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Secured Transactions Under the Uniform Commercial Code

Roy L. Steinheimer, Jr.

SECURED TRANSACTIONS

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By ROY L. STEINHEIMER, JR.

Hard working chairman of the State Bar Special Committee to Study the Commercial Code of the National Conference of Commissioners on Uniform State Laws, Roy L. Steinheimer, Jr., is a professor of law at the University of Michigan.

THE area of secured transactions covered by article 9 of the Code encompasses any use of chattels, documents, instruments and intangibles as security for indebtedness. By thorough analysis and evaluation of the components of existing devices for financing in this area, the drafters of the Code have isolated elements common to all devices and have created a pattern of rules for financing which simplifies considerably the complexities which have long been regarded by lawyers as a necessary evil.

In Michigan, as elsewhere, the need for a comprehensive revision of the law in this area is apparent. Chattel secured financing is now controlled by a variety of separate statutes, some more or less complete and some fragmentary. Much of the law governing such transactions is found in common law decisions. In some instances, there is no law to guide us. A variety of security devices is available but each has its own formal requirements, filing requirements, rights on default, operational limitations, etc. A brief summary of the present state of our law illustrates the complexity.

Chattel Mortgage—This device is governed by statutory provisions relating to filing,[1] foreclosure,[2] purchasers at fore-

1. Mich. Comp. Laws (1948) §§566.140 et seq., Mich. Stat. Ann. (1953) §§26.929 et seq.

2. Mich. Comp. Laws (1948) §§566.401 et seq., Mich. Stat. Ann. (1953) §§26.977 et seq.

closure sale[3] and discharge of the mortgage.[4] Also, a bulk mortgage of a merchant's stock in trade will be subject to the bulk mortgage statute if any past consideration is involved in the secured indebtedness.[5]

Conditional Sale – Filing is not required unless the sale is to a conditional vendee who is regularly engaged in the business of selling such goods and it is understood that the goods may be resold[6] or is a sale of railroad or street railway equipment or rolling stock.[7] By common law decision the remedy of the conditional vendor on default is severely limited. The conditional vendor has only the option to retake the goods and rescind the sale or to allow title to pass and bring action for the purchase price. There is no right to deficiency judgment after repossession.[8]

Continuing Lien on Inventory–This lien, created by statute, applies only to manufacturers and processors and contains its own rules relating to formalities, filing, rights of third parties, foreclosure and rights on default.[9]

Trust Receipts – The Uniform Trust Receipts Act[10] sets up a separate set of requirements as to formalities, filing, rights of third parties and rights on default which apply to transactions falling under the act. The chattel mortgage and conditional sale transactions are specifically excluded from its operation.

Pledge – Though much of the law of pledge is found in common law decisions, there is a statute governing sale of personal property pledged as collateral.[11]

Accounts Receivable – Assignment of accounts receivable as security for indebtedness is covered by a separate statute with its own separate requirements for validation of the assignment.[12]

Motor Vehicle Sales Financing – There are two acts governing financing of sales of motor vehicles with special provisions relating to filing, foreclosure, etc. which cut across the areas of chattel mortgage and conditional sales law referred to previously.[13]

This brief tabulation of Michigan laws relating to chattel secured transactions illustrates the fragmented situation which exists in Michigan today.

The Code would eliminate this complexity and would treat the subject of such secured transactions as a unified whole to the end of clarification and simplification. As a starting point, the Code recognizes that there are certain basic objectives which are common to all forms of security devices. First, the device must place the secured party in a position of priority if the debtor experiences financial difficulty. Second, secret liens must be avoided by assuring notice to third parties of the existence of the security interest. Since any secured transaction must be concerned with these fundamental objectives, it should be possible to design a set of rules which accomplishes these objectives

3. Mich. Comp. Laws (1948) §566.191, Mich. Stat. Ann. (1953) §26.941.

4. Mich. Comp. Laws (1948) §§566.201 et seq., Mich. Stat. Ann. (1953) §26.951 et seq.

5. Mich. Comp. Laws (1948) §§442.51 et seq., Mich. Stat. Ann. (1959) §§19.371 et seq.

6. Mich. Comp. Laws (1948) §442.101, Mich. Stat. Ann. (1959) §19.381.

7. Mich. Comp. Laws (1929) §§11371 et seq., Mich. Stat. Ann. (1937) §§22.641 et seq.

8. Massey and Sullivan, "Business Inventory as Security in Michigan," 37 M. S. B. J. (Feb. 1958) p. 11.

9. Mich. Comp. Laws (1948) §§570.501 et seq., Mich. Stat. Ann. (1953) §§26.415 et seq.

10. Mich. Comp. Laws (1948) §§555.401 et seq., Mich. Stat. Ann. (1959) §§19.535 et seq.

11. Mich. Comp. Laws (1948) §§442.301 et seq., Mich. Stat. Ann. (1959) §§19.411 et seq.

12. Mich. Comp. Laws (1948) §§691.901 et seq., Mich. Stat. Ann. (1959) §§19.841 et seq.

13. Motor Vehicle Retail Installment Sales Act (Mich. Comp. Laws (1948) §§566.301 et seq., Mich. Stat. Ann. (1959) §19.415). Motor Vehicle Sales Finance Act (Mich. Comp. Laws (1948) §492.101, Mich. Stat. Ann. (1957) §23.628).

without concern for the legal mechanics of the transaction. This is precisely what the Code does. Formal distinctions between types of security devices—chattel mortgage, conditional sale, trust receipt, etc.—become inconsequential. Whatever the form, the fundamental objectives are the same. Thus the Code treats any agreement providing security for an indebtedness as a "security agreement"[14] even though by present standards it would have all the earmarks of a chattel mortgage or a conditional sale contract. This security agreement creates a "security interest"[15] in the "secured party"[16] which emanates from the "debtor."[17] Having established a simple technique for creation of the security interest, the Code then proceeds to establish a set of rules governing this interest.

In order to avoid the difficulty of secret liens, the Code provides that the security interest may normally be perfected only by the collateral being placed in the possession of the secured party[18] or by filing.[19] Filing may be accomplished, except in the case of fixtures, by a single central filing of a financing statement or the security agreement in the office of, for example, the secretary of state.[20] The filing is normally effective for a period of five years without renewal.[21]

On the difficult problems involving conflicting claims and priorities in the collateral which is the subject of the security interest, the Code provides a comprehensive and detailed set of rules. Claims of purchase money security interests,[22] of buyers in the ordinary course of trade[23] and of certain statutory and common law lienors[24] are given a high order of priority. General rules of priority between conflicting claims to the collateral are spelled out in detail[25] with special treatment being given to priority problems affecting farm crops,[26] fixtures,[27] accessions,[28] processed and commingled goods[29] and proceeds from sale of the collateral.[30]

Rights on default under the security agreement are spelled out in part 5 of article 9 of the Code. The secured party is given the right to take possession of the collateral without judicial process if this can be done without breach of the peace.[31] The secured party may require the debtor to assemble at a designated place collateral which is located in several places and, if physical removal of the collateral from debtor's premises is not feasible, the secured party may render the collateral unusable until it is disposed of.[32] If the secured party sells the collateral he must dispose of it in a commercially reasonable manner. This may be either by public or private sale depending on the judgment of the secured party.[33] Debtor is liable for any deficiency.[34] The secured party may propose in writing to retain the collateral in satisfaction of the obligation. This is permissible unless the debtor or interested third parties, e.g., other creditors, insist upon a sale of the collateral.[35] Debtor may redeem collateral by tendering fulfillment of all obligations secured by the collateral plus reasonable expenses incurred by seller in connection with the default.[36]

14. UCC §9-105(h).
15. UCC §1-201(37).
16. UCC §9-105(i).
17. UCC §9-105(d).
18. UCC §9-305.
19. UCC §9-401.
20. Similar filing procedures are provided for in the Uniform Trust Receipts Act [Mich. Comp. Laws (1948) §555.413, Mich. Stat. Ann. (1959) §19.535(13)].
21. UCC §9-403.
22. UCC §9-312(3) and (4).
23. UCC §9-307.
24. UCC §9-310.
25. UCC §9-312(3), (4), (5) and (6).
26. UCC §9-312(2).
27. UCC §9-313.
28. UCC §9-314.
29. UCC §9-315.
30. UCC §9-306.
31. UCC §9-503.
32. Ibid.
33. UCC §9-504.
34. Ibid.
35. UCC §9-505.
36. UCC §9-506.

This general pattern for handling all secured transactions is a distinct improvement over the complex problems which have developed under our existing law as the result of separate treatment of the various forms of security devices.

Exceptions

It should be noted that the Code recognizes that there are situations in which exceptions to the general pattern are necessary. These exceptions, however, do not depend on legalistic distinctions as to the form of the security device. Instead, such exceptions are included because of functional differences in the commercial purposes served by the type of collateral involved. For example, documents, instruments and intangibles, e.g., accounts receivable, are handled somewhat differently than chattels by businessmen in secured transactions. To accommodate the differences in function of these forms of collateral, special treatment is given to them under the Code where necessary.[37] Also, with respect to chattels, the functions served by the chattel in commerce may make certain special rules desirable to further these functions. Accordingly, the Code divides chattels into four functional categories: (1) consumer goods, (2) equipment, (3) farm products and (4) inventory.[38] If the function of the chattel as collateral, e.g., consumer goods, demands an exception to the general rules, appropriate provision is made.[39] These exceptions are woven into the general pattern to make a most workable blueprint for secured transactions as a whole.

37. UCC §§9-102(1)(b), 9-105(1)(b), 9-106, 9-306, 9-308, for example.

38. UCC §9-109.

39. UCC §§9-204(4)(a), 9-307(1), 9-204(4)(b), 9-302(1)(c) and (d), for example.

Big Bill Now P.A. 236–Effective Jan. 1,1963

The 664-page House Bill No. 3 pictured on the cover of this issue of the Journal, is one of the longest pieces of legislation introduced to the Michigan legislature. It now is known as P.A. 236 of the 1961 session, and for short will be known as RJA—the revised judicature act. It becomes effective January 1, 1963.

Accomplishment was brought about as the result of tremendous efforts by the Joint Committee on Michigan Procedural Revision. Created four years ago, its membership included Representatives Wilfred G. Bassett, Joseph J. Kowalski, Joseph A. Gillis and Thomas J. Whinery; Senators Lynn O. Francis, Edward Hutchinson, Harold M. Ryan, George C. Steeh, Paul C. Younger, John W. Fitzgerald and Basil W. Brown. Other members were Prof. Charles W. Joiner of the law school, chairman, Chief Justice John R. Dethmers and Justices Eugene F. Black, Leland W. Carr and Thomas M. Kavanagh of the Supreme Court, Circuit Judges Fred N. Searl, Frank Fitzgerald and Timothy Quinn, then Justice of the Peace Donald E. Adams, Municipal Judge Earl E. McDonald, Attorney General Paul L. Adams, Court Administrator Meredith H. Doyle, Jason L. Honigman, vice-chairman, Edward C. McCobb, Harold S. Sawyer, Albert E. Blashfield, Peter E. Bradt, Hugh S. Carpenter, Frank E. Cooper, Norman Des Jardins, Buell A. Doelle, Stanton S. Faville, Walter A. Kleinert, Alexis J. Rogoski, Robert D. Ulrich, Leroy G. Vandeveer, Donald F. Winters and Ivan D. Wright.