Sales and Security Law

Edward T. Fagan Jr.

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From the early codifications of the law merchant, the sale has been recognized as the center of civil law commercial codes. This traditional recognition continues in the proposed Uniform Commercial Code. In the words of its Chief Reporter, Professor Karl N. Llewellyn, "The law of Sales of course became the center, with such overlap into 'agency' aspects of distribution as is needed to clarify the bona fide purchase and the security aspects that come in question."

The establishment of sales law as the hub and nucleus of the entire Code may well explain why a large portion of the existing Uniform Sales Act is merely reworded and modernized by Code Article Two, entitled "Sales," with but a few important substantive changes. Just as the jus gentium of Roman Law achieved a great degree of international commercial uniformity by virtue of its employment of universally accepted principles, so also a code which is intended to unify the commercial law of our states and territories should have

† Assistant Professor of Law, St. John's University School of Law.

1 Il Consolato del Mare; Roles d'Oleron (1266); Ordonnance sur le commerce de terre (Louis XIV 1674); Ordonnance sur la marine (Louis XIV 1681).

2 The Code text matter of this article is taken from the final draft No. 2 of the Proposed Uniform Commercial Code issued in the spring of 1951 as corrected by the June 1951 revisions. The comments are the latest published, which appear in final draft No. 1 issued in the spring of 1950.


4 Professor Grant Gilmore of the code drafting staff states, "Article 2 (Sales) generally restates its predecessor, albeit with a few controversial novelties, such as the abandonment of the concept of title or property in connection with the rights of parties to a sales contract and the introduction of special rules applying to merchants and contracts between merchants." Gilmore, The Secured Transactions Article of the Commercial Code, 16 LAW AND CONTEMP. PROB. 27, 28 (1951). See also Beutel, The Proposed Uniform Commercial Code as a Problem in Codification, 16 LAW AND CONTEMP. PROB. 141 (1951); Rabel, Sales in the Proposed Commercial Code, 17 U. of Chi. L. REV. 427 (1950); Waite, The Proposed New Uniform Sales Act, 48 Mich. L. REV. 603 (1950).
as its core a body of law which has already been accepted by these jurisdictions.

Indeed, it has been pointed out that the procedural modernization of sales law which the Code achieves is a strong argument in itself for the Code's adoption, especially when coupled with the radical substantive change in the related field of security law proposed by Code Article Nine entitled "Secured Transactions."[5]

It must be conceded that the substantive changes proposed by the Code in present sales law, as distinguished from those proposed in present security law, will not directly render obsolete the knowledge acquired in years of practice with business transactions.[6] An appreciation, however, of the relation which exists between sales and security law, particularly as treated in the Code, makes it apparent that the overall effect of the proposed Uniform Commercial Code on present sales law can only be properly determined after a joint consideration of Code Articles Two and Nine. Consequently, this article will discuss the important substantive changes which the sales section of the Code proposes in present New York sales law,[7] and in addition will contain an analysis of the proposed Code security law.

**Contractual Versus Title Theory**

The most important change which Code Article Two proposes in the present law of sales is the adoption of the "contractual approach" as a substitute for the "title" or "property" concept presently employed. This proposal represents a fundamental change in the basic theory of sales law, and would substantially alter the whole approach to the law of sales as applied under the Uniform Sales Act and New York decisions.

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At common law and under the present New York statute,\(^8\) title is the basis for determining risk of loss, rights, obligations and remedies under sales contracts. In recent years, however, it has become apparent to lawyers that the commercial world objects to the necessity of reliance upon abstract legal concepts as a guide to the solution of individual business problems.\(^9\) Code draftsmen deemed it essential, therefore, that the new commercial code express the legal consequences of certain fact situations rather than merely enunciate concepts which might create uncertainty when related to specific cases.\(^10\)

Accordingly, the new Code rejects the present legal concern with passage of title and deals with the issues between seller and buyer solely in terms of step by step performance or non-performance under the contract of sale.\(^11\) Of necessity, the new Code does contain certain title provisions for situations where the applicability of "public" regulation depends upon a "sale" or upon location of title without further definition.\(^12\) For this purpose, unless otherwise explicitly agreed, actual title to goods passes when the seller makes delivery of the goods, regardless of any stipulation concerning cash sale.\(^13\) If no delivery is necessary, title passes upon appropriation of goods to the contract. Any title reservation following such delivery or appropriation results in the retention by the seller of a security interest only. Any refusal to receive by the buyer or a justified revocation of acceptance will revest title in the seller.

Apart from public regulation problems the new Code emphasizes the fact that title is no longer the focal point of the sales contract. In fact the new Code defines a "contract


\(^9\) "The past generation has seen a general reaction against conceptions of absolute ownership. Both in Europe and America there has been more and more stress on a functional approach to property in terms of the apportionment of use, possession, and disposition. This is most evident in our commercial law, in which the question of title has lost most of its former importance and instead the nature of the goods, the type of transaction, the assumption of risk, and similar factors have become determinative of the rights of the parties." Berman, Justice in Russia 98 (1950).

\(^10\) Uniform Commercial Code § 2-101, Comment (Spring 1950).

\(^11\) Uniform Commercial Code § 2-401, Comment 1 (Spring 1950).

\(^12\) Ibid.

\(^13\) Uniform Commercial Code § 2-401 (Spring 1951).
for sale" as including both a present sale of goods and a contract to sell goods at a future time, thereby abolishing the common law distinction between the contract to make the sale and the sale itself.\textsuperscript{14} In effect, contract rights replace proprietary rights for all purposes, unless the Code expressly provides otherwise.\textsuperscript{15}

In line with this reasoning, under the new Code, unless otherwise explicitly agreed, as soon as goods are appropriated to the contract the buyer obtains a present interest in them, called an insurable interest. This interest arises independently of any transfer of title or risk of loss.\textsuperscript{16} The seller on the other hand retains an insurable interest so long as any security interest in the goods remains in him. The comments of an earlier Code draft make it clear that these interests, stemming from appropriation, are the basis for the application of the contractual approach in matters of risk of loss and remedies.\textsuperscript{17}

The logic of the contractual approach is evident upon a consideration of the problem of risk of loss. Under the new Code, the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.\textsuperscript{18} So also, if the buyer breaches before the risk of loss has passed under the contract, the seller may, to the extent of any deficiency in his effective insurance coverage, treat the risk of loss as resting on the buyer.

The choice of remedies is no longer dependent upon the question of whether title has or has not passed before breach. Under the new Code, neither passage of title to the goods nor the appointment of a day certain for payment is material to a price action.\textsuperscript{19} An action for price plus incidental damages may be maintained if goods are accepted or if the risk of loss has passed or if the goods have already been identified to the contract and cannot be resold at a reasonable price. The right of resale exists in the seller after any breach or insol-

\textsuperscript{14} Id. § 2-106.
\textsuperscript{15} \textit{Uniform Commercial Code} § 2-106, Comment 1 (Spring 1950).
\textsuperscript{16} \textit{Uniform Commercial Code} § 2-501 (Spring 1951).
\textsuperscript{17} \textit{Uniform Commercial Code} § 2-502, Comments 1-5 (May 1949).
\textsuperscript{18} \textit{Uniform Commercial Code} §§ 2-509, 2-510 (Spring 1951).
\textsuperscript{19} \textit{Uniform Commercial Code} § 2-709, Comment 1 (Spring 1950).
vency of the buyer, including anticipatory breach. In fact, if the contract is breached and the goods are unfinished, the seller may nevertheless complete the goods unless such action would materially increase the damages.\(^2\) Damages are the difference between the resale and contract price plus incidental damages, minus any saving as a result of breach. Reasonable notice of resale should be given to the buyer except in the case of public sale of perishables or goods which threaten to speedily decline in value.\(^2\)1

The buyer is given similar favored treatment in respect to his remedies under the new Code by liberalizing the application of the doctrine of specific performance.\(^2\)2 If specific performance is not available, "cover" will be afforded. Cover allows the buyer the difference between an actual contract made by the buyer with a third party as a substitute within a reasonable time after breach and the contract price, coupled with incidental damages.\(^2\)3 As an alternative to "cover," the buyer may recover the difference between market price and contract price at the time of breach, plus incidental damages. Here the contractual approach to a buyer's damages removes damage pricing difficulties which presently exist in New York law because of the title concept.\(^2\)4 Under the Code, the place for determining current market price is the place for tender, or, in cases of rejection after arrival or revocation of acceptance, the place of arrival, since the yardstick is the market in which the buyer would have obtained cover had he sought that relief.\(^2\)5

**RIGHT OF STOPPAGE**

Present New York sales law gives the seller the right of stoppage in transit only upon insolvency of the buyer prior

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\(^2\)0 **Uniform Commercial Code** § 2-704 (Spring 1951).

\(^2\)1 Id. § 2-706.

\(^2\)2 Id. § 2-716.

\(^2\)3 Id. §§ 2-712, 2-713.

\(^2\)4 Standard Casing Co. v. California Casing Co., 233 N. Y. 413, 135 N. E. 834 (1922) (wherein buyer's damages were based on San Francisco market prices in a breach of contract action involving a shipment F.O.B. San Francisco to New York, the court holding that title passed at place of shipment, even though the right of inspection was reserved by the buyer and the goods were shipped seller's order).

\(^2\)5 **Uniform Commercial Code** § 2-713(2) (Spring 1951).
The new Code proposes to extend this right to include any breach by the buyer prior to delivery. Either party has a right under the new Code to demand adequate assurance of due performance when reasonable grounds for insecurity arise with respect to such performance. Failure to supply such assurance within thirty days after justified demand will constitute a breach. It is therefore important to note that this failure to supply assurance will in itself be grounds for stoppage, as distinguished from the present necessity to establish real insolvency.

In addition to the right to stop in transit because of a mere threat of insolvency, or for that matter, for any other breach, the new Code will allow the seller to reclaim the goods already delivered to the buyer if insolvency exists within ten days following such delivery. Since this gives him preference over other creditors, reclamation if used is an exclusive remedy.

Policing Provisions

It is a well established canon of interpretation that in determining intent "... the fact that a construction contended for would make the contract unreasonable and place one of the parties at the mercy of the other may be properly taken into consideration." Harsh results in individual cases may not be avoided by judicial action, however, if the contract speaks clearly and without ambiguity for it is not the duty of the court to make the contract for the parties.

This canon of interpretation, with its limitations, exists in present New York sales law. While it is true that there have been New York decisions holding that fine print in commercial contracts is unenforceable, and statutes protect the buyer in retail installment sale contracts by requiring pro-

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27 Uniform Commercial Code § 2-705 (Spring 1951).
28 Id. § 2-609.
29 Id. § 2-702.
30 Schoellkopf v. Coatsworth, 166 N. Y. 77, 84 (1901).
visions to be in no less than eight-point type, nevertheless, the objection has in the main been directed against form contracts.

The new Code completely removes this judicial restriction in present law by allowing the court on its own motion to exercise an extensive judicial policing of sales contracts. The court is permitted to pass on the unconscionability of the whole contract or a particular clause therein and make a conclusion of law as to its unconscionability. Under such power, it may refuse to enforce the contract or strike any unconscionable clauses. In addition the court may look beyond the terms of the contract to its commercial setting, purpose and effect as an aid in making this determination. The Code comment states: "The principle is one of the prevention of unfair surprises and not of disturbance of allocation of risks because of superior bargaining power."

This judicial freedom may reflect in part the approach once taken by the New York Court of Appeals in *Schlegel Manufacturing Co. v. Cooper's Glue Factory* where the court denied damages in a requirement contract on the ground that the contract lacked mutuality. Actually, war conditions, causing the price to rise about two hundred percent, made the risk assumed basically unconscionable under the contract. Hence it has been suggested that unconscionability rather than lack of mutuality was the true ground for the court's decision.

The Code provisions, however, indicate much broader court power than that implied from the *Schlegel* case. Comment under an earlier Code draft states that even if parties deliberately enter into a lopsided bargain with full knowledge and awareness and have actually assented to unconscionable clauses, the court may still refuse to enforce the clause or agreement as unconscionable. Such a policy may well re-

33 N. Y. Pers. Prop. Law § 64a; N. Y. Lien Law § 239-i.
34 Uniform Commercial Code § 2-302, Comment 1 (Spring 1950).
35 Ibid.
36 Ibid.
38 See 18 U. of Chi. L. Rev. 146-150 (1950).
39 See note 37 supra.
sult in the substitution of equity notions of fair exchange for the principle of freedom of contract.

**Parol Evidence Rule**

Closely related to judicial policing of contracts is the judicial determination of the intent of the contracting parties. Under present New York law, before the court may go beyond a written contract to establish this intent, it must first determine that the language in the writing is ambiguous; otherwise there would be a violation of the parol evidence rule.\(^{41}\) Provision is made in present law for the introduction of evidence concerning custom and practice, but only to explain equivocal phraseology.\(^{42}\)

Under the new Code, evidence of course of dealing, usage of trade and course of performance is admissible although the written agreement may be clear and unambiguous on its face.\(^{43}\) The Code comment states: “Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used.”\(^{44}\)

The Code places particular emphasis upon the fact that merchants are in a category separate and apart from the casual or inexperienced buyer or seller.\(^{45}\) Hence, under the Code, commercial practice and course of dealing play important roles in determining contractual intent between such merchants.\(^{46}\) This differentiation in rules where merchants are involved has been criticized on the ground that it may breed much litigation over whether a party is or is not a merchant in individual cases.\(^{47}\) It is interesting to note, in line with this criticism, that while the codes of most civil

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\(^{42}\) N. Y. PERS. PROF. LAW § 99(2).

\(^{43}\) UNIFORM COMMERCIAL CODE §§ 2-202 (Spring 1951).

\(^{44}\) UNIFORM COMMERCIAL CODE §§ 2-202, Comment 2 (Spring 1950).

\(^{45}\) UNIFORM COMMERCIAL CODE §§ 2-104 (Spring 1951).

\(^{46}\) Id. §§ 1-205, 2-208.

law systems distinguish between civil law and the law merchant by applying separate rules to mercantile transactions, the most recent continental approach, as exemplified by the Italian Civil Code of 1942, has been to abandon the merchant category entirely by a merger of civil and commercial law.48

EXTENSION OF WARRANTY LIABILITY

Present New York sales law requires privity to exist between the parties before any liability may be established for breach of warranty, either express or implied.49 Other jurisdictions have gone further, holding that this liability is extended to include all parties who may reasonably be expected to use or consume the goods originally warranted.50

The new Code adopts a "middle of the road" position between these two extremes by extending the seller's warranty to any natural person who is in the family or household of the buyer or a guest in his home, "... if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by a breach of the warranty."51 The seller may not exclude or limit this extended liability. This position reflects an abandonment by Code draftsmen of the more liberal view expressed in earlier Code drafts which extended the seller's warranty to include all parties who may reasonably be expected to use or consume the goods originally warranted.52

From the point of view of New York law, however, the Code extension of warranty liability to the buyer's family will remove the present uncertainty on this point, created by the dictum in the Court of Appeals case of Pearlman v. Garrod Shoe Co.53 In this case, recovery was allowed for

51 Uniform Commercial Code § 2-318 (Spring 1951).
injuries and death resulting from a defective shoe purchased for deceased plaintiff by her mother. The court recognized that the general rule in New York barred breach of warranty suits in the absence of contractual privity. While recovery was based on negligence, the court observed that the special circumstances might present an exception to the rule applicable to warranty cases. Under the Code, breach of warranty would be the obvious cause of action on these facts.

**INTERRELATION OF SALES AND SECURITY LAW**

The preceding sections of this article have dealt solely with the more significant substantive innovations which Code Article Two proposes in present New York sales law. The scope of sales law, however, is nowhere defined with particularity for law knows no natural compartmentalization. Indeed, the fact patterns which sales law undertakes to regulate often encompass situations which might with equal right be denominated security transactions, as for example, the conditional sale contract.54

For this reason, Code draftsmen have rejected the arbitrary grouping of the Uniform Sales Act and other sales legislation, and have placed each commercial relationship in the Code where a considered analysis would indicate it belongs.55 One of the results of such policy is that to properly evaluate the changes wrought by the Code in existing sales law, the lawyer must proceed from Code Article Two to a study of Code Article Nine, for it is there that many notions traditionally grouped under present sales law will be found.

**COMPLETE SECURITY LAW CHANGE PROPOSED**

Article Nine, entitled "Secured Transactions, Sales, Chattel Paper and Contract Rights," 56 is that portion of the new commercial Code which, as previously stated, proposes the most radical departure from present New York sales and

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55 UNIFORM COMMERCIAL CODE § 2-102, Comments 1, 2 (Spring 1950).
56 Revised title, June 1951 Revisions.
security law. By combining portions of sales with security law, it supersedes not only the Uniform Trust Receipts Act and the Uniform Conditional Sales Act, but also existing state legislation dealing with chattel mortgages, factor's liens, pledges, and assignments of accounts receivable.\textsuperscript{57}

The method normally employed in this symposium, of comparing present New York law with proposed Code change, is inapplicable at this point since the Code completely discards present security law and substitutes an entirely new system in its stead.\textsuperscript{58} For this reason, the theories and principles embodied in the proposed system shall be treated independently and not on a comparative basis.

The explanation for this wholesale scrapping of present law lies in the conviction of the Code drafters that the present security system is rapidly becoming unworkable. Security law in recent years has grown in complexity at an alarming rate without adequate supervision or regulation. The recognition of new security devices, approved by a rapidly expanding lending business, has caused ever widening gaps in its structure. Increased costs and great uncertainty as to filing requirements and individual rights have resulted. The Code is intended to provide a simple and unified structure within which the immense variety of present and future secured financing transactions can go forward with less cost and greater certainty.\textsuperscript{59} This structure is best understood by examining first its overall scope. This entails a consideration of new concepts and basic theories. Once these are established, the procedural provisions will be summarized, for it is felt that the elements of form are capable of simple explanation despite reputable opinion to the contrary.\textsuperscript{60}

\textsuperscript{57}Uniform Commercial Code § 9-101, Comment (Spring 1950).
\textsuperscript{58}Professor Grant Gilmore states: "Article 9 . . . deliberately cuts loose from all anchorage in the past. It cuts across what have been regarded as separate fields of law, introduces a completely new terminology. . . ." Gilmore, The Secured Transactions Article of the Commercial Code, 16 Law and Contemp. Prob. 27, 28 (1951).
\textsuperscript{59}Uniform Commercial Code § 9-101, Comment (Spring 1950).
\textsuperscript{60}Homer Kripke in discussing the Secured Transactions Article states in part: "No paper of ordinary scope could summarize all of these provisions adequately or discuss all of the policy questions they raise. . . ." Kripke, The Secured Transactions Provisions of the Uniform Commercial Code, 33 Va. L. Rev. 577 (1949).
THEORIES OF PROPOSED SECURITY SYSTEM

(a) Functional Approach

The complexity of present security law results mainly from the myriad formal distinctions existing between security devices. Judicial emphasis placed on the importance of locating title to the collateral creates further problems. The Code, as a solution, applies one set of rules to any transaction, regardless of its form, which is intended to create a "security interest" in personal property. Its scope excludes only liens regulated by federal statutes and liens for materials, services, and rent. The transactions covered, however, must also comply with applicable state statutes regulating small loans, usury, and retail installment sales. The "contract approach" of Article Two is reapplied and actual location of title is held immaterial. The debtor still retains rights in the collateral which he may alienate and which can be reached by his creditors.

Necessary distinctions, allowing for flexibility, are made along functional lines by dividing all collateral into five basic types: chattel paper, accounts, contract rights, instruments, and goods. Wherever appropriate, the Code states special rules applicable to financing transactions involving each type of collateral. In the case of goods, the nature of the use of the collateral is significant in determining the scope of protection. Goods are subdivided, according to use, into consumer goods, equipment, farm products and inventory. The

62 The Code defines security interest as "an interest in property which secures payment or performance of an obligation. The reservation by a seller or consignor of property notwithstanding identification of goods to a contract for sale or notwithstanding shipment or delivery is a 'security interest.'" Uniform Commercial Code § 1-201(37) (Spring 1951).
63 Id. §§ 9-104.
64 Id. §§ 9-203(2).
65 Id. §§ 9-202.
66 Id. §§ 9-311(a), (b).
67 The Code states in part: "Chattel paper is a new term but one readily understood. It includes the conventional conditional sales contract and chattel mortgage and also the chattel lease. . . ." Uniform Commercial Code § 9-105, Comment 2 (Spring 1950).
principal use to which the goods are put determines their class in borderline cases.  

(b) The Purchase Money Security Interest

While it is true that the Code proposes an entirely new legal approach to secured transactions, even this metamorphosis recognizes and incorporates certain basic truisms of the present system.

Security law has always afforded preferred treatment to lenders who make advances for the purchase of goods, since the loan supplies collateral which would otherwise be unavailable. Despite this favored position, financiers have continually sought to remove such transactions from the security field by various devices such as the chattel or purchase money mortgage, conditional sale, and trust receipt. Equity controls and the advent of recording statutes have done much to keep alive this unending battle of legal distinctions.

The Code wisely adopts the existing priority of purchase money obligations yet quietly buries the age-old controversy of form by creating a new security interest appropriately labeled "purchase money security interest." This interest attaches to all transactions wherein a present advance is made for the purchase of collateral or an interest in the collateral is retained by the seller to secure the price. It thus replaces the chattel mortgage, conditional sale and trust receipt. Based on the "new value" theory of the Uniform Trust Receipts Act, the security interest created by a present advance has priorities equal to those accorded trust receipts under present law.

The new interest arises solely in a conditional seller or in a lender who makes advances for purchase purposes. Tracing difficulties in the latter case are avoided since advances made within ten days of receipt of collateral will create the lien even though the value given was not in fact used to pay the price.

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88 Uniform Commercial Code § 9-109 (Spring 1951), Comment 2 (Spring 1950).
89 Uniform Commercial Code § 9-107 (Spring 1951).
70 Uniform Commercial Code § 9-107, Comment 2 (Spring 1950).
71 Uniform Commercial Code § 9-107(c) (Spring 1951).
(c) Codification of Accounts Receivable Financing

Receivables and contract rights, because of their resemblance to inventory, are rated high on the list of liquid assets used in security finance. A receivable may be an open account or in itself an obligation secured by a conditional sale or chattel mortgage. The latter, under the Code, will ordinarily fall in the category of chattel paper.

The majority of states, including New York, do not presently require filing to validate the account or contract rights assignment despite their widespread use as financing devices. In addition to obvious creditor hardships, conflicts of law questions raise vexing problems in these jurisdictions. Yet, where filing is required, there exists no uniformity as to situs of accounts or recording procedure. In short, the present field of accounts receivable financing needs regulation and unification which the Code attempts to supply.

In recognition of current financing practice, the Code places both the absolute and collateral assignment of accounts or contract rights (except wage assignments) in the category of security transactions. Consequently, the absolute assignment, although actually a sale, must conform to the formal requirements for the creation of a security interest. Both the assignee buyer and the assignee for collateral purposes must file to perfect the assignment.

Problems have always existed in connection with realization on this type of collateral in view of the rights of the account debtor originating in the sales transaction. Cut off clauses, i.e., agreements not to assert defenses against assignees, are utilized under present law as a partial solution,

74 Uniform Commercial Code § 9-102(1) (a), (b) (Spring 1951).
75 Uniform Commercial Code § 9-105, Comment 1 (Spring 1950).
although New York law places definite limitations on their effectiveness.\textsuperscript{76}

Under the Code, the assignee of a purchase money security interest in consumer goods is subject to any claims or defenses arising out of the sale. A holder in due course of a negotiable instrument which was part of such a security agreement, is also subject to such claims or defenses.\textsuperscript{77} Cut off clauses in these instances are unenforceable. The restriction is limited however to the consumer sale in line with the Code distinctions between commercial and consumer financing.\textsuperscript{78}

"Cut off clauses" in sales of other than consumer goods are enforceable by the assignee as to personal but not real defenses, except that warranties contained in the original contract may not be disclaimed or limited.\textsuperscript{79} In absence of the cut off clause, the assignee of an account is subject to any defense arising from the contract or any claim against the assignor which accrues before the debtor receives notification of the assignment.\textsuperscript{80}

\textbf{(d) Recognition of the Floating Lien}

Early in the development of security law the after-acquired property clause was held void as a matter of public policy when used in chattel mortgages.\textsuperscript{81} Since liens cannot validly attach to changing stock unless the collateral is made flexible or the liens continually renewed, the immediate effect of the holding was the emasculation of one of the essentials of commercial growth—large scale inventory financing.

An attempt was made to remedy the situation in the industrial areas by the passage of Factor's Lien Acts, modeled on the early New York statute which permitted the floating lien in the mercantile field.\textsuperscript{82} The resulting illogical and

\textsuperscript{77} Uniform Commercial Code § 9-206(1) (June 1951).
\textsuperscript{78} The May 1949 Draft of the Code contained an entire part (Part 6) dealing with consumer financing, which has been since deleted.
\textsuperscript{79} Uniform Commercial Code § 9-206(2), (3) (June 1951).
\textsuperscript{80} Uniform Commercial Code § 9-318 (Spring 1951).
\textsuperscript{81} See Gilmore and Axelrod, Chattel Security, 57 Yale L. J. 517, 533 (1947).
\textsuperscript{82} N. Y. Pers. Prop. Law § 45.
anomalous state of the law both in New York and other jurisdictions is attributable to the failure to correlate factor's lien statutes with the law governing mortgages.\textsuperscript{83}

Under the Code, after-acquired property clauses are validated without qualification, although in deference to the distinction drawn between commercial and consumer financing, consumer goods do not come within the scope of the clause unless acquired within ten days after the secured party gives value.\textsuperscript{84} The Code also validates security agreements which provide that collateral under them shall secure future advances, for these are merely variations of the floating lien.\textsuperscript{85}

The theory underlying the Code approach to the problem is based on the general assumption that by liberalizing lender operations and simplifying the taking of security, broad new vistas will be opened to security financing with resultant benefits to both debtor and creditor alike.

Protection is provided the floating lien from third party creditor attack since the debtor is permitted to use or sell the collateral without restriction.\textsuperscript{86} Any sale of collateral results merely in a continuation of the security interest in the proceeds. If originally perfected, it continues in its perfected form for ten days after receipt of the proceeds and then must be refiled unless the continuation was provided for in the original security agreement.\textsuperscript{87} This affects accounts receivable financing in that the assignee who has not subjected accounts to his control is no longer required to closely supervise the assignor in the collection of proceeds since the lien automatically transfers.\textsuperscript{88}

The threat of voidable preference which might exist in bankruptcy proceedings by virtue of the after-acquired property interest is avoided by providing that the interest is not


\textsuperscript{84} \textit{Uniform Commercial Code} § 9-204(3), (4) (Spring 1951).

\textsuperscript{85} \textit{Id.} § 9-204(5).

\textsuperscript{86} \textit{Id.} § 9-205.

\textsuperscript{87} \textit{Id.} § 9-306.

\textsuperscript{88} Repealing the rule of Benedict v. Ratner, 268 U. S. 353 (1925) (wherein the Supreme Court of the United States held as a rule of New York law that it was "... inconsistent with the effective disposition of title and creation of a lien" for a financier to allow the collection of accounts assigned as security without requiring an account of the proceeds).
taken for an antecedent debt. However, security interests in proceeds are affected by bankruptcy to the extent that the secured party is restricted to the amount of cash proceeds received by the debtor within ten days before the institution of insolvency proceedings.

PRINCIPLES OF CODE SECURITY SYSTEM

(a) Formal Requisites of the Security Interest

The formal requisites which determine the origin and validity of a security interest are reduced to a minimum under the Code. To originate, a security interest must have as its basis either the physical transfer of property as security or a written security agreement signed by the debtor and reasonably identifying the collateral. If the collateral is oil, gas, crops, or minerals, then the writing must also contain a reasonable identification of the land concerned. The interest cannot attach pursuant to such agreement until the debtor has rights in the collateral and value is given by the secured party.

(b) Perfecting the Interest

Once a security interest validly attaches and is perfected, unless expressly subordinated by the security agreement, it creates an enforceable priority over all subsequent security interests and ordinary lien creditors in the same collateral. Subsequent purchasers of the collateral will also take subject to the perfected interest in most instances.

Perfecting the security interest is accomplished either by transferring possession of the collateral to the secured party or by filing notice of the interest. This general rule is qualified in one important respect. The Code makes it un-
necessary to file liens in connection with direct sales to consumers. Therefore purchase money security interests in consumer goods or in farm equipment not in excess of $2,500 (other than motor vehicles or goods affixed to realty) are perfected when they attach, without transfer of possession or filing.\textsuperscript{97}

It is important to note that by Code definition, the possession sufficient to perfect a security interest must be \textit{actual possession} and is not obtained if goods are left on the debtor's premises although controlled by the secured party and covered by a warehouse receipt.\textsuperscript{98} In such case the security interest can be perfected only by filing. This changes New York law which treats such a field warehousing device as a pledge, thereby making recordation and acknowledgment of the lien unnecessary.\textsuperscript{99}

Filing, the alternative method for perfecting security interests, is intended for the protection of non-possessory interests with the aforementioned exceptions. The Code, however, makes no provision for filing a security interest in documents or instruments, and therefore such an interest is not enforceable against third parties unless actual possession is transferred to the secured party.\textsuperscript{100} The Code provides a grace period of twenty-one days' protection from the time this non-possessory security interest attaches to such collateral if new value is given for the interest and in any event from the time possession is relinquished by the secured party.\textsuperscript{101} This protection is subordinate to any rights which might accrue during the period to a holder in due course.\textsuperscript{102} This grace period is to provide for short term transactions where the debtor must have possession of the collateral—for example, to get the goods which are represented by the documents or for a “day loan” of securities to a broker.\textsuperscript{103}

\textsuperscript{97}\textit{Id.} § 9-302(1) (c); N. Y. Pers. Prop. Law §§ 65, 69 reach a contrary result. Filing of conditional sales for resale is not recognized yet filing of conditional sales to consumers is required.

\textsuperscript{98}\textit{Uniform Commercial Code} § 9-305(1), (2) (Spring 1951).

\textsuperscript{99}Parshall v. Eggert, 54 N. Y. 18 (1873); Babcock v. Edson, 82 Misc. 144, 143 N. Y. Supp. 399 (County Ct. 1913); see Note, 133 A. L. R. 209 (1941).

\textsuperscript{100}\textit{Uniform Commercial Code} § 9-303(3) (Spring 1951).

\textsuperscript{101}\textit{Uniform Commercial Code} § 9-304(1), (2) (June 1951).

\textsuperscript{102}\textit{Uniform Commercial Code} § 9-309 (Spring 1951).

\textsuperscript{103}\textit{Uniform Commercial Code} § 9-304, Comment (Spring 1950).
Filing is accomplished by the tender of a financing statement plus filing fee to the filing officer.\textsuperscript{104} A financing statement need only be a copy of the security agreement signed by and including the addresses of both parties.\textsuperscript{105} Such notice in itself is not too informative. The Code therefore permits the debtor to submit to the secured party a statement of the current unpaid indebtedness plus an itemized list of the collateral covering it, with a request that it be approved or corrected.\textsuperscript{106} The secured party must comply with such a request within two weeks after receipt. Such list is then available to third parties who seek verified details not contained in the filed notice.

The Code has incorporated the centralized state filing of the Uniform Trust Receipts Act with county recording in establishing a single filing system to replace the present system of different files for each security device subject to filing requirements. Since centralized state filing is most useful where a business enterprise is involved, all security interests in accounts, contract rights, chattel paper, inventory and equipment are filed at the state capital.\textsuperscript{107} This allows the credit agencies to have one easy place of search of records for all debtors in the state. Anticipating opposition to this broad revision of present recording systems, the drafters of the Code have added an optional clause providing for the filing of these interests in the county of the debtor's places of business, provided they are all in one county, if the legislature should require local in addition to central filing as regards commercial financing.

Local filing, in the county of the debtor's residence, is reserved strictly for consumer goods and farm equipment. If the debtor is a non-resident, then filing is accomplished in the county where the goods are located. Security interests in crops must also be filed in the county where grown.\textsuperscript{108}

\textsuperscript{104} \textit{Uniform Commercial Code} § 9-403(1) (Spring 1951).

\textsuperscript{105} \textit{Id.} § 9-402(1).

\textsuperscript{106} \textit{Id.} §§ 9-208(1), (2), (3).

\textsuperscript{107} \textit{Uniform Commercial Code} § 9-401(1) (a) (June 1951).

\textsuperscript{108} \textit{Uniform Commercial Code} § 9-401(b) (Spring 1951).
At present, the Code requires only one filing which covers any subsequent change of residence, place of business or relocation of the collateral within the jurisdiction. The most recent draft revision intimates by comment, however, that re-recording in the new location will be required.109

The validity of security interests which attach to personal property prior to its transfer into a new jurisdiction depend on the law of the jurisdiction of attachment. Yet filing in the new jurisdiction is always required for perfecting such interests although if perfected prior to transfer, they continue as such for a period of four months after transfer.110 Security interests in mobile equipment normally used in more than one jurisdiction are filed in the jurisdiction where the debtor's chief place of business is located.111 Since accounts and contract rights are not represented by paper or tangible property, they may be properly filed only in the jurisdiction where the assignor's office which contains such records is located.112

Filing may be terminated at any time by filing a termination statement signed by the secured party, which he must furnish the debtor on demand once the obligation is satisfied.113 If a termination statement has not been filed, then after maturity date if stated in the filing, or in absence of such date, then five years after filing, the filing officer may notify the secured party that filing will lapse unless a continuation is filed within sixty days. Such refiling will result in an additional five-year coverage.114

(d) Conflicting Security Interests

The question of conflicting security interests in the same collateral is resolved by applying the ordinary rule of priority, viz., interests rank in the order of time of perfection.115 The floating lien is insured adequate protection since later

109 UNIFORM COMMERCIAL CODE § 9-401(3) (June 1951).
110 Id. § 9-103(2).
111 UNIFORM COMMERCIAL CODE § 9-103(1) (c) (Spring 1951).
112 Id. § 9-103(1) (b).
113 UNIFORM COMMERCIAL CODE § 9-404 (June 1951).
114 Id. § 9-403(3).
115 UNIFORM COMMERCIAL CODE § 9-312 (Spring 1951).
advances and provisions for interests in after-acquired collateral pursuant to the original security agreement receive the priority of the originally-perfected interest.\textsuperscript{116}

The purchase money interest, because of its favored position under the Code, takes priority over an after-acquired property clause, provided the interest is perfected within ten days after the acquisition of such property.\textsuperscript{117} If the collateral is inventory, the priority will not extend to the purchase money interest unless notification is given to the original secured party prior to possession by the debtor. Conflicting purchase money interests rank equally unless the actual purchase can be identified with one interest and such interest is perfected within ten days after the purchase.\textsuperscript{118}

A security interest in collateral which by attachment becomes part of realty or other goods after the interest originates, takes priority over all claims to the realty or other goods existing at the time of attachment. Filing is not necessary to achieve this priority.\textsuperscript{119}

Subsequent to attachment, however, purchasers, prior encumbrancers to the extent of new advances, and lien creditors of such realty or other goods who have no actual knowledge of the interest will take free of it unless it is filed. If the collateral is attached to realty, filing is accomplished in the office where a mortgage on the realty is recorded.\textsuperscript{120}

Present New York law which allows severance of such collateral by the secured party if no material injury results, has created much uncertainty and confusion.\textsuperscript{121} It is difficult to determine in many instances whether there will be a material injury caused by the removal. The Code settles this issue by permitting the removal in all cases upon reimbursement of those injured, other than the debtor, for the cost of repair caused by the removal. Security may be required before such removal is permitted.\textsuperscript{122}

\begin{itemize}
\item \textsuperscript{116} Id. § 9-312(2), (3).
\item \textsuperscript{117} Id. § 9-312(5).
\item \textsuperscript{118} Ibid.
\item \textsuperscript{119} Id. §§ 9-313(1), 9-314(1).
\item \textsuperscript{120} Id. § 9-401(1)(c).
\item \textsuperscript{121} N. Y. PERS. PROP. LAW § 67; In re Whitlock Avenue in City of N. Y., 278 N. Y. 276, 16 N. E. 2d 281 (1938).
\item \textsuperscript{122} UNIFORM COMMERCIAL CODE §§ 9-313(2), 9-314(2) (Spring 1951).
\end{itemize}
The "attachment priority" applies also to a security interest in a raw material or component part which loses its identity through a subsequent processing with other materials. The interest will continue in the product or resulting mass and, if perfected, in its perfected form without the necessity of refiling.\(^{123}\)

(e) **Rights of Purchasers of Collateral**

A purchaser of collateral will ordinarily take subject to a perfected security interest but if the secured party files a financing statement in which he claims a security interest in proceeds, the debtor has unlimited authority to sell the collateral free of the security interest, in the ordinary course of business.\(^{124}\)

Present New York law, in effect under the Uniform Trust Receipts Act, which gives superiority to the interest of subsequent purchasers of collateral in certain instances,\(^{125}\) is continued in fundamentally the same form under the Code. For example, a buyer of inventory goods in the ordinary course of business, even with actual knowledge, takes free of a perfected security interest in the inventory.\(^{126}\) So also, a buyer for value of chattel paper in the ordinary course of business, takes free of a perfected non-possessory security interest in such paper.\(^{127}\) As distinguished from the buyer of inventory goods, the buyer of chattel paper must take possession without actual knowledge of the non-possessory interest to defeat it.

Favored treatment is also afforded the purchaser of consumer goods or farm equipment (other than motor vehicles or goods affixed to realty) valued not in excess of $2,500 which are subject to a purchase money interest. While purchase money security interests in these items become perfected upon attachment, unless the lien is actually filed, subsequent purchasers of such goods or equipment who buy for

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\(^{123}\) Id. § 9-315(1).

\(^{124}\) Id. § 9-307(3).


\(^{127}\) Uniform Commercial Code § 9-308 (June 1951).
their own use without actual knowledge of the interest take free of it.\textsuperscript{128}

(f) Procedure on Default

Upon default of the debtor, the secured party may proceed both to judgment on the claim and against the collateral by assumption of possession, public or private sale, lease, or other disposition.\textsuperscript{129} He may prepare or process it for disposition if necessary and dispose of it on the debtor's premises.\textsuperscript{130} The debtor, on the other hand, has the right to reclaim the collateral at any time prior to disposition by tendering payment of all sums due plus reasonable expenses.\textsuperscript{131}

The only restriction on the method or manner of disposition is that it be "commercially reasonable."\textsuperscript{132} A failure in this respect will cause the secured party to be restrained by court order, and to suffer liability for any resulting loss.\textsuperscript{133} It seems fair to predict that the "commercially reasonable" requirement will be the basis of much litigation despite the fact that both section and comment elaborate upon its meaning and application.

Disposition transfers to the purchaser for value all the debtor's rights in the collateral and discharges the security interest under which it is made plus all subordinate interests.\textsuperscript{134} Appropriate notification of the intended disposition must be sent to the debtor and other secured parties unless the collateral is perishable or customarily sold on a recognized market.\textsuperscript{135}

Following disposition, the debtor is entitled to any surplus remaining after reasonable expenses, satisfaction of the indebtedness, and, on written demand, satisfaction of the

\textsuperscript{128} \textit{Uniform Commercial Code} § 9-307(2) (Spring 1951). The June 1951 Revision notes that such buyers may in later revisions be placed in the same category as buyers of inventory. \textsuperscript{129} \textit{Uniform Commercial Code} § 9-501(1) (June 1951). \textsuperscript{130} \textit{Id.} §§ 9-503, 9-504(1). \textsuperscript{131} \textit{Uniform Commercial Code} § 9-506 (Spring 1951). \textsuperscript{132} \textit{Id.} § 9-504(2). \textsuperscript{133} \textit{Id.} § 9-507(1). \textsuperscript{134} \textit{Id.} § 9-504(3). \textsuperscript{135} \textit{Id.} § 9-504(2).
indebtedness of any subordinate security interest in the same collateral. Unless otherwise agreed, the debtor is liable for any deficiency.

In the case of a purchase money interest in consumer goods where the debtor has paid sixty per cent of the cash price, the secured party in possession of the collateral must dispose of it within ninety days or be liable in conversion. In all other cases, the secured party in possession may elect to send written notice to the debtor and other secured parties stating that the collateral will be retained in complete discharge of the obligation. If an objection ensues within thirty days, the secured party must dispose of the collateral.

This default procedure will supersede present New York statutes which at times unreasonably hamper realization on collateral. The only creditor restraint which it offers in replacement however is a vague standard called "commercial reasonableness" which may well result in more anguish than the cure is worth.

CONCLUSION.

This article is in no way intended as a complete digest and analysis of all the important changes which the adoption of the Uniform Commercial Code will effect in present New York Sales and Security Law, nor is it intended as a critique. However, the more fundamental points of divergence have been highlighted and the structure of new law outlined on the assumption that only after the basic theories behind the Uniform Commercial Code are understood can a proper evaluation be made of it in entirety.

136 Id. § 9-504(1) (a), (b), (c).
137 Id. § 9-505(1).
138 UNIFORM COMMERCIAL CODE § 9-505(2) (June 1951).
139 N. Y. PERS. PROP. LAW §§ 56, 77-80.