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Commercial Law - Uniform Commercial Code - Perfection of Security Interests

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COMMERCIAL LAW—UNIFORM COMMERCIAL CODE—PERFECTION OF SECURITY INTERESTS*

Article 9 of New Mexico's Uniform Commercial Code[1] deals with secured transactions.[2] In order for a security interest[3] in personal property or fixtures to be perfected under the article's system of "notice filing"[4] certain formal requisites must be satisfied.

Section 9-203(1)(b) provides that a non-possessory security interest is enforceable only when "the debtor has signed a security agreement[5] which contains a description of the collateral. . . ."[6]

Section 9-402(1) sets forth the formal requirements of a financing statement[7]: "*A financing statement is sufficient if it is signed by*

* Strevell-Paterson Fin. Co. v. May, d/b/a Doc Holliday's Hock Shops, 77 N.M. 331, 422 P.2d 366 (1967).

1. The New Mexico version of the Uniform Commercial Code, N.M. Stat. Ann. §§ 50A-1-101 to -9-507 (Repl. 1962), was originally based on the 1958 Official Text, promulgated jointly by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. In 1967, the New Mexico statute was amended to adopt most of the changes found in the 1962 Official Text.

All references to the New Mexico Code, will be designated U.C.C. and will omit the complete statutory citation. Citation to "Comments" are those accompanying the 1962 Official Text.

2. U.C.C. § 9-101.

3. A "security interest" is the term that describes a creditor's interest. It acts as a lien upon certain property of the debtor which secures payment in the event of a default by the debtor. U.C.C. § 1-201(37).

4. Under the notice filing system of the Code (U.C.C. § 9-402), a simple financing statement will suffice to perfect a creditor's security interest. Under most pre-Code chattel-security and conditional sale statutes, the actual security agreement had to be filed. The requisites for the security agreement and the financing statement are listed in note 5 and note 7, *infra*. For a discussion of the notice filing system *see Coogan, Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 Iowa L. Rev. 289 (1962). *See also* Vernon, *The Uniform Commercial Code: Some New Mexico Problems and Proposed Legislative Solutions,* 3 Natural Resources J. 487 (1964).

5. U.C.C. § 9-105(1)(h): " 'Security agreement' means an agreement which creates or provides for a security interest." U.C.C. § 9-203, Comment 1 states that the reduction in formal requirements is patterned after the Uniform Trust Receipts Act; technical requirements of acknowledgment, and accompanying affidavits, inherent in many chattel mortgage statutes, are done away with. *See also* U.C.C. § 9-402, Comment 3 and N.M. Laws 1925, ch. 25 (repealed 1962).

6. U.C.C. § 9-203(1)(b). These formal requirements are intended to serve as a Statute of Frauds. A creditor will not be allowed to establish his security interest in the collateral by parol evidence. U.C.C § 9-203, Comment 5.

7. This section further provides that a copy of the security agreement itself *may* be filed "as a financing statement *if* it contains the above information and is signed by both parties." § 9-402(5) says that a financing statement which is in "substantial compliance" with the requirements of subsection (1) is effective, "even though it contains minor errors which are not seriously misleading."

A security agreement, as such, may be valid when signed only by the debtor, but it can only be filed as a financing statement when the creditor or secured party (usually the same person) has also signed it. National-Dime Bank v. Cleveland Bros. Equipment Co., 20 Pa. D. & C.2d 511 (1959), 1 U.C.C. Rptg. Serv. 454 (Callaghan).

the debtor AND the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral."[8]

A "signing" within the meaning of these sections is "any symbol executed or adopted by a party with present intention to authenticate a writing."[9]

Obviously, the security agreement has fewer formal requirements than the financing statement. The main questions to be discussed in this Comment are whether this difference is significant and whether it should be respected by strict compliance with the wording of the legislative mandate—the Code.

Strevell-Paterson Finance Company v. May, d/b/a Doc Holliday's Hock Shops,[10] involved a transaction for the sale of a guitar and an amplifier. On July 12, 1963, Chavez, the buyer, executed a chattel mortgage[11] which described the guitar and amplifier as security for the debt he owed the plaintiff-finance company. The chattel mortgage was filed as a financing statement.[12] Neither the signature nor the address of plaintiff, as secured party, appeared on the chattel mortgage. On November 8, 1963, Chavez traded in the guitar and the previously mortgaged amplifier. Plaintiff filed this agreement on June 29, 1964. On June 22, 1964, defendant received both of these items from Chavez on a pawn. When Chavez subsequently defaulted on payments, plaintiff claimed the right to take possession of the collateral. Chavez then informed plaintiff of the pledge to defendant and gave the claim tickets to plaintiff. When plaintiff demanded that defendant return the items, defendant refused, stating that he had already sold them to a third party. Plaintiff brought this suit for conversion. The trial court entered judgment for the plaintiff for $475, the value of the items. On appeal, the defendant argued

8. U.C.C. § 9-402 (1) Comment 2 states that "the notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described." § 9-208 provides a statutory procedure under which the secured party, at the debtor's request, may be required to make disclosure concerning the nature and amount of the security interest.

9. U.C.C. § 1-201(39). *See In Re* Bengston, note 32 *infra* for a good interpretation of the signature requirement.

10. 77 N.M. 331, 422 P.2d 366 (1967).

11. U.C.C. § 9-101, Comment; U.C.C. § 9-102, Comment 2. 77 N.M. at 334, 422 P.2d at 368:

The fact that an agreement offered for filing is denominated a "chattel mortgage" is immaterial. The traditional forms of security agreements in use before the enactment of . . . § 9-203, and § 9-402, . . . may continue to be used after their enactment.

12. *See* note 4 and note 7 *supra.*

that the security interest was improperly perfected and was unenforceable since the plaintiff had failed to comply with the requirements of section 9-402(1).[13] The New Mexico Supreme Court remanded to the district court with direction to vacate the judgment in favor of the plaintiff and enter a new judgment dismissing the plantiff's complaint.[14]

The result reached by the supreme court is unquestionably correct, but the court's analysis and application of the Code is unfortunate in that the court failed to consider all of the relevant sections of the code.[15]

The major error made by the supreme court was their assumption that any "perfected" security interest in the first guitar automatically attached to the new one for which it was traded without qualification. The second financing statement should not have been considered by the court since the filing occurred *after* the pledge to the defendant. Section 9-306(3) is controlling on this issue.[16] It provides for a continuation of perfection in identifiable proceeds from a sale, *exchange,* or other disposition of collateral for *ten days only* unless a security interest is also perfected in the proceeds.[17] Acknowledgement of these sections by the *Strevell* court would have obviated the necessity of even considering the omission of the secured party's signature and address from the financing statement. Assuming, however, as the court did, that the second financing statement was valid, let us consider their reasoning as to the signature and address requirements.

The court analyzed the instrument filed in terms of section 9-402(1).[18] They found, in Professor Gilmore's words, "no sensible reason for the discrepancies between the formal requisites of section 9-203 and section 9-402."[19] Thus, they concluded that "the

13. *See* note 10 *supra* at 333, 422 P.2d at 368.

14. *See* note 10 *supra* at 332, 422 P.2d at 367.

15. For a critical analysis of the court's handling of the case, *see* Annot., Willier and Hart, U.C.C. Rep. Digest § 9-402, A-19 (Supp. 1967); *See also* Editor's Note, 3 U.C.C. Rptg. Serv. 1094 (Callaghan 1967); Comment, *Uniform Commercial Code—Perfection of Security Interests—Notice filing Under Section 9-402,* 39 Colo. L. Rev. 609 (1967) (contra).

16. U.C.C. § 9-306(3).

17. U.C.C. § 9-306(1): "'Proceeds' includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of." *See also* Henson, *"Proceeds" Under the Uniform Commercial Code,* 65 Colum. L. Rev. 232, 238 (1965).

18. U.C.C. § 9-402. At the outset the court noted that since the guitar and amplifier were primarily used by Chavez to perform in night clubs they were "equipment", therefore, perfection by filing was required according to § 9-302(1)(d). This aspect of the decision is quite sound. Section 9-109(2) defines goods as equipment which are used primarily in business, including a profession.

19. 1 G. Gilmore, Security Interests in Personal Property 346, 347 (1965).

lack of the secured party's signature does not make the instrument defective within the meaning of section 9-402(1) . . ."[20]

In addition to citing Professor Gilmore's treatise, the court also referred to section 1-102[21] and *Alloway v. Stuart*,[22] a Kentucky case which involved the same type of signature problem as in *Strevell*.[23] The court in *Alloway* declared their policy not to interpret the then newly enacted Code literally by saying that a temporary "period of indulgence should be granted in connection with cases arising under the Commercial Code" to allow businessmen a chance to become familiar with its provisions.[24] That aspect of the *Alloway* decision has been sharply criticized.[25]

Even prior to the *Alloway* decision, the Attorney General of Kentucky had stated that the signature of the secured party was essential to validity of a financing statement under section 9-402.[26] The Kentucky court did not recognize this opinion or the case authority from other jurisdictions which supports it.[27]

The same pattern appears in the *Strevell* case. The New Mexico Attorney General had previously issued two opinions on the subject of financing statements.[28] Both of these opinions made it quite clear that a valid financing statement must be signed by both parties and contain the other information listed in section 9-402.[29] Most opinions from other states are in accord with this view.[30]

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20. *See* note 10 *supra* at 335, 422 P.2d at 369.

21. U.C.C. § 1-102: (1) This Act shall be liberally construed and applied to promote its underlying purposes and policies. (2) Underlying purposes and policies of this Act are (a) to simplify, clarify and modernize the law governing commercial transactions. . . .

22. 385 S.W.2d 41 (Ky. Ct. App. 1964).

23. *Id.* at 43. In that case, a chattel mortgage which lacked the secured party's signature was filed as a financing statement. The court found the omission not to be a fatal error because it could not have misled anyone. The case has been distinguished as a minority interpretation of a technical and mandatory provision.

24. 385 S.W.2d at 44.

25. Comment, *Uniform Commercial Code: Judicial Indulgence for Noncompliance with Recently Enacted Technical Provisions*, 65 Colum. L. Rev. 922, 924 (1965); Comment, *Uniform Commercial Code Section 9-402—Absence of Creditor's Handwritten Signature Invalidates Financing Statement*, 47 B.U.L. Rev. 292, 297 (1967).

26. Op. Att'y Gen., Ky. No. 623 (1963).

27. *See* note 32 *infra*.

28. Op. Att'y Gen., N.M. No. 62-2,-3 (1962). No. 62-2 adopts the financing statement "form" set out in § 9-402(3), as sufficient to comply with § 9-402(1). Note, the terms "assignee" and "assignor" are reversed in the suggested forms where they appear in parentheses.

29. Signatures and addresses of both the debtor and the secured party and a description of the collateral are required.

30. *See* note 26 *supra* and note 38 *infra*. *See also* as representative of the majority view, Op. Att'y Gen., Mo. No. 402 (1965), No. 49 (1966), 3 U.C.C. Rptg. Serv. 552 (Callaghan 1967) (photocopies valid); Op. Att'y Gen., N.M. No. 62-126 (1962), 1 U.C.C. Rptg. Serv. 748 (Callaghan 1962) (a carbon or photocopy of a signature is

Aside from ignoring these opinions as, at least, some source of authority, the New Mexico Supreme Court's total reliance on Gilmore[31] also precluded recognition of a substantial body of case law which would have occasioned an opposite result on the issue of the omitted secured party's signature.[32] Generally, these cases illustrate that omission of any one of the formal requisites specified in section 9-402(1)[33] would be a serious error, not in "substantial compliance" with the section. Even commentators who advocate a liberal interpretation of section 9-402 agree that its few simple requisites should be complied with.[34]

As further evidence of the fact that the *Strevell* court "read out"

valid); Op. Att'y Gen., Ohio No. 3289 (1962), 1 U.C.C. Rptg. Serv. 774 (Callaghan 1965) (original signature not necessary); Op. Att'y Gen., Okla. No. 65-275 (1965), 2 U.C.C. Rptg. Serv. 1177 (Callaghan 1966) (thermofax copy of a certified copy of a financing statement is valid); Op. Att'y Gen., Okla. No. 63-249 (1963), 1 U.C.C. Rptg. Serv. 790 (Callaghan 1965) (carbon copy valid); Op. Att'y Gen., Va. May 25, 1965, 3 U.C.C. Rptg. Serv. 248 (Callaghan 1967) (financing statement "signed" with any symbol is acceptable); Op. Att'y Gen., Md., March 20, 1964, 2 U.C.C. Rptg. Serv. 104 (Callaghan 1966) (financing statement must meet all the requirements of § 9-402(1)).

31. 1 G. Gilmore, *supra* note 19.

32. *See* Benedict v. Lebowitz, 346 F.2d 120 (2d Cir. 1965) (although formal signature not required to effectuate a financing statement, "any symbol executed or adopted by party with present intention to authenticate a writing" under § 1-201(39) is sufficient); *In Re* Excel Stores, Inc., 341 F.2d 961 (2d Cir. 1965) (financing statements signed "Excel Dept. Stores" instead of "Excel Stores, Inc.," is a minor error, "not seriously misleading"); *In Re* Smith, 205 F. Supp. 27 (E.D. Pa. 1962) (omission of one or more of the statutory requirements of § 9-402(1) is fatal and a filing officer may decline to receive it as being insufficient); *In Re* Horvath, 1 U.C.C. Rptg. Serv. 624 (Callaghan) (D. Conn. 1963) (typed name of scured party is sufficient authentication under § 9-402(1); *In Re* Bengston, 3 U.C.C. Rptg. Serv. 283 (Callaghan) (D. Conn. 1965) (printed signature substantially complies with § 9-402(1)); *In Re* Pennar Paper Co., 2 U.C.C. Rptg. Serv. 659 (Callaghan) (E.D. Pa. 1964) (minimum requirements of § 9-402 are necessary to constitute substantial compliance); *In Re* Murray, 2 U.C.C. Rptg. Serv. 667 (Callaghan) (D. Ore. 1964) (if two secured parties, both must sign financing statement); *In Re* Platt, 257 F. Supp. 478 (E.D. Pa. 1966) (failure of secured party to fulfil any one of the requisites regarding to filing and perfection preclude his asserting a security interest); *In Re* Carlstrom, 3 U.C.C. Rptg. Serv. 766 (Callaghan) (N.D. Me. 1966) (minor errors which are seriously misleading refer to such minor errors as misplacements, misspellings, and abbreviations; case regarded as a narrow interpretation as it required a "handwritten" signature); *In Re* Kane, 58 Lanc. L. Rev. 273 (E.D. Pa. in Bankruptcy, 1962. Unreported) (photostatic signature of debtor and secured party are not "signed" within meaning of § 9-402(1); a narrow holding, but § 1-201(39) literally seems to require a mark or symbol); *Cf.* Op. Att'y Gen., Ky. No. 64-708 (1964) (requires a manual signing upon photocopy); National Cash Register Co. v. Firestone & Co., 346 Mass. 255, 191 N.E.2d 471 (1963) (misspelled name of secured party is not seriously misleading); Sales Fin. Corp. v. McDermott Appliance Co., 340 Mass 493, 165 N.E.2d 119 (1960) (abbreviation "Co." for "company" is not misleading); Plemens v. Didde-Glaser, Inc., 244 Md. 556, 224 A.2d 464 (1966) (corporate officer's signing of financing statement without indication of representative capacity substantially complies with § 9-402).

33. *See* note 29 *supra.*

34. Comment, *Uniform Commercial Code—Liberal Interpretation of Financing Statement Requirements*, 41 Wash. L. Rev. 180, 186 (1966); *See also* note 19 *supra.*

the signature requirement, consider the following quotation by the court with their deleted words inserted in parenthesis:

> A financing statement is sufficient if it (is signed by the debtor and the secured party,) gives the [an] address of the secured party from which information concerning the security interest may be obtained. . . .[35]

The lack of the secured party's address presented the supreme court with a more difficult problem; however, it again relied on Professor Gilmore's treatise as persuasive:

> The addresses are required in the document which is filed for record and for simplicity's sake might as well be included in the underlying 'agreement'. . . .[36]

Consequently, the court determined that the instrument of July 12, 1963, did not meet the requirements of section 9-402(1) and was defective as a financing statement.[37]

In light of the foregoing discussion, which indicated the position of the majority of jurisdictions as to what constitutes "substantial compliance" with section 9-402, a statement made by the opinion writer in *Strevell,* Judge Hensley, provides the most poignant criticism of the court's handling of the case: "The filing system will perform its intended function only if [the] secured party substantially complies with the requirements of section 9-402(1). . . ."[38]

On the one hand, courts must be careful not to allow a trifling discrepancy to vitiate an otherwise valid financing statement; on the other hand, they must be alert not to interpret a substantial error or omission as "not seriously misleading" and, therefore, not detrimental to the statement's validity.[39]

With regard to section 9-402, the error in *Strevell* was of the latter type. Both the Code and case law make a clear distinction as to where the line should be drawn between the trifling discrepancy and the seriously misleading error. Hopefully, our Supreme Court

35. *See* note 10 *supra* at 335, 422 P.2d at 369.

36. *Supra* note 19.

37. Annot., Willier and Hart, U.C.C. Rep. Digest § 9-402, A-19 (1967): "While the court did not expressly refer to the subsection, the result in the case was apparently based upon section 9-402(5)." The court considered whether "in fact" the defendant had due notice from the financing statement which was filed. Testimony, however, indicated that defendant never inquired of Chavez as to his ownership nor did he check the filing records. Record at 16. 77 N.M. 331 (1967).

38. *See* note 10 *supra* at 336, 422 P.2d at 369.

39. *Cf.* Alloway v. Stuart, 385 S.W.2d 41 (Ky. Ct. App. 1964).

will follow this distinction more closely in future cases involving this section of the Code. Their failure to do so in this case is not extraordinarily important since, as previously noted, the correct decision was reached anyway. It is more important then, in that it provided food for analysis and ex post facto criticism which, hopefully, will present some aspects of the case which the court may not have considered.

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