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Article Nine: Secured Transactions -- Validity, Rights of the Parties; Default

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ARTICLE NINE: SECURED TRANSACTIONS— VALIDITY, RIGHTS OF THE PARTIES; DEFAULT

FRANK W. HANFT*

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PARTS ONE AND TWO

In this discussion there will be no section-by-section comment. Such a task is performed by the comments in the 1962 official text of the Code, and by the North Carolina Annotations to the Code prepared under the direction of the Legislative Council. Instead some of the important aspects of the new legislation contained in Article 9 will be discussed.

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I. COVERAGE OF THE ARTICLE

Article 9 deals with secured transactions. It applies to any transaction, regardless of form, which is intended to create a security interest in personal property or fixtures, including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights.¹ The article also applies to any sale of accounts, contract rights or chattel paper.² The present discussion, however, is concerned with security. The application of Article 9 is to security interests created by contract, specifically including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security.³ Expressly excluded from the application of the article are statutory liens,⁴ except for the section of Article 9 concerning priority of a possessory lien for services or materials furnished with respect to goods subject to a security interest.⁵ Further express exclusions are contained in a separate section⁶ and include, among others, a landlord's lien, an equipment trust covering railway rolling stock, a transfer of an interest or claim in or under any policy of insurance, creation or transfer of an interest in or lien on real estate save for fixtures, and transfers of any tort claim, or any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization.

II. THE REORGANIZATION OF THE LAW

Article 9 is no mere collection of changes made in the present law concerning security on personal property. It is a reorganization and rewriting of such law. Although numerous existing security devices are, as pointed out above, included in the coverage of the article, that does not mean that there are separate provisions relating to each as such, as is true in the present law. Instead

¹ G.S. § 25-9-102(1)(a).

² G.S. § 25-9-102(1)(b).

³ G.S. § 25-9-102(2). A surety's right to subrogation is not included as a security interest. *Jacobs v. Northeastern Corp.*, 416 Pa. 417, 206 A.2d 49 (1965). Leases intended as security will be discussed hereinafter.

⁴ G.S. § 25-9-102(2). The Code itself provides liens for warehousemen, G.S. §§ 25-7-209, -210 and carriers, §§ 25-7-307, -308, and a security interest for collecting banks, § 25-4-208.

⁵ G.S. §§ 25-9-102(2), -310.

⁶ G.S. § 25-9-104.

provisions are made for secured transactions, and these provisions apply to these various kinds of transaction, such as mortgage, conditional sale, trust receipt, etc., without regard to the separate forms that the transactions may take. They all come under the same provisions of the article. There are, however, provisions relating to the situation in which the secured party has possession of the collateral.

Not only are old forms of security transactions of no consequence for the purposes of the law set forth in the article, but the old terminology used in connection with these forms disappears. No such words as "mortgage," "mortgagor" or "mortgagee" are used to designate the inclusive kind of transaction with which the Code deals or the parties thereto. This was done deliberately in order to forestall the danger that if any of the old terms were used courts might import into the Code for the interpretation of its provisions some of the existing law clustering about those terms instead of looking to the rules and provisions laid down in the Code itself.⁷

The new terms for the inclusive kind of transaction covered and the parties thereto are defined. A general definition section of the Code, defining "security interest," reads in part, "'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation."⁸ A definition section contained in and relating to Article 9 provides, "'Security agreement' means an agreement which creates or provides for a security interest."⁹ "'Collateral' means the property subject to a security interest . . ."¹⁰ As to the parties it is provided, "'Debtor' means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral 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

⁷ G.S. § 25-9-105, comment 1. In *Lincoln Bank & Trust Co., v. Queenan*, 344 S.W.2d 383 (Ky. Ct. App. 1961), the court pointed out that the Code represents an entirely new approach especially as to security transactions, and that so far as possible the meaning of the law should be gathered from the Code unfettered by anachronisms indigenous to the respective jurisdictions.

⁸ G.S. § 25-1-201(37). The section contains forty-six definitions applicable in the Code generally.

⁹ G.S. § 25-9-105(1)(h).

¹⁰ G.S. § 25-9-105(1)(c).

include both where the context so requires."¹¹ "Secured party" means a lender . . . or other person in whose favor there is a security interest"¹²

In short, instead of the old terms such as "mortgage" or "conditional sale," etc., the Code uses the inclusive term, "security agreement"; in place of "mortgagor" or "conditional vendee," etc., the Code uses the inclusive term "debtor"; and instead of "mortgagee" or "conditional vendor," etc., the Code uses the words "secured party."

This does not mean that the old forms of transaction such as mortgage¹³ or conditional sale can no longer be used; on the contrary, as above indicated, the Code specifies that it applies to security interests created by these existing forms of bargain,¹⁴ thus making it clear that their use may continue,¹⁵ although the results under the Code no longer depend on the form. The cases examined by the writer decided under the Code in jurisdictions which have adopted it involved the existing and familiar forms of security transaction and their consequences under Code provisions. In the course of time forms of transaction especially adapted to the Code will probably become common, but it is obvious that meanwhile prudent lawyers and businessmen are sticking to the familiar forms. Moreover, it is to be noted that transactions entered into before the effective date of the Code, which in North Carolina is July 1, 1967, are governed by the old law.¹⁶

By bringing security agreements of many kinds under the same provisions of the Code, much of the useless complexity in the previously existing law is eliminated. A great number of decisions and statutes hitherto related to particular kinds of security transactions, and a separate body of law existed as to each with great and needless variations in the law from one transaction to another. For example, conditional sales were distinguished from chattel mortgages, and a separate body of law developed concerning each.¹⁷ The making of legal distinctions between conditional sales and pur-

¹¹ G.S. § 25-9-105(1)(d).

¹² G.S. § 25-9-105(1)(i).

¹³ North Carolina has an optional statutory form for a chattel mortgage. N.C. GEN. STAT. § 45-1 (1950). This statute is not specifically repealed by G.S. § 25-10-102.

¹⁴ G.S. § 25-9-102(2).

¹⁵ G.S. § 25-9-101, comment.

¹⁶ G.S. § 25-10-102(2).

¹⁷ VOLD, SALES 326 (2d ed. 1959).

chase-money chattel mortgages was criticized on the ground that although the forms of the two transactions were different the result accomplished was the same.¹⁸ In North Carolina it has been decided that a conditional sale has the legal effect of a chattel mortgage.¹⁹ Accordingly, although the Code will make a large scale change in the law of most other states by eliminating the difference between conditional sales and chattel mortgages,²⁰ the North Carolina law will be unchanged in this particular.

Detailed statutes often provided for and governed one particular kind of security transaction, such as, in North Carolina, an agricultural lien for advances,²¹ an assignment of accounts receivable,²² a factor's lien,²³ or a trust receipt;²⁴ but since these devices are all brought under the provisions of the Code as "security agreements," these statutes will no longer be necessary and are repealed.²⁵

In the past as new security devices were generated out of commercial life new bodies of law grew up concerning the particular device. A good illustration is the trust receipt. Its nature, requirements and legal consequences were the subject of many conflicting decisions. The trust receipt was variously "classified as a conditional sale, a chattel mortgage, a consignment for sale, a reservation of title, a pledge, a bailment, and as a principal-agency relationship; however, many courts have held it to be a security device *sui generis*."²⁶ In North Carolina the trust receipt transaction, whether a two-party²⁷ or a three-party transaction,²⁸ was treated as a con-

¹⁸ Bogert, *The Evolution of Conditional Sales Law in New York*, 8 CORNELL L.Q. 303, 304 (1923).

¹⁹ *State v. Stinnett*, 203 N.C. 829, 167 S.E. 63 (1933); *The Observer Co. v. Little*, 175 N.C. 42, 94 S.E. 526 (1917); G.S. § 25-9-102, N.C. comment.

²⁰ In *United States v. Baptist Golden Age Home*, 226 F. Supp. 892 (W.D. Ark. 1964), the court pointed out that it was no longer required to decide whether the transaction was a conditional sale or a chattel mortgage, which would have been important under prior Arkansas law, but that under UCC § 9-102 both forms are included.

²¹ N.C. GEN. STAT. §§ 44-52 to -64 (Supp. 1965).

²² N.C. GEN. STAT. §§ 44-79 to -85 (1950), 44-77 to -78 (Supp. 1965).

²³ N.C. GEN. STAT. §§ 44-70, -76 (Supp. 1965).

²⁴ N.C. GEN. STAT. §§ 45-46 to -66 (Supp. 1965).

²⁵ G.S. § 25-10-102(1).

²⁶ Carter, *The Trust Receipt and the Problem of Recordation or Notice Filing*, 1951 WASH. U.L.Q. 30, 37.

²⁷ *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960).

²⁸ *General Motors Acceptance Corp. v. Mayberry*, 195 N.C. 508, 142 S.E. 767 (1928).

ditional sale. Eventually much of this law was superseded by the Uniform Trust Receipts Act.²⁹ But the law which developed with regard to trust receipts, some of which was excellent and would have been valuable for other forms of security also, related to trust receipts and not, for example, to factor's liens. It is hoped that in the future the Code will preclude any such complicated device-by-device development of the law by making the Code provisions sufficiently inclusive so that newly generated devices may come under its terms as "security agreements."³⁰

The Code does not state whether the title to the collateral is in the secured party or whether it is in the debtor. Otherwise put, it does not adopt either the title theory or the lien theory. Instead Article 9 specifies, "Each provision of this article with regards (*sic* in N.C. statute, "regard" in 1962 Official Text) to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor."³¹

This, of course, is a departure from existing theory in North Carolina and the other American jurisdictions. As to mortgages on real estate, the country is divided into "title jurisdictions," in which title to the land passes to the mortgagee when the mortgage is executed, "lien jurisdictions" in which the mortgage gives the mortgagee only a lien and no title passes under the mortgage until foreclosure; and intermediate jurisdictions where title goes to the mortgagee on default.³² However, the courts are not consistent in carrying out the theory as to the location of title. For example, in title states the theory that the mortgagee has title would logically dictate that the mortgagee's wife would have dower, and that the mortgagor's wife would have no dower in his interest. Actually the law was just the reverse. The mortgagor's wife had dower in his interest,³³ and the mortgagee's wife had none.³⁴ For numerous other purposes the mortgagor's interest, although he does not have title, has been treated as real estate, and the mortgagee's interest

²⁹ N.C. GEN. STAT. §§ 45-46 to -66 (Supp. 1965), which is in turn superseded, as already stated, by the Code. G.S. § 25-10-102(1).

³⁰ G.S. § 25-9-101, comment.

³¹ G.S. § 25-9-202.

³² Durfee, *The Lien or Equitable Theory of the Mortgage—Some Generalizations*, 10 MICH. L. REV. 587 n.3 (1912).

³³ *Stevens v. Turlington*, 186 N.C. 191, 194, 119 S.E. 210, 211 (1923) (dictum); *Wilkins v. French*, 20 Me. 111 (1841); WALSH, MORTGAGES 25 (1934).

³⁴ WALSH, MORTGAGES 25 (1934).

as personal property, notwithstanding his title to the real estate.³⁵ Nevertheless the title theory is by no means all mere theory. One important consequence is that, in the absence of any agreement or implication to the contrary, the mortgagee in a title jurisdiction has the right to possession, even before default,³⁶ whereas in a lien jurisdiction the mortgagor has that right.³⁷

The fact that a jurisdiction was a lien jurisdiction as to real estate mortgages did not mean that it was also a lien jurisdiction as to chattel mortgages. The lien jurisdictions were more numerous in the case of real estate than of chattel mortgages.³⁸ North Carolina has been a title jurisdiction as to both,³⁹ with the result that in the case of chattel mortgages also the mortgagee has had the right to possession before as well as after default.⁴⁰

As to security interests in personal property, the imposing body of law and learning related to the title and lien theories will largely be put away in the attic of legal history. It is true that the parties can use the old forms of bargain if they want to, and the old forms may under existing law result in title being in the debtor or the secured party. This in turn may have a bearing on matters not covered by the Code, such as the incidence of taxation.⁴¹

But although there will be simplification of the law by sweeping away, so far as the results covered by the Code are concerned, differences in the law depending on the form of the bargain, a new set of variations is introduced by the Code. Under it some results vary, not with the form of the bargain, but with the kind of collateral. Certain sections state special rules regarding particular types of collateral. These types are accounts and contract rights, chattel paper, documents and instruments, general intangibles, and goods. Goods are in turn subdivided into consumer goods, equipment, farm

³⁵ *Stevens v. Turlington*, 186 N.C. 191, 119 S.E. 210 (1923); *WALSH, MORTGAGES* 25 (1934).

³⁶ *Weathersbee v. Goodwin*, 175 N.C. 234, 95 S.E. 491 (1918) (semble); *OSBORNE, MORTGAGES* 306 (1951).

³⁷ *OSBORNE, MORTGAGES* 311 (1951).

³⁸ 1 *JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES* § 1 (Bowers ed. 1933) [hereinafter cited as *JONES*].

³⁹ *Weathersbee v. Goodwin*, 175 N.C. 234, 95 S.E. 491 (1918) (real estate); *Hinson v. Smith*, 118 N.C. 503, 24 S.E. 541 (1896) (chattels).

⁴⁰ *Hinson v. Smith*, *supra* note 39; *Moore v. Hurtt*, 124 N.C. 27, 32 S.E. 317 (1899). A discussion of this aspect of secured transactions under the Code will appear hereinafter.

⁴¹ G.S. § 25-9-101, comment.

products, and inventory.⁴² Distinctions are designed to follow functional rather than formal lines.⁴³

It is obvious that lawyers dealing with matters covered by Article 9 will find it necessary to become familiar with the Code meanings of a considerable number of new terms, as well as with a reorganized body of law incorporating a new approach. In time, new headings and classifications will doubtless appear in reports, digests and treatises, and also in law school courses.

III. ARTICLE 9 SUBORDINATED TO CERTAIN STATUTES

Not all the existing statutes relating to matters within Article 9 are repealed. Article 9 provides that a transaction, although subject to Article 9, is also subject to the North Carolina Consumer Finance Act, General Statutes sections 53-164 through 53-191 (governing small loans), to General Statutes section 24-1 (prescribing six per cent as the legal interest rate), to section 24-2 (usury statute), and to sections 91-1 through 91-8 (pawnbrokers). In case of conflict between the provisions of Article 9 and those of any such statute, the latter prevail. Failure to comply with any applicable statute has only the effect specified therein.⁴⁴

In addition, there is a provision in Article 9 that nothing therein validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of the statute or regulation to any transaction not otherwise subject thereto.⁴⁵

IV. REQUIREMENTS FOR SECURITY AGREEMENTS

One of the most important changes in the law brought about by Article 9 is the replacing of formal requirements for the various kinds of security transactions with a set of simple requirements for a security agreement. The requirements are that the debtor sign a security agreement which contains a description of the collateral and, in addition, when the security interest covers crops or oil, gas, or

⁴² G.S. § 25-9-102, comment 5. There an index of sections stating special rules relating to the particular varieties of collateral is set forth. These terms for the kinds of collateral are defined in G.S. § 25-9-105 and sections there referred to.

⁴³ G.S. § 25-9-101, comment.

⁴⁴ G.S. § 25-9-203(2).

⁴⁵ G.S. § 25-9-201.

minerals to be extracted or timber to be cut, a description of the land concerned.⁴⁶ Thus, where land is not involved, the requirements come down to four, that there be a security agreement of some sort,⁴⁷ that it be in writing (the debtor could not sign an unwritten one), that the debtor sign it, and that it describe the collateral. That these minimum requirements must be met, save when the collateral is in the possession of the secured party,⁴⁸ is made plain by the language that otherwise a security interest is not enforceable against the debtor or third parties.

In this particular a change is introduced in North Carolina law. A chattel mortgage on a tractor has been held to be valid and enforceable against the mortgagors although the chattel-mortgage instrument was unsigned.⁴⁹ Indeed no writing at all was necessary; a verbal mortgage was, prior to the Code, valid and enforceable against the mortgagors.⁵⁰ No possession in the mortgagee was necessary to the validity of the oral mortgage.⁵¹ Oral conditional sales also were binding between the parties.⁵² The North Carolina decisions were in accord with the common-law rule that a valid mortgage of personal property could be made without a writing and without delivery of possession.⁵³

The simple requirements for a security agreement replace the requirements hitherto prescribed by statute for particular varieties of security such as agricultural liens for advances,⁵⁴ assignments of accounts receivable,⁵⁵ factor's liens,⁵⁶ and trust receipts.⁵⁷ When such devices are used, their creation is tested by the simple Code requirements of security agreement, writing, signature of the debtor, and description of the collateral.⁵⁸

⁴⁶ G.S. § 25-9-203(1)(b).

⁴⁷ It is to be recalled that "security agreement" simply means an agreement which creates or provides for a security interest. G.S. § 25-9-105(1)(h).

⁴⁸ G.S. § 25-9-203(1)(a). This means that where the collateral is in the creditor's possession no writing is necessary. This was true at common law. G.S. § 25-9-203, comment 3. A familiar example is the pledge.

⁴⁹ *Kearns v. Davis Bros.*, 186 N.C. 522, 120 S.E. 52 (1923).

⁵⁰ *Odom v. Clark*, 146 N.C. 544, 60 S.E. 513 (1908); *McCoy v. Lassiter*, 95 N.C. 88 (1886).

⁵¹ *McCoy v. Lassiter*, 95 N.C. 88 (1886).

⁵² *Butts v. Screws*, 95 N.C. 215 (1886).

⁵³ 1 JONES § 2.

⁵⁴ N.C. GEN. STAT. §§ 44-52, -62 (Supp. 1965).

⁵⁵ N.C. GEN. STAT. §§ 44-77, -78 (Supp. 1965).

⁵⁶ N.C. GEN. STAT. §§ 44-70 (1950), -71 (Supp. 1965).

⁵⁷ N.C. GEN. STAT. § 45-47 (Supp. 1965).

⁵⁸ Trust receipts were held to meet the requirements of UCC § 9-

Technical requirements for chattel mortgages existing in some states such as acknowledgment and affidavits of good faith are abandoned,⁵⁹ thus simplifying the task of preparing a security agreement which will be valid in the various states having the Code.

The Code requirement that there be a security agreement arose in a case in which a debtor corporation made a note to a partnership, and the debtor and the partner creditors as secured parties signed and filed a financing statement.⁶⁰ Such a filing is the recordation requirement of Article 9. The statement named the collateral as tools and dies of the debtor. The statement did not contain a grant of a security interest, but there was testimony that the debtor intended to grant such an interest. The court held that the partnership creditor did not have a security interest valid in the debtor's receivership. A financing statement which does not contain the debtor's grant of a security interest cannot serve as a security agreement.⁶¹

One of the requisites for a "security agreement" is, as stated above, a description of the collateral, and when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. As to what is required by way of description, it is provided that for the purposes of Article 9 "any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described."⁶² This is designed to eliminate the requirement in some of the older chattel-mortgage cases that descriptions must be exact and detailed.⁶³ The Code test of the sufficiency of the description, namely that it reasonably identifies what is described, "is substantially in accord with existing North Carolina law."⁶⁴ A description in a chattel mortgage, "1948 Auto-Car (Sleeper Cab Tractor) Motor No. ———" was held sufficient in this state when the mortgagor owned only one tractor.⁶⁵ The description did identify the

203(1)(b) for a valid security agreement since they were written agreements, signed by the debtor, granted security interests in collateral, and contained a description of the collateral. *In re* United Thrift Stores, Inc., 242 F. Supp. 714 (D.N.J. 1965).

⁵⁹ G.S. § 25-9-203, comment 1.

⁶⁰ The requisites for a financing statement are provided by G.S. § 25-9-402.

⁶¹ *American Card Co., Inc. v. H. M. H. Co.*, 196 A.2d 150 (R.I. 1963).

⁶² G.S. § 25-9-110.

⁶³ G.S. § 25-9-110, comment.

⁶⁴ G.S. § 25-9-110, N.C. comment.

⁶⁵ *Peek v. Wachovia Bank & Trust Co.*, 242 N.C. 1, 86 S.E.2d 745 (1955).

tractor even though the motor number was not given. Another description in a conditional sale was "One S. H. coupé No. ——— Model T." S. H. was an abbreviation for second hand. The vendee owned only this one automobile. The court held the description valid and referred to the North Carolina rule that the description is sufficient if it will enable third parties, aided by inquiries which the instrument suggests, to identify the property.⁶⁶ In North Carolina if the mortgaged property is described as a certain number of designated articles, for example "two horses," or "two wagons," the description is valid if the mortgagor has only two horses or two wagons, but invalid if he has more.⁶⁷ These North Carolina decisions would seem to be equally valid under the Code. The same could not be said of a decision involving a conditional sale in which the property was described as "one bay mule," whereas it was a black mule. The security was held to be valid against a purchaser from the conditional vendee since the parties to the conditional sale intended the security to be on the particular mule and the intention will not be defeated by a false description.⁶⁸ Certainly the *description* did not reasonably identify what was described and therefore would fail to meet the Code test.

In a case decided under the Code the description in a chattel mortgage was:

"1-2 pc. living room suite, wine
1-5 pc. chrome dinette set, yellow
1-3 pc. panel bedroom suite, lime oak, matt. & spgs."

This description was held sufficient against the mortgagor's trustee in bankruptcy over the objection that various articles could make up a set, for example, a five-piece dinette set could be a table and four chairs, or a table, a cabinet and three chairs.⁶⁹ But the court pointed out that the property was located at the address of the mortgagors and in their possession, therefore the description, assisted by external evidence that does not add to or contradict the terms of the mortgage would enable a third party to identify the mort-

⁶⁶ *Twin City Motor Co. v. Rouzer Motor Co.*, 197 N.C. 371, 148 S.E. 461 (1929).

⁶⁷ *Forehand v. Edenton Farmers' Co.*, 206 N.C. 827, 175 S.E. 183 (1934); *Holman v. Whitaker*, 119 N.C. 113, 25 S.E. 793 (1896); *Spivey v. Grant*, 96 N.C. 214, 2 S.E. 45 (1887).

⁶⁸ *Harris v. Woodward*, 96 N.C. 232, 1 S.E. 544 (1887).

⁶⁹ *In re Drane*, 202 F. Supp. 221 (W.D. Ky. 1962).

gaged property, whatever the items in the set turned out to be. Apparently the court assumed that the mortgagor had one set or suite and only one which met each description and had no more articles which might have created an alternative choice as to what constituted a set. The reasoning of the court resembled that of the North Carolina court in some of the description cases.

When a security interest covers crops, or oil, gas, or minerals to be extracted, or timber to be cut, under the Code the security interest must contain a description of the land concerned.⁷⁰ Previous North Carolina cases established the same requirement for mortgages on crops.⁷¹ A crop lien was given on "all my entire crop now growing or to be growing the present year, on my land, or on any other land I may cultivate the present year," etc. The North Carolina court held that this description was sufficiently certain as to the debtor's land and the crops grown on it, but not as to any other land and the crops grown thereon.⁷² The court reasoned that the lands of the maker of the lien, when he executed it, could be seen and known, but those he might cultivate thereafter could not. This is a liberal decision as to the debtor's own land, since so far as the description, "my own land," goes the land might be in Pakistan or Patagonia. Conversely, "land I may cultivate the present year," could be definitely ascertained as soon as there were any crops to be involved. However, whether right or wrong, the court appeared to be concerned with the same inquiry as that which would take place under the Code, namely whether the description of the land reasonably identified it, and the decision would probably be unaffected by the Code. The North Carolina court also held valid a mortgage on "My entire crop of Irish and sweet potatoes, corn, etc., grown in the year 1916 on the lands of Thomas Harris, being one-half of the crop grown on said land."⁷³ If "my own land" is a sufficient identification, it follows that "the lands of Thomas Harris" is likewise sufficient. The court also held that the description included crops besides the potatoes and corn. These were included by the term "etc." and the language, "one-half of

⁷⁰ G.S. § 25-9-203(1)(b).

⁷¹ *W. L. Hurley & Sons v. Ray*, 160 N.C. 376, 76 S.E. 234 (1912).

⁷² *Weil v. Flowers*, 109 N.C. 212, 13 S.E. 761 (1891). In *Woodlief v. Harris*, 95 N.C. 211 (1886), the court held sufficient the description, "all crops raised on lands owned . . . by me, during the present year" *Id.* at 212.

⁷³ *Gallop v. Elizabeth City Milling Co.*, 178 N.C. 1, 100 S.E. 130 (1919).

the crop." A mortgage on the mortgagor's "entire crop of cotton to be arised by me or my tenants on all my lands during the year 1899" was held, as against a subsequent mortgagee, to include cotton grown on land claimed by the mortgagor as his, and on which he had lived for fifteen years, even though, after the mortgage was made and registered a court held that the mortgagor did not own the lands. The court said that the purpose of the description was to identify the lands, and this was accomplished,⁷⁴ thus applying the same test as that later established in the Code.

A security interest which does not meet the Code requirements⁷⁵ is not enforceable, even against the debtor, and cannot be made so on any theory of equitable mortgage.⁷⁶ The theory of equitable mortgage to the extent that it allowed creditors to enforce informal security agreements against debtors⁷⁷ may well have developed to escape elaborate formal requirements for mortgages. Since the Code reduces formal requirements to what is thought to be a necessary minimum, there is no longer a need for the equitable mortgage doctrine.⁷⁸ The Code provision prescribing this minimum is a variety of Statute of Frauds.⁷⁹

The definition of "security agreement" is "an agreement which creates or provides for a security interest."⁸⁰ For this reason it is stated in the official comment that the requirement that there be a security agreement "is not intended to reject, and does not reject, the deeply rooted doctrine that a bill of sale although absolute in form may be shown to have been in fact given as a security."⁸¹ This may be shown by parol evidence.⁸² Perhaps the reasoning is that, since under prior law an absolute bill of sale shown to have been given as a security created a security, it is "an agreement which

⁷⁴ *Brown v. Miller*, 108 N.C. 395, 13 S.E. 167 (1891). In *Furgerson v. Twisdale*, 137 N.C. 414, 49 S.E. 914 (1905), the court looked to a number of factors in determining that a mortgage by two mortgagors on "all crops cultivated by us" on designated lands did not include a crop cultivated on the lands by one only of the mortgagors. *Id.* at 415, 49 S.E. at 914.

⁷⁵ G.S. § 25-9-203(1) (b).

⁷⁶ G.S. § 25-9-203, comment 5.

⁷⁷ 1 JONES § 13 sets forth various informal agreements which were held on equitable grounds to be mortgages. The test of the validity of these under the Code would be whether they complied with the requirements of UCC § 9-203.

⁷⁸ G.S. § 25-9-203, comment 5.

⁷⁹ *Ibid.*

⁸⁰ G.S. § 25-9-105(1) (h).

⁸¹ G.S. § 25-9-203, comment 4.

⁸² *Ibid.*

creates or provides for a security interest" under the Code definition of "security agreement." Or the official comment may have been based on the Code definition stating that "agreement" means the bargain of the parties as found in their language or by implication from other circumstances,⁸³ but no mention of this was made in the official comment relative to absolute bills of sale as security.⁸⁴ If the prior law was imported into the Code to determine when an absolute bill of sale created a security, the result may be unfortunate from the standpoint of the purpose of the Code to bring about uniformity in the law,⁸⁵ since the prior law was not uniform in the matter. In some states the ground for admission of parol evidence to prove the absolute bill of sale to be a mortgage is fraud, accident or mistake, although the better and more generally accepted rule in the United States is that parol evidence may be admitted simply to show intent.⁸⁶ The result will be especially unfortunate in North Carolina since this state adheres to the minority rule. It has been held that an absolute deed of personal property cannot be converted into a security without a showing of fraud, imposition, oppression or mistake.⁸⁷ Moreover, the intent that the absolute deed be a security must be shown by facts and circumstances "*de hors the deed*" incompatible with an absolute purchase. Parol evidence that a mortgage was intended is insufficient.⁸⁸

The usual rule in other jurisdictions is that all the attendant circumstances may be considered for the purpose of ascertaining the intent, such as the declarations of the parties, the existence of a previous debt from vendor to vendee, the seeking of a loan by

⁸³ G.S. § 25-1-201(3).

⁸⁴ G.S. § 25-9-203, comment 4.

⁸⁵ G.S. § 25-1-102(2)(c).

⁸⁶ 1 JONES § 23.

⁸⁷ *Whitfield v. Cates*, 59 N.C. 136 (1860).

⁸⁸ *Colvard v. Waugh*, 56 N.C. 335 (1857). The two cited North Carolina cases on absolute bills of sale of personal property as mortgages seem to be taking the same direction as the cases on absolute deeds of real property as mortgages. The real property cases have crystalized two requirements for holding an absolute deed to be a mortgage. First it must be proved that the defeasance clause was omitted by reason of ignorance, mistake, fraud or undue advantage. Second, the intent to create a security must be shown by proof, not merely of declarations, but of facts *de hors* (outside) the deed, inconsistent with an absolute purchase. *Poston v. Bowen*, 228 N.C. 202, 44 S.E.2d 881 (1947); *Newbern v. Newbern*, 178 N.C. 3, 100 S.E. 77 (1919). The North Carolina position is criticized in 26 N.C.L. Rev. 405 (1948). This note brings out that all other states seem to have abandoned the first requirement and require nothing beyond sufficient proof of intent.

the vendor from the vendee, the disproportionately greater value of the property as compared with the amount received, the continued possession of the property by the grantor, and his delay in asserting that the transaction was a mortgage.⁸⁹

Since the North Carolina position requiring more than a showing of intent in order to have an absolute bill of sale declared to be a security represents a view abandoned in most other states and imposes on the debtor a requirement of proof that he commonly cannot meet,⁹⁰ it would seem that the North Carolina court for the sake of uniformity with other states in the law of secured transactions on personal property might well abandon its more stringent requirements. However, the problem may not arise often. So far as cases reaching the supreme court of the state are any indication, absolute bills of sale of personalty are not much used in North Carolina. No case since 1860 involving such a device has been found.

Moreover, simply determining that an absolute bill of sale will be held to be a security agreement if such intent can be shown is not in itself a satisfactory solution of the problem. Of course a purpose of such a rule is to enable the debtor to show that the bill of sale was a security and enable him to redeem his property. To that extent it prevents oppression of the debtor. But an undesirable result is that under the Code a writing can be established as a security agreement even though the writing itself does not purport to create a security interest. After all, if a security is intended why should the writing not so state? Absolute transfers are a deceptive and undesirable form of security and are likely to be exacted by creditors from needy debtors.⁹¹ Perhaps the best solution would be for the several states to enact a statute making absolute bills of sale intended as security void, thus eliminating their use and avoiding what seems to be an undesirable result under the Code.⁹²

⁸⁹ 1 JONES § 24. The factors having a bearing on intent of the parties to create a security in the case of deeds to realty are listed in 16 N.C.L. REV. 416 (1938). They would seem to be equally applicable in the case of absolute bills of sale of personal property.

⁹⁰ This point is brought out in connection with absolute deeds of realty intended as security in 26 N.C.L. REV. 405 (1948).

⁹¹ *Ibid.*

⁹² Absolute deeds of real estate intended as mortgages are, in North Carolina, void as to the debtor's other creditors and subsequent purchasers from him. *Foster v. Moore*, 204 N.C. 9, 167 S.E. 383 (1933); *Gulley v. Macy*, 84 N.C. 434 (1881). The rule making such deeds void as to the grantor debtor's other creditors is discussed in 26 N.C.L. REV. 405 (1948).

V. WHAT IS A PURCHASE-MONEY SECURITY INTEREST?

Under the law prior to the Code, security given for purchase money sometimes had a priority which would not otherwise have been given. For example, if a security-covered property to be acquired by the debtor in the future, a purchase-money security given on the property when later acquired would prevail over the earlier after-acquired property security.⁹³ Under the Code also, certain priorities are given purchase-money security interests.⁹⁴ This makes it necessary to determine what constitutes a purchase-money security interest, and the Code states that a security interest is a purchase-money security interest to the extent that it is taken or retained by the seller of the collateral to secure all or part of its price.⁹⁵ This is the usual concept of a purchase-money security. The Code adds a security interest taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.⁹⁶ North Carolina has already held that the priority given a purchase-money security applies where the security is given one who advances money to the vendee to pay on the purchase price.⁹⁷ The cases involved real estate security, but on this point there is no apparent reason to distinguish real from personal property.⁹⁸

VI. BULK TRANSFER PROVISIONS INAPPLICABLE

The North Carolina Bulk Sales Act,⁹⁹ which by its terms applies only to a "sale in bulk," has been held inapplicable to a security for a present consideration.¹⁰⁰ The Code goes farther and specifically provides that the creation of a security interest is not a bulk

⁹³ *Goodrich Silvertown Stores v. Caesar*, 214 N.C. 85, 197 S.E. 698 (1938); *Standard Dry-Kiln Co. v. Ellington*, 172 N.C. 481, 90 S.E. 564 (1916); 17 N.C.L. Rev. 442 (1939). A case decided under the Code adhered to the same rule. *Blancob Constr. Corp. v. 246 Beaumont Equity, Inc.*, 23 App. Div. 2d 413, 261 N.Y.S.2d 227 (1965).

⁹⁴ G.S. § 25-9-107, comment 1.

⁹⁵ G.S. § 25-9-107(a).

⁹⁶ G.S. § 25-9-107(b).

⁹⁷ *Smith Builders Supply, Inc. v. Rivenbark*, 231 N.C. 213, 56 S.E.2d 431 (1949); *Savings Bank & Trust Co. v. Brock*, 196 N.C. 24, 144 S.E. 365 (1928); 7 N.C.L. Rev. 95 (1928). *OSBORNE, MORTGAGES* 555 (1951) states the same rule.

⁹⁸ G.S. § 25-9-107, N.C. comment.

⁹⁹ N.C. GEN. STAT. § 39-23 (Supp. 1965).

¹⁰⁰ *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960).

transfer under Article 6,¹⁰¹ the portion of the Code dealing with bulk transfers. When the Code goes into effect in North Carolina, its Bulk Sales Act will be repealed,¹⁰² Article 6 will replace it, and security transactions will not be required to comply with the provisions of that article.

VII. LANDLORD'S LIEN ON CROPS

In North Carolina by statute a landlord is given a lien on the crops raised on the land for rent and advancements made and expenses incurred in making the crops, which lien is preferred to all other liens.¹⁰³ Since Article 9 of the Code provides that the article does not apply to a landlord's lien,¹⁰⁴ the priority of that lien is preserved.¹⁰⁵ It has been held that the provision of the Code excluding a landlord's lien from its provisions applies to landlord's liens created by statute and not to a lien given by the terms of a lease.¹⁰⁶

VIII. APPLICATION TO LEASES INTENDED AS SECURITY

Under prior law, transactions nominally leases of personal property were held to be conditional sales if they were such in substance and included all the incidents of conditional sales such as installment payments which, though nominally rent, were absolutely payable in totals equalling the value of the goods and which entitled the buyer to full ownership on completion of the payments or on some nominal payment in addition.¹⁰⁷ Such a transaction was held

¹⁰¹ G.S. § 25-9-111. A parallel provision to the same effect is made in G.S. § 25-6-103(1).

¹⁰² G.S. § 25-10-102(1).

¹⁰³ N.C. GEN. STAT. § 42-15 (1950); *Eason v. Dew*, 244 N.C. 571, 94 S.E.2d 603 (1956).

¹⁰⁴ G.S. § 25-9-104(b).

¹⁰⁵ *In re Einhorn Bros., Inc.*, 171 F. Supp. 655 (E.D. Pa. 1959), *aff'd*, 272 F.2d 434 (3d Cir. 1959). The court held that since Article 9 does not apply to a landlord's lien its previous priority under the law of Pennsylvania was undisturbed, with the result that in a bankruptcy proceeding the landlord's lien took priority over a perfected security interest in inventory.

¹⁰⁶ *In re King Furniture City, Inc.*, 240 F. Supp. 453 (E.D. Ark. 1965). The court reasoned that a statutory landlord's lien fits in with the exclusion policy embodied in the various exceptions listed in UCC § 9-104, whereas a contract lien given a landlord does not.

¹⁰⁷ VOLD, SALES 326 (2d ed. 1959). The UNIFORM CONDITIONAL SALES ACT § 1(2) included in the definition of conditional sale "any contract for the bailment or leasing of goods by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value of the goods, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming the owner of such goods upon full compliance with the terms of the contract."

to be a conditional sale in North Carolina.¹⁰⁸ Article 9 of the Code applies to security interests created by contract including "lease or consignment intended as security."¹⁰⁹ Article 1 includes in the definition of "security interest" a provision, "Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security."¹¹⁰ This language would seem to incorporate the prior rule that in order for the lease to be held to be a conditional sale (security), the lease must bind the lessee to make payments substantially equal to the purchase price.¹¹¹ However, it has been held pursuant to these Code provisions that even where the lessee does not bind himself to lease the property long enough for the payments he is obliged to make to equal more than a small fraction of the purchase price, still the lease is a security agreement and subject to Code provisions as such.¹¹² The decision seems wrong. The lessee "upon compliance with the terms of the lease" did not become or have the option of becoming the owner for no additional consideration or for a nominal consideration. He apparently bound himself to lease the compressor involved for no more than one month, for which the rent was 800 dollars. The purchase price if the lessee purchased was 14,500 dollars. The lessee could lease for a period long enough so that applied rent payments would pay for the compressor, but it seems that the lessee did not bind itself to do so. The lessee could "comply with the terms of the lease" by keeping the compressor one month and pay-

¹⁰⁸ *Hamilton v. Highlands*, 144 N.C. 279, 56 S.E. 929 (1907). In *United States Leasing Corp. v. Hall*, 264 N.C. 110, 141 S.E.2d 30 (1965), the court held the lease of a duplicating machine not to be a conditional sale, but in that case the lessee had expressed a preference to rent the equipment rather than purchase it, and the lease so far as appears, contained no option to buy but rather provided for the return of the machine at the end of the five-year lease period.

¹⁰⁹ G.S. § 25-9-102(2).

¹¹⁰ G.S. § 25-1-201(37).

¹¹¹ See notes 107 and 108 *supra*.

¹¹² *United Rental Equip. Co. v. Potts & Callahan Contracting Co.*, 231 Md. 552, 191 A.2d 570 (1963). The lease being held to be a security agreement, it was invalid against a subsequent execution creditor of the lessee for lack of compliance with the Code's filing provisions.

ing one month's rent, but this plainly did not give the lessee the right to become the owner for no additional consideration or a nominal one.¹¹³ It is doubtful that the Code provision that the intent is to be determined by the facts of each case justifies going as far as did this decision.

Assuming that the decision is wrong, should other courts follow it for the sake of uniformity? Is the first court to apply a Code provision in a particular kind of case to preclude other courts from making up their own minds? Of course such an initial decision should have especial weight because to depart from it would impair a major purpose of the Code—uniformity. Nevertheless, initial decisions which are plainly bad ought to be rejected by other courts. The resultant doubt as to the correct interpretation of the Code could normally be cleared up by amendment.¹¹⁴

In accord with prior law as well as the Code provisions is a decision holding a lease of machinery with an option to purchase not to be a security agreement under the Code where if the option were exercised, besides rent a payment of twenty-five per cent of the purchase price was required. This twenty-five per cent would amount to 2,006.25 dollars, and this, the court, said was not a nominal consideration.¹¹⁵

IX. WHEN SECURITY INTEREST ATTACHES—AFTER-ACQUIRED PROPERTY

The common-law rule was that a mortgage can operate only on property in existence when the mortgage was given and then belonging to the mortgagor or potentially belonging to him. A mortgage of goods which the mortgagor did not own, though he afterwards acquired them, was void as against subsequent purchasers from, or attaching creditors of, the mortgagor taking after the property was acquired.¹¹⁶ Nevertheless, a mortgagor could mortgage goods which he had potentially, as where he had land or animals

¹¹³ A referee in bankruptcy likewise held a lease with an option to purchase, but no obligation to lease long enough to make up the purchase price, to create a security interest under the Code and laid down the test of whether the lessee acquires an equity in the property by making any rent payments. *In re Royer's Bakery, Inc.*, 1 UCC REPORTING SERV. 342 (E.D. Pa. Sept. 27, 1963).

¹¹⁴ See UCC, 1962 Official Text XI-XV, especially XIV SEVENTH (b), Appendix.

¹¹⁵ *In re Wheatland Elec. Prods. Co.*, 237 F. Supp. 820 (W.D. Pa. 1964).

¹¹⁶ 1 JONES § 138.

and mortgaged their future product.¹¹⁷ An otherwise invalid after-acquired property mortgage could be made good by some new act to bring the property under the mortgage after the property was acquired.¹¹⁸ However, in equity a mortgage on after-acquired property was good even against purchasers and lien creditors of the mortgagor and took effect when the property was acquired without any new act to bring the property under the mortgage.¹¹⁹ This latter rule is followed in North Carolina.¹²⁰ The North Carolina statute on factors' liens also makes provision that the lien is good on after-acquired property from the time of filing notice,¹²¹ the statute on assignment of accounts receivable includes accounts arising under future contracts,¹²² and the statute providing an agricultural lien for advances covers crops made within one year from the date of the agreement.¹²³ These statutes, supplanted by the Code, indicate long-standing North Carolina policy.

The Code provides that a security interest cannot attach until three requirements are fulfilled. These are first, that there is agreement that it attach, second, that value is given, and third, that the debtor has rights in the collateral. As soon as these three occur, the security interest does attach unless explicit agreement postpones the time of attaching.¹²⁴

Where the debtor does not have rights in the collateral at the time of the security agreement, the security interest cannot then attach, since the third of the three requirements is lacking. But when the debtor does obtain rights in the collateral the security interest then attaches, the other two requisites being present, since then all three conditions of attaching are met.

Thus the Code provides for security interests in after-acquired property together with the limitation that the security interest cannot attach to the property until the debtor has rights in it. There must be a bird in hand before the security interest attaches, and

¹¹⁷ *Id.* at § 140; *Woodlief v. Harris*, 95 N.C. 211 (1886).

¹¹⁸ 1 JONES §§ 158-69; 8 COLUM. L. REV. 307 (1908).

¹¹⁹ 1 JONES § 170. The leading case is *Holroyd v. Marshall*, 10 H.L. 191, 11 Eng. Rep. 999 (1861).

¹²⁰ *Standard Dry-Kiln Co. v. Ellington*, 172 N.C. 481, 90 S.E. 564 (1916), citing *Holroyd v. Marshall*, 10 H.L. 191, 11 Eng. Rep. 999 (1861); *Hickson Lumber Co. v. Gay Lumber Co.*, 150 N.C. 282, 63 S.E. 1045 (1909); G.S. § 25-9-204, N. C. comment.

¹²¹ N.C. GEN. STAT. § 44-71 (Supp. 1965).

¹²² N.C. GEN. STAT. § 44-77(1)(a) (Supp. 1965).

¹²³ N.C. GEN. STAT. § 44-52 (Supp. 1965).

¹²⁴ G.S. § 25-9-204(1).

then it does though the bird was not in hand when the security agreement was made.

Recognition of security interests on after-acquired property is also found in a provision that, with certain exceptions, a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.¹²⁵

As to when the debtor is deemed to have rights in the collateral, express provisions are made for certain types of cases. For the purposes of the section on when the security interest attaches he has no rights in crops until they are planted or otherwise become growing crops, in the young of livestock until they are conceived, in fish until caught, in oil, gas, or minerals until they are extracted, in timber until it is cut, in a contract right until the contract has been made, nor in an account until it comes into existence.¹²⁶

The Code provisions on security interests in after-acquired property discussed above thus appear to be in accord with prior North Carolina law. They spell out in more detail when the security interest attaches.

It is provided, with one type of exception, that no security interest attaches under an after-acquired property clause to crops which become such more than one year after the security agreement is executed.¹²⁷ This will expand to security interests on crops generally the prior North Carolina statutory limitation on agricultural liens for advances to crops made within one year.¹²⁸ The Code also provides that no security interest attaches under an after-acquired property clause to consumer goods, other than accessions when given as additional security, unless the debtor acquires rights in them within ten days after the secured party gives value.¹²⁹ This limitation appears to change to that extent the North Carolina law.¹³⁰

After-acquired property mortgages frequently present the problem of sufficiency of the description of such property. Broad general descriptions have been held valid in North Carolina, for example, a

¹²⁵ G.S. § 25-9-204(3).

¹²⁶ G.S. § 25-9-204(2).

¹²⁷ G.S. § 25-9-204(4)(a).

¹²⁸ N.C. GEN. STAT. § 44-52 (Supp. 1965).

¹²⁹ G.S. § 25-9-204(4)(b).

¹³⁰ G.S. § 25-9-204, N.C. comment. No such limitation appeared in *Twin City Motor Co. v. Rouzer Motor Co.*, 197 N.C. 371, 148 S.E. 461 (1929).

designated car "and all additions and improvements thereto."¹³¹ An even broader description held sufficient was, "Also all the property, real, personal, or mixed, wheresoever the same is situated, now owned by the Gay Lumber Company, or shall be owned during the continuance of the liability hereinafter mentioned."¹³² The court said that from its very nature such a clause cannot describe with accuracy the property which the mortgagor will acquire since it is unknown.

Such descriptions would seem to be equally valid under the Code. Pursuant to the Code the following description in a chattel mortgage was sustained: "our complete inventory of all parts and accessories now owned or which may hereafter be acquired." The court said that the description reasonably identified the motor parts and accessories in the mortgagor automobile dealer's inventory.¹³³ Another security agreement described the collateral as "inventory of merchandise to be maintained in an amount not less than \$10,000 . . . at seller's wholesale cost, contained in the Kiddy and Women's Wear Shop," etc. The court held this to be a sufficient description of the entire inventory. The provision that the inventory was to be maintained at a certain value meant that items added in the future were to be included. Since the description applied to the entire inventory, there was no problem of identifying the goods intended to be included.¹³⁴

X. USE OR DISPOSITION OF COLLATERAL WITHOUT ACCOUNTING

Under the Code a security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use or dispose of it without accounting for its proceeds or replacing it.¹³⁵ This

¹³¹ *Twin City Motor Co. v. Rouzer Motor Co.*, 197 N.C. 371, 148 S.E. 461 (1929).

¹³² *Hickson Lumber Co. v. Gay Lumber Co.*, 150 N.C. 282, 63 S.E. 1045 (1909).

¹³³ *Howarth v. Universal C.I.T. Credit Corp.*, 203 F. Supp. 279 (W.D. Pa. 1962).

¹³⁴ *In re Goodfriend*, 2 UCC REPORTING SERV. 160 (E.D. Pa. May 1, 1964). In *National Cash Register Co. v. Firestone & Co., Inc.*, 346 Mass. 255, 191 N.E.2d 471 (1963), it was held that a description "All contents of luncheonette including equipment such as:" then naming items, covers the contents and is not limited to the named items. *Id.* at 259, 191 N.E.2d at 473. Further, the disputed after-acquired cash register also was covered by other terms in the description.

¹³⁵ G.S. § 25-9-205.

changes the rule of cases like *Benedict v. Ratner*,¹³⁶ which held such security interests fraudulent and void as to the debtor's other creditors.¹³⁷ The Code provision will likewise overturn the North Carolina holding that a mortgage on a stock of goods left in the possession of the mortgagor which contains no provision for an account of sales and application of the proceeds to the debt is presumptively fraudulent as to existing creditors, but not subsequent creditors of or purchasers from the mortgagor.¹³⁸ Under the Code there would be no such presumption of fraud as to anyone. The North Carolina statute on assignments of accounts receivable resembles the Code in that it provides, "Any permission by the assignee to the assignor to exercise dominion and control over a protected assigned account or the proceeds thereof shall not invalidate the assignment as to third persons."¹³⁹ But although the validity of the assignment was saved, probably the dominion of the assignor over the proceeds was not, since the statute also provides that the assignor shall hold in trust for the assignee the proceeds of an assigned account.¹⁴⁰

XI. FUTURE ADVANCES

The Code provision on security for future advances is short and to the point. "Obligations covered by a security agreement may

¹³⁶ 268 U.S. 353 (1925). The Court applied the law of New York.

¹³⁷ G.S. § 25-9-205, comment 1. In the case of *In re United Thrift Stores, Inc.*, 2 UCC REPORTING SERV. 864 (D.N.J. June 24, 1965), the court commented that under the Code there is no requirement of "policing" the collateral by the secured party.

¹³⁸ *A. Blanton Grocery Co. v. Taylor*, 162 N.C. 307, 78 S.E. 276 (1913); G.S. § 25-9-205, N.C. comment. In *Messick v. Fries*, 128 N.C. 450, 39 S.E. 59 (1901), the court held valid as to subsequent creditors a mortgage on a stock of goods with authority in the mortgagor to sell apparently without accounting to the mortgagee, in the absence of proof of actual fraud, and indicated an inconsistency in the North Carolina cases on the validity of such mortgages against creditors. In *Merchants & Farmers Bank v. Pearson*, 186 N.C. 609, 120 S.E. 210 (1923), a registered mortgage on lumber at described locations which specified that the mortgagor agreed to keep not less than 500,000 board feet of lumber at said locations during the life of the mortgage was held valid in the absence of proof of fraud against a purchaser on execution sale although all the lumber on hand at the time of the mortgage had been sold and replaced by other lumber. The court did not say whether the execution creditor became a creditor prior or subsequent to the mortgage.

¹³⁹ N.C. GEN. STAT. § 44-83 (1950).

¹⁴⁰ N.C. GEN. STAT. § 44-84(2)(a) (1950). Of course this assignment of accounts receivable statute is repealed when the Code goes into effect. G.S. § 25-10-102(1).

include future advances or other value whether or not the advances or value are given pursuant to commitment."¹⁴¹ Previous law concerning mortgages to secure future advances was complicated. Such mortgages were held valid as against subsequent liens if the advances were obligatory, superior to liens accruing after optional advances were made, superior to liens accruing before optional advances were made if no notice was had by the mortgagee of the intervening lien, and inferior to liens of which the mortgagee had actual notice to the extent of optional advances made thereafter. If the optional advances were made after only constructive notice of intervening liens, there was a split of authority.¹⁴² The North Carolina law on the subject was fragmentary. A few cases involving real estate recognized the validity of mortgages to secure future advances, but did not distinguish between the types of situations just indicated.¹⁴³ The North Carolina statute on agricultural liens includes future advances,¹⁴⁴ as does the factor's lien statute.¹⁴⁵

XII. SECURITY INTERESTS ON SHIFTING STOCKS OF GOODS

The Code provisions on after-acquired property security interests plus the provision validating security interests where the debtor has the right to dispose of the collateral without accounting validate what has been called the floating charge or lien on a shifting stock.¹⁴⁶ In a Kentucky case the court held that a chattel mortgage on a changing stock of goods was invalid, the case being governed by prior Kentucky law, but added that it was comforted by the knowledge that the Code, in effect in the state by the time of the court's decision, permits mortgages on after-acquired property.¹⁴⁷ When the Code's flat authorization of security agreements to secure future advances is added, the result is to validate security interests on shift-

¹⁴¹ G.S. § 25-9-204(5).

¹⁴² 31 N.C.L. REV. 504 (1953); 6 VA. L. REV. 280 (1919). For a discussion of the priorities under the Code of future advances over intervening liens see Smith, *Article Nine: Secured Transactions—Perfection and Priorities*, 44 N.C.L. REV. 753.

¹⁴³ *McAdams v. Piedmont Trust Co.*, 167 N.C. 494, 83 S.E. 623 (1914); *Todd, Schenck & Co. v. Outlaw*, 79 N.C. 234 (1878); *Moore v. Ragland*, 74 N.C. 343 (1876).

¹⁴⁴ N.C. GEN. STAT. § 44-52 (Supp. 1965), repealed when the Code goes into effect. G.S. § 25-10-102(1).

¹⁴⁵ N.C. GEN. STAT. § 44-71(3) (Supp. 1965), repealed when the Code goes into effect. G.S. § 25-10-102(1).

¹⁴⁶ G.S. § 25-9-204, comment 3.

¹⁴⁷ *Phelps v. Turner*, 351 S.W.2d 176 (Ky. 1961).

ing stocks of goods to secure loans or value given or to be given over a future course of dealing.¹⁴⁸ Therein, the North Carolina statute on factors' liens,¹⁴⁹ within its more restricted area, resembles the results under the Code.

XIII. AGREEMENT NOT TO ASSERT DEFENSES AGAINST ASSIGNEE

Clauses are frequently inserted in conditional sales contracts by which the vendee agrees not to assert against an assignee of the contract defenses the vendee may have against the vendor. The prior law as to the validity of such clauses is in confusion. In some jurisdictions the clauses are held void as attempts to make the conditional sales contracts into negotiable instruments, or as being contrary to public policy.¹⁵⁰ A contrary policy was expressed by a New York court which said that if effect were not given to such provisions, it would be impossible for banks to finance installment purchases,¹⁵¹ and in the same state such a provision was enforced against both the buyer and its guarantors to prevent them from raising against a good faith assignee of conditional sales contracts of laundry equipment defenses based on the malfunctioning of the equipment.¹⁵² Most American courts enforce such clauses.¹⁵³ No North Carolina decisions on this matter have been found.¹⁵⁴

Section 9-206 of the Code provides that an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense.¹⁵⁵ It has been held under this provision that an assignee of a conditional sale is not

¹⁴⁸ G.S. § 25-9-204, N.C. comment. For a discussion of a hypothetical security agreement under the Code covering present and future assets to secure future advances, with the right in the debtor to dispose of the collateral without accounting, see Coogan, *The Lazy Lawyer's Guide to Secured Transactions Under the Code*, 60 MICH. L. REV. 685, 693 (1962).

¹⁴⁹ N.C. GEN. STAT. §§ 44-70 to -76 (Supp. 1965), repealed when the Code goes into effect. G.S. § 25-10-102(1).

¹⁵⁰ G.S. § 25-9-206, comment 1.

¹⁵¹ *National State Bank v. Dzurita*, 2 UCC REPORTING SERV. 728 (N.Y. Sup. Ct. April 13, 1965).

¹⁵² *B.W. Acceptance Corp. v. Richmond*, 46 Misc. 2d 447, 259 N.Y.S.2d 965 (Sup. Ct. 1965).

¹⁵³ G.S. § 25-9-206, N.C. comment.

¹⁵⁴ *Ibid.*

¹⁵⁵ G. S. § 25-9-206(1). The Code provision was applied in *First Nat'l Bank v. Husted*, 2 UCC REPORTING SERV. 777 (Ill. App. April 2, 1965).

entitled to summary judgment dismissing an action for cancellation where the conditional vendee contended that the baler sold was defective and did not comply with warranties and denied that the assignee took without notice of this claim against the conditional vendor.¹⁵⁶ An exception to the above Code provision making enforceable the agreement not to assert defenses against an assignee is made in the case of defenses good against a holder in due course of a negotiable instrument under Article 3 of the Code.¹⁵⁷ Otherwise put, the clause in the security agreement does not make such a writing more negotiable than a negotiable instrument. Moreover the opening language of section 9-206 leaves room for a further exception. The language is, "Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods" Under this provision a state statute or court decision could, in the case of sales or leases of consumer goods, make invalid an agreement by the buyer or lessee not to enforce his defenses against an assignee. Such a statute or decision might be founded on a desire to protect such buyers against financing institutions taking assignments of conditional sales or purchase-money chattel mortgages.¹⁵⁸

Section 9-206 also provides that a buyer who as part of one transaction signs both a negotiable instrument and a security agreement thereby makes an agreement that he will not assert against an assignee his claims or defenses against the seller or lessor. Thus the negotiable instrument imparts some of its character to the accompanying security agreement.

XIV. WHAT LAW GOVERNS

Under Code section 9-102 it is provided that except as otherwise provided in section 9-103 on multiple state transactions and in section 9-104 on excluded transactions, Article 9 applies so far as concerns any personal property and fixtures within the jurisdiction of this state. That amounts to saying, in most cases, that Article 9 applies when the collateral is physically located in this state.¹⁵⁹ Section 9-103 then states special rules in certain situations. This section is complicated and detailed, but the gist is as follows:

¹⁵⁶ *McCoy v. Mosley Mach. Co.*, 33 F.R.D. 287 (E.D. Ky. 1963).

¹⁵⁷ G.S. § 25-9-206(1).

¹⁵⁸ Some states have such statutes. G.S. § 25-9-206, comment 2.

¹⁵⁹ G.S. § 25-9-103, comment 1.

Subsection (1) relates to security interests in accounts and contract rights and provides that the law of the state wherein the assignor keeps his records concerning such accounts and contract rights governs the validity and perfection of the security interest and the possibility and effect of proper filing. Subsection (2) relates to security interests in general intangibles and goods of a type normally used in more than one jurisdiction if such goods are classified as equipment or classified as inventory by their being leased by the debtor to others. Here the law of the state wherein is located the chief place of business of the debtor governs validity, perfection, and the possibility and effect of proper filing. Subsection (3) provides that if personal property other than that governed by subsections (1) and (2) is already subject to a security interest when it is brought into this state, the validity of the security interest in this state is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. But if the parties understood at the time the security interest attached that the property would be kept in this state and it was brought here within thirty days after the security interest attached for purposes other than transportation through this state, then the law of this state determines the validity of the security interest in this state.

It is to be noted that thus far subsection (3) is concerned with what law governs the validity of the security interest, not what law governs the steps necessary to make it effective against other parties.

Subsection (3) proceeds by providing that if the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, it continues perfected in this state for four months, and also thereafter if within the four months, it is perfected here. It may be perfected here after the four months, in which case perfection dates from the time of the perfection here.

If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, it may be perfected in this state and the perfection dates from that time.

Subsection (4) provides that notwithstanding subsections (2) and (3), if a certificate of title to the property is issued under a statute of this state or any other jurisdiction which requires indica-

tion on a certificate of title of any security interest in the property as a condition of perfection, then perfection is governed by the law of the jurisdiction which issued the certificate. An obvious application is to motor vehicles.¹⁶⁰

Subsection (5) relates to the situation in which the assignor of accounts or contract rights keeps his records concerning them in an office that is located in a foreign country.

Subsection (1) will replace the present statutory provision as to when an account is deemed located in this state.¹⁶¹ This provision is part of a statute which the Code repeals.¹⁶² Although neither is mentioned in the repealer provisions of Article 10, the present North Carolina statute relating to liens on personal property created in another state¹⁶³ and the statute relating to security interests on motor vehicles when brought into the state¹⁶⁴ cover the same ground as Code section 9-103 and appear to be supplanted.

A number of cases in Code jurisdictions have involved this section. A Pennsylvania case involved the application of section 9-103(1). A debtor made a contract with the United States government for maintenance, repair and overhaul of vehicles and assigned to an agent of a lender the payments due or to become due under the contract. The court sustained the assignment against a receiver of the debtor. One question in the case arose out of a stipulation in the agreement with the lender that the agreement and its performance were to be governed by the laws of New York, and that under what is now section 1-105(1) of the Code the parties could stipulate that the laws of that other state (New York) "shall govern their rights and duties." But the court held that the Pennsylvania law governed because the case involved not just the rights and duties of the parties but of creditors also, and the applicable section was what is now 9-103(1), providing that in the case of assignment of accounts the validity and perfection of the security interest is determined by the law of the state in which is located the office where the assignor keeps his records concerning them. Otherwise

¹⁶⁰ North Carolina statutes provide for entry of security interests on motor vehicle title certificates, and make such entry adequate notice to all creditors and purchasers. N.C. GEN. STAT. §§ 20-58(a)-(b), 20-58.1, -58.2 (1965). 40 N.C.L. REV. 84 (1961).

¹⁶¹ N.C. GEN. STAT. § 44-78(5) (1950).

¹⁶² G.S. § 25-10-102(1).

¹⁶³ N.C. GEN. STAT. § 44-38.1 (Supp. 1965).

¹⁶⁴ N.C. GEN. STAT. § 20-58(c) (1965). Some of the language of this statute is the same as that in G.S. § 25-9-103.

it would be possible for two parties to render nugatory as to third parties an act of the legislature passed for the benefit of the third parties.¹⁶⁵

Section 9-103(3) was applied in a case in which a chattel deed of trust on equipment was made in West Virginia and filed in that state. The equipment was moved to Pennsylvania, a Code state, but the deed of trust was not properly filed there. The court decided that the creditor holding the deed of trust did not have a secured claim in the debtor's reorganization proceeding under Chapter X of the Bankruptcy Act. Under Code section 9-103(3) the security interest perfected in West Virginia continued perfected for four months on removal to Pennsylvania, but the four months had expired at the time of the petition for reorganization.¹⁶⁶

A conditional sale made in Rhode Island but not recorded there since no recordation was required was held by a New York court to be "perfected" in Rhode Island, so that it was good for four months after the car involved was removed to Pennsylvania, a Code state, and successive sales of the car in Pennsylvania during that period were held by the New York court to be subordinate to the Rhode Island conditional sale.¹⁶⁷

A conditional sale was also held perfected at a time when it was unfiled in a case where the conditional sale of a car was made in New York, and the car was on the same day sold by the vendee to *A*, who, also on the same day, took it to Pennsylvania, a Code state, and sold it to *B*, who on the next day sold it to *C*, who obtained a Pennsylvania title certificate. Seven days after the original conditional sale was made in New York, it was filed there. A Pennsylvania court held the conditional sale valid against the Pennsylvania purchasers since under the New York law if the conditional sale is filed within ten days, as it was here, it is valid from the time made as against lienholders and purchasers; therefore it was perfected under the New York law at the time of the Pennsylvania sales although not filed in New York until after the sales. The

¹⁶⁵ *Industrial Packaging Prod. Co. v. Fort Pitt Packaging Int'l, Inc.*, 399 Pa. 643, 161 A.2d 19 (1960).

¹⁶⁶ *In re Dumont-Airplane & Marine Instruments, Inc.*, 203 F. Supp. 511 (S.D.N.Y. 1962). A conditional sale made and duly recorded in another state was held perfected in Pennsylvania when resold there within four months. *Al Maroone Ford, Inc. v. Manheim Auto Auction, Inc.*, 2 UCC REPORTING SERV. 595 (Pa. Super. March 18, 1965).

¹⁶⁷ *Churchill Motors, Inc. v. A. C. Lohman, Inc.*, 16 App. Div. 2d 560, 229 N.Y.S.2d 570 (1962).

court then applied Code section 9-103(3), making the conditional sale perfected in New York continue perfected in Pennsylvania for four months.¹⁶⁸

Where a conditional sale of a car was made in the District of Columbia and the car was removed to Massachusetts where it was repossessed and sold, although the *validity* of the conditional sale, under Code section 9-103(3), is determined by the law of the District of Columbia where the security interest attached, the Code, effective in Massachusetts, governs the resale, and the required notice of such sale not having been given pursuant to Code section 9-504(3), the resale was illegal, and New York will not grant recovery of any alleged deficiency.¹⁶⁹

PART FIVE: DEFAULT

I. SECURED PARTY'S RIGHT TO TAKE POSSESSION AFTER DEFAULT

The right to possession of collateral under prior North Carolina law varied with the kind of security agreement. In the case of chattel mortgages, North Carolina being a title jurisdiction, the mortgagee had the right to possession before and after default.¹⁷⁰ Since in this state a conditional sale had the legal effect of a chattel mortgage,¹⁷¹ the conditional vendor at one time also had the right of possession before as well as after default.¹⁷² This North Carolina view that the conditional vendor was entitled to possession even before default was opposed to the general understanding of the commercial world that the conditional vendee has the right to possession so long as he keeps up his payments and is not otherwise in default¹⁷³ and was also opposed to the almost universal rule in

¹⁶⁸ *Casterline v. General Motors Acceptance Corp.*, 195 Pa. Super. 344, 171 A.2d 813 (1961). Although *A* obtained a New York registration certificate in his own name and assigned it to *B*, this did not affect the case since New York did not require notation on the title certificate of the conditional sale. Moreover, Pennsylvania did not then have what is now Code § 9-103(4). Editor's Note, 1 UCC REPORTING SERV. 382.

¹⁶⁹ *Associates Discount Corp. v. Cary*, 2 UCC REPORTING SERV. 937 (N.Y. Civ. Ct. Aug. 10, 1965).

¹⁷⁰ See note 40 *supra*.

¹⁷¹ See note 19 *supra*.

¹⁷² *State v. Stinnett*, 203 N.C. 829, 167 S.E. 63 (1933); 12 N.C.L. REV. 254 (1934); 11 N.C.L. REV. 321 (1933).

¹⁷³ 40 N.C.L. REV. 81 (1961).

other jurisdictions.¹⁷⁴ The result was the enactment of a statute providing for the right to possession in the buyer before default in the case of chattels sold on installment payments secured by conditional sale, purchase-money chattel mortgage, chattel deed of trust, or similar security on the article sold.¹⁷⁵ The statute leaves untouched the chattel mortgagee's right to possession in chattel mortgages other than those in installment sales. Under the Uniform Trust Receipts Act the entruster (secured creditor) has the right to possession on default.¹⁷⁶

The Code sweeps away the diversity in the prior law as to the right to possession by providing that unless otherwise agreed, a secured party has on default the right to take possession of the collateral.¹⁷⁷ This implies that before default the debtor has that right unless agreed otherwise.¹⁷⁸ The same section of the Code further provides that in taking possession a secured party may proceed without judicial process if this can be done without breach of the peace, or may he proceed by action. This is in accord with the prior North Carolina rule which allowed a conditional vendor to take possession without legal process if done peaceably,¹⁷⁹ but North Carolina has gone farther than the Code now does and has held that if on repossession there is such a show of force as to create a reasonable apprehension in the mind of the person in possession that he must yield to avoid a breach of the peace, and he does so yield, this is forceable trespass.¹⁸⁰

II. SALE OR DISPOSITION OF COLLATERAL ON DEFAULT

The Code provides that on default the secured party has not only the rights and remedies provided by the Code but also those contained in the security agreement, except that certain of the Code provisions may not be waived or varied. The secured party may also reduce his claim to judgment, foreclose or otherwise enforce

¹⁷⁴ 21 N.C.L. REV. 387 (1943); 11 N.C.L. REV. 321 (1933).

¹⁷⁵ N.C. GEN. STAT. § 45-3.1 (Supp. 1965).

¹⁷⁶ N.C. GEN. STAT. § 45-51(a) (1950).

¹⁷⁷ G.S. § 25-9-503.

¹⁷⁸ G.S. § 25-9-503, N.C. comment.

¹⁷⁹ *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127 S.E.2d 225 (1962).

¹⁸⁰ *Binder v. General Motors Acceptance Corp.*, 222 N.C. 512, 23 S.E.2d 894 (1943); *Freeman v. General Motors Acceptance Corp.*, 205 N.C. 257, 171 S.E. 63 (1933). The matter of trespass in retaking is discussed in 30 N.C.L. REV. 149 (1952).

the security interest by any available judicial procedure.¹⁸¹ The provisions relating to rights and remedies on default apply to pledges as well as other security interests.¹⁸² If a secured party reduces his claim to judgment and levies execution on the collateral based on the judgment, the lien relates back to the date of the perfection of the security interest. A judicial sale pursuant to the execution is a foreclosure by judicial procedure, and the secured party may purchase at the sale.¹⁸³

The Code further provides that after default a secured party may sell, lease or otherwise dispose of any or all of the collateral and apply the proceeds to the reasonable expenses of retaking, holding and resale, then to the indebtedness, and then to subordinate security interests if written notice of demand therefor is received and reasonable proof of such interest is furnished on demand. The debtor is entitled to any surplus and is liable for any deficiency. Disposition of the collateral may be by public or private proceedings.¹⁸⁴ Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms; but a basic requirement is made that every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Provision is made for prior notice of the sale or disposition to the debtor and other holders of security interests.¹⁸⁵ The secured party may buy at any public sale, and if the collateral is of a type customarily sold in a recognized market or is of a type subject to widely distributed standard price quotations, he may buy at private sale. The purchaser at the sale or disposition takes the property free of the security interest and subordinate security interests or liens.¹⁸⁶

Inasmuch as the Code authorizes a sale or other disposition by

¹⁸¹ G.S. § 25-9-501(1).

¹⁸² G.S. § 25-9-501, comment 2.

¹⁸³ G.S. § 25-9-501(5). In North Carolina such execution on the mortgaged property by the mortgagee on a judgment for the amount of the secured obligation is not allowed in the case of real estate. *McPeters v. English*, 141 N.C. 491, 54 S.E. 417 (1906).

¹⁸⁴ The provisions for private sale make possible disposal through regular commercial channels which frequently realize more on the collateral for the benefit of all parties. G.S. § 25-9-504, comment 1.

¹⁸⁵ An exception is made where the collateral is of a type customarily sold on a recognized market. This exception does not apply to used cars since they are subject to vacillation in pricing procedures, and the so-called "red book" purporting to fix prices according to year of manufacture is not based on actual market prices. *Alliance Discount Corp. v. Shaw*, 195 Pa. Super. 601, 171 A.2d 548 (1961).

¹⁸⁶ G.S. § 25-9-504.

a secured party after default, there seems to be no further need for the power of sale conferred on conditional vendors, chattel mortgagees or chattel trustees by a prior North Carolina statute.¹⁸⁷

Chapter 45 of the General Statutes of North Carolina sets out extensive provisions concerning mortgages, deeds of trust and conditional sales. Article 2A of chapter 45 governs in detail sales under power of sale contained in such instruments or provided by statute. No provision-by-provision comparison of Part 5 of Article 9 of the Code and article 2A of chapter 45 of the General Statutes is feasible here. So far as the latter deals with personal property the survival of its provisions is governed by the provision¹⁸⁸ that in case of conflict between chapter 45 of the General Statutes and Article 9 of the Code, the latter governs all transactions subject thereto and chapter 45 shall be of no effect, except that any remedy given by chapter 45 to a secured party shall be cumulative with, but shall not restrict, the rights and remedies granted by Article 9 of the Code.

Under prior North Carolina case law a chattel mortgagee was not permitted to bid in at his own foreclosure sale. If he did he was liable for damages.¹⁸⁹ Another decision held him liable for the true value of the property.¹⁹⁰ This law is replaced by the above Code provision covering the subject.¹⁹¹

III. COMPULSORY DISPOSITION OF COLLATERAL; ACCEPTANCE OF COLLATERAL AS DISCHARGE OF OBLIGATION .

If the debtor has paid sixty per cent of the cash price in the case of a purchase-money security interest in consumer goods or sixty per cent of the loan in the case of a nonpurchase-money security interest in such goods and has not signed after default a statement renouncing his rights under Part 5 of the Code, a secured party who has taken possession of the collateral must dispose of it under the sale-or-disposition section.¹⁹² If he fails to do so within ninety days after he takes possession, the debtor at his option may recover

¹⁸⁷ N.C. GEN. STAT. § 45-21.13 (1950).

¹⁸⁸ G.S. § 25-10-105. A note to UCC § 9-102 recommends the repeal of existing statutes dealing with conditional sales and chattel mortgages. This recommendation was not followed in this state.

¹⁸⁹ *Harris v. Hilliard*, 221 N.C. 329, 20 S.E.2d 278 (1942).

¹⁹⁰ *Smith v. French*, 152 N.C. 754, 67 S.E. 249 (1910).

¹⁹¹ G.S. § 25-9-504(3).

¹⁹² G.S. § 25-9-504.

in conversion or under the section¹⁹³ on the secured party's liability.¹⁹⁴

In any other case involving consumer goods or any other collateral the secured party in possession may after default propose to retain the collateral in satisfaction of the obligation by written notice to the debtor and in specified cases to other secured parties. If written objection is made within thirty days from receipt of notification by any party entitled to notice, or if any other secured party objects in writing within thirty days after the secured party obtains possession, the secured party must dispose of the collateral under the sale-or-disposition section, otherwise the secured party may retain the collateral in satisfaction of the debtor's obligation.¹⁹⁵

These provisions recognize the economic fact that the parties are frequently better off without a resale¹⁹⁶ and may not want one.

Under prior North Carolina law, as under these Code provisions, the debtor may elect to require a resale.¹⁹⁷ A provision in a purchase-money mortgage of a piano that in case of default all payments may be retained by the mortgagee for the use of the piano was held void since the mortgagee is entitled to interest but not rent. The court ordered that the buyer pay the amount due, and if not, that the piano be sold, the proceeds to be used to pay balance and costs, the surplus, if any, to be paid the buyer.¹⁹⁸ Although under the Code any such provision in a security agreement would also seem to be void,¹⁹⁹ the secured party might after default nevertheless retain the collateral in satisfaction of the obligation with the concurrence of the debtor under one of the above provisions.

IV. DEBTOR'S RIGHT TO REDEEM

At any time before the secured party has disposed of the collateral or made a contract for its disposal under the sale-or-disposition section²⁰⁰ or before the obligation has been discharged by

¹⁹³ G.S. § 25-9-507(1).

¹⁹⁴ G.S. § 25-9-505(1).

¹⁹⁵ G.S. § 25-9-505(2).

¹⁹⁶ G.S. § 25-9-505, comment 1.

¹⁹⁷ *Hamilton v. Highlands*, 144 N.C. 279, 56 S.E. 929 (1907); *A. D. Puffer & Sons Mfg. Co. v. Lucas*, 112 N.C. 378, 17 S.E. 174 (1893).

¹⁹⁸ *Chas. Hackley Piano Co. v. Kennedy*, 152 N.C. 196, 67 S.E. 488 (1910).

¹⁹⁹ G.S. §§ 25-9-501(1), (3)(a); G.S. § 25-9-501, comment 4.

²⁰⁰ G.S. § 25-9-504.

retention of the collateral,²⁰¹ the debtor or any other secured party may, unless otherwise agreed in writing, after default redeem the collateral by tendering the amount of the secured obligations and expenses.²⁰²

This Code provision contains the same principle as does the prior North Carolina statute on redemption prior to sale,²⁰³ but the details are different. The Code provision would accordingly supplant the statute. Prior cases also embodied the principle that the debtor be allowed to redeem before sale.²⁰⁴

V. SECURED PARTY'S LIABILITY FOR FAILURE TO COMPLY WITH PART FIVE

If it is established that the secured party is not proceeding in accord with the provisions of Part 5, disposition may be ordered or restrained on appropriate terms. If the nonconforming disposition has already occurred, the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition may recover from the secured party any loss caused by a failure to comply with the provisions of Part 5. If the collateral is consumer goods, the debtor may recover as a minimum the credit service charge plus ten per cent of the principal amount of the debt, or the time-price differential plus ten per cent of the cash price.²⁰⁵

One requirement for a sale or disposition is that it must be commercially reasonable. The fact that a better price could have been obtained by sale at a different time or by a different method is not alone enough to establish that the sale was not made in a commercially reasonable manner. If the secured party sells the collateral in the usual manner in any recognized market therefor or if he sells at a price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold, he has sold

²⁰¹ G.S. § 25-9-505(2).

²⁰² G.S. § 25-9-506.

²⁰³ N.C. GEN. STAT. § 45-21.20 (1950), concerning mortgages, deeds of trust and conditional sales.

²⁰⁴ *Chas. Hackley Piano Co. v. Kennedy*, 152 N.C. 196, 67 S.E. 488 (1910); *A.D. Puffer & Sons Mfg. Co. v. Lucas*, 112 N.C. 378, 17 S.E. 174 (1893).

²⁰⁵ G.S. § 25-9-507(1).

in a commercially reasonable manner. These principles apply also to types of disposition other than sales.²⁰⁶

In North Carolina where a car sold on conditional sale was repossessed but the resale was not advertised as required by law the buyer was held to be entitled to have the fair market value determined and to recover any amount by which this exceeded the balance due.²⁰⁷ No minimum recovery as now provided by the Code was indicated.

A number of cases involving repossession and resale under the Code have been decided. In one of them a secured party on default of the debtors retook the collateral, a mobile diner, by a claim and delivery action in which it was contended that the required bond did not comply with the applicable statute. An award to the debtor of actual and punitive damages for the retaking was reversed. The court pointed out that section 9-503 of the Code authorizes the secured party on default to take possession by judicial action. The question is whether the judicial action was so defective as to expose the secured party to the damage claims asserted. If there was some technical flaw in the claim and delivery sufficient to invalidate the process, this did not afford a cause of action for taking the diner. Under section 9-507(1) allowing recovery for "any loss caused by a failure to comply" with the provisions of Part 5 of the Code, "loss" refers to actual, not nominal, damages. There could be no punitive damages since the secured party acted in good faith, and no damages for loss to the business since the secured party was entitled to take possession. Taking possession presupposes termination of the business. However, the secured party must comply with section 9-504(3), which requires that the sale or disposition of the collateral be commercially reasonable. A new trial was granted to determine whether this had been done, and if not, what damages resulted from an improper sale.²⁰⁸

Several cases have involved failure to comply with section 9-504(3) requiring prior notice to the debtor of the sale or disposition of the collateral. In one the defendants purchased an automobile on an installment sale contract and gave a judgment note, which contract and note were assigned to the plaintiff. Plaintiff en-

²⁰⁶ G.S. § 25-9-507(2).

²⁰⁷ *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127 S.E.2d 225 (1962).

²⁰⁸ *Fort Knox Nat'l Bank v. Gustafson*, 385 S.W.2d 196 (Ky. 1964).

tered judgment on the note, retook the automobile, and sold it on private sale for a grossly inadequate price. One of the defendants petitioned to open the judgment, averring as a defense, *inter alia*, that the plaintiff failed to give the defendant any notice of the sale as required by section 9-504(3). It was contended, according to the court, that the defendant was limited in her rights of action to those set forth in section 9-504 (the court meant 9-507),²⁰⁹ but the court said that, while these rights are available to the defendant, she is in no way limited in her means of exercising them, and the court may, when a prima facie meritorious defense is shown, open the judgment.²¹⁰

Where an assignee of a vendor repossessed and resold without the notice to the vendee, the court applied section 9-507 to justify a counterclaim thereunder in an action for the balance due.²¹¹ Such failure to comply with the notice of sale requirement has also been held to preclude recovery for loss sustained by the secured party on a resale. The debtor should have an opportunity to bid at the resale. Also, a secured party who disposes of the collateral without notice denies the debtor the right to redeem provided in section 9-506.²¹²

²⁰⁹ Editor's Note, 1 UCC REPORTING SERV. 644.

²¹⁰ *Alliance Discount Corp. v. Shaw*, 195 Pa. Super. 601, 171 A.2d 548 (1961).

²¹¹ *Atlas Credit Corp. v. Dolbow*, 193 Pa. Super. 649, 165 A.2d 704 (1960).

²¹² *Skeels v. Universal C.I.T. Credit Corp.*, 222 F. Supp. 696 (W.D. Pa. 1963). On appeal the holding on this point was undisturbed, but the award of \$50,000 punitive damages was eliminated. 335 F.2d 846 (3d Cir. 1964).