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Article 9 and Fixtures: A Real Fix with No Perfect Solution

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ARTICLE 9 AND FIXTURES: A REAL FIX WITH NO PERFECT SOLUTION*

I. INTRODUCTION

"The law is said to be a seamless web, but the problem of fixtures can only be called a tangled web."[1] Nowhere is the fixture web more tangled than where a real property claimant and a secured creditor both claim rights in the same fixture. Several situations in which such a conflict may arise come quickly to mind. First, a subsequent purchaser or mortgagee may believe that the fixtures are included in his conveyance because they are "part" of the realty.[2] The second situation is where the fixtures are attached after a mortgagee has acquired an interest in the realty. Upon default by the mortgagor, the mortgagee may attempt to reach the fixtures in order to reduce any loss.[3] Yet another situation arises when a bankruptcy trustee assumes the status of hypothetical lien creditor or bona fide purchaser of the realty.[4] In order to understand these controversies, it is necessary to appreciate the difficulty the parties face in ascertaining when goods are or become "fixtures."

A. What is a Fixture?

The courts and scholars have struggled in vain for a satisfactory definition of exactly when an object "affixed" to realty becomes a "fixture."[5] A gray area lies between the realms of chattel and realty: "Fix-

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1. Kripke, *Fixtures Under the Uniform Commercial Code*, 64 COLUM. L. REV. 44, 51 (1964) [hereinafter cited as Kripke].

2. *But see infra* text accompanying note 206.

3. In a rising real estate market, the lender probably has an equity cushion sufficient to prevent loss in the event of foreclosure. The increase in property value makes risk of loss remote. In a falling real estate market, however, the equity cushion is constantly decreasing. If the value of the property diminishes to a point below the amount of the encumbrance, the property value will not cover both the mortgage and the fixture secured creditor. Shanker, *An Integrated Financing System for Purchase Money Collateral: A Proposed Solution to the Fixture Problem Under Section 9-313 of the Uniform Commercial Code*, 73 YALE L. J. 788, 792 (1964); *see also*, *A Look at the Work of the Article 9 Review Committee: A Panel Discussion*, 26 BUS. LAW. 307, 316 (1970).

4. *See infra* notes 117-34 & 159-74 and accompanying text.

5. *See, e.g.*, Horowitz, *The Law of Fixtures in California—A Critical Analysis*, 26 S. CAL. L. REV. 21 (1952) [hereinafter cited as Horowitz]. Note, *The Definition of Fixture in*

tures are objects so affixed to the realty that it seems odd to call them personal property because they are not portable; yet, they also are so ephemeral as compared to land that it is equally disquieting to call them realty."[6] For example, a table is a chattel; land and the improvement thereon is realty. A central air conditioning system falls in the gray area between "pure" chattel and "pure" real property.[7] It probably would be classified as a fixture under any one of a variety of theories: because it is "attached" to the realty,[8] or because it was the "intent" of the annexor of the air conditioner to make it a permanent part of the realty,[9] or because it is "integrated" into the realty,[10] or because it is part of the "institutional doctrine"[11] or an "assembled industrial plant."[12]

Article 9 of the U.C.C., 31 CASE W. RES. L. REV. 841 (1980); Note, *Uniform Commercial Code Section 9-313: Time for Adoption in California*, 27 HASTINGS L.J. 235 (1975); Note, *Toward a Satisfactory Fixture Definition for the Uniform Commercial Code*, 55 CORNELL L. REV. 477 (1970). *See also infra* note 21 and accompanying text.

6. Note, *The Definition of Fixture in Article 9 of the U.C.C.*, 31 CASE W. RES. L. REV. 841, 849 (1980). The drafters describe the gray area as "an intermediate class which has become real estate for certain purposes, but as to which chattel financing may be preserved." U.C.C. § 9-313 comment 3 (1972).

7. Ayer, *The New Article 9 and the California Commercial Code*, 21 U.C.L.A. L. REV. 937, 951 (1974).

8. *See, e.g., In re* Belmont Indus., 1 Bankr. 608, 610 (E.D. Tenn. 1979); *In re* Arlett, 22 Bankr. 732, 734-35 (E.D. Cal. 1982).

9. *See, e.g.*, Courtright Cattle Co. v. Dolsen Co., 94 Wash. 2d 645, 656-57, 619 P.2d 344, 349 (1980); McCarthy v. Bank, 423 A.2d 1280, 1283, 283 Pa. Super. 328, 332 (1980); Babson Credit Plan, Inc. v. Cordele Production Credit Ass'n, 24 U.C.C. Rep. Serv. 437, 440-41 (1978); George v. Commercial Credit Corp., 440 F.2d 551, 553 (7th Cir. 1971); Strain v. Green, 25 Wash. 2d 692, 699, 172 P.2d 216, 220 (1946); Teaff v. Hewitt, 1 Ohio St. 511, 530, 59 Am. Dec. 634, 644-45 (1853).

10. *See, e.g.*, Dauch v. Ginsburg, 214 Cal. 545-46, 6 P.2d 952, 954 (1931) (hotel building would not be hotel building without heating and plumbing fixtures).

11. *See, e.g., In re* Cooperstein, 7 Bankr. 618, 621-22 (S.D.N.Y. 1980) (applying New Jersey law); Lumpkin v. Holland Furnace Co., 118 N.J. Eq. 313, 316, 178 A. 788, 789 (Ct. Err. & App. 1935). Professor Gilmore has suggested that the "institutional doctrine" of fixtures came about because

> the New Jersey courts were less interested in priorities than they were in the plight of tenants in large apartment houses at a time when the collapse of real estate values had cast an unlovely light on some of the financing methods of the 1920's. Rather than see a substantial part of the population condemned to camping out on the New Jersey marshes without heat, light, or refrigeration, the courts ordered that the essential equipment be left in the apartment houses. This humanitarian gesture incidentally gave priority to the real estate mortgagee over the purchase money interest in the equipment.

Gilmore, *The Purchase Money Priority*, 76 HARV. L. REV. 1333, 1361 (1963) [hereinafter cited as Gilmore]. Professor Gilmore explained that the institutional doctrine disappeared from the New Jersey reports after 1940. *Id.* Apparently the New York bankruptcy court construing New Jersey law in *Cooperstein* was unaware of this fact.

12. *See, e.g.*, General Elec. Credit Corp. v. Pennsylvania Bank and Trust Co., 56 Pa. D. & C.2d 479, 11 U.C.C. Rep. Serv. 858 (1972); Voorhis v. Freeman, 2 W. & S. 116, 119 (Pa.

Scholarly literature abounds with suggested formulations for a "tidy" definition for fixtures.[13] Most scholars have taken a Procrustean[14] approach and have tried to force all fixtures into one definitional class. A fixture is not a fixture for all reasons.[15] One of the most recent suggestions for a fixture definition within the context of the Uniform Commericial Code is for "commercial law to abandon the unworkable and unnecessary concept of fixture. Commercial law should, instead, focus on establishing priorities between chattel secured creditors and real estate mortgagees."[16] Although this is a step in the right direction, it ignores the priority problems which arise with lien creditors and bankruptcy trustees.[17] Neither the secured creditor, the real estate mortgagee, the lien creditor, nor the trustee really cares how the object in question is defined, except to the extent that the definition is deemed to determine or affect the result. The tension which exists between the two competing interests relates to priority in the collateral, not to whether the thing itself is a chattel, or realty, or some hybrid. The secured creditor needs to know, however, how to take advantage of any priority system. He must be able to predict the outcome so that known

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1841) ("Whether fast or loose, . . . all the machinery of a manufactory which is necessary to constitute it, and without which it would not be a manufactory at all, must pass for a part of the freehold."). This doctrine has since been extended to private houses, office buildings, and restaurants among others. Gilmore, *supra* note 11, at 1362.

It is beyond the scope of this paper to discuss in depth the differences among these several definitions. It is enough to note that the area is confused.

13. Kripke, *supra* note 1, at 63; *see also* note 5 and accompanying text. The definitional problem is not without its lighter side. In *In re* Carlyle, the creditor took possession of the debtor's cactus plant, a rock saw, and a cash register. The debtor claimed these items as part of his personal property exemption. In a whimsical mood, the court stated: "The parties having settled the controversy concerning the rock saw and the cactus plant (now deceased), now bring the matter of the cash register before this Court for determination." 22 Bankr. 743, 743 (C.D. Ill. 1982). The cash register was not a fixture because it was not attached to or related to the real property. *Id.* at 744.

14. Proscrustes, of Greek mythology, was a robber of Attica who seized travelers and tied them to an iron bedstead. If they were shorter than the bed, he stretched their limbs to make them fit it; if they were longer, he lopped off their legs. T. BULFINCH, BULFINCH'S MYTHOLOGY 151 (1970).

15. The discussion in this Comment will not consider fixtures in the context of eminent domain, *see, e.g.*, Los Angeles v. Klinker, 219 Cal. 198, 209, 25 P.2d 826, 831 (1933) (because printing presses are part of the realty, the condemnee is entitled to just compensation); in the context of tax cases, *see, e.g.*, Security Data, Inc. v. County of Contra Costa, 145 Cal. App. 3d 108, 117, 193 Cal. Rptr. 121, 126 (1983) (fixtures are real property for purposes of local taxation); in the context of consumer protection, *see, e.g.*, Williams v. Western Pacific Financial Corp., 643 F.2d 331, 337 (5th Cir. 1981) (Regulation Z issues); or in other areas apart from commercial law.

16. Note, *The Definition of Fixture in Article 9 of the U.C.C.*, 31 CASE. W. RES. L. REV. 841, 861 (1980).

17. *See infra* notes 117-34 and accompanying text.

risks can be factored into the credit structure.[18]

B. The Inadequacies of the 1962 Uniform Commercial Code Version of Section 9-313 and the 1972 Improvements

In 1962, the drafters of the Uniform Commercial Code (UCC) set out, in section 9-313, Priority of Security Interests in Fixtures,[19] to present a practical, logical system to determine priorities in fixtures.[20] The

18. *See infra* notes 198-211 and accompanying text.

19. U.C.C. § 9-313 (1962) provided:

(1) The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like and no security interest in them exists under this Article unless the structure remains personal property under applicable law. The law of this state other than this Act determines whether and when other goods become fixtures. This Act does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.

(2) A security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4).

(3) A security interest which attaches to goods after they become fixtures is valid against all persons subsequently acquiring interests in the real estate except as stated in subsection (4) but is invalid against any person with an interest in the real estate at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as fixtures.

(4) The security interests described in subsections (2) and (3) do not take priority over

(a) a subsequent purchaser for value of any interest in the real estate; or

(b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or

(c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section.

(5) When under subsections (2) or (3) and (4) a secured party has priority over the claims of all persons who have interests in the real estate, he may, on default, subject to the provisions of Part 5, remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

Arguably, goods enumerated in section 9-313(1) are more properly classified as "accessions." *See* U.C.C. § 9-314(1) (1962). This section has not been amended. U.C.C. § 9-314(1) (1972). The author concurs with Professor Gilmore: "[T]he problem of accessions is one of limited interest which could hardly be expected to excite the passions of even the most fanatical devotee of Article 9. It will not be further discussed in this paper." Gilmore, *supra* note 11, at 1371 n.91.

20. *A Second Look at the Amendments to Article 9 of the Uniform Commercial Code: A Panel*, 29 BUS. LAW. 973, 982 (1973) [hereinafter cited as Panel].

drafters did not understand the complexity of the task they had undertaken and even they admitted failure.[21] California flatly rejected this version of section 9-313.[22] Then, in 1972, the drafters presented the states with an overhauled version of section 9-313.[23] After considerable

21. "The draftsmen of the Code assumed that . . . Section 7 of the Uniform Conditional Sales Act (USCA) had worked satisfactorily . . .; the problem was simply to redraft and clarify the solutions of the USCA and to integrate them into the Code. How wrong we were!" Kripke, *supra* note 1, at 46. *See also* UNIFORM COMMERCIAL CODE § 9-313, 3 U.L.A. 580 (1981); Coogan, *Fixtures—Uniformity in Words or in Fact*? 113 U. PA. L. REV. 1186 (1964); Gilmore, *supra* note 11; Coogan, Security Interests in Fixtures Under the Uniform Commercial Code, 75 HARV. L. REV. 1319 (1961).

The USCA was the first attempt to organize the myriad differing rules in the various states concerning the sales of goods. Its success was limited, being adopted in only 12 states. Kripke, *supra* note 1, at 47.

22. *Final Report of the Uniform Commercial Code Committee on Section 9-313 of the Uniform Commercial Code*, 1979-1980 CAL. ASSEMBLY DAILY J. 19,429, 19,431 [hereinafter cited as Final Report]. It was no more popular in some other states. *See* Nathan, *Priorities in Fixture Collateral in Ohio: A Proposal for Reform*, 34 OHIO ST. L.J. 719, 720 (1973) [hereinafter cited as Nathan]. Ohio reversed the priority provisions of the 1962 Code. Idaho reversed the Code's priority scheme where one party had an interest in the real property at the time the goods became fixtures. Iowa specifically rendered Article 9 inapplicable where one of the claimants held an interest in real property. *Id.*

23. The revised version of § 9-313 "is an attempt to meet that problem in hopes that the states like California and Ohio, which did not adopt Section 9-313 at all or modified it out of recognition might come back into the fold and yet leave other states with a program that we can live with." *A Look at the Work of the Article 9 Review Committee: A Panel Discussion*, 26 BUS. LAW. 307, 316 (1970). The 1972 version of § 9-313 provides:

(1) In this section and in the provisions of Part 4 of this Article referring to fixture filing, unless the context otherwise requires
  (a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law
  (b) a "fixture filing" is the filing in the office where a mortgage on the real estate would be filed or recorded of a financing statement covering goods which are or are to become fixtures and conforming to the requirements of subsection (5) of Section 9—402
  (c) a mortagage is a "construction mortgage" to the extent that it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates.

(2) A security interest under this Article may be created in goods which are fixtures or may continue in goods which become fixtures, but no security interest exists under this Article in ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of an encumbrance upon fixtures pursuant to real estate law.

(4) A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where
  (a) the security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, the security interest is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate; or
  (b) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the security interest has priority

hesitancy, California took the 1972 Uniform version, reworked it, and adopted a nonuniform version of section 9-313 in 1980.[24]

This Comment will (1) show why and how California modified UCC section 9-313, (2) explain why the modified California version should be adopted by the UCC, (3) point out the unresolved tangles still remaining in fixture law, and (4) show how they might be unraveled.

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over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the debtor has an interest of record in the real estate or is in possession of the real estate; or

(c) the fixtures are readily removable factory or office machines or readily removable replacements of domestic appliances which are consumer goods, and before the goods become fixtures the security interest is perfected by any method permitted by this Article; or

(d) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this Article.

(5) A security interest in fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate where

(a) the encumbrancer or owner has consented in writing to the security interest or has disclaimed an interest in the goods as fixtures; or

(b) the debtor has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates, the priority of the security interest continues for a reasonable time.

(6) Notwithstanding paragraph (a) of subsection (4) but otherwise subject to subsections (4) and (5), a security interest in fixtures is subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent that it is given to refinance a construction mortgage, a mortgage has this priority to the same extent as the construction mortgage.

(7) In cases not within the preceeding subsections, a security interest in fixtures is subordinate to the conflicting interest of an encumbrancer or owner of the related real estate who is not the debtor.

(8) When the secured party has priority over all owners and encumbrancers of the real estate, he may, on default, subject to the provisions of Part 5, remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

The 1972 version of section 9-401 makes it clear that fixture filings are to be kept where the mortgages on the real estate would be filed or recorded. U.C.C. § 9-401 (1972). *See also infra* note 64.

24. 1980 Cal. Stat. ch. 1156.

II. THE DEVELOPMENT OF THE CALIFORNIA VERSION OF UNIFORM COMMERCIAL CODE SECTION 9-313

A. California Rejected the 1962 Version of Commercial Code Section 9-313

1. Deficiencies in the 1962 version

The 1962 Code required that an initial determination be made that the goods were fixtures under state law before the priority provisions were triggered.[25] The definitional problem caused immediate uncertainty and made it difficult for the secured creditor to determine how to achieve priority under section 9-313.[26] California was one of the states without a precise definition of fixtures.[27] Further, section 9-313 assumed a tripartite division of property: chattel, realty, and fixtures.[28] In some states, however, there were only two classifications of property: chattel and realty.[29] In those states, when an object became a fixture it lost its chattel status and became realty.[30] Section 9-313 was unworkable from the outset in those states, including California, without a tripartite division of property because a fixture does not exist as an independent entity apart from the realty.

In addition, construction lenders were disfavored under section 9-313 of the UCC.[31] A lender who perfected his interest in goods before they became fixtures obtained a superior claim to the goods over the lender who had provided the underlying funds for construction of the entire unit.[32]

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25. U.C.C. § 9-313(1) (1962). *See supra* note 19.

26. *See infra* notes 198-211 and accompanying text.

27. *See infra* note 53 and accompanying text.

28. Nathan, *supra* note 22, at 732.

29. *Id. See also* SIXTH PROGRESS REPORT TO THE LEGISLATURE BY SENATE FACT FINDING COMMITTEE ON JUDICIARY, PART I, THE UNIFORM COMMERCIAL CODE 577-78 (1959-1961) [hereinafter cited as Marsh and Warren Report].

30. *See, e.g., In re* Arlett, 22 Bankr. 732, 734-35 (E.D. Cal. 1982), and *infra* notes 150-58 and accompanying text.

31. U.C.C. § 9-313(2) (1962). *See supra* note 19. *See also infra* note 63 and accompanying text.

32. *Id.* A construction lender expects a completed building as security for his loan. Gilmore, *supra* note 11, at 1368-69. Dauch v. Ginsburg, 214 Cal. 540, 545-46, 6 P.2d 952, 954 (1931) (conditional seller of heating and plumbing equipment knew the entire building was security for the construction loan; his rights in the equipment had to yield to those of the prior encumbrancer).

Construction loans generally are short-term financing arrangements. When the project is completed, a long-term "take out" loan usually replaces the construction loan. H. DAVEY, FINANCING REAL ESTATE IN CALIFORNIA 86 (1976). The "take out" may come from the same lender, but usually comes from a different source. *Id.* The 1972 Code provides that a refinancing of the original construction mortgage has priority over the fixture financer to the

Finally, the 1962 version did not insure that fixture filings would be made with the real estate records.[33] A subsequent purchaser or mortgagee would not find the perfected security interest when he searched the real estate records. Nevertheless, the perfected fixture security interest prevailed.[34]

2. Why California rejected the 1962 version of section 9-313

California did not reject the 1962 version of section 9-313 because it was satisfied with its existing fixture law.[35] The courts took a case-by-case approach which led to a lack of predictability in fixture law. For example, the term "fixtures" was used not only to make factual determinations, but also to describe the nature of legal relations between parties within the factual situations.[36] The so-called California "wall bed" cases illustrate the interrelationship between the factual and legal determination of whether goods are fixtures.[37]

In *Fisher v. Pennington*,[38] a tenant was injured when the wall-bed door fell on the bed. The landlord had a duty to provide his tenant with "personalty" which was fit for its intended use.[39] Thus, in order to place liability on the landlord, the court had to label the wall bed "personalty" rather than "fixture."[40] In *Southern California Hardwood and*

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same extent as the construction mortgage. U.C.C. § 9-313(6) (1972); *see supra* note 23. Thus, if the fixture lender acquires a security interest after construction is completed, but prior to the refinancing, the refinancing lender is still protected to the extent that the second loan refinances the first.

33. U.C.C. § 9-401(1) (1962) provided that the fixture filing be made in the office where the real estate records were kept. Recording officers read the 1962 version as meaning that they were to maintain a separate recording system for fixture filings. Headrick, *The New Article Nine of the Uniform Commercial Code: An Introduction and Critique*, 34 MONT. L. REV. 28, 46 (1973). Some filing officers "filed" the financing statements in desk drawers and in shoe boxes. G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 818 (1965). Thus, "[r]eal estate people had a legitimate kick [because] in many states there was no effort to make sure that these fixture filings came to the attention of the real estate searcher." Panel, *supra* note 20, at 986.

34. U.C.C. § 9-313 (1962). *See supra* note 19. Title companies also objected to the 1962 version. For example, the California Land Title Association believed that the 1962 version would create secret liens on real property because a search of the realty records would not disclose fixture liens recorded in a separate system. Note, *Uniform Commercial Code Section 9-313: Time for Adoption in California*, 27 HASTINGS L.J. 235, 259, (1975) (citing Letter from Robert D. Crawford (Chairman, California Land Title Association) to Sean E. McCarthy (Assistant Legislative Counsel, California Land Title Association), March 18, 1974).

35. Final Report, *supra* note 22, at 19,435.

36. Horowitz, *supra* note 5, at 55.

37. *See id.*

38. 116 Cal. App. 248, 2 P.2d 518 (1931).

39. *Id.* at 250-51, 2 P.2d at 520.

40. *Id.* at 250, 2 P.2d at 519.

Manufacturing Co. v. Borton,[41] a conflict arose between the conditional seller of wall beds and the real property owner's assignee for the benefit of creditors. The Court of Appeal held that the assignee had no greater rights in the property than did his assignor because the assignee was not a purchaser for value.[42] The California Supreme Court refused to hear the case, but added its opinion to that of the Court of Appeal: "These beds were not fixtures."[43] Thus, in these two cases, the legal conclusions mandated that the wall beds be personalty and not realty.[44]

In two other cases, identical wall beds were classified as fixtures. In *Pacific Mortgage Guaranty Co. v. Rosoff*,[45] after the real property was encumbered with a construction mortgage, the conditional seller sold wall beds to the owner of the realty. The priority dispute arose between the mortgagee and the vendor.[46] In *Broadway Improvement & Investment Co. v. Tumansky*,[47] the circumstances were reversed. The mortgagor installed the fixtures and then gave a mortgage on the property.[48] In both cases the court sought to protect the party with an interest in the real property, the mortgagee. The court could reach this result only if the beds were part of the realty, i.e., fixtures. Therefore, the desired legal conclusion required that the court classify the beds as fixtures.

"Fixture," therefore, is not just a description; "fixture" is a result which reflects a policy decision.[49] In other words, application of the label "fixture" merely means that the chattel has become part of the real estate so that the real property claimant may prevail in a priority dispute.[50]

Existing law had been soundly criticized by the State Bar Committee on the Uniform Commerical Code[51] and by Professors Marsh and Warren in their report to the Legislature.[52] The reasons for California's rejection were embedded within the 1962 version of section 9-313. As explained by Professors Marsh and Warren:

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41. 46 Cal. App. 524, 189 P. 1022 (1920).
42. *Id.* at 529-30, 189 P. at 1024-25.
43. *Id.* at 531, 189 P. at 1025.
44. Horowitz, *supra* note 5, at 55.
45. 20 Cal. App. 2d 383, 67 P.2d 110 (1937).
46. *Id.* at 384, 67 P.2d at 110.
47. 2 Cal. 2d 465, 41 P.2d 553 (1935).
48. *Id.* at 467, 41 P.2d at 553-54.
49. *See* Horowitz, *supra* note 5, at 55.
50. Kripke, *supra* note 1, at 45 (footnote omitted).
51. *Uniform Commercial Code—Special Report by the California State Bar Committee on the Commercial Code*, 37 CAL. ST. B.J. 119, 201 (1962).
52. Final Report, *supra* note 22, at 19,435.

> The scheme of this Section of the Code is that the law of the State outside of the Code determines whether an object is a "fixture" and this Section of the Code then supplies the legal conclusion flowing from this classification. Any such bifurcation of the existing law of fixtures is impossible, since what the Code treats as two separate processes of judgment are all one under existing law. In other words, what the Code asks the judge to do is to decide in the abstract under "existing law" whether an object is a "fixture", and the Code will then tell him whether, for example, a subsequent mortgagee of the land will prevail over the owner of an interest in the object apart from the land. But under the only existing law that there is, an answer to the first question answers the second also; and the answer might very well be different if the legal problem presented were different.
>
> It would probably be a great advance in the law if the law of fixtures could be codified and separated into two distinct problems: A factual classification of an object as a "fixture", which is recognized as something different both from "realty" and "personalty", and, secondly, a statement of the legal results in various circumstances which follow from such a classification. It is impossible, however, to do only half of this job without making a greater mess than there was before. We agree with the criticism that this Section would only "add to the confusion" of the California law of fixtures (which is not unique in that regard.)[53]

3. California's first "solution" to the fixture "mess"

California adopted the 1962 Uniform Commercial Code in 1963,[54] but did not adopt section 9-313.[55] Instead, the Legislature drafted around the absence of a fixture provision by adding subsection (1)(c) to subdivision 9102 of the California Uniform Commercial Code which provided that real estate law would control when a dispute arose between a fixture secured creditor and a third party with an interest in the real property.[56] Thus, the Legislature decided that Article 9 should not

53. *Id.* at 19,437.

54. 1963 Cal. Stat. ch. 819.

55. *See supra* note 22.

56. Section 9102(1)(c) provided that division 9 applied:

> To any transaction (regardless of its form) which is intended to create a security interest in goods which are or later become "fixtures" under the law of this state, but as against third parties having or acquiring an interest in or a lien on the real

apply in such circumstances. Nevertheless, confusion continued to reign in the California law of fixtures.[57]

B. California Postponed a Decision on the 1972 Version

1. The 1972 version ameliorated some of the problems

Ten years later, the drafters of the Uniform Commercial Code presented a revised version of section 9-313.[58] They deleted the requirement that the goods must be preclassified as fixtures according to state law before the Code would determine priorities.[59] The 1972 version provides that "goods are fixtures when they become so related to particular real estate that an interest in them arises under real estate law."[60] The California Committee on section 9-313 of the UCC interpreted the revised version as permitting consideration of the impact of the Code in determining whether goods are fixtures.[61] No preliminary, independent classification of fixture/non-fixture must be made. All that is necessary is that a conflict of interest arise between the secured party and a real property interest in order to trigger the priority scheme of section 9-313. In other words, "[t]he mere existence of the interest in the goods incident to the real estate interest mean[s] that an interest [arises] under 'real estate law.' "[62] Thus, theoretically at least, the 1972 version is an improvement in the sense that no precise definition or preclassification of fixtures is needed to enable the creditor to benefit from the priority system of section 9-313. Yet, as the following discussion will show, the secured creditor still cannot benefit from the Code's priority system if he misclassifies the goods. The 1972 version of section 9-313 also protects construction lenders[63] and provides for the fil-

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property, the rights and duties of the parties to the secured transaction are governed by the law of this state relating to real property and fixtures.

CAL. COM. CODE § 9102(1)(c) (West 1964).

Note that in California, "Article 9" becomes "Division 9," and Article 9 "subsections" become "subdivisions." For simplicity, this Comment will use the words "Article" and "subsection" throughout. California has also deleted the dash in the numbering system. Thus, U.C.C. § 9-102 becomes § 9102 in California. The dash will be omitted when referring to the California statute.

57. *See, e.g.*, Goldie v. Bauchet Properties, 15 Cal. 3d 307, 540 P.2d 1, 124 Cal. Rptr. 161 (1975); *see infra* notes 72-94 and accompanying text for a discussion of *Goldie*.

58. *See supra* note 23 and accompanying text.

59. U.C.C. § 9-313(1)(a) (1972). *See supra* note 23.

60. *Id.*

61. Final Report, *supra* note 22, at 19,436.

62. *Id.* at 19,456.

63. U.C.C. § 9-313(6) (1972), *supra* note 23.

Even without this revision, some courts had begun to adopt odd methods in order to protect the construction lender. *See, e.g.*, Sears, Roebuck & Co. v. Detroit Federal Savings

ing of financing statements with the real estate records thus curing two of the 1962 flaws.[64]

2. The 1972 version does not correct the problem of perfection where the exact character of the collateral is not certain

Although the California Commission for section 9-313 interpreted the 1972 version as not requiring a separate fixture preclassification according to state law in order to trigger the priority scheme,[65] in reality the secured creditor often must do exactly that. In states using the 1972 version of section 9-313, this problem arises because the secured creditor must determine (i.e., guess) whether the collateral is or will become

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& Loan Ass'n, 79 Mich. App. 378, 23 U.C.C. Rep. Serv. 494 (1977). In a classic example of fuzzy reasoning, the Michigan Court of Appeals determined that "the goods secured were inventory within the meaning of § 9-109." 79 Mich. App. at 383-84, 23 U.C.C. Rep. Serv. at 498.

Inventory refers to goods which are held for sale in the ordinary course of business. *Id.* at 383, 23 U.C.C. Rep. Serv. at 497. The court failed to distinguish the sale of a completed condominium from the sale of appliances and carpeting in the ordinary course of business. Surely, the ordinary course of business for this builder was the sale of condominiums and not the sale of carpeting. The court further stated: "The code implies that materials and goods consumed or used in business are inventory." *Id.*, 23 U.C.C. Rep. Serv. at 497-98. *See also* U.C.C. § 9-109 comment 4 (1972).

It is difficult to see how appliances and carpets are "used up" in this context. Nevertheless, Sears' failure to comply with section 9-312(3) "doom[ed] plaintiff's claim to any priority under the code." *Id.* at 386, 23 U.C.C. Rep. Serv. at 499.

If the builder wishes to obtain better financing for the fixtures needed for his project, he can get consent from his construction lender. U.C.C. § 9-313(5)(a) (1972), *supra* note 23. Thus, notwithstanding the protection given to the construction lender in section 9-313(6), he can waive that protection under subsection (6). This has the effect of subordinating the construction loan to the loan of the fixture financer. If it were to be uniformly held that fixture lenders were junior to construction lenders, one might expect that no fixture lender would agree to lend for new construction in the absence of a subordination agreement from construction lenders.

64. U.C.C. § 9-402(5) (1972). Subsection (5) provides in pertinent part:

> A financing statement . . . filed as a fixture filing (Section 9-313) . . . must show that it covers this type of collateral, must recite that it is to be filed [for record] in the real estate records, and the financing statement must contain a description of the real estate. . . . If the debtor does not have an interest of record in the real estate, the financing statement must show the name of a record owner.

U.C.C. § 9-403(7) (1972) insures that the filing officer will know where to file the financing statement. Subsection (7) provides in pertinent part:

> When a financing statement . . . is filed as a fixture filing, [it shall be filed for record and] the filing officer shall index it under the names of the debtor and any owner of record shown on the financing statement in the same fashion as if they were the mortgagors in a mortgage of the real estate described, and, to the extent that the law of this state provides for indexing of mortgages under the name of the mortgagee, under the name of the secured party as if he were the mortgagee thereunder, or where indexing is by description in the same fashion as if the financing statement were a mortgage of the real estate described.

65. *See supra* notes 61-62 and accompanying text.

fixtures before he can determine where to perfect his security interest. If the goods are personal property, the creditor perfects his interest by filing his financing statement with the Secretary of State.[66] If the goods

66. U.C.C. § 9-401 (1972). In § 9-401, the UCC drafters provided the states with three alternatives:

First Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:
   (a) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or when the financing statement is filed as a fixture filing (Section 9—313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;
   (b) in all other cases, in the office of the [Secretary of State].

Second Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:
   (a) when the collateral is equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . . . in the county where the goods are kept, and in addition when the collateral is crops growing or to be grown in the office of the . . . . . in the county where the land is located;
   (b) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or when the financing statement is filed as a fixture filing (Section 9—313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;
   (c) in all other cases, in the office of the [Secretary of State].

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   (a) when the collateral is equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . . . in the county where the goods are kept, and in addition when the collateral is crops growing or to be grown in the office of the . . . . . in the county where the land is located;
   (b) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or when the financing statement is filed as a fixture filing (Section 9—313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;
   (c) in all other cases, in the office of the [Secretary of State] and in addition, if the debtor has a place of business in only one county of this state, also in the office of . . . . . of such county, or, if the debtor has no place of business in this state, but resides in the state, also in the office of . . . . . of the county in which he resides.

Note: *One of the three alternatives should be selected as subsection (1).*

A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this Article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective

are fixtures, the creditor perfects his interest locally by filing the financing statement with the real estate records.[67] Only if the secured creditor makes the correct choice and perfects his interest in the proper place can he be assured of priority when a dispute arises.

The modified version therefore leaves a major problem unresolved: the fixture financer who filed his financing statement in the wrong office is vulnerable to attack from the bankruptcy trustee and a subsequent purchaser or mortgagee.[68] He needs to determine whether the collateral is a fixture before he can know where to perfect. Thus, the definition problem remains;[69] the structure of the analysis shifts, but the substantive dilemma remains.

3. California hesitated to adopt the 1972 version

The reasons for the omission of revised section 9-313 from the major code revision undertaken by the California Legislature in 1974 are less clear than those behind the State's rejection of the 1962 version. Although the 1972 version of section 9-313 was included in the original bill, the bill was passed in 1974 without the fixtures provision.[70] Apparently the fixtures provision was stricken at the request of title companies who wanted additional time to study the proposed legislation.[71]

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even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

Alternative subsection (3)

[(3) A filing which is made in the proper county continues effective for four months after a change to another county of the debtor's residence or place of business or the location of the collateral, whichever controlled the original filing. It becomes ineffective thereafter unless a copy of the financing statement signed by the secured party is filed in the new county within said period. The security interest may also be perfected in the new county after the expiration of the four-month period; in such case perfection dates from the time of perfection in the new county. A change in the use of the collateral does not impair the effectiveness of the original filing.]

(4) The rules stated in Section 9—103 determine whether filing is necessary in this state.

(5) Notwithstanding the preceeding subsections, and subject to subsection (3) of Section 9—302, the proper place to file in order to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the [Secretary of State]. This filing constitutes a fixture filing (Section 9—313) as to the collateral described therein which is or is to become fixtures.

(6) For the purposes of this section, the residence of an organization is its place of business if it has one or its chief executive office if it has more than one place of business.

67. *Id.*

68. *See infra* notes 117-45 & 159-74 and accompanying text.

69. *See supra* notes 5-16 and accompanying text.

70. Final Report, *supra* note 22, at 19,437.

71. *Id.*

What was needed was a push in the direction of section 9-313 in order to bring order to the chaos which existed in California fixture law.

C. *The Propelling Force Toward Adoption of Section 9-313 in California*

The propelling force behind the California decision to adopt some form of section 9-313 was the case of *Goldie v. Bauchet Properties*.[72] An analysis of *Goldie* will illustrate one of the chaotic and confused tangles in California fixture law.

1. The California Supreme Court's confusion was apparent in *Goldie v. Bauchet Properties*

a. the factual conflict

In *Goldie*, an automatic food packaging machine was affixed to real property. In a sale and lease-back arrangement, the owners of the machine and real property conveyed the real property to Bauchet Properties. Under an unrecorded lease, the seller/lessee gave Bauchet a security interest in the machine to protect the lessor against default by the lessee. The lessee, who to all outward appearances owned the machine, proceeded to borrow money from Goldie. He gave Goldie a note and security interest in the machine. Goldie perfected his security interest by filing his security agreement with the Secretary of State, apparently in accordance with section 9401(1)(c) of the California Uniform Commercial Code.[73] When the lessee defaulted on the lease and note, Goldie demanded possession of the machine. The lessor refused and Goldie sued.[74]

b. the legal conflict

Goldie argued that the machine was a trade fixture and, as such, was personal property.[75] Since personal property interests are covered

72. 15 Cal. 3d 307, 540 P.2d 1, 124 Cal. Rptr. 161 (1975). In the same year a Note was published which correctly described the California law of fixtures as being "in a state of chaos." Final Report at 19,436 (citing Note, *Uniform Commercial Code Section 9-313: Time for Adoption in California*, 27 HASTINGS L.J. 235, 240 (1975)).

73. CAL. COM. CODE § 9401(1)(c) (West Supp. 1984). This section states in pertinent part that "[t]he proper place to file in order to perfect a security interest is . . . in the office of the Secretary of State." The Legislature did not change this provision in 1980 when it adopted its version of § 9313. *See infra* notes 102-108 and accompanying text.

74. 15 Cal. 3d at 312, 540 P.2d at 4-5, 124 Cal. Rptr. at 164-65.

75. Goldie could have been relying on the California trade fixtures statute which provides:

A tenant may remove from the demised premises, any time during the continuance

by Article 9 of the Uniform Commercial Code, he argued that his perfected security interest should prevail over the holder of an unrecorded lease.[76] The trial court agreed.[77]

Bauchet Properties argued that it had a superior right to the machine because the parties' rights were governed by landlord-tenant law which remained unchanged by adoption of the Code.[78]

c. the flaws in the court's analysis

On appeal, the California Supreme Court was faced with two issues: (1) whether trade fixtures are included within the classification of personal property under the Code and (2) whether the lessor had a superior claim to the machine arising from its interest in the real property. The court agreed with the trial court on the first issue stating that: "[I]n the instant case the trial court quite logically determined that 'trade fixtures' are 'personal property' within the meaning of the California Uniform Commercial Code."[79] It appears, therefore, for purposes of the Code, a trade fixture is personal property and is to be treated no differently than any other fixture.[80]

> of his term, anything affixed thereto for purposes of trade, manufacture, ornament, or domestic use, if the removal can be effected without injury to the premises, unless the thing has, by the manner in which it is affixed, become an integral part of the premises.

CAL. CIV. CODE § 1019 (West 1982). Section 1019 is an exception to § 1013 which provides: "When a person affixes his property to the land of another, . . . the thing affixed . . . belongs to the owner of the land," unless there is a contrary agreement. CAL. CIV. CODE § 1013 (West 1982).

76. 15 Cal. 3d at 314, 540 P.2d at 6, 124 Cal. Rptr. at 166.

77. *Id.* at 312, 540 P.2d at 5, 124 Cal. Rptr. at 165.

78. *Id.* Under landlord-tenant law, lease provisions giving the landlord the tenant's property upon the tenant's breach of the lease are valid. *Id.* at 313, 540 P.2d at 6, 124 Cal. Rptr. at 166 (citing Bridges v. Cal-Pacific Leasing Co., 16 Cal. App. 3d 118, 128, 93 Cal. Rptr. 796, 801 (1971)).

Section 9-102 defines the scope of Article 9. UCC § 9-102(1)(a) provides: "Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures . . . ."

When the *Goldie* opinion was written, "fixtures" were not included in the California version of the same section. CAL. COM. CODE § 9102(1)(a) (West 1964). The word "fixtures" was added to § 9102(1)(a) when § 9313 was enacted in California. Final Report, *supra* note 22, at 19,438. Subsection (1)(a) of § 9102 now provides: "Except as otherwise provided in Section 9104 on excluded transactions, this division applies . . . [t]o any transaction (regardless of its form) which is intended to create a security interest in personal property, or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts . . . ." CAL. COM. CODE § 9102(1)(a) (West Supp. 1984).

79. 15 Cal. 3d at 316, 540 P.2d at 8, 124 Cal. Rptr. at 168.

80. For an extended analysis of trade fixtures within the context of Goldie v. Bauchet Properties, see Note, *Treatment of Trade Fixtures Under the California Commercial Code*, 65

With respect to the second question, the *Goldie* court made a confused attempt to unravel the fixture tangle which was created in part by the California Legislature's failure to adopt UCC section 9-313. In effect, the Legislature had drafted around the gap created by the absence of section 9-313 by modifying section 9102(1)(a) which defined the scope of Article 9.[81] The Uniform version of section 9-102(1)(a) includes "fixtures."[82] The California Legislature deleted "fixtures" from this section and added a nonuniform provision, section 9102(1)(c), which stated that real estate law would govern disputes between a fixtures secured creditor and a party with an interest in the real property.[83] Thus, section 9102(1)(c) explicitly excluded from Article 9 claims based upon interests in real property.[84]

The *Goldie* court, construing the California legislative intent behind sections 9102(1)(a) and 9102(1)(c), stated that the Legislature "made it clear that its purpose in so doing was to immunize from the reach of the California Uniform Commercial Code the rights of holders of interests not only in real property but thereby also in property affixed to it."[85] But the court already had determined that trade fixtures were personal property and not fixtures.[86] Faced with this dilemma, the court concluded that "[t]he Legislature apparenty overlooked the fact that the rights of holders of interests in real property and thereby to property affixed to it, might be affected by security interests in 'personal property' falling within section 9102, subdivision (1), subsection (a)."[87]

The court closed the gap by interpreting the term "fixtures" in subdivision (1), subsection (a), "to mean goods affixed to real property regardless of whether as a result of their classification under the law of fixtures the affixed goods are treated as 'personalty' or 'realty.' "[88] Thus, where there were competing claims in goods which were "affixed," the Code did not apply and priorities were to be established under real property law.[89]

If the court had ended its analysis at that point, the result would

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CAL. L. REV. 367 (1977). *But see In re* Factory Homes Corp., 9 U.C.C. Rep. Serv. 1300 (W.D. Ark. 1971) (trade fixtures are equipment and not fixtures).

81. *See supra* note 78.

82. *Id.*

83. CAL. COM. CODE § 9102(1)(a) (West Supp. 1984), *supra* note 78.

84. Final Report, *supra* note 22, at 19,438.

85. 15 Cal. 3d at 317, 540 P.2d at 8, 124 Cal. Rptr. at 168.

86. *See supra* notes 79-80 and accompanying text.

87. 15 Cal. 3d at 317, 540 P.2d at 9, 124 Cal. Rptr. at 169.

88. *Id.*

89. *Id.* at 317-18, 540 P.2d at 9, 124 Cal. Rptr. at 169.

have been that the California Code simply could not be applied where there were competing interests in personal property which had been "affixed" to real property. The court, however, continued its analysis. If the lessor's interest was "derivative" from its interest in the real property,[90] and the tenant lost his right to remove the machine, the chattel mortgagee, Goldie, could not remove the machine either.[91] But, if Bauchet Properties' interest in the machine was not derivative, it could be a security interest under the lease, in which case the Code would apply.[92] The court did not explain how a security interest under the lease could arise in light of its earlier determination that the California Legislature intended to insulate from the Code the rights of holders of real property in the property affixed to it.[93] The machine was "affixed;" it was bolted to the floor.[94] Nevertheless, the *Goldie* court remanded

90. The "rights of the chattel mortgagee are derivative. He cannot assert a greater right against the lessor than can the lessees." *Id.* at 313, 540 P.2d at 6, 124 Cal. Rptr. at 166 (quoting Rinaldi v. Goller, 48 Cal. 2d 276, 281, 309 P.2d 451, 454 (1957)).

The *Rinaldi* court borrowed the principle of derivative rights in real property from the Supreme Court of the State of Washington. In Donahue v. Hardman Estate, 91 Wash. 125, 128, 157 P. 478, 480 (1916), the court held: "A mortgagee from a tenant has no greater right to remove trade fixtures from the premises after the tenant has surrendered possession to the landlord than the tenant himself would have."

91. 15 Cal. 3d at 313, 540 P.2d at 6, 124 Cal. Rptr. at 166.

92. Of interest is why the *Goldie* court ignored California Uniform Commercial Code § 9104(j). *See* Note, *Goldie v. Bauchet Properties—California Uniform Commercial Code: Division Nine's Application to Ownership Interests in Trade Fixtures Acquired Under a Real Property Lease*, 3 PEPPERDINE L. REV. 377 (1976).

When *Goldie* was decided, subsection (j) of § 9104 provided that Article 9 did not apply "[t]o the creation of transfer or an interest in or lien on real estate, including a lease or rents thereunder." CAL. COM. CODE § 9104(j) (West 1964). If the court had applied § 9104(j), it could have avoided its entire analysis of both trade fixtures and the Commerical Code. Simply put, because Bauchet's interest arose through a lease, Article 9 was totally irrelevant to the determination of priority in the collateral. Real property law would have governed by default. By holding that Article 9 does not apply to conflicts between a landlord whose interest in his tenant's trade fixtures is derived from his ownership interest in the real property and a secured creditor with an interest in the trade fixture, the court reached the same result as if it had applied § 9104(j). The tortured analysis of derivative interests versus security interests under the Code would have been unnecessary because § 9104(j) excluded security interest created under a lease from Article 9. If the court had found that Bauchet's lease created a security interest, this would have been in direct conflict with § 9104(j); it is not possible to have a Code protected interest under a lease. 3 PEPPERDINE L. REV. at 384 n.40. The court, unwittingly perhaps, merged its conclusion with that required by § 9104(j). This undercuts the vitality of *Goldie* because § 9104(j) excludes the entire issue.

After 1980, § 9104(j) provided: "This division does not apply . . . except to the extent that provision is made for fixtures in Section 9313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder and to any interest of a lessor and lessee in any such lease or rents." CAL. COM. CODE § 9104(j) (West Supp. 1984).

93. 15 Cal. 3d at 318, 540 P.2d at 9, 124 Cal. Rptr. at 169.

94. *Id.* at 311, 540 P.2d at 4, 124 Cal. Rptr. at 164.

for a determination of the nature of Bauchet Properties' interest: derivative from its real estate interest or a security interest created under the lease.[95]

2. The aftermath of *Goldie*

After *Goldie*, fixture lenders could not predict which way the law would move. Would secret liens created by landlord and tenant in unrecorded leases be construed as the landlord's right derived from his real property interest? If so, no fixture lender would feel secure about lending on a tenant's chattel. Would the secret lien be construed as a security interest created under a lease? Only then would the code protect a chattel lender.

In *Goldie*, the dispute arose over a fixture-in-place. A lender who accepts fixtures-in-place as collateral will extend credit only if he can be assured of protection against secret leases which grant a security interest in the same collateral. This would have a negative effect on the tenant. His trade fixtures may be his only source of collateral. Credit may be necessary for the successful operation of his business. If secret liens are permitted, through rights derived from real estate law, the tenant is excluded from the credit market. The insecure fixture financier will not extend credit. This in turn may cause the tenant (and hence his landlord) economic hardship. On the other hand, a knowledgeable lender could convince an unsophisticated landlord to subordinate his interest.[96] This also could cause the landlord economic hardship.

The *Goldie* decision did not jeopardize the priority of a fixture lender who takes a security interest in goods before they become fixtures. For example, if a tenant purchases goods on conditional sale, the vendor perfects his interest, and then the tenant affixes the goods to the landlord's property, the landlord cannot prevail against the secured creditor unless his tenant could prevail.[97] Thus, if the tenant defaults on his lease and security agreement, the secured creditor has priority in the goods. This makes sense because the landlord did not rely on those goods as security when the lease was created.

Thus, if Goldie had taken a security interest in the packaging machine and perfected his interest before the tenant bolted the machine to the floor, no reservation under Bauchet Properties' lease could have defeated Goldie's priority in the machine.

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95. *Id.* at 318-19, 540 P.2d at 10-11, 124 Cal. Rptr. at 170-71.

96. *See supra* note 63.

97. 15 Cal. 3d at 313-14 n.5, 540 P.2d at 6 n.5, 124 Cal. Rptr. 166 n.5 and cases cited therein.

3. Summary of the law after *Goldie*

After *Goldie*, the secured creditor knew that trade fixtures were personal property for purposes of the Code. Legislative intent was construed as excluding the secured creditor's interest in anything "affixed" to realty from the protection of the Code. Maybe a secret lien under a lease defeated a secured creditor's interest because the landlord's interest was "derived" from his real property interest. On the other hand, the landlord's lease could have created a security interest. If so, priority in the collateral was governed by the Code. Fixture lenders had every right to be concerned, as did tenants in need of credit. Clearly, it was time for the California Legislature to step in and clear up the confusion.

III. CALIFORNIA MODIFIED SECTION 9-313

By 1975, California decisional fixture law had been characterized as being "in a state of chaos."[98] In 1980, the California Legislature enacted a nonuniform version of section 9-313 of the UCC and its related sections.[99] This section will outline the modifications to the Uni-

98. Note, *Uniform Commercial Code Section 9-313: Time for Adoption in California*, 27 HASTINGS L.J. 235, 240 (1975).

99. *See supra* note 26. California Uniform Commercial Code § 9313 provides:

(1) In this section and in the provisions of Chapter 4 (commencing with Section 9401) referring to fixture filing, unless the context otherwise requires

(a) Goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law.

(b) A "fixture filing" is the filing in the office where a mortgage on the real estate would be recorded of a financing statement covering goods which are or are to become fixtures and conforming to the requirements of subdivision (5) of Section 9402.

(c) A mortgage is a "construction mortgage" to the extent that it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates.

(2) A security interest under this division may be created in goods which are fixtures or may continue in goods which become fixtures, but no security interest exists under this division in ordinary building materials incorporated into an improvement on land.

(3) This division does not prevent creation of an encumbrance upon fixtures pursuant to real estate law.

(4) A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where

(a) The security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, a fixture filing covering the fixtures is filed before the goods become fixtures or within 10 days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate; or

(b) A fixture filing covering the fixtures is filed before the interest of the encumbrancer or owner is of record, the security interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the

form Code made by the California Legislature. An analysis of the California section 9313 in its entirety is beyond the scope of this Comment.[100] The primary focus will be on the California scheme for perfection found in section 9401 and the interaction between that perfection and subdivision (4) of section 9313.

A. The California modifications

The Legislature adopted subsections (1)-(3) of Uniform section 9-313 with little change. A parenthetical, however, has been added to subsection (1). Section 9313(1) begins: "In this section and in the provisions of Chapter 4 (commencing with Section 9401) referring to fixture filing . . . ."[101] This seemingly minor addition is significant. It instantly alerts the practitioner that the proper place to begin analysis is not with section 9313, but with section 9401.

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debtor has an interest of record in the real estate or is in possession of the real estate; or

(c) The fixtures are readily removable factory or office machines or readily removable replacements of domestic appliances which are consumer goods; or

(d) The conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this division.

(5) A security interest in fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate where

(a) The encumbrancer or owner has consented in writing to the security interest or has disclaimed an interest in the goods as fixtures; or

(b) The debtor has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates, the priority of the security interest continues for a reasonable time.

(6) Notwithstanding paragraph (a) of subdivision (4) but otherwise subject to subdivisions (4) and (5), a security interest in fixtures is subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent that it is given to refinance a construction mortgage, a mortgage has this priority to the same extent as the construction mortgage.

(7) In the cases not within the preceeding subdivisions, a security interest in fixtures is subordinate to the conflicting interest of an encumbrancer or owner of the related real estate who is not the debtor.

(8) When the secured party has priority over all owners and encumbrancers of the real estate, he may, on default, subject to the provisions of Chapter 5 (commencing with Section 9501), remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

100. *See* Bayer, *California's New Law of Fixtures: Section 9313 of the Uniform Commercial Code*, 56 CAL. ST. B.J. 60 (1981) for an analysis from a practitioner's point of view.

101. CAL. COM. CODE § 9313(1) (West Supp. 1984), *supra* note 99.

1. Section 9401

There are two reasons for the parenthetical addition. In order to understand the first, it is necessary to compare the method and place of perfection under the Uniform Code with that provided in the California Code. The Uniform version offers three alternative choices of subsection (1) of section 9-401.[102] In all three, the proper place to file in order to perfect a security interest in goods which are or will become fixtures is where a mortgage on the real estate would be filed or recorded.[103] That "fixture" language is missing from the California version of section 9401(1).[104] Thus, the only possible construction of section 9401 in California is that the proper place to file in order to perfect a security interest is in the office of the Secretary of State.[105] In other words, in California, a security interest in fixtures can only be perfected by filing a financing statement with the Secretary of State, whereas, under the Uniform version, a security interest in fixtures can

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102. *See supra* note 66.

103. *Id.*

104. CAL. COM. CODE § 9401(1) (West Supp. 1984). Section 9401 provides:

(1) The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this state, then in the office of county recorder of the county in which the goods are kept;

(b) When the collateral is crops growing or to be grown, timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subdivision (5) of Section 9103, then in the office where a mortgage on the real estate would be recorded.

(c) In all other cases, in the office of the Secretary of State.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this division and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) The rules stated in Section 9103 determine whether filing is necessary in this state.

(5) Notwithstanding subdivision (1), and subject to subdivision (3) of Section 9302, the proper place to file in order to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the Secretary of State. This filing also constitutes a fixture filing (Section 9313) as to the collateral described therein which is or to become fixtures.

(6) For the purposes of this section, the residence of an organization is its place of business if it has one or its chief executive office if it has more than one place of business.

(7) The proper place to file a financing statement filed as a fixture filing is in the office where a mortgage on the real estate would be recorded.

105. *Id.* The USCA provided a uniform set of perfection rules. One of the UCC drafters, Professor Kripke, preferred this approach. Kripke, *supra* note 1, at 57.

only be perfected by a filing in the local office with the real estate records.[106]

The second reason for the parenthetical in subsection (1) of the California section 9313 is the addition of subsection (7) to section 9401: "The proper place to file a financing statement filed as a fixture filing is in the office where a mortgage on the real estate would be recorded."[107] This subsection is not part of the Uniform Code. California thus has severed the concept of "perfection" of a fixture security interest from the concept of a fixture "filing."[108] In other words, all security interests are perfected with the Secretary of State; all fixture financing statements are filed with the real estate records. A fixture filing with the real estate records never perfects the security interest and the interest must be perfected before the local filing is effective against real estate interests.

2. Section 9313

The major change to this section is the effect of the perfection modifications in section 9401. It is section 9401, acting upon section 9313, that makes section 9313 a radical departure from the Uniform version. Thus, the word "perfection" has been changed to "filed" in California's section 9313(4)(a),(b).[109]

The Legislature made two additional changes to Uniform section 9-313(4)(c).[110] Under the Uniform version, a perfected security interest in readily removable factory or office machines, or readily removable replacements of domestic appliances which are consumer goods, has priority if "before the goods become fixtures the security interest is perfected by any method permitted by this Article."[111] In California, this

106. Depending on whether Article 9 applies at all, and on the nature of the collateral, filing may not be required for perfection: "A security interest is perfected when it has attached and when all the applicable steps required for perfection have been taken. . . ." U.C.C. § 9-303(1) (1972); CAL. COM. CODE § 9303(1) (West Supp. 1984). Filing is not required to perfect an interest in certain types of goods. For example, no filing is required in order to perfect a security interest in consumer goods. *See generally* U.C.C. § 9-302 (1972); CAL. COM. CODE § 9302 (West Supp. 1984).

107. CAL. COM. CODE § 9401(7), *supra* note 104.

108. *See infra* note 109 and accompanying text. Professor Kripke first "suggested that the terms 'filing' and 'perfection' not be used with connection with the procedure in the real estate records." Kripke, *supra* note 1, at 60. He further suggested that this procedure be called "real estate notification." *Id.* California, however, does not refer to the real estate filing as a notification.

109. CAL. COM. CODE § 9-313(4)(a), (b), *supra* note 99.

110. U.C.C. § 9-313(4)(c) (1972), *supra* note 23.

111. *Id.*

entire phrase has been deleted.[112]

The deletion of the phrase does two things. First, in California, a secured creditor with goods of the type described in section 9313(4)(c) cannot perfect by "any method." The creditor is bound by the perfection method determined by section 9401, that is, he must perfect his interest by filing a financing statement with the Secretary of State.[113] Second, under the Uniform provision, the creditor must perfect his security interest before the goods become fixtures.[114] The California Committee on the Uniform Commercial Code deleted the reference to time because, as a policy matter, security interests in goods of this type "should prevail over adverse real estate interests regardless of the time of perfection."[115] There will, therefore, be no disputes over whether goods of this type are or are not fixtures. The holder of a perfected security interest will always prevail. Any dispute probably will center around exactly what are "readily removable" office machines and "replacements" of domestic appliances,[116] and these are fringe disputes of a much lower commercial voltage than the fixture ambiguity.

The remainder of the language in section 9313 is substantially the same as the language in the Uniform version.

B. Advantages of the California Approach over the Uniform Version in Bankruptcy Proceedings Where the Trustee is a Hypothetical Lien Creditor

This section will explain why the California Code provisions relating to fixtures are an improvement over the Uniform Code's provisions with respect to the bankruptcy trustee's status as a hypothetical lien creditor.

1. The "acid test"

The "acid test" of a security interest is whether it will withstand an attack by the bankruptcy trustee.[117] In 1974, the UCC drafters pre-

112. CAL. COM. CODE § 9313(4)(c), *supra* note 99.

113. CAL. COM. CODE § 9401. *See also* Final Report, *supra* note 22, at 19,437 (citing Marsh and Warren Report, *supra* note 29).

114. U.C.C. § 9-313(4)(c) (1972), note 23.

115. Final Report, *supra* note 22, at 19,444.

116. Headrick, *The New Article Nine of the Uniform Commercial Code: An Introduction and Critique*, 34 MONT. L. REV. 28, 46-47 (1973).

117. R. HENSON, HANDBOOK ON SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 7-3 at 258 (2d ed. 1979); Del Gaudio; *Article 9 of the Uniform Commercial Code and the Bankruptcy Reform Act of 1978*, 12 TOL. L. REV. 305, 306 (1981) [hereinafter cited as Del Gaudio].

dicted that "[i]f the new bankruptcy act were adopted, one could protect a fixture security interest by any sort of perfection which is proper under the Code."[118] The new Bankruptcy Act was enacted by Congress and signed into law by the President in 1978.[119] Section 544(a)(1) of the Bankruptcy Code gives the trustee the status of a hypothetical lien creditor from the date of the commencement of the bankruptcy proceedings.[120] Under section 544(a), the trustee's powers are those which state law[121] would give to a creditor of the debtor who had perfected a lien upon all the property available for satisfaction of his claim against the debtor.[122] In order to survive an attack by the trustee as a lien creditor, it appears from the language of section 544(a)(1) that the secured creditor need only file his financing statement somewhere—anywhere—that a state permits in order to perfect his interest prior to the commencement of the proceedings. The secured creditor should be able to perfect by filing his financing statement with the Secretary of State, with the real estate records, or without making any filing at all.[123]

a. state law should protect the perfected secured creditor

If the secured creditor complies with state law, he should be safe from the trustee's attack because the trustee's powers under section 544(a)(1) of the Bankruptcy Code are derived from state law.[124] Section 9301(1)(b) of the California Uniform Commercial Code, one source of the trustee's power,[125] governs the rights of lien creditors.[126]

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118. Panel, *supra* note 20, at 984.

119. Bankruptcy Reform Act of 1978, 11 U.S.C. (1982).

120. Bankruptcy Reform Act of 1978, 11 U.S.C. § 544(a)(1) (1982). This section provides:

> The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by . . . a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists.

121. A more accurate expression here would be nonbankruptcy law. In all but a small proportion of bankruptcies, nonbankruptcy law is state law. However, in the District of Columbia or in a territory, some federal law would govern. State law as used herein includes federal law which applies in these limited situations. 4 COLLIER ON BANKRUPTCY § 544.02 at 544-5 n.3 (15th ed. 1983).

122. State law determines whether a security interest is perfected. *See, e.g.*, *In re* Independence Land Title Corp., 4 C.B.C.2d 118 (Bankr. N.D. Ill. 1981) (perfection of security interest controlled by Illinois law); *In re* Smith, 10 Bankr. 883 (M.D. Ga. 1981) (perfection of security interest controlled by Georgia law).

123. *See supra* note 106.

124. Del Gaudio, *supra* note 117, at 321.

125. *Id.*

126. CAL. COM. CODE § 9301(1)(b) provides: "[A]n unperfected security interest is

Section 544(a)(1) does not grant the trustee greater rights than those granted by state law to a creditor holding a lien by legal or equitable proceedings.[127]

Section 9301(1)(b) provides that an unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected.[128] Therefore, a perfected security interest retains priority over a subsequent lien creditor. The bankruptcy trustee is deemed to be a lien creditor.[129] If California Commercial Code section 9301(1)(b) is read with section 9313(4)(d), an even stronger case is made for the priority of a fixtures creditor who perfects by filing with the Secretary of State over the trustee as lien creditor. Section 9313(4)(d) provides that a perfected security interest in fixtures takes priority where the conflicting interest is a subsequent lien on the real estate obtained by legal or equitable proceedings.[130] The drafters of the UCC adopted the phrase "lien by legal or equitable proceedings" from former section 70c of the Bankruptcy Act.[131] They intended UCC section 9-313(4)(d) to encompass all liens on the real property obtained by legal or equitable proceedings.[132] Substantive state law under section 9313, therefore, also should protect the earlier perfected security interest.

The drafters view subsection 9-313(4)(d) as a "bastard kind of perfection."[133] "We say that any sort of filing is good as against the lien

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subordinate to the rights of . . . [a] person who becomes a lien creditor before the security interest is perfected." This version is identical to the Uniform version.

127. COLLIER, *supra* note 121, at 544-10.

128. *See supra* note 126.

129. CAL. COM. CODE § 9301(3) provides in pertinent part: "A 'lien creditor' means a creditor who has acquired a lien on the property involved by attachment, levy or the like . . . , and includes . . . a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment." This is identical to the Uniform version.

130. CAL. COM. CODE § 9313(4)(d), *supra* note 99; U.C.C. § 9-313(4)(d) (1972), *supra* note 23.

131. U.C.C. § 9-313 comment 4c (1972). Section 70c provided in pertinent part:

> The trustee shall have as of the date of the bankruptcy the rights and powers of . . . a creditor who upon the date of the bankruptcy obtained a lien by legal or equitable proceedings upon all property . . . upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien . . . .

4A COLLIER ON BANKRUPTCY § 70 at 4 (14th ed. 1979). This so-called "strong arm clause" is now § 544(a) of the Bankruptcy Code. *See supra* note 120. Although the language "lien by legal or equitable proceedings" did not survive, it was the intent of Congress that § 544(a) have the same effect as former § 70c. H.R. REP. NO. 595, 95th Cong., 1st Sess. 370 (1977); S. REP. NO. 989, 95th Cong., 2d Sess. 85 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 6326 & 5871.

132. U.C.C. § 9-313 comment 4c (1972).

133. Panel, *supra* note 23, at 984.

creditor and, therefore, against the trustee in bankruptcy."[134] If that were true in the real world, a secured creditor who errs when he guesses "fixture" and perfects locally rather than with the Secretary of State should have a perfected interest as against a lien creditor or the bankruptcy trustee. This should be true even if a court later holds that the secured creditor's collateral is not a fixture. Conversely, a secured creditor who decides the goods are personalty and files with the Secretary of State should be perfected if a court later decides that his collateral is a fixture.

b. the secured creditor loses under the Uniform Code's perfection requirements

Unfortunately, bankruptcy courts have not seen eye-to-eye with the drafters. A sampling of recent bankruptcy cases indicates that a "wrong guess" which leads a "secured" creditor down the path to the wrong filing office also leads him to the depths of unsecured creditor status. For example, in *In re Belmont Industries*,[135] a dispute arose between the bankruptcy trustee and a secured creditor. The court phrased the issue as "whether the defendant filed its financing statement in the correct place."[136] The collateral was a boiler and machines connected to the realty by means of air or steam pipes. The court held that the machines were not fixtures. The trustee was able to set aside the creditor's interest in the machines because "defendant failed to perfect its security interest in the equipment because it filed its financing statement locally rather than with the Secretary of State."[137] The boiler, however, was held to be a fixture. Therefore, the secured creditor retained his priority because he had guessed correctly as to the nature of the boiler and filed his financing statement locally.[138]

In another case, conditional sellers of a mobile home filed their financing statement according to the provisions of UCC section 9-302(1)(d) because they considered the mobile home to be a "motor vehicle."[139] The bankrupt affixed the vehicle to her land. The trustee successfully claimed that the mobile home became a fixture when it was affixed to the realty. The court reduced the conditional sellers to

134. *Id.* "[T]here is no requirement that as against a judgment lien or of the real estate, the prior filing of the fixture security interest must be in the real estate records." *See supra* note 132.

135. 1 Bankr. 608 (E.D. Tenn. 1979).

136. *Id.* at 609.

137. *Id.* at 614.

138. *Id.* at 613.

139. *In re* Fink, 4 Bankr. 741 (W.D.N.Y. 1980).

the status of "an unsecured creditor [because] their filing should have been under UCC § 9-313 rather than under UCC § 9-302(1)(d)."[140] As in *Belmont*, a factual determination of the status of the goods, fixture or non-fixture, was separated from any legal conclusion as to who had priority in the thing itself, and yet the two issues are linked in a tight circle.[141]

Needless to say, dual filings would have assured perfection in the above cases. In fact, the *Belmont* court commented: "[A] creditor that files its financing statement locally only is hazarding a decision in a confusing area of the law. A court or other creditors may disagree."[142] The *Belmont* court proposed an odd rule indeed. Merely because fixtures are neither " 'fish nor fowl,' part chattel and part real estate,"[143] is no reason to create such a nonsensical and diseconomic rule. The bankruptcy trustee did not rely on the collateral in order to extend credit or to purchase or to take a mortgage on the property. He had no rights in the collateral until the commencement of the bankruptcy proceedings.[144] He should take his debtor as he finds him. It is inequitable to permit him to marshall prior secured assets merely because the creditor chose "fish *or* fowl" instead of the more expensive "fish *and* fowl." This was not the intent of the drafters.[145] Nevertheless, this is the effect produced by the Uniform Code and its perfection method.

c. summary of the failure of the Uniform Code's perfection scheme

It would appear that the drafters of the Uniform Code intended that the Code walk hand-in-hand with the new Bankruptcy Code. The UCC drafters who predicted that a security interest perfected by any means under Article 9 should survive the acid test where the bankruptcy trustee is a hypothetical lien creditor should be correct. As the above discussion indicates, their prediction may be wrong. Under the Uniform version, if the fixtures secured creditor files his financing statement locally, and the court then decides his collateral is person-

140. 4 Bankr. at 744. *See also In re* Boden Mining Corp., 11 Bankr. 562, 564 (S.D. W.Va. 1981), which involved a three-way dispute between two creditors and a bankruptcy trustee. Although decided on other grounds, the court observed that if the coal washing plant was a fixture, neither creditor perfected because neither filed "in the manner prescribed by the Uniform Commercial Code," *i.e.*, in accordance with § 9-313.

141. *See supra* notes 42-50 and accompanying text.

142. *In re* Belmont, 1 Bankr. at 613.

143. Panel, *supra* note 20, at 984.

144. *See* 11 U.S.C. § 544(a) at note 117; Teofan, *The Trustee's Avoiding Powers Under the Bankruptcy Act and the New Code: A Comparative Analysis*, 11 ST. MARY'S L.J. 311, 314 (1979).

145. *See supra* notes 133-34 and accompanying text.

alty, he may not be protected from the trustee's attack because he did not "properly" perfect his interest.[146] If the secured creditor guesses that his collateral is not fixtures but is personal property, and he filed his financing statement with the Secretary of State, he may lose his perfection and his priority when the bankruptcy court decides that the collateral is fixtures.[147] As the following discussion will show, the California approach—that the only place to perfect an interest in fixtures is by filing a financing statement with the Secretary of State—should eliminate the "wrong guess" dilemma and concomitant loss of perfection.

2. The California benefit

The California approach to perfection under section 9401, in conjunction with sections 9301 and 9313, should provide complete protection to the secured creditor from the trustee as lien creditor. In fact, the California Committee members stated that a fixture filing is limited to "establishing priority as against conflicting real estate interests."[148] A fortiori, perfection without an additional fixture filing must protect the secured creditor in California from a trustee's attack as a hypothetical lien creditor. When applying the substantive law of the California Uniform Commercial Code section 9301(1)(b) or section 9313(4)(d) in juxtaposition with Bankruptcy Code section 544(a)(1), the analysis becomes: perfection is required; the only place to file to perfect is in the Office of the Secretary of State. The substantive law of the state should then protect the perfected secured creditor from the trustee. Thus, California has avoided the consequences in bankruptcy disputes concerning fixtures in the "wrong guess" scenario prevalent in the bankruptcy courts in the states which have adopted UCC sections 9301 and 9313 "as is." The benefit is clear; the caveat is whether bankruptcy courts will accept and honor the intent of the California Legislature.[149]

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146. *See supra* notes 135-40 and accompanying text.

147. *Id.*

148. Final Report, *supra* note 22, at 19,443.

149. It also appears that congressional intent is in line with the California position. Congress specified that perfection would insulate a fixture transfer from a challenge under § 547(e)(91)(A) of the Bankruptcy Code. "This section . . . modernizes the preference provisions and brings them more into conformity with commercial practice and the Uniform Commercial Code." H.R. REP., *supra* note 131, at 372; S. REP., *supra* note 131, at 87.

> Section 547(e)(1)(A), (B) provides in pertinent part: (A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and (B) a transfer of *a fixture* or property other than real property is perfected

3. A caveat for California's fixtures secured creditors

A recent decision of a California Bankruptcy Court provides the basis for the caveat and gives a fixture secured creditor every reason to suspect that bankruptcy judges may ignore substantive state law relating to fixtures. *In re Arlett*[150] involved a debtor who purchased a solar water heater from a conditional seller. The parties entered into a security agreement, but the secured creditor did not file a financing statement. The court noted in passing that "[t]he filing of a financing statement is a requirement for the perfection of a security interest as against third parties, including the Trustee."[151] The analysis should have been: perfection is required; the secured creditor did not perfect; therefore, the security interest succumbs to the trustee's attack.

Had the court ended its analysis at that point, the decision would have been unobjectionable. Instead, the court engaged in a lengthy analysis of California real property fixture law.[152] Because the solar heater "was bolted to the roof of the residence, connected to and made a part of the plumbing system, and holes were drilled in the structure," the heater was "deemed to be part and parcel" of the structure.[153] "This event transformed the character of the solar water heater from personal property to real property."[154] The court held that "[t]he transformation of the character of the solar water heater has abrogated the [creditor's] security interest in the solar water heater."[155]

The court's metaphysical transformation is illogical. "If a vendor sells a horse to a vendee, and the problem arises whether the horseshoes on the horse were included in the bill of sale, it would not help much to say the issue in the case was whether horseshoes had become 'horses,' "[156] By analogy, it begs the question to say that personalty, the solar heater, had been "transformed" into realty, the structure. The important question was who had priority in the collateral. The *Arlett*

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when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferree.

11 U.S.C. § 547(e)(1)(A), (B) (1982) (emphasis added).

150. 22 Bankr. 732 (E.D. Cal. 1982).

151. *Id.* at 734.

152. *Id.* at 734-35. The court analyzed the common law three-part fixtures test in relation to California real property law. This analysis cannot be reconciled with the California Uniform Commerical Code. Article 9 applies "[t]o any transaction . . . which is intended to create a security interest in . . . fixtures . . . ." CAL. COM. CODE § 9102(1)(a). There is no doubt that the creditor and the debtor in *Arlett* intended to create a security interest.

153. *Id.* at 735.

154. *Id.*

155. *Id.*

156. Horowitz, *supra* note 5, at 30.

court could have answered this question without resort to hoseshoe reasoning. The creditor never perfected his interest under section 9401 by filing a financing statement with the Secretary of State.[157] Therefore, the trustee was entitled to have the creditor's interest set aside.[158] It would appear from the above analysis that if the bankruptcy courts in California understood the perfection system in the California Uniform Commercial Code, the secured creditor who properly perfected his interest with the Secretary of State in goods which are fixtures would be immune from the bankruptcy trustee's attack as lien creditor. The *Arlett* case is ominous, however, because it indicates that the old confusion may yet remain.

IV. THE UNRESOLVED PROBLEMS UNDER THE CALIFORNIA SYSTEM

This section of the Comment first will point out the unresolved problems remaining with the California version of section 9-313. It then will explain how each of these problems can be resolved.

The first problem is that the perfected secured creditor may survive the attack of the bankruptcy trustee as a hypothetical lien creditor only to succumb to his attack as a hypothetical bona fide purchaser of the realty. The second problem is that a perfected security interest will vanish if the secured creditor has not made an additional filing—a fixture filing—and a true bona fide purchaser or encumbrancer acquires an interest in the realty.

A. The Difficulty Created by the Trustee as Hypothetical Bona Fide Purchaser of the Realty

In definitive language, the California Committee on the Uniform Commercial Code concluded that a fixture filing with the real estate records is limited to "establishing priority as against conflicting real estate interests, and . . . the same rules of perfection [are to be applied]

157. 22 Bankr. at 734. The court referred to § 9402 of the Code. That section refers to the requisites of a financing statement. Section 9401 would appear to be more on point because the problem in the case was the lack of a filing rather than an improperly prepared financing statement. *See supra* note 104.

158. At first reading, it might appear that the water heater in the debtor's residence could have been classified as consumer goods and therefore the secured creditor's security interest was perfected without filing. CAL. COM. CODE § 9109(1). No financing statement is required to perfect a security interest in consumer goods. CAL. COM. CODE § 9302(1)(a). The exemption of consumer goods from filing as a means of perfection does not extend to consumer goods which are fixtures: "[A] fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9313." CAL. COM. CODE § 9302(1)(d).

to goods which are fixtures as are applied to goods which are not."[159] A single filing in the real estate records does not perfect a fixture security interest.[160] Can a California secured creditor of fixtures prevail against a bankruptcy trustee when the trustee assumes the role of a bona fide purchaser of the realty and the perfected creditor has not made a fixture filing? The answer should be "yes" because the security interest is perfected. The answer, however, is "perhaps."

1. The trustee's argument

Under section 544(a)(3) of the Bankruptcy Code, the trustee acquires the status of a hypothetical bona fide purchaser of real property. The trustee can void a transfer of property of the debtor that would be voidable by a bona fide purchaser of real property from the debtor.[161] California Uniform Commercial Code subsection 9313(4)(b) governs the bona fide purchaser of the realty. It provides that a perfected security interest in fixtures has priority over a conflicting real estate interest if (1) the security interest has priority over previous real estate interests, and (2) the debtor has an interest of record in the real estate.[162] The purpose of this section is to give notice to the subsequent purchaser.[163] Assume that a real property owner of a restaurant purchased large signs from a conditional seller who took a security interest in the signs.[164] The parties agreed that the signs were to remain personal property. The secured creditor perfected his interest by filing his financing statement with the Secretary of State as required for personal property security interests.[165] He did not comply with the Uniform Code by making an additional fixture filing. The signs were anchored

159. Final Report, *supra* note 22, at 19,430.

160. *Id.* at 19,443.

161. 11 U.S.C. § 544(a)(3) (1982) provides:

> The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may void any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by . . . a bona fide purchaser of real property from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or not such a purchaser exists.

162. *See supra* note 99. The Uniform version has identical provisions. See *supra* note 23.

163. GILMORE, *supra* note 33, at 834-36 (1965). Professor Gilmore suggested that a revision of the 1962 version of UCC § 9-313 might include fixture filings with the real estate mortgages in order to provide notice to subsequent purchasers and mortgagees. *Id.* The Revision Committee implemented his proposal in the 1972 version of UCC § 9-313. See U.C.C. § 9-313(4), *supra* note 23.

164. Cummings, Inc. v. Beardsley, 271 Ark. 596, 609 S.W.2d 66, 30 U.C.C. Rep. Serv. 1133 (1980).

165. *Id.* at 597, 609 S.W.2d at 67, 30 U.C.C. Rep. Serv. at 1134.

in concrete at the restaurant site. Assume further that the debtor defaulted on the underlying real property mortgage and the lender foreclosed and sold the property to a third party. The third party would take free of the security interest not because the secured creditor was unperfected, but rather because the purchaser had no notice of the secured creditor's interest. The purchaser "had the right to rely on the records in the office of the [County Recorder], where filings covering fixtures are to be made, to determine if a lien was in existence at the time of their purchase."[166]

This example clearly illustrates that the purpose of UCC section 9-313(4)(b) is to give notice of the lien to subsequent purchasers and mortgagees. This is unrelated to perfection. The theory is that notice is required because a subsequent purchaser or encumbrancer will pay less if he is aware that the property is subject to the lien of another. If he gives full value for the property, it would be unfair to hold him responsible for a secret lien. Bankruptcy considerations aside, there is no need to perfect locally; the purpose of the local filing is not to perfect but rather to give notice to subsequent purchasers and encumbrancers.[167] California has further refined this principle because it has separated totally the concept of perfection from that of a fixture filing.

Suppose the conditional seller of the solar water heater in *Arlett*[168] had perfected his security interest by filing a financing statement with the Secretary of State, but had not made a local fixture filing. A subsequent bona fide purchaser would take the property free of the secured creditor's interest because the purchaser had no notice of the creditor's prior lien. Only a fixture filing would have protected his interest from subsequent purchasers.[169] An argument can be made that the trustee, as hypothetical bona fide purchaser, also takes the real property free of the security interest if the perfected creditor has not made a fixture filing.[170]

2. The trustee's argument is flawed

First, it is not clear that Congress intended this result. For prefer-

166. *Id.* at 600, 609 S.W.2d at 69, 30 U.C.C. Rep. Serv. at 1136.

167. This is the approach suggested by Professor Kripke. Kripke, *supra* note 1, at 60. *See also supra* note 108 and accompanying text.

168. 22 Bankr. 732. *See supra* notes 150-58 and accompanying text.

169. CAL. COM. CODE § 9313(4)(b), *supra* note 99. By the same token, the fixture filing would be irrelevant in a bankruptcy proceeding.

170. Del Gaudio, *supra* note 117, at 323. *See also* Breitowitz, *Article 9 Security Interests as Voidable Preferences*, 3 CARDOZO L. REV. 357, 386 (1982); Shanor, *A New Deal for Secured Creditors in Bankruptcy*, 28 EMORY L.J. 587, 598-99 (1979).

ence purposes under section 547(e)(1)(B) of the Bankruptcy Code, fixtures are personal property.[171] A secured creditor need only perfect his interest in personal property to protect himself from the trustee's attack under section 547(e)(1)(B). It seems unlikely that Congress deliberately would protect the fixtures secured creditor from an attack under this section and, at the same time, expose the same creditor to vulnerability under the avoidance powers conferred upon the trustee in section 544(a)(3). Legislative history indicates that the omission of a fixtures exclusion in section 544 of the Bankruptcy Code was due to a congressional oversight.[172]

Second, the trustee is not a creditor who would rely on a fixture filing. He is not a reliance creditor whom the filing system is designed to protect,[173] unlike a bona fide purchaser of the realty who inspects the

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171. 11 U.S.C. § 547(e)(1)(B), *supra* note 149.

172. Breitowitz, *supra* note 141, at 386-87 & n.86.

The saga of Congress's attempt to wrestle with the many criticisms of the 1978 Bankruptcy Reform Act began in 1980 when the Senate sent S. 658 to the House. H.R. REP. No. 1195, 96th Cong., 2d Sess. 1-2 (1980). This bill proposed substantive changes and technical corrections to the Bankruptcy Code. *Id.* S. 658 would have added "other than fixtures" to Bankruptcy Code § 544(a)(3). H.R. REP. No. 1195 at 84. Thus, this section would have been amended to provide in pertinent part: "The trustee shall have . . . the rights and powers of, or may avoid any transfer of property of the debtor . . . that is voidable by . . . a bona fide purchaser of real property, *other than fixtures*, from the debtor . . . ." *Id.* (emphasis added). The House did not enact S. 658. S. REP. No. 150, 97th Cong., 1st Sess. 2 (1981).

In 1981, the Senate included the same fixtures language in S. 863, 97th Cong., 1st Sess. 127 CONG. REC. S7893-907 (1981). The portion of S. 863 relating to commodities brokers was enacted. Bankruptcy Act Amendments, Pub. L. No. 97-222, 96 Stat. 235 (1982). Other substantive changes and the technical corrections, including the correction relating to fixtures, were not.

The Senate tried again with S. 2000, 97th Cong., 1st Sess., 128 CONG. REC. S15,673 (1981). Senator Metzenbaum summed up the reaction to S. 2000: "Along came the so-called bankruptcy amendments of 1982, and that bill was debated, argued, amended, criticized, praised, and wound up not being enacted into law." 129 CONG. REC. S5386 (1983).

Undaunted, in 1983 the Senate passed the "Omnibus Bankruptcy Improvements Act of 1983." S. 445, 98th Cong., 1st Sess. 129 CONG. REC. S5388 (1983); S. REP. No. 65, 98th Cong., 1st Sess. 1 (1983). S. 445 was sent to the House and is now pending in the Monopoly & Commercial Law Subcommittee on Judiciary. Telephone interview with Clerk, House Committee on Judiciary (Feb. 13, 1984). The fixtures language which would conform the fixtures protection of 11 U.S.C. § 544 to 11 U.S.C. § 547 is found in the Omnibus Bill. S. 445, 98th Cong., 1st Sess. (1983).

173. Del Gaudio, *supra* note 117, at 324. Although the lack of the trustee's reliance usually is irrelevant in the context of avoidance-powers issues, his failure to rely (and hence the potential for a windfall to the estate) is important in the context of his status as a hypothetical bona fide purchaser because he expressly has been denied the avoidance power as a hypothetical lien creditor. To hold otherwise would be to interpret the Bankruptcy Code to be internally inconsistent. Such a statutory construction is to be avoided. *See* United States v. Bass, 404 U.S. 336, 344 (1971).

public records for liens before he invests in the property. Perfection alone should allow the fixture financer to prevail over the trustee.

Third, California set out a perfection scheme to protect fixture secured creditors from bankruptcy trustees as lien creditors.[174] There is, therefore, no sound reason why California fixtures secured creditors should not be able to rely on the protection the state has given them against the trustee in sections 9401 and 9313 of the California Uniform Commercial Code.

3. The economic benefit in the California scheme

Finally, there is an economic benefit to the California solution to the perfection problem. However legally practical dual filings may be,[175] they are diseconomic. Therefore, unnecessary dual filings defeat one of the goals of the UCC drafters, that of providing a simple and unified structure so that secured financing transactions can go forward at less cost and with greater certainty.[176] If the secured creditor wishes protection only against lien creditors and bankruptcy trustees (as distinguished from reliance subsequent bona fide purchasers or mortgagees), he should be able to do so in the most economically efficient manner. California's one-stop perfection process for goods which are or could be fixtures advances the Code's goal of providing secured financing with less cost and greater certainty. It is illogical and impractical to have the Commercial Code and the Bankruptcy Code at odds with one another. Sound public policy requires that the bankruptcy courts follow the lead of the California Legislature and adhere to the principle that perfection of a fixture security interest with the Secretary of State immunizes the creditor from the trustee's attack as a lien creditor. Anything less confers an unintended windfall on unsecured creditors. Therefore, it is inappropriate to permit the trustee to attack the same collateral as a bona fide purchaser of the realty simply because a court later determines the goods are fixtures. The drafters of the UCC would do well to consider the impact of economics on the fixtures secured creditor in future revisions of section 9-313.

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174. *See* CAL. COM. CODE § 9313(4)(d), *supra* note 99.

175. There is an additional benefit to a rule requiring dual filings. The practitioner evades the threshold definitional problem. "All that is required is that he be aware that there is a *question* as to which [fixture or chattel] is involved." Shanker, *supra* note 3, at 797 (emphasis in original).

176. U.C.C. 9-101 comment (1972).

B. The True Bona Fide Purchaser Defeats the Perfected Secured Creditor in the Absence of a Prior Fixture Filing

A perfected secured creditor who also has made a fixture filing will prevail over a subsequent purchaser or encumbrancer.[177] He prevails because his fixture filing has given notice to the subsequent purchaser/encumbrancer—not because the fixture filing perfected his interest. He makes a fixture filing to minimize risk of loss from the purchaser or encumbrancer. However, in a situation where the perfected secured creditor does not make a fixture filing, the creditor may not know that the goods have or may become fixtures. Nevertheless, the cost of making an additional filing outweighs the risk that a presently unknown purchaser or mortgagee may come upon the scene and strip him of his priority.[178] This will be true particularly where the debt is small and the agreement is for a short term.

Section 9313 not only establishes priorities, it allocates risk between the secured creditor and real estate interests. Under section 9313(4)(b),[179] the risk is placed upon the secured creditor because he will lose his priority unless he makes dual filings. Such a risk allocation can be supported only if the secured creditor has knowledge of the risk and the ability to spread transaction costs.[180] This section of the Comment will describe the circumstances under which a secured creditor might not make a fixture filing. It then will establish a framework for analyzing who (secured creditor or bona fide purchaser) is in the best position to bear the risk if a fixture filing is not made. Finally, it will suggest a structure for establishing priorities when a perfected secured creditor has not made an additional fixture filing.

1. The economics behind a security interest in fixtures-in-place

A conflict between a secured creditor of fixtures-in-place and a real property interest was the situation the California Supreme Court faced in *Goldie v. Bauchet Properties*.[181] California Uniform Commercial Code section 9313(5) would have protected Goldie because when

177. *See* Final Report, *supra* note 22, at 19,443-44, comment 4(c).

178. *See infra* note 196 and accompanying text.

179. CAL. COM. CODE § 9313(4)(b). *See supra* note 99.

180. Transaction costs are "the costs of effecting a transfer of rights . . . ." R. POSNER, ECONOMIC ANALYSIS OF LAW 30 (2d ed. 1977). Real property law gives the right to fixtures to the real property owner. *See* CAL. CIV. CODE § 1013, *supra* note 75. The transfer of rights within the context of section 9313 is from the owner of the realty to the secured creditor of the fixtures. *See supra* note 99. Transaction costs, therefore, are all the costs of acquiring that right from the real property owner.

181. 15 Cal. 3d 307, 540 P.2d 1, 124 Cal. Rptr. 161 (1975).

the debtor's rights to remove the machine terminated, Goldie would have had a "reasonable time" in which to remove the machine.[182] Also, after *Goldie*, a tenant's trade fixtures are personal property covered by Article 9.[183] A lender of trade fixtures-in-place has the most clear-cut path of any fixture lender to protect his interests.[184] Requiring a second filing with the real estate records can be supported economically.

a. transaction costs

A creditor must have access to information before he can evaluate the costs of acquiring and processing it. In a typical transaction relating to a loan where fixtures-in-place are the proffered collateral, the creditor knows the collateral consists of fixtures. The borrower makes written application for a loan. In his application, the borrower provides information as to the location of the fixture, and whether he is a tenant or owner of the property where the fixture is located. If he is a tenant, the lender has two choices under section 9313(5). He can obtain from the landlord a written waiver of his interest in the fixtures,[185] or he can determine from the landlord that the tenant has the right to remove the fixtures at the end of the term.[186] In either case, the lender will be secure if he loans on the fixture collateral. He must, of course, perfect his interest if he wishes protection from an attack from a bankruptcy trustee but, under the Code, he need not perfect or make a fixture filing to protect his interest against the existing owner.[187]

An identical process is followed where the fixtures are encumbered along with the real property. The fixture lender inspects the property and the public records to determine if there is an existing mortgage on the real property. Either he gets a written waiver from the first mortgagee as to the fixtures[188] or he determines by examining the lease that the tenant has the right to remove the goods as against the mortgagee.[189] If neither requirement is fulfilled, the loan probably will not be made.

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182. CAL. COM. CODE § 9313(5), *supra* note 99.

183. *See supra* note 79 and accompanying text.

184. This assumes that the secured creditor recognizes the collateral as a fixture. *Cf. supra* note 175 and accompanying text.

185. *See* CAL. COM. CODE § 9313(5)(a), *supra* note 99.

186. *See* CAL. COM. CODE § 9313(5)(b), *supra* note 99.

187. *See* CAL. COM. CODE § 9313(5)(a), (b), *supra* note 99.

188. *See supra* note 63.

189. *See* CAL. COM. CODE § 9313(5)(b), *supra* note 99.

b. the best cost spreader

The rationale behind this scheme can be supported by economic reasoning. In this situation, the fixtures financer is in the best position to ascertain the status of the proposed collateral. He is the party with access to information;[190] he has a loan application and is in a position to verify its information. The transactional cost of obtaining information can be passed on to the borrower.[191]

If the secured creditor wishes protection against a subsequent bona fide purchaser or encumbrancer, he must incur additional costs; he must make a fixture filing under section 9313(4)(b).[192] This cost is minimal, however, because he already has incurred the expenses of gathering information and inspecting the collateral. Further, because this is a known cost, it also can be passed on to the borrower. The borrower benefits because he gets needed financing and can, in turn, pass the cost on to the ultimate consumer of his business output. It is economically justified, therefore, to place the burden of providing notice by means of a fixture filing on the secured creditor as opposed to placing the burden of a search of the chattel records on a subsequent purchaser or encumbrancer.[193]

c. the cheapest cost avoider

An additional economic reason supports placing the burden of a fixture filing on the lender in this situation. Risk of loss should be placed on the party who could have avoided the problem at least cost.[194] This gives that party an incentive to avoid the loss. Assume the lender does not make a fixture filing and the real property is subsequently purchased by a bona fide purchaser. Assume further that the value of the fixture is substantial. Because the purchaser was without notice, he will pay more for the realty than its fair market value; a portion of the property, the fixtures, was encumbered.[195] It is the fix-

190. *See supra* notes 185-86 and accompanying text.

191. The process of passing costs on to others sometimes is called "internalization." Costs are thus shared by all interested parties. *See* Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347-57 (1967). An "externality" is an external cost which the decision-maker does not take into account in pricing his goods; some segment of society bears the cost. R. POSNER, *supra* note 180, at 51-52.

192. CAL. COM. CODE § 9313(4)(b), *supra* note 99.

193. Economic justification in one case, however, is an insufficient reason to maintain a dual filing system for all cases. *See infra* notes 197-204 and accompanying text.

194. *See* R. POSNER, *supra* note 180, at 177 (liability should be placed on the person who could have avoided the problem at the least cost).

195. A different result is possible if the value of the fixtures is negligible in relation to the cost of the real property. *See infra* text accompanying note 206.

ture financer who could have avoided the problem at the least cost by providing notice by means of a fixture filing. If the burden was placed on the purchaser, he would have the expense of acquiring information which the fixture lender already has acquired. Obtaining information probably is more costly than making a fixture filing.[196] According to the theory of least cost avoidance, the purchaser without notice should (and does) take free of the fixture financer's perfected security interest if the fixture financer has failed to make a fixture filing.[197]

2. The purchase money security interest in fixtures

The purchase money secured creditor may not be the cheapest cost avoider. Normally he extends credit before the goods become fixtures. Assume that a conditional vendor sold grain storage bins to the owner of real property.[198] Buyer and seller executed a security agreement which included the provision that, upon default, the debtor "shall assemble the goods and make them available to secured party at a place reasonably convenient to both parties."[199] Thus, the vendor extended credit before the goods became fixtures. In addition, the parties treated the goods as personal property and not fixtures. The security agreement also showed that both parties believed that the grain bins were personal property. The secured creditor filed a financing statement, but he did not make a fixture filing.[200]

Under the Uniform Code, if the bins were fixtures, the vendor could have protected his purchase money security interest "by a fixture filing before the goods [became] fixtures or within ten days thereafter."[201] This also would have perfected his interest under the Uniform Code.[202] In an actual case the vendor lost his priority because the court decided the bins were fixtures.[203]

Two questions arise. First, how is the vendor to know the goods will become fixtures and, second, why should a preferred interest under

196. Cost of filing a financing statement with the real estate records is $4 for the first page and $1 for each additional page. Information provided by the Clerk of the Office of the Los Angeles County Recorder. A typical financing statement is one page. See CAL. COM. CODE § 9402 (West Supp. 1984) for a suggested form.

197. *See* CAL. COM. CODE § 9313(4)(b), *supra* note 99.

198. *See* Corning Bank v. Bank of Rector, 265 Ark. 68, 576 S.W.2d 949, 26 U.C.C. Rep. Serv. 1367 (1979).

199. *Id.* at 72, 576 S.W.2d at 951, 26 U.C.C. Rep. Serv. at 1369.

200. *Id.*

201. U.C.C. § 9-313(4)(a), *supra* note 23. *See also* CAL. COM. CODE § 9313(4)(a), *supra* note 99.

202. *See* U.C.C. § 9-313(1)(b), *supra* note 23.

203. 265 Ark. at 76-77, 576 S.W.2d at 954, 26 U.C.C. Rep. Serv. at 1370-71.

the Code, a purchase money security interest,[204] bear the risk of loss as against an encumbrancer or purchaser of the real property? The following discussion will illustrate why the vendor does not always know that his goods are or will become fixtures. Because of this lack of knowledge, perhaps he should not bear the risk of loss against a bona fide purchaser.

a. the vendor who unknowingly fails to make a second filing

The vendor of goods does have access to information as to the creditworthiness of his buyer. He also has access to means of verifying the information the prospective purchaser provides. What the seller does not have is access to reliable information at reasonable cost concerning the future status of the goods he sells. He can ask what the purchaser intends to do with a portable dishwasher, for example. The vendee may say that he is going to place it in an apartment building he owns.[205] Therefore, the conditional seller does not make a fixture filing. Later, the purchaser remodels the kitchen and installs the portable dishwasher under the kitchen countertop. No one would seriously suggest that a seller of several hundred portable dishwashers each year should pursue each debtor to determine whether the seller needs to make a fixture filing because the buyer anchored the portable dishwasher to realty.

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204. *See generally* U.C.C. § 9-312 (1972); CAL. COM. CODE § 9312 (West Supp. 1984); *see also* Creedon, *Some Reactions to the Review Committee's Proposal to Amend the Fixture Provisions of the Code*, 25 BUS. LAW. 313, 315 (1969) ("the purchase money financer . . . has a strong equitable right to priority over conflicting interests").

205. In this case, the dishwasher would be classified under the Code as equipment because it is bought for use in a business, the rental unit. U.C.C. § 9-109(2) (1972); CAL. COM. CODE § 9109(2) (West Supp. 1984). Because the dishwasher is for business use, the vendor must file a financing statement to perfect his interest in the collateral.

The purchaser could also say that the dishwasher is going to be used in his residence. The dishwasher then would be classified as consumer goods. U.C.C. § 9-109(1); CAL. COM. CODE § 9109(1). The vendor need not file a financing statement to perfect his interest in consumer goods unless the goods will become fixtures. U.C.C. § 9-302(1)(d) (1972); CAL. COM. CODE § 9302(1)(d) (West Supp. 1984). *See supra* note 158. A vendor would consider the dishwasher to be consumer goods and therefore consider his interest perfected because no filing is required. The catch 22 is that if the vendee attaches the dishwasher to realty, a filing is required.

There is, of course, no way for a vendor to ascertain whether the vendee may change his mind about his stated intended use, or lie about it in the first place. It is Byzantine to say that if the secured creditor "wants to be fully secure . . . [he] has to either spy on the debtor . . . or else file doubly, first in the chattel records and then in the realty records." Headrick, *supra* note 116, at 49.

b. the vendor who knowingly chooses not to make a fixture filing

A conditional seller may also decide that the costs of making a fixture filing outweigh his risk of loss to a bona fide purchaser. Consider the conditional seller of portable spas. He sells thousands of units per year on short-term installment sale contracts. Some, even many, of the purchasers construct decking around the units or otherwise make them "built-ins." As an inducement to sale, the homeowner may not dismantle his handiwork when he sells his property. The new buyer pays nothing extra for the spa. Although the conditional seller of the spa knew it might become a fixture, he consciously assumed the risk of loss because of the cost of making a fixture filing and because his exposure to the risk of a subsequent bona fide purchaser is only for the relatively short life of the installment sale contract. The buyer of the realty obtains a windfall merely because he had no notice of the conditional seller's interest.

A search of the chattel records is less costly relative to the purchase price of the realty[206] than is the cost of a fixture filing relative to the purchase price of a dishwasher or spa.[207] For example, assume a house sells for $100,000[208] and a portable dishwasher for $400. Putting aside all transaction costs, the $4 filing fee[209] to file a financing statement with the County Recorder's Office represents one percent of the cost of the dishwasher. On the other hand, assuming a search cost of the chattel records of approximately $28,[210] the cost of such a search to the

206. *See supra* note 195 and accompanying text.

207. The cost for a search of the chattel records in Sacramento is $5 for the first page of information and $1 for each additional page. Searches of the chattel records are commonly done by title search services. The service charges approximately $20 for the search of a single debtor, plus the $5 fee and $3 for "special handling" which enables it to acquire the data in approximately 10 days. A private individual who undertakes his own search often must wait several months for a response by mail. Telephone interview with Representative of Cal. Title-Search, Inc., 1005 Twelfth St., Ste. No. 10, Sacramento, CA 95814 (Feb. 16, 1984).

208. The median value of a single family residence in California in 1980 was $84,500. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1982-83, 755 (103d ed. 1982). Values are higher in California's two major cities: Los Angeles, $96,100; San Francisco, $103,900. *Id.* at 756. Thus, the $100,000 figure selected to illustrate the example is a reasonable one on which to base the calculation.

209. Telephone interview with the Clerk, Los Angeles County Recorder's Office (Feb. 14, 1984).

210. The author acknowledges that this approach seems more easily applied where the debtor owns the realty than where the debtor is a tenant. A prudent purchaser or encumbrancer of realty, however, gets copies of lease agreements as a condition of the contract of sale. He thus acquires the information he needs to search the chattel records. The search costs are increased to the extent that each search will cost approximately $28. A greater number of tenants, however, indicates a greater purchase price for the realty. It would be a

purchaser or encumbrancer of the realty represents a mere .028 percent of the price of the property. It is not unreasonable to expect a similar relative percentage disparity between, for instance, the cost of an air conditioning system versus the price of a commercial or industrial building. In this instance, the burden of filing and risk of loss is placed more equitably on the purchaser of the realty. Alternatively, all recording of chattel and real estate interests might be made in a central filing system located in the Office of the Secretary of State.[211]

C. Three Proposals Which Will Eliminate the Unresolved Problems

1. The UCC should adopt the California perfection scheme

The confusion which exists as to whether the bankruptcy trustee may shift gears from lien creditor to bona fide purchaser in order to seize secured personal property which also may be fixtures must be resolved by Congress. If, as expected, Congress limits the trustee to his status as lien creditor in fixture cases, the California perfection scheme should eliminate disputes between the perfected secured creditor and the trustee. Regardless of whether a court later holds that the collateral is a fixture, the secured creditor will be perfected with a single state filing. This also eliminates the initial definitional problem inherent in fixture law because the creditor need not determine the nature of the collateral in order to know where to perfect his interest. Therefore, the Review Committee for the Uniform Commercial Code should adopt the California perfection plan.

2. California and the UCC Review Committee should insert a knowledge requirement into subsection 9-313(4)(a), (b) to protect the bona fide fixtures vendor

This Comment also proposes that if a purchase money vendor does not know, or have reason to know, that the chattels he sells will become fixtures, he should not be held to the provisions of subsection (4)(a) and (4)(b) of both the UCC section 9-313 and the California Uniform Commercial Code section 9313.[212] The burden should be on the

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rare case indeed where the total search costs would equal the 1% of the purchase price found in the dishwasher hypothetical. It is conceded that the higher the cost of the goods in relation to the cost of the realty, the lower the percentage of filing fee relative to the cost of the goods. For example, in the case of a $4,000 spa, the $4 filing free represents .01% of the total cost of the collateral. Obviously, the heaviest burden is on the vendor of less expensive goods if he must file two financing statements, the first with the Secretary of State and the second locally.

211. *See infra* note 213 and accompanying text.

212. U.C.C. § 9-313, *supra* note 23; CAL. COM. CODE § 9313, *supra* note 99.

purchaser to search the chattel records to make certain that there are no liens on goods included in the conveyance. If the purchaser does not make the search, he should bear the risk of loss, that is, he should take the real property subject to the chattel liens. Therefore, California and the UCC Review Committee should amend the Codes by inserting a knowledge provision into subsection 9-313(4)(a), (b).

3. California and the UCC drafters should deal forthrightly with the issue of a unitary state filing system

If the purchaser must search the chattel records for purchase money security interests covering goods which are included in the conveyance, perhaps the better alternative is to establish a single filing system for all security interests, encumbrances, and conveyances of personal and real property with the Secretary of State. Computerization of record-keeping makes this feasible and economical. The UCC draftsmen viewed section 9-313 as a "workable compromise" between inconsistent objectives, "namely, a total desire to protect real estate interests and a total desire to protect chattel interests."[213] It seems, however, that this is not a "compromise." Rather, the balance in fixture law is tipped strongly in favor of real estate interests. "The true explanation of the 'real estate filing' is political: it is expedient to avoid a bitter and protracted battle [with real estate interests] by casting on the holder of the fixture security interest the additional burden of making a real estate filing."[214] A unified filing system would restore the balance, no matter how politically unpopular the concept is.

V. CONCLUSION

California has taken a remarkable step forward in unraveling some of the tangles in fixture law. All definitional problems vanish as to the lien creditor, including the bankruptcy trustee, because perfection of the security interest always takes place in one location, the Office of the Secretary of State. The UCC Review Committee should adopt the California approach.

Congress must act in order to protect the secured creditor from the bankruptcy trustee as bona fide purchaser of the realty. This is necessary to protect (1) the fixture financer who does not make a fixture filing because the transaction costs are excessive relative to the value of the goods and (2) the financer who does not make a fixture filing be-

213. Panel, *supra* note 20, at 982.
214. GILMORE, *supra* note 33, at 817-18.

cause he does not know that the collateral has become a fixture. Further, the bona fide fixtures vendor without knowledge that the goods have or will become fixtures should be protected from the true bona fide purchaser. California subsection 9313(4)(a), (b) and UCC subsection 9-313(4)(a), (b) should be amended to include a knowledge requirement.

The next step that should be taken by both California and the Uniform Commercial Code Review Committee is to unify the local real estate recording offices with the state chattel recording office. One data bank for real estate, fixture, and chattel interests would benefit both real estate interests and fixture secured creditors because the fixture secured creditors need make only one filing and the real estate purchasers need make only one search. The author concedes that adoption of a unitary filing system is unlikely. An alternative would be to require dual filings for all goods which conceivably might become fixtures. This would eliminate the trap for the unwary and the extra cost will be factored into the cost of credit.

Charlotte Costan