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Kentucky Law Survey: Commercial Law

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Commercial Law

BY RICHARD H. NOWKA*

INTRODUCTION

The Kentucky Uniform Commercial Code continues to be a fruitful source of judicial and legislative activity. In the last two years there have been twenty cases¹ and five legislative acts² having a bearing on the Kentucky Uniform Commercial Code. One legislative act and three cases are particularly noteworthy for the commercial law practitioner. In the Automated Motor Vehicle Registration System Act,³ the General Assembly has provided

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¹ See *Overstreet v. Norden Labs., Inc.*, 669 F.2d 1286 (6th Cir. 1982) (citing Ky. REV. STAT. § 355.2-313) (Bobbs-Merrill 1970) [hereinafter cited as KRS]; *Kimberly & European Diamonds, Inc. v. Burbank*, 518 F. Supp. 599 (W.D. Ky. 1981), *aff'd*, 684 F.2d 363 (6th Cir. 1982) (citing KRS § 355.2-403 (1970)); *In re Wilson*, 17 Bankr. 350 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-204 (1970)); *In re Hopper*, 17 Bankr. 292 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-204 (1970)); *In re Harris*, 17 Bankr. 210 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-204 (1970)); *In re Calloway*, 17 Bankr. 212 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-204 (1970)); *In re Fulkerson*, 17 Bankr. 207 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-204 (1970)); *In re Radcliffe Door Co., Inc.*, 17 Bankr. 153 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-302, -403 (1970 & Supp. 1982)); *Peoples Security Fin. v. Aldrich*, 16 Bankr. 825 (Bankr. W.D. Ky. 1982) (citing KRS § 355.9-204 (1970)); *Associate Fin. v. Conn*, 16 Bankr. 454 (Bankr. W.D. KY. 1982) (citing KRS § 355.9-107 (1970)); *In re Velasco*, 13 Bankr. 872 (Bankr. W.D. Ky. 1981) (citing KRS § 355.1-105 (1970)); *International Harvester Credit Corp. v. McGrew*, 20 Bankr. 264 (Bankr. W.D. KY. 1981) (citing KRS § 355.9-103 (1970)); *Tabers v. Jackson Purchase Prod. Credit Ass'n*, 649 S.W.2d 202 (Ky. Ct. App. 1983) (citing KRS § 355.9-105 (Cum. Supp. 1982)); *American Bank & Trust Co. v. Shouse & Burris*, 648 S.W.2d 540 (Ky. Ct. App. 1983) (citing KRS § 355.8-102, 103, 201 (1970 & Supp. 1982)); *United Ky. Bank v. Eagle Mach. Co., Inc.*, 644 S.W.2d 649 (Ky. Ct. App. 1983) (citing KRS § 355.4-202 (1970)); *Vanover v. Bank of Alexandria*, 644 S.W.2d 948 (Ky. Ct. App. 1983) (citing KRS § 355.9-302(1970)); *Bonded Elevator, Inc. v. First Nat'l Bank*, 29 Ky. L. SUMM. 10 at 5 (Ky. Ct. App. 1982) [hereinafter cited as KLS] (citing KRS § 355.7-204 (1970)); *Corbin Deposit Bank & Trust Co. v. Mullins Enters., Inc.*, 641 S.W.2d 760 (Ky. Ct. App. 1982) (citing KRS § 355.3-109(1) (1970)); *Hertz Commercial Leasing Corp. v. Joseph*, 641 S.W.2d 753 (Ky. Ct. App. 1982) (citing KRS § 355.1-102 & 2-102 (1970)); *ITT Indus. Credit Co. v. Union Bank & Trust*, 615 S.W.2d 2 (Ky. Ct. App. 1981) (citing KRS § 355.9-204 (1970)).

² 1982 Ky. Acts, ch. 329, § 1 at 897 (amending KRS § 355.8-311 (1970)); 1982 Ky. Acts, ch. 199, § 2 at 506-07 (amending KRS § 355.9-312 (1970)); 1982 Ky. Acts, ch. 199, § 1 at 506 (amending KRS § 355.9-301 (1970)); 1982 Ky. Acts, ch. 164 at 350-74 (enacting the Automated Motor Vehicle Registration System Act KRS §§ 186A.010-.990 (Cum. Supp. 1982)); 1982 Ky. Acts, ch. 89, § 1 at 164-65 (amending KRS § 355.9-307 (1970)).

³ KRS § § 186A.010-.990 (Cum. Supp. 1982).

stability for the procedure of perfecting a security interest in a motor vehicle. The case of *ITT Industrial Credit Co. v. Union Bank & Trust Co.*,⁴ limited the ability of an original financing statement to fix the priority of a subsequent advance made by the same secured party when the subsequent advance was neither contemplated by the original parties nor covered in the security agreement by a future advance clause. In *Tabers v. Jackson Purchase Production Credit Association*,⁵ the court of appeals disregarded the priority scheme of Kentucky Revised Statutes (KRS) section 355.9-301(1)(c). Finally, the case of *Hertz Commercial Leasing Corp. v. Joseph*,⁶ enlarged the scope of Article Two of the Uniform Commercial Code to include equipment leases.

I. PERFECTION OF SECURITY INTERESTS IN MOTOR VEHICLES AND THE AUTOMATED MOTOR VEHICLE REGISTRATION SYSTEM

Motor vehicles continue to be a fertile source of collateral for secured transactions. Proper perfection of such security interests is necessary to insure the priority of the secured party in the collateral.⁷ This has not been an easy task in Kentucky. Prior to the passage of the Automated Motor Vehicle Registration System Act (Act),⁸ Kentucky case law⁹ and statutes¹⁰ combined to make the path to perfection of security interests in motor vehicles one strewn with uncertainties.¹¹ The Act should prove to make the process more definite and less hazardous for the unwary.

⁴ 615 S.W.2d 2 (Ky. Ct. App. 1982).

⁵ 649 S.W.2d 202 (Ky. Ct. App. 1983).

⁶ 641 S.W.2d 753 (Ky Ct. App. 1982).

⁷ See KRS §§ 355.9-301-.9-318, 186A.190-.195 (1970 & Cum. Supp. 1982).

⁸ KRS §§ 186A.010-.990 (Cum. Supp. 1982).

⁹ See *General Motors Acceptance Corp. v. Hodge*, 485 S.W.2d 894 (Ky 1972); *Lincoln Bank & Trust Co. v. Queenan*, 344 S.W.2d 383 (Ky. 1961); *McKenzie v. Oliver*, 571 S.W.2d 102 (Ky. Ct. App. 1978).

¹⁰ See KRS § 186.045 (1980).

¹¹ Under KRS § 186.045(1), (2), both the filing of a financing statement and the notation of the security interest on the certificate of registration and ownership were required to perfect a security interest in a motor vehicle. The Kentucky courts never decided whether KRS § 186.045 was the type of statute contemplated by KRS § 355.9-302(3),(4) (1970) where filing was unnecessary, and perfection could only result when the security interest was noted on a certificate of registration. Therefore, it appeared that a secured party could perfect

The Act must be compared with Article Nine of the Kentucky Uniform Commercial Code¹² to determine its effect. KRS section 355.9-302(3) provides that the provisions of Article Nine providing for perfection by filing a financing statement, "do not apply to a security interest in property subject to a statute . . . of this state . . . which requires indication on a certificate of title of such security interests in such property." This would seem to imply that if a Kentucky statute requires indication of a security interest in a motor vehicle on the certificate of title for the vehicle, the perfection by filing provisions of Article Nine do not apply.¹³ How then may a security interest in the motor vehicle be perfected? KRS section 355.9-302(4) allows perfection *only* by indication of the security interest on the vehicle's certificate of title. Thus, two options exist: perfection of a security interest in a motor vehicle by filing a financing statement; or perfection by indication of the security interest on the certificate of title. The correct choice may be determined by examining the provisions of the Act to see if it includes the provisions contemplated by KRS section 355.9-302(3), (4).

The question is whether the Act requires indication of a security interest in a motor vehicle on the certificate of title. KRS section 186A.190 is entitled: "Financing statement required on title document." It provides that "[f]inancing statements relating to vehicles required to be titled . . . *shall be filed* in the office of the county

a security interest and have priority established simply by filing a financing statement. However, the Kentucky courts chose not to accept that argument.

Two Kentucky cases involved a question of priority between a secured party whose security interest was not noted on a certificate of registration and an innocent subsequent purchaser. *See* General Motors Acceptance Corp. v. Hodge, 485 S.W.2d 894, 895 (Ky. 1972) (financing statement filed); McKenzie v. Oliver, 571 S.W.2d 102, 103-05 (no financing statement filing). Both courts pinned their decisions on the fact that the security interest was not noted on the certificate of registration, and held against the secured party, in favor of the innocent purchaser. 485 S.W.2d at 895-97; 571 S.W.2d at 107-08. Since neither court addressed the issue of whether KRS § 186.045(1),(2) (1980) and KRS § 355.9-302(3), (4) (1970) rendered the Article 9 filing provisions inapplicable, or whether filing alone was sufficient to perfect the security interest, secured parties in Kentucky were left in a state of confusion as to the effect of only filing a financing statement.

¹² KRS §§ 355.9-101-9.507 (1970 & Cum. Supp. 1982).

¹³ Courts in other states have held that security interests in motor vehicles may be perfected only by notation of the lien on the certificate of title. *See* Davis v. Kisko, 7 Bankr. 10, 13 (Bankr. W.D. Fla. 1980); McLemore v. Simpson Co. Bank, 6 Bankr. 443, 447 (Bankr. M.D. Tenn. 1980).

clerk of the county in which the debtor resides.”¹⁴ Nothing in that section requires indication of the security interest on the certificate of title. KRS section 186A.190(4) comes closer to such a requirement by providing for “recording the filing of a financing statement upon a certificate of title.” Greater clarity in this matter could have been provided had the subsection “required” the clerk to record the information present on the financing statement on the certificate of title. However, the section’s heading and its language indicate that the security interest must be noted on the certificate of title. This conclusion makes KRS section 186A.190 the type of statute contemplated by KRS section 355.9-302(3).

Further support for this proposition comes from KRS section 186A.195(1), which provides that when “a financing statement and the required fees accompany the application for first title of a vehicle . . . the county clerk shall enter the information required by KRS [section] 186A.190(4) into the automated system” so that the certificate of title bears such information.

If any doubt exists regarding the legislative intent of the method of perfection for a security interest in a motor vehicle, KRS section 186A.190(1) should resolve it: “Notwithstanding the existence of any filed financing statement relating to any vehicle . . . the sole means of determining priority of security interests in such vehicle shall be the notation of the security interest on such vehicle’s registration or title.” Perfection and priority go hand in hand. Legislative intent reveals that even if a financing statement has been filed, there is no priority without notation of the security interest on the title. The Act requires notation (or indication) of the security interest on the certificate of title for priority purposes.¹⁵ Obviously, this is a step in the perfection of a security interest in a motor vehicle which is achieved by filing a financing statement with the county clerk and insuring that the financing statement is recorded on the certificate of title.¹⁶

Why does the legislation confuse the issue by requiring the filing of a financing statement? Perhaps the best way to insure a simple method of placing the required information with the county clerk

¹⁴ KRS § 186A.190(1) (Cum. Supp. 1982) (emphasis added).

¹⁵ See KRS § 186A.190(1).

¹⁶ *Id.*

is to require a financing statement. Further, the financing statement form is a familiar process for the bar. The legislature could have provided that the financing statement be "presented" to the county clerk, but "filing" accomplishes that in a well understood manner. Be advised, however, that simply filing will not result in perfection or priority. Recall that KRS section 355.9-302(3), (4) provides that when a Kentucky statute requires indication of a security interest on a certificate of title, Article Nine filing provisions for perfection are not applicable.

A branch of the problem which existed prior to enactment of the Act is still troublesome. KRS section 186.045 survived the passage of the Act. It provides for the filing of a financing statement and for notation of the security interest on the certificate of registration and ownership.¹⁷ Notation of the security interest on the certificate of registration has been held necessary for priority in the vehicle,¹⁸ and a certificate of registration is still required by the Act.¹⁹ Is notation of the security interest on the certificate of registration a necessary step for perfection? The Act does not require it, but KRS section 186.045 does.²⁰ There is no reason why such a step should be required. Indication on the certificate of title, a permanent document,²¹ is more definite. Furthermore, the cer-

¹⁷ KRS § 186.045(1)-(2)(a) (1980).

¹⁸ See *General Motors Acceptance Corp. v. Hodge*, 485 S.W.2d at 895; *McKenzie v. Oliver*, 571 S.W.2d at 103-05.

¹⁹ See KRS § 186A.065 (Cum. Supp. 1982).

²⁰ KRS § 186.045(2)(a) provides:

Whenever a financing statement required by KRS chapter 355 relating to any vehicle registered or required to be registered in Kentucky for use on the highway is presented to a county clerk for filing, such clerk shall also immediately note information required by the department relative thereto on the owner's copy of the certificate of registration and ownership or transfer receipt issued for the current registration period as noted in subsection (2) of KRS 186.170, which the secured party must obtain and present to the county clerk, along with the financing statement, within fifteen (15) days, exclusive of Sundays and holidays, after execution of the security agreement. The clerk shall also note such information on the clerk's copy of the certificate of registration and ownership or transfer receipt maintained in his office in numerical order. The clerk noting the information on the owner's copy of the certificate of registration and ownership or transfer receipt shall return such receipt to the owner within five (5) days after making such notation....

²¹ KRS § 186A.180 (Cum. Supp. 1982) provides that an owner is not required to periodically renew a certificate of title.

tificate of registration produced when a vehicle is registered has no place for such a notation; only the certificate of title contains a space for indication of a security interest.

Greater certainty in this issue would have resulted had the Act required the clerk to record the information noted on a financing statement on a certificate of title rather than providing for "recording the filing of a financing statement"²² and had the legislation repealed the provisions of KRS section 186.045 which continue to require indication of the security interest on the certificate of registration. It seems clear, however, that the provisions of the Act represent the type of statute contemplated by KRS section 355.9-302(3), (4). Therefore, perfection of a security interest in a motor vehicle in Kentucky is achieved through compliance with KRS sections 186A.190 and 186A.195.

II. A LIMITATION ON THE OPERATION OF FUTURE ADVANCE CLAUSES

*ITT Industrial Credit Co. v. Union Bank & Trust Co.*²³ presented an Article Nine priority contest between two secured parties with security interests in the same collateral. In *ITT*, Hogan, the debtor, "executed a security agreement [without a future advance clause] and a financing statement listing [a] trencher as collateral."²⁴ The security agreement, executed in 1973, called for full payment by September, 1977. This security interest was assigned to ITT, and the security agreement and financing statement were filed to perfect the security interest. In 1975, Hogan created another security interest in favor of Union Bank and Trust Co. (Union Bank). The obligation to Union Bank was secured in part by the "trencher." A few weeks after the obligation to ITT was repaid, Hogan financed an equipment purchase with a loan from ITT. A new security agreement which listed the "trencher" as collateral was executed and filed in October of 1977. Both ITT and Union Bank claimed priority in the trencher.²⁵

The court of appeals framed the issue as follows:

²² KRS § 186A.190(4) (Cum. Supp. 1982).

²³ 615 S.W.2d 2 (Ky. Ct. App. 1981).

²⁴ *Id.* at 2.

²⁵ *Id.* at 2-3.

[W]hat priority must be given to a perfected security interest in a single large item of equipment, as evidenced by a recorded security agreement and a financing statement which make no provisions for future advances, in relation to a subsequent creditor with a perfected interest in the same item, after the obligation of the first security agreement has been paid in full and the original creditor makes a new loan for new and different equipment taking a new security agreement and naming the original item as additional collateral[?]²⁶

Since the court chose to analyze the case as a future advance problem,²⁷ a brief discussion of future advances under the Kentucky Uniform Commercial Code is in order. As the Code provides, “[o]bligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment.”²⁸ This section allows the secured party to include a clause in the security agreement which provides that the collateral secures not only the existing obligation but any future obligations owed the secured party by the debtor. When such a clause is included in a security agreement, the parties need not execute a separate security agreement when the subsequent advance is made because the original security agreement covers the subsequent advance.²⁹ If the security agreement is perfected by filing a financing statement which adequately describes the collateral, no further filing is necessary.³⁰ Accordingly, a future advance clause allows the parties to secure several obligations with one security agreement and one financing statement.

The priority of the subsequent advance is governed by KRS section 355.9-312(5)(a) which gives priority between conflicting security interests in the same collateral in the order of filing regardless of which security interest attached first and whether it attached before or after filing.³¹ For example, suppose Gannon takes a security interest in equipment and perfects it by filing a

²⁶ *Id.* at 3.

²⁷ *Id.* at 3-5.

²⁸ KRS § 355.9-204(5) (1970).

²⁹ U.C.C. § 9-204 Comment 8 (1962).

³⁰ U.C.C. § 9-204 Comment 5 (1972).

³¹ Note that KRS § 355.9-402(1) (1970) validates the practice of filing a financing statement before a security agreement is made or a security interest otherwise attaches.

financing statement on February 1. The security agreement includes a future advance clause. On March 1, Kean takes a security interest in the same equipment and also perfects it by filing a financing statement. Gannon makes a further advance against the same machinery on May 1. The advance is covered by the original financing statement and thus perfected when made. Gannon has priority over Kean under KRS section 9-312(5)(a) as to both advances because he filed first even though Kean's security interest attached and was perfected before the May 1 advance.³²

The court of appeals in *ITT* focused on the fact that the security agreement involved did not include a future advance clause³³ and thus the parties apparently did not contemplate future advances secured by the trencher.³⁴ The court stated:

[I]t is better practice . . . to require the original creditor to provide in his agreement for future advances, if there is an agreement between the debtor and the creditor for such advances. In our opinion, the statute requires this statement, and such a statement provides actual notice of the intention to a would-be subsequent creditor.³⁵

Due to those factors, the court refused to allow the priority of *ITT*'s 1977 security interest to be determined by the 1973 financing statement.³⁶ Thus, *ITT*'s security interest was inferior to Union Bank's security interest.

The court of appeals' reasoning was correct in that the Uniform Commercial Code "support[s] the view that the [security] agreement must specifically provide for future advances."³⁷ However, that statement is valid only in relation to a situation where the

³² See U.C.C. § 9-312 Comment 4 (1962). See also *Allis-Chalmers Credit Corp. v. Cheney Inv., Inc.*, 605 P.2d 525 (Kan. 1980); *Thorp Fin. Corp. v. Ken Hodgins & Sons*, 251 N.W.2d 614 (Mich. Ct. App. 1977).

³³ The court made such statements as "a recorded security agreement and a financing statement which make no provision for future advances"; "where the original security agreement did not provide for future advances"; and "[t]he Official Code Comment appears to support the view that the agreement must specifically provide for future advances." *ITT Indus. Credit Co. v. Union Bank & Trust*, 615 S.W.2d at 3-4.

³⁴ "[I]t is certainly not apparent that *ITT* and Hogan [the debtor] contemplated the future advance at the time the original loan was made." 615 S.W.2d at 4.

³⁵ *Id.* at 5.

³⁶ *Id.*

³⁷ *Id.* at 4.

parties want to make the execution of another security agreement unnecessary. Thus, the issue is not determined by merely quoting the future advance clause rule.

The true issue in *ITT* is one the court did not directly address: can a financing statement, filed to perfect the original security interest, perfect a separate security interest for future advances using the same collateral as the original transaction when no future advance clause is included in the original security agreement. The answer is yes and thus, *ITT* should have had priority in the trencher under the first to file rule of KRS section 355.9-312(5)(a). This issue is the other branch of future advances. KRS Section 355.9-204(5) provides simply that “[o]bligations covered by a security agreement *may* include future advances.”³⁸ Future (or subsequent) advances can be made pursuant to a future advance clause in a security agreement under KRS section 355.9-204(5), but they may also be made pursuant to a separate security agreement. If this is not accurate, the creditor who failed to include a future advance clause in the original security agreement would be prohibited from taking another security interest in the same collateral. Such a result would certainly not facilitate commercial transactions and clearly would be at odds with the purposes and policies of the Uniform Commercial Code.³⁹

Recall the facts of *ITT*. In 1973, *ITT* perfected a security interest in the trencher by filing the security agreement and a financing statement.⁴⁰ In 1975, Union Bank perfected a security interest in the same trencher by filing a financing statement. In 1977, after the original obligation was repaid, *ITT* secured a subsequent advance with the trencher and a new security agreement was executed. *ITT*'s filed financing statement preceded the attachment of its second security interest.⁴¹

The Uniform Commercial Code clearly allows a financing statement to be filed “before a security agreement is made or a security interest otherwise attaches.”⁴² Article Nine and its Official Com-

³⁸ KRS § 355.9-204(3) (emphasis added).

³⁹ See KRS § 355.1-102 (1970).

⁴⁰ 615 S.W.2d at 2. Filing of the security agreement was not necessary. See KRS § 355.9-402(1).

⁴¹ 615 S.W.2d at 2-3. A security interest cannot attach until there is an agreement that it attach, value is given, and the debtor has rights in the collateral. KRS § 355.9-204(1).

⁴² See KRS § 355.9-402(1).

ments also speak of the situation where "the steps for perfection have been taken in advance (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral)."⁴³ *ITT* completed the steps for perfection by filing a financing statement before the second secured transaction occurred. When the new security interest attached it was automatically perfected.⁴⁴ Thus, *ITT* involved a priority contest between secured parties who perfected by filing a financing statement. The first to file receives priority "regardless of which security interest attached first . . . and whether it attached before or after filing."⁴⁵ Applying KRS section 355.9-312(5)(a) to the *ITT* case, *ITT* had priority in the trencher because it was first to file a financing statement covering the trencher. The Official Comment supports this conclusion:

A files against X (debtor) on February 1. B files against X on March 1. B makes a non-purchase money advance against certain collateral on April 1. A makes an advance against the same collateral on May 1. A has priority even though B's advance was made earlier and was perfected when made. It makes no difference whether or not A knew of B's interest when he made his advance.

The problem stated in the example is peculiar to a notice filing system under which filing may be made before the security interest attaches (see Section 9-402). . . . This Article follows several of the accounts receivable statutes in determining priority by order of filing. The justification for the rule lies in the necessity of protecting the filing system—that is, of allowing the secured party who has first filed to make subsequent advances without each time having, as a condition of protection, to check for filings later than his.⁴⁶

While the example pertains to the first advance made by a secured party, nothing would compel a departure from the rule when the advance is not the original advance but an advance subsequent to the original obligation.

⁴³ U.C.C. § 9-303 & Comment 1 (1962). KRS § 355.9-303(1) (1970) states "[i]f such steps are taken before the security interest attaches, it is perfected at the time when it attaches."

⁴⁴ See KRS § 355.9-303(1).

⁴⁵ KRS § 355.9-312(5)(a) (emphasis added). For a general discussion of this section see text accompanying notes 31-32 *supra*.

⁴⁶ U.C.C. § 9-312 Comment 4 (1962).

The court of appeals found support for its holding in *Coin-O-Matic Service Co. v. Rhode Island Hospital Trust Co.*⁴⁷ The facts of *Coin-O-Matic* are similar to *ITT*. An advance subsequent to the original secured transaction was made by Rhode Island Hospital Trust under a new security agreement after the intervening security interest of *Coin-O-Matic* had arisen.⁴⁸ The main difference in the cases was that in *Coin-O-Matic*, part of the original debt was outstanding when the subsequent advance was made.⁴⁹ Rhode Island Hospital Trust rightfully contended, under the equivalent of KRS section 355.9-312(5)(a), that “the original financing statement is an umbrella which gives the defendant a priority with respect to its second security transaction notwithstanding that the plaintiff’s security interest was established in point of time prior to defendant’s second security transaction.”⁵⁰ The court responded:

[T]he reasonable interpretation of 6 A-9-312 [KRS section 355.9-312] is that a security agreement which does not provide for future advances is a single transaction and in the case of subsequent security agreements there is required a new financing statement. That is to say, a single financing statement in connection with a security agreement when no provision is made for future advances is not an umbrella for future advances based upon new security agreements, notwithstanding the fact that involved is the same collateral.⁵¹

Focusing on the intent of the debtor and the original secured party, the court found the parties intended the original transaction to be terminated and the subsequent advance to be a separate and unrelated transaction.⁵² Subordinating the subsequent advance to the intervening security interest, the court held the priority given to the first to file a financing statement by the Rhode Island equivalent of KRS section 355.9-312(5) does not relate to a separate and distinct security transaction.⁵³

The Kentucky Court of Appeals may have been influenced by the *Coin-O-Matic* rationale, though the rationale of *ITT* is unclear.

⁴⁷ 3 U.C.C. Rep. Serv. (Callaghan) 1112 (R.I. 1966).

⁴⁸ *Id.* at 1113-14.

⁴⁹ *Id.* at 1114.

⁵⁰ *Id.* at 1115.

⁵¹ *Id.* at 1120.

⁵² *Id.*

⁵³ *Id.*

The court indicated that ITT and the debtor apparently did not contemplate the future advance at the time the original loan was made⁵⁴ and that ITT was attempting to resurrect a financing statement which had not expired at the time of its new loan.⁵⁵ These factors fit well into the rationale of *Coin-O-Matic*, but the Kentucky Court of Appeals did not articulate such a theory. This makes *ITT* a difficult case to analyze for the secured party in a position similar to ITT.

ITT had supported its position with the case of *Allis-Chalmers Credit Corp. v. Cheney Investment, Inc.*⁵⁶ The facts of *Allis-Chalmers* are similar to *ITT* and *Coin-O-Matic*. The debtor created a security interest in a combine in favor of an Allis-Chalmers equipment dealer who then assigned the security interest to Allis-Chalmers Credit Corporation. The security agreement contained no future advance clause. One month later the debtor created a security interest in favor of Cheney Investment using the same collateral. When the debtor subsequently purchased additional equipment from Allis-Chalmers on credit, the original obligation was cancelled and the balance owing on it included in the balance due on the subsequent obligation. A security interest had been taken by Allis-Chalmers in the original combine. The issue was whether the original financing statement fixed the priority of the subsequent security interest.⁵⁷

The *Allis-Chalmers* court rejected the *Coin-O-Matic* holding and noted that the vast majority of jurisdictions had also rejected *Coin-O-Matic*.⁵⁸ The decision of the Kansas court awarding the subsequent security interest priority over the intervening security interest was based primarily on the remarks regarding *Coin-O-Matic* made by the Uniform Commercial Code Permanent Editorial Board and by the Official Comments to Article Nine.⁵⁹

When revisions to the 1962 Uniform Commercial Code were being considered by the Permanent Editorial Board Review Committee for Article Nine, the committee "considered drafting a pro-

⁵⁴ *ITT Indus. Credit Co. v. Union Bank & Trust Co.*, 615 S.W.2d at 4.

⁵⁵ *Id.*

⁵⁶ 605 P.2d 525 (Kan. 1980).

⁵⁷ *Id.* at 525-26.

⁵⁸ *Id.* at 529-31.

⁵⁹ *See id.* at 530-31.

vision emphasizing its disagreement with the *Coin-O-Matic* line of cases, but concluded that the existing Code [the 1962 Code] is clear enough, and should not be disturbed just to overrule some lower court cases.”⁶⁰ The Official Comments now include the following paragraph:

However, even in the case of filings that do not necessarily involve a series of transactions the financing statement is effective to encompass transactions under a security agreement not in existence and not contemplated at the time the notice was filed, if the description of the collateral in the financing statement is broad enough to encompass them.⁶¹

An addition to the Official Comments also supports ITT’s position:

The filing of a financing statement is effective to perfect security interests as to which the other required elements for perfection exist, whether the security agreement involved is one existing at the date of filing with an after acquired property clause or a future advance clause, or whether the applicable security agreement is executed later. . . . There is no need to refer to after acquired property or future advances in the financing statement.⁶²

However, the best evidence may come from the Official Comments to U.C.C. section 9-312:

Example 5. On February 1 A makes an advance against machinery in the debtor’s possession and files his financing statement. On March 1 B makes an advance against the same machinery and files his financing statement. On April 1 A makes a further advance, under the original security agreement, against the same machinery (which is covered by the original financing statement and thus perfected when made). A has priority over B both as to the February 1 and as to the April 1 advance and it makes no difference whether or not A knows of B’s intervening advance when he makes his second advance.

A wins, as to the April 1 advance, because he first filed even though B’s interest attached, and indeed was perfected, before the April 1 advance. . . .

⁶⁰ PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REVIEW COMMITTEE FOR ARTICLE NINE OF THE U.C.C., FINAL REPORT E-40, at 227 (April 25, 1971).

⁶¹ U.C.C. § 9-402 comment 3 (1972).

⁶² U.C.C. § 9-204 comment 5 (1972), (U.C.C. § 9-204 deals with future advances).

*The same result would be reached even though A's April I advance was not under the original security agreement, but was under a new security agreement under A's same financing statement . . .*⁶³

Thus, the drafters of Article Nine would clearly support the priority of ITT. If the court had been writing on a clean slate, the argument that an unanticipated subsequent advance not made pursuant to a future advance clause requires a new financing statement might be defensible. The language of the comments to the Uniform Commercial Code, however, compels a different conclusion.

In addition to the fact that ITT and the debtor apparently did not contemplate the future advance,⁶⁴ the court of appeals also grounded its decision on the notice Union Bank obtained from ITT's filing of both the financing statement and the security agreement.⁶⁵ The terms of the security agreement called for payment in full by September, 1977, with no provision for future advances.⁶⁶ The following statements made by the court indicate that it was concerned with the notice Union Bank received from the information contained in the documents filed for record by ITT:

There are also many times, however, when the subsequent creditor desires to do business with the debtor and to make what appears to be a good loan. In such instances the subsequent creditor may not want the first creditor to know that the debtor is now bringing his business elsewhere. *In such cases, the subsequent creditor should be able to rely upon the records and the law.*

. . . .

We have already pointed out why we believe a subsequent creditor should not be required to contact the original creditor when there is no written provision or indication that the security agreement covers future advances. . . . The bank knew that ITT had priority in the 1973 trencher for as long as the interest contemplated existed. If the debt was paid as required, it would be satisfied in 1977. The Bank therefore reasoned that after that time, it

⁶³ U.C.C. § 9-312 comment 7 (1972) (emphasis indicates statements added subsequent to the *Coin-O-Matic* decision).

⁶⁴ See notes 54-55 *supra* and accompanying text.

⁶⁵ See 615 S.W.2d at 2-4.

⁶⁶ *Id.* at 2.

would have a good and valid first lien on both the 1973 and 1976 trenchers.⁶⁷

The court's reliance on the notice Union Bank obtained from the filings is misplaced. Security agreements need not be filed⁶⁸ and financing statements are not required to include either the maturity date of the obligation⁶⁹ or the fact that the security agreement covers future advances.⁷⁰ The logic of protecting a creditor based on the type of notice it received from the filings does not extend to the usual situation where only a financing statement is filed. Therefore, such logic should not be employed as the underpinnings of a decision which will influence the course of commercial practice.

One basis arguably exists for the court's decision in *ITT*, though the court failed to consider it. KRS section 355.9-404(2) requires a secured party to file a termination statement indicating the security interest is no longer claimed under the financing statement within fifteen days after a security interest has terminated.⁷¹ Upon presentation of a termination statement the filing officer removes the financing statement from the files.⁷² Based on the existence of such a duty, the argument could be made that even if a termination statement is not filed, the validity of the financing statement ceases once the secured transaction, and thus the security interest, terminates.⁷³ I do not think KRS section 355.9-404(2) forces such a conclusion. Although the section imposes a duty on the secured party to "clear the record,"⁷⁴ the damages for breach of the duty run solely to the debtor.⁷⁵ Furthermore, to reach such a conclu-

⁶⁷ *Id.* at 2-4 (emphasis added).

⁶⁸ KRS § 355.9-402(1).

⁶⁹ *Id.*

⁷⁰ U.C.C. § 9-204 comment 8 (1962). *See also* U.C.C. § 9-204 comment 5 (1972).

⁷¹ KRS § 355.9-404(2) (1970).

⁷² KRS § 355.9-404(3) (1970).

⁷³ *Cf. In re Hagler*, 10 U.C.C. Rep. Serv. (Callaghan) 1285 (Bankr. E.D. Tenn. 1972). In *Hagler*, the bankruptcy referee gave priority to the "intervening creditor" basing his decision in part on TENN. CODE ANN. § 47-9-404 (1981) (U.C.C. § 9-404) and TENN. CODE ANN. chapter 25, § 64-2501 [currently found at TENN. CODE ANN. § 66-25-101 (1983)] which required a mortgagee to satisfy the record when a debt secured by a lien has been fully satisfied. 10 U.C.C. Rep. Serv. at 1287-88.

⁷⁴ KRS § 355.9-404(2).

⁷⁵ *Id.*

sion by implication, when other sections of Article Nine such as KRS sections 355.9-312 and .9-402, specifically allow one financing statement to perfect and determine priority for separate security interests, would not be in accord with sound rules of construction. Failure to file a termination statement may result in damage to the debtor, but that is its only consequence under KRS section 355.9-404(2). It mandates no change in priorities.

In *ITT*, the Kentucky Court of Appeals has aligned itself with a small minority of jurisdictions which have not recognized the full potential of the notice filing system contemplated by the drafters of the Uniform Commercial Code. The drafters intended for one financing statement to perfect and establish priority for several security interests, whether they arose pursuant to a future advance clause or separate security agreements, so long as the collateral was the same. The Kentucky Court of Appeals found that unless a security agreement includes a future advance clause the priority of a subsequent security interest in the same collateral cannot be governed by the original financing statement. Such a holding does not facilitate commercial transactions since the secured party who wishes to make a subsequent advance, but did not include a future advance clause in the original security agreement, must now file another financing statement. This creates a situation where the unwary secured party may lose priority of a security interest when the intention of the Uniform Commercial Code is to give that security interest priority.

III. THE PURCHASER AND THE UNPERFECTED SECURED PARTY

The priority between a purchaser of goods at a sheriff's execution sale and a secured party with a security interest in the goods which remained unsatisfied after the execution sale was presented in *Tabers v. Jackson Purchase Production Credit Association*.⁷⁶ Kenneth and Pamela Green created a security interest in a 1979 Jeep in favor of Jackson Purchase Production Credit Association (PCA). The Greens gave Phil Archer a subordinate security interest in the Jeep. When the Greens defaulted in payment to the PCA, it brought suit to obtain a money judgment against the Greens.⁷⁷ Phil Archer sought to intervene in the action alleging

⁷⁶ 649 S.W.2d 202 (Ky. Ct. App. 1983).

⁷⁷ *Id.* Such a suit for money damages is permissible under KRS § 355.9-501 (1970).

the existence of a security interest, but he asked for a money judgment, not enforcement of the security interest.⁷⁸ Both PCA and Archer were awarded money judgments.⁷⁹ The Jeep was sold at a sheriff's execution sale but Archer realized no proceeds from the sale.⁸⁰ Archer then began proceedings under KRS section 426.290 to have the Jeep resold to satisfy his security interest.⁸¹ Gerald Tabers, purchaser at the execution sale, contended that the security interest was subordinate to his interest as purchaser of the Jeep.⁸²

Archer admitted that his security interest was unperfected because his financing statement had lapsed.⁸³ Therefore, Archer and Tabers considered the issue to be whether an unperfected non-purchase money security interest takes priority over a subsequent purchaser.⁸⁴ Both parties argued KRS section 355.9-301(1)(c) controlled the issue. This section provides:

[A]n unperfected security interest is subordinate to the rights of . . . a person who is not a secured party and who is a transferee in bulk or other buyer not in the ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected.⁸⁵

Tabers was not a secured party and was a buyer not in the ordinary course of business.⁸⁶ The fact that Taber was a purchaser at a judicial sale does not prevent the operation of KRS section 355.9-301.⁸⁷

The only condition of KRS section 355.9-301(1)(c) in controversy was whether Tabers had knowledge of the security in-

⁷⁸ Brief for Appellant Gerald Tabers at 2, *Tabers v. Jackson Purchase Prod. Credit Ass'n*, 649 S.W.2d 202 (Ky. Ct. App. 1983). See 649 S.W.2d at 203.

⁷⁹ 649 S.W.2d at 202.

⁸⁰ *Id.* Both PCA and Archer levied an execution on the Jeep, but Archer's execution was returned "no property found," despite the sheriff's possession of the Jeep at the time pursuant to PCA's execution. *Id.*

⁸¹ *Id.* KRS § 426.290 (1970) allows encumbered property of the defendant to be sold subject to the encumbrance. In order to satisfy the encumbrance, a creditor holding an encumbrance not satisfied in the execution sale may subject the property to a second sale. *Id.*

⁸² 649 S.W.2d at 203.

⁸³ Brief for Appellee Phil Archer at 6, *Tabers v. Jackson Purchase Prod. Credit Ass'n*, 649 S.W.2d 202 (Ky. Ct. App. 1983).

⁸⁴ *Id.* at 5.

⁸⁵ KRS § 355.9-301(1)(c).

⁸⁶ See 649 S.W.2d at 203.

⁸⁷ See D. LEIBSON & R. NOWAKA, *THE UNIFORM COMMERCIAL CODE OF KENTUCKY* § 8.4(B)(2), at 753 (1983).

terest. Archer contended Tabers had such knowledge because a security interest was shown on the Jeep's license receipt on file with the county clerk and Archer's financing statement (although it had lapsed) was on file with the county clerk.⁸⁸ Tabers argued that the judgment for Archer made no mention of a security interest and that the "Notice of Sheriff's Sale" made reference only to pending litigation, not to the security interest of Archer.⁸⁹

The court of appeals seemed to rely in part on KRS section 355.9-301(1)(c) to reach its decision, although the section was not cited in the opinion. The court affirmed the judgement of the trial court, holding Archer's security interest valid against Tabers: "Although the 'lapsed' financing statement may not in itself have been enough to place Tabers on notice of Archer's lien, certainly Archer's appearance in the judicial proceeding from which the sale arose, together with his *nulla bona* execution should have placed him, as a reasonable man, on notice."⁹⁰

The key words in the above passage are "on notice." Since the court was concerned with whether Tabers had notice of Archer's security interest, it was probably addressing the arguments of the parties pertaining to notice and hence the conditions for the purchaser's priority under KRS section 355.9-301(1)(c).

The type of notice, actual or constructive, found by the court is critical to the application of KRS section 355.9-301(1)(c), which requires the purchaser to be without "knowledge" of the security interest. The "definitional cross references" to section 9-301 of the Official Text of the Uniform Commercial Code⁹¹ direct the reader to section 1-201 for the definition of "knowledge." KRS section 355.1-201(25) provides that "[a] person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it."⁹² Archer did not contend⁹³ and neither the trial court nor the court of appeals found Tabers had "knowledge" of the security interest.⁹⁴

⁸⁸ Brief for Appellee, *supra* note 82, at 6.

⁸⁹ Brief for Appellant, *supra* note 77, at 2-3, 6.

⁹⁰ 649 S.W.2d at 203.

⁹¹ The Kentucky Uniform Commercial Code, contained in KRS chapter 355, provides no "definitional cross references" to supplement the statutory provisions. However, KRS § 355.9-105(4) (1960) applies the definitions contained in Article One to Article Nine.

⁹² KRS § 355.1-201(25) (1970).

⁹³ Brief for Appellee, *supra* note 82, at 6.

⁹⁴ 649 S.W.2d at 202-04. The court may have believed that Tabers had constructive

Thus, assuming all other conditions of KRS section 355.9-301(1)(c) were met, if Tabers did not have actual knowledge of the security interest, he had priority over Archer and the court of appeals should have awarded Tabers the Jeep.⁹⁵

The court of appeals cited as support KRS section 426.290(1),⁹⁶ which provides that when the defendant owns property subject to a "bona fide encumbrance" created prior to the execution lien, the property may be sold subject to the encumbrance. The purchaser, however, acquires only a lien on the property, subject to the prior encumbrance.⁹⁷

Did Tabers only acquire a lien on the Jeep subordinate to the security interest of Archer? If Archer had a "bona fide encumbrance," KRS section 426.290 mandates such a result.

The "bona fide encumbrance" language, coupled with the effect of KRS section 355.9-301(1)(c), should result in an interpretation of section 426.290(1) which equates "bona fide" with "perfected." Thus, if the security interest is not perfected, it is not bona fide. However, no Kentucky cases interpret "bona fide encumbrance." An argument can be made that "bona fide" means simply that a good faith encumbrance exists and perfection is irrelevant. However, such an interpretation is contrary to KRS section 355.9-301(1)(c). In order to construe KRS sections 426.290 and 355.9-301(1)(c) so as to give meaning to both sections, "bona fide encumbrance" should be interpreted to mean a security interest which is perfected.⁹⁸ Accordingly, Tabers should have been given a priority in the Jeep over the security interest of Archer under either KRS section 426.290 or KRS section 355.9-301(1)(c). The only issue in such cases is whether the purchaser meets the requirements of KRS section 355.9-301(1)(c).

IV. ARTICLE TWO AS APPLIED TO EQUIPMENT LEASES

In *Hertz Commercial Leasing Corp. v. Joseph*,⁹⁹ the Kentucky Court of Appeals enlarged the scope of Article Two of the Ken-

notice of Archer's security interest. See *id.* at 203. However, constructive notice, as noted in the text, is insufficient to give Archer priority over Tabers.

⁹⁵ See KRS § 355.9-301(1)(c).

⁹⁶ 649 S.W.2d at 202.

⁹⁷ See KRS § 426.290(1), (2).

⁹⁸ D. LEIBSON & R. NOWKA, *supra*, note 86, § 8.4(B)(2), at 754.

⁹⁹ 641 S.W.2d 753 (Ky. Ct. App. 1982).

tucky Uniform Commercial Code by applying it to equipment leases, and possibly to *any* lease of goods.¹⁰⁰ To achieve this result, the court relied on KRS section 355.2-102 which provides that “[u]nless the context otherwise requires, this article applies to transactions in goods.”¹⁰¹

Hertz and Joseph entered into a lease of a muffler pipe bending machine for a period of sixty-six months.¹⁰² Joseph signed the lease on the first page. The lease contained additional terms and conditions below the signature and on the back side of the first page.¹⁰³ When Joseph unilaterally terminated the lease, Hertz sought to recover the machine and the remaining rentals pursuant to the terms and conditions appearing below Joseph’s signature.¹⁰⁴

Joseph contended he was not bound by any provisions of the lease appearing after his signature. He relied on KRS section 446.060(1) which provides that a writing “shall not be deemed to be signed unless the signature is subscribed at the end or close of the writing.”¹⁰⁵ Hertz argued that the lease was governed by Article Two of the Uniform Commercial Code¹⁰⁶ which contains its own provisions for testing the validity and enforcement of signed writings.¹⁰⁷ The trial court dismissed Hertz’s petition. The fact that Joseph’s signature appeared at the bottom of the first page, while the penalty and termination provisions appeared after the signature and on back of the first page, was deemed to make these clauses unsigned and unenforceable.¹⁰⁸

In 1979, the Kentucky Court of Appeals agreed with an argument similar to the one advanced by Joseph in *R.C. Durr Co., Inc. v. Bennett Industries, Inc.*¹⁰⁹ There the court, basing its holding on KRS section 446.060(1), invalidated provisions appearing after

¹⁰⁰ *Id.* at 757.

¹⁰¹ *Id.*

¹⁰² Brief for Appellee Marcus Joseph at 1, *Hertz Commercial Leasing Corp. v. Joseph*, 641 S.W.2d 753 (Ky. Ct. App. 1982).

¹⁰³ 641 S.W.2d at 755.

¹⁰⁴ Brief for Appellee, *supra* note 102, at 2.

¹⁰⁵ *Id.* at 5-6 (citing KRS § 446.060(1) (1975)). See 641 S.W.2d at 756.

¹⁰⁶ Brief for Appellant Hertz Commercial Leasing Corp. at 9, *Hertz Commercial Leasing Corp. v. Joseph*, 641 S.W.2d 753 (Ky. Ct. App. 1982). See 641 S.W.2d at 754.

¹⁰⁷ See, e.g., KRS § 355.1-201(39) (1970) (defines “signed”); KRS § 355.2-201(1) (1960) (statute of frauds provision for Article Two).

¹⁰⁸ 641 S.W.2d at 754-55.

¹⁰⁹ 590 S.W.2d 333 (Ky. Ct. App. 1979).

the signature in a contract for the sale of steel girders.¹¹⁰ In *Durr* the court also rejected an argument that KRS section 446.060(1) was negated by the Uniform Commercial Code. The court stated that the definition of "signed" in the Uniform Commercial Code concerns what constitutes a valid signature, not where the signature must be placed.¹¹¹

Although the trial court in *Hertz* cited no statutes or case law as authority for its decision, the court of appeals assumed the lower court was guided by the *Durr* opinion.¹¹² The court noted that in *Durr* the language in the contract which incorporated by reference other "terms and conditions" on the back of the agreement appeared below the signatures.¹¹³ In *Hertz*, Joseph's signature appeared after the language incorporating by reference the "Terms and Conditions set forth below."¹¹⁴ That fact distinguished *Hertz* from the rationale of *Durr*.¹¹⁵ Accordingly, the court found¹¹⁶ the litigation to come within the scope of *Childers & Venters, Inc. v. Sowards*,¹¹⁷ a case where the Court refused to construe KRS section 446.060(1) to abolish incorporation of terms and conditions by reference when the language appeared before the signature.¹¹⁸

The court of appeals could have ended the opinion at that point, simply holding that the signature appeared after the language incorporating the terms and conditions by reference and thus, such terms became part of the contract under the *Childers* rationale. The case would then have been remanded to the trial court to determine *Hertz's* rights under the lease. The court chose, however, to address what they considered "the most important issue of this case" namely, whether "the lease agreement . . . should be governed by the Uniform Commercial Code."¹¹⁹

The applicability of the Uniform Commercial Code was thrust into issue by *Hertz*, which had stated that: "[t]he single issue...

¹¹⁰ *Id.* at 339-40.

¹¹¹ *Id.* at 340.

¹¹² 641 S.W.2d at 756.

¹¹³ *Id.*

¹¹⁴ *Id.* at 755.

¹¹⁵ *Id.* at 756.

¹¹⁶ *Id.*

¹¹⁷ 460 S.W.2d 343 (Ky. 1970).

¹¹⁸ *Id.* at 344-45.

¹¹⁹ 641 S.W.2d at 756.

is whether the terms of the [l]ease which follow[ed] the signatures of the parties can be enforced against the lessee."¹²⁰ Hertz contended since the Uniform Commercial Code sections regarding the statute of frauds and the definition of "signed" provide a means of testing the validity and enforcement of contracts similar to the one in issue, the court needed to decide whether the lease falls under the Code, and if so, whether appellee's signature on the lease satisfies the requirement for enforceability under the Code.¹²¹ Joseph countered Hertz's contention that the lease was a transaction in goods governed by the Uniform Commercial Code by arguing that such a contention runs counter to the rationale of *Durr*.¹²² However, the leasing of goods has become a widely employed substitute for purchase. In light of this fact, the court felt "some uniformity must be extended to the rights and remedies of the parties entering into these types of agreements."¹²³ More than any other factor, this undoubtedly prompted the court to address the issue.

The court quoted extensively from what it termed the "appropriate philosophy"¹²⁴ regarding the issue found in *Hertz Commercial Leasing Corp. v. Transportation Clearing House*.¹²⁵ In that case the lessee of equipment defended an action for recovery of rentals on the ground that the lessor breached the implied warranty of merchantability. The lessor contended that the lease disclaimed all warranties.¹²⁶ At issue was whether the lease was governed by the Uniform Commercial Code so that any disclaimer of warranties had to comply with the provisions of the Uniform Commercial Code.¹²⁷ The court noted the trend to substitute a lease for a sale and stated: "[I]t would be anomalous if this large body of commercial transactions [leases] were subject to different rules of law than other commercial transactions [sales] which tend to the identical economic result."¹²⁸ The court found the basis for

¹²⁰ Brief for Appellant, *supra* note 106, at 4.

¹²¹ *Id.* at 9-10.

¹²² Brief for Appellee, *supra* note 102, at 7-8. *But see* text accompanying notes 112-116 *supra*.

¹²³ 641 S.W.2d at 756.

¹²⁴ *Id.* at 756-57.

¹²⁵ 298 N.Y.S.2d 392 (Civ. Ct. 1969), *rev'd on other grounds*, 316 N.Y.S.2d 585 (App. Div. 1970).

¹²⁶ *Id.* at 394, 398.

¹²⁷ *Id.* at 394.

¹²⁸ *Id.* at 395.

expanding the operation of the Uniform Commercial Code to cover leases in section 1-102(2) and its Official Comment. The purpose of the Code is “[t]o simplify, clarify and modernize the law governing commercial transactions; to permit the continued expansion of commercial practices through custom, usage and agreement of the parties.”¹²⁹ This Act “is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices.”¹³⁰ Finally, the court noted:

The very wording of § 2-102 of the Code, defining the scope of the Article, [Article Two] states: “[u]nless the context otherwise requires, this Article applies to transactions in goods. . .” Clearly, a “transaction” encompasses a far wider area of activity than a “sale” and it cannot be assumed that the word was carelessly chosen.¹³¹

Thus, the New York court found a legal basis for applying Article Two to leases. It found the rationale to be economic in nature, due to the wide substitution of leases for sales. The court concluded: “Article 2 of the Uniform Commercial Code, to the extent that its provisions can be considered applicable, governs the equipment lease before the court.”¹³²

After quoting extensively from the New York court and noting several other jurisdictions which have reached the same result, the Kentucky Court of Appeals reviewed the purpose of the Uniform Commercial Code as set forth in KRS section 355.1-102 and found that the “legislature has sought to simplify, clarify, and modernize the law of commercial transactions as well as permit the continued expansion of commercial practices and make uniform the law applicable thereto among the various jurisdictions.”¹³³ In order to bring “uniformity to the law governing lease agreements,” the court held that the Uniform Commercial Code is applicable to such transactions.¹³⁴

Economic reason and the Uniform Commercial Code were both

¹²⁹ U.C.C. § 1-102(2) (1962).

¹³⁰ U.C.C. § 1-102(2) comment 1 (1962).

¹³¹ 298 N.Y.S.2d at 396 (citing U.C.C. § 2-102 (1962)).

¹³² *Id.* at 397.

¹³³ *Hertz Commercial Leasing Corp. v. Joseph*, 641 S.W.2d at 757.

¹³⁴ *Id.*

considerations for the court's decision. Leases are a widely used substitute in commerce for purchases when the objective of the transaction is to use, not consume, the goods. Certainly, the drafters of the Code could not be expected to foresee every future commercial device employed. They clearly expected the Code to stretch: "[The Code] is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices."¹³⁵ Article Two's "transactions in goods"¹³⁶ language also indicates that more than "sales" of goods are within the scope of Article Two.¹³⁷ Thus, the court of appeals was on sound footing with its holding. Moreover, since leasing plays an important part in commercial transactions, the court of appeals was correct in its contention that uniformity must be brought to the rights and remedies of the parties to such transactions. The Uniform Commercial Code is a tested body of commercial law which can be extended to govern these rights.

Yet, several questions remain unanswered by the court's opinion. The lease in *Hertz* was an equipment lease. Will this be extended to all commercial transactions involving a lease, or will it be restricted to equipment leases? The court spoke in terms of "business transactions,"¹³⁸ "lease agreement,"¹³⁹ "equipment rental commerce,"¹⁴⁰ and finally, in its holding, "lease agreement."¹⁴¹ Thus, while the facts of the case present an equipment lease, the language of the holding appears to apply to all lease agreements. Of course, the lease must still be one involving goods or Article Two will not apply.¹⁴²

Notwithstanding the facts of *Hertz*, it seems the court intended for its opinion to apply to all leases of goods. The language of the holding points to such a conclusion, and the court intimated that, in part, it considered the issue because of the "thousands

¹³⁵ See U.C.C. § 1-102(2) & comment 1 (1962). See also *Hertz Commercial Leasing Corp. v. Transportation Clearing House*, 298 N.Y.S.2d 392 for a court so construing the Code.

¹³⁶ KRS § 355.2-102.

¹³⁷ See 641 S.W.2d at 757.

¹³⁸ *Id.* at 756.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 757.

¹⁴² See KRS § 355.2-102.

of individual automobiles being leased throughout the commonwealth."¹⁴³ The court believed that "some uniformity must be extended to the rights and remedies of the parties entering into these types of agreements."¹⁴⁴ Thus, the court was apparently concerned with leases of goods generally, and the holding may be applied to any such transactions, not just leases of equipment.

Therefore, the consumer who rents an appliance or an automobile from a leasing company can cite this case as support for an argument that Article Two should govern the lease agreement. However, if the facts show a consumer lease, *Hertz* can only apply by analogy since its facts involved an equipment lease.¹⁴⁵ There seems to be no good reason why Article Two should not apply to all leases of goods. Except for a few sections, Article Two is not limited to transactions in goods between merchants, but also applies to consumer transactions.¹⁴⁶ In fact, the consumer may most need the protection of Article Two since he is generally not as sophisticated in reading and understanding contracts as is the businessman.

The application of Article Two to leases may pose interpretation problems with specific sections of the Article. By their own terms, some sections of Article Two apply to a "contract for sale,"¹⁴⁷ other sections apply to a "contract,"¹⁴⁸ while still others apply to "sellers"¹⁴⁹ and "buyers."¹⁵⁰ Will all or none of these sections be applicable to the lease agreement? Can a section which speaks in terms of "contract for sale" or "buyer" and "seller" apply to the parties of a lease? Since the court remanded the case it is impossible at this time to determine what sections the trial court will apply to decide the case.¹⁵¹ The court of appeals held

¹⁴³ 641 S.W.2d at 756.

¹⁴⁴ *Id.*

¹⁴⁵ An automobile or appliance leased by a consumer might be considered, "equipment," but the classification of an item as a consumer good or equipment will usually depend on the lessee's use. See KRS § 355.9-109(3) (1970). This section also applies to Article Two. KRS § 355.2-103(3) (1960).

¹⁴⁶ See, e.g., KRS § 355.2-207 (1970).

¹⁴⁷ E.g., KRS § 355.2-208(1) (1970).

¹⁴⁸ E.g., KRS § 355.2-302 (1970).

¹⁴⁹ E.g., KRS § 355.2-313 (1970).

¹⁵⁰ E.g., KRS § 355.2-318 (1970).

¹⁵¹ The definition of "signed" in KRS § 355.1-201(39) is not restricted to contracts and thus would appear to be applicable to leases. However, the statute of frauds provi-

“the Uniform Commercial Code [to be] applicable to such transactions.”¹⁵² But, despite this apparent application of the Uniform Commercial Code across the board, the court did not hold the lease was actually a disguised sale. Thus, this area will need further development by the courts.

Three main groups of cases have held Article Two applicable to leases. Inclusion in a particular group depends upon the rationale employed by the court to apply Article Two to a lease agreement. Some courts have concluded Article Two is applicable because a lease is a “transaction in goods.”¹⁵³ *Hertz* is such a case. Other courts have found Article Two applicable because the terms of the lease are sufficiently analogous to a “sale of goods” to be in reality a disguised sale.¹⁵⁴ The third group of courts has determined that certain provisions of Article Two are applicable by analogy to leases when the lease involves the same factors on which Article Two is premised.¹⁵⁵

Many of the cases which have considered this issue are warranty cases and have applied the warranty provisions of Article Two to a lease, even though the warranty sections (KRS sections 355.2-313 to -315) speak of warranties made by a “seller.” Only the cases in the last group avoid this problem, since they apply Article Two by analogy and thus the labels used by the drafters to identify the parties affected are not relevant. The Kentucky courts must wrestle with the argument that although a lease may be considered a transaction in goods so that Article Two generally applies, certain sections, by their own terms, remain inapplicable. If the

sions, KRS § 355.2-201(1), speaks specifically of “contracts;” therefore its application would be uncertain. Without further guidance, the application of provisions like the statute of frauds will remain questionable.

¹⁵² 641 S.W.2d at 757.

¹⁵³ See, e.g., *In re Vaillancourt*, 7 U.C.C. Rep. Serv. (Callahan) 748 (D. Me. 1970); *Owens v. Patteon Scaffolding Co.*, 354 N.Y.S.2d 778 (Sup. Ct. 1974), *rev'd on other grounds*, 376 N.Y.S.2d 948 (App. Div. 1975); *Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House*, 298 N.Y.S.2d at 392, *rev'd on other grounds*, 316 N.Y.S.2d 585 (App. Div. 1970).

¹⁵⁴ See, e.g., *United States Leasing Corp. v. Franklin Plaza Apartments*, 319 N.Y.S.2d 531 (Civ. Ct. 1971); *Asco Mining Co. v. Gross Contracting Co.*, 3 U.C.C. Rep. Serv. (Callaghan) 293 (Pa. Commw. Ct. 1965).

¹⁵⁵ See, e.g., *KLPR TV, Inc., v. Visual Elecs. Corp.*, 465 F.2d 1382 (8th Cir. 1972); *Sawyer v. Pioneer Leasing Corp.*, 428 S.W.2d 46 (Ark. 1968); *W.E. Johnson Equip. Co. v. United Airlines*, 238 So.2d 98 (Fla. 1970).

Code is “liberally construed and applied to promote its underlying purposes and policies”¹⁵⁶ and is “to be developed by the courts in the light of unforeseen and new circumstances and practices,”¹⁵⁷ then this internal conflict should be resolved in favor of application of such provisions.

¹⁵⁶ KRS § 355.1-201(1) (1970).

¹⁵⁷ U.C.C. § 1-201 comment 1 (1962).

