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C H A P T E R 1 0

Article Nine: Secured Transactions

PETER F. COOGAN *and* O. W. HAUSSERMANN, JR.

§10.1. General.¹ Article 9 of the Uniform Commercial Code formulates a comprehensive set of rules that govern practically all security transactions with respect to tangible and intangible personal property.

Although Article 9 looks formidable at first blush, it actually does not change to any very great degree the fundamentals of security law in Massachusetts which must be mastered by the practitioner. For example, a person drafting a chattel mortgage in Massachusetts must presently concern himself with the following questions: (1) What provisions must the mortgage contain? (2) What is the effect of a provision purporting to create security interest in after-acquired property or for future advances? (3) Is a "free handed" mortgage valid? (4) Where must the mortgage be recorded? (5) How soon must the mortgage be recorded? (6) What protection does recording give? (7) What remedies are available on foreclosure? (8) How must these remedies be carried out? Being already aware of these problems, the practitioner will under the Code turn to Article 9 for a solution to each of them instead of turning to a mass of cases and statutes which are often confusing and incomplete. He will also find that these problems fairly well represent the general scope of situations with which Article 9 is concerned.

Why then go to the trouble of adopting Article 9? In the first place, the very fact that Article 9 is a Code which sets forth in one place a complete set of rules for practically all security transactions in personal property is a distinct advantage in itself. The present Massachusetts law as to security transactions is a hodgepodge of different rules for the many different types of security devices which are available. Thus a lender must choose whether to use any or all of the

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§10.1. ¹Since the Massachusetts Annotations to Article 9 were prepared largely by the authors of this chapter and are available in Annotated Laws of Massachusetts, c. 106, Special Supp. 1958, no useful purpose would be served in reproducing here the section-by-section comparisons of Article 9 with the Massachusetts statutory and case law which it replaces. Where references are made herein to sections of Article 9, those references generally include a reference to the corresponding Massachusetts Annotations.

following devices available to him under present Massachusetts law: a pledge, a chattel mortgage, a conditional sale, a trust receipt, a trust, a factor's lien, an assignment of accounts receivable, a consignment, a lease or some other type of device resembling one of the above but with a different label. He may prefer one device (e.g., a conditional sale instead of a chattel mortgage) because the special rules relating to the device permit certain provisions that are not permitted in other devices, but he may find that he pays a penalty in using this device because of the lack of statutory or case authority which will give him authoritative answers to the problem areas he must anticipate.

Article 9 does much to remove this dilemma. In broad outline, Article 9 appears to have achieved at least four general objectives which would seem to represent valuable contributions to Massachusetts law. The purpose of this brief discussion of Article 9 is to touch upon these four general objectives.

§ 10.2. Elimination of traps created by distinctions based upon the type of security device used. One of the important contributions of Article 9 is the elimination of traps to the unwary lender or the secured seller who under present law may find that the security device he thought he had used turns out to be as a matter of law an entirely different device and thus ineffective because the special rules relating to such a device were not followed.

Article 9 will eliminate technical distinctions among various types of security devices so that the lender or the secured seller will need only have the borrower or buyer sign a simple security agreement containing a general description of the collateral¹ without worrying about the necessity of characterizing the transaction as a "chattel mortgage," "conditional sale" or the like.² This security agreement will then be enforceable against all persons to the extent provided in Article 9,³ so that the lender will need only turn to the provisions of Article 9 to find out the extent to which his agreement is effective in accordance with its terms. And even if a particular provision, such as a provision for a particular remedy upon default, went beyond the permitted provisions of Article 9, the lender would not find his entire agreement rendered invalid as a security device, as might well be the case in many situations under present Massachusetts law, but only that the particular provision in question was rendered inapplicable.⁴

Not every trap for the secured seller or lender is eliminated by the adoption of the Code, since Acts of 1957, c. 765, amends rather than repeals some of the "police type" regulations⁵ of the old law. The various "police statutes" with which the secured party would still have

§10.2. ¹ UCC §9-110.

² *Id.* §9-102.

³ See UCC, Article 9, Parts 2 and 3.

⁴ See UCC §9-504(1), and Massachusetts Annotations in Mass. Ann. Laws, c. 106, Special Supp. 1958.

⁵ In addition to UCC §§9-201, 9-203(2), Acts of 1957, c. 765, §§6-16, 18, should be consulted.

to comply relate principally to the small loan field and the sale of consumer goods which are fairly well defined segments of the field of security transactions. Further, Article 9 does make distinctions based upon the subject matter of the security transaction, such as "consumer goods," "farm products," "equipment," "inventory" and "accounts."⁶ These distinctions, however, can be disregarded for many purposes. They are important principally with respect to the necessity⁷ and to the place⁸ of filing and with respect to remedies on default.⁹ The Code classifications, while new, correspond directly with business realities and should present relatively few problems. As to filing, the careful practitioner can always protect his client by following the more stringent filing requirements. In the case of a physician's car, no filing is necessary if the car is "consumer goods" (because used principally for personal use) but filing is required if the car is "equipment" (principally used in a business or profession); the simple answer is to file.

§10.3. Simplification of legal steps which are necessary in order to implement an after-acquired property clause. Under present Massachusetts law, although a security agreement may validly contain an after-acquired property clause, the mechanics of implementing such a clause to make it effective against third persons are often so cumbersome that either the secured party must "run for luck" as to the protection to which he is entitled under such a clause or must insist upon a great deal of time-consuming and expensive paper work on the part of the borrower.

Thus, under present law, a lender who uses a chattel mortgage must implement an after-acquired property clause by recording a supplemental mortgage with respect to each item of after-acquired property as each item comes into existence; if the lender lends on the security of accounts receivable, the borrower must deliver to the lender a new assignment as each account comes into existence.¹ Should the lender attempt to acquire a valid lien on future inventory and receivables arising therefrom, he must under the Factor's Lien Act require the borrower periodically to supply him with written statements describing additions to inventory as they are made.² Thus, although there seems to be no policy against a lender obtaining a good lien on after-acquired property, the obstacles placed in his way seem unnecessarily complicated and, by the same token, in many situations unnecessarily costly in terms of time and money to the borrower.

⁶ UCC §§9-105, 9-106, 9-109.

⁷ Id. §9-302.

⁸ Id. §9-401. See also §9-307 which, because of the definition of "buyer in ordinary course of business" in §1-201(9), allows the buyer of inventory to disregard the existence of a security interest but requires buyers of equipment to take subject thereto.

⁹ See, e.g., UCC §9-505.

§ 10.3. ¹ See Massachusetts Annotations to UCC §9-204, in Mass. Ann. Laws, c. 106, Special Supp. 1958.

² G.L., c. 255, §§40-47.

Article 9 will generally make an effective security interest in after-acquired property almost as easy to get as an effective security interest in existing property. If the parties contract for such security, then the secured party, by describing in general terms the type of after-acquired property he intends to take as security in the recorded financing statement, for all practical purposes has an interest in the after-acquired property which will become perfected against third persons almost to the same extent as existing property without the necessity of additional filings or daily, weekly, etc., written assignments on the part of the borrower.³ In other words, the lender under Article 9 can get the same sort of protection as it is now theoretically possible for him to get under present law but at far less trouble and expense to both borrower and lender and, generally, at the same time he puts third persons on notice of his claim by a public filing.⁴

One device which makes feasible the creation of a security interest in after-acquired property is the new-type "notice" filing system required by the Code which is similar to that now required by the Uniform Trust Receipts Act and the Factor's Lien Act⁵ rather than the recording of the actual instrument required with respect to chattel mortgages.⁶ While the security agreement itself may be filed, in its stead there may be filed a simplified "financing statement."⁷ Like the financing statements required under the two acts mentioned above, the purpose of the filing is to put the public on notice that a security interest has been created without attempting to describe it in detail. An appropriate notice may cover repeated transactions as in inventory financing. In general, filing is required with respect to all transactions (other than pledges) where the debtor is a business entity (including conditional sales and assignments of accounts receivable which heretofore have not required filing or recording) but filing is not required with respect to purchase money security interests in consumer goods.⁸

Section 9-204, which deals principally with problems of after-acquired property, also in Subsection (5) clarifies the law with respect to securing advances made subsequent to the creation of the security interest.

§ 10.4. Elimination of the problem of *Benedict v. Ratner*. In some neighboring states, particularly New York, there has grown up over the years an unduly harsh doctrine that the secured party who gives to his borrower what a court at a later time finds to have been too

³ For important provisions for retention of a purchase money security interest on goods which otherwise fall under the after-acquired property clause of another security agreement, see UCC §9-312(3), (4), and the sponsors' comments thereon. As to possible preference problems, see Massachusetts Annotations to UCC §9-108, in Mass. Ann. Laws, c. 106, Special Supp. 1958.

⁴ UCC §§9-302, 9-401.

⁵ G.L., c. 255A, §§7-9; c. 255, §§41-43.

⁶ Id., c. 255, §1.

⁷ UCC §9-402.

⁸ Id. §9-302.

much "dominion" of the collateral for that reason loses his secured position regardless of the lack of actual fraud. The case which embodies this doctrine is *Benedict v. Ratner*.¹ The doctrine was pushed so far that an otherwise valid assignment of accounts receivable was held invalid because the borrower was allowed to deal freely with returned goods having a face value of 1¾ percent of the security involved.² While the rule of that case was rejected by legislative action in New York³ and in many other states, including Massachusetts,⁴ the negation of this rule in the instances which have been brought to the attention of the General Court might indicate that the general rule applies in Massachusetts.⁵

Section 9-205 permits a debtor to use, dispose of and otherwise act in a normal business manner in relation to collateral without having to account to the creditor; if the creditor gives such permission, the security interest is not void or fraudulent against creditors. This section restates what has been the law in Massachusetts for over a century.⁶

§10.5. Plugging gaps in Massachusetts law in situations in which there is little or no reliable Massachusetts authority. A detailed survey of the gaps in Massachusetts law filled by Article 9 is beyond the scope of this discussion.¹

Very often the type of gap which is filled by the Article is in connection with a specific problem for which there is now an answer if one type of security device is used but for which there is no authoritative answer if another type of security device is used. For example, except with respect to inventory liens under the Factor's Lien Act or trust receipt transactions, there is no Massachusetts authority as to the extent to which a secured party's lien covers proceeds of sales of property in which he has a security interest. Article 9 covers this situation by adopting a rule similar to that presently contained in the Massachusetts Trust Receipts Act but generally applies this rule to all security transactions in personal property.²

Part 5 of Article 9, dealing with remedies upon default, presents the most typical example of this feature, and it may be helpful to one's general perspective in this connection to discuss Part 5 very briefly in this light.

There are no startling innovations produced by the remedial pro-

§10.4. 1268 U.S. 353, 45 Sup. Ct. 566, 69 L. Ed. 991 (1925).

² *Lee v. State Bank and Trust Co.*, 54 F.2d 518 (2d Cir. 1931).

³ See N.Y. Personal Property Law §45, as amended.

⁴ See, e.g., as to returned goods, G.L., c. 107A, §5; as to crops, id., c. 255, §§7B, 7C.

⁵ See *Manchester National Bank v. Roche*, 186 F.2d 827 (1st Cir. 1951), applying New Hampshire law.

⁶ *Briggs v. Parkman*, 2 Metc. 258 (Mass. 1841); *Shurtleff v. Willard*, 19 Pick. 202 (Mass. 1837); *Federal Finance Corp. v. Reed*, 296 Fed. 1 (1st Cir. 1924); *Brett v. Carter*, 4 Fed. Cas. 67, No. 1844 (D. Mass 1875).

§10.5. ¹ See, generally, the authors' annotations to Article 9 in *Mass. Ann. Laws*, c. 106, Special Supp. 1958.

² See annotations to UCC §9-306 in *Mass. Ann. Laws*, c. 106, Special Supp. 1958.

visions of Part 5. In broad outline, Part 5 recognizes, as does present Massachusetts law, the right of a secured party to take possession of collateral on default, to sell or otherwise dispose of the collateral without resort to judicial process, the duty of the secured party to account to the debtor for any surplus from such a sale or his right to sue for any deficiency, the right of the debtor to redeem and to have foreclosure carried out in good faith.

Some express changes are made in existing Massachusetts law. Thus, the debtor is entitled to redeem at any time before the collateral is sold by the secured party³ instead of having his right to redeem cut off at the end of a specified period of time, whether or not the collateral is sold. No period is specified for which advance notice of a sale of collateral is required as is presently the case in most situations; rather, "reasonable notification" is required.⁴

The main virtue of the remedial provisions of Article 9 is to set forth a fairly complete, although not exhaustive,⁵ set of rules which govern the exercise of rights on default and thus spell out solutions to problems in some areas for which there is at present no case or statutory authority available.

Thus, Article 9 not only provides that a secured party may take possession on default, but also specifically provides that he may render equipment unusable and dispose of it on the debtor's premises.⁶ In addition, mechanics for an agreement for retention of collateral in satisfaction of the debt are set up which, although it would tend to produce the same effect as the foreclosure of a right of redemption under present chattel mortgage law, would nevertheless provide a remedy for which there seems to be no answer under present law in other security transactions.⁷ Then, too, in providing that a good faith purchaser on foreclosure gets good title, Article 9 fills a gap as to which there is apparently no authority in Massachusetts law.⁸

Still another partial gap which Article 9 fills in present Massachusetts law is the furnishing of fairly comprehensive standards which would govern foreclosure sales. Section 9-504 (3) of the Code permits the disposition on foreclosure to be at public or private sale, under one or more contracts, in one or more parcels, at any time and place and on any terms, provided that the disposition is effected in a "commercially reasonable" manner in these respects.⁹ As mentioned above, "reasonable notification" of the time and place of the sale must be given to the debtor. Furthermore, Section 9-504 (3) permits the secured party to buy in at any public sale under any circumstances and to buy in at private sale if there is a "recognized market" for the collateral

³ UCC §9-506.

⁴ *Id.*, §9-504(3).

⁵ *Id.*, §9-501.

⁶ *Id.*, §9-503.

⁷ *Id.*, §9-505.

⁸ *Id.*, §9-504.

⁹ See also UCC §9-507.

or if the collateral is of a type for which there are “widely distributed standard price quotations.”

In conclusion, it seems fair to say that Article 9 does not work any very significant change in fundamental Massachusetts policies relating to security transactions. In general, it supplies answers in areas for which there is at present no definitive answer. In addition, although it may, and does, change rules which presently apply to a particular type of security device, in so doing in the vast majority of instances it adopts rules which have a present Massachusetts precedent in another type of security device, usually a device which has been introduced by a more recent statute embodying more modern concepts.¹⁰ Indeed, the instances in which rules are adopted which add new features for which there is no Massachusetts precedent, and rules are adopted which represent changes in Massachusetts law for which there is no present counterpart in some field of Massachusetts security law, are surprisingly few.

¹⁰ Uniform Trust Receipts Act, G.L., c. 255A; Factor's Lien Act, G.L., c. 255, §§40-47.