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THE NEW ARTICLE NINE OF THE UNIFORM COMMERCIAL CODE: AN INTRODUCTION AND CRITIQUE

William C. Headrick*

Part II†

The first part of this article, which appears in the previous issue of the Montana Law Review, was concerned primarily with the rules relating to the attachment and perfection of security interests under the new Article Nine. The bulk of this part of the article deals with the subject of priorities, after which certain conflict of laws problems will be considered.

Priorities Among Perfected Security Interests

As between two security interests, of which one is perfected and the other is not, the perfected one will invariably prevail, even when it is later in time and the party who perfected knew of the existence of the rival interest. There remains for discussion only the possible conflicts between perfected security interests. For such situations the old and new section 9-312 has rules governing three cases: first, the conflict over inventory between a floor-plan financer with an after-acquired property clause and a later purchase money secured party; second, the conflict over goods other than inventory (which would be mainly equipment) between an older security interest with an after-acquired property clause and a later one of the purchase money variety; and third, all other conflicts, which are governed by a general rule.

a) Purchase money priority in equipment

The conflict over equipment involves a value judgment on the financer who claims such goods in an after-acquired property clause. The Code does not invalidate after-acquired property clauses in equipment, but it surrounds them with unfavored treatment. Section 9-108 declares the after-acquired equipment to be received for an antecedent debt, thus making the security interest vulnerable in bankruptcy if the other elements of a preference are shown. And the priorities rule in section 9-312(4) cuts it down also, by allowing a rival purchase money security interest to prevail over it. The only difference between the old and the new version of this subsection is that the new one specifies that the purchase money secured party prevails not only with respect to the equipment itself, but also with respect to the proceeds thereof.

The rule of section 9-312(4) also resolves an entirely different conflict: one in which equipment is bought under a purchase money

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agreement and later used by the debtor as collateral to obtain a loan. It is obvious that the purchase money party should prevail, and he will if he files within the ten day period for retroactive perfection which is granted by section 9-301(2). For consumer goods the same is true, except that the purchase money party has a perfected interest without filing. Thus no lender can be secure with a chattel mortgage on consumer goods. Even if he files and a rival purchase money party fails to file, the latter will prevail over him.

b) Purchase money priority in inventory

The rule on inventory, which is found in section 9-312(3), could have been simplified by providing that the floor plan financer, assuming he has filed, prevails over the later purchase money party. Such a simple rule would have made sense, because a debtor who gets inventory financing through a floor plan has no business financing himself again on the same collateral by buying it subject to a purchase money interest. One contemplating obtaining such an interest should first consult the files to see whether the debtor has mortgaged his inventory, and, if he has, the purchase money creditor would know that he is subordinate, and might decide not to extend credit.

But the approach taken by Article Nine is not so simple. The draftsmen evidently wanted to allow the debtor to receive the benefit of purchase money financing when he could do so on more favorable terms than those of his existing floor plan. The only way to do this is to allow the purchase money party to prevail over the floor plan financer. But then it becomes necessary to warn the floor plan financer of the debtor's intended purchase, so that he does not extend credit on the merchandise as it comes into the debtor's possession. He cannot be made to rely on the debtor's honesty in not asking him for credit when he has given a purchase money interest to another; hence, the rule is that the purchase money creditor must give notice of his intent to finance to his potential rival, on pain of losing his priority. This rule was left intact in the revision, but no less than four changes of detail were made in the subsection.

First, the old subsection provides that the prospective purchase money creditor must give notice not only to floor plan financers whose interests are on file, but also to those whom he happens to know. In line with its policy of eliminating the requirement of knowledge and strengthening the filing system, the new Article Nine provides that only floor plan creditors with interests on file are entitled to notice.

Second, the old subsection describes the floor plan lender, if he was not known to the prospective purchase money party, as one who “prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement.” This phrase assumed that the purchase money party was filing as soon as he
obtained his interest. But there are two situations in which a purchase money security interest can be filed after the interest attaches and still be perfected from its inception. One is the general rule of section 9-301 (2), giving purchase money creditors ten days to file with retroactive effect; the other is the special rule on trust receipts of section 9-304(4) and (5), which gives a twenty-one day perfected security interest without filing.

The old Article Nine contemplates the first of these two rules on belated filing, but not the second. It deals with the first by depriving the purchase money creditor of his ten day period for filing, when it says that for priority his interest must be “perfected at the time the debtor receives possession of the collateral” (section 9-312(3) (a)). In place of “perfected,” the word “filed” should have been used, but the meaning is clear from the context when subsection (3) is compared with subsection (4).

The second case of belated filing, which exists in the trust receipts situation, was not contemplated in the old section 9-312(3). The consequence, if the words are taken literally, is that the purchase money creditor does not need to give notice until he files, which may be twenty-one days after the debtor received possession of the goods. Thus the debtor could deceive his floor plan financer into advancing money to him on the strength of the goods during those twenty-one days. Since one should not read a statute literally to cover a case not contemplated by the draftsmen, the better view, under the old Code, would be to give priority to the floor plan financer unless he received notice before the debtor obtained the goods. The new Code makes this reading explicit by providing that the notice must be given “before the beginning of the 21 day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of Section 9-304)” (section 9-312(3) (b)). Hence, a trust receipt lender must search the files before releasing the document or goods to the debtor, although he still has twenty-one days thereafter in which to file his financing statement. But if the goods become proceeds during that time, he has only ten days from the time of their sale or other disposition in which to file his interest in the resulting accounts or chattel paper.

The quoted language makes reference only to subsection (5) of section 9-304, but the same principle should apply to the very similar case under subsection (4) of section 9-304. This subsection describes the rights which a bank acquires when it finances a purchase of goods represented by documents, without having previously issued a letter of credit. Upon receipt of the documents, the bank pays the accompanying draft, and releases the documents to the debtor upon obtaining a written security agreement or trust receipt. The bank is a purchase money lender in such a case, and if a floor plan financer has an interest on file covering the inventory, the bank should be required to give him
notice at the moment it releases the documents to the debtor, at the risk of losing its priority. It is from this time on that the debtor has constructive possession of the goods, and he may at any time obtain actual possession by surrendering the documents.

The third change made in section 9-312(3) deals with the continuation of the purchase money lender's priority in proceeds. The old subsection is silent on this point and its most natural reading is that whatever priority exists for the original collateral exists also for the proceeds. The possibility of this reading was frightening to accounts financers, since accounts are proceeds of inventory. Of course, they could not be prejudiced unless they received notice of the inventory financer's superior claim to their accounts, but they had no way of knowing whether a given account, as it arose, was traceable to inventory which was unburdened or to inventory subject to the purchase money security interest of which they had received notice. For this reason, accounts financers prohibited their debtors from buying inventory subject to purchase money security interests and declared a default whenever they received a notice. The revised section 9-312(3) insulates the accounts financers from purchase money security interests in inventory. It does so by omitting accounts from the types of proceeds in which the purchase money interest continues to have priority. The priority is only for such proceeds as are "identifiable cash proceeds received on or before the delivery of the inventory to a buyer" (section 9-312(3)).

The fourth change in subsection (3) is a statement of how far in advance a valid notice may be given. There is no requirement of giving notice for each purchase money transaction, since the notice may be not only of a transaction which has taken place, but also of an intent to engage in transactions in the future. For how long is such a notice valid? The old Code is silent on this point; the new Code makes it effective for five years. That may seem like a long time for a floor plan financer to remain aware of a notice, but at least the period has the virtue of lasting as long as a filing, and thus being in itself easy to remember.

c) **General Rule of Priority**

Subsection (5) of section 9-312 contains the general rule for all cases not covered elsewhere. The old version is phrased in two parts: if both security interests are perfected by filing, priority depends on the order of filing; if one is perfected by filing and the other is perfected in some other way, priority depends on the order of perfection. This dual approach was required by the possibility of notice filing. An interest can be filed long before it arises and is perfected. (That there can be no perfection before attachment is made clear by section 9-303(1).) Thus, in the case of interests perfected by filing, an order-of-filing rule makes sense. The problems arise in the opposite case, where one security interest is perfected by filing and the other is not. The order-of-per-
fection rule of the old section 9-312(5) gives rise to difficulties mainly in the field of proceeds, since other interests are taken care of in subsections (3) and (4). The most important situation is the one in which an accounts financer has filed first, and then the debtor gives a floor plan security interest in inventory to another lender. The other lender will lay claim to the accounts as proceeds of the sale of the inventory. It is debatable whether this security interest in the accounts as proceeds is perfected by the filing with respect to the inventory or by the ten-day rule of secret perfection for proceeds. If it is assumed that the floor plan financer's security interest in proceeds is perfected without filing, then his priority against the accounts financer must be determined by the order-of-perfection rule. Who perfected first? It will usually be the inventory financer, whose interest arose when the goods came into the debtor's possession. The assignee of accounts will, under the usual arrangements of future advances and future accounts, not given value and hence not have a perfected interest until the debtor assigns the accounts to him. Hence, the inventory financer will prevail over the accounts financer despite the fact that the accounts financer was first to file.

This possibility is enough to undermine the foundation of accounts financing, since no accounts financer can be secure if a later-to-file inventory financer can come ahead of him. He can only assure himself of priority at the high cost to the debtor of taking a security interest in his inventory, thus preventing him from assigning it to some other lender.

The new Article Nine has resolved the problem by providing, first, that "conflicting security interests rank according to priority in time of filing or perfection," (section 9-312(5) (a)) thus replacing the dual rule of the old Article Nine with a single and much simpler rule; and second, by specifying that the date of filing or perfection as to the original collateral is also the date on which the right to proceeds is deemed to have been filed or perfected.

Under the new system, the accounts financer who files first is prior to any later inventory financer. But he must still beware of filing afterwards. Suppose the debtor who is opening a new business gives a security interest in his inventory to a financer. At this point, his inventory is the only source of badly needed financing, since no accounts arise until he has made sales. As his business begins to develop, he assigns his accounts to another financer. The accounts financer will be subordinate. The inventory financer has a claim to the accounts as proceeds. And if the debtor's principal executive office is at the same location as the inventory, as is apt to be the case with a small business, the inventory financer is not required to refile for proceeds. Hence, he prevails over the accounts financer with respect to all the accounts, whether they arose during the last ten days or prior to that time.

This feature of the new Article Nine is undesirable, because it prevents financing arrangements from being made in the natural order.
of first inventory and then accounts. It would have been preferable to say that the inventory financer's right to proceeds is limited to cash proceeds, thus leaving accounts unencumbered for later financing.

d) **Priority of Consignors**

The consignor is one who delivers (or consigns) goods to a merchant, for him to sell as agent of the consignor, with the right to return any unsold merchandise and the obligation to render accounts periodically as the consignor's good are sold. Consignment is used primarily as a substitute for financing. The consignor is comparable to a seller who retains a purchase money security interest in inventory, and the consignee is comparable to a debtor. For this reason, the consignor is required to publicize the arrangement by filing unless it is notorious (sections 2-326(3) and 9-408).

A new section 9-114, which is added to the Code by the revision, carries the analogy to a security interest one step further, and gives the same rule of priority to the consignor as section 9-312(3) gives to the purchase money secured party. The conflict resolved is that between a prior floor plan inventory financer and a later consignor. The consignor gets a priority only if he gives notice to the inventory financer of his consignment or intent to consign before the consignee-debtor gets possession of the goods.

**Priorities in Crops and Fixtures**

a) **General Rule**

In cases on the borderline between real and personal property, such as crops, timber, minerals, and fixtures, the question of priority is still more complicated than it is with respect to pure goods. There is not only the potential conflict between successive chattel security interests, which would have to be resolved under section 9-312, there is also the conflict over original collateral between real estate parties (typically mortgagees and grantees) and the Article Nine secured creditor. The general solution consists of compelling the secured creditor to file his financing statement in the real estate records, and to utilize the first-to-file rule for priority. In the case of fixtures, the principle is explicitly stated in old section 9-313(4) and new section 9-313(3)(b). Crops are the exception.

b) **Priorities in Crops**

Since a security interest in growing crops must be filed in the chattel records (section 9-401), it is uncertain whether the first-to-file rule is the proper one to resolve the conflict between the crop mortgagee and real estate parties, since a filing in the chattel records is not constructive notice to them. The whole area of crop priorities was left untouched by the draftsmen, except for one provision of detail contained in section 9-312(3), which they carried over from the old Code, despite
The gist of the rule of section 9-312(2) is that a crop loan which enables a farmer to produce his current crop has priority over earlier security interests in the crops, but only if the farmer is six months or more in default in the payment of the earlier interests. The rule is very misleading, because it gives the impression that it embodies a policy of allowing farmers to obtain enabling crop loans despite prior encumbrances. Such a policy would have been a very wise one to pursue. The crop priority of the current lender would work no injustice on the prior financers, who would have him to thank for any crop at all. Yet the General Comment\(^2\) claims that no demand was expressed for an effective crop priority rule, and that if one were inserted it would “create a revolutionary change.” In fact, it would probably be ineffectual, since there would be no way to prevent bankers from getting around it by making the obtaining of a crop loan an event of default.

Under these circumstances, why not abolish the rule of section 9-312(2)? This important question has been left unanswered by the General Comment. Perhaps there is no bankers’ opposition to it, because it contains a loophole as large as itself. This loophole is the requirement that the prior loan be in default by more than six months. To take advantage of it, the original financer can either insert in his agreement a clause allowing him to grant extensions of time to the farmer until the latter decides to pay the debt, in effect preventing the debt from becoming in default; or, if no such a clause has been inserted, insist that the farmer agree to an extension under threat of foreclosure. The crop priorities rule, which appears to embody a policy of facilitating crop financing, in reality is no more than a trap for the occasional lender who lets his loan stay in default for more than six months, either out of kindness or an inability to understand the words “to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise,” which are part of a paragraph-long sentence without punctuation (section 9-312(2)).

c) **Purchase Money Priority in Fixtures Against Non-Construction Mortgages.**

For the borderline cases other than fixtures, the first-to-file rule is enough. But for fixtures there is the possibility of purchase money security interests which arise in the goods before they become fixtures. Hence a rule is needed, analogous to the one in section 9-312(4), which gives the purchase money creditor a priority over lender-type security interests. Such a rule is justified by the fact that the purchase money financer supplies and adds the goods to the real estate, and that to deny him a priority would produce an unjust enrichment for the competing

\(^1\) General Comment, paragraph B-7.

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lender, who claims an interest in the goods as after-acquired property in a previously recorded mortgage. The priority for purchase money interests exists in both the old version of Article Nine (section 9-313(2)) and in the new version (section 9-313(4)(a)).

Yet there is a world of difference between the old and the new rule. The old rule went too far in protecting the purchase money party; in contrast, the new rule shows a decided bias in favor of the mortgagee.

A serious defect of the old system, which is pointed out in Comment 4(a) to the new section 9-313, is that it subordinates the mortgagee to the rival purchase money party, even when the latter fails to file his interest. As an exception, the mortgagee is protected only to the extent that he makes an advance during the perfection gap of the purchase money interest. The reason for this exception is the assumption that the mortgagee relies on the record when he makes an advance (either as an original loan or a future advance), but does not rely on future fixtures, which are claimed without any assurance that they will ever be placed on the land. This assumption is valid for most mortgages, but is inaccurate in the case of construction mortgages, where the mortgagee, who finances the fixtures as well as the building, does rely on fixtures in extending credit even before they are installed. Hence, the old section 9-313 contains two injustices: it fails to require perfection of the purchase money interest as a condition to priority over real estate mortgagees (perfection should always be required in the priority contest, as proof of seriousness); and it forgets the construction mortgagee, with his peculiar reliance on future fixtures.

Under the new section 9-313, the purchase money interest can obtain priority over an ordinary, non-construction mortgage under complex rules which depend on whether the fixture is a machine, a consumer appliance, or equipment in general. This applies to the usual situation, where the mortgage is recorded before the owner buys the fixtures with purchase money financing. In this case, as a general rule, the purchase money financer will have to fixture file before the goods become fixtures or within ten days thereafter (section 9-313(4)(a)). His failure to file or his belated filing is considered proof of lack of seriousness on his part, and he is subordinated despite the fact that the mortgagee could not have relied on the fixture as security.

When a purchase money interest is filed before the goods become fixtures, the only mortgagee with whom a conflict could arise is a prior mortgagee, one who claimed the fixtures under an after-acquired property or future-fixtures clause. But when a ten-day grace period is given, a mortgagee could conceivably intervene during that period. It would be necessary for the mortgagee to extend credit and record within that time. For this situation, subsection (4)(a) specially provides that the ten-day grace period is effective only if "the interest of the encumbrancer or owner arises before the goods become fixtures." The purchase money
party who files within ten days is therefore protected only against the claims of prior mortgagees armed with future-fixture clauses. He is not protected against the intervening mortgagee who, during the ten-day period, obtained and recorded his mortgage, provided, as always, that the mortgage was recorded first.

This dent in the ten-day grace period is not of great importance, yet it breaks with the system established for chattels in section 9-312(4), and it undermines the value of the grace period for the purchase money financer. Under the new system, if he wants to be assured of a first priority over the fixtures he supplies, the financer must file before affixation takes place; otherwise, he runs the risk of an intervening mortgagee obtaining priority over him.

There are exceptions to the requirement of a fixture filing for factory or office machines and for domestic appliances which are consumer goods, if such objects are "readily removable." In these cases, the purchase money party prevails over the mortgagee if the security interest is "perfected by any method permitted by this Article" (section 9-313(4)(c)). In the case of removable consumer appliances the purchase money interest gains perfection without need even of a chattel filing (section 9-302(1)(d)), so that the financer of such goods prevails under the new Code in the same way as he does under the old.

Consumer appliances which are not readily removable are not within the exception. Hence the purchase money financer of such goods will have to fixture file either before they are affixed or within ten days thereafter, in order to prevail over the pre-existing mortgagee under subsection (4)(a).

Fixture appliances which are not consumer goods, i.e., appliances installed in apartment buildings or in single dwellings used for rental purposes, are also treated like fixtures in general, and subject to the rule of subsection (4)(a).

The multiplicity of distinctions among the various classes of domestic appliances which become fixtures encourages financers to fixture file as a safeguard against errors of classification. The tight exception for those which are readily removable and consumer goods is more useful as a means of doing justice to a carefree financer than as a guide to sound business practice.

Readily removable machines are governed by the same rule as readily removable consumer appliances, except that the "method permitted by this Article" for their perfection is a chattel filing, which must take place "before the goods become fixtures." Once they are affixed, it is too late to chattel file.

The timing requirement for the chattel filing is severe and unnecessary. It is predicated on the notion that chattel filing is possible only for chattels, which is what the machines are before affixation. But if
the assumption that the mortgagee does not rely on the machines is correct, then the financer should not be penalized if he fails to realize that these "readily removable" objects will become "fixtures" and therefore uses the chattel files after affixation.

However, if the financer is aware of the fact that his machines will become fixtures, he can take advantage of a second chance: he still has ten days from the date of affixation in which to fixture file under subsection (4)(a). In other words, once the machine is affixed, the purchase money financer loses the benefit of the special rule on removable machines which permits him to chattel file; thereafter he is subjected to the same rule as purchase money financers of fixtures in general, and he must fixture file if he wishes to attain priority over the mortgagee.

The double filing system for removable machines appears too complex to be fully useful in everyday transactions. The safest course for a purchase money financer to follow is to fixture file whenever any piece of equipment is sold for use as a fixture. The special rule on chattel filing would serve as an escape hatch whenever the equipment is a machine and the financer chattel-filed because he did not know that it would be affixed.

A question likely to arise often under these exceptions is: when is a fixture "readily removable"? There is no easy answer. There must be some fixtures which are neither ordinary building materials nor readily removable machines or appliances. The exclusion of ordinary building materials from the scope of Article Nine (section 9-313(2)) makes it necessary to distinguish among the other fixtures, those which are readily removable and those which are not. The question of ready removability is one which should be decided uniformly throughout the country. Hence, the fact that an object is a fixture under local law does not mean that it is not readily removable. Beyond these generalizations, it is not possible to give concrete meaning to the new concept. Drawing of the line between what is readily removable and what is not will take place as cases are decided.

Of course, in many situations readily removable machines or appliances will not be fixtures. Only if they are, because of the intent that they remain permanently on the premises despite the looseness of their affixation, does the real estate party have an interest in them. If the machines or appliances are chattels, perfection may be required for priority over conflicting chattel financers and lien creditors, but not for priority over real estate parties.

The rules governing the conflict between non-construction mortgagees and purchase money parties have been oriented significantly in favor of the former. The ten-day grace period has been cut down; it is good only if a fixture filing is made and there is no intervening mortgagee. A chattel-filing, which is permitted for removable machines, must be made immediately; otherwise even prior mortgagees can defeat the
financer's interest. The no-filing rule for appliances is restricted to those which are readily removable and constitute consumer goods. In no case is the mortgagee claiming present property subordinated to a purchase money interest which is filed later.

I have dealt only with the conflict between the purchase money secured party and the mortgagee. The same rules apply to the conflict between the purchase money secured party and the owner of the land. Here two situations must be distinguished: the owner may be a later buyer of the premises or the debtor's lessor.

The basic rule governing the conflict between the fixture financer and the buyer of the land is the first-to-file-or-record rule of subsection (4)(b). The necessary filing must be a fixture filing, unless a removable machine is involved, in which case a chattel filing would also suffice if it were made before the goods became fixtures (section 9-313(4)(c)). For removable consumer appliances, no filing is required.

This last rule appears to make sense in terms of the purpose of freeing the purchase money financer of replacement appliances from the burden of filing. However, it is at variance with the rule of section 9-307(2), under which a buyer of consumer goods for his own personal, family, or household purposes prevails over the secured party, unless the secured party has filed a financing statement. No reason appears why the buyer of an appliance as a part of a house should receive less protection than a buyer of the appliance alone.

The situation of a landlord, who under his lease becomes the owner of the fixtures installed by his tenant, vis-a-vis the fixture financer, is governed primarily by subsection (4)(a). The fixture financer prevails if he has fixture filed either before affixation or within the following ten days. The two exceptions in favor of removable machines and removable consumer appliances are also applicable (section 9-313(4)(c)). Thus the landlord is treated like the prior mortgagee, unless under the lease the tenant has the right to remove the fixtures. Then the landlord has no claim to them, and the fixture financer prevails over him even if his interest is completely unperfected (section 9-313(5)(b)).

A word must be said about the conflict between a purchase money financer and a lien creditor. The equities of a creditor are far lower than those of a mortgagee. To prevail over a lien creditor, the financer need only perfect his interest "by any method permitted by this Article" (section 9-313(4)(d)). Although he has supplied a fixture which is not a removable machine, he is still protected against the lien creditor by a chattel filing. The reason for his protection is that he is often unable to know whether the buyer will affix the goods or use them as chat-
tels. Hence a chattel filing is not in and of itself an indication of lack of seriousness on the part of the secured party.

Comment 4(c) expresses the hope that the purchase money security interest in a fixture, which is mistakenly filed in the chattel records, will be valid in bankruptcy under the rule, devised for chattels, which declares void as against the trustee any transfer or security interest which would be void against a lien creditor under state law. The question is one of bankruptcy law, upon which the draftsmen of the revision were powerless to do more than express an opinion. I fully concur in their views, because fixtures are not necessarily realty for all purposes. The fact that a security interest can arise in them under Article Nine, and that they can be repossessed like chattels in ease of non-payment, without complying with the formalities of a realty foreclosure, is proof of their hybrid character. When the Bankruptcy Act sets up the dichotomy of real and personal property, it leaves open the question whether fixtures should be considered as one or the other for each particular purpose. Surely, if fixtures are chattels under state law for purposes of perfection (though not for priority over prior mortgagees), they should be considered such under the trustee's power of avoidance, which is exercised by him in his capacity as representative of the bankrupt's creditors.

d) Priority of Construction Mortgages

Construction mortgages have been singled out in section 9-313(6) for a special priority. They are prior to purchase money interests in fixtures, even if the fixture financer files within ten days after the affixation, subject only to the limitation that the affixation take place "before the completion of the construction."

The need for this priority stems from the custom (or perhaps merely the desire) of banks which finance construction to put up money not only for the buildings themselves, but also, especially in cases of home construction, for the fixtures to be installed therein. The construction mortgagee is a prior mortgagee, but unlike other prior mortgagees he relies on the future fixtures at the time he executes his mortgage. He therefore has a much stronger right to them than the ordinary mortgagee, who claims future fixtures merely as an added precaution.

The old Code's failure to recognize the construction mortgagee's special situation is probably its greatest shortcoming. It allows a contractor or owner, who has obtained construction financing for fixtures, to buy them later subject to a purchase money interest which gains an automatic priority, without having to be filed. To the extent that this rule influences banks in their lending, it tends to make them finance each stage of the construction (and especially the last one, in which most fixtures are installed) after it has taken place instead of before. Under this form of financing the bank can rely on the files, because
to the extent that it makes a future advance it is protected by subsection (4)(c) if the purchase money security interest is unfiled. The consequence is the socially undesirable one of dampening construction financing.

Under the new rules, the important question is: when is a mortgage a "construction mortgage"? From the definition in section 9-313(1)(c), it appears that the "recorded writing" must indicate that a construction mortgage is involved. And there is the substantive requirement that the mortgage have been executed "for the construction of an improvement on land."

From these words it clearly appears that no distinction can be made between a construction mortgage and an improvement mortgage. Whether a structure is being created from its very foundation or merely being improved, a mortgage to finance the work is a "construction mortgage."

The distinguishing feature of a construction mortgage is that an improvement on land is "constructed." If the improvement consists merely of the installation of a new fixture or set of fixtures, the interest is a purchase money security interest, not a construction mortgage. Under a true construction mortgage, labor is performed which is substantial in relation to the value of the fixtures installed.

An important limitation placed upon the priority of construction mortgagees stems from the fact that under subsection (4)(c), purchase money financers of readily removable machines have claims which are prior even to construction mortgagees. This priority is achieved by perfecting the purchase money interest before the machines become fixtures "by any method permitted by this Article," which gives a choice between a chattel filing and a fixture filing.

The reason for this exception for removable machines lies in the fact that construction mortgagees do not customarily finance the acquisition of machinery. They were therefore willing to relinquish their priority in relation to this type of fixture. In so doing, however, they set a trap for the unwary chattel financer: if he doesn't file before the machines become fixtures, he loses his priority. He does not enjoy the usual ten-day grace period. This burden of immediate filing is an excessive one for three reasons: first, the financer is often an assignee who buys the contract some time after the sale of the machine and at a time when it is still unfiled; second, he may not know, and should not be put under a duty to inquire, whether the machine was sold for installation in a factory still under construction; and third, the construction mortgagee places no reliance on the machine when he advances funds for the construction, and hence has no legitimate complaint if a filing takes place within the usual grace period.

Domestic appliances are treated differently from machines. The subordination of construction mortgagees to purchase money financers
THE NEW ARTICLE NINE does not apply to domestic appliances unless they are replacements, but it applies to machines even though they are originals. No financer of an appliance enjoys a priority, because appliances installed during construction are necessarily original appliances. The different rule for appliances is based on the practice of banks of financing all appliances installed in a home, including those that are readily removable.

In summary, there are three types of fixtures of interest to a construction mortgagee: fixtures in general, with respect to which he has priority over the later purchase money financer; readily removable machines, with respect to which it is the financer who has priority if he chattel files or fixture files before affixation; and domestic appliances of all sorts, with respect to which the construction mortgagee again prevails, provided the appliances were installed during construction.

A question which is likely to occur often, especially in the case of home construction is: when precisely does the construction terminate? Almost all readily removable appliances are installed in homes after the roof has been completed. Should the construction mortgagee's priority depend upon whether the window frames remain to be painted when the appliances are put into place? Emphatically not. Doubts about when the construction ends can be intelligently resolved only by asking whether the appliances are included in the plans on the basis of which the construction mortgagee extended credit. However, the purchase money financer also needs protection when a fixture is to be installed in a house which appears completed. With his interest in mind, I would say that if the owner has already moved into the house, although some details remain to be completed, the construction mortgagee's priority is cut off. There may be some mixed situations, in which a fixture financed by the bank under the construction plan is nevertheless installed after the appearance of a completed building has been created. No hard and fast rule can be laid down for these difficult cases. The judge will have to make an equitable determination on the basis of the special facts of each case.

Viewing the new rules on construction mortgages in economic terms, it can easily be seen that a lot of fixture financing business, which under the old Code is carried on by finance companies, will, under the revision, go to the mortgage banks. It appears that when the old version was drafted the finance companies exerted considerable influence, and that the mortgage banks have made their power felt much more effectively in the course of the revision. The result is not one-sided, however. The fixture financing business was divided up more or less fairly: the finance companies will do the lending on machines in newly built factories and offices, and the mortgage banks will get the appliance business for new homes. But while the mortgage banks receive their priority as a direct consequence of the recordation of their construction mortgage, the finance companies attain theirs only by a very prompt filing "before the goods become fixtures" and without the usual ten-day grace period.
Their priority is therefore much more vulnerable than that of the banks. It is this vulnerability which is unfair. Against both construction and non-construction prior mortgagees, the financer of removable machines should be given the choice between chattel filing within ten days from the date of delivery or fixture filing within ten days from the date of affixation.

Rights of Creditors Making Future Advances

The old Article Nine expressly allows a future advance clause to be contained in a security agreement (section 9-204(5)). The effect of such a clause is to save the parties the trouble of making a new security agreement every time fresh capital is advanced to the debtor. But no rules are provided to resolve the conflict that can arise between the creditor who claims to be secured in his future advance, and another secured creditor, a buyer of the encumbered goods or a judicial lien creditor. Answers to these problems are given by the new Article Nine in sections 9-312(7), 9-307(3) and 9-301(4).

a) Conflict with other secured creditor

The conflict between one secured creditor who has made a future advance and a conflicting secured party is resolved very simply by the rule of priority in time of filing or perfection. But is the priority given even in the case in which the security agreement contained no future advance clause? Here a distinction has to be made. If the security interest is perfected by possession, as in the case of a field warehouse, the creditor's possession gives constructive notice of the content of the security agreement and no more. A later competing creditor takes free of a future advance which, since it is not stipulated in the original security agreement, would have to be contained in a later one, which could be verbal and even implied, under section 9-203(1). On the other hand, if the security interest is perfected by filing, the filing constitutes notice, not only of the agreement itself, but also, under the system of notice filing, of any future agreement entered into with respect to the described collateral. Hence the first secured creditor who has filed a financing statement prevails over the second one, whether his future advance is made under cover of a clause in his agreement or by virtue of a new agreement which, in this case, would have to be in writing, but need not be filed. This rule is in sharp contrast to the one which prevails in the field of real estate mortgages, where a first mortgagee prevails only if he makes his advance without notice of the existence of a second mortgage or pursuant to commitment. If he makes it with notice and voluntarily, he loses. But the Article Nine secured party prevails over a later secured lender even in this situation.

b) **Conflict with Buyer**

The rule for buyers is more complex. The concern is with bulk transferees only, since buyers in the ordinary course take free of any security interest created by their seller. The rule which protects bulk transferees, contained in section 9-307(3), is mainly designed to prevent fraud. Indeed, it would be fraudulent for a secured creditor to make a future advance to his debtor, secured by inventory or equipment which he knew the debtor had already sold. Therefore, the basic principle is that the secured creditor loses against the buyer, if he knew of the sale at the time he made his future advance, unless he made it pursuant to a commitment. This rule did not seem strong enough to the draftsmen because of the difficulty of proving knowledge. They established that if the creditor made his advance, without a prior commitment, more than forty-five days after the sale, he should also lose against the buyer. In other words, after forty-five days, the creditor is irrebuttably presumed to have acquired knowledge of the sale.

c) **Conflict with Lien Creditor**

The position of a lien creditor is much weaker than that of a buyer. Under the rule in section 9-301(4), there is nothing to prevent the debtor and his secured creditor from conspiring, during a full forty-five days after the lien is obtained, to deprive the lien creditor of the value of the property covered by his lien. After that period there is no presumption of knowledge (as in the case of a buyer), but the lien creditor carries the burden of proving that the secured party knew of his lien when he made his advance without prior commitment. Why so harsh a rule? The answer, found in the Comment, lies in the fact that the Tax Lien Act of 1966 gives a priority to the federal tax lien over future advances, unless the secured creditor would, under state law, prevail for a full forty-five days over lien creditors, regardless of knowledge of the lien. The culprit is therefore Congress, for having passed a statute which tempts state legislatures to make an unjust rule with respect to all lien creditors, so that its financing agencies may prevail over the Internal Revenue Service with respect to future advances. Now that the futility of the federal rule is apparent, its repeal or amendment is likely. When this happens, state legislatures should change section 9-301(4), and enact a more sensible rule, such as that embodied in section 9-307(3) on purchasers.

**The Financing Statement**

The financing statement is an abbreviated version of the security agreement, which, if filed and indexed under the name of the debtor, will provide the person who searches the files with knowledge that the assets described in the statement have been assigned (in the case of
accounts or chattel paper) or transferred as security. Matters relating to the debt, as opposed to the security interest, do not appear in the financing statement. The amount of the debt, its maturity, the rate of interest, the creditor’s right to accelerate payment, and his right to be free from defenses of the account debtor are not intended to appear in the financing statement, as the form given in section 9-402(3) indicates. The searcher may obtain this information by making an inquiry of the secured party. If he obtains no response, he may have the debtor acquire this information for his benefit from the secured party under section 9-208.

a) Debtor’s name

One of the most important features of a financing statement is the debtor’s name. If the debtor is an individual doing business under a trade name, must the trade name be used? If the debtor is a partnership, must the names of all the partners appear on the financing statement? The answers to these two previously vexing questions are given in the new Article Nine. Section 9-402(7) provides that in the case of an individual, the individual name must be used; and in the case of a partnership, the partnership name must be used. Trade names and names of partners are irrelevant. But what if they are used anyway, without the legally required name? Could it be argued that this is a minor error which is not seriously misleading, making the filing valid under section 9-402(5)? The answer should be in the negative, because a reasonable man searching the files would not look under these irrelevant names. However, if the searcher looks under these irrelevant names because he is acting under the same mistake as the person who filed, or for some other reason, he should be precluded from asserting superior rights (see, section 9-401(2) for an appropriate analogy).

b) Debtor’s signature

The old Article Nine provides that both the debtor and the secured party must sign the financing statement. The requirement makes apparent good sense, since the names of both the debtor and the secured party must appear on the statement. It is paradoxical, however, that under the Statute of Frauds provision relating to the security agreement (section 9-203(1)(b)), only the debtor’s signature is needed. It hardly makes sense to require more formalities for the financing statement than for the security agreement itself. The rule is also a dangerous pitfall for persons whose legal tradition is not one of double signing, as in the Civil Law, but of signature only by the transferor or person to be charged. Under the new Article Nine, the need for the secured party’s signature has been done away with. Only that of the debtor is required (section 9-402(1)).

However, there are four cases, listed in section 9-402(2), in which the secured party’s signature is needed instead of that of the debtor.
They are cases of refiling and of filing with respect to proceeds. And under subsection (4), in the case of an amendment to the financing statement, both signatures are still required to prevent either party from prejudicing the rights of the other.

c) Changes of Debtor's Name

There are various cases where refilings are required. Most of them will be dealt with later, under the heading of “Place of Filing.” The others are the filing of a continuation statement before the original filing lapses (section 9-403(3)), the filing of a new financial statement after it has lapsed (section 9-402(2)(c)), and the change in name of the debtor. On this last point, an innovation in the new Code provides: “Where the debtor so changes his name, . . . identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time” (section 9-402(7)). Does this phrase require a refiling for the continued perfection of a security interest which attached before the debtor changed his name? The Comment supplies a clear negative answer. Refiling is required only for after-acquired property which comes into the debtor's possession more than four months after his change of name. Why not require a refiling for continued perfection in the original collateral as well? The rule which does not require refiling gives the debtor a free hand to mislead third parties by changing his name, so that under his new name his assets appear unencumbered in the files; and the secured party can, with full knowledge of what is going on, sit back without refiling. The opposite rule, which would require a refiling within four months of the change of name, might be harsh if applied to all cases, since it would compel the secured party to keep track of the debtor's name at all times. Therefore I would advocate for old collateral, a four-month rule which begins to run, not from the date of the change of name, but from the date on which the secured party was informed of that change. The burden of proving his knowledge and when he obtained it would rest on the competing party, so that the first secured party would not be exposed to an unfair surprise. Yet this proposed rule would avoid the scandal of a secured party passively cooperating with his debtor's attempts to defraud later lenders by changing his name.

d) Change of Debtor's Person

The last sentence of section 9-402(7) contains a rule that runs parallel to the one on a change of name. It has to do with a change of the debtor's person. Such a change takes place when the original debtor sells the collateral to another, subject to the security interest. The buyer in such a case usually assumes the debt. The new rule, which is really
a corollary of the old section 9-306(2), provides: "A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer" (section 9-402(7)). On behalf of this rule, it can be said that it does not invite fraud to the same extent as the one on change of name. Yet I would favor the opposite rule with a four-month period to refile, because the security interest requires as much publicity in the hands of the new debtor as in those of the old.

Does the rule on new debtors extend into the area of after-acquired property? Suppose that a bulk sale of a business has been made, and the buyer, who has assumed the seller's debts and security agreements, buys new merchandise. Does the merchandise fall under the after-acquired property clause of the inherited inventory security interest? As between the buyer and the secured party it does, since the buyer is now in privity of agreement with the secured party as a result of the latter's acceptance of the delegation. Yet, in the words of the Comment, it is "clear that a secured party could not be safe without a filing against the new debtor." I agree, if by "not safe" the author of the Comment means "not perfected." This conclusion is based on the analogy with a change of name, for which a new filing is needed in relation to after-acquired property. The same reason for a refiling exists in the case of a change of debtor as in the case of a change of name; namely, the need for publicity of security interests. Furthermore, the words "collateral transferred by the debtor" (meaning the original debtor) can be taken to exclude after-acquired collateral, which is not transferred by him, but by the new debtor.

Thus, for after-acquired property, the secured party must refile when there has been a change of debtor. Does he enjoy a four-month period in which to refile, as in the case of a change of name? On this point, the new Code is ambiguous. It lends itself to the argument that no such a period is given, because section 9-402(7) contains side by side two rules, one for the change of name and the other for the change of debtor, and it gives a four-month period in the first case and not in the second. Yet, I would subscribe to the opposite view, which draws upon the analogy between the two cases. If a four-month grace period is given for refiling in the case of a change of name, such a period should also exist in the case of a transfer to another debtor. Both events are beyond the creditor's control, and he may not be informed about them the very instant they take place. It would be unfair to require an immediate refiling with the consequence, in most cases, of a gap in perfection.

*General Comment, paragraph I-10.

**These words appear in the last sentence of Section 9-402(7), which has to do with change of debtor.**
Duration of Filing and Lapse

a) Duration of Filing

Under the old Article Nine, a financing statement is good for sixty days after the maturity date stated thereon and, if no maturity date appears, for a period of five years (section 9-403(2)). Since a maturity date is not intended to appear on a financing statement in the first place, this rule makes little sense. Any creditor who wishes to avoid lapse after sixty days from maturity can circumvent the rule by simply not stating a maturity date.

This useless rule has been abolished and in its place a five-year period of effectiveness has been given to all financing statements with but two exceptions, both of which have the effect of prolonging, not shortening, the duration of the filing. A very generous exception is provided for transmission utilities, the financing statements of which remain effective indefinitely until a termination statement is filed (section 9-403(6)). A less generous one is provided where a financing statement lapses during the course of an insolvency proceeding. Here the creditor is excused from not filing a continuation statement until sixty days after the proceeding is finished. He might neglect to refile, in the belief that the debtor will receive a discharge, and then find himself unperfected if the discharge is not granted.

The advantage of a uniform five-year period of effectiveness is that it allows the filing officer to clear the files every five years, if he arranges them chronologically. What should be done with the two exceptions? For transmitting utilities, a separate filing system will have to be set up. And for the sake of insolvency proceedings, the duty is imposed on filing officers by section 9-403(3) to keep the files or microfilm copies for a full year after lapse. When a continuation statement is filed, the filing officer must remove the financing statement from the year of its original filing, attach it to the continuation statement, and place both in the files of the current year (section 9-403(3)).

Why did the Review Committee make an exception for transmitting utilities and not for other corporations which are also apt to be long-term debtors? The General Comment (paragraph I-4) gives the impression that this question was hotly debated. The policy question is whether the filing officers should be inconvenienced by having to go over their files one by one each year to see which ones have lapsed or been terminated, or whether the bankers and other lenders should have to set up files of their own to remind themselves of financing statements which are about to lapse. The victory scored by filing officers will probably mean that the files will be less cluttered and easier to search.

b) Effect of Lapse

The effect of lapse is unclear under the existing Code, except for interests which arise after lapse, in which case it is self-evident that the
lapsed financing statement has no prejudicial effect. The doubts arise in the case of pre-lapse junior secured creditors, pre-lapse lien creditors, and pre-lapse buyers outside the ordinary course of business. The doubts are easiest to resolve the junior secured party. If his interest is perfected, he prevails over the creditor whose filing has lapsed, by application of the principle that a perfected secured creditor prevails over one who is not perfected. This point is explicitly made in Comment 3 to the old section 9-403. As to pre-lapse judicial lienors, the solution under the old Code is also clear for those who were foolish enough to consult the files before obtaining their liens. Such creditors would have knowledge of the lapsed security interest and would lose under the old section 9-301(1)(b). The same is true for the pre-lapse bulk buyer who consulted the files before he bought. But if the judicial lienor or bulk buyer did not consult the files, there is no satisfactory answer provided by the old Code. Literally, they would lose under the old Code in spite of the lapse, since they acquired their rights after the now lapsed security interest became perfected. But such a rule is extremely unfair, since, as between the secured party who allowed his statement to lapse and the innocent judicial lienor or bulk buyer, the equities are heavily on the side of the latter.

The new Code gives a simple and fair rule on the effect of lapse. Section 9-403(2) states that “if the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.” Thus all pre-lapse and all post-lapse judicial lienors and purchasers, i.e., secured parties and buyers, prevail over the creditor who let his statement lapse. Therefore, creditors whose loans mature after more than five years or who extended their loans beyond that time, should keep accurate records of when their filings lapse.

Place of Filing

There are three levels at which the question of where to file a financing statement can arise: the state level (where to file within the state), the national level (in which state to file), and the international level.

a) Place of filing on the state level

There have been only two changes in the new Article Nine on where to file within a state. A reference is made to the greater number of cases in which a realty filing is required: for fixtures, uncut timber, extracted minerals, and accounts arising from the sale thereof, but not crop mortgages, since for crops perfection is by means of a chattel filing. The rule for transmitting utilities is stated, to the effect that these companies need make only one filing per state for all of their chattels and fixtures, in the office of the secretary of state (section 9-401(5)). Apart from that, the place to file within the state depends on the “alternative” chosen by the state in question.
b) **Place of filing on the national level**

The rules of the old Article Nine on the place to file on the national level were so carelessly drafted that they were difficult to apply in a great many cases. Instead of facing the issue of where to file as such, the draftsmen began with the generalization that “this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state” (section 9-102(1)), then tried to create exceptions to it. These exceptions are framed as choice of law rules on the law applicable to the “validity and perfection,” or, at times, due to wabbling draftsmanship, merely the “validity” of the security interest (section 9-103, especially subsection (3)).

There are separate rules for ordinary goods, accounts, and general intangibles, with which mobile goods are lumped together. There is something wrong with every rule.

The problem with the rule on ordinary goods is that one cannot tell for sure what it is. It is unclear whether one should apply section 9-103(3), which would make sense, but speaks of “validity” instead of “perfection”; or whether one should fall back on the generalization of section 9-102(1), leaving unanswered the problem of goods which are moved into another jurisdiction.

The old rule for accounts is that the filing must take place in the state where the assignor keeps his records. The difficulty with it is that in the case of a large corporation, the searcher does not always know which of its many offices is its central accounting office.

The place of filing for general intangibles and mobile goods is the debtor’s chief place of business. But that test leaves in doubt the case of a corporation having its plant in one location and its executive office in another.

1) **New place of filing for ordinary goods**

In the new Article Nine, the generalization has been removed from section 9-102, and section 9-103 has been completely rewritten. The language used is overtechnical, but the meaning comes through. The place to file for ordinary goods as well as documents is the state “where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.” That is, the state where the collateral is located at the time a conflict arises with respect to it. There is an exception when the goods are intended to be moved to another jurisdiction, though it is limited to purchase money interests. Under this exception the right state for filing is the state of destination, and the interest is perfected from its inception if the filing takes place within the relevant grace period (ten days for ordinary purchase money interests; twenty-one days for trust receipt transactions) and the goods arrive at their destination within thirty days from the time of attachment.
There is also a requirement of refiling and a four-month grace period in which to do it, for goods moved from one state to another after a security interest in them has been perfected. As in the case of other refilings the four-month period is a compromise between the need to protect the creditor, who cannot be required to refile right away, and the need to protect competing good faith parties, all too often buyers, whose search of the files in the state where the goods are located would reveal nothing until the secured creditor refiled.

There is another, more subtle and more just, way of resolving this conflict of interest. It consists in giving the secured party a short period for refiling, say ten days from the time he learns of the removal, but in no case to exceed four months from the date of the removal itself. This solution would avoid the unfortunate situation which can arise under the Code, of the secured party waiting out his full four months and then, after the goods have been sold, repossessing them from a bona fide purchaser who would have been protected had the creditor promptly refiled. It would also share the virtue of the Code rule, of avoiding an indefinite and in some cases very prolonged period of uncertainty. The bona fide purchaser who bought the goods before reperfection within the four-month period would have the heavy burden of proving when the secured creditor obtained knowledge of the removal, but he would at least have a chance to vindicate a just solution.

Returning to the Code rule, what is the solution for the buyer who makes his purchase during the four-month period, when the creditor fails to file before its expiration? Under the old Article Nine anyone who purchases or levies on the goods during that time loses to the secured party, even if the secured party never reperfec ts his interest. The new Article Nine takes the opposite view when it says that if reperfection has not taken place during the four months, the security interest "is deemed to have been unperfected as against a person who became a purchaser after removal" (section 9-103(1)(d)(i)). Thus persons who purchase during the four-month period take free of the security interest if the secured party fails to refile during that period. This change is but one aspect of the new Code's tougher policy on secured creditors who do not perfect their interests.

The lien creditor is left out of this scheme, since he is not a "purchaser." It is clear that if the secured party reperfec ts during the four months following removal of the goods, the creditor's lien will be subordinate to the security interest. But what if there is no reperfection during that period? Does the lien creditor then prevail? The proper inference to draw is that since the security interest is deemed unperfected as against a purchaser, it is deemed perfected as against a lien
creditor. Therefore, the secured party prevails over the lien creditor, whether the lien is obtained during or after the four months, even if the secured party completely fails to reperfect. This inference is justified by the fact that the lien creditor is not a reliance creditor. He has a right to insist on perfection as proof of seriousness, but not as a form of publicity; hence, the filing in the jurisdiction of origin is enough to subordinate him. The consequence of all this in bankruptcy is that the secured party need have no fear of bankruptcy in the case of removal of goods, even if he fails to reperfect, since the trustee in bankruptcy, under section 70(c) of the Bankruptcy Act, has no greater rights than a lien creditor would have under state law.

There is also a problem with purchasers in the case of removal of goods and failure of the secured party to file within the allotted four months. What if a purchaser knows at the time he buys the goods that they have been wrongfully removed from the state where an interest in them is perfected and are sold in violation of the rights of the secured party? A literal reading of section 9-103(d) of the new Code would allow the buyer to prevail if the secured party, through ignorance of the removal or for some other excusable reason, had failed to refile in the jurisdiction in which the goods were bought. Actually, however, this unjust result need not be reached, since a buyer who is not in the ordinary course must qualify under section 9-301(c) which, even under the new Code, requires that he be ignorant of the unperfected security interest in order to prevail over the secured party.

2) New place of filing for intangible property and mobile goods

The differing rules of the old Article Nine on accounts, general intangibles, and mobile goods have been consolidated into a single rule by the new Article: “The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest” (section 9-103(3)(b)). The allusion to the conflict of laws rules echoes the technique of the Restatement Second, Conflict of Laws, and has the defect of not stating which conflict of laws rule a court sitting at the location of the debtor must apply. Taken literally, there is nothing in the rule which would prevent a court sitting at the location of the debtor from deciding for itself that the law governing the perfection of security interests in accounts is, say, the “situs” of the account, or the assignee’s domicile or any other place. But the intent is, clearly, to have the domestic law of the assignor’s location govern the perfection of the security interest, and hence the reference to its conflict of laws rules has to be overlooked. The place to file with respect to a security interest in accounts, mobile goods, and general intangibles, is therefore


"RESTATEMENT (SECOND) OF CONFLICT OF LAWS, ch. 9, topic 2 at 17 (P.O.D. III 1969)."
the debtor's location. By location is meant, as subsection (3)(d) explains, place of business, but if the debtor has more than one such place, his chief executive office, and if he has no place of business, his residence.

A change in the debtor's location is expressly contemplated by section 9-103(3)(e). This rule is an adaptation of the one on removal of ordinary goods. The secured party must refile at the debtor's new location within four months from the date of the change. If he fails to do so, he is subordinated to "any person who became a purchaser after the change," i.e., to a buyer of mobile equipment and to any person who obtained a security interest in accounts, general intangibles, and mobile equipment, at any time during or after those four months, but not to a lien creditor.

Finally, the place to file a security interest in chattel paper (if such an interest is perfected by filing) is also at the debtor's location, as section 9-103(4) makes clear. The analogy of chattel paper to accounts is certainly closer than to ordinary goods, which is the way the old Code treats chattel paper for lack of a specific rule. The result is different every time the debtor keeps his chattel paper in his local offices instead of at his chief executive office. It is certainly easier for the secured party, as well as the person searching the files, to refer to just this one place, rather than to search the many states where the debtor may have local offices where he keeps chattel paper.

c) PLACE OF FILING ON THE INTERNATIONAL LEVEL

On the international level, there is only one rule expressly given in section 9-103, which relates to accounts, chattel paper, general intangibles, and mobile goods. It is an exception to the usual place-of-filing rule. Thus, the place to file in other situations is governed by the same rule on the international level as on the national level.

For accounts, chattel paper, general intangibles, and mobile goods, the special rule is given by section 9-103(3)(e). Had it not been made, the form of perfection used in the foreign country could have been recognized, and any assignment of accounts, chattel paper, or general intangibles or any security interest in mobile goods would be considered perfected in the United States if the creditor had taken the appropriate steps under the law of the debtor's location to perfect his interest. However, this approach, which is the one used for ordinary goods, was rejected. In its place, section 9-103(3)(e) gives various rules for perfection in the United States, which have nothing to do with whether the relevant security interest is perfected under foreign law, except that if the foreign law provides for perfection by filing, then that perfection will be recognized.

There are three ways in which a security interest in accounts, chattel paper, general intangibles, and mobile goods can be perfected in the United States when the location of the debtor is in a foreign
country. These are: (1) as already stated, recognition of a filing in the foreign country as a form of perfection; (2) filing in the jurisdiction in the United States in which the debtor has his principal branch office, assuming he has an American branch; and (3) in the case of accounts and general intangibles representing a right to the payment of money, notification of the account debtor. The account debtor has to be an American for this third rule to operate. If he is a foreigner, the question of the perfection of the interest would arise in a foreign court, as competing parties asserted rights to the payment owed by him.

The possibility of filing at the debtor's main executive office in the United States is a partial attempt to remedy the impossibility of perfecting security interests in accounts, chattel paper, general intangibles, and mobile goods when the law of the debtor's location does not provide for perfection by filing. For mobile goods, filing is the only alternative. This means that if the foreign debtor is located in a jurisdiction which does not consider a security interest as perfected by a local filing when the goods are outside of its territory, then a filing in the state of the main office of its U.S. branch is the only possibility for perfection. Of course, if it has no branch office, perfection of the security interest simply cannot be attained. There is no way in which the draftsmen could have remedied this situation. The source of the difficulty lies with the foreign law, which fails to have a special rule for mobile goods allowing perfection at the debtor's location, no matter where the goods are taken. The same can be said of chattel paper, whenever the foreign law does not allow perfection by filing.

In the case of accounts and general intangibles for the payment of money, the choices are wider. If perfection by filing is impossible at the assignor's domicile, and if he has no branch office in the U.S., the assignment can be perfected by notifying the account debtors. This is true even if under the law of the debtor's location, the assignment would be regarded as unperfected, since the rule on perfection by notification is not a conflict of laws rule, but a rule of United States law.

There is but one point in the system devised by section 9-103(3)(c) which raises a doubt in my mind, and that is the fact that we recognize the foreign form of perfection for assignments of accounts if that form is filing. Why recognize any foreign type of perfection when the account debtor is in this country? It would have been simpler and better to eliminate this possibility for accounts (though preserving it for mobile goods) and to decide that the form of perfection for accounts owing by American businessmen to foreigners is notification to them with no alternative. When there is one system of perfection, there is also one way of resolving priorities. When two systems compete with each other it becomes, to say the least, extremely difficult. Moreover, prospective reliance creditors, in this case prospective assignees, have to search both systems to assure themselves of a priority, and that, if the prospective assignee is an American lender, requires knowing foreign law.
Perfection by Indication on a Certificate of Title in Multi-state Cases

The old Article Nine has a very simple rule on perfection by indication on a certificate of title in multi-state cases: "the perfection is governed by the law of the jurisdiction which issued the certificate" (section 9-103(4)). A good many consequences can be derived from this statement, some of which are made explicit by the revision. But an equal number of consequences are unpredictable.11

There are three situations dealt with by the detailed rules of the new Article Nine: first, where the goods are moved from a non-certificate of title state into a certificate state; second, where they are moved between the same two states, but in the opposite direction; and third, where they are moved from one certificate state into another. The case in which they go from a non-certificate state into another non-certificate state is governed by the general rule on ordinary goods, discussed earlier.

The first case is that in which goods on which an interest is perfected in a non-certificate of title state are moved into a certificate state. Suppose that because of the debtor's false declaration that the goods are unmortgaged, a clean certificate is issued for them. The general rule is that the secured party must reperfect within four months, as in the case of ordinary goods (section 9-103(2)(c)). But there is an obstacle to reperfection, which is the fact that it can only be done on the certificate of title, which is not in the secured party's possession. The Comment suggests that he can repossess the goods. But is that true where removal was not made an event of default in the security agreement and the debtor has not yet defaulted in his payments? In such a situation, the only remedy is to seek an injunction to compel the debtor to surrender the certificate of title long enough to allow the secured party to note his interest on it. The moral of this story is that a creditor secured by goods which in some other states are subject to a certificate of title law ought to make removal into those states an event of default. He can then either repossess or ask for the certificate of title under threat of repossession.

What is the situation of third parties (mainly buyers and subsequent secured creditors) who have relied on the clean certificate of title before the secured party reperfected his interest? The Committee worked out a compromise between protecting the secured party for a full four months, as in other cases, and protecting all purchasers who rely on the certificate. Purchasers were divided into two classes: dealers and others. Dealers are subject to the security interest; non-dealers, including lenders, are protected to the extent they relied on the clean certificate. They take free of the security interest, even during the first four months following

11The old as well as the new law is analyzed in Rohner, Autos, Title Certificates, and U.C.C. 9-108, 27 THE BUSINESS LAWYER 1177 (1972).
removal. Hence the secured party is very seriously exposed. Perhaps to protect him, his state legislature should pass a certificate of title law. But the dealer in the jurisdiction of removal is also very seriously exposed. His only way of making sure that he is not receiving a “hot” car, is not to buy it unless the certificate of title is more than four months old.

In the second case, the goods are moved from a certificate of title state into one which does not have a certificate law. The security interest is perfected by notation on the certificate (section 9-302(3)(b)). The owner registers them in the new jurisdiction, then sells them. Section 9-103(2)(b) gives no less than three different periods for perfection. The general rule is the four-month period from the date of removal. But if the goods are not registered until after that four-month period has elapsed, the secured party need not reperfect until they are registered. On the other hand, if the secured party surrenders the certificate of title before the four-month period is over, he loses his perfected status, and hence he must file his security interest before he surrenders the certificate.

In the third case, in which the goods are removed from one certificate of title state into another, there is likely to be no problem, since the public official of the state of removal will copy the notation of the security interest from the old certificate and make it appear on the new one. But there might be cases of fraud, in which the debtor, for example, obtains a new certificate of title from the state of origin by falsely swearing that he has lost the old one and that the goods are unencumbered. In such cases, the certificate of title in the new jurisdiction would be issued clean. The same rules would govern as if the goods had come from a non-certificate state. Non-dealers who purchase the goods are protected in their reliance on the certificate, but dealers are not protected until four months have passed without the secured party having reperfected.

Other Conflict of Laws Problems

In speaking of where to perfect a security interest, the problem of what law is applicable to perfect such an interest was discussed. Two questions remain. What law is applicable to the validity of a security interest? What law is applicable to its foreclosure?

a) LAW APPLICABLE TO VALIDITY OF SECURITY AGREEMENT

The old Article Nine equates and confuses validity and perfection by making the same law applicable to both. But the policies underlying them are entirely different, since validity has to do with the relationship of the contracting parties among themselves, and is a matter of contract law; whereas perfection is a means of determining third party rights, and the basic principle is consequently the law of the situs.
Conflict of laws questions relating to the validity of security agreements are not likely to arise very often because the U.C.C. is in force in all states but one (Louisiana) and all territories but one (Puerto Rico), and where the same law is in force in both jurisdictions there is no true conflict of laws.

However, there can easily be conflicts between jurisdictions governed by the U.C.C. and jurisdictions outside its scope (including foreign countries) because the U.C.C. has comparatively few rules of invalidity while in other jurisdictions there may still persist rules of the kind swept aside by section 9-205 or the requirement that the security interest be in a notarized instrument or be filed for its validity. Under the new Article Nine, such conflicts are resolved by section 1-105, which contains two rules: first, if the parties have chosen the applicable law by a clause in the contract, that clause will be given effect, if the transaction bears a "reasonable relation" to the chosen law; and second, if there is no choice-of-law clause in the contract, then the law of "this state" governs, assuming there is an "appropriate relation" between this state and the transaction. The expressions chosen are among the vaguest in the English language, and their natural effect is to let the judge decide the conflict according to his own enlightened, but unguided, judgment. In a word, they are not rules of law at all. Were the rules meant to let modern interest analysis take the place of rigid rules? If so, the second rule, applicable in the absence of a choice-of-law clause, is badly framed, and the first one is undesirable.

With respect to the first rule, there is no reason why the parties should have any power at all to choose the law relating to the validity of their agreement. Rules of invalidity are not foolish technicalities that defeat legitimate commercial transactions; they are rules of public policy, and their purpose in most cases, especially under the U.C.C., is to protect the debtor from attempts by the creditor to take undue advantage of his superior bargaining position. The creditor in effect dictates the contract. He should not also be allowed to dictate a choice-of-law clause to get around the public policy provisions which are intended to protect the debtor.

The second rule, which, in the absence of a choice of law clause, dictates application of the law of "this state" assuming it bears an "appropriate relation" to the transaction, is not a fair or correct way to invite interest analysis, but seems instead designed to foster parochialism. Many of the conflicts which will arise regarding questions of validity will be conflicts with foreign nations. In this context the prejudice of judges in favor of their own law needs to be reduced rather than enhanced by legislation. True interest analysis calls for a weighing of the interests of both jurisdictions, not merely of "this state," and requires the court to give effect to the law of the state which has, in the words of the Restatement, Second, "the most significant relation-
ship to the transaction and the parties.” These are the words which should have been put into the Code.

One final question on the law governing the validity of security agreements. Do the Code conflicts rules apply to the possible invalidity of the security agreement which is caused by the invalidity of the debt? The question arises when the secured debt is a loan usurious under the law of one state but not of another; or if the borrowed money was intended, with full knowledge of the creditor, to be used in a way contrary to the public policy of one of two contending states, a situation which, for example, might involve the purchase of gambling equipment. Although such a case seems to involve the validity of the security agreement, in reality the invalidity of the security stems from the invalidity of the obligation secured. A security interest cannot exist by itself, independent of an indebtedness. To exist, it needs the support of a valid obligation. Therefore, all conflict of laws questions having to do with the validity of the debt are outside of the Code, even though the invalidity of the debt carries with it the invalidity of the security agreement.

b) LAW APPLICABLE TO FORECLOSURE

Rules on foreclosure are typically rules of public policy against which the parties are practically powerless to stipulate. The choice-of-law rule is not one relating to the agreement, but one which will decide which of these conflicting public policy rules will prevail over the other. The Comment to section 9-103 of the old Code contains a hint that the same law which governs questions of perfection also governs default rights. There is nothing in the Code to support this Comment. It is also wrong, since perfection and rights on default do not involve the same policy considerations and cannot sensibly be governed by the same rule. The new Comment has wisely deleted the remark.

Unfortunately, the new Code does not have a sensible solution to put in its place. The Reasons for Change in the Final Report and the new Comment attempt to say that all questions of conflict of laws except those relating to perfection are governed by section 1-105. This ill-conceived section is indeed written in such a way as to cover, when taken literally, not only questions of contract, but also questions of foreclosure. It provides that the law chosen by the parties shall govern their “rights and duties” and otherwise that “this Act applies to trans-

12Restatement (Second) of Conflict of Laws § 179 (P.O.D. Part II 1968).
13Comment 7, third paragraph, distinguished between questions of validity or formal requisites, which are governed by the law applicable to contract questions, and “other matters (rights of third parties, rights on default and so on) which are governed by this Article.” See, G. Gilmore, Security Interests § 44-11 (1965), and R. Weintraub, Commentary on the Conflict of Laws 357 (1971).
14See Comment and Reason for Change to section 9-103.
actions bearing an appropriate relation to this state." But these words, no matter how broad they may be in meaning, cannot cover the two completely different problem areas of contracts and foreclosure. It is as absurd to equate these two areas as it is to equate foreclosure and perfection, as the old Comment did. Validity of contract, perfection, and formalities of foreclosure are three distinct areas, each with its own policies and purposes, and neither one can be intelligently governed by a conflicts rule conceived for the other.

Of course, it would have been much better to omit from the Code any rule on conflict of laws, except in the area of perfection, than to have the unfortunate rules of section 1-105. But since that section was not removed by the Review Committee, the most that can be done to save the situation is to attempt to cleanse it of absurdities by a hardy process of interpretation. I do not hesitate to say that section 1-105 was not drafted with the problems of foreclosure in mind, but merely those of contract, and that the intention of the draftsmen would not be carried out by extending it through a literal reading into an area for which it was not conceived and is wholly unsuited.

Since section 1-105 should not apply to foreclosure questions, what law should apply? In my opinion it should be the case law in this area prior to the Code. The better view under the cases, not all of which are in full harmony, calls for the application of the law of the state where the debtor is located, since that state's interest in protecting him usually outweighs the interest of any other state, such as the state of the creditor's location or of the location of the goods at the time of repossession or of the foreclosure sale.¹⁵

Foreclosure of the Security Interest

a) Persons entitled to notice

Only one change was made in the new Article Nine in this area. It relates to the technical question of who, apart from the debtor, is entitled to notice of the time and place of foreclosure and of the intent of the secured party to retain the collateral (if he has it) in satisfaction of the debt. The old Article Nine requires that notice of these two facts be given to all competing secured parties whose interest is filed or who are known to the foreclosing secured party. As explained in the Reasons for Change, this system required the foreclosing secured party to search the files for every foreclosure and to keep track of any knowledge he receives of competing security interests. The authors of the revision felt that this was too heavy a burden for the foreclosing party to bear, and reduced the number of persons entitled to notice to those

¹⁵The cases are discussed and the view followed here is expressed in Weintraub, supra note 13 at 347-352.
who had sent to the foreclosing party a written notice of their claim to the collateral (sections 9-504(3) and 9-505(2)).

The new system seems built on the premise that the foreclosing party is the one with priority. The Reason for Change to section 9-504 speaks of the party entitled to notice as a “junior secured party.” That is, of course, the usual case. But the reverse can also occur if, for example, the debtor defaults to the junior party before he defaults to the senior one. In this case the junior party would in all likelihood be the one to take possession and attempt to sell or keep the collateral. The senior secured party may have obtained his security interest prior to the time when the junior party obtained his, so that his consultation of the files at that time did not reveal the future existence of the junior party. If the senior party has not found out about the junior party through some other means, how will he be able to send him a “written notice of his claim”? Under the new rules, if he does not do so, he is not entitled to notice of the time and place of sale or of the foreclosing party’s intention to retain the collateral. The fact that he has an action against him, to have him declared a constructive trustee of the funds or of the retained collateral is no answer to the objection that he also should have had notice, so as to protect his rights at an early stage by enticing bidders for the collateral.

To meet this objection, the new Article Nine should have provided, as an exception to the general rule which it sets up, a requirement that a junior secured party give notice to any senior party of whose existence he had knowledge at the time he took possession of the collateral.

b) Creditor’s Power of Self-Help

During June, 1972, when the new Article Nine was being distributed by the printer, the U.S. Supreme Court decided the companion cases of Fuentes v. Shevin and Parham v. Cortese. The decisions in these cases raise the important question whether the procedure of self-help repossession, outlined in section 9-503 and left intact by the revision, violates the due process clause of the fourteenth amendment. The procedure used in the cases was not self-help, but rather a replevin action begun by having the sheriff seize the collateral upon the posting of a bond by the secured party, but without a hearing afforded to the debtor until after the seizure. This replevin procedure must be used, according to section 9-503, whenever seizure by self-help cannot take place without a breach of the peace, and may be used in other cases too. The holding of Fuentes is that the due process clause is violated when the debtor is not afforded a hearing prior to the sheriff’s seizure. It could easily be argued that the court was chastising the state for seizing property without due process, and that there is nothing in the opinion to prevent a private citizen from doing so, since the Constitution is addressed
only to seizures by the state. But I would reject such a reading as being not only contrary to the spirit of the decision, but also quite absurd. If repossession by the sheriff under a writ of replevin is too barbaric for the Court, repossession by the secured creditor's own act or by some repossession team hired by him for the purpose, is still more offensive to common decency. And it is also unconstitutional for the state to tolerate it. The state is responsible for the taking if it has a law either expressly or implicitly permitting one person to seize the goods of another without a determination of his right prior to the seizure.

It would be easy to argue that the security agreement itself contained, either expressly or by reference to the law, a consent by the debtor to the repossession in case of default. But this argument will not stand up, because if the law is unconstitutional, no repetition of its words in a security agreement will do the secured party any good. I do not share the view of Mr. Justice White, in his dissent, that all that is needed to get around the decision is to waive the right to a pre-seizure hearing in the security agreement. The majority makes it very plain that a clause of this kind, being a waiver of constitutional rights, is void if it is contained in contracts of adhesion, which include most security agreements, at least in the consumer field. Nor would it make any real difference whether the clause were printed in a conspicuous manner or specially brought to the attention of the debtor before he signed for the loan. His adherence would be no more voluntary than if the clause were completely buried in fine print. Nevertheless, in a truly bargained contract, a clause allowing private repossession would, I think, be valid under the Court's decision.

It is regrettable that this case was not decided during the process of revision. The Permanent Editorial Board may still take cognizance of it, and may decide, as a result, to recommend a change in section 9-503 before the new Article Nine is passed by state legislatures. This change would probably consist in the establishment of a summary procedure under which the debtor can have an opportunity to be heard before the collateral is removed from his possession. At the very end of the opinion, the Court makes clear that such a hearing need not be a trial in which the merits are conclusively established. Due process is satisfied, according to the Court, if the hearing establishes "at least the probable validity" of the secured party's claim to repossession, since its sole purpose is "to prevent unfair and mistaken deprivation of the debtor's property."17

Transition Provisions

a) NEED TO FILE OR REFILE

The provisions for the transition from the old Article Nine to the new are concerned mostly with problems of filing, and their basic aim
is to avoid surprise to secured parties who have perfected their interests under the old law. There is but one case where a refiling will have to take place on or before the effective date of the new Code. This is the case of an assignment of future accounts, if the place where the debtor keeps his accounts does not coincide with his main executive office (section 11-105(2)). For security interests in equipment or inventory there will be no need to refile, because the place of filing is the same under both the old and the new Codes. For accounts already assigned prior to the effective date, no refiling is required, because of the short-term character of the accounts.

Purchase money security interests in agricultural equipment costing less than $2,500 are exempt from filing under the old Article Nine, but not under the new. Instead of requiring a filing on the effective date, however, section 11-106(1) gives a three-year period from the date the new Code comes into force for the secured party to file. In practice, this means that he will almost never have to file because purchase money interests in such inexpensive equipment very seldom extend beyond three years.

Security interests on the property of transmission utilities are subject to complex provisions. If the old U.C.C. has been amended in the state to provide a filing of indefinite duration in the office of the secretary of state, the new Article Nine brings no change, and the old filing remains effective. But if the state had dealt with the problem of transmission utilities by a different statute or had not dealt with it at all, a filing must be made with the secretary of state. There is a double rule for such filing: for existing equipment, in which the secured party already has a perfected interest, a three-year period of grace is given; but for new equipment which becomes subject to the security interest after the effective date, a new filing must take place, at the very latest, on the day the utility obtains possession of the new equipment under section 11-105(2).

Why three years for refiling in the case of existing equipment? Perhaps the reason for the distinction between existing and future equipment of a transmission utility is merely a conceptual one: in the case of future equipment, the interest arises during the effectiveness of the new Code, but in the case of old equipment the interest was already perfected prior to that time. This reason does not seem convincing, since it makes a distinction between notice filing and ordinary or perfection filing prior to the effective date, and gives the latter more force and effect than the former. The prejudice against notice filing is one which I thought had been completely overcome when the old Code was drafted. It would have been better to require filing with the secretary of state on or before the effective date for present as well as future interests in transmission utility equipment. If the advice of allowing ample time between enactment and effectiveness (found in the Discussion to section 11-101) is followed, there would be opportunity enough for the financers
of transmission utilities to inform themselves of the need to refile and to do so. Even under the new rule, they ought to refile prior to effectivity, to cover any new equipment which the utility may thereafter acquire.

b) LAPSE

There is a different rule for lapse under the old and the new Codes. Under the old Code, if the financing statement contained a maturity date less than five years from the date of filing, the statement lapsed sixty days after maturity. Under the new Code it lapses five years from the date of filing in all cases (section 9-403(2)). To answer the question how long a filing caught in the change would last, section 11-105(1) provides that it would be effective "not less than five years after the filing." Hence filing officers who have not already done so will have to arrange their existing files by years as soon as the new Article Nine comes into force, and disregard any maturity date which may appear on financing statements which have not yet lapsed on the effective date.

c) PRIORITIES

The principal difference between the old and the new Article Nine lies in the area of priorities, for which the unforeseen consequences of the old rules relating to construction mortgages and accounts as proceeds of inventory have been remedied. Another important change in the area of priorities relates to the position of lien creditors who, under the new Code, will prevail over unperfected security interests despite their knowledge of the existence of such interests.

There is one area where the old Code is clear and one where it is not. Where it is clear, which is in regard to lien creditors and fixtures, it is impossible to say that the new Code is declaratory of the meaning of the old. Hence, section 11-107 provides that the old U.C.C. will apply if "the positions of the parties were fixed prior to the effective date of the new U.C.C." But for the priority problems on which the old Code was vague and unintending, as in the area of accounts and inventory, it would be wrong to apply this principle. Instead, recourse should be had to the rule of section 11-108, by virtue of which, "unless a change in law has clearly been made, the provisions of the new U.C.C. shall be deemed declaratory of the meaning of the old U.C.C."

In fact, even before the new U.C.C. becomes effective, its provisions constitute scholarly authority, similar to that of the Restatements, and can guide courts around the ambiguities and away from the unintended results of the old Code.

Conclusion

It is impossible at this point to know whether the New Article Nine will be a successful and long-lasting statute. The most I can offer
therefore is my personal evaluation of its innovations, based on an
analysis of the way the rules are framed.

Half of the total number of sections have been revised and seven
sections, among the most important, have been completely rewritten.
And yet few changes of substance have been introduced. The vast ma-
jority of the changes are improvements of draftsmanship, clarifications
of points left in doubt, and corrections of mistakes due to an inability
at the time of the original drafting to realize the consequences certain
rules would have. Some substantial changes have been made, and many
have yet to be accomplished. To show the relationship between the
different types of changes and non-changes, I will use the time-honored
method of drawing up a balance sheet. Under the heading of “assets”
are placed the positive substantial changes. Under the heading of
“liabilities” are the changes which, in my opinion, ought to have been
made, but were left out. As “surplus” are listed the most outstanding
improvements of a technical nature, though use of the word “surplus”
is dictated by generally accepted accounting practices and not by a
personal belief that such improvements are unnecessary.

a) Assets

The greatest improvements of the new Article Nine were brought
about in the area of priorities. The relative position of the earlier
accounts financee and the later inventory financee has been adjusted
in favor of the former. The priority position of consignors has been
established by analogy to that of purchase money financees of inventory.
The mortgagee of real property will not be subordinated to later pur-
chase money security interests in fixtures, unless such interests are fix-
ture filed or, in the case of readily removable machines and consumer
appliances, at least perfected. And the construction mortgagee is given
a new priority in relation to all fixtures installed during construction,
with the exception of removable machines, on which he places no re-
liance. The knowing lien creditor is no longer subordinate to the unfilled
security interest. And the rank of the secured party making future
advances has been elaborately, if not always fairly, established.

Apart from the area of priorities there are only two substantial
changes. Both have to do with the place of perfection. They deal with
the place of filing on the national level and with the problems arising
when motor vehicles move into or out of certificate of title jurisdictions.

b) Surplus

Most of the technical changes have to do with proceeds and the
financing statement. Proceeds need no longer be claimed expressly,
either in the security agreement or on the financing statement. On
the other hand, a claim to them must be perfected within ten days if
the original filing is not suitable for them. Insurance proceeds are now
clearly proceeds. Financing statements need no longer contain the
signature of the secured party. The debtor’s name must be his real name, not his trade name, and if a partnership it must contain the name of the partnership rather than that of the partners. The financing statement lapses after five years regardless of the maturity of the debt; and lapse has a retroactive effect to the prejudice of the secured party. Other changes are: the concept of “contract rights” has been deleted; agricultural equipment worth less than $2,500 is now subject to filing; notice of time and place of foreclosure need be given only to those junior secured parties who request it in writing; security interests in extracted minerals and the accounts arising from their sale must be filed in the realty records of the wellhead or minehead; the filing of a security interest in fixtures in the chattel records is a means of perfection; and interests in the assets of transmission utilities (whether the assets be chattels or fixtures) need be filed but once in each state, in the office of the secretary of state, with the duration of such filings being indefinite.

c) Liabilities

Many serious defects plague Article Nine even after the revision. Foremost among them is the failure to require equipment leases to be filed, thus creating a loophole in the Code’s coverage which encourages evasion and litigation. The next most serious defect is the callous indifference to the interests of the farmer in the area of crop financing. Despite the admitted defects of the old Code, the draftsmen of the revision felt that improvements were not worth making. They did not require a real estate filing for crop mortgages, thereby undermining the financing of crops because of the impossibility of determining priorities between crop mortgagees and real estate parties. As a favor to lenders, they did abolish the restriction on mortgaging future crops, although in contradiction to that decision, they retained the feeble enabling crop priority rule, apparently because its small practical importance made a deletion not worth the effort. The third serious defect in the new Article Nine is the casual way in which all conflict of laws questions, with the exception and those on place to file, are combined in section 1-105, which is not adequate as a statement of conflicts in contract matters, and less as a pointer to the law governing foreclosure. Among the lesser defects are the following: the failure to specify that the statute of frauds is complied with when the debtor signs a financing statement in lieu of the security agreement; the failure to set up rules for cash proceeds outside insolvency proceedings; the failure to render void a security interest in future equipment, thus solving problems of priority and bankruptcy in a single stroke; the failure to allow the buyer in the ordinary course of business to prevail over the secured party when the security interest had been created not by the seller, but by a third person; the failure to say explicitly that a fixture filing is enough to perfect an interest in goods likely to become fixtures, although they are not installed on the land as foreseen; the failure to delete the word
“products” from the form of a financing statement; the failure to say outright that accounts are not proceeds of inventory, thereby making it possible for a new business to obtain financing by first mortgaging the inventory and later assigning the accounts; and finally, the failure to take the short step of proclaiming that perfection of a security interest is necessary for its validity against the debtor, not only to simplify the overall structure of the Code, but more importantly to safeguard the debtor against casual security agreements which do not become important for the creditor until the debtor goes into default.

d) **Net Worth**

Accountants place the “surplus” on the same side of the balance sheet as “liabilities,” but to do so in an evaluation of the new Article Nine would be impossible. Departing, then, from accepted practices, and adding together assets and surplus, there are significant improvements, both in number and in quality. The changes are almost all for the better, and thus the new Article Nine should be passed in every jurisdiction of this country which has already enacted the Uniform Commercial Code, though with a non-conforming amendment in the area of crops. Passage should not take place under the illusion that we now have a definite and perfect statement of the law of security interests in chattels. The new Article Nine still needs to be revised, and it is my hope that within the next few decades another Review Committee will be appointed to make still further improvements, which will not be hampered by external restrictions, such as those which limited the work of the recent Review Committee to proposing piecemeal amendments to sections that had proved unworkable or obviously required amendment.

A new Review Committee should be free to take a fresh look at the general structure of the Code, and to rewrite many of its provisions in a more understandable form. Indeed, one of the gravest defects of the old Articles Nine which has aggravated itself in the new one, is the style of draftsmanship. It oscillates between long sentences devoid of punctuation and extremely concise, often delphic, statements, the full implications of which do not become clear until after a lengthy study. Another serious defect of style is the dividing up of a single sentence into a large number of subsections or paragraphs, in an attempt to compress rules. From the point of view of content, the new Article Nine is a very advanced and modern statute, but it is being deprived of the influence over foreign legislation which it deserves by the fact that it is totally untranslatable. In fact, to most foreign comparatists it is incomprehensible even in English. The same complaint can also be heard from intelligent attorneys in the United States, and to the extent that their complaint is true, the purpose of the law is defeated. To be carried out effectively, its rules and policies must be within the reach of ordinary lawyers and susceptible of being explained by them to their
clients. No law should be a mystery, the secrets of which are kept by specialists, particularly when those secrets are not released evenly to all who seek advice, but given exclusively to those who have retained the specialists. The obscurity of the law then inevitably becomes an instrument of social injustice.