Article 9—A Restatement and Revision of Chattel Security

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The Article on Secured Transactions has been completely rewritten more times than any other article of the Code. Six separate printed drafts were submitted to the combined membership of the American Law Institute and the Conference of Commissioners on Uniform State Laws before the final text was prepared upon the basis of some thirty-six amendments voted at the 1951 meetings of the two bodies in joint session.

In addition to these six printed drafts, an even larger number of separate mimeographed drafts were prepared by the drafting staff and were circulated for discussion with the advisers appointed by the Institute and the Commissioners, with the Editorial Board, and with various committees and groups of lawyers and businessmen in all parts of the country.[1] Many of these drafts bear a superficial similarity to one or more of the other drafts. This similarity is only superficial because a change in the policy of a few key sections generally served to change the impact of Article 9 as a whole.

A number of these printed and mimeographed drafts have been the subject of important law review articles,[2] important for their discussion of basic problems, for their criticism of policies expressed in a particular draft, and for their analysis of inconsistencies or ambiguities.

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[1] Schnader, *The New Commercial Code*, 36 A.B.A.J. 179, 253 (1950); Mentschikoff, *The Uniform Commercial Code, An Experiment in Democracy in Drafting*, *id.* at 419.

[2] A few of them are: Llewellyn, *Problems of Codifying Security Law*, 13 LAW & CONTEMP. PROB. 687 (1948); Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L.J. 1341 (1948); Kripke, *The "Secured Transactions" Provisions of the Uniform Commercial Code*, 37 VA. L. REV. 577 (1949); Ireton, *The Proposed Commercial Code—A New Deal in Chattel Security*, 43 ILL. L. REV. 794 (1949); Dunham, *Inventory and Accounts Receivable Financing*, 62 HARV. L. REV. 588 (1949); Kripke, *Chattel Paper as a Negotiable Specialty Under The Uniform Commercial Code*, 59 YALE L.J. 1209 (1950); Schwartz, *Pennsylvania Chattel Security and the Uniform Commercial Code*, 98 U. OF PA. L. REV. 530 (1950); Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 LAW & CONTEMP. PROB. 27 (1951); Everett, *Securing Security*, *id.* at 49; Countryman, *The Secured Transactions Article and Section 60*, *id.* at 76; Hunt and Coates, *The Impact of the Secured Transactions Article on Commercial Practices with Respect to Agricultural Financing*, *id.* at 165; Kripke, *Modernization of Commercial Security Under the Uniform Commercial Code*, *id.* at 183.

However, now that Article 9 has reached final form, it becomes subject to Section 1-102(3)(g):

> Prior drafts of text and comments *may not be* used to ascertain legislative intent. [Italics supplied.]

This mandate applies with peculiar force to Article 9 and to the law review discussions of its prior drafts.

Hence the present paper will resist the fascinating challenge of tracing the growth of each section of the final text through all of the prior drafts, and recounting the arguments pro and con which led to the ultimate provision. It will be confined to an analysis of the final text and suggestions as to various techniques to be employed in operating under it. The aim will be to simplify the statute by presenting it in "round, unvarnished" language, in the hope that such a presentation will be of assistance not only to lawyers, but also to legislators and business men who have not had legal training. For this reason, reference to prior law in the various jurisdictions will not be elaborated by citation and discussion; for these the reader is referred to the law review articles which have been noted.[3]

General Policy Considerations

Before undertaking consideration of the detailed provisions of Article 9, it is important to consider the basic policies which are its foundation.

Facilitating the Creation of the Security Interest

The most important feature of basic policy is the recognition that chattel security is a legitimate component of the credit structure—no longer to be regarded as a dangerous excrescence. As a necessary concomitant the road to legally "good" security under Article 9 is straight, paved, clearly marked and well-lighted; no longer is it an obstacle course seeded with booby traps.

Such a result is the climax of nearly a century of legal, economic and social evolution. The process started in a simpler society when an individual who owed money was considered to be somewhat shiftless unless his credit was good enough to enable him to borrow from his banker. At the same time, the businessman whose assets were encumbered likewise was considered somewhat second-class. Liens[4]

[3] *Supra*, note 2. See also Gilmore and Axelrod, *Chattel Security: I*, 57 Yale L.J. 517 (1948); Gilmore, *Chattel Security: II*, *id.* at 761 (1948).

[4] "Liens" will frequently be used herein as a general term to cover chattel mortgages, pledges, conditional sales, and other forms of security. Similarly "chattel security" will be often used as inclusive of accounts, chattel paper, instruments and documents as well as goods.

on assets of the householder or of the businessman were frequently secret and, therefore, entrapped general creditors who expected assets to be unencumbered.

Hence, both legislatures and courts manifested hostility to chattel security. There developed elaborate and technical requirements as to the formalities of the security agreement: acknowledgments, affidavits of good faith (sometimes by the creditor, sometimes by the debtor, sometimes by both of them), requirements that the security be not only identified but also described with the utmost particularity (*e.g.* serial numbers on household furniture). In some cases where the statute required an affidavit to be "affixed," the courts deliberated whether a wire staple affixed it adequately or whether mucilage was essential.

In some states there were absolute prohibitions on chattel security in certain situations, for example, on a stock of merchandise. In others, disfavor was shown to a lien on after-acquired property, or to a lien securing subsequent advances.

Again, state law against fraudulent conveyances was applied to strike down security transactions where the assignor of accounts receivable was not deprived of "unfettered dominion" over collections, or was permitted to deal with a few items of returned merchandise without strict accountability.

The list of hostile manifestations could be extended, as could the enumeration of techniques by which lawyers representing creditor interests sought to provide protection for the desired collateral. Conditional sale contracts were used with varying degrees of success to retain title to the collateral as against the buyer and his creditors until the purchase price was paid. Drafts with invoice attached were adapted from overseas trade, and were combined with trust receipts adapted from special banking transactions, in order to finance the movement of automobiles and like articles from manufacturer to distributor and from distributor to dealer. Inventory on the premises of a manufacturer or jobber was segregated into a "field warehouse" (often merely a room or a fenced-off enclosure on the same premises), and negotiable warehouse receipts covering the inventory were used to collateralize loans.

Each of these and similar techniques were challenged in court as "secret liens," as "devices," as "form without substance." Sometimes the attack succeeded, in other cases it failed; but always the courts were assiduously ready to search for technical reasons why even the form was not good. Occasionally creditor interests obtained statutory

protection for techniques which had been adapted from the common law.

All of this is a thing of the past under Article 9, which recognizes that chattel security is here to stay, and which therefore proceeds on the theory that the statute should facilitate, rather than hinder, the obtaining of completely valid security.

The Credit Risk

A second basic policy is that the statute's function is to provide *legal* security in credit transactions, but to leave *many* (but not all) risks of the debtor's dishonesty on the creditor just because it is a *credit* transaction.

As will be discussed later, the greatest facility is provided for legally valid inventory liens; but if the inventory is gone when the debt matures, or if it has declined in value below the agreed ratio, this is no concern of the statute.

Similarly, full legal validity is afforded to transactions secured by accounts receivable; but if the debtor is allowed to collect the receivables, and if he dissipates the collections, the statute cannot restore them.

Hence, procedures which were evolved in prior years for the double purpose of obtaining both legal and practical protection will retain their full utility for obtaining practical protection. Indeed such procedures are more satisfactory under Article 9 than heretofore, for now they can be flexibly applied in accordance with the needs of a particular case and with knowledge that legal invalidity of the lien will not result from minor relaxations.

Uniformity

The third policy of Article 9 is uniformity. Uniformity of the law in various states which enact the Commercial Code will be of great convenience to those whose secured transactions cover a number of states and who, at the present time, must conform to the differing requirements of the individual jurisdictions in which they do business or to the differing laws which govern their transactions in the several states.

However, the more novel and more important aspect of the uniformity achieved by the Code results from a recognition of the essential uniformity of credit transactions.

Conditional sale contracts, chattel mortgages, consignments, trust receipts, bailment leases, and field warehousing transactions are all different in form, and each one derives from a different legal back-

ground. However, they have essentially the same purpose, namely, to permit credit to be extended on a secured basis.

All of them are used in a part of the process which is now a commonplace of the American economic scene. We all take for granted the extension of credit represented by an issue of corporate bonds secured by a lien on a factory's land and buildings. The bond issue is in effect one method by which the factory obtains working capital. However, when credit is extended (a) to the factory for additional machinery and equipment, (b) to the factory for supplies, such as fuel, (c) to the factory for raw materials, (d) to the factory with respect to inventory built up for future sale, (e) to the distributor or dealer for his equipment (fixtures in the store or automotive equipment for delivery purposes), (f) to the distributor or dealer for his inventory, (g) to the factory, distributor or dealer for his accounts receivable or his installment paper—in these and in other like situations the equivalent of working capital is being provided through credit.[5]

Where such credit can be obtained on an unsecured basis, well and good. Where security is demanded, it really makes no difference of substance whether the credit is extended by a seller to a buyer, by a lender to a borrower, or by an intermediary which characteristically is a finance company. In essence, each transaction has the same substance and, as between the parties directly involved in the transaction and also between each of them and third parties, should be governed by the same rules.

Furthermore, it makes little sense that differences in form should entail different legal results. Whether equipment is bought under a conditional sale contract or a purchase money chattel mortgage, the transaction is fundamentally the same; there should be the same requirements and consequences, between the parties and as to third parties. Yet in the past there have frequently been different requirements as to the formalities of execution of the agreement, different rules as to public filing or recording, different procedures as to repossession, and different liabilities as to any deficiency.

In the same way, if a dealer's inventory is being financed, why should the legal efficacy of a trust receipt depend upon whether a technical "legal title" passed first to the dealer? In fact, what difference should it make whether possession of the inventory was acquired before or after the financing transaction was completed, since the purpose is to finance the inventory in the dealer's possession?

[5] Birnbaum, *Form and Substance in Field Warehousing*, 13 LAW & CONTEMP. PROB. 579 (1948).

All such differences of form and all such technical distinctions are treated as of no consequence by Article 9. The parties to a transaction are perfectly free to use the old documents or to adopt a new "security agreement." But regardless of which form of agreement is employed, the substance of the transaction will be the same between the parties and as to third parties. There will be the same tests to determine when the security interest is acquired, when it is perfected, how far it is protected against third parties, and what are the consequences and procedures on default.

It is true, of course, that uniformity can be overdone. Therefore, Article 9 recognizes that there are credit transactions which should be excluded entirely or partially.[6] It also recognizes other distinctions, based upon whether the debtor is a business concern or a consumer, or whether the transaction essentially involves purchase-money rather than a loan. These, however, are exceptions to the general policy of uniformity.

To summarize, the three major policies of Article 9 are (1) to facilitate the *legal* perfection of security interests; (2) to leave unaffected any procedures which give *practical* protection; and (3) to disregard all distinctions based solely on form or technicality.

There are obvious reasons for adopting the second and third of these policies. As to the choice of decision which underlies the first policy a word should be said. Hostility to secured credit does not prevent such credit from being extended, but serves only to make it more expensive. For example, the rule of *Benedict v. Ratner*[7] did not eliminate the collection of accounts receivable by the assignor, but it required time-consuming and costly mechanics for special bank accounts, daily reports, and daily remittances accompanied by new loans or daily releases of collections against the assignment of new accounts. In addition, the rate of interest had to be increased so as to permit of a "reserve" against the possibility that some slip-up in the mechanics would be seized upon at a later date to form the basis of an attack upon the validity of the entire assignment. The increased expense attributable to both factors was economically wasteful, and the risk of invalidity served to deter many low-rate lenders from entering that field of financing. Examples in other fields could easily be given, such as inventory financing, where hostility did not prevent the transactions but merely increased the expense.

Once it is recognized that secured credit is here to stay, the choice

[6] U.C.C. §§ 9-104, 9-302(2). All citations to the UNIFORM COMMERCIAL CODE are to the Final Text Edition (November 1951), unless otherwise indicated.
[7] 268 U.S. 353 (1925).

seems plain: give complete legal security to the transaction, and permit the transaction to be effected in the simplest possible way. In a freely competitive banking and financing industry, this must reduce the cost of credit and thereby reduce the cost of goods.[8]

Definitions and General Principles

To paraphrase an old saying, the draftsman of a statute may well feel, "Let me frame the definitions and the text will shape itself." Certainly the definitions in the Commercial Code are a most important part of the statute, and a detailed discussion of Article 9 must start with the defined terms. They appear partly among the general definitions in Section 1-201 as well as in other articles.[9] The first important definition is "buyer in ordinary course of trade."[10] This term was specially chosen in the Uniform Trust Receipts Act[11] and was carried forward with a new definition to the Commercial Code to permit a concept more precise than "bona fide purchaser." The term first refers to a *buyer*, a much narrower category than *purchaser*.[12] Next, it requires the transaction to be in *ordinary course*. Next, it requires that the *seller* be in the *business of selling goods of that kind*. Next, it *excludes* sales made by *farmers* or *pawnbrokers*, *transfers in bulk*, *transfers as security for a money debt*, and *transfers in total or partial satisfaction of a money debt*. Finally, it includes *buying for cash*, *buying on secured or unsecured credit*, and receiving goods or a document of title under a *pre-existing contract for sale*. Such precision of definition is necessary, as to Article 9, because a buyer in ordinary course of business is sometimes given priority over the holder of a perfected security interest.[13]

"Good faith" means honesty in fact.[14]

"Insolvency proceedings" include any assignment for the benefit of creditors and any other liquidation or rehabilitation proceeding.[15]

"Notice" to a purchaser or holder means that he has reason to know the ultimate fact from all of the facts and circumstances which he knows at the time.[16]

"Purchaser" includes a buyer, mortgagee, pledgee, person with a

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[8] Birnbaum, *supra* note 5, at 592; Dunham, *The New Commercial Code*, 55 Com. L.J. 197 (1950).
[9] U.C.C. §§ 9-105 through 9-109, including cross references.
[10] U.C.C. § 1-201(9).
[11] 9A U.L.A. 284, § 1 (1951).
[12] U.C.C. §§ 1-201(32) and (33).
[13] *E.g.*, U.C.C. § 9-307.
[14] U.C.C. § 1-201(19).
[15] U.C.C. § 1-201(22).
[16] U.C.C. §§ 1-201(25), (26) and (27).

lien, donee or any other person acquiring an interest in property.[17]

"Security interest" means an interest in property which secures payment or performance of an obligation. It includes a reservation of title and also the interest of a buyer of accounts, chattel paper, or contract rights,[18] and, of course, by necessary implication includes the interest represented by a mortgage, deed of trust, pledge, lien and the like. It should be noted and emphasized that security may be given for *performance* of an obligation, as well as for *payment;* thus a secured transaction need not involve a money debt, either solely or at all.

"Warehouse receipt" means a receipt issued by a person engaged in the business of storing goods and, by necessary implication from other sections of the Code includes a "field warehousing" receipt.[19]

The terms "debtor"[20] and "secured party"[21] were chosen because they do not have a history of judicial construction in the field of chattel security. "Debtor" includes both a borrower and a conditional purchaser; "secured party" includes both a lender and a conditional seller and an intermediary financing agency. Since the same rules are applied to transactions of loan, to transactions of sale on credit, and to many hybrid transactions, it was necessary to avoid such terms as, for example, *borrower* and *lender*. Such terms would have made it more difficult to effectuate the declaration that:

> Nothing in this Article validates any charge or practice illegal under any rule of law or regulation governing usury, small loans, retail installment sales, or the like, or extends the application of any such rule of law or regulation to any transaction not otherwise subject thereto.[22]

Some of the rules of Article 9 governing the pledge of accounts, chattel paper or contract rights are also applicable to outright sales of such receivables; for that reason "debtor" includes the seller of such receivables and "secured party" includes the buyer.

Occasionally the collateral for an obligation is furnished by a third party who, however, may not assume personal liability for the obliga-

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[17] U.C.C. §§ 1-201(32) and (33). With purchaser so broadly defined, the term "bona fide purchaser" would have worked havoc in Article 9.

[18] U.C.C. § 1-201(37).

[19] U.C.C. § 1-201(44). Section 7-205(2) and Section 9-305(2) are parallel provisions in the Articles on Documents of Title and Secured Transactions which give specific recognition to field warehousing. The net effect of these sections is to give full validity when they are used as an instrumentality of commerce and to require filing under Section 9-302 when they are used as an instrumentality of financing.

[20] U.C.C. § 9-105(1)(d).

[21] U.C.C. § 9-105(1)(i).

[22] U.C.C. § 9-201.

tion. The term "debtor" includes such an owner of the collateral unless the context indicates that a distinction is intended.[23]

There are some separate rules for "instruments"[24] and for "chattel paper."[25] Sometimes chattel paper consists of only a conditional sale contract, chattel mortgage or bailment lease; sometimes such an agreement is accompanied by a negotiable note or series of notes. In the latter case the notes become part of the chattel paper for purposes of definition, and the definitions of "chattel paper" and "instruments" so provide.

"Purchase money security interest" is defined[26] more broadly than many courts have done. The term is used to cover three situations:

(i) a seller's reservation of title;

(ii) a lender's lien, where the lender gives value (either by advancing money or by incurring an obligation) to enable the debtor to acquire the collateral, and where the value is *actually used* for that purpose, regardless of how long a time elapses in the interim; and

(iii) a lender's lien, where the agreement of the lender and the borrower is the same as in (ii) and where the value is given not more than ten days before or after the borrower acquires possession of the collateral, even though the value furnished by the lender is *not actually used* to pay the price.[27]

"Value"[28] has a slightly different text in Article 9 from that used in other articles.[29]

The concept of antecedent indebtedness has played an important part in the substantive law of secured debts and Article 9 therefore frequently uses the term "new value."[30] The term "new value" is not expressly defined.[31] It is defined *ejusdem generis* in Section 9-108(2)

[23] Notably in Section 9-112, which states the separate rights of the owner of the collateral, as distinguished from the rights of the actual debtor.

[24] U.C.C. § 9-105(1)(g).

[25] U.C.C. § 9-105(1)(b).

[26] U.C.C. § 9-107.

[27] This provision of Section 9-107(c) is one of the instances where the rights of the secured party are not affected by the debtor's dishonesty, *i.e.*, diverting the funds to another purpose. In addition, this provision makes it possible for the lender to acquire a "purchase money security interest" when the loan is made (within the stated time limit) to reimburse a borrower who had laid out his own funds in the first instance.

[28] U.C.C. § 9-108(1).

[29] *Cf.* U.C.C. § 3-303. Section 9-108(1) is substantially identical with Sections 7-102(1)(g) and 8-303, and therefore with the definition applicable to Article 2—Sales, Section 2-103(3).

[30] *E.g.*, U.C.C. §§ 9-108(2), 9-111, 9-306(4), 9-308, 9-312(6) and (7). See also U.C.C. § 6-103(1).

[31] This is one of the few instances where the difficulties of framing a completely satisfactory text proved insuperable. It was felt that, with the help of Sections

as ". . . makes an advance, incurs an obligation or otherwise gives new value"; in Section 9-111 as ". . . a new advance or new obligation or other new value"; and in Section 9-312(6) and (7) as ". . . makes a new advance, incurs a new obligation, releases a perfected security interest or gives other new value." The meaning of the term is spelled out without using the words in Section 9-304(1): ". . . makes a new advance, releases a perfected security interest or incurs a new obligation."

A new concept in Section 9-108(2) deserves special mention. If "new value" is given and the transaction specifically contemplates after-acquired collateral, the after-acquired collateral is deemed to come under the security agreement for *new* value and not as security for a pre-existing debt if the debtor acquired his rights in the additional collateral in the ordinary course of business, or under a contract of purchase made pursuant to the security agreement and also made within a reasonable time after the security agreement. This is a distinct modernization of the law of preference, and conforms with business practice. If Section 9-108(2) survives the impact of the Bankruptcy Act, as it should, a valuable result will be achieved; if not, the secured party will be no worse off than under existing law.

"Description," with regard to collateral, means any reasonable identification,[32] so that the old concepts which required greater precision are not adopted by the Code. A serial number may be a useful identification but is not necessarily indispensable to an adequate description.

These are the most important definitions, the others being more conventional in their scope.

Application and Exclusions

Exclusions

It may be helpful to list the excluded transactions first, in order to obtain a clearer view of the scope of Article 9.

The exclusions are listed in Section 9-104, as follows:

1. A security interest covered by the Ship Mortgage Act of 1920,[33] which requires recording with the Collector of Customs for validity against third parties; any other present or future Federal statute of

such as 9-108(2), 9-111, 9-304(1) and 9-312(6) and (7), the courts would have no difficulty in distinguishing between "old value" and "new value."

[32] U.C.C. § 9-110.

[33] 41 Stat. 1000 (1920), 46 U.S.C. § 911 *ff* (1946); Section 921 covers all mortgages on vessels of the United States, both common mortgages and those which, under Section 922, are preferred mortgages.

similar import will likewise result in the exclusion of transactions covered by it;

2. A landlord's lien (on the personal property of his tenant, under the laws of certain states), or a lien on real estate;

3. A materialman's or mechanic's lien; Section 9-310 gives such liens priority over a security interest unless the statute creating the lien disclaims priority;

4. A wage assignment; and

5. An equipment trust covering railway rolling stock.[34]

Subject to these exclusions, Article 9 covers any transaction involving a security interest in personal property.[35] "Personal property" includes goods,[36] documents of title,[37] instruments,[38] chattel paper,[39] accounts,[40] and contract rights.[41] Applying the policy of uniformity, the coverage applies regardless of the form of the transactions, *i.e.*, the rules of Article 9 apply, whether the parties use a new type of "security agreement,"[42] or the old form of pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, bailment lease, trust receipt, some other form of lien or title retention contract, or a lease intended as security.[43]

Consignments

Some regret may be felt that Article 9 does not expressly refer to a consignment of merchandise, which bears many striking similarities to other forms of supplying working capital to a manufacturer or merchant. Section 2-326(2) (in the Article on Sales) treats of "on consignment," "on memorandum," and similar words,[44] and says

[34] The first class was excluded because of the priority of Federal law within the area indicated. The second and third classes were excluded because they were non-contractual. The fourth class was excluded because wage assignments are not commercial transactions. The fifth class was excluded at the direct request of spokesmen for the railroads, who feared that the securities market for railroad equipment trust certificates might be unsettled.

[35] U.C.C. § 9-102(1).

[36] U.C.C. § 9-105(1)(f).

[37] U.C.C. § 1-201(15). These are chiefly bills of lading and warehouse receipts.

[38] U.C.C. § 9-105(1)(g). These are chiefly negotiable instruments defined in Section 3-102, and securities defined in Section 8-102 such as stocks and bonds.

[39] U.C.C. § 9-105(1)(b).

[40] U.C.C. § 9-106.

[41] *Ibid.*

[42] U.C.C. § 9-105(1)(h). See also U.C.C. § 1-201(37).

[43] U.C.C. § 9-102(2).

[44] U.C.C. § 2-326(2) reads, in part:

> Where the buyer has a place of business at which he deals in goods of the kind involved, such words as "on consignment" or "on memorandum" or other words purporting to reserve title to the seller until payment or resale are insufficient as against the buyer's creditors to keep the transaction from being a sale or return unless the seller complies with any applicable law requiring a consignor's interest or the like to be evidenced by a sign or

that the seller will be protected against the creditors of the party to whom goods are so delivered only if the seller complies with a so-called "sign statute" or with the filing requirements of Article 9, or if the party in possession is known to be engaged primarily in selling the goods of others. Hence, sellers cannot generally adopt the consignment form in order to avoid the impact of Article 9.

Conflict of Laws

Where the parties to the transaction are residents of a state which has adopted the Code, and if the collateral is within the jurisdiction of that state, conflict of laws problems do not arise. However, chattel security transactions frequently cross state lines, for example, in sales of heavy machinery or inventory. Moreover, many chattels are transitory in use, such as automobiles and trucks, rolling stock, airplanes, road building equipment, commercial harvesting equipment, and construction machinery. Even where the seller and the buyer are located in the same state, the financing agency is frequently located elsewhere.[45] If the debtor is a business concern, it will frequently have places of business in more than one state. In the case of accounts, it often happens that the secured party (assignee) will be located in one state, the debtor (assignor) will be located in a second state, and the account debtors (obligors on the accounts) will be scattered through a number of other states. Finally, chattels are inherently mobile; a manufacturer may ship inventory from the factory to warehouses scattered through strategic distribution areas; a householder may move his residence and his furniture and automobile.

It can readily be appreciated that the conflict of laws problems cannot be dodged. Even when the Code is adopted by all of the states, so that the law is uniform, the question will still frequently arise as to the state in which the financing statement should be filed.

The Code does not create the problems; they exist today in the most aggravated form, for conflict rules as well as substantive laws differ as between the states. Where a written assignment of accounts is delivered and accepted in State A, executed by a debtor (assignor) located in State B, covering an account owed by an account debtor (obligor) located in State C, it is possible for each of the three states to claim that the validity of the assignment is governed by its laws.

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establishes that the buyer is known to be primarily engaged in selling the goods of others or complies with the filing provisions of the Article on Secured Transactions (Article 9).

Unusual cases such as Zendman v. Harry Winston Inc., 279 App. Div. 28, 107 N.Y.S. 2d 618 (1951) will still prove troublesome under the Code; they will require a consideration of Sections 1-201(9), 2-326, 2-403(2) and 9-307(1).

[46] This also happens with pledges of documents or instruments.

The Code has attempted to state workable solutions to the conflicts problems, not only in general terms for sales, commercial paper, bank deposits, letters of credit, documents of title, and investment securities,[46] but also specifically for bulk transfers[47] and secured transactions.[48] The provisions are discussed at length in the Article by Judge Goodrich.[49] However, a few words regarding the rules for secured transactions[50] are proper at this point.

Tangible Property and Commercial Paper

If the collateral is tangible property (goods) or is a specialty (like negotiable instruments, documents of title or securities) and is physically present in Code State A, while subject to a security interest, the security interest is governed by Article 9. If Code State B has a relationship to the transaction (for example if one of the parties resides there), it will yield to State A. If non-Code State C has a relationship to the transaction, it may or may not yield to State A; that, however, is true today and the Code cannot control the action of State C. If the collateral is not physically present in Code State A, State A will not claim that Article 9 governs the security interest at its inception even though State A has a relationship to the transaction (*e.g.*, because of the residence of one of the parties). In all cases where a Code state and a non-Code state are involved, the secured party may have to comply with the law of both states in order to be sure his security is valid; that also is true today.

Accounts and Contract Rights

Where the collateral is accounts or contract rights, Code State A will govern only if the office where the assignor (debtor) keeps his records concerning the collateral is located in Code State A. In any other case, Code State A yields to the law of the state where such office is located, including its conflict of laws rules, so far as concerns the validity and perfection of the security interest and the possibility and effect of proper filing.[51] It may be, for example, that the other state considers the governing law to be the law of the state where the transaction of assignment was effected, or the law of the state where the account debtor (obligor) resides. If so, Code State A will follow along. It may be that, even though Code State A purports to govern the security interest in the assigned accounts or contract rights be-

[46] U.C.C. §§ 1-105(2) and (3).
[47] U.C.C. § 6-102.
[48] U.C.C. § 9-103.
[49] *Supra*, p. 199.
[50] U.C.C. §§ 9-102(1), 9-103.
[51] U.C.C. § 9-103(1).

cause the record keeping office is located there, non-Code States B or C may also claim that their laws govern. That is true today and the secured party may have to comply with the laws of more than one state until the Code is adopted by all states.

Mobile Equipment

Following the rule for accounts, the Code rule is parallel with regard to equipment of a type which is normally used in more than one jurisdiction.[52] The test here is the chief place of business of the debtor.[53] If it is located in Code State A, Article 9 governs the validity and perfection of a security interest in the equipment and the possibility and effect of proper filing, even though the equipment is used in other states or is in transit through them and does not depend upon whether or not the equipment is physically present in Code State A. However, if the other states are non-Code states, they may claim that their laws govern, and the secured party may have to comply with their laws as well, just as today.[54]

Change in Location of Collateral

If the security interest first attaches to collateral while it is in another state (for example, if furniture is bought in State B under a conditional sale contract and is later moved to Code State A), the validity of the security interest will generally be governed by the law of the state where the security interest first attaches (State B). The exception is the case where the secured party and the debtor understood that the property was to be kept in Code State A and it is brought to Code State A for that purpose within thirty days thereafter.[55] If the security interest is already perfected before the collateral reaches Code State A, Code State A regards the security interest as perfected for four months. During the four-month period the secured party can take whatever steps are necessary[56] under Article 9 to perfect the security interest in Code State A, and the perfection will be deemed continuous. However, if the secured party delays for more than four months, or if the security interest was not perfected

[52] U.C.C. § 9-103(2).

[53] Note that this is not necessarily the state of incorporation of a corporate debtor, or the residence of a non-corporate debtor.

[54] If the equipment is such as to be subject to licensing by other states, and if liens are required to be shown on the licenses, for example, there will, in effect, be filing in more than one state. See U.C.C. § 9-302(2)(b).

[55] U.C.C. § 9-103(3).

[56] Ordinarily the only steps would be to file under Section 9-401 if the collateral is such that filing is required under Section 9-302(1). The period of four months allowed for filing under these circumstances is a compromise solution of the problem raised by cases such as Reconstruction Finance Corp. v. Weiner, 192 F.2d 760 (2d Cir. 1951).

under the law of State B at the time the collateral was brought into Code State A, any subsequent perfection of the security interest in Code State A will date from the time of perfection, so that the validity of the security interest will be vulnerable to attack under the preference provisions of the Bankruptcy Act or other applicable law.

Agreement to be Governed by Law of a Particular State

Where a transaction bears a reasonable relationship to more than one state, for example where a sales or security transaction crosses state lines, Section 1-105(6) permits the parties to agree as to the law of which state "shall govern their rights and duties." This rule, of course, applies to transactions governed by Article 9, as between the parties. Section 1-102(3) (b), however, provides that rights and duties of a third party may not be adversely affected by an agreement to which he is not a party or by which he is not otherwise bound. In a secured transaction, the rights of a third party depend upon perfection of the security interest under the rules of Part 3 of Article 9. Consequently no mere agreement of the parties to be governed by the law of State B could exempt the collateral from the requirements of Code State A which are otherwise applicable, insofar as the rights of third parties are concerned.

Substantive Provisions

All of the foregoing is an uninteresting but indispensable prologue to the four real divisions of Article 9: (1) attachment of a security interest; (2) perfection of a security interest; (3) filing; (4) enforcement.

Attachment of a Security Interest

Its Creation

A security interest is created by simple agreement between the secured party and the debtor.[57] The only formality of the agreement is that it must be in writing, and must describe the collateral; and must also describe the land if the collateral is crops, or is oil, gas or minerals which are to be extracted from the land.[58] The description need only reasonably identify the collateral or land, as the case may be.[59] Moreover, an oral agreement is sufficient if the collateral is in the possession of the secured party.[60]

Thus, the formalities of the security agreement have been reduced to the minimum. Signature of the secured party, acknowledg-

[57] U.C.C. § 9-201.
[58] U.C.C. § 9-203(1)(b).
[59] U.C.C. § 9-110.
[60] U.C.C. § 9-203(1)(a).

ment, affidavit of good faith, and all other technicalities are unnecessary. The old forms of agreements may be used by those who desire, but they will be superseded in many or most cases by a new and simpler form which will have the additional advantage of not suggesting that old rules are applicable.

Whatever the form of the agreement, it is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.[61] Of course, the agreement is subject to the various provisions of the Code such as the rule in Section 1-107 that a written waiver of rights arising out of default is binding without consideration, and the rules in Sections 1-203 through 1-208 which deal with good faith, reasonable time, course of dealing and use of trade, receipts, payments under protest and acceleration clauses.

The agreement is also subject to other rules of law or regulations,[62] which are otherwise applicable. For example, if the debtor is a public utility, the public utilities law must be complied with; if the transaction involves a loan instead of a sale on credit, the usury law or the small loan law may be applicable; if the Federal Reserve Board regulations of installment credit are in effect at the time, the transaction may have to comply with them. However, the mere assimilation under Article 9 of the various forms of transaction specifically does not subject a transaction to any rule of law or regulation which would not otherwise be applicable.[63]

Time of Attachment

So much for the *creation* of a security interest. It *attaches* as soon as (a) the security agreement is made and (b) value[64] is given and (c) the debtor has rights in the collateral.[65] The parties can agree to postpone the time of attachment.[66]

Future Advances

A security agreement may provide that it shall secure future advances,[67] and may provide that after-acquired collateral shall be included.[68] However, there are two limitations[69] on after-acquired col-

[61] U.C.C. § 9-201.
[62] *Ibid.*; also U.C.C. § 9-203(2).
[63] U.C.C. § 9-201.
[64] For this purpose "value" may be "old value" or "new value"; see discussion of Section 9-108, *supra*, at notes 30 and 31.
[65] U.C.C. § 9-204(1). See *In re* Cumings, 99 F. Supp. 690 (S.D. Tex. 1951).
[66] *Ibid.* Obviously the parties cannot advance the time of attachment, for that would mean that it attached ahead of the agreement, or without consideration, or before the debtor even had rights in the collateral (let alone ownership). Beal v. Universal C.I.T. Credit Corp., 82 A.2d 412 (Me. 1951).
[67] U.C.C. § 9-204(5). No time limit or amount of advance need be specified.
[68] U.C.C. § 9-204(3).
[69] U.C.C. § 9-204(4)(a).

lateral: (a) a specific time limit is contemplated as to farm crops, which each state may fix according to local conditions[70] unless the security interest is in conjunction with a real estate transaction; (b) where consumer goods come under an after-acquired property clause *as additional collateral*, they must have been acquired by the debtor within ten days after the secured party gave value (so as to prevent the current purchases from automatically securing a previous debt).[71]

Security for the Buyer

Section 9-204(6) treats a somewhat novel situation which, however, is coming to be of frequent occurrence. Usually it is the seller who gives credit to the buyer. Sometimes, however, the buyer gives credit to the seller, either by paying in advance or by guaranteeing the seller's payroll or his purchases of raw materials. Where this is done in contemplation of specific goods to be furnished to the buyer under a contract for sale (see Section 2-106(1)), the contract for sale may provide for a security interest in favor of the buyer, which will attach as soon as the goods have been identified to the contract under Section 2-501. Section 9-204(6) is another instance, like Section 9-108(2),[72] where Article 9 has recognized a need to modernize existing law. Heretofore there has been no practical way in which a buyer who paid in advance could be protected, except by a cumbersome (and often impossible) taking of "open, notorious and exclusive possession" of the goods on the seller's premises. The experiences of World War II in connection with progress payments would alone justify the simple technique afforded by Section 9-204(6).

Accounts Receivable and Chattel Paper as Security

Section 9-205 is drawn to put to rest, once and for all, *Benedict v. Ratner*,[73] *Lee v. State Bank & Trust Co.*,[74] and the companion line of

[70] For a discussion of certain problems relating to secured transactions involving farm products, see Hunt and Coates, *The Impact of the Secured Transactions Article on Commercial Practices with Respect to Agricultural Financing*, 16 LAW & CONTEMP. PROB. 165 (1951).

[71] If the new security agreement covering the current purchase also subjects it to the previous debt, this will be a transaction for "old value" and may be a preference. The so-called "add-on," whereby the current goods after they are paid for are to stand as security for future purchases, is not automatically validated under Section 9-204(5), for the subsequent sale would not constitute a "future advance." On the other hand, if a consumer explicitly mortgages his interest in the previously purchased goods at the time of the subsequent purchase, this is entirely valid. In other words, even in the consumer field, the Code allows freedom of contract, but in this field rejects the automatic effect of the after-acquired property clause or the future advance clause.

[72] *Supra*, p. 357.

[73] 268 U.S. 353 (1925). *Cf.* Second Nat. Bank v. Phillips, 189 F.2d 115 (5th Cir. 1951); Mount v. Norfolk Sav. & Loan Corp., 192 F.2d 286 (4th Cir. 1951).

[74] 54 F.2d 518 (2d Cir. 1931).

cases. An assignment of accounts or chattel paper, or a security interest in inventory, receives publicity through filing under Section 9-401. The hostility of the former decisions, based largely upon a dislike of secret liens, is contrary to the policy of the Code. Instead of treating a failure of the secured party to insist on strict accountability for the collateral as a badge of fraud, the Code permits the extent of "policing" of the collateral to be a matter of discretion. For that reason, the Code takes a great forward step in sound business relations. Flexibility on the part of the secured party is now possible, for he can tighten up when the need arises without fear that his lien will be attacked as a preference unless he has insisted on rigid accountability at least four months before bankruptcy.

The only effect of relaxation on the part of the secured party is that the quantity of collateral available at the time of default may be shrunken.[75] That is a *credit* risk which, by hypothesis, is to be borne by the secured party.

Policing the Credit Risk

To summarize Section 9-205, a security interest is not invalid or fraudulent against creditors because of liberty on the part of the debtor:

(i) to use or consume the collateral;

(ii) to sell the collateral (including repossessed and returned goods covered by assigned accounts or chattel paper);

(iii) to collect or compromise assigned accounts, contract rights or chattel papers;

(iv) to accept the return of goods, or to repossess goods, covered by assigned accounts or chattel paper; or

(v) to use or dispose of proceeds;[76]

or by reason of the failure of the secured party to require (a) accounting for proceeds; or (b) substitution of collateral which has been used, consumed or sold.

Inevitably the effect of Section 9-205 should greatly reduce the expense of handling the assignment of receivables, just as other sections should reduce the expense of handling inventory loans.[77] At the same time, it must be recognized that many of the formalities of "policing"

[75] In this connection, there should be borne in mind the limited right to "proceeds" under Section 9-306.

[76] "Proceeds" are defined in Section 9-306(3).

[77] Especially those permitting a floating inventory lien to be obtained through mere filing of a financing statement; *infra*, at notes 251 *ff*. See also U.C.C. § 9-315(1).

have had their practical benefits for the secured party in the past and will be equally valuable in the future.[78]

For example, on inventory loans covering such things as automobiles, it has been the practice to send an inspector to the dealer's place of business at irregular intervals and without advance notice, for the purpose of checking the serial numbers of the cars on hand against those shown on the outstanding trust receipts. This procedure will be just as valuable under Article 9 as before.

Again, on other types of inventory loans, it has been frequent practice to have a custodian (sometimes through the mechanics of a "field warehouse") at the debtor's premises for the express purpose of checking goods in and out and making daily or weekly reports to the lender who could thereby maintain a running inventory of his collateral. The usefulness of this technique from a credit standpoint is not affected by Article 9.

On receivables of all types, it has been frequent practice to "spot-check" the authenticity of the receivables by sending so-called "audit letters" to a representative sampling of the obligors, or even by personal communication with them. This technique is also unaffected.

Even the separate bank account for collections, the requirement that new accounts be assigned to replace those on which repossessions have been made, or that new accounts be assigned in an amount equal to previous collections made and retained by the debtor, the audit of the debtor's collection records to determine how many of the assigned receivables are past-due, and similar practices will have their place to a greater or lesser extent.

Generally stated, a good, wide-awake credit man will be just as valuable under Article 9 as in the past. The great difference is that he will not need to have a lawyer at his elbow.[79]

Warranties, Defenses, Loss of Collateral, Etc.

A few other observations are required concerning the remaining sections relating to the rights of the parties to a security agreement.

1. If the security transaction is part of a sale of goods, the warranties are governed by Article 2—Sales.[80]

2. Generally the debtor can agree to waive, as against an innocent assignee, defenses which the debtor has against the assignor[81] and the

[78] See Burman, *Practical Aspects of Inventory and Receivables Financing*, 13 LAW & CONTEMP. PROB. 555, 559-60, 564 (1948).

[79] See Llewellyn, *Problems of Codifying Security Law*, 13 LAW & CONTEMP. PROB. 687, 689-90 (1948).

[80] U.C.C. § 9-206(3); see especially U.C.C. §§ 2-312 through 2-318.

[81] U.C.C. § 9-206(2); *cf.* U.C.C. § 3-305, listing defenses good against a holder in due course.

signing of negotiable notes in connection with a security agreement constitutes the debtor's agreement to waive such defenses in favor of a holder in due course.

3. However, a buyer of consumer goods is not permitted to waive defenses arising out of the sale. If he also signs negotiable notes, even a holder of the notes is subject to the defenses if he seeks to proceed against the collateral, either directly by repossession, or indirectly by attaching or levying upon the goods.[82]

4. The secured party must use reasonable care in the custody of collateral which is in his possession; for breach of this obligation the secured party is liable for any loss suffered by the debtor but does not lose the security interest.[83]

5. Mechanics are provided whereby the debtor is enabled to obtain a statement of how much he owes and how much collateral the secured party holds or claims.[84] This is particularly necessary because of the floating lien on inventory or receivables which Article 9 permits.[85] It will be especially useful when a debtor is negotiating with another financing agency to take over the loan.

6. The general rule of Section 1-208 governs so-called "insecurity clauses" and acceleration. When invoking such a clause, the test is no longer "sole discretion" or "reasonableness." The secured party must in good faith believe that the prospect of payment is impaired; the debtor has the burden of proving lack of good faith (*i.e.* lack of honest belief).

Perfection of a Security Interest

In the matter of how a security interest, once attached, is perfected against third parties who are strangers to the transaction, Article 9 shows the greatest departure from the policy of uniformity.

Some security interests are perfected by change in possession; some are *temporarily* perfected without change in possession; some are perfected by filing; some are perfected without any formality as soon as they attach.

It is also true, under Article 9, that "perfected" against third par-

[82] U.C.C. § 9-206(1). The theory of this provision is that the secured party is in a better position than the consumer to investigate the dealer in advance, and is in a stronger economic position to force the dealer to make good if the article is misrepresented or defective. A consumer who also signs a note and who has other assets from which a judgment can be collected is not protected by this provision, but he is no worse off than if he had signed a note without any security agreement.

[83] U.C.C. § 9-207.

[84] U.C.C. § 9-208.

[85] *Infra*, at notes 251 *ff.*

ties does not always mean perfected against *all* possible third parties.[86] In several instances certain third parties are given priority over a perfected security interest, and in a few cases are given a parity status; this has been done in the interest of freedom of commerce or as the cutting of a Gordian knot.

This problem of perfection is really the essence of Article 9. Its treatment is necessarily as complex as the factors which are involved. An accurate discussion cannot be simple.

The Status of an Unperfected Security Interest

The first phase to be considered is the relative priority of a secured party and third parties, when the security interest has not been perfected.

In case of a purchase money security interest,[87] a secured party who files within ten days after he gives value has priority over the rights of transferees in bulk and of lien creditors[88] which arise between the time the security interest attaches[89] and the time of filing.[90]

In all other cases, an unperfected security interest is subordinate to

(i) persons who would take priority over a *perfected* security interest, *i.e.*, buyers in ordinary course of business, and certain other buyers, in case the collateral is inventory; certain purchasers of chattel paper left in the possession of the debtor (assignor); a holder in due course, etc., of negotiable instruments, documents of title or securities; some liens for materials and services; and a person with a previously perfected security interest;

(ii) a subsequent secured party who is the first to perfect his security interest and who does not know of the earlier *unperfected* security interest;

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[86] The task of drafting this part of the Code was made much easier by the 1950 amendment of Section 60a of the Bankruptcy Act, 64 STAT. 22 (1950), 11 U.S.C. § 96(a) (Supp. 1951). Article 9 gives certain bona fide purchasers priority over a perfected security interest. *Infra*, at notes 96, 108-110 and 115. This can be done safely, now that it no longer runs into conflict with the potential bona fide purchaser test of preference in bankruptcy in chattel transactions, as was true under the prior Section 60a. See Corn Exchange Bank v. Klauder, 318 U.S. 434 (1943); *In re* Vardaman Shoe Co., 52 F. Supp. 562 (E.D. Mo. 1943). *Cf.* Coin Machine Acceptance Corp. v. O'Donnell, 192 F.2d 773 (4th Cir. 1951) *reversing In re* Harvey Distributing Co., 88 F. Supp. 466 (E.D. Va. 1950); *In re* Rosen, 157 F.2d 997 (3rd Cir. 1946).

[87] U.C.C. § 9-107.

[88] U.C.C. § 9-301(3). "Lien creditor" is defined to mean a creditor armed with legal process and includes an assignee for the benefit of creditors, a trustee in bankruptcy, and a receiver in equity. A creditor armed with legal process has the status of a lien creditor from the time process is issued, provided that the attachment, levy, or the like, follows within a reasonable time.

[89] *Supra*, at notes 64-66.

[90] U.C.C. § 9-301(2).

(iii) a lien creditor who becomes such without knowledge of the security interest and before it is perfected; and

(iv) a transferee in bulk or other buyer out of the ordinary course of business who receives delivery of the collateral without knowledge of the security interest and before it is perfected.[91]

Thus, in general terms, an *unperfected* security interest is protected against persons who know about it, against transferees in bulk and buyers not in the ordinary course of business who fail to obtain delivery of the collateral, and other persons who delay in perfecting their own rights.

Perfection Through Possession of the Secured Party

In general, possession by the secured party of goods, negotiable instruments, securities, documents of title, or chattel paper perfects the security interest without further formality.[92] The date of perfection is the date of taking possession, with one exception: where a security interest in negotiable instruments, securities or documents of title arises for *new value*,[93] the date of perfection is related back to the date of attachment if that is not more than twenty-one days earlier.[94]

Possession of a bailee who has notice of the secured party's interest is equivalent to possession of the secured party,[95] again with one exception: in the case of field warehousing, filing is required.[96]

With regard to collateral consisting of securities, documents of title, or negotiable instruments (except notes which constitute part of chattel paper under the definitions contained in Sections 9-105(1) (a) and (f)), possession by the secured party is the sole method of perfecting a security interest[97] for more than twenty-one days.[98] Filing is ineffective with regard to such collateral,[99] and must be so, if the negotiability of such instruments and documents is to be preserved. The twenty-one day period under Section 9-304 involves protection only against creditors and persons other than holders in due course.[100] Transferees who are holders in due course of negotiable instruments,

[91] U.C.C. § 9-301(1).
[92] U.C.C. § 9-305(1). Perfection through possession is inapplicable to intangibles like accounts or contract rights.
[93] *Supra*, at notes 30 and 31.
[94] U.C.C. § 9-305(1), last sentence.
[95] U.C.C. § 9-305(1), second sentence.
[96] U.C.C. § 9-305(2). The theory of a field warehouse is that possession of the warehouseman is "notorious" because a sign is conspicuously posted. The theory of Article 9 is that the most conspicuous place to post a sign is in the central filing records under Section 9-401.
[97] U.C.C. § 9-303(3).
[98] U.C.C. § 9-304.
[99] U.C.C. § 9-309.
[100] U.C.C. § 9-304.

holders to whom documents of title have been duly negotiated, and bona fide purchasers of securities, need not examine the filing records, any more than the buyer of inventory in the ordinary course of business.[101]

Perfection Through Filing

Where the security interest is not perfected through possession of the secured party, filing is the only method of perfection in regard to the following classes of collateral:[102]

(i) purchase money security interests[103] in consumer goods[104] which are part of the realty (Section 9-313), in farm equipment having a purchase price in excess of $2500 or which are part of the realty, and in motor vehicles required to be licensed;[105]

(ii) inventory,[106] whether or not a purchase money security interest;

(iii) equipment,[107] whether or not a purchase money security interest;

(iv) farm products,[108] whether or not a purchase money security interest;

(v) accounts or contract rights, unless the assignment is for collection only or does not represent a significant part of the assignor's outstanding accounts or contract rights.[109]

(vi) chattel paper left in the debtor's (assignor's) possession;[110]

(vii) consumer goods, where the security interest is not a purchase money security interest.[111]

Filing does not, in all cases, give the security interest priority over *all* third parties. The cases where it does not are the following:

1. A buyer in the ordinary course of business[112] takes free of a perfected security interest in inventory, or in other goods as to which the financing statement which is on file claims an interest in proceeds.[113]

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[101] *Cf.* U.C.C. § 9-307(1).

[102] Section 9-302 says that filing is required in all cases not specifically excepted. The writer will attempt, for purposes of clarification, to list the various classes of collateral where filing is required.

[103] U.C.C. § 9-107.

[104] U.C.C. § 9-109(1).

[105] U.C.C. §§ 9-302(1)(c) and (d).

[106] U.C.C. § 9-109(4).

[107] U.C.C. § 9-109(2).

[108] U.C.C. § 9-109(3).

[109] U.C.C. § 9-302(1)(e).

[110] U.C.C. § 9-308.

[111] U.C.C. § 9-304(1).

[112] U.C.C. § 1-201(9).

[113] U.C.C. § 9-307(1). See, however, note 44 *supra* and the problem raised by the *Zendman* case as to purchasers from an auctioner.

This is true even though the buyer knows of the security interest. Therefore, the ordinary buyer can buy from the ordinary dealer without troubling himself about Article 9.

2. A purchaser of chattel paper left in the possession of the debtor (assignor) takes priority over a security interest perfected by filing, if the purchaser gives new value in the ordinary course of his business, takes possession of the paper, and does not know (by reason of a notation on the face of the paper, for example) that the specific chattel paper is subject to a security interest.[114] Therefore, filing on chattel paper gives protection against creditors and transfers for antecedent indebtedness or other transfers not in the ordinary course of business. Nevertheless, it allows a secured party dealing in the large volume of chattel paper of huge department stores or chain organizations to eliminate the effort and expense involved in stamping a notice of assignment on the paper or effecting a change of possession. The secured party is protected against the *bankruptcy* risk, but is not protected against the *credit* risk of the debtor's dishonesty in subsequently transferring the same chattel paper to a person protected under Section 9-308.

Perfection Without Filing or Possession in the Secured Party

A purchase money security interest[115] in consumer goods[116] which are neither a part of the realty under Section 9-313 nor a motor vehicle,[117] is perfected without filing. The same rule applies to farm equipment having a purchase price of $2500 or less, provided such equipment is neither part of the realty under Section 9-313 nor a motor vehicle.[118] The perfection is only against creditors, pledgees and mortgagees, since a buyer who does not know of the security interest, who gives value, and who buys for his own personal, family or household purposes or his own farming operations is protected unless the security interest is filed.[119] Thus Article 9 gives conditional sellers, financing agencies who acquire the chattel paper, and other secured parties with purchase money security interests automatic protection against creditors. However, if they desire protection also

[114] U.C.C. § 9-308. The rule would also apply to items of chattel paper which are returned to the assignor by the assignee, if the inadvertent inclusion of "or chattel paper" in Section 9-304(2) in the Final Text Edition is corrected.

[115] U.C.C. § 9-107.

[116] U.C.C. § 9-109(1).

[117] U.C.C. § 9-302(1)(d).

[118] U.C.C. § 9-302(1)(c).

[119] U.C.C. § 9-307(2). "Buyer . . . for his own personal, family or household purposes "is narrower than" purchaser"; therefore a subsequent lender is not protected by this subsection.

against *bona fide* purchasers, they must file.[120] It follows that a consumer or farmer who buys consumer goods or farm equipment from another consumer or farmer is under the legal necessity of examining the filing records (as is the case today in all states having chattel mortgage laws and in those states where conditional sale contracts have to be filed). The consumer goods or farm equipment may be covered by a security interest for other than purchase money, in which case the secured party probably will have filed, or they may be covered by a purchase money security interest which the secured party has elected to file. Even if the seller exhibits a receipt showing that he has paid the original purchase price, he still may have borrowed on the security of the goods or equipment and the lender may have filed. In practice, as today, many buyers will fail to examine the filing records, and only a few will prove to be victims of dishonesty.

The other classes of collateral where a security interest is protected without filing and without possession in the secured party are negotiable instruments, securities and documents of title. Here the protection is for only twenty-one days, and is only against creditors and transferees other than holders in due course and the like.[121] The theory of Article 9 on this point is that creditors will not be prejudiced by such short term transactions, whereas the filing records would be clogged if filing were required; and holders in due course are protected in any event. On the other hand, there is frequently a real commercial necessity for the debtor to have temporary possession of such instruments and documents for such purposes as collection, registration, transfer of securities on the issuer's books, or obtaining delivery of goods covered by a document of title. Often it is more feasible for this to be handled by the debtor than by the secured party.

Sometimes the temporary possession by the debtor of instruments or documents will occur at the time the security interest attaches to the collateral. On other occasions the instrument or documents will be transferred to the possession of the secured party at the outset and individual items will be released to the debtor as the need arises. Under Section 9-304(2) the security interest will still be perfected for twenty-one days against all creditors of the debtor and against transferees other than holders in due course, etc., whose rights are governed by Section 9-309.

[120] In practice, such secured parties doing a large volume of business will doubtless continue the practice of not filing except where a large amount of money is involved in an individual transaction. In the first place, experience has shown that most consumers are honest. Secondly, the saving in the clerical expense involved in filing is not inconsiderable. Finally, the saving in filing fees is a substantial reserve against loss from fraudulent resales.

[121] U.C.C. §§ 9-304, 9-309.

The Final Text Edition (November 1951) inadvertently includes "or chattel paper" in Subsection (2) of Section 9-304, which should be corrected before the Code is enacted. After such correction a secured party who has filed a financing statement with respect to chattel paper will be able to return items to the debtor for such purposes as collection or adjustment without thereby losing the protection afforded under Section 9-308. Filing under Section 9-308 gives protection with regard to chattel paper originally left in the possession of the debtor, against all creditors and against all transferees except a purchaser for new value in the ordinary course of business who takes possession of the paper and who does not have actual knowledge of the fact that it is subject to a security interest. *A fortiori*, filing would give the same protection where possession of the chattel paper was originally transferred to the secured party and where individual items were thereafter returned to the debtor.

A third instance of where filing is not required is where a secured party who is in the business of financing accounts, chattel paper or contract rights makes a further assignment of collateral previously assigned to him.[122]

The fourth instance is that the assignment of a perfected security interest does not require filing.[123]

Filing under Article 9 does not apply where certain substitute systems of filing are already in effect,[124] *i.e.*, (a) where a Federal statute provides for national registration or filing of security interests in the collateral involved; and (b) where the Code State has a system for central filing of such security interests in the collateral, or requires indication of such security interests on a certificate of title.[125] Compliance with any such statute is equivalent to filing under Article 9.[126]

Time of Perfection

Where filing is required, the security interest is perfected when it is filed or when it attaches, whichever is later. Thus advance filing is encouraged.[127]

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[122] U.C.C. § 9-302(1)(f).

[123] U.C.C. § 9-302(2), preamble.

[124] U.C.C. §§ 9-302(2)(a) and (b).

[125] See Townsend, *The Case of the Mysterious Accessory*, 16 LAW & CONTEMP. PROB. 197 (1951) for an analysis of the variation between the certificate of title laws in the different states. If the laws of a particular state require indication on the certificate of title of both inventory liens and so-called retail liens, no filing under Article 9 would be required; if only retail liens are indicated on the certificate of title as in some states, then inventory liens would have to be filed under Article 9.

[126] U.C.C. § 9-302(2), postamble.

[127] U.C.C. § 9-303(1)(a).

Where perfection occurs through possession of the secured party, the date of possession is the date of perfection, except that the date of perfection may be related back for a maximum of twenty-one days in cases where a security interest in instruments or documents is given for new value.[128]

Where filing under a Federal statute or another statute of the Code State is equivalent to filing under Article 9,[129] the date of perfection is the date of filing, registration or indication of the lien on the certificate of title under such other statute.[130]

When goods are already subject to a security interest when they are brought into the Code State, the date of perfection depends upon whether the security interest was perfected in the prior state. If so, and if any steps required for perfection in the Code State[131] are duly taken within four months thereafter, the date of perfection is related back to the original date and the period of perfection in both states is continuous.[132] However, if compliance with the Code State requirements is delayed beyond four months, or if the security interest is perfected for the first time in the Code State, the date of perfection is not related back.[133]

Proceeds from the Disposal of Collateral

Between the parties to a security agreement, the security interest attaches to goods, accounts, chattel paper, money, instruments or documents which are identifiable proceeds[134] of collateral which has been exchanged, sold, collected or otherwise disposed of by the debtor.[135] If the security interest in the collateral was perfected, the security interest in the proceeds is also perfected.[136]

However, the security interest in the proceeds is perfected only for a ten-day period unless one of two conditions is satisfied: (a) if a financing statement was filed to perfect the security interest in the collateral and if the statement specifically included proceeds received on disposition of collateral,[137] the perfected status continues;

[128] U.C.C. § 9-303(1)(b).
[129] U.C.C. § 9-302(2), postamble.
[130] U.C.C. § 9-303(1)(c).
[131] Such as filing in the Code State under Section 9-401.
[132] U.C.C. § 9-103(3).
[133] *Ibid.*
[134] "Proceeds" and "cash proceeds" are defined in U.C.C. § 9-306(3).
[135] U.C.C. § 9-306(1). It will be noted that no separate assignment of the proceeds to the secured party is requisite. This is of major importance in the factoring industry where there is a security interest in inventory; when sales are made, the usual practice is merely to imprint on the invoice a notice that it is payable to the factor, with no formal assignment of the account.
[136] If the security interest in the collateral was unperfected, the security interest in the proceeds is likewise unperfected.
[137] See form in Section 9-402(3), item 4.

or (b) if the secured party directly perfects the security interest in the proceeds by filing or taking possession within the ten-day period, the perfected status also continues.[138]

Of course, the original collateral may continue to be subject to the security interest in the hands of the transferee, either because he had knowledge of it or because it failed to qualify for priority under Sections 9-301 or 9-303(2). However, in many cases the transferee will be protected, especially where the collateral is inventory, instruments or documents.[139] Thus, in some cases the secured party may look both to the original collateral and the proceeds. In other cases he may be able to look only to one or the other.

In insolvency proceedings[140] the secured party with a perfected security interest has a right[141] to the debtor's cash and bank accounts equal to the cash proceeds received by the debtor within ten days before the proceedings were instituted minus the portion thereof paid over to the secured party within said ten days.[142] For example, if the debtor collected $1000 in May and $500 in the first ten days of June, and remitted $300 to the secured party on June 5, and if insolvency proceedings were instituted on June 11, at which time the debtor's cash on hand and in the bank amounted to $900, the result would be as follows: (a) the secured party would have no lien in respect to the $1000; (b) the secured party would have a lien on the $900 cash on hand, to the extent of $500; (c) the $500 lien might be reduced to $200 if it could be shown that the $300 remittance on June 5 represented June collections.

Where the collateral is inventory, a large proportion of the proceeds of sale will consist of accounts or chattel paper. Wherever this is the case, there may occasionally be a conflict between the secured party and some other financing agency to whom debtor may have sold or pledged the accounts or chattel paper. Such a sale or pledge may constitute a breach of contract on the part of the debtor.[143] However, as a matter of policy Article 9 states that a transferee for new value[144] in the ordinary course of business has priority over the secured party's

[138] U.C.C. § 9-306(1).

[139] Under Sections 9-307(1) or 9-309. On occasion the transferee will be protected as to consumer goods under Section 9-307(2) or as to chattel paper under Section 9-308. In other cases the transferee will be protected because the debtor's transfer or exchange was authorized by the secured party.

[140] Section 1-201(22) defines this term to include an assignment for the benefit of creditors, and rehabilitation proceedings as well as liquidation.

[141] In the nature of a lien or a claim to specific assets.

[142] U.C.C. § 9-306(2).

[143] See U.C.C. § 9-201: ". . . a security agreement is effective according to its terms between the parties, . . ."

[144] *Supra*, at notes 30 and 31.

claim to the chattel paper as proceeds, if the subsequent transferee takes possession of the chattel paper without actual knowledge that the specific paper is subject to the "proceeds lien."[145] The secured party must continue to protect himself against such a breach of contract relating to chattel paper by practical procedures such as have been used in the past; either he must inspect the collateral periodically, or install a custodian or the like. Here, again, the law is no substitute for diligence.

Other cases of conflict may arise when collateral is returned to the debtor by the purchaser after it has once been sold.

(i) If the indebtedness originally secured by the collateral has been paid to the secured party, he has no claim to the returned property; otherwise, his security interest continues as against the debtor.[146]

(ii) An unpaid transferee of the chattel paper arising out of the sale of the collateral has a security interest in the returned property as against the debtor but must perfect it in order to be protected against third parties;[147]

(iii) If the secured party and the transferee of chattel paper are both unpaid, and if each claims the returned property, the transferee has priority.[148]

The rule is contrary to the foregoing, where the proceeds are accounts. In that case the individual financer is protected against the subsequent transferee of the accounts to the extent specified in Section 9-306(1). By inference the same distinction applies under Section 9-306(5) in the case of returned goods where the proceeds were accounts; the individual financer will be protected to the same extent that he was protected as to accounts.

Conflicting Security Interests

A. *General Rules Relating to Priority.* The general rule of priority is that security interests rank in the order in which they are perfected.[149] However, there are a large number of exceptions under the statute (in addition to those which may be made by agreement, for any person entitled to priority may agree to subordination).[150]

1. A secured party with a *perfected* security interest who makes

[145] U.C.C. § 9-306(4).
[146] U.C.C. § 9-306(5)(a).
[147] U.C.C. § 9-306(5)(b).
[148] U.C.C. § 9-306(5)(c).
[149] U.C.C. § 9-312.
[150] U.C.C. § 9-316.

subsequent advances[151] under the same security agreement and on the same collateral has priority as to the later advances, as against another secured party who has made intervening advances to the debtor on the same collateral and who expected to obtain a security interest junior only to the original debt.[152]

2. Where a security agreement has an after-acquired property clause[153] and the security interest is perfected, it has priority as to the after-acquired property against another lender who makes a loan secured by the after-acquired property.[154]

3. However, sometimes rights claimed under an after-acquired property clause will conflict with a purchase money security interest.[155] Here, the party with the purchase money security interest in the after-acquired property is not required to protect himself by obtaining a subordination agreement under Section 9-316. He can obtain priority by perfecting his security interest before the debtor receives the collateral or within ten days thereafter. If the collateral is inventory, he must also notify any holder of an earlier perfected security interest before the debtor receives the collateral,[156] in order to prevent the former from making later advances upon the original inventory as thereby augmented.

4. Sometimes there will be two conflicting purchase money security interests. For example, *A* may advance $1000 to the debtor to be used to pay for the collateral, *B* may also advance $1000 to the debtor for the same purpose within ten days after the debtor receives the collateral, and both of them may learn that *C* (the seller) actually shipped the goods to the debtor under a conditional sale contract. *A*, *B* and *C* all have purchase money security interests.[157] Assume each interest is perfected at the time the collateral is received by the debtor or within ten days thereafter. In these circumstances, *C* would have priority; however, if *C* had been paid, *A* or *B* would have priority depending on which one's money was used to pay *C*. If neither one's money was used to pay *C*, the conflicting interests would rank on a parity.[158]

5. Where the collateral is crops, a security interest given for new

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[151] Section 9-204(5) sanctions agreements for future advances.

[152] U.C.C. § 9-312(2); this is peculiarly a case where the second lender would often first secure a subordination agreement under Section 9-316 from the first lender with regard to later advances.

[153] Sanctioned by Section 9-204(3).

[154] Here again, a subordination agreement under Section 9-316 will often be appropriate.

[155] U.C.C. § 9-107.

[156] U.C.C. § 9-312(4).

[157] U.C.C. § 9-107.

[158] U.C.C. § 9-312(5).

value, which is in the nature of an enabling advance, made during the production season or within three months before the crop is planted takes priority over the interest of an earlier secured party to the extent that the obligation to him (such as rent, or interest or principal on a mortgage) was due more than six months before the crops were planted.[159]

6. A security interest in favor of a surety is subordinate to a security interest given for new value to enable the debtor to perform the principal obligation.[160]

7. Subject to the foregoing, if *A* files first and then gives value, and *B* gives value ahead of *A* but files after *A*, *A* will have priority.[161]

B. *Fixtures.* The problems of fixtures, which have caused so much difficulty under previous statutes, including the Uniform Conditional Sales Act,[162] have been dealt with realistically and therefore simply.

1. A perfected security interest in goods which are deemed to be part of the realty is protected against everyone, provided the secured party files before the goods become part of the realty.[163] However, in case of repossession, he is liable for the cost of repairing any physical injury to the realty,[164] unless the owner of the realty is also the debtor. Before repossession the secured party may be required to give adequate security for the cost of repairs.[165] In practice the secured party may often be able to protect himself against even this liability for repairs, by agreement with any prior encumbrancer (and with the owner of the realty, if he is not the debtor) before arranging to finance the installation.[166] If this is done, his only risk is the possibility of a subsequent encumbrancer of the realty from whom an agreement might be without consideration.

2. If the security interest is not filed until after the goods become part of the realty, the secured party will nevertheless be protected against the owner of the realty, but subject to the liability for repairs.[167] The security interest will, however, be subordinate to the

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[159] U.C.C. § 9-312(6).

[160] U.C.C. § 9-312(7). For a discussion of the problems which are involved, see Nichols, *Assignment of Claims Act of 1940—A Decade Later*, 12 U. OF PITT. L. REV. 538 (1951). See also *In re* Italian Cook Oil Co., 190 F.2d 994 (3rd Cir. 1951).

[161] U.C.C. § 9-312(1). The result will often be affected by the rules as to purchase money security interests.

[162] 2 U.L.A. § 7.

[163] U.C.C. § 9-313(1).

[164] But under Section 9-313(2) not for any diminution in value of the realty resulting from the absence of the repossessed goods or the necessity of replacing them.

[165] *Ibid.*

[166] *Ibid.*

[167] *Supra*, at note 164.

rights of three classes of persons: (a) a subsequent purchaser[168] of the realty for value; (b) a subsequent judgment creditor with a lien on the realty; (c) a prior encumbrancer to the extent of any subsequent advances which he makes; provided that the purchase is made, or the lien arises, or the subsequent advances are made not only without knowledge of the security interest but also before it is finally perfected.[169]

In other words, a diligent conditional seller will never find himself *legally* unable to repossess the goods, but he may face the practical issue whether the value of the repossessed goods is worth the cost of their removal plus the cost of repairing physical damage to the realty. This again is a *credit* question which can be appraised before entering into the transaction.

C. *Accessions.* A question similar to that of fixtures sometimes arises when a chattel is affixed to another chattel (*e.g.* new tires put on an old motor vehicle or a new engine installed in an airplane or a vessel). The rules here are the same as in the case of fixtures.[170]

D. *Commingling and Processing of Goods.* It not infrequently happens that fungible collateral under one security interest will be commingled with collateral under a second security interest.[171] More commonly, component parts will be processed or assembled into one end-product.

If this occurs and only the collateral of one secured party has been thus commingled with that of the owner, the security interest continues on the product if the security agreement so provides or if the secured party did not acquiesce in the loss of identity of his collateral.[172] If the security interest in the original collateral was perfected, the perfection will continue as to the product, if the financing statement covered "products"[173] or if the secured party did not acquiesce in the loss of identity of the collateral.

Therefore, the problem of financing goods during their manufacturing process has been greatly simplified. Prior to Article 9, if the manufacture of shoes were to be so financed, the lender might establish a field warehouse for the leather. Once the leather was being cut and sewn, it was impracticable for the warehouse to maintain possession, and the lien was lost unless it could be maintained under a

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[168] "Purchaser" includes "mortgagee," U.C.C. § 1-201(32). However, a prior encumbrancer who purchases at foreclosure sale is not a "subsequent" purchaser under the last sentence of Section 9-313(1).

[169] U.C.C. § 9-313(1).

[170] U.C.C. § 9-314.

[171] *Cf.*, U.C.C. § 7-207, relating to fungible goods commingled in a warehouse.

[172] U.C.C. § 9-315(1).

[173] U.C.C. § 9-402(3), item 4.

trust receipt during the interim period. When the finished shoes were delivered to the field warehouse, was this a technical preference? And what of the debtor's thread and linings which were now a part of the shoes?[174] Such problems, and the techniques employed in an effort to solve them, are now past.

Occasionally the collateral of two or more secured parties will be thus commingled in an end-product or a fungible mass. In such cases, the security interests rank on a parity in the ratio of the cost of the respective goods to the cost of the total product or mass.[175]

Accounts as Collateral

A secured party does not become liable on the debtor's contracts concerning the collateral (for example, the debtor's warranties under a contract for sale),[176] merely by virtue of the security interest or the authority given to the debtor to dispose of, or use, the collateral.[177] Such liability will arise, if at all, only through the participation by the secured party, in the disposition or use of the collateral.

On the other hand, the secured party takes an assignment of accounts or chattel paper subject to defenses and claims of the account debtor arising out of the contract between him and the assignor;[178] and also defenses and claims in favor of the account debtor which accrue before the account debtor receives notification[179] of the assignment or the arrangement for assignment.[180] However, the account debtor may agree not to assert such claims or defenses, unless he is a consumer.[181]

In cases where money to be earned in the future under a contract is assigned, the question has frequently arisen as to the legal right of the parties to the contract to amend it after notice of the assignment has been given. Article 9 meets this problem as follows:

(i) any modification or substitution is effective if made in good faith and in accordance with reasonable commercial standards;

(ii) the secured party-assignee acquires corresponding rights under the modified or substituted contract;

(iii) the original assignment may provide that any modification or substitution to which the secured party-assignee does not consent is a breach of contract by the debtor-assignor.[182]

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[174] *Cf.* Birnbaum, *supra* note 5, at 582-583.
[175] U.C.C. § 9-315(2).
[176] *Cf.* U.C.C. §§ 2-312 through 2-318.
[177] U.C.C. § 9-317.
[178] U.C.C. § 9-318(1)(a).
[179] Defined in U.C.C. § 1-201(26).
[180] U.C.C. § 9-318(1)(b).
[181] U.C.C. § 9-318; *cf.* § 9-206(2).
[182] U.C.C. § 9-318(2). See Rhode Island Discount Co. v. U.S., 94 F.Supp. 669 (Ct. Cl. 1951).

An account debtor, who has not received notification[183] that he is to pay the secured party-assignee, is protected on payments made to the debtor-assignor, if the debtor is permitted to collect the accounts or if he is put in possession of chattel paper which does not specify a place of payment other than the debtor's place of business.

Prior to the Assignment of Claims Act of 1940,[184] the Federal Government placed severe restrictions upon the assignability of claims against the United States.[185] Private account debtors sometimes undertake to prohibit assignment of accounts or money to be earned in the future under a contract, but Article 9 makes such prohibition ineffective.[186] However, an account debtor who is notified to make payment to the secured party is entitled to call for reasonable proof of the authenticity of the asserted assignment, such as a photostatic copy. Without such proof, the account debtor is justified in withholding payment, for he would be paying at his peril.[187] Similarly, the notification may fail to identify the particular account which has been assigned. In such a case the secured party-assignee is at fault, and the account debtor will be protected on payments made to the debtor-assignor until reasonable identification of the assigned account or contract right is furnished by the secured party-assignee.[188]

Filing

The filing framework of Article 9 is a model of simplicity.

What to File

Either a copy of the security agreement[189] or a financing statement[190] may be filed. In either case the paper must be signed by the debtor and the secured party, and must contain the following minimum information:

(i) an address of the secured party at which can be obtained more specific information concerning the security transaction, *e.g.*, the specific collateral, the amount of indebtedness, and the like;

(ii) a mailing address of the debtor;

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[183] Defined in U.C.C. § 1-201(26).

[184] 54 STAT. 1029 (1940), 31 U.S.C. § 203 (1946), as amended; the most recent amendments are Public Law 30, 82nd Cong. and § 105(b) (5) of the Renegotiation Act of 1951, Public Law 9, 82d Cong.

[185] Fortunately for the V-Loans of World War II, this Act substantially modified the previous policy. See Nichols, *supra* note 160; Kupfer, *The Federal Assignment of Claims Act Comes of Age*, 125 N.Y.L.J. Nos. 107-9; Cable, *1951 Assignment of Claims Amendment*, 68 BANKING L.J. 437 (1951).

[186] U.C.C. § 9-318(4), first sentence, thereby stating a rule contrary to Allhusen v. Caristo Construction Corp., 303 N.Y. 446, 103 N.E.2d 891 (1952).

[187] U.C.C. § 9-318(4), second sentence.

[188] U.C.C. § 9-318(4), third sentence.

[189] U.C.C. § 9-402(1), third sentence.

[190] U.C.C. § 9-402(1), first sentence.

(iii) an indication of the type of collateral or a description of the items of collateral;[191]

(iv) if the collateral is crops or fixtures, a description of the realty involved;[192]

(v) if the collateral is fixtures, it must be described by items, not by mere general type.[193]

The secured party's signature alone is sufficient in two cases:[194] (a) where filing in the Code State is done in order to perfect in that state a security interest which was in existence when the collateral was brought into the state;[195] (b) where the secured party with a perfected security interest in collateral is later seeking to perfect a security interest in proceeds under Section 9-306(1).

As in the Uniform Trust Receipts Act and various statutes relating to the assignment of accounts receivable, a suitable form of financing statement is contained in Article 9.[196]

Where to File

The place of filing is determined by the type of collateral:

(i) if fixtures, in the office where a mortgage on the realty concerned would be filed or recorded;[197]

(ii) if consumer goods held by the consumer, in the filing office of the county where the debtor resides; if he is a non-resident, then in the county where the goods are kept;[198]

(iii) if farming equipment, farm products, or accounts arising from the sale of farm products by a farmer, in the filing office of the county where the debtor resides; if he is a non-resident, then in the county where the equipment or farm products are kept; and, if crops are involved, also in the county in which is located the land where the crops are growing or are to be grown;[199]

(iv) in all other cases, *i.e.*, accounts (other than farm accounts), chattel paper, contract rights, inventory, and equipment (other than farm equipment), in the office of the Secretary of State or an equivalent state office.[200]

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[191] These three items are found in U.C.C. § 9-402(1), first sentence.
[192] U.C.C. § 9-402(1), second sentence.
[193] U.C.C. § 9-402(1), fourth sentence.
[194] U.C.C. § 9-402(2). Some states will adopt the alternative provision for refiling on removal from one county to another contained in Section 9-401(3); in such case, signature by the secured party is sufficient.
[195] U.C.C. § 9-103(3).
[196] U.C.C. § 9-402(3).
[197] U.C.C. § 9-401(1)(c).
[198] U.C.C. § 9-401(1)(b).
[199] *Ibid.*
[200] U.C.C. § 9-401(1)(a).

In other words, where the transaction is purely local and the debtor is not engaged in business, the filing is local. On the other hand, where the transaction primarily concerns business as such, the central filing provision of the Uniform Trust Receipts Act has been copied. This has worked well in practice, for it provides a single place where the searcher will find the filing record of all transactions.

Some states, however, will desire to add local filing (in addition to central filing) where the business transaction is essentially local in that all of the debtor's places of business are located in a single county.[201] If that is done, the convenience of local creditors may be served. However, central filing for business transactions should be preserved in either event, because local filing alone induces much confusion. An individual businessman may reside in one county and maintain his business in another county; equipment may be located in an establishment which is not the debtor's chief place of business. A provision for local filing in such cases breeds confusion as to where to file and where to search.

Article 9 departs from the rule laid down in many cases which hold that an error in the place of filing makes the filing completely non-effective. Section 9-401(2) states that incorrect filing is, nevertheless, good as against persons who acquire knowledge of the filing. Moreover, if filing in several places is required because the collateral is located in several places, filing in one place is at least good as to the collateral located there, even if it is inadequate as to collateral located elsewhere.

In case of removal, Article 9 proposes to the legislature a choice between two alternative rules: under one rule, filing remains effective even though the debtor's residence or place of business, or the location of the collateral, is later changed; under the other rule, filing of a copy of the financing statement, signed by the secured party, must be made at the new location within 120 days.[202]

Time and Duration of Filing

Instead of specifying a time limit or requiring "immediate" filing, as do many of the present statutes, Article 9 does not fix any time within which filing is required. If filing is necessary and it is delayed, the security interest remains unperfected[203] and therefore vulnerable. Hence prompt filing is always desirable. Where a conditional sale or the acquisition of inventory is involved, filing before the debtor

[201] See bracketed language at the end of U.C.C. § 9-401(1)(a).
[202] U.C.C. § 9-401(3).
[203] U.C.C. § 9-303(1)(a).

receives possession of the collateral is preferable.[204] However, in all cases where a third party was not injured by delay in filing because his rights accrued after filing was ultimately accomplished, he will not be allowed to complain of the delay and the secured party will be protected.[205]

If the financing statement specifies the maturity date of the debtor's obligation, filing is effective until that date and thereafter until the filing lapses.[206] This will ordinarily be true only if a copy of the security agreement is filed as the financing statement. In the absence of a stated maturity, the filing is effective until it lapses. Upon lapse, or upon filing of a termination statement, the security interest becomes unperfected with regard to rights of others which accrue thereafter.[207]

Two methods of putting an end to the effective filing of a financing statement are provided. The first is a termination notice signed by the secured party.[208] The debtor is entitled to demand this when he has no outstanding obligation to the secured party and when the secured party has no outstanding commitment to make advances, incur obligations or otherwise give value to the debtor. This termination statement can be filed to wipe the slate clean.[209]

The second method involves action by the filing officer. At any time after the stated maturity date, or at any time after five years following the filing of a financing statement which contains no stated maturity, the filing officer may notify the secured party that the effectiveness of the filing statement will lapse unless a continuation statement is filed.[210] The continuation statement must be filed not later than sixty days after the date of notification by the filing officer.[211] It must be signed by the secured party, and need merely identify the original statement by file number and state that it is still effective.[212] This continues the perfected status for another five years, at which time the procedure may be repeated.[213]

Enforcement of a Security Interest

Article 9 does not surround enforcement of a security interest with the technicalities which are present in many state statutes.

[204] *Cf.* U.C.C. § 9-313 as to fixtures; § 9-314 as to accessions; § 9-312(4) as to conflicts between a purchase money security interest and an after-acquired property clause; § 9-312(5) as to conflicting purchase money security interests.
[205] *Cf. supra*, at note 91.
[206] *Infra*, at note 210.
[207] U.C.C. § 9-403(2).
[208] U.C.C. § 9-404(1).
[209] U.C.C. § 9-404(2).
[210] U.C.C. § 9-403(3), first sentence.
[211] The continuation statement may, of course, be filed before notice from the filing officer; this will frequently be done to prevent any oversight.
[212] U.C.C. § 9-403(3), second sentence.
[213] U.C.C. § 9-403(3), third sentence.

Such requirements as tendering back part of the debtor's payments if a conditional sale contract is used rather than a purchase money chattel mortgage, or waiting a prescribed period before resale, or electing between repossessing and suing on the obligation, and other like requirements have been eliminated. On the other hand, the policy of Article 9 is to encourage the maximum realization on the collateral by the secured party in the interest of both himself and the debtor.

In all cases the remedies of the secured party are cumulative.[214] He may always reduce the debtor's obligation to judgment.[215] In addition he has the following remedies.

If the collateral is accounts, chattel paper, contract rights, negotiable instruments or securities, the secured party may sell them, or may collect them, or may collect them as long as it is advantageous to do so and then sell them.[216]

If the collateral is bills of lading or warehouse receipts, he may sell either the documents or the goods covered by the documents.[217] If the collateral is goods, he may accept them in discharge of the debtor's obligation or as an alternative he may employ judicial foreclosure, or may repossess the goods, prepare them for resale and after resale recover any deficiency.[218] If the collateral is both real and personal property, he may proceed under Article 9 as to the personal property, or under the real estate foreclosure procedure as to both kinds of collateral.[219]

On the other hand, when the secured party is in possession of the collateral, he must exercise due care in its custody and preservation.[220] The debtor has a right of redemption and a right to require the secured party to dispose of the collateral in accordance with Article 9.[221]

With regard to accounts, chattel paper, contract rights and negotiable instruments, the security agreement may provide for collections to be made by the secured party from the outset, or it may authorize the debtor to make collections until default or until notice to him to the contrary. Under Article 9 the secured party has the right to take over collections in case of default even if the agreement is silent.[222] Transactions with regard to this type of collateral are

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[214] U.C.C. §§ 9-501(1) and (3).
[215] U.C.C. § 9-501(1), first sentence.
[216] U.C.C. § 9-501(1), second sentence.
[217] U.C.C. § 9-501(1), third sentence.
[218] U.C.C. § 9-501(1), fourth sentence.
[219] U.C.C. § 9-501(4).
[220] *Cf.* U.C.C. § 9-207.
[221] U.C.C. § 9-501(2).
[222] U.C.C. § 9-502(1).

sometimes a pledge, sometimes a sale subject to repurchase in case of non-payment by the account debtor (*e.g.* a retail customer), sometimes a sale with a portion of the price withheld as security against non-payment by the account debtor, and sometimes an outright sale without recourse of any kind. In the latter case alone, the debtor-assignor (*e.g.* a retailer) is not concerned with the manner or extent of realization on the collateral by the secured party. In all other cases, the debtor-assignor is vitally concerned either because of his potential liability or his so-called "equity" in the withheld portion of the price. For all of these cases Article 9 prescribes the following rules:

(i) a secured party who takes control of collections must proceed thereafter in a commercially reasonable manner;[223]

(ii) the secured party is entitled to deduct his reasonable expenses;

(iii) if the security agreement specifies whether the debtor is entitled to any surplus if the net realization exceeds his obligation, or whether he is liable for any deficiency, or both, the agreement will control (usually the agreement is specific);

(iv) if the agreement is silent, then the results are determined by whether the transaction is in fact an outright sale or a loan; in the former case the debtor is neither entitled to any surplus nor liable for any deficiency; in the latter case, he is both entitled to any surplus and liable for any deficiency.[224]

With regard to tangible collateral like consumer goods, equipment, inventory, and farm products, and also with regard to collateral such as instruments, documents and chattel paper, the secured party has the right to take possession on default, unless the parties have otherwise agreed.[225] Peaceable repossession, without resort to judicial process, is allowed.[226] In order to avoid unnecessary expense, the secured party is also entitled to leave equipment temporarily

[223] "Commercially reasonable" is used repeatedly in other articles of the Code, as well as in Part 5 of Article 9. It constitutes a flexible standard which is certainly the most appropriate to the nature of the transaction, although it is indefinite; flexibility is preferable to rigidity. See U.C.C. § 9-507(2) for a partial definition of the term; *infra*, at note 243.

[224] U.C.C. § 9-502(2).

[225] U.C.C. § 9-503. It will be noted that the rules giving rights to the debtor and imposing duties on the secured party, under Part 5 of Article 9, may not be waived or varied unless the text specifically so provides. U.C.C. § 9-501(3), second sentence. Section 1-107 on waiver of rights arising out of breach, and Section 1-208 on acceleration based on "insecurity" should both be kept in mind.

[226] U.C.C. § 9-503, second sentence.

on the debtor's premises, render it unusable and sell it at that location.[227] This will frequently increase the net realization.

The resale provisions of Article 9 are also flexible.[228] Before disposing of the collateral, the secured party may, if he elects, process or prepare it in any commercially reasonable manner.[229] He may proceed at a public sale or may make a privately negotiated transaction; he may treat the collateral as a unit or may divide it into parcels; he may choose the time and place, and the terms (whether cash or credit); he may buy at a public sale, and may even buy at a private sale if the collateral is of a type which is customarily sold in a recognized market or is the subject of widely distributed standard price quotations.[230] There are only two general limitations which are imposed for the benefit of the debtor and others: (a) reasonable notice must be given to the debtor and to any other secured party who has a security interest in the collateral and who is known or who has filed a financing statement, unless the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market; and (b) "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."[231]

So far as the debtor is concerned, the proceeds of disposition are applied, first to cover the secured party's reimbursable expenses, second to the satisfaction of the indebtedness to the secured party, and third to the satisfaction of any subordinate security interest in the same collateral, if demand is made before distribution of the proceeds is completed. The debtor is entitled to any surplus and is liable for any deficiency if the security interest secures an indebtedness of the debtor. However, if the collateral is instruments, chattel paper, accounts or contract rights, and the transaction between the debtor and the secured party is a sale, the right to surplus or liability for deficiency must be spelled out in the agreement or it will not exist.[232]

So far as purchasers of the collateral and other transferees are

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[227] U.C.C. § 9-503, last three sentences.

[228] In addition to reselling collateral after default, the secured party may dispose of it in other ways, such as by leasing it. U.C.C. § 9-504(1).

[229] U.C.C. § 9-504(1), first sentence.

[230] U.C.C. § 9-504(2), first, second and last sentences.

[231] U.C.C. § 9-504(2), second, third and fourth sentences.

[232] U.C.C. § 9-504(1). As to the last sentence of the text, it should be noted that the postamble to Section 9-504(1) in the Final Text Edition (November 1951) is to be reworded. As drawn, it might appear to sanction a provision in a conditional sale contract depriving the buyer of any right to surplus after resale but making him liable for any deficiency, which is a result that was not intended and one that would be contrary to the policy of Section 9-505.

concerned, they acquire all rights of the debtor in the collateral and take free of the security interest and all subordinate security interests[233] even though the secured party fails to comply with the requirements of Article 9 (if he is proceeding under it) or of any applicable judicial proceedings under which the secured party is acting. This is, however, subject to two conditions: (a) if a judicial sale is involved, the purchaser must not know of any defects in the sale and must not buy in collusion with the secured party or other bidders; (b) in any other method of disposition of the collateral the purchaser must be in good faith.[234]

In case of a purchase money security interest in consumer goods, where the debtor has paid 60% of the cash price, the secured party must dispose of the collateral within ninety days. Otherwise, the debtor may sue for conversion or for a return of the so-called "finance charge" plus 10% of the cash price of the goods (or 10% of the principal, in case of a loan).[235] However, the consequence of a resale by the secured party is that the debtor is liable for any deficiency.[236] The debtor may wish to avoid the risk that there may be a deficiency, and the secured party may desire to avoid the expense of a resale; to accomplish this Article 9 gives the debtor the right to renounce his right to insist upon a resale, by a written agreement to that effect made after default.[237] Such an agreement will usually also release the debtor from further liability.

When the debtor has paid less than 60% of the purchase price of consumer goods covered by a purchase money security interest, and in case of any other collateral, the secured party who is in possession of the collateral after default may propose that he retain the collateral in satisfaction of the indebtedness. The proposal must be made to the debtor and also to any other person who is known to have a security interest in the collateral or who has filed a financing statement. If objection is made within thirty days, the secured party must dispose of the collateral in accordance with Section 9-504. In the absence of such objection, the secured party's proposal is deemed to be accepted by all concerned.[238]

The debtor's right of redemption may be exercised at any time before the secured party has disposed of the collateral or has made a

[233] So far as *prior* security interests are concerned, the situation is the same as when a second mortgage is foreclosed and the property is sold subject to an existing first mortgage.

[234] U.C.C. § 9-504(3). "Good faith" means honesty in fact, U.C.C. § 1-201(19).

[235] U.C.C. §§ 9-505(1) and 9-507(1), last sentence.

[236] U.C.C. § 9-504(1), postamble.

[237] U.C.C. § 9-505(1).

[238] U.C.C. § 9-505(2).

contract for such disposition and, of course, before the secured party's proposal to retain the collateral in satisfaction of the indebtedness has been deemed to be accepted. To redeem, the debtor must tender all sums due under the defaulted agreement[239] as well as the reasonable expenses of retaking, holding and preparing for disposition of the collateral.[240]

The court is given the power to order, to restrain, or to supervise the disposition of the collateral by the secured party.[241] If disposition has already been completed, the secured party is liable for any loss caused by failure to comply with Part 5 of Article 9.[242]

On the other hand, the secured party is specifically protected against mere harassing claims that he has failed to comply with the requirements of the Code. In the first place, the mere fact that a better price could have been obtained at a different time or by a different method does not, by itself, prove that the secured party's action was not commercially reasonable.[243] On the contrary, "commercially reasonable" includes, among other things (a) dealing in the usual manner in any recognized market, (b) conducting a private sale at the current market price, (c) following the reasonable commercial practices among dealers in that type of property, or (d) acting with the approval of the court in a judicial proceeding, or of a bona fide creditors' committee or representative of creditors.[244]

Conclusion

One objection to Article 9 which cannot be denied is that Article 9 represents new law for every state where the Code is adopted. It will require lawyers to learn new rules and to abandon old precedents. This is the price of progress to a system of law which is uniform and which is molded to current economic and business conditions.

A second objection, that Article 9 is unduly favorable to secured creditors, has less foundation. Article 9 does reduce the pitfalls and traps which have surrounded secured credit in the past. On the other

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[239] Including the full balance of the debt if accelerated; acceleration on default is clearly valid, *cf.* U.C.C. § 1-208.

[240] U.C.C. § 9-506.

[241] U.C.C. § 9-507(1), first sentence. Previous decisions which turned on who had "title" to the collateral are no longer in point, because all provisions of Article 9 apply regardless of whether title is in the secured party or is in the debtor. See U.C.C. § 9-202.

[242] U.C.C. § 9-507(1). In case of a consumer, there is a specific penalty regardless of actual damage; *supra*, at note 235.

[243] U.C.C. § 9-507(2), first sentence.

[244] U.C.C. § 9-507(2).

hand, it has recognized that this is necessary if wasteful expenses in the handling of secured credit are to be eliminated and if the cost of secured credit is to be reduced through decreased cost of handling such transactions. Moreover, the rights of debtors and general creditors are not only rendered more certain by the Code, these rights are protected by specific provisions and by general requirements such as public filing for most business transactions,[245] and the "commercially reasonable" test for steps taken by the secured party in realizing upon his collateral.

The major advances which Article 9 achieves are the following:

1. It makes certain types of secured credit available in states where previous rules made it impossible or at best difficult. The best example is inventory financing: in various states a chattel mortgage on a merchant's stock of goods has been invalid, and the courts in some of those states have gone far to strike down various attempts to use other techniques on the ground that in substance they amounted to a chattel mortgage.

2. Objections to secured credit have frequently been predicated upon secrecy and upon the ease with which they appeared to effect preferences to favored creditors; the security came into being, as well as into public view, only when the debtor was hard pressed. The approach of Article 9 to secret liens has just been mentioned.[246] The approach of Article 9 to preferences is shown by the careful distinction which is made throughout between "old value" and "new value." New value is treated as adding something to the debtor's general assets to offset the security interest in the specific collateral. New value is recognized as something which helps to keep the debtor going and to give him the opportunity to earn money to pay his debts. New value looks to the continuation of the business and should be encouraged. Old value looks to its liquidation—let the law of fraudulent conveyances and the preference rule in bankruptcy take their toll.

3. The "commercially reasonable" rule for realization upon collateral is a great step forward. The rigid formality of old-fashioned foreclosures has often resulted in loss to all except those who purchased at foreclosure sales. Under Article 9, the secured party is encouraged to liquidate like a merchant, and so long as he acts like

[245] The principal exception is the twenty-one day temporary perfection of a security interest in instruments and documents in the debtor's possession; such protection existed at common law and is also recognized by the Uniform Trust Receipts Act.

[246] *Supra*, at note 245.

an honest[247] and reasonable merchant, he is protected against attack based on the wisdom which comes after the event.[248]

4. Heretofore, financing of goods which were to be affixed to the realty was perilous in many states. The simple rules of Section 9-313 are much more feasible and are more just to all of the various interests which are involved. The same is true of accessions under Section 9-314.

5. The procedure for financing the manufacturing or processing of raw materials into finished merchandise[249] is a definite improvement over prior requirements.

6. The repeal of *Benedict v. Ratner* and kindred cases,[250] which sometimes resulted in a windfall to general creditors but which gave them no other practical protection, should materially reduce the handling expense of many loans on inventory and receivables, as well as greatly reduce the legal hazard of such loans.

7. The trend of financing in many situations has been toward a "floating lien." The debtor's financial needs are seasonal, and fluctuate during the season. It is a great convenience and a great economy for him to be able to increase or curtail his loan within the season in accordance with his requirements. What he would like to say to his banker is this: "So long as I maintain at least a minimum quantity or ratio of collateral, let me use money when I need it and for as long as I need it, and charge me interest on the average daily balance of the loan." Article 9 has gone far to facilitate exactly this technique by many provisions, such as: (a) sanction of security agreements providing for after-acquired collateral and future advances,[251] (b) declaration that such transactions are for "new value,"[252] (c) validation of a filing statement which merely describes the type of collateral,[253] (d) clarification of the rules regarding conflicting security interests,[254] and (e) procedure for following proceeds[255] and products.[256]

8. Loans on farm products are given far greater recognition.

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[247] "Every contract . . . imposes an obligation of good faith in its . . . enforcement." U.C.C. § 1-203. " 'Good faith' means honesty in fact," U.C.C. § 1-201(19).

[248] See U.C.C. § 9-507(2).

[249] *Supra*, at note 171 *ff.*

[250] *Supra*, at notes 72 and 73.

[251] U.C.C. §§ 9-204(3) and (5).

[252] U.C.C. § 9-108(2).

[253] U.C.C. § 9-402(1).

[254] U.C.C. §§ 9-312(3), (4) and (5).

[255] U.C.C. §§ 9-306 and 9-502(1).

[256] U.C.C. §§ 9-315 and 9-402(3), item 4.

9. Finally security agreements will become simpler. Just as a financing statement has been reduced to its minimum,[257] so also a "security agreement" can now become a very simple contract. One basic form of security agreement can replace ten old forms.[258] The basic form must describe the collateral and any real estate which is concerned, and must be signed by the debtor.[259] To this must properly be added the specific agreements and undertakings of each party, including their understanding as to "events of default." At this point the agreement can well end.

Experience alone will demonstrate whether Article 9 has been soundly conceived and well drawn. It is bound to achieve greater simplicity and uniformity than in the past. If, in addition, it results in more credit at lower cost, Article 9 may well prove to be one of the most important phases of the Uniform Commercial Code.

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[257] U.C.C. § 9-402.
[258] *Cf.* U.C.C. § 9-102(2).
[259] U.C.C. § 9-203(1)(b).