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Article 9: Secured Transactions

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ARTICLE 9: SECURED TRANSACTIONS; SALES OF ACCOUNTS,
CONTRACT RIGHTS AND CHATTEL PAPER

SECTION 9-102. Policy and Scope of Article.

(1) Except as otherwise provided in Section 9-103 on multiple state transactions and in Section 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state

- (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights. . . .

United States v. Somerville, 211 F. Supp. 843 (W.D. Pa. 1962).

Flickinger obtained several loans over a four year period from the Farmers Home Administration (FHA) which were secured by all of Flickinger's farm equipment, crops and livestock. The security agreement was properly filed as a financing statement under the Code. Flickinger delivered three cows to defendant, a cattle auctioneer, to be sold at auction. Auctioneers, such as defendant, retained possession of cattle received for sale only long enough to sell them.

Defendant, not knowing of the security interest of FHA, auctioned the Flickinger cattel to the highest bidders for a total of \$377.49. Upon learning of this sale, FHA urged Flickinger to conduct a liquidation sale of all his property, which he did, leaving a remaining indebtedness to FHA of over \$500. Plaintiff, on behalf of FHA, brought an action in conversion against defendant for the value of the three cows.

The court decided that the agreement and conduct of both parties, referring to and complying with the Code, under Section 9-102, indicated that the local law applied. It then found the defendant liable for the proceeds from the conversion, basing its decision solely on Pennsylvania agency law. As to defendant's argument that FHA did not act in good faith because it did not furnish a list of debtor farmers, the court held that since the security agreement was filed in accordance with Section 9-401, and even though the Code does not expressly confer constructive notice upon sellers, defendant could have easily consulted the public records periodically to keep informed of the security interests in chattels with which he may deal.

[Annotator's Comment: This case is squarely in line with *Erb v. Stoner*, 19 Pa. D. & C.2d. 25, 56 Lanc. L. R. 434 (1959) (2 B.C. Ind. & Com. L. Rev. 112, 114 (1960)). Although the results of these two cases are identical, the reasoning used to reach these results raise some interesting questions. In the *Erb* case, the auctioneer had knowledge that the cows were subject to creditor's security interest, and the court put emphasis on this fact. But in the instant case, the auctioneer did not have knowledge of creditor's security interest, yet the court held him

to something akin to constructive knowledge because the security agreement was duly filed pursuant to Section 9-401. By so doing, the court is applying and expanding Section 9-301. Section 9-301(1) provides that a perfected security interest has priority over the interest of a subsequent lien creditor, bulk transferee, or buyer not in ordinary course of business. An auctioneer found to be the agent of the debtor is *not* one of these parties.

The court, however, discusses the filing as "constructive notice," not as an act of perfection. Filing is not required to perfect certain security interests, such as purchase money security interests in consumer goods, and there would be no "constructive notice" in such cases. Quere whether the court would reach the same result by applying Section 9-301(1) literally. Of course, on a strict agency theory, the auctioneer, acting in behalf of the debtor, would be liable for unauthorized disposition in the same way that the debtor would. The knowledge of the debtor would be imputed to the agent. If the auctioneer were a buyer for resale, he would be in no better position since, as a buyer of farm products from a farmer, he does not qualify for the protection afforded a buyer in ordinary course of business under Section 9-307(1) and would have an interest subordinate to that of the secured party as a buyer under Section 9-301(1).

Even in light of Section 9-104, which prescribes application of the Code to a transaction governed by a federal law to the extent the federal law does not apply, the court was correct in applying state law to this transaction, for Section 21 of the Bankhead-Jones Farm Tenant Act, 60 Stat. 1071, 7 U.S.C. § 1007, makes no provision for this type transaction. The act was repealed in 1961 and replaced by 75 Stat. 307, 7 U.S.C. §§ 1921-90 (Supp. III 1962). The replacing statute also does not provide for perfection and priorities in this type of transaction leaving state law to control.]

SECTION 9-103. Accounts, Contract Rights, General Intangibles and Equipment Relating to Another Jurisdiction; and Incoming Goods Already Subject to a Security Interest.

. . . .

(3) If personal property other than that governed by subsections (1) and (2) is already subject to a security interest when it is brought into this state, the validity of the security interest in this state is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. However, if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the validity of the security interest in this state is to be determined by the law of this state. If the security interest was already perfected under the law of the

jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues perfected in this state for four months and also thereafter if within the four month period it is perfected in this state. The security interest may also be perfected in this state after the expiration of the four month period; in such case perfection dates from the time of perfection in this state. If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, it may be perfected in this state; in such case perfection dates from the time of perfection in this state.

(4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of this state or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.

Commercial Credit Corp. v. Bongiorno, 45 Erie Leg. J. 92 (Pa. 1961).

Kreager executed a chattel mortgage on his automobile to the plaintiff in Michigan. It was recorded on June 24, 1957. On September 11, 1957, Agostino, the agent of a Pennsylvania auto dealer, purchased the car from Kreager and received a "discharge or placement of lien" purportedly signed by the plaintiff's manager. The discharge contained many blank spaces; only the name of the seller and the make of the automobile were inserted. A procedure was set out for the securing of an unencumbered certificate of title from the state of Michigan. A new certificate was not obtained. Having transported the vehicle to Pennsylvania, where a certificate of title was procured, the dealer subsequently sold the vehicle. The plaintiff then brought an action in conversion against the dealer averring that the release had been a forgery. The defendant demurred, alleging that the laws of Pennsylvania, particularly Section 9-103, protect innocent purchasers of property subject to foreign mortgages.

The court held that the rights of the parties must be determined in accordance with Michigan law since the mortgage and sale were both made there. Under that law, the purchasers did not take free of the mortgage. The incomplete release should have aroused suspicion. An effort to secure a new title certificate or to inquire at the plaintiff's office would have disclosed the fraud. The demurrer was overruled and the defendants allowed to file an answer.

[Annotator's Comment: It is significant to note that the defendant in this case was not the ultimate buyer; had it been, the result might have been different upon the grounds urged by the defendant.

Section 9-103(4) provides that *perfection* of the security interest is governed by the law of the jurisdiction issuing a certificate of title covering the vehicle. This case illustrates the potential difficulty which may arise where *two* jurisdictions issue certificates of title covering the

same motor vehicle. The court was correct in applying Michigan law since the defendant's status as a good faith purchaser arose, if at all, in that state where the vehicle was purchased. Were the Code effective in Michigan at that time, the result would have been the same since, if the security interest were perfected, good faith purchasers would take subject to it under Section 9-301(1). The defendant dealer in this case was not a buyer in ordinary course of business.

Even had the court applied the Code under Pennsylvania law and assuming the security interest was not perfected within four months of removal under Section 9-103(3), the facts were such that defendant's good faith would be in question, requiring the overruling of the demurrer.]

Skinner v. Tober Foreign Motors, Inc., — Mass. —, 187 N.E.2d 699 (1963).

See the Annotation to Section 2-209, *supra*.

SECTION 9-301. Persons Who Take Priority Over Unperfected Security Interests; "Lien Creditor".

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

- (a) persons entitled to priority under Section 9-312;
- (b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected;
- (c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

. . . .

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the collateral comes into possession of the debtor, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest.

United States v. Sommerville, 211 F. Supp. 843 (W.D. Pa. 1962).

See the Annotation to Section 9-102, *supra*.

SECTION 9-306. "Proceeds"; Secured Party's Rights on Disposition of Collateral.

. . . .

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest

- (a) in identifiable non-cash proceeds;
- (b) in identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;
- (c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and
- (d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is
 - (i) subject to any right of set-off; and
 - (ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period.

Middle Atl. Credit Corp. v. First Pa. Banking & Trust Co., — Pa. Super. —, 185 A.2d 818 (1962).

In August 1959, Middle Atlantic and Zucker executed a security agreement whereby Middle Atlantic would purchase the accounts receivable of Zucker. The security interest was properly perfected by filing. Zucker was to turn over the proceeds from the accounts in the form in which they were received. In January 1961, Zucker assigned to Middle Atlantic a sum to become due under a construction contract. On February 16, 1961, he received a check under that contract, but deposited it in his own account with defendant bank. Four days later, Zucker filed a petition under Chapter XI of the Bankruptcy Act. The bank appropriated the balance of the deposit of February 16 in set-off against an outstanding loan made to Zucker in 1960. Middle Atlantic brought an action against the bank to recover the sum appropriated. The lower court denied plaintiff's motion for judgment on the pleadings. On

appeal, reversed, with judgment on the pleadings entered for plaintiff.

Under established Pennsylvania case law, the bank could not set off funds of a third party in the debtor's account. Section 9-306(4) (d), as amended in 1959 to conform to the 1958 Code, did not create any new right of set-off, but allowed any existing right. Had the legislature intended to create a new right under this section, it would have been more clearly indicated.

[Annotator's Comment: Apparently Zucker had no other funds in the account when the deposit was made. Therefore, the assignee had a perfected security interest in and could recover the entire remaining sum either as identifiable proceeds or as commingled proceeds received within ten days of insolvency proceedings. Had there been other funds in the account, the claim could have been only upon the latter basis.

The court correctly construed the provision relating to the bank's right of set-off. Prior Pennsylvania law had established that the bank's notice of the third party's interest was not required to deny the right of set-off. In jurisdictions where notice *is* required, the court may properly find that the filed financing statement constitutes such notice.]

SECTION 9-307. Protection of Buyers of Goods.

(1) A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

(2) In the case consumer goods and in the case of farm equipment having an original purchase price not in excess of \$2500 (other than fixtures, see Section 9-313), a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods.

United States v. Sommerville, 211 F. Supp. 843 (W.D. Pa. 1962).

See the Annotation to Section 9-102, *supra*.

SECTION 9-401. Place of Filing; Erroneous Filing; Removal of Collateral.

(1) The proper place to file in order to perfect a security interest is as follows:

Optional paragraph (a)

- (a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products

UNIFORM COMMERCIAL CODE ANNOTATIONS

by a farmer, or consumer goods, then in the office of the
..... in the county of the debtor's residence or if the
debtor is not a resident of this state then in the office of the
..... in the county where the goods are kept, and in addition
when the collateral in crops in the office of the
in the county where the land on which the crops are growing
or to be grown is located;

United States v. Sommerville, 211 F. Supp. 843 (W.D. Pa. 1962).

See the annotation to Section 9-102, supra.
