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Interstate Movement of Motor Vehicles Subject to Security Interests a Case for Repealing UCC 9-103(4)

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NOTES

INTERSTATE MOVEMENT OF MOTOR VEHICLES SUBJECT TO SECURITY INTERESTS: A CASE FOR REPEALING UCC § 9-103(4)

High vehicular mobility and easy credit frequently result in parties from different states acquiring conflicting interests in the same vehicle. Typically, such a vehicle is purchased on credit in one state and a security interest is perfected there in favor of the lender. The purchaser then drives to another state and, without divulging the existence of his creditor's security interest, sells the vehicle or uses it as collateral for another loan. If the original creditor pursues the vehicle and tries to enforce his security interest against the subsequent purchaser or creditor,[1] the courts must decide whose interest will prevail.

On the above facts, the pre-Code law of most states favored the out-of-state creditor's prior security interest.[2] UCC section 9-103 modifies that majority rule and, in the case of subsection (4), injects substantial confusion into this area of the law.[3]

I

SECTION 9-103'S RULES FOR VEHICULAR SECURITY INTERESTS

In keeping with the Code's objective of molding rules to transac-

1 The debtor probably has committed some actionable wrong in this situation. Moving the car interstate is most likely a breach of his contract with the original lender (*see, e.g.*, 5 ULA, UNIFORM COMMERCIAL CODE FORMS AND MATERIALS, Form 9-1560, ¶ 5 (1968)), and he remains liable on the contract for payment of his original debt. Also, his concealment of the outstanding security interest should make him liable to the purchaser or creditor in the entered state. However, such debtors always seem to be absent or judgment proof by the time litigation commences, and any loss will therefore remain with the original creditor or the party in the second state.

2 *See* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 605-06 (1965) [hereinafter cited as GILMORE]; Vernon, *Recorded Chattel Security Interests in the Conflict of Laws*, 47 IOWA L. REV. 346, 350 n.10 (1962); Annot., 13 A.L.R.2d 1312, 1318-29 (1950).

A minority of jurisdictions gave preference to the subsequent bona fide purchaser or creditor. *See* Leary, *Horse and Buggy Lien Law and Migratory Automobiles*, 96 U. PA. L. REV. 455, 456 n.4 (1948); Annot., 13 A.L.R.2d 1312, 1336-41 (1950).

3 *See* 1 GILMORE 328, 623; 2 BENDER'S UCC SERV.—REP. DIG. CASE ANNOTS. 2-928. Two commentators have given subsection (4) extended treatment: Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72, 88-96 (1967); Comment, *Uniform Commercial Code—Perfection of Security Interests in Multi-State Transactions When Property Is Covered by a Certificate of Title*, 47 B.U.L. REV. 430 (1967).

tional circumstances, subsections (2), (3), and (4) of section 9-103 each have independent significance and application. Subsection (2) covers vehicles of the type used for business purposes and rental vehicles, if either are normally used in more than one jurisdiction.[4] Perfection of security interests in such vehicles is governed by the law of the jurisdiction in which the debtor's chief place of business is located. Even after interstate movement, a security interest perfected in that jurisdiction prevails over interests perfected in other states.[5]

Subsection (3) covers all vehicles not described by subsection (2)[6] —primarily consumer-owned automobiles. This subsection provides

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[4] UCC § 9-103(2) applies to "goods of a type which are normally used in more than one jurisdiction . . . if such goods are classified as equipment or classified as inventory by reason of their being leased by the debtor to others."

This provision is discussed in 1 GILMORE 619-23. It covers only those commercial vehicles (*i.e.*, "equipment" and leased "inventory") not governed by the Federal Motor Vehicle Lien Act, 49 U.S.C. § 313 (1964). That Act governs perfection of security interests in large interstate trucks and buses operated by common carriers.

[5] UCC § 9-103(2). This rule is easily applied by the courts and should be representative of the expectations of the parties involved; the debtor's chief place of business has a clear connection with a commercial vehicle, and it would be the first jurisdiction checked in any search for outstanding liens.

[6] The relevant part of subsection (3) reads:

> 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.

For discussion of subsection (3), see 1 GILMORE 624; Vernon, *supra* note 2, at 376-79; Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72, 73-88 (1967). These commentators suggest four ways in which subsection (3) could be improved:

(*1*) The out-of-state creditor should have to re-perfect in the entered state within the four month period if he learns of the movement of his collateral. For the way in which a modern statute handles this problem, see § 7(2) of the Ontario Personal Property Security Act, 1967. STAT. ONTARIO 1967, c. 73, § 7(2).

(*2*) Subsection (3)'s handling of validity and perfection should be coordinated. Comment, *supra*, at 81.

(*3*) It should be made clear that subsection (3)'s four month period is an absolute one, and that it will not disappear retroactively if the security interest is not re-perfected in the entered state within the period. Interpreting it as absolute are First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 163, 225 A.2d 162, 169 (L. Div. 1966); Churchill Motors, Inc. v. A.C. Lohman, Inc., 16 App. Div. 2d 560, 566-67, 229 N.Y.S.2d 570, 577 (4th Dep't 1962); 1 GILMORE 627 n.7. *Contra*, Vernon, *supra*, at 377-78.

(*4*) If re-perfected within four months the date of the out-of-state original perfection should continue to be the date of perfection to avoid problems with the preference provisions of the Bankruptcy Act. 2 GILMORE 1316; Comment, *supra*, at 85-88.

The present discussion assumes that these revisions have been made, but no conclusions will be dependent upon them.

for recognition of a security interest perfected in another state for a period of four months after the vehicle enters a new state.[7] After the four month period, the security interest becomes unperfected[8] unless

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[7] See the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act (found at 9B ULA MISCELLANEOUS ACTS 369 (1966)), which has been enacted in its entirety in three states: Connecticut, Georgia, and New Hampshire. CONN. GEN. STAT. ANN. §§ 14-165 to -211 (1958); GA. CODE ANN. §§ 68-401a to -443a (1967); N.H. REV. STAT. ANN. §§ 269-A:1 to -:49 (Supp. 1967). Section 20(c) of the Uniform Act states in part:

> (c) If a vehicle is subject to a security interest when brought into this state, the validity of the security interest is determined by the law of the jurisdiction where the vehicle was when the security interest attached, subject to the following:
>
> (2) If the security interest was perfected under the law of the jurisdiction where the vehicle was when the security interest attached, the following rules apply:
>
> (A) If the name of the lienholder is shown on an existing certificate of title issued by that jurisdiction, his security interest continues perfected in this state.
>
> (B) If the name of the lienholder is not shown on an existing certificate of title issued by that jurisdiction, the security interest continues perfected in this state for four (4) months after a first certificate of title of the vehicle is issued in this state, and also, thereafter if, within the four (4) month period, it is perfected in this state. The security interest may also be perfected in this state after the expiration of the four (4) month period; in that case perfection dates from the time of perfection in this state.

Section 20(c)(2)(A) is identical in substance to UCC § 9-103(4), while subsection (B) parallels UCC § 9-103(3) (except for determining when the four month period begins) when "the name of the lienholder is not shown on an existing certificate" issued by the first state. The essential difference between the Uniform Act and the UCC is that § 20(c)(2)(A) only looks to a certificate when issued by "that jurisdiction," thereby explicitly siding with the authorities discussed at note 32 *infra* and accompanying text. Because the Uniform Act has been enacted in only three jurisdictions since its appearance in 1955, and in light of the Code's almost universal acceptance, this note will focus on UCC § 9-103 rather than § 20 of the Uniform Act.

Another reason for ignoring the Uniform Act is that one of the three jurisdictions which have enacted it has deleted § 20's rules in favor of those in subsections (2), (3), and (4) of UCC § 9-103. CONN. GEN. STAT. ANN. § 14-185(d) (Supp. 1968). In Georgia and New Hampshire both § 20 of the Uniform Act and UCC § 9-103 are law. How they will be reconciled is uncertain.

[8] UCC § 9-301 lists the interests which take priority over unperfected security interests. Lien creditors who become such without knowledge of the security interest, § 9-301(1)(b), and buyers not in the ordinary course of business who give value and receive delivery without knowledge of the security interest, § 9-301(1)(c), take priority over a creditor with an unperfected security interest. A conflicting perfected security interest apparently takes priority over an unperfected interest even if the former's holder has knowledge of the out-of-state unperfected interest when he perfects. §§ 9-301(1)(a), 9-312(5). A trustee in bankruptcy is treated like a lien creditor without knowledge if at least one of the creditors he represents is without knowledge. § 9-301(3). Buyers in the ordinary course of business are treated in § 9-307.

Commentators have criticized § 9-312(5) for allowing a subsequent creditor *with*

the creditor re-perfects his interest in the entered state. Thus, unlike the pre-Code majority rule which always favored the foreign creditor and unlike subsection (2)'s focus on the chief place of business, subsection (3) uses a pre-set balancing approach for consumer-owned automobiles. During the four month period after entry, the balance is weighted in favor of the original creditor; after the four month period, it favors the subsequent purchaser or creditor.[9]

When the Code was originally proposed,[10] subsections (2) and (3) constituted the sole rules governing perfection of vehicular security interests after interstate movement. The 1958 amendments added subsection (4),[11] thereby recognizing and implicitly supporting the trend toward using endorsements on certificates of title as the means of perfecting such security interests.[12] The new subsection suspends

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knowledge to perfect and defeat an earlier unperfected security interest. For discussion of the problem, and the possibilities of its elimination, see 2 GILMORE 893-915; Felsenfeld, *Knowledge as a Factor in Determining Priorities Under The Uniform Commercial Code*, 42 N.Y.U.L. REV. 246 (1967).

9 As explained by the Code's Comments, in comparison to the pre-Code majority rule,

> Subsection (3) proceeds on the theory that not only the secured party whose collateral has been removed but also creditors of and purchasers from the debtor in this state should be considered. 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, although originally perfected in the state where it attached, is subject to defeat here by those persons who take priority over an unperfected security interest (see Section 9-301).

UCC § 9-103, Comment 7.

Compare § 7(1) of the Ontario Personal Property Security Act, 1967, which provides a protective period of only sixty days. STAT. ONTARIO 1967, c. 73, § 7(1).

10 *See* UCC § 9-103 (1952 version).

11 UCC § 9-103(4) provides that,

> 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.

12 Certificates of title have been discussed in depth by others. 1 GILMORE 550-78; Leary, *Horse and Buggy Lien Law And Migratory Automobiles*, 96 U. PA. L. REV. 455 (1948); Townsend, *The Case of the Mysterious Accessory*, 16 LAW & CONTEMP. PROB. 197 (1951); Welsh, *Security Interests in Motor Vehicles Under Section 9-302 of the Uniform Commercial Code*, 37 U. CIN. L. REV. 265 (1968); Comment, *The California Used Car Dealer and the Foreign Lien—A Study in the Conflict of Laws*, 47 CALIF. L. REV. 543 (1959); Note, *Security Interests in Motor Vehicles Under the UCC: A New Chassis for Certificate of Title Legislation*, 70 YALE L.J. 995 (1961); Annot., 18 A.L.R.2d 813 (1951).

The states not having certificate-of-title legislation are Alabama, Kentucky, Maine, Massachusetts, Minnesota, Mississippi, New York, Rhode Island, and Vermont. A study

the application of subsections (2) and (3) when a "complete" certificate is present.[13] If either the original creditor or the second party (the purchaser or creditor in the entered state) has noted his interest on a certificate covering the vehicle, the "law" of the jurisdiction issuing the certificate governs perfection and the noted interest takes priority over all others.[14] In this way the chief-place-of-business rule of subsec-

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conducted in 1959 noted 12 non-certificate states (the District of Columbia does have a certificate law). Comment, *supra*, at 574-75. Three have subsequently adopted such legislation: Connecticut, Georgia, and New Hampshire. *See* citations, note 7 *supra*.

Certificate-of-title acts are of two general types—"complete" and "incomplete." Complete acts require all interests in the vehicle to be noted on the certificate, and such notation accomplishes perfection. Incomplete acts usually require such notation only when ownership of the vehicle is transferred, and notation in any event does not alone constitute perfection. *See* 1 GILMORE 553; Note, *supra*, at 996-99. Subsection (4) of UCC § 9-103 refers only to complete acts.

Of the 42 jurisdictions having certificate legislation, only 4 have incomplete statutes: Indiana, Maryland, North Dakota, and Oklahoma. The 1959 study in Comment, *supra*, at 576-77, noted 9 incomplete jurisdictions. Five have subsequently become complete: Illinois, North Carolina, South Dakota, West Virginia, and Wisconsin. ILL. ANN. STAT. ch. 95 1/2, § 3-202 (Smith-Hurd Supp. 1969); N.C. GEN. STAT. § 20-58 (1965); S.D. CODE § 44.0203 (Supp. 1960); W. VA. CODE ANN. § 17A-4A-2 (1966); WIS. STAT. ANN. § 342.19 (Supp. 1968). Illinois and North Carolina made their statutes complete by adopting § 20 of the Uniform Act, note 7 *supra*.

13 The phrasing of subsection (4) limits its coverage to complete certificate acts. Because only 4 of the 42 certificate-of-title jurisdictions have incomplete acts, and because even those 4 acts may have become complete under UCC § 9-302(4) (*see* Note, *supra* note 12, at 999-1000), the discussion in this note will deal only with complete certificate acts.

14 Subsection (4) refers to the "law" of the jurisdiction issuing the certificate. In this context, "law" has been interpreted by all of the courts which have passed upon the question as the certificate legislation in the issuing state (cases cited notes 15 & 41 *infra*), and thus the party with his interest noted on such a certificate prevails. However, another possible interpretation of subsection (4) is that the law referred to is the Code law in subsections (2) and (3) of § 9-103. (In Connecticut such an interpretation would appear mandatory since subsections (2) and (3) are the relevant certificate law. *See* note 7 *supra*, last para.) If subsection (4)'s "law" is so interpreted, the entered state might decide to use the rules embodied in subsections (2) and (3), thus making subsection (4) a circuitous route for returning to the rules which would govern in its absence. In effect, it would be superfluous.

Subsection (4) will usually come into operation only when notice of an outstanding security interest is not conveyed to a subsequent purchaser or creditor. When proper notice is conveyed, the security interest usually prevails with or without subsection (4): (*1*) If a vehicle travels to a state with certificate legislation and the out-of-state security interest is properly noted on the certificate, the interest becomes perfected under the law of the entered state—irrespective of subsection (4). Thus, with the interest perfected in both jurisdictions it would take priority. (*2*) If the out-of-state security interest is not properly noted on a certificate in the entered state (whether the entered state has certificate legislation or not), and is unperfected, notice of the interest should still be conveyed by the debtor. If he gives such notice to a general creditor, lien creditor, or purchaser, UCC §§ 9-301(1)(b) and (c) prevent those parties from defeating the unperfected out-of-

tion (2) and the balancing approach of subsection (3) are superseded by an across-the-board emphasis on certificate notation as the means of resolving conflicting claims.

Poor draftsmanship has caused problems for courts attempting to apply subsection (4). For example, the subsection does not make clear whether it applies only to vehicles already covered by a certificate when they enter the state, or whether it also applies to vehicles which are covered by a certificate issued by the entered state.[15] Nor does the subsection provide guidelines for a situation in which a vehicle is covered by more than one certificate.

Commentators have suggested amendments and interpretations designed to clarify the subsection's language.[16] In their efforts, however, they have ignored a more basic problem: Does subsection (4) represent an improvement over the Code as originally drafted? If not, its deletion, which would effect a reinstatement of the rules of subsections (2) and (3) for all motor vehicles, is desirable.[17]

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state security interest. As for the two possible exceptions to this rule of "knowledge prevents priority," see note 8 *supra*. The rules for a buyer in the ordinary course of business are the same whether the security interest is perfected or unperfected. UCC § 9-307(1) and Comment 1. Accordingly, the discussion here will deal with situations in which notice has not been effected, usually because of fraud on the part of the debtor.

15 At least two courts have found subsection (4) not applicable when a vehicle not covered by a certificate enters and subsequently becomes covered by a certificate issued by the entered state. First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 225 A.2d 162 (L. Div. 1966); Churchill Motors, Inc. v. A.C. Lohman, Inc., 16 App. Div. 2d 560, 569, 229 N.Y.S.2d 570, 579 (4th Dep't 1962) (dictum—subsection (4) not yet in effect). One court, on the other hand, has enforced the locally issued certificate. GMAC v. Manheim Auto Auction, 25 Pa. D.&C.2d 179, 188 (C.P. 1961) (alternative holding). Another court, under slightly different circumstances, has ignored subsection (4) altogether and applied pre-Code law. Hardware Mut. Cas. Co. v. Gall, 15 Ohio St. 2d 261, 240 N.E.2d 502 (1968).

16 The most comprehensive of such proposals is the amendment found in Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72, 94 (1967). That amendment would make it clear that subsection (4) applies ouly to vehicles covered by a certificate *at the time of entry* into the second state. (It therefore removes the subsection's effects when a vehicle not covered by a certificate enters but is subsequently covered by one issued by the entered state.) The amendment thus negates subsection (4)'s potential in the filing-to-title state pattern (*see* note 24 *infra*), but boilerplates its coverage in the title-to-title and title-to-filing state situations.

Interpretative proposals are found in Comment, *Uniform Commercial Code—Perfection of Security Interests in Multi-State Transactions When Property Is Covered by a Certificate of Title*, 47 B.U.L. REV. 430, 438-41 (1967), and note 27 *infra*.

17 The tacit premise here is that the only function of subsection (4) is to determine, in multi-state situations, which state's law should control perfection. Arguably, subsection (4) is necessary to assure that perfection by certificate, *as a means of perfection*, is recognized. However, UCC §§ 9-302(3) and (4) recognize certificates as a proper *means* of perfecting security interests in vehicles.

II

SUBSECTION (4)'S OBSOLESCENCE IN TERMS OF SUBSECTION (2) VEHICLES

Although subsection (4) governs perfection, if a certificate is present, for both commercial vehicles and consumer-owned automobiles, its *purpose* in terms of the former must be viewed separately. This is so because of the apparent duplication of effort between subsection (4)'s certificate standard and subsection (2)'s chief-place-of-business rule; both choose one determinative jurisdiction for purposes of perfection in interstate situations.

Prior to subsection (4)'s enactment, when only a few states had adopted the Code, creditors discovered that non-Code states with certificate legislation required notation of security interests upon their certificates. And such notation was not excused when the vehicle was one described by section 9-103(2), under which perfection would also be required in the debtor's chief place of business.[18] To avoid the conflict, and because the Code could not impose its standards on non-Code states, subsection (4) adopted the rule of the non-Code states and embodied it in the Code.[19]

Today, however, the Code is law in all jurisdictions except Louisiana.[20] The possibility of a non-Code state refusing to recognize subsection (2)'s chief-place-of-business rule is all but extinct. Subsection (2)'s rule would now be uniformly applied, and subsection (4) thus appears to have outlived its original purpose regarding subsection (2) vehicles.

Moreover, because a debtor's chief place of business is readily ascertainable[21] and because the jurisdiction in which the chief place

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18 If a consumer-owned automobile is involved, the problem is not as great; subsection (3)'s situs perfection is of limited duration once an automobile is moved interstate. As for non-Code states without certificate legislation, the pre-Code majority rule assured recognition by them of the out-of-state perfection (whether that was a chief-place-of-business perfection under subsection (2) or a situs perfection under subsection (3)).

19 Subsection (4), however, left unanswered the problems arising when two or more title states require perfection on their own certificates. Thus its purpose was to avoid the necessity of parallel perfection in both the chief place of business and a non-Code title state, but, in accomplishing that purpose, it created an additional problem of parallel perfection between two title states.

20 The Code is presently under study by the Louisiana Law Institute. Mashaw, *A Sketch of the Consequences for Louisiana Law of the Adoption of "Article 2: Sales" of the Uniform Commercial Code*, 42 TUL. L. REV. 740 (1968).

21 Gilmore points out some problems in determining the chief place of business, but they are certainly not insurmountable. 1 GILMORE 320-25.

of business is located has visible ties to a subsection (2) commercial vehicle,[22] it is the more appropriate place for purposes of perfection than a jurisdiction which has merely issued a certificate.[23]

III

SUBSECTION (4) AND CONSUMER-OWNED AUTOMOBILES: AN INEQUITABLE RULE

Unlike the situation with commercial vehicles, no single jurisdiction stands out as the best place for perfecting security interests in consumer-owned automobiles. Accordingly, one of two tests—the balancing approach under subsection (3) or the certificate method under subsection (4)—must be applied to choose a jurisdiction when a certificate is present. To determine which test should be used, three factual patterns must be examined.[24]

A. *Title to Title State*

In discussing subsection (4), one commentator has aptly said, "Nobody seems to know what happens when both the foreign state and the state to which the collateral is removed both [*sic*] require notation of encumbrances on certificates of title."[25] Any application of subsection (4) would be self-contradictory when two certificates are present[26]—a court can recognize one certificate only by ignoring the other. The problem is lessened somewhat if the subsection is interpreted to

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22 *See* note 5 *supra.*

23 Subsection (2) would not prevent Code states with certificate legislation from requiring perfection upon their certificates, but it would assure that, in the case of conflicting claims, perfection in the chief place of business would be determinative.

24 Subsection (4) is applied only when a certificate covers a vehicle. There are three factual patterns in which such coverage is present: (*a*) an automobile traveling from a state with no certificate-of-title statute (here called a filing or non-title state) to a state with certificate legislation (here called a title state); (*b*) a vehicle traveling between two title states; and (*c*) an automobile moving from a title state to a non-title state.

Three or more states could be involved (*e.g.*, car purchased in State *A*, certificate issued in State *B* while car temporarily in State *B*, and then car moved to State *C*), but the state in which the security interest attached and the state where the car is finally located are most relevant. As to the issue of the sufficiency of the contacts with a jurisdiction before a certificate can be issued, see 1 GILMORE 327. For a three-state situation, see GMAC v. Whisnant, 387 F.2d 774 (5th Cir. 1968).

25 2 BENDER'S UCC SERV., *supra* note 3, at 2-928.

26 In today's mobile society three or more certificates might cover a vehicle, increasing the confusion. If the entered title state has not yet issued a certificate, and if that alone does not void the transaction, the situation is analogous to the title-to-filing state pattern.

mean that the issuance of the second certificate negatives the first,[27] but subsection (4) does not say that. A recent Ohio decision apparently resolved the dilemma by completely ignoring section 9-103, which was applicable, and applying pre-Code law to the situation.[28]

Under some rationale, however, a court has to recognize one of the two or more certificates present in this situation. Once that choice is made, an evaluation of subsection (4)'s effects in the title-to-title state pattern merely parallels an evaluation of its effects in either the filing-to-title or title-to-filing state situation. For if a court recognizes the original certificate perfection, we have the title-to-filing state pattern. If the second certificate is favored, we, in effect, have the filing-to-title state situation.

B. *Filing to Title State*

A car is purchased on credit in a filing state (such as New York) and is then sold or used as collateral under a clean certificate in a neighboring title state (such as New Jersey).[29] If applied, subsection (4) gives preference to the interest of the New Jersey purchaser or creditor relying upon the clean certificate.[30] To do so, however, greatly undermines the effectiveness of perfected vehicular security interests in non-title states, since such interests then become unperfected as soon as the debtor acquires a clean certificate in another state. The creditor in a non-title state is completely at the mercy of the certificate issuing system of the title state,[31] and, in effect, he is penalized for doing business in a non-title state.

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27 "Implicit in subsection 4, therefore, must be the notion that perfection is governed by the law of the state which issued the first certificate, until such time as the local title act requires the issuance of a new certificate." Note, *supra* note 12, at 1015.

28 Hardware Mut. Cas. Co. v. Gall, 15 Ohio St. 2d 261, 240 N.E.2d 502 (1968).

29 The obvious question here is how one can obtain the clean certificate. For discussion of the fraudulent practices involved in procuring and manipulating certificates of title, see 1 GILMORE 562-65; Leary, *supra* note 12, at 476; Comment, *supra* note 12, at 548.

Section 9(b) of the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, note 7 *supra*, provides an interesting safeguard when a certificate is issued covering a vehicle which has come from a non-title state. In lieu of a bond being posted to protect prior or subsequent parties from loss due to undisclosed encumbrances, the certificate must be issued with the caption "This vehicle may be subject to an undisclosed lien." After four months a new certificate, without the cautionary caption, can be obtained.

30 *See* notes 11 & 14 *supra*.

31 A point often overlooked by courts and commentators is that the out-of-state creditor would find it almost impossible to re-perfect if the entered state were a title state. The only means of perfection in a title state is notation on the certificate, and the certificate would be difficult to procure if it were in the hands of the debtor or a local

Because of such harsh results, some courts facing non-title-to-title state situations have considered subsection (4) inapplicable and applied instead subsection (3).[32] Although in so finding these courts appear to reject a literal reading of the statute, the 1956 recommendation of subsection (4)'s draftsmen and the Code's Official Comments support their reasoning.[33]

The only credible support for subsection (4)'s certificate favoritism in the filing-to-title state situation is found in the thesis that some standard of complete reliability is necessary in motor vehicle transac-

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purchaser or creditor. Section 9-402(2)(a) solves the problem when a financing statement is used; it requires only the out-of-state creditor's signature on a duplicate financing statement for re-perfection. However, the Code is silent concerning re-perfection by certificate. Section 20(c)(4) of the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, note 7 *supra*, provides that re-perfection can be accomplished by delivering a "notice of security interest" to the Department of Motor Vehicles in the entered state. Evidently some further action would then be taken by the department.

32 *E.g.*, First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 225 A.2d 162 (L. Div. 1966); Churchill Motors, Inc. v. A.C. Lohman, Inc., 16 App. Div. 2d 560, 569, 229 N.Y.S.2d 570, 579 (4th Dep't 1962) (dictum—subsection (4) not yet in effect).

33 The 1956 recommendation stated that the purpose of subsection (4) was to "avoid the possible necessity of duplicating perfection in the case of vehicles subject to a certificate of title law . . . ." ALI & NAT'L CONF. COMM'RS ON UNIFORM STATE LAWS, 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 257 (1957). Apart from the incongruity of an apparently administrative afterthought causing the substantial changes which subsection (4) has effected, the purpose of "avoidance of duplicity of perfection" is inconsistent with the realities of the filing-to-title state situation now that the Code is law in almost all jurisdictions. Under subsection (3) no re-perfection would be necessary until after four months from entry. If a certificate is issued within the four month period, however, subsection (4) forces the out-of-state creditor to re-perfect, thereby *increasing* the necessity of duplicate perfection.

Comment 7 to § 9-103 states that "Collateral . . . may be brought into this State subject to a security interest . . . perfected under the laws of another jurisdiction. If the property is covered by a certificate of title, subsection (4) applies." Although ambignously phrased, the most natural reading of the two sentences is, "If the property [when brought into this state] is covered by a certificate . . . subsection (4) applies." An automobile coming from a filing state cannot be "covered" by a certificate when it enters the title state.

Thus both the Official Comments and the 1956 recommendation indicate that subsection (4) was not intended to be used in today's filing-to-title state situation. Two commentators have noted that the phrase "*this state* or any other jurisdiction" [emphasis added] can only mean that the filing-to-title state situation is covered, because otherwise "this state" is superfluous. Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72, 92 n.77 (1967); Comment, *Uniform Commercial Code—Perfection of Security Interests in Multi-State Transactions When Property Is Covered by a Certificate of Title*, 47 B.U.L. REV. 430, 437 (1967). However, when a vehicle is moved from one title state to another, the words "this state" are necessary if the local state is ever to look to its own certificate. Also, the draftsmen of the Code may have thought that "this state" was necessary to assure recognition of certificate perfection in completely intrastate transactions.

tions, and that certificate perfection is the best possible standard. However, although certificates do provide reliability within a title state, if a transaction also includes contacts with a non-title state, the reliance factor is completely one-sided. Subsection (4) looks only to the reliance upon the clean certificate by the party in the entered state, and completely ignores the original creditor's reliance upon his perfection by filing—the only means open to him.[34]

To refrain from using subsection (4) here, as most courts have done and as its drafters may have intended, does not effect any catastrophic change. Results differ only within the four month period after entry into the title state,[35] and usually then only if fraud or mistake has prevented proper notice.[36] And although under subsection (4) the party in the entered state has no assurance that a clean certificate provides an accurate picture during the four month period after entry,[37] the original creditor never has any assurance of his perfection under subsection (3). To give the original security interest holder four months of perfection, and thereafter to favor the subsequently created interest, seems the fairest way of resolving the problem. Consequently subsection (3), not subsection (4), should govern in the filing-to-title state pattern.[38]

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34 If used here, subsection (4) reverses the pre-Code majority rule favoring the out-of-state perfected security interest. If the draftsmen had intended such a change, they probably would have expressly mentioned it.

35 In the filing-to-title state situation, only transactions occurring within the four month period immediately after the vehicle has entered the title state are relevant for the purpose of comparing results under subsections (3) and (4). Both subsections reach identical results for transactions taking place after the four month period. For example, if, after four months, the out-of-state creditor has not re-perfected, subsection (3)'s four month protective period will have lapsed and subsection (3) will favor the local party—the same party favored under subsection (4) because of his reliance upon the clean certificate. If there has been timely re-perfection through notation on the certificate issued locally (*see* note 31 *supra*), the out-of-state creditor meets the requirements of both subsections (3) and (4) and is favored by both.

Conversely, in the title-to-filing state pattern discussed at pp. 621-23 *infra*, subsections (3) and (4) both recognize the out-of-state perfection during the four month period after entry. Only after that period do the results differ—subsection (3) holding the security interest unperfected, while subsection (4) continues to recognize the out-of-state certificate perfection.

36 *See* note 14 *supra*, second para.

37 A possible method for at least putting the local party on notice that during the four month period he cannot completely rely upon the clean certificate is discussed at note 29 *supra*, second para.

38 An amendment to subsection (4) which would accomplish this result has been offered. Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72 (1967). That amendment would be sufficient if this were the only change

C. *Title to Filing State*

The draftsmen of subsection (4) apparently thought that an original certificate perfection should continue perfected after interstate movement of the vehicle. Thus, when the debtor conceals or alters the certificate in such a manner that a subsequent creditor or purchaser receives no notice of the outstanding security interest, the interest continues to be recognized under subsection (4) for as long as the certificate perfection is recognized by the issuing jurisdiction.[39] This literal application of subsection (4) can be avoided by finding the vehicle not "covered" by the certificate after entry or after any given period of time,[40] but in general subsection (4)'s message is clear in the title-to-filing state situation—it adopts the pre-Code majority rule giving absolute protection to the initially perfected security interest.

In this situation the consensus is that subsection (4) provides an acceptable standard for choosing between the conflicting claims.[41] But just as subsection (2) contains a better standard for commercial vehicles,[42] subsection (3)'s balancing approach is more desirable when other vehicles travel from a title to a filing state.

Subsection (4) usually comes into play only when the subsequent purchaser or creditor has not received proper notice. It thus becomes a restatement of the doctrine of caveat emptor, giving perpetual enforceability to an original certificate perfection, no matter what the circumstances,[43] and completely ignoring the interests of subsequent

needed in subsection (4), but it is here thought that, even with the amendment, the subsection remains defective.

39 Most statutes have automatic expiration dates for perfected security interests. UCC § 9-403(2) provides that filing a financing statement effects perfection for a period of 5 years. The Uniform Motor Vehicle Certfiicate of Title and Anti-Theft Act, *supra* note 7, contains no provision limiting the duration of certificate perfection, but most state certificate laws have a limit of from 3 to 5 years. *E.g.*, PA. STAT. ANN. tit. 75, § 203(b) (1960) (4 year duration). Of course, the perfection can be renewed after expiration.

40 *Cf. In re* Singleton, Bankruptcy No. 1821, 2 ALI UCC REP. SERV. 195 (E.D. Ky., Jan. 15, 1963). In this case the referee held that when the certificate of title was surrendered in the filing state, the vehicle was no longer covered within the meaning of subsection (4).

41 *See, e.g.*, I GILMORE 622; Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72, 88-96 (1967). The criticism has been directed at the subsection's application in the filing-to-title and title-to-title state patterns. As an example of subsection (4)'s application in the title-to-filing state pattern, see *In re* White, 266 F. Supp. 863 (N.D.N.Y. 1967).

42 *See* Part II, *supra* pp. 616-17.

43 Under subsection (4) the original certificate perfection is all that is necessary even when the creditor knows, or learns, of the movement of the automobile. It is obvious that he should not be allowed to sit back and permit innocent third parties to be duped by his debtor. Although an amendment to subsection (4) could cure this particular prob-

bona fide purchasers and creditors. Nor does the rule necessarily promote the extension of credit in our credit-oriented society. Creditors and purchasers in the entered state are as much a part of our commercial society as the original security interest holder, and their extension of credit is greatly undermined by subsection (4).[44]

Subsection (3), on the other hand, strikes a reasonable balance by giving the original creditor four months of absolute protection after entry, allowing him to extend that period by re-perfection,[45] but then recognizing the interests of creditors and purchasers in the entered state after the four month period if there has been no re-perfection. Of course, the reliability of certificates as the exclusive means of perfection is thereby lessened, but not in all instances. For even when unperfected, the original security interest cannot be defeated by general creditors, purchasers with knowledge, or lien creditors with knowledge.[46] Only conflicting perfected security interest holders and trustees in bankruptcy can defeat an unperfected security interest when proper notice has been conveyed,[47] and these parties cannot defeat the prior interest if there is timely re-perfection in the filing state.

Thus, certificate efficacy is reduced under subsection (3), but quite often only when the certificate has not fulfilled its important function of notice-giving, and in any event only when there has been no re-perfection. An extra burden would accordingly be placed upon the original creditor, but it would not be an unreasonable one in light of the mobility of the chattel he has accepted as collateral and the possibility of innocent third parties being defrauded in interstate

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lem, the larger issue of the continual enforceability of a "hidden lien" would remain. Deletion of subsection (4) would solve both problems.

44 At first blush this reasoning seems contrary to that offered in rejecting subsection (4) in the filing-to-title state pattern. There it was argued that the original creditor should have a four month protective period after the vehicle's entry into a second state. Here it is thought that four months is long enough, and that thereafter parties in the second state should be favored.

45 In contrast to the filing-to-title state situation, the out-of-state creditor could easily re-perfect here under UCC § 9-402(2)(a). This is not meant to imply, however, that the original creditor will always, or even often, be able to locate the vehicle and re-perfect within the four month period (see note 31 *supra* for problems concerning re-perfection in a title state). If he does not, his interest will become unperfected after four months, and those interests which take priority over an unperfected security interest will thereafter defeat it. As the text points out, this would be a conscious choice, putting the risk of loss on the original creditor after the four month period. Prior to that time, the risk is placed upon the parties in the entered state.

46 *See* note 8 *supra*.

47 *Id.*

transactions. For these reasons, the present consensus is wrong, and subsection (4) is no more acceptable in the title-to-filing state situation than in other instances. Although it contains some deficiencies which should be corrected,[48] subsection (3) uses a scheme of balancing which is more appropriate in an area where preference must often be given to one of two conflicting, but equally viable, claims.

In all situations, then, subsections (2) and (3), not subsection (4), provide the better rules for determining which jurisdiction should govern perfection when a vehicle moves interstate.[49]

James M. Hughes

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48 These deficiencies are discussed in note 6 *supra*.

49 It is hoped that these suggestions will be considered by the Article 9 Review Committee rather than enacted by individual jurisdictions. For a discussion of that committee's functions, see Braucher, *Report on the Work of the Article 9 Review Committee*, 23 Bus. L. 890 (1968).