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COMMENTS

A FURTHER CRITIQUE OF THE FIXTURE SECTION OF THE UNIFORM COMMERCIAL CODE

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Section 9-313, the fixture section of the Uniform Commercial Code, has been shown to be a potential source of serious problems.[1] Partly, no doubt, because of these problems, California refused to adopt this section when it enacted the Code; and Ohio, after living with Section 9-313 for about a year, decided to revise it substantially.[2] Hence, a reappraisal of Section 9-313 is now taking place. In this reappraisal the consensus seems to be that both the underlying philosophies and fundamental objectives of Section 9-313 are sound;[3] and that the problems of Section 9-313 arise from the specific mechanics which have been adopted to accomplish its objectives. Thus, most of the current discussion has been directed to the question of improving these mechanics.[4]

The author has already contributed a major article to this academic dialogue.[5] The ideas contained therein will not be repeated here. Rather, this paper will deal with two problem areas not previously covered by the author: (1) the indexing rules in Section 9-313 for a fixture financing statement and (2) the relationship of a Section 9-313 fixture security interest to a real estate improvement lien, particularly the construction mortgage and mechanics liens.

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1 See Coogan & Clovis, The Uniform Commercial Code and Real Estate Law, 38 Ind. L.J. 535 (1963); Coogan, Security Interests in Fixtures under the Uniform Commercial Code, 75 Harv. L. Rev. 1319 (1962).

2 Ohio no longer accepts Section 9-313's rule that the fixture security interest may prevail over the prior real estate mortgagee. See discussion by Shanker, An Integrated Financing System for Purchase Money Collateral: A Proposed Solution to the Fixture Problem under Section 9-313 of the Uniform Commercial Code, 73 Yale L.J. 788 (1964).

3 Shanker, supra note 2. Kripke, Fixtures under the Uniform Commercial Code, 64 Colum. L. Rev. 44 (1964); Gilmore, The Purchase Money Priority, 76 Harv. L. Rev. 1333 (1963), particularly at p. 1395 and following. For a contrary view, see Hollander, Imperfections in Perfection of Ohio Fixture Liens, 14 W. Res. L. Rev. 683 (1963). Mr. Hollander's views seem to have been accepted by the Ohio legislature in its revision of Section 9-313 (Ohio Rev. Code Section 1309.32 effective Oct. 8, 1963).

4 See Shanker, supra note 2, at 790 and following; Kripke, supra note 3, at 48 and following.

5 Shanker, supra note 2.

I. THE INDEXING PROBLEM

A. *Whose Name Should Appear on The Fixture Financing Statement*

Section 9-401(1)(b) presently requires the fixture financing statement to be filed in the real estate records.[6] The obvious purpose of this rule is to permit real estate title searchers to discover fixture security interests which may encumber the title to the land. Nonetheless, as the Code now reads, it is quite possible that land title searchers may be misled. This arises from the fact that only the "debtor's" name is presently required on the fixture financing statement.[7] Similarly the Code's indexing system is set up on a "debtor" basis.[8] Real estate records, however, are normally searched and indexed by the name of the "owner" or "lessee" of the land. Thus, confusion is possible because the "debtor" who created the fixture security interest is not the same person as the owner or lessee of the land where the fixture is installed. An example would be the case where a building contractor (the debtor) gives a security interest on a fixture to be installed on land owned by another person.

For at least two reasons, however, the problem is not as critical as might initially appear. First, a fixture financing statement must reasonably identify the land on which the fixture is installed.[9] Thus, in counties where land records are indexed by tract, the fixture security interest would be discovered even though the debtor's name did not correspond to the owner's name.[10] Secondly, even in a county where the official land records are indexed by the owner, a rather plausible argument could then be made that the Code presently requires the fixture financing statement to indicate the owner of the fixture (real estate) where he is different from the person owing the obligation on the fixture security interest. This stems from Section 9-105(1)(d) which defines "debtor" to include the owner of the collateral in any part of Article 9 which deals with the collateral, if the "debtor" and "owner" are not the same person.[11]

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[6] But see Shanker, supra note 2, at 796 and following, where the author proposes that the Code be amended to require the filing of fixture financing statements both in the chattel and the real estate records. If the author's proposals contained in his Yale Law Journal article are accepted, then the thoughts contained in this article can readily be adapted thereto. See further Kripke, supra note 3, at 51 and following, where he discusses this general problem and then proposes that fixture filings be recorded in the chattel records with an additional filing in the real estate records at the option of the fixture secured party.

[7] Uniform Commercial Code (hereinafter cited as "U.C.C.") §§ 9-402(1), 9-402(3).

[8] U.C.C. § 9-403(4).

[9] U.C.C. § 9-402(1) and (3); U.C.C. § 9-110.

[10] Even in counties where the official land records are indexed by the owner's name, professional title companies who carry on much of the title searching in many large urban areas often have established what amounts to their own private tract index. Thus, such title companies are likely to discover the fixture security interest.

[11] U.C.C. § 9-105(1) (d), in part, states the following:

One cannot of course be certain, however, that this argument would be sustained by the courts.[12] It is even less sure that Section 9-105(1)(d) can be interpreted to permit or to require the listing on the fixture financing statement of the name of a lessee or licensee who is actually occupying the land but who is not the actual fee owner thereof, even though he is the person for whom the fixture was installed or with whom the fixture secured party had all of his dealings.

These ambiguities and uncertainties should be clarified by an amendment to Section 9-402 specifically requiring the name of the owner, lessee, or licensee in possession of the land to be listed on the fixture financing statement in addition to the name of the debtor who may have incurred the fixture obligation. Section 9-403 should then also be amended to require filing officers to index financing statements in both names. Thus, persons searching only the land records would be put on notice of the fixure security interest. Similarly, persons searching the usual debtor index would also discover the appropriate financing statement. In fact, a number of states have already added such a requirement. Unfortunately, most have required the listing to be that of the "record" owner or lessee of the real estate.[13] Certainly, many situations can be imagined where the "record" owner or lessee is not in fact the actual owner or the actual lessee in possession of the land. Yet perfection of the fixture security interest in these states will depend upon the financing statement listing the name of the "record" land owner who may be entirely foreign to the fixture transaction. Thus, in these states, the fixture secured party must go to the considerable burden and expense of a title land search to determine who is the "record" owner. Such cost may seem relatively small when the fixture is an elevator. On the other hand, it may be prohibitive where the fixture is a wash basin.

The theory accepted by Article 9 was that the formalities needed to perfect a security interest were to be minimized.[14] Thus, to require the fixure secured party to determine the "record" owner of land on pain of losing his security interest seems a harsh burden imposed uniquely upon him and upon no other secured party.

Until the law of real property universally requires all land to be Torrenized, whereby the "record" owner and "actual" owner of the

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Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires.

[12] Until the courts do resolve this problem, cautious fixture secured parties should certainly name both the debtor and the owner on the financing statement.

[13] These states are as follows: Connecticut, Georgia, Maine, Massachusetts, New Jersey, New York, Ohio, Rhode Island, Tennessee, Virginia, and Wisconsin. New Hampshire requires the listing of the "known" record owner.

[14] See Official Comments 3 and 5 to U.C.C. § 9-402.

land are equated, it seems unfair to require the fixture secured party alone to search land records to be assured of his security interest. It ought to be sufficient if the fixture secured party lists the actual owner, the acual lessee, or the actual possessor of the land. In the overwhelming number of cases, such persons will, in fact, also turn out to be the record owner or record lessee of the land. If not, the real estate description required on the fixure security financing statement will be of substantial assistance in directing title searchers to the parcel of land encumbered by the fixture security interest.[15]

Some cases, notwithstanding, undoubtedly would arise where persons relying on the real estate record, would not actually discover the fixture security interest in the name of the actual owner. This is unfortunate. It would not, however, be the first time that persons relying on real estate records have been misled. Their misfortune arises from the imperfections of our present real estate law which recognizes and protects many non-record interests in non-Torrenized land. If correction is needed, then it should be brought about by a change in the real estate laws and recording statutes. Until the state legislatures are willing to do this, it seems the fixture secured party alone should not be asked to bear the burden of their imperfection in giving complete notice to title searchers.[16]

B. *Indexing Security Interests on Torrenized Land*

Where the fixture is to be installed on Torrenized land,[17] the present Code raises the question whether a financing statement filed in the general mortgage records will be effective even though no notation thereof has been made on the Torrens title certificate.

The language of Section 9-401(1)(b) merely requires that fixture financing statements be filed in the "office" where real estate mortgages on that land would be filed. Where the fixture is installed on Torrenized land, one might, therefore, make the argument that a general filing in the "office" which holds the Torrens certificate is all that is required; and that there is no further requirement that the security interest be noted directly on the Torrens certificate. If this argument were sustained, it might defeat a basic policy of the Torrens statutes, namely, that all liens and encumbrances affecting the land should be noted directly on the Torrens title certificate, so that title searchers may rely entirely on said certificate.

On the other hand, an equally plausible argument in favor of requiring notation on the Torrens certificate arises from Sections

[15] See supra notes 8 and 9 and accompanying text.

[16] But see Coogan & Clovis, supra note 1, at 555, urging that the "record owner" be required. Compare Kripke, supra note 3, at 70.

[17] For another discussion of this problem, see Kripke, supra note 3, at 53.

9-302(3) and (4). These sections continue the effect of any local statutes beyond the Commercial Code which set up a certificate of title law. They also make clear that Code security interest in collateral for which a Certificate of Title has been issued can be perfected only by notation on the Certificate. A strong argument certainly could be made that Torrens statutes are certificate of title laws within the meaning of 9-302(3) and (4).

However, these questions should not be left in an ambiguous state. Probably they can be fully clarified by an amendment to the official commentary sections of the Code, stating that fixture financing statements dealing with Torrens land are subject to the certificate of title provisions of Section 9-302; and that notation on the Torrens certificate is therefore essential to obtain perfection in fixtures installed on such Torrens land.

II. THE FIXTURE SECURITY INTEREST AND THE REAL ESTATE IMPROVEMENT LIEN

A. *The Construction Mortgagee v. The Fixture Security Interest*

Special attention must be given to the priority conflict between a construction mortgage and a fixture security interest. An underlying assumption of Section 9-313 is that a fixture secured party should be favored over a prior real estate mortgagee since the fixture secured party added new value to the land upon which the prior real estate mortgagee could not have relied when he advanced his funds. Indeed, it is this assumption which justifies the Code's present priority rule favoring the fixture security interest over the prior real estate mortgagee.[18] Where a construction mortgage is involved, however, this assumption is a specious one. Rather, the fact in this situation is that the construction motgagee makes his advances with the clear expectation that they will be secured by the new structure, including its new fixtures.[19]

Prior to the Code, most courts which considered this question seemed impressed by this special and unique equity in favor of the construction mortgagee and normally favored him over a conflicting fixture security interest.[20] However, these courts never seem to have considered the fact that the fixture security party could claim precisely the same kind of equity: namely, that he, too, had extended his credit in the belief that its repayment would be secured by the new fixture. It therefore appears that the construction mortgagee and the fixture secured party can stake equal claims to the fixture in that both relied

[18] See discussion by Shanker, supra note 2, at 790 and following.

[19] Gilmore, supra note 3, discusses this problem at 1367 (under pre-Code law) and at 1398 (under the Uniform Commercial Code).

[20] See cases cited by Gilmore, supra note 3, at 1267.

on it to secure repayment of their advances. Superficially, there thus seems little reason to favor one over the other.[21]

Notwithstanding, Section 9-313 has apparently adopted a policy in favor of the fixture security interest which is timely perfected. Under subsection 4 of Section 9-313 a construction mortgagee will defeat a fixture security interest only to the extent that he actually advances his funds or contracts for such advances without knowledge of the fixture security interest and prior to its perfection.[22]

It seems that Section 9-313 has made the correct choice in thus resolving the conflict. This is so because the construction mortgagee normally is in the better position to protect himself and to avoid loss to the fixture secured party by controlling the disbursement of the

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[21] See discussion by Gilmore, supra note 3, at 1368.

[22] In a conversation with the author in August, 1964, Professor Grant Gilmore pointed to the possibility that the "contracted for" language in Section 9-313(4) might be read to defeat any fixture security interest—even those which had been timely perfected—by a prior mortgage which originally contained a future advance clause. If this is the correct interpretation of Section 9-313(4), then prior mortgagees are divided into two classes: (1) those whose mortgage instrument contains a future advance clause and whose advances thereunder will defeat any fixture security interest; and (2) those whose original mortgage instrument does not contain a future advance clause and whose advances will defeat a fixture security interest only in the limited situations mentioned in the text.

Section 9-313(4) need not be read to create this dichotomy. Indeed, a more plausible reading suggests that no advantage was intended in favor of the mortgagee making advances under a future advance clause contained in the original mortgage instrument and the mortgagee whose original mortgage instrument contained no such clause. Instead, both are to be treated alike. Neither will defeat a fixture security interest under the "contracted for" statutory language unless the contract for the subsequent advance is made in the time interval between the fixture security interest coming into existence ("attaching" in U.C.C. § 9-204(1) parlance) and the perfection thereof.

This interpretation arises from the fact that Section 9-313(4) does not protect prior mortgagees just because they have contracted for a future advance. A contractural commitment is protected only if two other conditions accompany it: (1) the fixture security interest is "not perfected" and (2) the mortgagee had "no knowledge" of the fixture security interest. These two additional conditions are as much necessary to bring the statute into operation in favor of prior mortgagees as is the contractual commitment. Yet, these two additional conditions seem possible only with respect to fixture security interests which are already in existence (attached).

One might, of course, argue that a future advance clause inserted in a mortgage at a time when the fixture or a security interest therein was not even in existence is a contractural commitment made by the mortgagee when technically he was without knowledge of the nonexisting fixture security interest and before its perfection. It seems more likely, however, that the Commercial Code uses the words "without knowledge" to refer to one's individual ignorance respecting an *existing* state of affairs (see U.C.C. § 1-201(25)) and not to refer to the ignorance of mankind generally as to future events. Similarly, it seems more likely that the Commercial Code uses the idea of "no perfection" to refer to security interests which actually have already attached and thereby are capable of being perfected (see U.C.C. § 9-303) and does not use the "no perfection" idea to refer to security interests arising in the future which have no present possibility of perfection.

For another discussion of this problem and a plea for clarification thereof, see Kripke, supra note 3, at 71.

mortgage funds under safeguards which assure payment to those who actually add the fixtures and other improvements to the land. If this supervision of the mortgage disbursement is claimed to be a burden, then it is one which most construction mortgagees have already assumed. At worst, the only additional task imposed upon the construction mortgagee by Section 9-313 is that he check the fixture filings before actually parting with his money.

Most construction mortgagees are financial institutions who must constantly refer to the public filings. Thus, it is likely that the means for making necessary fixture filing checks are already readily available to the typical construction mortgagee. If not, such an additional investigation burden seems slight, in light of the present practice of most construction mortgagees to demand architect certificates, contractor's bills, subcontractor's bills, workman's bills, mechanics lien releases, etc. before paying out any mortgage funds.

Thus Section 9-313, in favoring the fixture secured party over the construction mortgagee, is merely recognizing the present facts of commercial life. Accordingly, no change in its language is needed to deal with this problem.[23] However, the official commentary probably should be amended to make clear that pre-Code cases reaching a contrary result are intended to be overruled.

B. *The Fixture Security Interest and The Real Estate Mechanics Lien*

A person installing a fixture may obtain a Code fixture security interest for the purchase price. Under the law of most states he would be equally entitled to obtain a mechanics lien. Section 9-313(1) seems to preserve this right expressly.[24] Hence, unless state law beyond the Code prohibits his so doing,[25] the fixture secured party can apparently

[23] Kripke, supra note 3, at 71 apparently agrees. At p. 71 he states that:

> ... [T]here seems to be no need for a refinement [of § 9-313] in favor of construction lenders. They can protect themselves by searches before each advance, as many of them have always done under the Uniform Conditional Sales Act.

[24] Section 9-313(1) reads, in part: "This Act does not prevent creation of an incumbrance upon fixtures or real estate pursuant to the law applicable to real estate."

[25] According to Kripke, supra note 3, at 70, n. 78, the pre-Code New York and Pennsylvania mechanics lien statutes prevented one from asserting both a conditional sales contract on a fixture and a mechanics lien on the structure. The Ohio Mechanics Lien Law *may* also be an example of a state statute beyond the Commercial Code which prohibits a party from both obtaining a fixture security interest and a mechanics lien. Section 1311.22 of the Ohio Revised Code provides that a mechanics lien:

> . . . shall [not] be defeated or waived by the taking by the lien claimant from any person of any promissory note or any security for such debt *other than upon the real estate itself* . . . . (Emphasis supplied.)

Query: does the taking of a fixture security interest amount to the taking of a lien upon the real estate in which the fixture is installed. This problem has been, as yet, unresolved by the Ohio courts. In light of Ohio's revision of Section 9-313 (see text accompanying note 2), it is unlikely that the problem will ever be presented.

obtain both a mechanics lien and a Code security interest for having installed the same fixture.

However, fixture security interests and mechanics liens differ markedly with respect to their effect and enforcement. The typical mechanics lien statute gives a lien on the entire structure (including the fixtures installed therein). However, that total structure must normally be shared with other mechanics liens which arise from other improvements called for by the same general construction contract which authorized installation of the fixture.

On the other hand, where a fixture security interest is involved, Section 9-313 permits the secured party to claim a paramount right to the fixture over all other real estate interests.[26] Thus, a claimant who has taken care to obtain both a mechanics lien and a fixture security interest is in an enviable position. He may first remove the fixture for the purpose of foreclosures on his security interest.[27] This, of course, diminishes the value of the remaining structure for those who have filed only mechanics liens. Nonetheless, if the fixture does not bring full collection to the fixture claimant, he may then apparently turn to his mechanics lien on the remaining structure to collect the balance. In this step, the fixture claimant will probably have to share the remaining value of the structure with other mechanics liens arising from the same general construction contract. This may not concern the fixture claimant who has already eaten his proverbial cake and still continues to enjoy it. However, it may be rather offensive to the other mechanics, who have already lost the full value of the removed fixture to the fixture claimant, to now have to share the balance of the structure with the fixture claimant.

This may be an inequity so far as the other mechanics lienors are concerned. However, the Commercial Code is probably not the place to determine whether a fixture secured party should also have full advantage of the local mechanics lien laws; or whether some limitations ought to be imposed.[28] That is best left to local determination. An amendment to the Code's commentary sections may, however, be in order to remind the states that they are free to limit the right of one who has enforced a fixture security interest from also having the full advantage of the local mechanics lien laws.

[26] See Shanker, supra note 2, at 790.

[27] U.C.C. § 9-313(5).

[28] Compare Kripke, supra note 3, at 70, arguing that persons who sell chattels knowing that the buyer will install them in buildings owned by others should be denied a Commercial Code security interest, and should be required to look only to mechanics lien statutes for protection.