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Security Transactions--Notice Filing--Uniform Commercial Code Does Not Require Financing Statement to Include After-Acquired Property Clause (National Cash Register Co. v. Firestone & Co., 191 N.E.2d 471 (Mass. 1963))

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SECURITY TRANSACTIONS — NOTICE FILING — UNIFORM COMMERCIAL CODE DOES NOT REQUIRE FINANCING STATEMENT TO INCLUDE AFTER-ACQUIRED PROPERTY CLAUSE. — Plaintiff entered into a conditional sales contract with a vendee for the sale of a cash register, which was to be delivered at a future date. Subsequently, the defendant made a loan to the plaintiff's vendee. Under the terms of this security agreement the collateral for the loan was to include all after-acquired property. Thereafter, the defendant filed a financing statement which failed to refer to the after-acquired property clause. Subsequent to this loan, the plaintiff delivered the cash register, and filed his financing statement one month later. Upon the vendee's default with both parties, the defendant took possession of the cash register and sold it. In an action for conversion by the conditional vendor, the Supreme Judicial Court of Massachusetts, in reversing both the trial court and the appellate division, found for the defendant, and *held* that the financing statement was sufficient notice of defendant's interest in any after-acquired property. *National Cash Register Co. v. Firestone & Co.*, —— Mass. ——, 191 N.E.2d 471 (1963).

The instant case was concerned with three basic policies of Article 9 of the Uniform Commercial Code: the provision for notice filing;[1] the enforceability of after-acquired property clauses;[2] and the priorities among creditors.[3]

In order to understand these policies fully, it is necessary to examine the difficulties of operating under pre-Code security law.

Under pre-Code law there were many types of security arrangements such as chattel mortgages, conditional sales contracts, trust receipts, factor's liens, and assignments of accounts receivable. The manner of perfecting these interests was determined by the type of security arrangement that was used.[4]

The Code, in order to simplify this complexity, devised a method of perfection which would apply to all security transactions.[5] Distinctions based on the form of the agreement are eliminated[6] and the Code provides that perfection shall be determined by

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[1] See UNIFORM COMMERCIAL CODE §§ 9-302, 9-401, 9-407 (hereinafter cited as UCC).

[2] See UCC § 9-204.

[3] See UCC §§ 9-301, 9-318.

[4] See Coogan, *Public Notice Under The Uniform Commercial Code And Other Recent Chattel Security Laws Including "Notice Filing,"* 47 IOWA L. REV. 289, 291 n.4 (1962).

[5] UCC § 9-102, comment.

[6] See UCC § 1-201 (37) which defines a "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation."

the type of collateral in which the security interest inheres.[7] In order to create a security interest under the Code, the parties must enter into a "security agreement;" [8] the secured party must give value at some time; and the debtor must acquire rights in the collateral.[9] When these three steps have been taken, the security interest is said to have "attached." [10]

The fact that the security interest has "attached" to the collateral does not make the security agreement enforceable against a debtor, or against any subsequent creditors. To make the agreement enforceable against a debtor, it is necessary to have him sign the agreement or have the secured party take possession of the collateral.[11] In order to make the agreement enforceable against subsequent creditors one further step is necessary. A "financing statement" must be filed, or the secured party must take possession of the collateral.[12] When this is done the security interest is said to be "perfected." [13] Upon perfection, the secured party will generally be permitted to recover the collateral even against the debtor's trustee in bankruptcy.[14]

The first of the three policies discussed in the principal case was notice filing. Under pre-Code law, evidence of the security interest generally had to be filed to be enforceable against subsequent creditors.[15] The evidence required was the agreement itself in most cases, and it usually had to be accompanied by some supplementary document, such as an affidavit or an acknowledgment.[16] These requirements had to be followed precisely and any deviation, however slight, rendered the agreement unenforceable against subsequent creditors.

Columbus Merchandise Co. v. Kline [17] is perhaps the classic example of the exactness required. The applicable Ohio statute

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[7] SPIVACK, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 77 (1962).

[8] UCC § 9-105 (1)(h) defines a "security agreement" as "an agreement which creates or provides for a security interest."

[9] UCC § 9-204 (1).

[10] UCC § 9-204 (1).

[11] UCC § 9-203 (1).

[12] UCC §§ 9-302, 9-304.

[13] UCC § 9-303. The sequence of these necessary steps may be varied in any manner by the parties. The time of "perfection" then occurs when all the required steps have been taken.

[14] UCC §§ 9-301(1), (2), 9-310.

[15] Coogan, *Public Notice Under The Uniform Commercial Code And Other Recent Chattel Security Laws Including "Notice Filing,"* 47 IOWA L. REV. 289, 311 (1962).

[16] Coogan, *supra* note 15, at 311, 313.

[17] 248 Fed. 296 (S.D. Ohio 1917). See General Motors Acceptance Corp. v. Haley, 329 Mass. 559, 109 N.E.2d 143 (1952) (the failure of exactness was that "E. R. Miller Company" was used instead of "E. R. Miller Co., Inc." as designation of the trustee).

stated that a conditional sales contract would not be enforceable unless its conditions were evidenced by a writing signed by the purchaser, and unless a "statement thereon under oath" made by the seller as to the claim of title was included. Because the affidavit was stapled to the conditional sales contract, the court held that this did not meet the statutory requirement of "thereon." Therefore, the conditional seller was reduced to the status of a general creditor.

It was evident that the courts had come to view filing as a ritual which was to be rigidly adhered to, and had lost sight of the true purpose of filing, which was notice.[18] This attitude of the courts has been called "fanatical and impossibly refined." [19]

Because of this, the Code adopts for all security transactions the system of filing adopted under the Uniform Trust Receipts Act.[20] It is no longer necessary to file the agreement itself, and the statutory requirements are minimal. What is to be filed is a "financing statement" or a copy of the security agreement. The financing statement is adequate if it is signed by both parties, gives the address of the debtor and secured party, and contains a description of the types or items of collateral.[21] It need not be specific, and it is sufficient if it reasonably identifies what is described. Minor errors are to be disregarded provided that they are not "seriously misleading." [22]

The second policy discussed by the Court in the instant case was the enforceability of after-acquired property clauses. Until 1843, property to be created or acquired in the future could not be transferred or encumbered prior to the creation or acquisition of the property.[23] Since then, New York has recognized, with respect to subsequent purchasers, a recorded mortgage of after-acquired property as fully effective.[24] However, its effectiveness is limited by courts, which hold that a mortgagee benefiting from an after-acquired property clause has a subordinate claim to creditors acquiring an interest in the property before the mortgagee takes possession.[25] This result is justified on the ground that the recording is not constructive notice to creditors.[26] This same rationale applies to subsequent purchasers. For example, in

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[18] Coogan, *supra* note 15, at 319.
[19] UCC § 9-402, comment.
[20] Coogan, *supra* note 15, at 290; see N.Y. PERS. PROP. LAW § 59(e).
[21] UCC § 9-402(1).
[22] UCC § 9-402(5).
[23] Mitchell v. Winslow, 17 Fed. Cas. 527 (No. 9673) (C.C.D. Me. 1843).
[24] Kribbs v. Alford, 120 N.Y. 519, 24 N.E. 811 (1890); See also Titusville Iron Co. v. New York, 207 N.Y. 203, 209, 100 N.E. 806, 808 (1912).
[25] Titusville Iron Co. v. New York, *supra* note 24; Zartman v. First Nat'l Bank, 189 N.Y. 267, 82 N.E. 127 (1907).
[26] *Ibid.*

Rochester Distilling Co. v. Rasey,[27] the judgment debtor had mortgaged his future crops to the defendant's vendor. Prior to the commencement of foreclosure proceedings under this mortgage, the sheriff levied execution on the crops for the benefit of the judgment creditor. The court, in finding for the plaintiff, held that a chattel mortgage containing an after-acquired property clause was void against a subsequent purchaser at an execution sale.

These after-acquired property clauses are enforceable only in equity, where they are viewed as covenants to give a lien,[28] and will be enforced only when the rights of other creditors will not be prejudiced.[29]

In contrast to the present laws, the Code validates the effectiveness of after-acquired property clauses on a broad plain.[30] Article 9 makes possible the perfection of security interests in after-acquired property in almost all classes of security,[31] without any further act at the time the property comes into existence or into the debtor's possession.[32]

The third policy of article 9 discussed in the main case is priorities among creditors. According to New York's present law, a conditional sales interest has priority over the interest of a prior mortgagee under an after-acquired property clause, whether or not the contract is filed.[33] This preference, which pre-Code law gave to a "purchase money security interest," [34] was usually justified because title remained in the conditional vendor.[35]

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[27] 142 N.Y. 570, 37 N.E. 632 (1894).

[28] Guaranty Trust Co. v. New York & Queens County Ry., 253 N.Y. 190, 199, 170 N.E. 887, 890 (1930).

[29] Zartman v. First Nat'l Bank, *supra* note 25, at 271, 82 N.E. at 128.

[30] UCC § 9-204(3); see UCC § 9-204, comment.

[31] UCC § 9-204(3), (4); see Coogan, *Operating Under Article 9 of the Uniform Commercial Code Without Help or Hindrance of the "Floating Lien,"* 15 BUS. LAW. 373 (1959-60) for a full discussion of the policy considerations.

[32] See UCC § 9-204, comment. Under pre-Code law it was necessary to refile each time new collateral came into existence or into the mortgagor's possession. Coogan, *Public Notice Under The Uniform Commercial Code And Other Recent Chattel Security Laws Including "Notice Filing,"* 47 IOWA L. REV. 284, 302 (1962).

[33] New York & Suburban Fed. Sav. & Loan Ass'n v. Crescent Const'n Corp., 196 Misc. 532, 92 N.Y.S.2d 533 (Sup. Ct. 1949). However, if the mortgage is subsequent to a conditional sales contract which has not been filed, the mortgagee prevails. Central Chandelier Co. v. Irving Trust Co., 259 N.Y. 343, 182 N.E. 10 (1932).

[34] UCC § 9-107.

[35] Perfect Lighting Fixtures Co. v. Grubar Realty Corp., 228 App. Div. 141, 239 N.Y. Supp. 286 (1st Dep't 1930).

Although the Code rules apply regardless of ownership,[36] it recognizes this preference for a purchase money security interest and gives it a priority over a prior conflicting interest in the same collateral, upon the condition that the interest be perfected when the debtor receives possession of the collateral or within ten days thereafter.[37] In cases where the purchase money security interest does not qualify for this special priority, the relative priorities will be governed by three rules: (1) first to file if both are perfected by filing; (2) first to perfect unless both are perfected by filing; and (3) first to attach unless either is perfected.[38]

In the instant decision the Court was presented with a case of first impression under the Code. The plaintiff's main contention was that the defendant's financing statement should have contained an after-acquired property clause in order for the security interest to attach.[39]

As a preliminary to reaching the main issue the Court reasoned that the intent of the parties is to be judged by the language of the security agreement and that the security agreement was sufficiently broad to cover the cash register.[40] The security agreement referred to "all contents of luncheonette" and to "all property and articles now, and which may hereafter be, used . . . with, (or) added . . . to . . . any of the foregoing described property." [41] The Court held that this description complied with the standard of "reasonable identification" of the collateral as expressed in the Code.[42]

In deciding for the defendant, the Court held that the financing statement was sufficient notice to plaintiff. In view of the broad purposes of the Code, the Court held that it could best carry out the intention of the framers by not giving a restrictive interpretation to the section which established notice filing and the use of a more flexible financing statement.[43]

Because the Code gives only the debtor the right to demand further information from the secured party, the plaintiff contended that this procedure would not aid prospective creditors if the

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[36] UCC § 9-202 provides that "each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor."

[37] UCC § 9-312(4).

[38] UCC § 9-312(5).

[39] National Cash Register Co. v. Firestone & Co., —, Mass. —, —, 191 N.E.2d 471, 474 (1963).

[40] *Id.* at —, 191 N.E.2d at 473.

[41] *Ibid.*

[42] *Ibid.* The provision for reasonable identification is found in Section 9-110 of the Uniform Commercial Code.

[43] National Cash Register Co. v. Firestone & Co., *supra* note 39, at —, 191 N.E.2d at 474.

debtor or named creditor is slow in giving, or refuses to give the necessary information.[44] The Court stated that the procedure was authorized by the Code and if the plaintiff's contention was true the remedy was with the legislature and not the courts.

By broadly construing the filing requirements as to description of the collateral, the Court, in effect, made a policy determination which, if followed, will minimize the "notice" value of a filing to an interested party. The purpose of notice filing under the Code is two-fold: to protect a security interest, and to give potential creditors a means of ascertaining information.[45] Thus the statute requires a description which will indicate either the types or items of collateral.[46] As a result of this case, it would seem that the financing statement in Massachusetts need only contain the name and address of the debtor and secured party and some indication that the secured party has an interest in some or all of the debtor's property. Furthermore, the Court implies that after-acquired property is not a separate and distinct "type" of property, and that "all equipment" is sufficiently broad to cover it.

These results will necessitate regular usage of the imperfect discovery procedure set forth in the Code.[47] Under this procedure the inquiring party is unable to force the disclosure of the information. Because of this, the practitioner should not exploit the leniency of the Code by supplying as little information as possible. Otherwise priority problems and unnecessary litigation would arise, tending to defeat the purpose of the Code's filing system.[48]

The criticisms already set forth may lead New York courts to find that a failure to refer to after-acquired property in the financing statement is misleading. Coupled with the inadequacies in the Code's discovery procedure and the importance of giving proper notice is a strong policy favoring the purchase money creditor. Thus, the result in New York may well be different from that arrived at by the Massachusetts Court.[49]

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[44] *Id.* at —, 191 N.E.2d at 474 n.5; see Coogan, *Public Notice Under The Uniform Commercial Code And Other Recent Chattel Security Laws Including "Notice Filing,"* 47 IOWA L. REV. 289, 344 (1962). Upon failure to comply with this request within two weeks, the secured party runs the risk of losing his security interest. UCC § 9-208.

[45] UCC § 9-402, comment.

[46] UCC § 9-402(1).

[47] UCC § 9-208. See Coogan, *supra* note 44.

[48] See Coogan, *supra* note 44, at 344 for a discussion of the problems and a comparison of Section 9-208 and other notice filing statutes.

[49] In the principal case the Massachusetts Commissioners on Uniform State Laws submitted a brief as amicus curiae sustaining the defendant's contentions. Notwithstanding the weight of this authority, unless the courts do not follow this case notice filing will give little, if any "notice."