the most unsettled and confusing areas of modern contract law. The confusion arises in part from the overlap of two separate problems: determining what constitutes the agreement to be interpreted (the true parol evidence rule problem), and determining the meaning of whatever is found to constitute the agreement. Difficulties arise in part from the fact that a court often must interpret the parties' language to determine what constitutes the contract, and then may exclude evidence inconsistent with the contract as found. If a court can do all that, it would seem (at least to the judiciary) that a court can determine the "plain meaning" of a written contract, and exclude evidence inconsistent with that meaning.

Commercial security agreements under Article Nine only rarely raise true parol evidence rule problems. Partly through prudence and partly to comply with Article Nine's writing requirement, the parties customarily place all the terms of the basic security agreement in a single document. Even when, through oversight, the terms of a security agreement are not embodied in a single writing, conflicts rarely arise over what constitutes the agreement itself. Multiple documents or multiple written security agreements are usually consistent and cumulative rather than conflicting.

239. Article Nine contains no parol evidence rule. The definitional fabric of the Code does not lead from Article Nine into the parol evidence rule of Article Two, U.C.C. § 2-202. The common-law parol evidence rule applies to security agreements under Article Nine through U.C.C. § 1-103. True parol evidence rule problems occasionally do arise under Article Nine. For example, in Kitmitto v. First Pa. Bank, 518 F. Supp. 297 (E.D. Pa. 1981), there was a secondary issue as to whether a written pledge agreement was completely integrated or whether additional terms were contained in other documents. Id. at 299 n.2. Since the terms of the documents did not conflict, the central issue was interpretation. For an example from non-Code law, see Estes v. Republic Nat'l Bank, 462 S.W.2d 273 (Tex. 1970) (court excluded evidence of oral agreement that written deed of trust containing an all obligations clause would secure only the primary obligation).
240. U.C.C. § 9-203(l)(a) (when the secured creditor does not have possession of the collateral, the security agreement, to attach and be enforceable, must be in a writing or writings meeting certain formal requirements).
241. E.g., In re Bollinger Corp., 614 F.2d 924 (3d Cir. 1980) (statute of frauds met in the absence of a single written security agreement, when a financing statement, promissory note, and a course of dealing all indicated an intent to create a security interest).
A few cases, however, have raised what might be called psuedo-parol evidence rule problems. As in most cases discussed in this Article, a professional lender has extended credit on a secured basis, and a small business debtor has executed a printed standard-form security agreement containing an all obligations clause. However, unlike the typical case where there is no evidence as to whether the debtor read or understood the clause, the debtor in these cases admits having read the clause, but claims to have understood it to exclude certain secondary obligations. For example, in *Kimbell Foods, Inc. v. Republic National Bank* 242 three security agreements between a private lender and a business debtor contained all obligations clauses. Resisting the extension of the security interests to secure secondary obligations, the debtor offered evidence of his uncommunicated subjective intent at the time he executed the original agreements. 243 The court excluded the offered evidence as "a classic violation of the parol evidence rule and clearly inadmissible," holding that the "language of the contract, unless ambiguous, represents the intention of the parties." 244

Although the court reached the correct result in *Kimbell Foods*, holding the secondary obligations to be secured, its invocation of the parol evidence rule to exclude evidence of the debtor's subjective intent was analytically unsound. The case presented no true parol evidence problem because all agreed that the writings constituted the complete and exclusive security agreements. 245 The basic issue was the interpretation—not the content—of the all obligations clauses in the written agreements.

Under the Code, all evidence relevant to the determination of the parties' meaning or intention should be admissible. The parties' "bargain in fact" is to be determined from all "relevant circumstances," 246 which include the subjective intent of one party. Moreover, according to the Comments, Article Nine, following pre-Code law, allows a debtor to show by parol evidence that a conveyance absolute on its face was intended for security, 247 and it necessarily follows that either party could introduce parol evidence as to which of the debtor's obligations were intended to be secured. It would be consistent with this approach to allow

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243. Id. at 495 & n.7.
244. Id. at 496.
246. U.C.C. § 1-201(3).
247. Id. § 9-203 comment 4.
a debtor to introduce parol evidence to show that a written security agreement containing an all obligations clause was not intended by him to extend to some types of obligations.

The Nature and Timing of Secondary Obligations

Secondary obligations of the debtor to the creditor often arise at a time different from that of the primary obligation. These secondary obligations are often different in nature from the primary obligation. The determination of whether a particular secondary obligation is within the allowable scope of the security agreement cannot be made through the application of mechanical tests, but only through a determination of the objectively reasonable expectations of the parties. In addition, the secured creditors should be held to the duty of good faith. Both the reasonable expectations of the parties and the content of the duty of good faith are highly fact-specific. With that caveat in mind, I shall briefly discuss particular types of secondary obligations which raise problems.

Antecedent Debts

As the Arkansas Supreme Court was formulating the strict "same class-relatedness" rule of construction, it laid down even more severe restrictions on the conditions under which a security instrument could operate to secure an existing unsecured debt: "[W]here a mortgage is given to secure a specific debt named, the security will not be extended as to antecedent debts unless the instrument so provides and identifies those intended to be secured in clear terms . . . ." 248 The rule was restated by the federal district court in National Bank v. Blankenship, 249 and was claimed by Professor Gilmore to be part of the "general" pre-Code law 250 which he argued should continue to be applied under the Code. 251

Just as the restrictive "same class-relatedness" rule is inconsistent with the Code, so the requirement that the security agreement specifically identify antecedent debts is not justified by Article Nine. The Code allows antecedent debts to be among those obligations secured, 252 and

250. 2 G. GILMORE, supra note 2, § 35.2, at 921.
251. Id. § 35.5, at 932.
252. U.C.C. § 9-204(3) ("Obligations covered by a security agreement may include future advances or other value . . . .") (emphasis added); id. § 1-201(44)(b)("[A] person gives 'value' for rights if he acquires them . . . as security for . . . a pre-existing claim . . . .").
there is no stated requirement that such debts be specifically identified.253

At least when the secured creditor is a professional financer lending relatively large sums against a large portion of a commercial debtor's assets, it is not unreasonable for the financer to expect that outstanding unsecured debts be secured along with the primary secured obligations. The debtor, on reflection, should not be surprised at the lender's wish to be fully secured.254 In other situations, however, determination of the parties' objectively reasonable expectations may be more difficult.

Separate Loans for Personal and Business Purposes

A professional lender may make separate loans to a small business person for either personal or business purposes. A problem arises when the lender claims that an all obligations clause in one security agreement extends the security interest to secure repayment of another loan made for a different purpose. Many variations on this problem are possible. Either the business loan or the personal loan may be first in time, and the agreement securing the repayment of either loan may contain the all obligations clause claimed to extend the security of that agreement to the other loan. Application of the "same class-relatedness" rule in such cases will usually result in a holding that the secondary obligation is of a different class than the primary, and is therefore not secured by operation of the primary security agreement's all obligations clause.255

The problem raised by the claimed extension of an interest securing a primary loan to secure a loan for a different purpose admits to no general solution. When the loan is a substantial one for business purposes and the financer takes a security interest in a substantial part of the debtor's business assets under a security agreement containing an all obligations clause, the financer has probably made a policy decision to proceed with the individual debtor only on a comprehensively secured basis. Both the debtor and even moderately sophisticated third-party creditors should understand that, in extending credit for several different purposes,

253. Id. § 9-201 (a security agreement is "effective according to its terms"); cf. id. § 9-203(1)(a) (stating minimal formal requirements for the attachment and enforceability of a security agreement).

254. See Marine Nat'l Bank v. Airco, Inc., 389 F. Supp. 231 (W.D. Pa. 1975) (antecedent debts were secured by operation of all obligations clauses in subsequent security agreements when all loans were for working capital for business debtor); Reeves v. Habersham Bank, 254 Ga. 615, 331 S.E.2d 589 (1985) (antecedent debt of principal debtor to bank secured by operation of all obligations clause in surety's security agreement with bank).

255. E.g., In re Blair, 26 Bankr. 228 (Bankr. E.D. Tenn. 1982) (secondary business loan not secured by operation of all obligations clause in security agreement to secure repayment of personal obligations).
the financer is relying in part on the comprehensive scope of his security interest.

But when the primary secured loan is for personal purposes, for example, a purchase money loan for an automobile, and the second, otherwise unsecured loan is for business purposes, the lender and the borrower are likely to have differing expectations, neither of which is unreasonable. The lender, through use of the all obligations clause in the personal loan, has made a policy decision to proceed only on a comprehensively secured basis, and has probably failed to secure or perfect the business loan separately only through oversight. The borrower, on the other hand, may reasonably regard his personal accounts as separate from his business, and expect the bank to recognize the division. Faced with an absence of direct evidence which would tip the scales, a court may find the bank’s position slightly stronger. Certainly such a conclusion would be consistent with the Code’s broad purpose to reduce secured creditors’ risks. It may be instructive that when the Tennessee bankruptcy courts consistently favored debtors and third-party creditors against lending banks in such cases, the Tennessee legislature effectively overruled them by declaring that a security agreement containing an all obligations clause should be enforced “as written.”

**Debtor’s Obligation to Pay for Creditor’s Services**

When a professional financer lends a business debtor relatively large sums against a substantial portion of the debtor’s business assets under a security agreement containing an all obligations clause, both the financer and the debtor should reasonably expect the security interest to secure the debtor’s obligations to pay for future services extended to the debtor. Thus, despite a significant case to the contrary, a debtor’s obligation to repay a checking account overdraft should ordinarily be secured under a debtor-bank security agreement which contains an all obligations clause. Similarly, a pre-Code case which held that the se-

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256. Article Nine distinguishes between security interests in consumer goods and those in other collateral. See U.C.C. § 9-109. For example, Article Nine limits the extent to which a creditor may take a security interest in after-acquired consumer goods. Id. § 9-204(2).

257. See supra note 16 & accompanying text.


259. See supra text accompanying notes 101, 106-07.

260. Community Bank v. Jones, 278 Or. 647, 566 P.2d 470 (1977) (applying “same class-relatedness” rule, and holding that checking account overdrafts were not related to primary inventory financing and thus were not secured under all obligations clause in original security agreement with bank).

261. See, e.g., In re Midas Coin Co., 264 F. Supp. 193 (E.D. Mo. 1967), aff’d per curiam sub nom. Zuke v. St. Johns Community Bank, 387 F.2d 118 (8th Cir. 1968); In re Sunshine
curity of an agreement containing an all obligations clause extended to the debtor’s obligation to pay for the creditor’s services as stock transfer agent should also be followed under the Code.

Debtor as Surety

Sometimes the owner of the collateral is not the principal debtor to whom the creditor extends secured value, but a surety. When the security agreement contains an all obligations clause, and the value of the collateral belonging to the surety exceeds the outstanding debt, the creditor may regard the security interest as an insurance policy. Fortified against risk, the creditor may make otherwise ill-advised loans to the debtor for new and possibly risky projects, sometimes regardless of the debtor’s financial weakness. Concluding that the creditor’s making of objectively unreasonable future advances in reliance upon the surety’s collateral is in most cases unjustifiable, especially in light of the surety’s good Samaritan accommodation status, courts have historically held that the clause assertedly covering the surety’s obligation is to be construed strictissimi juris, i.e., of the strictest law. Strictly construing the


263. See U.C.C. § 9-105(1)(d) (defining “debtor” to include owner of collateral who does not owe the payment or performance of the obligation secured).

264. Functionally the same situation can arise when the collateral is jointly owned and subject to a security instrument containing a joint and several all obligations clause. For example, in First v. Byrne, 238 Iowa 712, 28 N.W.2d 509 (1947), discussed in 2 G. Gilmore, supra note 2, § 35.2, at 918-19, the parties were joint owners of real property subject to a mortgage containing a joint and several all obligations clause. The court rejected an attempt by the mortgagee to impress a lien upon the property to secure a previously unsecured individual debt of First, contracted long before the mortgage. Such joint ownership problems are rare in purely commercial security arrangements under Article Nine.

265. L. Simpson, Handbook of the Law of Suretyship 94-100 (1915); A. Stearns, The Law of Suretyship § 1.2, at 2; § 2.4, at 11-12; § 5.1, at 89-90 (5th ed. 1951); Alces, The Efficacy of Guaranty Contracts in Sophisticated Commercial Transactions, 61 N.C.L. Rev. 655, 660 (1983) (“[T]he enactment of statutory law and the evolution of common law have betrayed a discernible deference to any party that becomes obligated to answer for the debt of another.”); cf. Restatement of Security § 88 (1941) (“The contract of a surety is interpreted according to the standards that govern the interpretation of contracts in general.”); id. comment b, Special Note (“Where there is a special standard of interpretation requiring contracts to be interpreted strictly in favor of one party or the other, such rule is frequently referred to as the rule of strictissimi juris.”).
surety's contract often results in a holding that the security did not extend to the creditor's future advances to the principal debtor.

When under Article Nine a surety has put up her collateral as an accommodation to the principal debtor under a substantially adhesive security agreement with a professional lender containing an all obligations clause, the surety's security agreement should be strictly construed in accordance with the standards traditionally applied in surety arrangements. In such a case, the "same class-relatedness" rule may be treated as a formulation of suretyship's strictissimi juris rule of construction, and may appropriately be applied as a principle supplementing the Code.

Secured Creditor Advances Made to "Squeeze Out" an Intervening Lien Creditor

In 1972, the drafters of the Code added section 9-301(4), which provides absolute priority for advances made by a perfected secured creditor over an intervening judicial lien for forty-five days after the lien attaches, and which also extends the priority for advances made without knowledge of the rival lien more than forty-five days after its attachment. The principal purpose of section 9-301(4) was to conform state law to the requirements of the Federal Tax Lien Act of 1966 so that commercial secured creditors could have priority for certain future advances over the

266. The relationship between corporate contract bond surety law and Article Nine is complex and beyond the scope of this Article. In general, the professional contract bond surety in construction contracts has subrogation rights which are outside Article Nine. National Shawmut Bank v. New Amsterdam Casualty Co., 411 F.2d 843 (1st Cir. 1969). The relationship between other claims of the professional surety and Article Nine is not so clear. See generally Whitney, Rubin & Stabbe, Twenty Years of the Uniform Commercial Code and Fidelity and Surety Bonding—Some Random Observations, 18 FORUM 670 (1983); Wisner, Improving the Surety's Secured Position Under an Indemnity Agreement, 40 INS. COUNS. J. 564 (1973).

267. See Kitmitto v. First Pa. Bank, 518 F. Supp. 297 (E.D. Pa. 1981) (Pennsylvania would probably apply relatedness rule to determine scope of surety's agreement containing all obligations clause; surety issues not discussed as such); see also Reeves v. Habersham Bank, 254 Ga. 615, 331 S.E.2d 589 (1985) (antecedent debt of principal debtor to bank secured by operation of all obligations clause in surety's security agreement with bank); Estate of Beyer v. Bank of Pa., 449 Pa. 24, 295 A.2d 280 (1972) (court treated six-year course of dealing between bank and surety as evidence that surety's security agreement containing all obligations clause intended to secure future obligations of principal debtor to bank).

268. U.C.C. § 1-103 (principles of law and equity supplement the Code).

269. Id. § 9-301(4). The person with a lien on specific property acquired through judicial process is a "lien creditor." Id. § 9-301(3). An "intervening" judicial lien is one which attaches to collateral after the security interest has been perfected but before the secured creditor has made future advances.

federal government’s filed tax lien.\footnote{271}

Explaining the adoption of section 9-301(4), the drafters stated:

It seems unfair to make it possible for a debtor and secured party with knowledge of the judgment lien to squeeze out a judgment creditor who has successfully levied on a valuable equity subject to a security interest by permitting later enlargement of the security interest by an additional [optional] advance . . . .\footnote{272}

The drafters’ statement seems to be more of a critique than a justification for section 9-301(4). It should be unnecessary to adjust priority rules as a means of regulating secured creditors because the courts have other means of redressing actions taken by secured creditors and debtors for the purpose of harming third-party creditors. If a secured creditor makes a future advance deliberately to “squeeze out” the intervening judicial lienor, the court should find that the advance was made in bad faith, beyond community standards of fairness and commercial reasonableness, and should refuse to accord it priority over intervening liens, notwithstanding section 9-301(4). Alternatively, the court may find that a security interest deliberately extended under a future advance clause in order to “squeeze out” a lien creditor should be voided as a fraudulent conveyance.\footnote{273} On the other hand, if the secured creditor makes future advances within the forty-five day period allowed by section 9-301(4), even with knowledge of the intervening judgment lien, for the purpose of saving the debtor from financial collapse or preserving the value of collateral, the court should find that such advances were made in good faith and not fraudulently, and should enforce them as secured obligations entitled to priority under section 9-301(4).

Debtor’s Performance Obligations

Although the Code and commentators have spent much effort on classifying the types of collateral, they have not worried much about the taxonomy of secured obligations, perhaps because results so rarely turn on characterizations in this area. The Code recognizes two types of se-

cured obligations: payment obligations and performance obligations.\textsuperscript{274} A payment obligation is a debtor’s obligation to pay money to the creditor. The obligation may be to repay the creditor for advances, which in that case may be called “advance obligations.” Alternatively, the payment obligation may be to reimburse the creditors for administrative, collection, legal, or other expenditures made in connection with the security arrangement. Such reimbursement obligations may be called “nonadvance obligations.”\textsuperscript{275}

A debtor’s performance obligation is an obligation to do something other than simply to pay money to the creditor, or an obligation to refrain from acting in a particular way.\textsuperscript{276} Most commercial security agreements will impose many performance obligations on the debtor incidental to the security arrangement itself. For example, the debtor may agree to maintain the collateral, to insure it, to keep it in one location, to keep it free of encumbrances, and not to sell it. Breach of such incidental performance obligations is typically an event of default authorizing acceleration of the debt and foreclosure of the security interest, but the debtor’s breach usually does not otherwise entitle the creditor to damages.

We are concerned here with what might be called the debtor’s “independent” or “nonincidental” secured contractual performance obligations,\textsuperscript{277} that is, those obligations to do or not do something independent of, and not merely incidental to, the security arrangement itself. For example, a debtor may agree not to compete with the creditor, or to supply all the creditor’s requirements for particular goods or services, or to

\textsuperscript{274} U.C.C. § 1-201(37) (“‘Security interest’ means an interest . . . which secures payment or performance of an obligation.”).

\textsuperscript{275} The Second Circuit distinguished “nonadvance” from “advance” obligations in Dick Warner Cargo Handling Corp. v. Aetna Business Credit, 746 F.2d 126, 130 (2d Cir. 1984) (“We will call the debtor’s obligations to pay interest and to indemnify the lender for various expenses incurred by him obligations for ‘non-advances.’”).

\textsuperscript{276} Obviously, one could say that the obligation to pay money is simply a special type of performance obligation, but that would vitiate a useful distinction. In addition, the debtor’s breach of some performance obligations may be redressed by money damages, the payment of which is secured. However, in that case the secured creditor’s original right is to the performance, and the payment obligation which follows from a breach is merely remedial. A performance obligation is a form of “nonadvance” obligation.

\textsuperscript{277} In addition to voluntarily assumed contractual performance obligations, each debtor will have general tort duties running to the creditor. Such duties may be considered a form of performance obligation and may be claimed to be secured under an all obligations clause. However, no case has been found in which a secured creditor even claimed that a debtor’s liability to pay damages for violation of a general tort duty was secured. In the absence of highly special circumstances, an all obligations clause should not be held to extend the security to cover tortious conduct which is not a breach of the debtor’s contractual obligations, or which does not arise out of the parties’ course of dealing.
warrant that goods sold to the creditor will be of a certain quality, or to purchase all its requirements from the creditor or otherwise deal exclusively with the creditor. The debtor's performance of any such independent obligation may be secured either as a primary\textsuperscript{278} or secondary\textsuperscript{279} obligation.

A secured creditor's claim that a debtor's independent performance obligation is secured under an all obligations clause in a security agreement raises difficult interpretive and regulatory problems. Application of the "same class-relatedness" rule will almost always result in a holding that an independent performance obligation is unsecured, since such an obligation will always be of a different class than a primary payment obligation. The better approach, as with other secondary obligations, is to determine the objectively reasonable expectations of the parties as to the scope of the security agreement, and to hold the creditor to his obligation of good faith.

In *John Miller Supply Co. v. Western State Bank*,\textsuperscript{280} a financing buyer, John Miller Supply Co., lent a seller, Willow Creek Manufacturing, $5000 as partial financing for the manufacture of grain storage bins.\textsuperscript{281} Willow Creek signed a security agreement giving John Miller a security interest in certain collateral to secure the original loan and all other liabilities of Willow Creek to John Miller. Subsequently, John Miller and Willow Creek further agreed that John Miller would be the exclusive distributor of the bins.\textsuperscript{282} Willow Creek later acquired more financing from Western State Bank, which took a subordinate security interest in the same collateral as that covered by the John Miller security interest.

After the grain storage bin project failed, Western State Bank foreclosed its security interest in the collateral. John Miller then brought an action against the bank, asserting its priority interest in the proceeds. John Miller claimed that its interest secured not only repayment of the $5000 loan, but also Willow Creek's performance of its sales and exclusive distribution contracts with John Miller.\textsuperscript{283} John Miller alleged that Willow Creek had breached these contracts and that these breaches had caused it $63,000 in damages. John Miller further claimed that Willow

\begin{footnotesize}
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\item[278.] "Primary secured obligation" is defined \textit{supra} note 3.
\item[279.] "Secondary secured obligation" is defined \textit{supra} note 4. Since a performance obligation is a "nonadvance" obligation, it would never be secured under a future advance clause, no matter how broad.
\item[280.] 55 Wis. 2d 385, 199 N.W.2d 161 (1972).
\item[281.] \textit{Id.} at 388, 199 N.W.2d at 162.
\item[282.] \textit{Id.} at 387-88, 199 N.W.2d at 161-62.
\item[283.] \textit{Id.} at 389, 199 N.W.2d at 162.
\end{itemize}
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Creek's obligation to pay these damages was secured by its security interest in Willow Creek's collateral. 284

The Wisconsin Supreme Court correctly concluded that the controlling version of Article Nine permits the securing of performance obligations, 285 but it failed to cite the two sections (9-201 286 and 9-204(3) 287) which directly supported its conclusion. Instead, the court cited section 9-204(5), 288 which authorizes the securing of future advances and other value, 289 and which is marginally relevant at best since Willow Creek's allegedly secured warranty and exclusive dealing obligations were obligations to perform, not to repay advances or other value extended by John Miller.

The court defined the principal issue to be the intent of John Miller and Willow Creek as to the scope of their security agreement. 290 Applying the "same class-relatedness" rule of construction, the court found that Willow Creek's executory performance obligations were in a different class from the primary repayment obligation, and that the secondary performance obligations were not related to the primary obligation. 291 The court concluded that the parties did not intend to include Willow Creek's performance obligations among those secured under the agreement. 292

The grounds upon which the Wisconsin Supreme Court decided John Miller are shaky at best. As applied in the case, the "same class-relatedness" test amounts to a rule of law that a secondary performance obligation can never be secured under an all obligations clause in a security agreement in which the debtor's primary obligation is to repay value extended by the creditor. The secondary performance obligation will always be of a different class than the primary repayment obligation. However, as we have seen, there is no justification in the Code for such a restrictive rule of law. 293

284 Id.
285 Id. at 391-92, 199 N.W.2d at 164 (citing the 1962 version of the U.C.C.).
286 U.C.C. § 9-201 (security agreement is effective according to its terms).
287 Id. § 9-204(3) (security agreement may provide that collateral shall secure all obligations covered by the security agreement).
288 John Miller, 55 Wis. 2d at 393, 199 N.W.2d at 164.
289 U.C.C. § 9-204(5) (1962) (obligations covered by a security agreement may include future advances or other value).
290 John Miller, 55 Wis. 2d at 390, 199 N.W.2d at 163.
291 Id. at 393-94, 199 N.W.2d at 164-65.
292 Id.
293 See supra text accompanying notes 149-53. Part of the court's finding under the "same class-relatedness" test is also doubtful. Although a performance obligation is plainly of a different class than a repayment obligation, under the facts of John Miller it appears, con-
A better approach in *John Miller* would have been for the court initially to have determined the objectively reasonable expectations of John Miller and Willow Creek as to the scope of their relationship. It is reasonable to infer that the parties expected their relationship to be comprehensive, and that they expected both primary repayment and secondary performance obligations to be secured. It is not unreasonable for a financing buyer to take security for the debtor-seller's performance obligations as well as for that party's repayment of advances.

But whatever the parties' initial expectations, John Miller, as secured creditor, was obligated to enforce its security agreement in good faith. Although the case report does not contain enough facts to make a definitive determination, John Miller's claim reeks of bad faith. The companies may have been so closely connected that Willow Creek was virtually a captive of John Miller. If that were the situation, John Miller would bear substantial responsibility for Willow Creek's defaults, and should not be allowed to take collateral from Western State Bank to compensate for its own failures. Moreover, it would be helpful to know when and to what extent John Miller asserted its breach of contract claims against Willow Creek. If John Miller waited until Willow Creek finally collapsed before vigorously asserting its contract claims, the delay would be strong evidence that John Miller was acting in bad faith in asserting that its contract claims were secured.

**Creditor Assignees**

Creditors can be assignees of security agreements or of previously unsecured obligations of the debtor. Both situations can present difficult interpretive and regulatory problems.

**Previously Unsecured Creditor as Assignee of Debtor's Security Agreement**

The Code clearly permits the assignment of a security agreement, and such assignments are routinely made in retail installment and other

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294. U.C.C. § 9-206(1) (clause in security agreement waiving as against assignee debtor's claims or defenses against seller or lessor enforceable by certain assignees of security agreement); id. § 9-302(2) ("If a secured party assigns a perfected security interest, no filing under this Article is required in order to continue the perfected status of the security interest . . . ."); id. § 9-302 comment 7 (example of permitted assignment); id. § 9-405 (recording assignment of security interest and financing statement).
financing. Occasionally, a debtor's previously unsecured creditors will take an assignment of the debtor's security agreement, and assert that the previously unsecured debts become secured under the agreement's all obligations clause. Professor Gilmore regarded such claims by secured creditors as abuses justifying the strict "same class-relatedness" rule. A debtor's previously unsecured secondary obligation is never of the same class as the primary obligation under the security agreement, and can, under the rule, easily be held to be unsecured.

The "same class-relatedness" rule, however, is not necessary to find that an all obligations clause in an assigned agreement does not extend the security to the debtor's previously unsecured debts. In the absence of highly special circumstances, the debtor and original secured party could not reasonably expect that the clause was a license for the secured creditor's assignee unilaterally to convert the debtor's previously unsecured debts into secured obligations. Nothing in existing commercial practice or the Code's system of secured credit affords creditor assignees such power. Correlatively, a creditor assignee who asserts that a debtor's previously unsecured obligation is secured under an all obligations clause would appear to be overreaching, acting in bad faith. Taking the assignment may be an attempt on the part of the assignee to recapture the opportunity to secure the originally unsecured debt, an opportunity deliberately foregone when the debt was originally contracted.

Secured Creditor's Acquisition of Debtor's Previously Unsecured Debts

A secured creditor may acquire the debtor's previously unsecured obligation owed to a third party and claim that the acquired obligation has become secured under the security agreement's all obligations clause. The leading case of this type is *Gillet v. Bank of America*, a

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295. *E.g., Ex parte* Chandler, 477 So. 2d 360 (Ala. 1985) (all obligations clause in security agreement taken by assignment does not secure debtor's pre-assignment debt to assignee); cf. Thorp Sales Corp. v. Dolese Bros. Co., 453 F. Supp. 196 (W.D. Okla. 1978) (all obligations clause in security agreement taken by assignment does not secure debtor's separate third-party debt also taken by assignment).

296. 2 G. GILMORE, supra note 2, § 35.2, at 917-18.

297. See generally Muris, supra note 108.


299. This is likewise a claim thought by Professor Gilmore to be illegitimate. 2 G. GILMORE, supra note 2, § 35.2, at 918.

300. 160 N.Y. 549, 55 N.E. 292 (1899); see also Thorp Sales Corp. v. Dolese Bros. Co., 453 F. Supp. 196 (W.D. Okla. 1978) (all obligations clause in security agreement taken by assignment did not secure debtor's separate third-party debt also taken by assignment); *In re Tiffany Lingerie, Inc.*, 28 Misc. 2d 96, 208 N.Y.S.2d 471 (N.Y. Sup. Ct. 1960) (pre-Code case; all
pre-Code case discussed above in detail. In *Gillet*, the court held that an all obligations clause in a printed-form stock pledge agreement did not operate to secure the debtor's previously unsecured note which the secured creditor had acquired by assignment after the debtor's default.

In such cases under the Code, the courts should ascertain, as did the court in *Gillet*, the objectively reasonable expectations of the parties as to the scope of their debtor-creditor relationship, and should also ensure that the secured creditor is acting in good faith in claiming that the purchased obligation is secured. Probably in most cases of this nature, the securing of the acquired unsecured obligation will be both beyond the objectively reasonable expectations of the parties and a claim made in bad faith.

Still, no per se rule of invalidity should be applied in these cases. There may be circumstances in which it would not be unreasonable for a secured creditor to purchase an outstanding third-party obligation and add it to those obligations secured under an all obligations clause. If the agreement has a future advance or all obligations clause, the secured creditor could simply advance funds directly to the debtor to pay off the third-party debt. Then repayment of the advance would be secured. At least when there is the express or tacit agreement of the debtor, and oppressive results do not otherwise occur, the secured creditor should be able to advance funds directly to the third-party creditor by purchasing the obligation for fair value, and thus secure his obligation.

**Post-Assignment Advances Made to Debtor by Assignee of Security Agreement**

Occasionally, the assignee of a security agreement makes an advance to the debtor after the assignment, and then asserts that repayment of the advance is secured under the agreement's future advance or all obligations clause. At least two courts have concluded, without informed discussion, that such advances are secured under Article Nine. However, post-assignment advances can easily present problems of interpretation and regulation similar to those raised by claims that other obligations are secured under a broad future advance or all obligations clause. Such cases thus deserve close examination to determine the reasonable expectations and bona fides of all parties.

obligations clause in factoring agreement did not allow assignee of accounts receivable to apply receipts to previously unsecured third-party debts of assignor acquired by purchase).

301. See supra text accompanying notes 174-83.
302. 160 N.Y. at 556, 55 N.E. at 294.
Conclusion

Article Nine worked a revolution in liberating the law of secured credit from the restrictions of the past, in democratizing it so that virtually all financers and small businesses could easily, cheaply, and safely engage in secured transactions, and in creating a system of priorities which overwhelmingly favors secured creditors against rival claimants to the debtor's collateral. Although the drafters did not clearly state their purposes in the Comments to the Code, the main purpose of Article Nine was to encourage the extension of credit on a secured basis toward the ultimate end of promoting economic growth.

The new system grounds the debtor-secured creditor relationship largely in contract law. The parties are given substantial freedom to shape their relationship in their original security agreement, which, if it meets minimal formalities, is made effective between them and against third parties. As a corollary to the general freedom of debtor-creditor contract created by Article Nine, an agreement enables the parties to secure all secondary obligations of the debtor to the creditor, including, among others, the debtor's obligation to perform contractual duties other than to pay money.

The Code's comprehensive validation of future advance and all obligations clauses in security agreements has created difficult interpretive and regulatory problems. Many commercial security agreements containing broad future advance or all obligations clauses are both relational, in that they establish a continuing debtor-creditor relationship, and adhesive, in that they are on printed forms supplied by the creditor which are merely adhered to by the debtor. Under these circumstances, the parties' intent to include a particular secondary obligation of the debtor among those secured under the original agreement is ascertained by determining the objectively reasonable expectations of the parties as to the scope of their continuing debtor-creditor relationship. In addition, secured creditor overreaching and other abusive behavior is both deterred and redressed by requiring creditors to act in good faith, that is, in accordance with community standards of commercial reasonableness and fair dealing.

The allowable scope of a security agreement containing a future advance or all obligations clause should not be determined by applying the "same class-relatedness" rule of construction. This rule states that to be secured under a future advance or all obligations clause, the secondary obligation must be of the same class as the primary obligation and so related to it that the debtor's consent to its inclusion as a secured obligation may be inferred. The rule is inappropriate under Article Nine for
several reasons. It is without determinate content, as neither "class" nor "relatedness" is defined. Courts are unclear as to whether the rule is merely an aid to interpretation or a rule of strict construction which operates as a rule of law. As a restrictive rule of law, the "same class-relatedness" test is wholly unjustified under the Code, since it restricts Article Nine's validation of future advance and all obligations clauses, frustrating the Code's purpose to reduce transaction costs and secured creditor risks. Finally, although the restrictive "same class-relatedness" rule is alleged to have been part of the general pre-Code law, an examination of pre-Code law suggests that it was a minority rule of limited application, and that most jurisdictions, whatever their verbal formulations, applied tests of commercially reasonable expectations and good faith appropriate to the time and circumstance.