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Recent Developments under Article 9 of the Uniform Commercial Code

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A review of the recent decisions under Article 9 of the Uniform Commercial Code reveals little of startling significance. The mainstream of these decisions does, however, evidence a gratifying comprehension by our courts of the purposes which were intended to be served by the secured transactions provisions of Code.

SCOPE AND COVERAGE OF ARTICLE 9

Earlier uncertainties as to the status under Article 9 of a surety on a construction contractor's bond seem now to be well on the way to satisfactory resolution. The argument that a perfoming surety's rights to subrogation are "security interests" under Article 9 which require filing for protection has now been rejected by a number of courts[1], including the Kansas Supreme Court.[2]

The distinction between "pure" leases which are not subject to Article 9 and leases which are "intended as security," and require perfection under Article 9, continues to cause difficulty largely because the distinction between the two turns on the facts of each case. The inclusion of an option to purchase in the lease agreement does not, of itself, make the lease one which is "intended as security" under Article 9. But if the option to purchase can be exercised for no consideration or for a nominal consideration the lease is one "intended as security."[3] The fact that the lease agreement does not include an express option to purchase will not prevent a court from finding on appropriate facts that the lease was nevertheless "intended as security."[4]

Consignment arrangements seem to be a recurrent source of difficulty under the Code. The difficulty apparently stems from the fact that persons using this type of arrangement do not appreciate the fact that even though a consignment arrangement may not be one "intended as security" under Article 9, the Code nevertheless requires that creditors of the consignee have notice of the existence of the consignment arrangement as provided in Section 2-326(3) if the consignor is to prevail against such creditors.[5] Because of the Code's treatment of consignment arrangements which are not "intended as security," if the consignee returns consigned goods to the consignor within four months of the consignee's bankruptcy, there is the danger that

[1] National Shawmut Bank v. New Amsterdam Casualty Co., 411 F.2d 843 (1st Cir. 1969); In re J. V. Gleason Co., Inc., 9 UCC Rep. Serv. 1317 (8th Cir. 1971).

[2] U.S. Fidelity & Guaranty Co. v. First State Bank of Salina, 10 UCC Rep. Serv. 682 (1972).

[3] James Talcott, Inc. v. Franklin National Bank, 10 UCC Rep. Serv. 11 (Minn. 1972); Dynalectron Corp. v. Jack Richards Aircraft Co., 10 UCC Rep. Serv. 491 (WD Okla. 1972).

[4] In re Brothers Coach Corp., 9 UCC Rep. Serv. 502 (ED N.Y. 1971).

[5] Modular Housing, Inc. v. GAC Trans-World Acceptance Corp., 10 UCC Rep. Serv. 125 (Ala. 1972).

a voidable preference may be involved under section 60 of the Bankruptcy Act unless the notice requirements of the Code have been satisfied.[6]

Manufacturers Acceptance Corp. v. Penning's Sales, Inc.[7] presents an interesting set of facts which suggest two problems with the Code's consignment provisions. One problem involves the consignor's dilemma if he wants to give notice of a consignment arrangement which is not "intended as security" under Article 9. In many states the only feasible method of giving such notice will be through the filing of a financing statement. But if the consignor files a financing statement, what assurance does he have that his act of filing the financing statement will not be regarded as an admission that his consignment arrangement is really "intended as security" and is a secured transaction under Article 9? After the Final Report of the Review Committee for Article 9 was published in April, 1971, this problem was considered by the Committee and it has been suggested that a new section be added to Article 9 which would read as follows:

> "SECTION 9-408. *Financing Statements Covering Consigned or Leased Goods.*
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> "A consignor or lessor of goods may file a financing statement using the terms 'consignor,' 'consignee,' 'lessor,' 'lessee' or the like instead of the terms specified in Section 9-402. The provisions of this part shall apply as appropriate to such a financing statement but its filing shall not of itself be a factor in determining whether or not the consignment or lease is intended as security [Section 1-201 (37)]. However, if it is determined for other reasons that the consignment or lease is so intended, a security interest of the consignor or lessor which attaches to the consigned or leased goods is perfected by such filing."

This provision will be helpful not only to the consignor of goods but also to the lessor of goods who intends to create a "pure" lease which does not require filing but who is always fearful of the possibility that the lease may be found to be "intended as security" and subject to Article 9.

The other problem suggested by the *Manufacturers Acceptance* case involves the possible conflict between a secured party who has a perfected security interest in a debtor's inventory and a consignor who delivers inventory to the debtor "on consignment" and who gives notice of the consignment arrangement by filing a financing statement. As the Code now stands, the consignor in this situation would prevail over the inventory secured party despite the fact that the inventory secured party may have had no actual knowledge of the fact that his inventory security was threatened by the delivery of goods into debtor's inventory "on consignment."

The problem is closely akin to that of the inventory lender who may be threatened by a competing purchase money security interest in the same inventory. Section 9-312(3) provides some protection to the inventory lender in the purchase money situation but there is no similar protection provided in the consignment situation. Under the recommendations of the Review Committee for Article 9, this gap in the Code would be filled by

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[6] In re Gross Mfg. & Importing Co., Inc., 9 UCC Rep. Serv. 355 (D N.J. 1971).
[7] 9 UCC Rep. Serv. 797 (Wash. 1971).

the addition of a new section which reads as follows:

"SECTION 9-114. *Consignment*

(1) A person who delivers goods under a consignment which is not a security interest and who would be required to file under this Article by paragraph (3) (c) of Section 2-326 has priority over a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee, and also has priority with respect to identifiable cash proceeds received on or before delivery of the goods to a buyer, if

(a) the consignor complies with the filing provision of the Article on Sales with respect to consignments [paragraph (3) (c) of Section 2-326] before the debtor receives possession of the goods; and

(b) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor; and

(c) the holder of the security interest receives the notification within five years before the debtor receives possession of the goods; and

(d) the notification states that the consignor expects to deliver goods on consignment to the debtor, describing the goods by item or type.

(2) In the case of a consignment which is not a security interest and in which the requirements of the preceding sub-section have not been met, a person who delivers goods to another is subordinate to a person who would have a perfected security interest in the goods if they were the property of the debtor."

CONFLICT OF LAWS

When a security interest in a motor vehicle is perfected by notation of the lien on a certificate of title in State A and then the vehicle is removed to State B where notation is also the accepted method of perfection, the perfection in State A continues effective in State B until a new certificate of title is issued in State B.[8] If a security interest in a motor vehicle is properly perfected in State A, a non-title certificate state, by filing a financing statement and then the vehicle is removed to State B which is a title certificate state, under section 9-103(3), the perfection in State A remains effective in State B for four months.[9] With this in mind, suppose that during the four month period State B issues a clean certificate of title on the vehicle which is then sold within the four month period to a bona fide purchaser for value. As the Code stands, the security interest perfected by filing in State A should prevail against the bona fide purchaser. However, one might well question the fairness of such a result as did the Texas Supreme Court in *Phil Phillips Ford, Inc. v. St. Paul Fire & Marine Insurance Co.*[10] Indeed, the Review Com-

[8] In re Wolf, 9 UCC Rep. Serv. 177 (WD, Mich. 1971); Town House Motel, Inc. v. Ward, 10 UCC Rep. Serv. 267 (Ill. App. 1971).

[9] Doenges-Glass, Inc. v. General Motors Acceptance Corp., 288 P.2d 879 (Colo. 1971).

[10] 8 UCC Rep. Serv. 1331 (1971).

mittee for Article 9 seems to be equally unhappy with the result the Code seems to call for and has recommended that a non-dealer buyer of the vehicle should be protected in this situation.[11]

[11] See Final Report, §9-103(2)(d).

SECURITY AGREEMENT AND FINANCING STATEMENT

While a financing statement in the usual form will not satisfy the requirements of a written security agreement necessary to the creation of an enforceable security interest, several recent decisions indicate that our courts will strive to find a sufficient writing if at all possible. In *Evans v. Everett*,[12] the North Carolina Supreme Court found a sufficient written security agreement embodied in a promissory note which recited that it "is secured by Uniform Commercial Code financing statement of North Carolina" and a reciprocal reference to the financing statement that it covered certain described collateral "same securing note for advanced money to produce crops for the year 1969." *In re Carmichael Enterprises, Inc.*[13] found a sufficient written security agreement from the fact that a letter from the lender to the debtor recited the indebtedness and requested debtor to sign an enclosed financing statement and these contemporaneously executed documents were held to be a written security agreement.

While the Code gives considerable latitude on the matter of description of the collateral in the security agreement and in the financing statement, the limits of tolerance of our courts in this regard vary considerably. Two recent decisions of the United States District Court in Kansas are interest-

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[12] 279 N.C. 352, 183 S.E.2d 109 (1971).

[13] 9 UCC Rep. Serv. 990 (ND Ga. 1971). See also, In re Nunnemaker Transportation Co., Inc., 10 UCC Rep. Serv. 468 (9th Cir. 1972).