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SECTION 9-103 AND THE INTERSTATE MOVEMENT OF GOODS

With the increased mobility of our population, the interstate movement of goods subject to a security interest has created an extensive problem for both the legislatures and the courts: what are the rights and priorities of the parties to secured transactions in such goods. The problem generally arises in the following situation. A creditor in state *A* takes and perfects a security interest in goods while the goods are located there. The debtor, without the knowledge or consent of the secured creditor, removes the collateral to state *B*. While the property is located in state *B*, a third party, without notice that the goods are subject to a security interest, acquires an interest in the goods either as a purchaser, secured creditor, or attaching creditor. The debtor then disappears or is so judgment proof that any action against him would be unavailing. The secured creditor from state *A* seeks to assert his interest against the party who has acquired an interest in the goods in state *B*. In determining which of these two conflicting claimants has priority in the collateral, the courts and legislatures are often forced to a choice between two innocent parties.

Prior to the adoption of the Uniform Commercial Code,[1] the vast majority of states, in the absence of statutory directive to the contrary, would protect the secured creditor from state *A* in the hypothetical situation.[2] An exception to the general rule was made if the secured party knew of or consented to the removal of the collateral, or, having subsequently acquired knowledge of the removal, acquiesced therein and failed to take the necessary steps to perfect his interest in the state to which the collateral had been removed.[3]

The Uniform Commercial Code in section 9-103(3) and (4) deals with the situation where goods subject to a security interest are moved interstate. Section 9-103(3) provides:

> If personal property . . . is already subject to a security interest when it is brought into this state, the validity of the security interest in this state is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. However, if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the

[1] The Uniform Commercial Code has been adopted in all states except Louisiana as well as in the Virgin Islands and the District of Columbia. All citations to the Code will be to the 1962 Official Text.

[2] E.g., Pruitt Truck & Implement Co. v. Ferguson, 216 Ark. 848, 227 S.W.2d 944 (1950); Hinton v. Bond Discount Co., 214 Ark. 718, 218 S.W.2d 75 (1949); First Nat'l Bank v. Ripley, 204 Iowa 590, 215 N.W. 647 (1927); Hart v. Oliver Farm Equip. Sales Co., 37 N.M. 267, 21 P.2d 96 (1933); see Annot., 13 A.L.R.2d 1312 (1950).

[3] E.g., Hess-Harrington, Inc. v. State Exch. Bank, 155 Kan. 118, 122 P.2d 739 (1942); Great Am. Indem. Co. v. Utility Contractors, 21 Tenn. App. 463, 111 S.W.2d 901 (1937); see Annot., 13 A.L.R.2d 1312 (1950).

> validity of the security interest in this state is to be determined by the law of this state. If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues perfected in this state for four months and also thereafter if within the four month period it is perfected in this state. The security interest may also be perfected in this state after the expiration of the four month period; in such case perfection dates from the time of perfection in this state.

However, where property is covered by a certificate of title when it enters state *B* in the hypothetical situation outlined above, section 9-103(4) applies "notwithstanding subsection 3." A majority of states have enacted certificate-of-title acts which provide, as a method of perfection of certain security interests in motor vehicles, that such security interests be noted on a certificate of title issued by the state.[4] Section 9-103(4) provides:

> Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of this state or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.

This article will examine the numerous problems of interpretation and application that have arisen under section 9-103(3) and (4). Amendments to section 9-103 will be suggested where it is felt that such amendments are either necessary for clarification or compelled by policy. Such suggested amendments are not intended as proposals for individual state adoption, since a primary concern in problems involving multi-state secured transactions is uniformity. Amendments suggested herein are offered as proposals for consideration by the Permanent Editorial Board, which has undertaken an in-depth study of Article 9.[5]

I. SECTION 9-103(3)

In analyzing the purposes and evaluating the effect of section 9-103(3), it is appropriate to examine the statutory law from which it was derived.[6]

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4 The following jurisdictions have certificate-of-title acts: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Missouri, Montana, Nebraska, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. See Comment, The California Used Car Dealer and the Foreign Lien—A Study in the Conflict of Laws, 47 Calif. L. Rev. 543, 576-86 (1959). Since the above Comment was published, Connecticut, Georgia and Kentucky have adopted certificate-of-title acts. Conn. Gen. Stat. Ann. § 14-185 (1960); Ga. Code Ann. § 68-421(a) (1966); Ky. Rev. Stat. Ann. § 186.195 (1963).

5 3 Permanent Editorial Board for the Uniform Commercial Code Rep. x-xi (1967).

6 Vernon, Recorded Chattel Security Interests in the Conflict of Laws, 47 Iowa L. Rev. 346, 366-76 (1962) contains a detailed analysis of pre-Code statutes relating to the status of security interests created in another state.

Section 9-103(3) is primarily based upon two distinct types of pre-Code statutes. One type required the out-of-state secured creditor to perfect his interest in the state to which the collateral had been removed only if he received notice of the removal. A second type, which closely resembles section 9-103(3), required the out-of-state secured creditor to perfect his interests locally within a specified period of time, whether or not he received notice of the removal of the collateral.

Section 14 of the Uniform Conditional Sales Act dealt with conditional sales contracts which were executed in another jurisdiction. It provided that the reservation of title by the seller was void unless the conditional sale contract or a copy was filed within ten days after the seller received notice of the filing district to which the goods had been removed.[7] Section 14 was, in effect, an attempted codification of the general rule which protected the out-of-state secured creditor unless he consented to or had knowledge of the fact that the collateral had been removed to another state.[8] Under section 14, if the conditional seller never received notice of the removal of the collateral, his position of priority over local claimants would continue indefinitely.

Three states, Alabama,[9] Georgia,[10] and Oklahoma,[11] enacted statutes which granted the out-of-state secured creditor a specified period of time in which to perfect his interest once the collateral had been brought into the state. These statutes rejected the idea contained in section 14 of the U.C.S.A. that, if the secured creditor never received notice of the removal of the collateral, his position of priority would continue indefinitely. Under these statutes, an out-of-state filing was constructive notice of the security interest for the entire period provided in the statute, even though the out-of-state secured party received notice that the collateral had been relocated.

Section 9-103(3) closely resembles the Alabama, Georgia, and Oklahoma statutes by granting the out-of-state secured creditor a specified period of time to perfect his interest in the state to which the collateral has been removed. In order to get the benefit of the four month period in the Code state, two pre-conditions must be met. First, the security interest must have been "perfected under the law of the jurisdiction where the property was when the security interest attached." Second, the security interest must have been perfected before the collateral is brought into the Code state. As the comments to section 9-103(3) point out, subsection (3) is based substantially upon the theory that the secured creditor should be able to discover the location of the collateral and take the necessary steps to perfect

[7] Uniform Conditional Sales Act § 14; under § 14, a creditor "received notice" of the removal when he had "knowledge" that the collateral had been removed. Gardinier v. Mack Int'l Motor Truck Corp., 36 F.2d 721 (2d Cir. 1929). See Annot., 68 A.L.R. 554 (1930).

[8] See cases cited notes 2 & 3 supra.

[9] Ala. Code tit. 47, §§ 111, 123, 131 (1958), repealed, Ala. Code tit. 7A, § 10-102 (1966).

[10] Ga. Code Ann. § 67-108 (1967), repealed in part, Ga. Code Ann. § 109A-10-104 (1962).

[11] Okla. Stat. Ann. tit. 46, § 58 (1954), repealed, Okla. Stat. Ann. tit. 12A, § 10-104 (1963).

his interest within a four month period.[12] If the out-of-state secured creditor fails to perfect within four months after the collateral has been removed to a Code state, his interest is thereafter treated as unperfected and is subject to defeat by those persons who take priority over an unperfected security interest.[13]

Although section 9-103(3) rejects the idea, contained in Section 14 of the U.C.S.A., that if the secured party never receives notice of the removal of the collateral, his position of priority continues indefinitely, section 9-103(3) does provide for the situation where the parties understood that the goods would be kept in the new state. This provision is similar to Section 14 of the U.C.S.A., yet it is in fact much narrower. It applies only if two pre-conditions are met. First, the parties had to understand at the time the security interest attached "that the property would be kept in the Code state." Second, the collateral must have in fact come into the Code state "within 30 days after the security interest attached for purposes other than transportation" through the Code state. This provision, unlike section 14, does not apply where the collateral is removed without the knowledge of the secured creditor.

It can be seen that section 9-103(3), in theory, does not represent a radical departure from pre-Code law. Instead, it has evolved from various pre-Code statutes dealing with security interests created in other states. Despite this evolution, major questions remain concerning the efficacy and applicability of section 9-103(3). First, the question arises whether the out-of-state secured creditor should be afforded the full four month period of perfection when he has learned that the collateral is in another state a short time after the debtor has relocated it there. Second, a potentially difficult problem is raised by the distinction in section 9-103(3) between the "validity" of and the "perfection" of security interests. The issue is whether the out-of-state secured creditor receives the benefit of the four month period even though he understood at the time the security interest attached that the property would be kept in another state. A third problem involves the nature of the four month period. Specifically, the question is whether interests acquired during the initial four months after the collateral has been relocated take priority over an out-of-state secured creditor who fails to perfect his interest within that period. A fourth question concerns the interrelationship of the four month period contained in section 9-103(3) and the preference provisions of the Bankruptcy Act.

A. *Knowledge of Removal During the Four Month Period*

In evaluating the efficacy of section 9-103(3), one problem which does not appear to have received adequate coverage arises from the situation where the secured creditor learns that the collateral is in another jurisdiction shortly after the debtor has relocated it there. For example, on January 1, a security interest is taken and perfected in goods while they are located in State *A*. On January 5, the goods are removed without the knowledge or consent of the secured creditor to state *B*, a Code state. On January 15, the secured creditor

[12] U.C.C. § 9-103, Comment 7.

[13] Id. For those persons who take priority over an unperfected security interest, see U.C.C. § 9-301.

learns that the debtor has taken the collateral to state *B*. On February 15, the debtor sells the property to an innocent purchaser for value. On March 1, the creditor perfects his interest in state *B*.

In this situation, since the security interest was perfected in state *A* and before the collateral was brought into state *B*, section 9-103(3) provides that the security interest continues perfected in state *B* for four months and also thereafter since it was perfected under the law of State *B*. Even though the secured creditor learned that the property was in state *B* within fifteen days of its removal from state *A*, he still retains the benefit of the full four months to perfect his interest. It may be questioned whether this is a result consistent with fundamental Code policy in that it permits innocent parties to rely upon the debtor's ostensible freedom to dispose of the collateral for an unnecessary length of time.

Section 9-103(3) attempts to reach a compromise between the conflicting claims of the out-of-state secured creditor and local claimants who acquire an interest in the collateral by providing a four month period of perfection. As the comments to section 9-103(3) point out, it is felt that the four month period is sufficient time for the secured creditor "to discover in most cases that the collateral has been removed" and to perfect his interest.[14] The four month period of continued perfection promotes the extension of credit in a credit oriented society. It provides a means of protecting the reasonable expectations of the secured creditor since, if the debtor fails to pay, the creditor will have greater opportunities for recourse against the collateral. On the other hand, the four month period represents a legislative recognition that not only the out-of-state secured creditor but also other parties who acquire an interest in the collateral should be considered.

However, if the secured creditor learns that the collateral is in another jurisdiction shortly after the debtor has removed it there, he no longer has need of a full four month period to perfect his interest. Certainly, the out-of-state secured creditor should not be required to perfect in state *B* if the goods are there only temporarily, as in the situation where an encumbered automobile is brought into state *B* during the debtor's vacation. On the other hand, if the secured party knows that the debtor intends to keep the property in state *B* on a permanent basis, as in a situation where the debtor changes his residence, the secured creditor should be required to perfect in state *B* soon after he receives such notice. Such a requirement would tend to strengthen the compromise between the conflicting claims of secured creditors and other persons who acquire an interest in the collateral. At the same time, it would not have an adverse effect on the reasonable expectations of the secured creditor, since he would be required to perfect only if he had notice of the permanent removal.

Prior to the adoption of the Uniform Commercial Code, the North Carolina statute relating to security interests created in another state[15] combined provisions similar to the ten day notice period of Section 14 of the U.C.S.A. and the four month period of section 9-103(3). The statute emphasized filing of the security interest in the state in which the property was

[14] U.C.C. § 9-103, Comment 7.

[15] N.C. Gen. Stat. § 44-38.1 (1965), repealed, N.C. Gen. Stat. § 25-10-104 (1965).

kept before being brought into North Carolina.[16] Where property subject to a filed security interest was brought into North Carolina with the intention of keeping it there permanently, the statute provided that the security interest would be enforceable, prior to filing in North Carolina, as against lien creditors of and purchasers from the debtor only if two conditions were met. First, the statute required that the security interest be properly filed in North Carolina within ten days after the secured creditor had knowledge that the collateral had been removed there.[17] Second, it required that, in any event, the security interest had to be properly filed within four months after the collateral had been removed to North Carolina.[18] Thus, under the statute the four month period was merely an outside limit within which the secured party had to locate the collateral and file his interest in order to maintain a position of priority over third parties who acquired an interest in the collateral. Where, however, the second creditor had knowledge within the four month period of an intended permanent removal of the collateral to North Carolina, he was required to file within ten days after he had such knowledge. It is submitted that the theory underlying the North Carolina legislation is sound. While a four month period may be a reasonable time to allow the secured creditor to try to discover the location of the collateral, it is an unreasonable time to allow him to perfect his interest once he has in fact discovered its location. With these considerations in mind, the following amendment to section 9-103(3) is suggested:

> If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues perfected in this state *for the shorter of the following periods:*
>
> (*a*) *for ten days after the secured party has notice of the permanent removal of the collateral to this state*
>
> (*b*) for four months . . .[19]

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16 Where the security interest was not filed in the state from which the property came, the North Carolina statute provided that it would not be effective against specified local claimants unless filed in North Carolina. Id. § 44-38.1(d).

17 Id. § 44-38.1(b)(2).

18 Id. § 44-38.1(b)(3).

19 Suggested amendments here, and in the remainder of the comment, are indicated by italics.

The meaning of "notice" in the suggested amendment will be governed by U.C.C. § 1-201(25) which provides:

> A person has "notice" of a fact when
> (a) he has actual knowledge of it; or
> (b) he has received a notice or notification of it; or
> (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

Under U.C.C. § 1-201(26): "A person 'receives' a notice or notification when (a) it comes to his attention; or (b) it is duly delivered at [his] place of business . . . ."

The four month period, as it now stands in § 9-103(3), does not raise difficult fact questions. The only questions are, when did the property come into the Code state, and, was the security interest perfected within the four month period. The suggested ten day notice provision raises a more difficult fact question as to whether the secured

B. *Validity and Perfection of Security Interests*

Potentially difficult problems arise in connection with the Code's distinction between the "validity" and the "perfection" of security interests and the interrelationship of these concepts in section 9-103(3). The initial two sentences of section 9-103(3) provide rules for determining which jurisdiction's law governs the "validity" of the security interest when property subject to such an interest is removed to a Code state; while the last two sentences relate to the "perfection" of such a security interest. A proper understanding of section 9-103(3) requires an analysis of the Code's distinction between the "validity" and "perfection" of security interests.

Part 3 of Article 9 deals with "perfected" and "unperfected" security interests. Section 9-303(1) provides that "[a] security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305 and 9-306." For most types of collateral, filing and taking possession of the collateral are alternative methods for perfection of a security interest.[20] Section 9-302(1) states the general rule that to perfect a security interest, a financing statement must be filed. Subsections (1)(a) through (1)(f) exempt certain transactions from the filing requirements. Section 9-305 permits a security interest in goods,[21] instruments,[22] documents[23] and chattel paper[24] to be perfected by transfer of possession to the secured party. Section 9-301(1) lists the classes of persons who take priority over an unperfected security interest. All such parties are third parties who acquire an interest in the collateral, for example, lien creditors of and purchasers from the debtor. It is not necessary that a security interest be perfected in order to enforce the security agreement against the debtor. Perfection is primarily related to providing notice of the security interest to third parties. Thus "perfection" of a security interest means the taking of the steps, such as public filing or possession of the collateral, which are necessary to insure that the secured creditor's rights in the collateral are superior to the rights of third parties who acquire an interest. A perfected security interest may still be or become

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creditor had "notice of the permanent removal." It is felt, however, that the need for such a provision outweighs any difficulties in proof which it may raise.

20 An exception is made for a security interest in certain instruments. U.C.C. § 9-304(1) provides that such a security interest can be perfected only by the secured party's taking possession.

21 U.C.C. § 9-109 contains the Code's classification of "goods." It provides:

Goods are

(1) "consumer goods" if they are used or bought for use primarily for personal, family, or household purposes;

(2) "equipment" if they used primarily in business. . . .

(3) "farm products" if they are crops or livestock or supplies used or produced in farming operations. . . .

(4) "inventory" if they are held by a person who holds them for sale or lease or to be furnished under contracts of service . . . .

22 U.C.C. § 9-105(1)(g).

23 U.C.C. §§ 1-201(15), 9-105(1)(e).

24 U.C.C. § 9-105(1)(b).

subordinate to other interests[25] but in general after perfection the secured party is protected against creditors and transferees of the debtor.[26]

Part 2 of Article 9 is entitled: "Validity of Security Agreement and Rights of Parties Thereto." Unfortunately, the term "validity" is not defined. The comments to section 9-103(3) indicate that the "validity" of a security interest refers to the "formal requisites" of a security interest.[27] Section 9-203(1) provides: "[A] security interest is not enforceable against the debtor or third parties unless (a) the collateral is in the possession of the secured party; or (b) the debtor has signed a security agreement which contains a description of the collateral . . . ." The official comments to this section indicate that the "formal requisites" stated are in the nature of a Statute of Frauds.[28] Section 9-204(1) states that a security interest cannot attach until there is an agreement, value is given, and the debtor acquires rights in the collateral. The comments indicate that agreement, value, and collateral are basic "prerequisites" to the existence of a security interest.[29] The "validity" of a security interest thus refers to factors such as the requirements of a written security agreement, value and good faith which go to the creation of a security interest whereas the "perfection" of a security interest refers to the steps designed to give third parties notice of the existence of the security interest.[30]

In certain situations, the same steps which go to the creation of a "valid" security interest, for example, taking possession of the collateral where there is no written security agreement, will also fulfill the notice function required for perfection.[31] In other situations, perfection will depend upon the additional step of filing a financing statement.[32] Thus where a security agreement covering goods owned by the debtor is properly executed, but the secured creditor does not file as required, his security interest is "valid" but "unperfected."

A problem with the interrelationship of the "validity" and "perfection"

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25 E.g., U.C.C. § 9-307(1), providing: "A buyer in the ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the buyer knows of its existence."

26 U.C.C. § 9-303, Comment 1.

27 U.C.C. § 9-103, Comment 7.

28 U.C.C. § 9-203, Comment 5.

29 U.C.C. § 9-204, Comment 1.

30 Compare "validity" and "perfection" as those terms are used U.C.C. § 9-103(3) with the terms as they are used in The Federal Motor Vehicle Lien Act, 49 U.S.C. § 313 (1964). 49 U.S.C. § 313(a)(4) provides:

> "[P]erfection" in connection with a security interest means the taking of the steps (including but not limited to public filing . . .), or the existence of the facts required by applicable law to make a security interest enforceable against general creditors and subsequent lien creditors of a debtor carrier, but does not include any reference to compliance with requirements, if any, as to capacity, authority, form of instruments, value, consideration, good faith, and other matters which go only to the creation of a valid security interest as between the debtor carrier and the secured party.

31 U.C.C. §§ 9-203(1)(a), -305.

32 U.C.C. § 9-302.

provisions in section 9-103(3) arises in the following situation. A security agreement covering specific goods is executed in state *A*. While the property is located there, the secured party takes the necessary steps to perfect his interest under the law of state *A*. Both parties understood at the time the security interest attached that the property was to be kept in state *B* and a few days after the security agreement is executed the property is in fact removed to state *B*. A short time later, the debtor sells the goods in state *B* to a purchaser who is without notice that the goods are subject to a security interest. Within four months after the goods have been removed to state *B*, the secured party perfects his interest in state *B* by filing a financing statement. The issue is whether the secured creditor gets the benefit of the four month period even though he understood at the time the security interest attached that the goods would be kept in state *B*.

The second sentence of section 9-103(3) provides:

> [I]f the parties to the transaction understood at the time the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the *validity* of the security interest in this state is to be determined by the law of this state. (Emphasis added.)

Applying this provision to the hypothetical situation outlined above, the law of state *B* would govern the "validity" of the security interest since both parties understood that the collateral would be kept in state *B* and it was brought there shortly thereafter. Since the provision quoted above relates only to the "validity" of the security interest, a question remains as to the efficacy in state *B* of the perfection in State *A* after the goods have been relocated.

On the issue of perfection, section 9-103(3) provides:

> If the security interest was already *perfected* under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues *perfected* in this state for four months and also thereafter if within the four month period it is *perfected* in this state. (Emphasis added.)

There is no indication in subsection (3) that this provision was not intended to apply where the parties understood at the time the security interest attached that the collateral would be kept in another state. Applying this provision to the hypothetical situation outlined above, the security interest would continue perfected in state *B* for four months since it was perfected under the law of state *A* before the collateral was removed to state *B*.

Combining the "validity" and "perfection" provisions, section 9-103(3) literally provides that the "validity" of the security interest is determined by the law of state *B* and the security interest is "perfected" in state *B* for four months and also thereafter since the secured creditor "perfected" his interest within the four month period. The secured creditor would prevail in an action against the innocent purchaser.[33]

The result reached by a strict literal interpretation of section 9-103(3) seems at odds with the policy underlying the four month period. Where the collateral is removed to another jurisdiction pursuant to an understanding of the parties existing at the time the security interest attached, the secured creditor has no need of a four month period to discover the location of the collateral. The out-of-state secured creditor should stand on no better footing than a local creditor in this situation. Both the "validity" and "perfection" of the security interest in the jurisdiction to which the collateral is removed should be governed by the law of that state. This result can be achieved by interpreting the four month provision to be inapplicable to the situation under discussion. Section 9-103(3) would then dictate only that the "validity" of the security interest is to be determined by the law of the entered state and would not state a rule relating to the "perfection" of such security interests. Section 9-102(1) provides that, except as otherwise provided by section 9-103(3), local law applies to secured transactions where the collateral is within the jurisdiction of the state. By construing the four month period to be inapplicable, local law would be the Article 9 perfection provisions. Thus, under this interpretation, both "validity" and "perfection" would be governed by the law of the entered state, notwithstanding the four month period.

It will still be possible, however, for some courts to be confused by the distinction between "validity" and "perfection." They may literally interpret section 9-103(3) so that the "validity" of the security interest will be governed by the law of the entered state and the security interest will continue "perfected" in that state for four months. To be certain that such a result is avoided, the following amendment is suggested:

> *Notwithstanding the above provisions* [the four month period], if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the validity *and the perfection* of the security interest in this state *are* to be determined by the law of this state.

This amendment should obviate the problem involved with the interrelationship of the "validity" and "perfection" provisions as they currently stand

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33 Section 9-301 provides:

(1) [A]n unperfected security interest is subordinate to the rights of

. . . .

(c) in the case of goods . . . a person who is [a] . . . buyer not in the ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected.

If the four month period is applicable, however, the security interest was in fact perfected. Section 9-201 would therefore govern since it provides that "except as otherwise provided . . . a security agreement is effective according to its terms . . . against purchasers of the collateral and against creditors."

in section 9-103(3). The suggested amendment provides, in essence, that the four month period is not viable if the parties knew at the time of attachment that the collateral would be kept in another state and it was brought into that state shortly thereafter. The amendment proceeds on the theory that there is no need for a four month period in this situation.

C. *The Nature of the Four Month Period*

Further questions of application and policy arise in connection with the nature of the four month period of perfection provided in section 9-103(3) for security interests which have been perfected in another state. In regard to such interests, section 9-103(3) provides:

> If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, *the security interest continues perfected* in this state for four months and also thereafter if within the four month period it is perfected in this state. (Emphasis added.)

A difficult question as to the exact meaning of this provision arises where interests are acquired in the collateral by third parties within the four month period and the secured creditor does not take the necessary steps to perfect his interest within that period. For example, a security interest in goods is perfected in state *A* while the property is located there. The debtor moves the property to state *B* and within four months sells it there to a purchaser who is without notice that the goods are subject to an outstanding security interest. The secured creditor from state *A* does not perfect his interest in state *B* within the four month period. After the expiration of the four month period, the secured creditor seeks to assert his interest against the purchaser. The question is basically one of priority and the solution depends upon the nature of the four month period. Alternative interpretations of the nature of this period are possible.

Under one interpretation, failure to perfect by the secured party within the four month period has no bearing on his status in relation to interests acquired during that period. It is only after the expiration of the initial four months that failure to perfect in the second state results in his interest being treated as unperfected. Under this interpretation, the four month period is a period of absolute perfection. Applying this interpretation to the hypothetical situation posed above, the fact that the secured creditor from state *A* did not perfect his interest in state *B* within the four month period has no effect on his status within that period. Since his interest was perfected in state *A* and before the collateral was brought into state *B*, his interest is absolutely and indefeasibly perfected in state *B* for four months and the innocent purchaser there takes subject to his interest.[34]

A second possible interpretation of the nature of the four month period is that failure by the out-of-state secured party to perfect within that period forfeits the initial four month period of protection and the security interest is treated as unperfected from the time the collateral comes into the state. Under

[34] See note 33 supra.

this interpretation, the four month period is a period of grace. Applying this line of approach in the hypothetical situation outlined above, the fact that the secured creditor did not perfect in state *B* within four months after the collateral was removed there results in a forfeiture of the initial four months of protection and his security interest is treated as unperfected from the time the collateral came into state *B*. Thus, the innocent purchaser in state *B* would take the collateral free of the security interest.[35]

The question of the operative effect of the four month period in the situation under discussion has been considered in two recent cases.[36] Both decisions, the later case relying exclusively upon the holding in the earlier case, held that the four month period is a period of absolute perfection and thus failure to perfect in the second state within the four month period was held to have no bearing on the status of the security interest within that period.[37] Both courts concluded that the four month period provided in section 9-103(3) is different from the ten day grace period allowed under the Uniform Conditional Sales Act for the filing of conditional sales contracts.[38] Both felt that the phrase, "continues perfected," could only be interpreted to mean absolute perfection.

Professor Vernon suggests a contrary reading of section 9-103(3).[39] Vernon relies on the comments to section 9-103(3) which explain that a second conflicting security interest in the collateral which is taken and perfected in the second state within the four month period takes priority over the out-of-state security interest which is not perfected within that period.[40] Vernon points out that, although no specific answer is given as to the status of other persons who acquire an interest in the collateral within the four month period, the fact that a second secured creditor prevails over the security interest created in another state is an indication that the four month period is less than a period of absolute perfection.[41] He concludes that the four month period is a period of grace which is forfeited if the secured creditor fails to perfect his interest within the period allowed.[42]

The position of the courts that the four month period is a period of absolute perfection is clearly justified by the language of section 9-103(3) which provides that the security interest "continues perfected" for four

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35 U.C.C. § 9-301(1)(c).

36 Churchill Motors, Inc. v. A.C. Lohman, Inc., 16 App. Div. 2d 560, 229 N.Y.S.2d 570 (1962); First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 225 A.2d 162 (L. Div. 1966).

37 Churchill Motors, Inc. v. A.C. Lohman, Inc., 16 App. Div. 2d at 566-67, 229 N.Y.S.2d at 577; First Nat'l Bank v. Stamper, 93 N.J. Super. at 163, 225 A.2d at 169.

38 Id.

39 Vernon, supra note 6, at 377-78.

40 Id. U.C.C. § 9-103, Comment 7 explains in part:

> The four month period is long enough for a secured party to discover in most cases that the collateral has been removed and to file in this state; thereafter, if he has not done so, his interest . . . is subject to defeat here by those persons who take priority over an unperfected security interest (see section 9-301). Under Section 9-312(5) the holder of a perfected conflicting security interest is such a person even though during the four month period the conflicting interest was junior.

41 Vernon, supra note 6, at 378.

42 Id.

months.[43] In other areas where the draftsmen were concerned with interests arising prior to the perfection of the security interest, they have specifically provided for a period of grace within which the secured creditor must perfect in order to take priority over such intervening interests.[44] The absence of such an explicit provision in section 9-103(3) indicates that the four month period is a period of absolute perfection. The comment to section 9-103(3) provides that, if the secured creditor does not perfect within four months, "*thereafter* . . . his interest . . . is subject to defeat . . . by those persons who take priority over [such] interests."[45] (Emphasis added.) Use of the word "thereafter" is further indication that failure to perfect within the four month period has no bearing on the out-of-state secured creditor's status in relationship to interests acquired during that period.

The comment further provides, however, that a conflicting security interest perfected in the second state within the four month period may defeat the out-of-state security interest which is not perfected within the four month period.[46] It is arguable that this comment is in conflict with the absolute perfection language contained in section 9-103(3). While the former part of the comment indicates that failure to perfect within the four month period has no effect on the relationship between the out-of-state security interest and interests acquired during the four month period, the latter phrase indicates the opposite, at least as to secured creditors who acquire an interest within the period.[47] Since it is the language of the Code itself and not the language of the comments that is enacted into law, however, such conflict must be resolved in favor of the Code language as a reflection of statutory intent and policy.

In addition, the comment in question cites section 9-312(5) as authority for the proposition that a second conflicting security interest perfected within the four month period is promoted to the status of senior lien if the out-of-state secured creditor does not perfect his interest within the four month period.[48]

Section 9-312(5) provides:

> [P]riority between conflicting security interests in the same collateral shall be as determined as follows:
> (a) in the order of filing if both are perfected by filing . . .
> (b) in the order of perfection unless both are perfected by filing . . .
> (c) in the order of attachment under Section 9-204(1) so long as neither is perfected.

The comment to section 9-103(3) apparently interprets section 9-312(5)

[43] Cases cited note 36 supra.

[44] E.g., U.C.C. § 9-301(2), providing a ten day grace period for purchase money security interests.

[45] U.C.C. § 9-103, Comment 7.

[46] Id.

[47] Professor Gilmore criticizes Comment 7 to § 9-103 and Comment 3 to § 9-403, pointing out that he was generally responsible for the preparation of the Article 9 comments but that he did not prepare these comments and is unaware of their origin. 1 G. Gilmore, Security Interests in Personal Property 589-90 n.4 (1965).

[48] See note 40 supra.

to require the out-of-state secured creditor to perfect within the four month period in order to maintain priority over the second conflicting security interest. This interpretation creates a conflict between sections 9-103(3) and 9-312(5). Section 9-103(3) suggests that the four month period is a period of absolute perfection while this interpretation of section 9-312(5) would make it a period of grace as to conflicting security interests. Section 9-312(5) can, however, be interpreted consistently with the language of section 9-103(3). In order to obtain the benefit of the four month period, the security interest must be perfected before the collateral is brought into the Code state. Where a conflicting security interest is taken in the second state within the four month period, it would seem that the only relevant perfection by the out-of-state secured creditor in determining priorities between the two creditors would be the perfection in the first state. Applying this to section 9-312(5), the out-of-state secured creditor would take priority over the conflicting security interest perfected within the four month period since the out-of-state security interest was perfected first. Failure to perfect within the four month period would have significance only in regard to interests which are acquired after the initial four month period. Under this interpretation, section 9-103(3) would, as the language therein indicates, be interpreted to provide a period of absolute perfection both as to purchasers and conflicting secured creditors who perfect their interests within the four month period. Thus it is submitted that the comment to section 9-103(3) is substantively incorrect because it raises inconsistencies between that section and section 9-312(5) where such inconsistencies can be avoided by a proper interpretation of the interrelationship of these sections.

D. *Section 9-103(3) and the Bankruptcy Act*

An additional problem with the four month period provided in section 9-103(3) concerns its relationship with the preference provisions of the Bankruptcy Act.[49] It is arguable, from a literal interpretation of these provisions, that even though the secured creditor perfects his interest within the four month period, his interest may be set aside as a preference if the debtor becomes bankrupt shortly thereafter.

As defined in Section 60(a)(1) of the Bankruptcy Act:

> A preference is a transfer . . . of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt made . . . by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.[50]

The classic preference arises when an insolvent debtor pays one or more of his general creditors on the eve of bankruptcy. The inequity to other general creditors is obvious. No less inequitable is the situation where the debtor executes a security interest in favor of one of his general creditors.

[49] 11 U.S.C. § 96 (1964).
[50] Id. § 96(a)(1).

If the security interest were enforceable, the preferred creditor would have an unfair advantage over other general creditors. To avoid the abuses inherent in this situation, the term "transfer" includes "fixing a lien upon property . . . voluntarily . . . as a . . . pledge, mortgage, lien, encumbrance . . . ."[51]

The pivotal date for determining if a preference does exist is the date of transfer since, in order to constitute a preference, the transfer must be made for an antecedent debt, while the debtor is insolvent and within four months of the filing of a petition in bankruptcy. Sections 60(a)(2) and 60(a)(7) provide rules for determining the date of transfer. Section 60(a)(2) provides:

> [A] transfer of property . . . shall be deemed to have been made . . . when it became so far perfected that no subsequent lien . . . obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.[52]

In regard to security interests, section 9-301(1)(b) provides that an unperfected security interest is inferior to the rights of a person who becomes a lien creditor without knowledge of the security interest. Thus, where the transfer is the creation of a security interest, the transfer "becomes so far perfected" within the meaning of section 60(a)(2) when it is perfected under Article 9.

The following example is illustrative of the problem presented by the interrelationship of Section 60(a)(2) of the Bankruptcy Act and Section 9-103(3) of the Code. On January 1, the creditor takes a security interest in specified property while the property is located in state *A*. On the same day the creditor perfects his interest by filing a financing statement in state *A*. On July 1, the debtor moves the collateral to state *B*. On July 15, the secured creditor from state *A* perfects his security interest in state *B* by filing a financing statement there. On August 1, a petition is filed in bankruptcy. The question is when did the transfer "become so far perfected that no subsequent lien . . . obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee" within the meaning of section 60(a)(2). If it became "so far perfected" on July 15, section 60(a)(2) would "deem" the transfer to be made on that date. Then the transfer would be made for an antecedent debt, while the debtor was insolvent and within four months of bankruptcy and, therefore, it would be a voidable preference. On the other hand, if the transfer became "so far perfected" on January 1, the transfer would not be made for an antecedent debt and would not constitute a preference. Section 9-103(3) provides that the security interest "continues perfected for four months and also thereafter if within the four month period it is perfected in this state." As suggested above, the four month period is a period of absolute perfection. Where the secured creditor perfects within the four month period in state *B*, his interest has continued perfected from the initial filing of the security interest in state *A*. Section 9-303(2) provides that if a security interest is originally perfected by one method and is subsequently reperfected by another method,

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[51] Id. § 1(30).
[52] Id. § 96(a)(2).

without a gap when the security interest became unperfected, "the security interest shall be deemed to be perfected continuously." Reading these provisions with section 60(a)(2), it is submitted, that the transfer "became so far perfected" under the Code on January 1, and thus would not constitute a preference.[53] This appears to be the most equitable reading of section 60(a)(2). To read section 60(a)(2) as prescribing the date of transfer to be the date of perfection in the second state would void the secured creditor's interest as a preference merely on the fortuitous circumstance that the goods were moved to another state within four months of bankruptcy.

Section 60(a)(7) contains provisions relating to the perfection of security interests where an additional step such as filing or taking possession of the collateral is necessary. It provides:

> Any provision in this subdivision (a) to the contrary notwithstanding if the applicable law requires a transfer of property other than real property for or on account of a new and contemporaneous consideration to be perfected by recording, delivery, or otherwise in order that no lien described in paragraph (2) . . . could become superior to the rights of the transferee therein, . . . the time of transfer shall be determined by the following rules:
>
> I. Where (A) the applicable law specifies a stated period of time of not more than twenty-one days after the transfer within which recording, delivery, or some other act is required and compliance therewith is had within such stated period of time; or where (B) the applicable law specifies no such stated period of time or where such stated period of time is more than twenty-one days, and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made or suffered at the time of the transfer.
>
> II. Where compliance with the law applicable to the transfer is not had in accordance with the provisions of subparagraph I, . . . the transfer shall be deemed to be made . . . at the time of compliance therewith . . . .[54]

A problem with the interrelationship of section 9-103(3) and section 60-(a)(7) is exemplified by the following situation. On January 1, the creditor lends $50,000 to the debtor and takes a security interest in the debtor's inventory which is located in State *A*. On January 2, the secured creditor perfects his interest by filing a financing statement as required by the law of state *A*. On January 4, the debtor moves his inventory to state *B*. On February 4, within the four month period provided by section 9-103(3), the secured creditor locates the collateral in state *B* and files a financing statement there. On March 1, a petition is filed in bankruptcy. During the entire period, the creditor knows the debtor to be insolvent.

[53] Professor Gilmore states: "No one ever suggested that a chattel mortgage reperfected without lapse under any pre-Code chattel mortgage act somehow became open to attack under § 60 at the time of reperfection. There is no earthly reason why reperfection under Article 9 should be treated differently from reperfection under any pre-Code statute." 2 G. Gilmore, Security Interests in Personal Property 1317 (1965).

[54] 11 U.S.C. § 96(a)(7) (1964).

It has been suggested that Section 60(a)(7) of the Bankruptcy Act may apply to this situation because section 9-103(3) is "applicable law [which] requires a transfer of property . . . to be perfected by recording . . . in order that no lien [obtainable by legal or equitable proceedings on a simple contract] could become superior to the rights of the transferee" within the meaning of section 60(a)(7).[55] If section 60(a)(7) does apply, since the four month period granted by section 9-103(3) exceeds twenty-one days and compliance was not had within twenty-one days after the creation of the security interest, section 60(a)(7)(II) would control. This section provides that, where perfection is not accomplished within the twenty-one day period, the transfer is "deemed to have been made" when the secured creditor complies by recording. Thus, under this approach, the transfer would be "deemed to have been made" when the secured creditor complies by recording and the transaction would be voidable as a preference.

It has been argued, however, that section 60(a)(7) was not intended to apply in the situation covered by section 9-103(3).[56] This argument interprets section 60(a)(7) as intended to apply only to the initial perfection of a security interest in one state and not with the renewal or continuation of a security interest which has already been perfected.[57]

The transfer, for purposes of section 60(a)(7), is the creation of the security interest. In the wholly intrastate transaction, if the secured creditor perfects with twenty-one days, "the transfer [is] deemed to be made at the time of the transfer." In other words, the transfer is deemed to be made at the time of the creation of the security interest. Section 60(a)(7)(I)(B) applies where "applicable law" specifies a stated period of more than twenty-one days after the transfer within which recording or delivery is required. Section 9-103(3) would not seem to be "applicable law." It does not relate to the creation of the security interest. It does not specify a stated period "after the transfer" within which recording is required. It specifies a stated period of time after the goods have been moved into the Code state. Furthermore, to apply section 60(a)(7) would require the impossible in the case where the collateral is removed to another state more than twenty-one days after the security interest was created. In this case, the secured creditor could not possibly comply with the recording requirements within twenty-one days after the transfer. For these reasons it is submitted that section 60(a)(7) does not apply in the situation covered by section 9-103(3).

II. SECTION 9-103(4)

A. *Certificate-of-Title Acts*

A majority of states have enacted certificate-of-title acts which provide as a method of perfection of security interests in vehicles subject to the

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[55] Countryman, The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act, 16 Law & Contemp. Prob. 76, 98 (1951). Countryman was in no sense arguing that § 60(a)(7) should apply but merely suggesting it.

[56] W. Willier & F. Hart, Forms and Procedures under the Uniform Commercial Code 9-114 (1963); 2 G. Gilmore, supra note 53.

[57] Id.

act that the interest be noted on a certificate of title issued by the state.[58] Of the states which have such certificate-of-title legislation most have enacted "complete" title acts.[59] Such acts provide that all security interests in a vehicle subject to the act are to be noted on the certificate substantially at the time they are created regardless of whether it be at the time of transfer or between transfers.[60] A minority of the jurisdictions have enacted "incomplete" title acts.[61] Such acts provide that only liens existing at the time of transfer are to be noted on the certificate.[62] Security interests created between transfers are governed by local recording statutes.[63]

Section 9-103(4) governs interstate removal where a vehicle is covered by a certificate of title. It provides:

> Notwithstanding subsection (2) and (3) if personal property is covered by a certificate of title issued under a statute of this state or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.[64]

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58 The Uniform Commercial Code adopts the notation requirements of these statutes in § 9-302(3)(b). See Comment, Security Interests in Motor Vehicles Under the U.C.C.: A New Chassis for Certificate of Title Legislation, 70 Yale L.J. 995, 999-1000 (1961). It is to be noted that where a certificate-of-title act provides for notation of a security interest on a certificate of title as a permissible method of perfection, § 9-302(4) requires that this method alone is to be used. See U.C.C. § 9-302(4); 1 G. Gilmore, supra note 53, at 575. Thus, in those states which have both the Code and a certificate-of-title act, the statutes would "require" indication of security interests subject to their respective acts within the meaning of § 9-103(4) on the certificate of title.

59 The following jurisdictions have "complete" title acts: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Michigan, Missouri, Montana, Nebraska, New Jersey, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wyoming. See Comment, The California Used Car Dealer and the Foreign Lien—A Study in the Conflict of Laws, 47 Calif. L. Rev. 543, 578-86 (1959). Since the above comment was published, Connecticut, Georgia, Illinois, Kentucky, North Carolina, South Dakota, West Virginia, and Wisconsin have enacted "complete" title acts. Conn. Gen. Stat. Ann. § 14-185 (1960); Ga. Code Ann. § 68-421(a) (1966); Ill. Ann. Stat. ch. 95½, § 3-202 (Smith-Hurd Supp. 1966); Ky. Rev. Stat. Ann. § 186.195 (1963); N.C. Gen. Stat. § 20-58.1 (1965); S.D. Code §§ 44.0202-03 (Supp. 1960); W. Va. Code Ann. § 17A-4A-2 (1966); Wis. Stat. Ann. § 342.19 (1967).

60 E.g., Conn. Gen. Stat. Ann. § 14-185 (1960); Ga. Code Ann. § 68-421(a) (1966).

61 The following states have "incomplete" title acts: Indiana, Maryland, North Dakota, and Oklahoma. See Comment, supra note 59, at 576-77 (1959).

62 E.g., Ind. Ann. Stat. § 47-2051 (1966).

63 See Comment, supra note 58, at 995, 997.

64 Section 9-103(4) applies notwithstanding subsection (3). In relation to this provision, see In Re White, 266 F. Supp. 863 (N.D.N.Y. 1967) wherein the secured creditor whose interest was noted on a Virginia certificate of title prevailed over the trustee in bankruptcy notwithstanding the fact that the vehicle had been in New York for six months and the secured creditor had taken no steps to perfect his interest prior to bankruptcy. Section 9-103(4) applies only where the property is "covered" by a certificate of title. On the meaning of "covered," see In Re Singleton, Bankruptcy No. 1821, 2 U.C.C. Rep. Serv. 195 (E.D. Ky. Jan. 15, 1963) wherein the referee held that the vehicle was no longer covered within the meaning of § 9-103(4) when the debtor

In order for this section to apply, the vehicle must be "covered" by a certificate of title issued under a title act "which requires indication on a certificate of title of *any* security interest." (Emphasis added.) An initial question arises as to whether the type of title act described in subsection (4) is the "complete" title act alone or both the "complete" and "incomplete" title act. A further problem with the scope of this section is whether it applies where a vehicle subject to a security interest is brought from a state which does not have a certificate-of-title act to one which does and a certificate which does not note the lien is issued in the second state. An understanding of section 9-103(4) requires an analysis of these problems.

B. *The Relationship of Section 9-103(4) to Complete and Incomplete Title Acts*

An initial interpretive problem is presented by the interrelationship of section 9-103(4) and the "complete" and "incomplete" title acts. As a precondition to the applicablity of subsection (4), the property must be covered by a certificate of title "issued under a statute . . . which requires indication of *any* security interest, in the property as a condition of perfection." (Emphasis added.) This provision is ambiguous. It clearly describes neither "complete" nor "incomplete" title acts.

The phrase "any security interest" in section 9-103(4) could be interpreted to mean "all security interests." Under this interpretation, section 9-103(4) would apply only if the certificate were issued pursuant to a "complete" title act, since such acts provide that "all security interests" be noted on the certificate as a condition of perfection.[65]

On the other hand, another possible interpretation of "any security interest" is that it means "some security interests." Under this approach, section 9-103(4) would apply regardless of the type of act under which the certificate was issued since both types provide that "some security interests" are to be noted on the certificate.[66]

The intent of the draftsmen is not made clear in either the section itself or in the comments. In attempting to find a suitable solution, it is important to note that the issue is primarily one of notice. Where property subject to a security interest is brought from one state to another, local filing in the first state does not provide effective notice to parties who may acquire an interest in the collateral in the second state. Section 9-103(3) proceeds on this theory by requiring an out-of-state secured creditor to perfect his interest within four months at the risk of having it treated as unperfected in the jurisdiction to which the collateral is removed. However, if the security interest is noted on a title document, it should provide notice to those who deal with the vehicle. Since the issue is one of notice, it is submitted that the primary consideration should not be whether the certificate was issued under one or the other type of title act but whether the lien is in fact noted on the certificate. Section 20 of the Uniform Motor Vehicle

brought the vehicle to a non-title state where he surrendered the certificate and received a registration certificate which did not note the lien.

[65] See notes 59 & 60 supra.

[66] See notes 59-62 supra.

Certificate of Title Act adopts this approach by providing that if the name of the lienholder appears on a certificate of title when it enters the state, the security interest so noted continues perfected indefinitely.[67]

The following amendment to section 9-103(4), as it relates to property covered by a certificate of title issued by another jurisdiction, is therefore suggested:

> Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of . . . any other jurisdiction, *noting the name of the lienholder*, perfection *of interests noted on the certificate* is governed by the law of the jurisdiction which issued the certificate.[68]

The suggested amendment reflects the theory that perfection is primarily a question of notice and if the lien is in fact noted, it will generally provide effective notice of the existence of the security interest.

C. *Certificates of Title "Issued Under a Statute of This State"*

The extent to which section 9-103(4) applies where a motor vehicle subject to a security interest is moved from a state which does not have a certificate-of-title act to a Code state which does have such legislation is a question which has been the subject of recent judicial determination. The question may be illustrated by the following example. A security interest is retained in an automobile in state *A*, which does not have a certificate-of-title act. The security interest is perfected by filing locally in state *A*. The vehicle is then removed to state *B*, where the debtor applies for and receives a certificate of title. The certificate does not indicate the existence of the security interest created in state *A*. The vehicle is sold in state *B* to an innócent purchaser within four months after the property is removed there. The purchaser relies on the certificate of title.

In *GMAC v. Manheim Auto Auction*,[69] section 9-103(4) was held applicable to this situation. The court noted that section 9-103(4) provides: "[I]f personal property is covered by a certificate of title issued under a statute of this state . . . then the perfection is governed by the law of the jurisdiction which issued the certificate."[70] The court concluded that since Pennsylvania (state *B* in the above hypothetical) had issued the certificate, section 9-103(4) dictated that perfection of the out-of-state security interest

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67 Uniform Motor Vehicle Certificate of Title Act § 20(c)(2)(A).

68 This amendment, like the present § 9-103(4), may be of doubtful value in those states which do not have a certificate-of-title act. In order to dispense with the four month period provided in § 9-103(3), it must be assumed that the certificate of title will provide adequate notice of the existing security interests. This appears unlikely in those states which have no certificate-of-title act simply because parties are unlikely to be familiar with a certificate-of-title system and, therefore, may not request the certificates of title issued by the state from which the vehicle was removed. The better solution may lie, however, in the enactment of a certificate-of-title act. The following states have no certificate-of-title legislation: Alabama, Hawaii, Maine, Massachusetts, Minnesota, Mississippi, Nevada, New Hampshire, New York, Rhode Island, and Vermont. See Comment, supra note 59, at 574.

69 25 Pa. D. & C.2d 179 (Lancaster County Ct. 1961).

70 Id. at 188.

be governed by the law of Pennsylvania, notwithstanding the four month period provided by section 9-103(3).[71] Since the secured creditor had not perfected his interest by having it noted on the certificate, the local purchaser acquired the vehicle free of the interest.

In *First National Bank v. Stamper*,[72] a New Jersey court reached an opposite result in a similar fact situation. The local purchaser argued that, since he had relied on a clean certificate issued by New Jersey (state *B* in the above hypothetical), section 9-103(4) dictated that perfection be governed by the law of New Jersey.[73] The court held that section 9-103(4) does not apply, noting that, prior to the adoption of the Code, New Jersey followed the general rule protecting the out-of-state secured creditor.[74] In reaching its decision, the court pointed out that the New Jersey Study Comments to section 9-103 specify that section 9-103(4) restates the law of New Jersey as it existed prior to the adoption of the Code.[75] In addition, the court relied on the recommendation made by the draftsmen of the Code in 1956, wherein the draftsmen stated: "Subsection (4) is new to avoid the possible necessity of duplicating perfection in the case of vehicles subject to a certificate-of-title law requiring compliance therewith to perfect security interest. The certificate-of-title law requirements are adopted as the test for perfection."[76] This note, the court concluded, makes it clear that subsection (4) does not apply where a vehicle subject to a security interest is brought from a state which does not have a certificate-of-title act to a state which does.[77] Although not stated explicity, the *Stamper* court apparently

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[71] Id.

[72] 93 N.J. Super. 150, 225 A.2d 162 (L. Div. 1966).

[73] Id. at 164, 225 A.2d at 170.

[74] Id. at 164-65, 225 A.2d at 170.

[75] Id. at 165, 225 A.2d at 170.

[76] Id. at 164, 225 A.2d at 170. American Law Institute and National Conference of Commissioners on Uniform State Laws, 1956 Recommendations of the Editorial Board For the Uniform Commercial Code 257 (1957).

[77] 93 N.J. Super. at 164-65, 225 A.2d at 170. The note by the draftsmen is susceptible of two meanings. It states that § 9-103(4) seeks to "avoid the possible necessity of duplicating perfection." The note could be taken to mean that where a vehicle covered by a certificate of title comes into a Code state, § 9-103(4) "avoids the necessity of duplicating perfection" within the four month period. A second possible interpretation of the note is that § 9-103(4) "avoids the necessity of duplicating perfection" in the debtor's "chief place of business" where a certificate of title was issued by a non-Code state. In litigation involving equipment covered by § 9-103(2), all Code states would look to the law of the "chief place of business" to ascertain whether the security interest was perfected. If the "chief place of business" is also a Code state, it would require the security interest to be perfected there. However, if the situs of the equipment is a non-Code state, it would probably require that perfection be governed by its law. Thus, in this situation, the secured creditor in order to protect himself would have to "duplicate perfection" by perfecting in the "chief place of business" state and also the situs state. If the situs state is a certificate-of-title-act state and a certificate was issued, § 9-103(4) dictates that the law of that state would govern perfection, thus "avoiding the necessity of duplicating perfection" in the "chief place of business." Although susceptible of these two interpretations, the note by the draftsmen does not seem to make clear, as the *Stamper* court suggests, that § 9-103(4) was not intended to apply to the situation where a vehicle is brought from a non-certificate-of-title-act state to a state which does have such legislation. The note by the draftsmen gives no indication of when the provision regarding a certificate of title "issued under a statute of this state" was intended to apply.

felt that section 9-103(4) applies only where the vehicle is covered by a certificate of title when it enters the state.

The result in *Manheim*, holding section 9-103(4) applicable, clearly follows from a literal reading of that section. The vehicle was in fact "covered" by a Pennsylvania certificate of title. Under these circumstances, section 9-103(4) would appear to provide that perfection be governed by the "law of the jurisdiction which issued the certificate," in this case Pennsylvania. However, if the *Manheim* interpretation is correct, section 9-103(4) represents a complete departure from the pre-Code rule. Prior to the adoption of the Code, as the *Stamper* court recognized, virtually all states would grant priority to the perfected out-of-state security interest over local claimants, even though the latter acquired their interest relying on a certificate of title which did not indicate the existence of the lien.[78] There is no clear signal in section 9-103(4) itself or in the comments or recommendations made by the draftsmen relating to that section which would indicate that such a complete reversal of the pre-Code rule was intended.[79]

Furthermore, if *Manheim* were accepted, to require the interest to be noted on the certificate as a condition of perfection places an undue burden on the secured party. For example, in *Manheim*, the vehicle was moved into Pennsylvania between March 28 and March 30.[80] On March 30, the auto was sold to a purchaser who, on the same day, applied for and received a Pennsylvania certificate which did not note the out-of-state security interest.[81] Between March 30 and April 7, the purchaser sold the auto to one Miller who relied on the certificate.[82] The *Manheim* interpretation of section 9-103(4) would in this situation have required the secured creditor to have his interest noted on the certificate within a week from the date of removal in order to be protected. This requirement would be imposed whether or not the secured creditor had knowledge or notice that the collateral was in another state.

Section 9-103(3) attempts to reach a compromise between the conflicting claims of the out-of-state secured creditors and local claimants by providing a four month period in which the secured creditor should be able to locate the collateral and perfect his interest. If the provision regarding a certificate of title "issued under a statute of this state" is construed not to apply to the *Stamper-Manheim* situation, section 9-103(3) would remain applicable. It is submitted that this is the more equitable result and section 9-103(4)

78 A leading case is Bank of Atlanta v. Fretz, 148 Tex. 551, 226 S.W.2d 843 (1950), wherein a chattel mortgagee from Georgia whose interest was properly perfected there prevailed over an innocent purchaser in Texas who relied on a Texas certificate of title which did not show the existence of the Georgia mortgage; accord, Ragner v. GMAC, 66 Ariz. 157, 185 P.2d 525 (1947); Federico v. Universal C.I.T. Credit Corp., 140 Colo. 145, 343 P.2d 830 (1959). Contra, First Nat'l Bank v. Sheldon, 161 Pa. Super. 265, 54 A.2d 61 (1947).

79 In other areas where a rejection of an established pre-Code rule was intended, the draftsmen of the Code have specified that a change was intended. E.g., U.C.C. §§ 9-205, Comment 1, 9-301, Comment 3.

80 25 Pa. D. & C.2d at 180-81.

81 Id. at 181.

82 Id. at 181-82.

should not be applied when a vehicle subject to a security interest is brought from a non-certificate state to a certificate state where a certificate is issued which does not note the security interest.[83]

This result may be reached either through construing section 9-103(4) to be inapplicable, as did the *Stamper* court, or through an amendment to that section. Any such judicial construction, however, would conflict with the explicit language of section 9-103(4) which provides that if a certificate of title is issued, perfection is governed by the law of the issuing state. For this reason, it is submitted that the inapplicability of section 9-103(4) should be achieved through the amendment process. The following amendment is suggested:

> (4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued *by another* jurisdiction, noting the name of the lienholder, perfection of interests noted on the certificate is governed by the law of the jurisdiction which issued the certificate.[84]

The theory of this amendment is that where property is covered by a certificate of title which notes the lien, the certificate should provide notice to those who deal with the property. The amended section would clearly not apply to the *Manheim-Stamper* situation where a vehicle is brought from a non-certificate-of-title-act state to a state which does have such legislation. In such cases, section 9-103(3) would remain applicable. As suggested, this is the most equitable result.

III. Section 9-103: Proposed Interpretation and Amendment

This article has examined the major problems arising under section 9-103(3) and (4). On the basis of this examination, the following amended section 9-103(3) and (4) is offered:

> (3) If personal property other than that governed by subsections (1) and (2) is already subject to a security interest when

[83] A number of solutions have been offered for this problem. First, the problem would probably not have arisen if the first state had a certificate-of-title law. The lien would have been noted on a certificate and the second state would not have issued a new certificate without surrender of the old certificate. Professor Leary has suggested a titling procedure under which a certificate would not be issued to an applicant from another state unless the applicant had first obtained from the officials of such state a statement of all liens. Leary, Horse and Buggy Lien Law and Migratory Automobiles, 96 U. Pa. L. Rev. 455, 476-83 (1948). The Uniform Motor Vehicle Certificate of Title Act § 9(b) contains a provision for issuing a so-called "distinctive" certificate of title when a vehicle is brought from a non-certificate state. The certificate states: "This vehicle may be subject to an undisclosed lien." After four months, an ordinary certificate is issued. Under § 11(b), if the department of motor vehicles is not satisfied that there are no liens outstanding, it can require the applicant to post a bond in the amount of one and one-half times the value of the vehicle to indemnify secured creditors and purchasers.

[84] This amendment to § 9-103(4) should be undertaken in connection with an amendment to § 9-103(2) providing that if "equipment" of a type normally used in more than one jurisdiction is covered by a certificate of title issued locally, perfection is governed by the law of that state notwithstanding the "chief place of business" provisions.

it is brought into this state, the validity of the security interest in this state is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues perfected in this state *for the shorter of the following periods:*

(*a*) *for ten days after the secured party has notice of the permanent removal of the collateral to this state*

(*b*) for four months

and also thereafter if within the period *allowed* it is perfected in this state. The security interest may also be perfected in this state after the expiration of the period *allowed*; in such case perfection dates from the time of perfection in this state. If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, it may be perfected in this state; in such case perfection dates from the time of perfection in this state. *Notwithstanding the above provisions,* if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the validity *and the perfection* of the security interest in this state *are* to be determined by the law of this state.

(4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued *by another* jurisdiction, *noting the name of the lienholder,* perfection *of interests noted on the certificate* is governed by the law of the jurisdiction which issued the certificate.

The suggested amendment of section 9-103(3) provides that the four month period is merely an outside limit of perfection after which, if the secured party does not discover the location of the collateral and perfect, his interest is treated as unperfected. If the secured creditor does in fact discover the location of the collateral within the four month period, he is required to perfect within ten days if he is on notice that the removal is permanent. The "continues perfected" language is retained. It is felt that this is a sufficient indication that the four month period is a period of absolute perfection. Failure to perfect within the four month period has no bearing on the relationship between the out-of-state security interest and interests acquired during that period. That part of Comment 7 which indicates that the period is a period of grace as to conflicting security interests should be deleted since it is inconsistent with the "continues perfected" language of the section itself.

Since the four month period is a period of absolute perfection, it is submitted that the date of perfection in the first state is the date of perfection for purposes of Section 60(a)(2) of the Bankruptcy Act. To hold otherwise—that the date of perfection in the second state is the date of perfection for purposes of section 60(a)(2)—would lead to the avoidance of secured transactions merely on the fortuitous circumstance that the collateral was moved to another state within four months of bankruptcy proceedings by or against the debtor.

The last sentence of the suggested amendment of subsection (3) provides that where the parties understood at the time of attachment that the goods would be kept in the Code state and were brought there shortly thereafter, both "validity" and "perfection" of the security interest in the Code state are to be determined by the law of that state. In such a case, the secured creditor has no need of a four month period and the amendment clearly states that he does not receive it.

The suggested amendment of section 9-103(4) provides that if the security interest is noted on a certificate of title, it continues perfected in the Code state. The amendment deletes the present section's reference to the type of title act under which the certificate is issued. If the lien is in fact indicated it should provide adequate notice. The suggested amendment applies only where the property is covered by a certificate of title issued by another jurisdiction. It does not apply to the situation where an automobile is brought from a non-certificate-of-title-act state to a state which does have such legislation. It, thus, avoids the result in *Manheim*, requiring the out-of-state secured creditor, in order to be protected, to have his interest noted on the certificate a week from the date of removal.

As indicated at the outset of this article, in problems of multi-state secured transactions, courts and legislatures are often forced to a choice between two innocent parties, the out-of-state secured creditor and a party who deals with the goods in the second state as though the goods were unencumbered. In making such a choice, an equitable adjustment, a compromise, is needed between the conflicting claims. Although the suggested amendments, like any attempt to solve complex problems in the brief language of a statutory provision, may raise interpretive problems, it is felt that they contribute to a fortification of the equitable adjustment presently written into section 9-103(3) and (4).

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