SECTION 9-104(e) OF THE UCC: THE DANGERS OF ADOPTING THE 1972 OFFICIAL TEXT

Since 1972, at least fifteen states have followed the example set by the 1972 Official Text of the Uniform Commercial Code and have excluded any transfer by a government or governmental subdivision or agency from Article 9 of the Uniform Commercial Code.[1] One of these states, New York, has encountered unanticipated difficulties with this exclusion, difficulties which suggest that uncritical adoption of this seemingly innocuous recommendation of the Official Text can have serious and undesirable consequences for certain governmental purchases, sales, borrowings, or financings.

On July 2, 1978, an act amending portions of Articles 1, 2, 5, 9, 10, and 11 of the New York Uniform Commercial Code took effect.[2] Enacted to help

1. To date, Arizona, Arkansas, California, Connecticut, Illinois, Iowa, Maine, Nevada, New York, North Carolina, North Dakota, Oregon, Texas, Utah, and West Virginia have adopted the amendment to § 9-104(e) recommended by the 1972 Official Text. 3 Uniform Laws Annotated, Revised Article 9, Conforming Amendments, Article 11 (1978 Pamphlet) 2, 21. As amended by the 1972 Official Text, § 9-104 reads:

§9—104. Transactions Excluded From Article

This Article does not apply

(a) to a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property; or

(b) to a landlord's lien; or

(c) to a lien given by statute or other rule of law for services or materials except as provided in Section 9–310 on priority of such liens; or

(d) to a transfer of a claim for wages, salary or other compensation of an employee; or

(e) to a transfer by a government or governmental subdivision or agency; or

(f) to a sale of accounts or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts or chattel paper which is for the purpose of collection only, or a transfer of a right to payment under a contract to an assignee who is also to do the performance under the contract or a transfer of a single account to an assignee in whole or partial satisfaction of a preexisting indebtedness; or

(g) to a transfer of an interest in or claim in or under any policy of insurance, except as provided with respect to proceeds (Section 9–306) and priorities in proceeds (Section 9–312); or

(h) to a right represented by a judgment (other than a judgment taken on a right to payment which was collateral); or

(i) to any right of set-off; or

(j) except to the extent that provision is made for fixtures in Section 9–313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder; or

(k) to a transfer in whole or in part of any claim arising out of tort; or

(l) to a transfer of an interest in any deposit account (subsection (1) of Section 9–105), except as provided with respect to proceeds (Section 9–306) and priorities in proceeds (Section 9–312).

U.C.C. § 9-104 (1972 version). The 1978 Official Text continues to recommend this provision but offers no further amplification or comment.

Several states have gone beyond the recommendation of the 1972 Official Text and have made other changes in § 9-104. New York, for example, has changed a phrase in § 9-104(a) from "governs the rights of parties" to "governs the rights or parties," has eliminated the word "in" which follows the word "interest" in § 9-104(g) of the 1972 Official Text, and has added the phrase "or contract for an annuity including a variable annuity," to subsection (g). N.Y. Uniform Commercial Code Law (McKinney), § 9-104 (Supp. 1977-78). California, however, has been more expansive, adding a different subsection (l), excluding any security interest created by the assignment of the benefits of any public construction contract under the Improvement Act of 1911, as well as the amended § 9-104(e). Cal. Commercial Code § 9104 (1978 Supp.) (West). According to the California Code Comment, subsection (l) was added in 1967 in order to make clear that public securities are not included in the transactions referred to in Division 9, Cal. Commercial Code § 9104 California Code Comment (1978 Supp.) (West), and, according to one California analyst, the 1976 amendments, including the amended 9104(e), "broaden the exclusion for security interests created by the state or its political subdivisions to apply to any 'transfer by a government or governmental subdivision or agency'." Small, *Coming Changes in Division 9 of California Commercial Code,* 51 Los Angeles Bar J., 272 (1975).

To date, Minnesota, Virginia, and Wisconsin have considered amendment of § 9-104(e) but have chosen to reject the version recommended by the 1972 Official Text. 3 Uniform Laws Annotated, Revised Article 9, Conforming Amendments, Article 11 (1978 Pamphlet) 2, 21.

2. 1977 N.Y. Laws c. 866 § 38.

conform the New York Uniform Commercial Code to the 1972 Official Text of the Code,[3] this legislation amended § 9-104, the section dealing with specific exclusions from Article 9. What had been subsection (e), excluding an equipment trust covering railway rolling stock from Article 9, was deleted by the legislation, and a new subsection (e), excluding a transfer by a government or governmental subdivision or agency, was added.[4] As a result, both the New York Code and the 1972 Official Text exclude any security interest arising from a governmental transfer from the otherwise applicable coverage and perfection provisions of Article 9.

The sole apparent reason for this change in § 9-104(e) was to make clear that Article 9 no longer applies to governmental debtors.[5] Beyond this, however, the exclusion evidently rests on the assumption that governmental transfers are usually permitted and controlled by special statutes and so do not need the procedures implemented by Article 9. Proponents thus assumed that any special statute which permitted a governmental transfer would also

3. This was the only apparent purpose of the Act. The amendments were offered in both the New York Assembly and Senate in order to make provisions of the New York Code conform to the 1972 Official Text with respect to secured transactions, consignments, sales of accounts, and chattel paper (as well as to clarify rules applicable to inter-jurisdictional transactions and to impose consumer-protective duties upon a secured party when the collateral for the transaction is consumer goods). *New York Legislative Record and Index,* 1977. S. 260, A 323. Memoranda submitted in support of the amendments made the same point; one report, prepared by the Business Law Committee of the Banking, Corporate and Business Law Section of the New York State Bar Association, noted:

> This bill, sponsored by the New York Commission on Uniform State Laws, would enact in New York the 1972 Official Text of Article 9 of the Uniform Commercial Code (UCC).
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> New York enacted the original UCC in 1962 and was in the forefront of the major commercial states in adopting this comprehensive legislation. In the following years, every state in the country, except Louisiana, adopted the UCC. Unfortunately, in some states there were significant departures from the uniform text, particularly in Article 9. Some of these were improvements, but others represented simply local reluctance to depart from prior concepts. By the mid-sixties, there were over 300 such variations. As a result, the sponsoring bodies of the UCC established an Article 9 Review Committee to study these state variations and to consider how well the provisions of the Article were working in practice.
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> That Committee worked from 1967 through 1970, when it submitted its recommendations. After study by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, the 1972 Official Text was adopted and recommended to the states for enactment. It is this text which is contained in the subject bill.
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> This Committee of the Bar Association has reviewed the text in detail and find its provisions to be a substantial improvement over current law. Fortunately, the changes have been limited to those which, during the years, have proven to be necessary to clarify and improve the current provisions. It appears that there are no changes simply for the sake of change or because the Review Committee disagreed with language in the prior text which appears to be working well. The new text reconciles many of the major differences arising out of nonuniform amendments and responds to defects found in the original text.

New York State Bar Association, Legislation Report, Report No. 75, 1977.

Ultimately, this legislative purpose was incorporated into the amendment as passed. Chapter 866 is entitled "An Act to amend the Uniform Commercial Code, in relation to conforming it to the nineteen hundred seventy-two Official Text with respect to secured transactions, consignments, sales of accounts, and chattel paper and repealing sections 9-103 and 9-404 relating thereto." 1977 N.Y. Laws c. 866 (preamble). This purpose applies to each amendment contained in the Act, and no other legislative purpose is mentioned.

4. 1977 N.Y. Laws c. 866 § 38.
5. Permanent Editorial Board for the Uniform Commercial Code Review Committee for Article 9 of the Uniform Commercial Code, Final Report, 35 (1971).

provide the equivalent of Article 9 protection for any security interests which might arise; this made the requirements of Article 9 redundant.[6]

Although this view evinces a laudable concern for textual efficiency and economy, it fails to recognize several facts of governmental life. One such fact is that some governmental transfers are too routine to be protected by special provisions of law.[7] A second fact is that certain governmental transfers may be conducted pursuant to statutes which expressly rely on Article 9 to protect the security interests arising under their auspices.[8] A third fact, discovered in New York after § 9-104(e) had been amended, is that certain statutes permitting governmental transfers make no provision at all for the protection of involved security interests and instead depend implicitly on Article 9.[9] In sum, not all security interests created by governmental transfers are governed by special statutes. Whether these transfers involve mundane but essential purchases or sophisticated borrowings and financings, they benefit from the protection

6. According to Comment 5 of the 1971 Official Comments to § 9-104:

> 5. Certain governmental borrowings include collateral in the form of assignments of water, electricity or sewer charges, rents on dormitories or industrial buildings, tools, etc. Since these assignments are usually governed by special provisions of law, these governmental transfers are excluded from this Article.

Permanent Editorial Board for the Uniform Commercial Code Review Committee for Article 9 of the Uniform Commercial Code, *Final Report,* 36 (1971).

Analysts of the Official Text have discerned the same purpose. As one of these analysts noted, "The other new exclusion is a transfer by a government or a governmental subdivision or agency. Such transfers are often made pursuant to special statutes and it was felt that they did not need to be subject to the requirements of Article 9 as well." Funk, *The Proposed Revision of Article 9 of the Uniform Commercial Code.* 27 Bus. Law. 321, 329 (1971).

7. This particular fact disconcerted Professor William D. Hawkland who, in analyzing the amendment as proposed, quoted the purpose set forth in Comment 5 of the the 1971 Official Comments, then added:

> But it is not only "these" governmental security interests that would be excluded from Article 9 if the Committee's proposal were enacted but *all* security interests created by government debtors. In making this proposal the Committee has apparently overlooked the fact that many small municipalities and other governmental agencies purchase many items like police cars, fire trucks, school equipment and so forth on purchase money security contracts that are not governed by "special provisions of the laws." Literally thousands of these transactions occur every year in the small towns of America. If Article 9 is not to govern these transactions, what law will govern them? Clearly, it would seem, the Committee has gone too far and proposed § 9-104(e) should be redrafted to exempt only those security interests created by governmental debtors that are governed by special provisions of law.

Hawkland, *Proposed Amendments to Article 9 of the Uniform Commercial Code: Part IV - The Scope of Article 9,* 77 Com. L.J. 79, 82 (1972).

8. Although such express reliance is possible, it is rarely convenient. Often the legislation permitting involved governmental transfers dispenses with any filing requirements, so as to make any pledge of revenues or other moneys valid and binding from the time the pledge is made; less often a statute will go out of its way to avoid Code provisions, as does the Niagara Frontier Transportation Act:

> 5. It is the intention hereof that any pledge, mortgage or security instrument made by the authority shall be valid and binding from the time when the pledge, mortgage or security instrument is made; that the monies or property so pledged, mortgaged and entrusted and thereafter received by the authority shall immediately be subject to the lien of such pledge, mortgage or security instrument without any physical delivery thereof or further act; and that the lien of any such pledge, mortgage or security instrument shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the authority, irrespective of whether such parties have notice thereof. Neither the resolution nor any mortgage, security instrument or other instrument by which a pledge, mortgage lien or other security is created need be recorded or filed and the authority shall not be required to comply with any of the provisions of the uniform commercial code.

N.Y. Pub. Auth. Law (McKinney) § 1299-i (5).

9. The most conspicuous and ominous example of such a statute is the New York State Industrial Development Agency Act, N.Y. Gen. Mun. Law (McKinney) § 850 *et seq.,* the legislative vehicle used by over one hundred industrial development agencies within New York to issue and secure industrial development bonds.

afforded by Article 9 to their involved security interests. Under the amended § 9-104(e), these security interests are now denied this protection.

As a consequence of the amended § 9-104(e) and its indiscriminate exclusion, one central but practical question arises: what law does govern governmental transfers not made pursuant to a protective special statute? Although even the outline of a satisfactory answer to this question is, in the words of one analyst, "entirely unclear,"[10] several posibilities exist. Each has its own inherent difficulties.

The first and most immediately apparent possibility is that the applicable law is that which prevailed before the adoption of the Uniform Commercial Code.[11] Supported by the view that the law of chattel security did not cease to exist at the birth of the Uniform Commercial Code and that the Code has changed this law far less than might be supposed, this possibility treats the Code as a framework for the law of chattel security. If this framework is artificially removed, the body of chattel security law which it supported would still exist and could still be used.[12] The principal difficulty with this view is that it requires a determination of what the law of chattel security actually is. Such a determination involves more than just statutory construction; at a minimum it involves a decision as to whether statutory law or common law survives and controls.

Prior to the adoption of the Uniform Commercial Code, the vast bulk of chattel security law was contained in statutory provisions governing pledges and chattel mortgages.[13] The Code expressly repealed many such statutes, however, and the extent to which they may be deemed to govern transactions excluded from the Code is uncertain.[14] Even if extant and applicable, such statutes pose problems: they may require basic redefinition,[15] and they may

10. Note, *Commercial Law: Revision of Article 9,* 1973 Ill. Law Forum 467, 469.
11. This possibility has some support in case law, albeit by analogy. In Law Research Serv., Inc. v. Martin Lutz App. Print., Inc., 498 F. 2d 836 (2nd Cir., 1974), the court construed § 9-104(h) of the New York Code so as to exclude a right represented by a judgment from Article 9 and to force reliance on pre-Code law. In doing so, the court depended upon the practice commentary accompanying Article 9 and concluded that no statutory law governing perfection of assignment of judgments existed. 498 F. 2d at 840. Yet, in so concluding, the court did not examine the degree of notice which such assignments require, the integration of pre-Code statutory law with the repealing effects of the Code, or the impact of the Practice Commentary upon subsections of § 9-104 other than § 9-104(h). In essence, the court maintained that assignment of judgments need not be filed to be perfected, regardless of which law applied. This uniformity of result would not necessarily prove true for security interests excluded by the amended § 9-104(e).
12. 1 U.C.C. Rep. (Bender) Secured Transactions Under the Uniform Commercial Code, 214.
13. For example, under the New York Lien Law, which governed chattel mortgages before the adoption of the Uniform Commercial Code, every mortgage or conveyance intended to operate as a mortgage of goods and chattels which was not accompanied by immediate delivery and followed by actual and continued possession of the item mortgaged was absolutely void against creditors unless filed within ten days of its making. Later filing was valid as against creditors, but the mortgage was deemed to have come into existence only at the time of filing. N.Y. Lien Law (McKinney) § 230. In general, chattel mortgages were required to be filed in the office of the clerk in the town or city in which the mortgagor resided at the time of the execution of the mortgage. N.Y. Lien Law (McKinney) § 232.
14. For example, except for certain portions of the statute dealing with corporate mortgages against real and personal property, the provisions of the New York Lien Law dealing with chattel morgages were repealed by § 10-102 of the New York Uniform Commercial Code. N.Y. Lien Law (McKinney) Article 10 – Chattel Mortgages. Unless these provisions are in some way revived, a security interest excluded from the scope of Article 9 of the New York Uniform Commercial Code cannot obtain the equivalent of perfection under the series of recording statutes which culminated in the New York Lien Law.
15. Using pre-Code law, for instance, would require what had existed as a "security interest" under the Code to be redefined as either a pledge or a chattel mortgage.

provide legally adequate but ineffective notice to creditors accustomed to defining adequacy of notice in terms of compliance with the procedures of the Uniform Commercial Code.[16]

The common law of chattel security is a similarly unrewarding solution. Although the common law of chattel security has the advantage of being extant and applicable, its preference for possession of collateral[17] imparts the disadvantage of permitting a mortgagee to prevail over subsequent claimants without having to file, record, or perfect his interest.[18] As a consequence, subsequent creditors, purchasers, or mortgagees involved in governmental transfers need have no notice of existing security interests, a result of common law application which is clearly at odds with the spirit of the Uniform Commercial Code.

A second possible answer affords no more certainty. This possibility suggests that since the law governing perfection of security interests arising from excluded and unprotected governmental transfers is unclear, the parties involved in the transaction at issue make their own law by specifying in their contracts or purchase agreements which law applies. Based on this or a similar statement, the parties could then perfect in accordance with Article 9 or with other selected law. The principal difficulty with this solution, however, is its enforceability. As one proponent of this solution has observed, in view of the explicit language of the amended § 9-104(e), a court might well refuse to enforce the Article 9 rights of a party to a governmental transfer, even when such rights and coverage were specified.[19]

A third possibility is that no law governs excluded and unprotected governmental transfers.[20] In such a situation, certain provisions of the Code itself may operate to make Article 9 ultimately applicable in spite of the exclusion set forth in the amended § 9-104(e).[21] Two provisions which may have this effect are the transition sections of the Code and the "erroneous filing" provisions of Article 9.

The first of these options—the transition sections of the Code—is not a solution recommended by the Official Text.[22] As enacted in at least one state,

16. This result would prove especially prevalent in situations in which the filing locations or entries differed from those specified by Article 9 and in situations in which no filing at all was needed under pre-Code law.
17. Under the common law of chattel security, filing pursuant to a recording statute was considered a less desirable alternative to possession taken by the secured party. The traditional point of view stigmatized any security agreement outside the real property area in which the debtor was allowed to retain possession of the collateral as a fraudulent conveyance or something akin to one. See 1 Gilmore, Security Interests in Real Property § 15.1 (1965). This attitude, however, did not necessarily deny priority to the secured party; retention of possession by a mortgagor was not fraud *per se* but at most merely evidence of fraud, rebuttable by proof that no fraud was in fact intended by the parties. *See* Brown, The Law of Personal Property § 112 (2d. ed. 1955).
18. As the Official Comment to § 9-101 of the 1972 Official Text suggests, however, this result could vary from state to state and could depend upon whether the interest was deemed a chattel mortgage or a conditional sale. U.C.C. § 9-101 Comment (1972 version).
19. Note, *supra* note 10, at 469.
20. Such a possibility would be predicated on the assumption that pre-Code statutes had pre-empted and codified the common law and that the pre-Code statutes had been repealed by the Uniform Commercial Code.
21. The overwhelming difficulty with this solution is conceptual in nature: a security interest specifically excluded by Article 9 could only be properly protected under the provisions of Article 9 and would be perfectable under this Article in spite of its express exclusion.
22. Article 10 of the Official Text, containing the transition provisions for the 1962 Official Text, contains no suitable tool for this particular use, while Article 11 of the Official Text, containing the transitioin provisions for the changes implemented by the 1972 Official Text, is specifically termed a "working draft." U.C.C. Article 11 (1972 version). This "draft," however, may be and has been adopted and altered by several states.

however, the transition sections of the Code have been expanded to cover security interests caught in the shift from pre-Code law to Article 9.[23] As a result of this expansion, a security interest which was not perfected when Article 9 took effect, which could have been perfected under now-repealed law, and which could be perfected by filing if Article 9 applied to it, can still be perfected merely by compliance with the filing requirements of Article 9.[24] Many existing but unprotected security interests arising from governmental transfers could meet this test.

It is not existing security interests, however, which raise the question. Security interests not yet in existence will be most affected by the exclusion imposed by the amended § 9-104(e), and the thrust of the transition sections indicates that only those security interests in existence and capable of being perfected at the time the appropriate Article 9 takes effect will be perfected.[25] Beyond potential problems with regard to the interaction of varying

23. When the original Article 9 took effect in New York, on September 27, 1964, it supplanted and repealed a number of statutes, including the Factor's Lien Act, the Uniform Trust Receipts Act, the Uniform Conditional Sales Act, and sections of the New York Lien Law relating to the rules covering chattel mortgages. N.Y. Uniform Commercial Code Law (McKinney) § 10-105 (Schedule of Laws Repealed). To provide for transition between these repealed statutes and Article 9, § 10-102 set forth a scheme covering security interests which had been perfected under the repealed statutes. N.Y. Uniform Commercial Code Law (McKinney) § 10-102(2). As passed in New York, however, this scheme was amplified by the addition of subsection (3), governing other security interests caught in the transition. According to it:

> (3) Notwithstanding subsection (2):
>
> (a) The perfection of a security interest, however denominated in any law repealed by this Act, which was perfected when this Act takes effect by a filing, refiling or recording under a law repealed by this Act, and for the perfection of which, if this Act applied, no filing of a financing statement would be required, continues under this Act.
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> (b) A security interest, however denominated in any law repealed by this Act, which was not perfected when this Act takes effect but which could have been perfected before this Act takes effect by a filing, refiling or recording under a law repealed by this Act, and which, if this Act applied, could be perfected by the filing of a financing statement under this Act, may be perfected by the filing of a financing statement in accordance with this Act.
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> (c) A security interest, however denominated in any law repealed or modified by this Act, which was not perfected when this Act takes effect but which could have been perfected before this Act takes effect by the secured party's taking possession of the collateral, may be perfected by the secured party's taking possession of the collateral in accordance with this Act. L.1962, c. 553; amended L.1964, c. 476, §§ 21, 22, eff. Sept. 27, 1964.

N.Y. Uniform Commercial Code Law (McKinney) § 10-102(3).

24. N.Y. Uniform Commercial Code Law (McKinney) § 10-102(3).

25. Central to this indication are the words "which was not perfected when this Act takes effect but which could have been perfected" as used in § 10-102(3) (b) of the New York Code. Although the words "which could have been perfected" can be construed to apply to any interest, whether in existence before the New York Uniform Commercial Code took effect or not, they may also be construed to apply only to those interests in existence and capable of being perfected at the time the Code took effect.

This latter construction more nearly reflects the New York Commission Comments to § 10-102, which state:

> Subsection (1) has been revised to conform to New York practice. The addition to subsection (2) [proviso clause and all text following] and the addition of subsection (3) provide a method for the continued perfection of security interests created before the Act takes effect.

N.Y. Uniform Commerical Code Law (McKinney) § 10-102 (N.Y. Commission Comments). It also reflects judicial analysis as set forth in Lynch v. County Trust Company, 404 F. 2d. 1149 (2nd Cir., 1968). In *Lynch,* the court affirmed the validity of a conditional sales contract erroneously filed under pre-Code law and subsequently filed in accordance with Code requirements. Although the court advocated a spirit of liberality and substantial justice for application to the entire Code as adopted in New York, it limited its construction of § 10-102(3)(b) to interests in existence at the time the Code took effect. 404 F. 2d at 1150-1151. Although the security interest in question in *Lynch* was already in existence at the time the Code took effect and so raised no larger issues, the court showed no tendency to give § 10-102(3)(b) an expansive interpretation or application.

transition sections or articles[26] and with regard to the possibility that prior governing law was Article 9 itself,[27] the fatal flaw in the option offered by the transition sections is that while it is clear that the sections apply to existing security interests, it is at best doubtful that they apply to security interests which were governed by prior law in theory but which do not yet exist.

A second way in which to make Article 9 applicable is through use of its "erroneous filing" provisions.[28] Such use depends on the absence of applicable, effective law, since the filing of a security interest under Article 9 would not be in "good faith" if another refuge were apparent.[29] If adequate notice is essential, however, and if there is no other alternative, a filing which is technically inadequate because of the exclusion implemented by the amended § 9-104(e) may nonetheless be effective.[30]

26. The transition provisions which permit this perfection were changed by the act which amended § 9-104 to exclude governmental transfers. In effect, what had been Article 10 was renumbered as Article 13, and a new Article 11 was introduced, providing for transition from the original Article 9 of 1964 to the revised Article 9 of 1978. N.Y. Uniform Commercial Code Law (McKinney) §§ 10-101 to 10-105, 11-101 to 11-108, 13-101 to 13-105 (Supp. 1977-78). Although the effective date of the Act (that is, the Uniform Commercial Code as a whole) has not been changed and, for the purposes of the transition provisions, is still defined as September 27, 1964, N.Y. Uniform Commerical Code Law (McKinney), § 13-105 (Supp. 1977-78), § 10-105, Article 11 draws a distinction between the original and the revised Article 9 and states that for the purposes of the old transition provisions (which are referred to as Article 10 and not the renumbered Article 13) the original and the revised Article 9 shall be considered one continuous statute. N.Y. Uniform Commerical Code Law (McKinney) §§ 11-101, 11-102 (Supp. 1977-78). This suggests that the changes made in Article 13, notably the three subsections added to § 13-102(3) dealing with security interests perfected on or before the effective date of the Act, do not apply to revised Article 9; it also suggests that Article 10 applies to revised Article 9 as it did to the original, 1964 Article.

27. Assuming that § 10-102(3)(b) applies to the revised Article 9 and assuming that § 10-102(3)(b) allows a party possessing a valid but as yet unperfected security interest on the effective date of the Act to file under the provisions of Article 9 and protect the substantive rights he would have had under pre-Code law (this based on the suppositions that a person searching the chattel security records would more naturally refer to the Code filing system and that it would be expensive, needless duplication for the state to maintain concurrently two up-to-date but incomplete chattel filing systems, Janover and Dulles, *The Application of the Transitional Provisions of Uniform Commercial Code Article 10 to Chattel Security Filing*, 39 N.Y.U. L. Rev. 1027, 1039 (1964)), the remaining question is whether a security interest excluded from Article 9 by the amended § 9-104(e) may be brought within the scope of Article 9 by Article 10. The heart of this question is the question of what the otherwise applicable law is. If the law applicable to a security interest which is excluded from Article 9 by the amended § 9-104(e) and which is not governed by a special statutory method fits within the confines of § 10-102(3)(b), filing under Article 9 may be enough to perfect the interest.

    Although a case can be made for the proposition that the applicable law is that of the original Article 9, a more effective position is that the exclusion provided by § 9-104(e) eliminates Article 9 from contention. If there is no special statutory method for perfection of the security interest, the applicable law is not Article 9 in any form but is pre-Code law. It is possible that the applicable pre-Code law is not one of the statutes which was repealed by the New York Uniform Commercial Code, but it is more probable that such a security interest was perfected by recording under Article 10 of the New York Lien Law. N.Y. Lien Law (McKinney) §§ 230, 232-234. Since all but one section of this article were repealed by Article 9 of the New York Uniform Commercial Code, N.Y. Uniform Commercial Code Law (McKinney) § 10-105 (Schedule of Laws Repealed), and since the transition provisions of Article 10 of the U.C.C. apply to the revised Article 9, the excluded security interest fits within the confines of § 10-102(3)(b): the repealed law denominating the security interest is Article 10 of the New York Lien Law, and the interest was not perfected when the revised Article 9 took effect but could have been perfected by filing before the revised Article 9 took effect. If the revised Article 9 applied to the excluded interest, the interest could be perfected by filing under the U.C.C., and so, under § 10-102(3)(b) as applied, the security interest otherwise excluded from Article 9 may be perfected by filing in accordance with the Article.

28. In both the 1972 Official Text and the New York Uniform Commercial Code these provisions are set forth in § 9-401(2).

29. This position assumes that the standard of good faith which applies to § 9-401(2) is that set out in § 1-201(19) of both the 1972 Official Text and the New York Code.

30. *See* U.C.C. § 9-401. Official Comment 5 (1972 version).

Yet, such effectiveness is at best conditional. Section 9-401(2) provides that if a filing is made in good faith in an improper place with knowledge by any person against whom the interest is asserted of the contents of the financing statement, the filing will be deemed effective.[31] As summarized by one analyst, the "erroneous filing" subsection provides "that when an honest, if fumbling, attempt at filing is coupled with awareness of that attempt by the other secured party, it is rewarded."[32] Since good faith is always subject to judicial scrutiny[33] and since good faith and knowledge by the other parties

31. In general, § 9-401 establishes the proper place or places in which to file on Article 9 financing statement. Under all the alternatives listed in § 9-401(1) the filing must be made in the appropriate place or places or the filing is ineffective and the security interest invalid against those persons taking priority over attached but unperfected security interests, that is, those creditors protected by § 9-301. When the filing is either partially or totally ineffective, as when a dual filing is required but only one filing is made or when one of the two required filings is made in the wrong place, the security interest remains unperfected, absent special circumstances.

    The special circumstances are covered in § 9-401(2), which states:

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

    N.Y. Uniform Commercial Code Law (McKinney) § 9-401(2).

32. 12 Uniform Commercial Code Law Letter, No. 5, 1 (July, 1978).

33. For instance, at least one United States District Court case has taken the position that "good faith" under § 9-401(2) means more than simply making an effort to file. In this case, *In re* Luckenbill, 156 F. Supp. 129 (E.D. Pa., 1957), an installment seller who had not strictly complied with the Code filing requirements claimed that since there were no other creditors in existence who could contest the validity of his lien, his interest was superior to that of a trustee in bankruptcy. In rejecting this argument the court noted:

    > Reclamation petitioner seeks to escape from the dilemma in which he finds himself by relying on Section 9-401(2) of the Code which reads:
    >
    > > "A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing was proper and with regard to all collateral against any person who has knowledge of the filing of the financing statement which indicates that a security interest in all collateral wherever located was intended."
    >
    > He urges that such partial filing as was accomplished prior to bankruptcy was made "in good faith" and that it constituted notice to the trustee and all other creditors of the bankrupts and was constructive "knowledge of the filing of a financing statement which indicated that a security interest in all collateral wherever located was intended."
    >
    > While the language of this Section is not as clear as it might be, it is evident that petitioner's construction would nullify Section 9-401(1) which is the primary statutory provision governing where filing shall take place. Furthermore, as Referee Hiller well points out:
    >
    > > "This is unsound reasoning. It ignores at the outset the distinction between notice and knowledge. There is no showing anywhere that the trustee had knowledge as of the date of bankruptcy or as of the date of his election on March 15, 1957 of any filing whatsoever by the petitioner. It is difficult to understand moreover what the petitioner and the Code mean by a filing which is made 'in good faith' in an improper place or not in all of the places required by the Code. One may ask, under what circumstances is a filing not made 'in good faith'? Conceivably petitioner's filing after bankruptcy, with knowledge of the bankruptcy, could have been a filing not made in good faith. We think it fairly certain and sound that a failure to comply with the filing requirements of the Code cannot be excused by a mere showing of good faith on the part of the party whose omission brought him to grief."
    >
    > 156 F. Supp at 131.

have been viewed as interdependent elements,[34] the applicability of § 9-401(2) to security interests arising from governmental transfers would appear to be limited.[35]

What the above suggests is that no satisfactory answer exists to the question of what law applies to governmental transfers excluded from Article 9 by the amended § 9-104(e) but not made pursuant to a protective special statute. Since the law provides no satisfactory answer, two practical approaches to the amended § 9-104(e) recommend themselves.

34. Case law has required the interdependence of the elements of good faith and of knowledge by the other parties and, at the same time, has distinguished between notice and knowledge. Three cases illustrate the strength of this insistence. In the first, *In re* Lux's Superette, Inc., 206 F. Supp. 368 (E.D. Pa., 1962), petitioners claimed that by virtue of a local filing and § 9-401(2) they held a perfected security interest in property in the possession of a bankrupt. The court denied their claim, maintaining that § 9-401(2) required either that a proper filing be made as to some property or that creditors have knowledge of the filing of a financing statement in one if not all the places specified in § 9-401(1). When neither condition existed, an inadequate filing made in good faith was – in the view of the court – not enough to perfect the security interest; thus, even when a good faith attempt at filing was made, an awareness of that attempt on the part of other creditors was necessary to make the otherwise wholly inadequate filing effective. Similarly, the court in *In re* Davidoff, 351 F. Supp. 440 (S.D.N.Y., 1972) rejected the argument that knowledge that most of a bankrupt's equipment was covered by a chattel mortgage did not constitute knowledge of the contents of the financing statement. According to the court:

> We believe this interpretation of U.C.C. § 9-401(2) is too narrow and literal, and does not represent the law of New York with respect to actual notice as compared with constructive notice. Rather, the New York rule is as stated in the New York Annotations to § 9-401 of the Uniform Commercial Code, "In New York one with actual notice cannot sucessfully defeat an adverse interest on the ground of improper filing." (McKinney's Consol. Laws Book 62 1/2, Part 3, p. 556).
>
> It appears that Hebard, on the Bank's version of the facts, had all the knowledge which it would have had if its officer had visited the County Clerk's Office and read the statement. It had actual notice of the "contents of such financing statement" within the meaning of U.C.C. § 9-401(2). Such a reading would have shown those facts, and only those facts set forth on New York Standard Form UCC–1, that is, the debtor's name and address, the secured party's name and address, and the type of property. If all this information was specifically imparted to Hebard, as the record indicates, then that is enough in New York to create actual notice, just as if Hebard's principals had read a copy of the improperly filed statement.

351 F. Supp. at 442-3. This position has also been adopted by the New York Supreme Court, Appellate Term, Second Department, which in *In re* Enark Industries, Inc. (Bush), 86 Misc. 2d. 985 (1976) stated:

> It is the opinion of this court that even though "knowledge of the contents of such financing statement" means actual knowledge (Uniform Commercial Code, § 1-201, subd. [25]) and that mere knowledge of the existence of a security agreement will not be sufficient (White and Summers, *supra*, § 23-15, pp 829–833), we are persuaded that the rationale of *Matter of Davidoff* 351 F. Supp. 440) is applicable herein. The code does not require that the junior creditor see the statement filed or even know of the filing. What is required is that the junior creditor know the contents of the financing statement. 86 Misc. 2d. at 987.

35. Other reasons for preferring a narrow construction of § 9-401(2) exist. A broad interpretation of the subsection could effectively permit knowledge of a security interest to equal a filing, a position in conflict with the "pure race" aspects of Article 9, notably those contained in § 9-312(5). In addition, policy reasons impel a narrow construction: at least one source has maintained that a creditor filing in the wrong place should not be given greater rights than a creditor who has failed to file, especially when a third creditor has knowledge of the security interest of each. White and Summers, Handbook of the Law Under the Uniform Commercial Code (1972) § 23-15.

If § 9-401(2) is narrowly construed, its applicability to filings made under Article 9 but technically inadequate as a result of the exclusion of the amended § 9-104(e) would seem to be limited. Even if read more broadly, the subsection is an uncertain solution. As two analysts have concluded, "It must be conceded that while the motivating spirit behind section 9-401(2) is fairly evident and may be a laudable one in the interests of justice, its wording is far from perfect. The section demonstrates the age-old difficulty of trying to incorporate purely equitable principles into a statutory scheme." Robinson and Marsh, *Some Observations on Article 9 of the Uniform Commercial Code*, 63 Dick. L. Rev. 45, 47 (1958).

The first approach is avoidance of the exclusionary impact of the subsection, perhaps best accomplished through construction of its terms. For example, if an entity could establish that, by definition, the terms of § 9-104(e) do not apply to its transactions, it might be able to rely on the protection afforded by Article 9. In the case of § 9-104(e), two terms may offer such an opportunity: the term "governmental agency" and the term "transfer." Logically, whether these terms allow avoidance of the impact of the amended § 9-104(e) will depend on the definitions imposed on the terms by the Code itself[36] and by case law.[37]

A second solution is careful consideration of the impact of the version of § 9-104(e) promulgated by the 1972 Official Text, a consideration best undertaken prior to legislative acceptance. Difficulties with the amended § 9-104(e) exist: the exclusion indiscriminately applies to any and all governmental transfers, and it fails to concern itself with transfers not protected by special statutes. If pointed examination reveals the possibility of unprotected security interests arising from governmental transfers and the possibility of a void of applicable law because of the amended § 9-104(e), redrafting the exclusion so as to cover only those security interests created by governmental transfers which are governed by special provisions of law may prove advisable.[38] The alternative—jeopardizing state, county, and municipal purchases, borrowings, and financings by enacting the oversight of the Official Text—is unattractive.

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36. The first of these terms, "governmental agency," is not defined or restricted in either the New York Code or the 1972 Official Text. The second term, "transfer," is also not defined by Article 9 or Article 1. The effect of the transfer of an instrument and of a transfer of a security instrument is, however, outlined in U.C.C. § 3-201 (1972 version). Since the provisions of Article 3 are subject to the provisions of Article 9, through the operation of U.C.C. § 3-103(2), a link between the two articles does exist, and the Article 3 usage of "transfer" may color the term as used in Article 9.

37. Questions exist as to how the term "governmental agency" should be construed. One question is whether the term refers to corporations whose stock is owned by a government or whether the term refers exclusively to governmental branches or commissions. A second question is whether the use of the term in the phrase "government or governmental subdivision or agency" indicates a series of alternatives or a subordination. If the phrase should be construed so as to read "a transfer by a government or a governmental subdivision or a governmental agency," its impact may be different than if it were to be read to mean "a transfer by a government or a governmental (a) subdivision or (b) agency." Although either reading is plausible, analysts have suggested that the second version more strongly indicates that the agency is a part of the structure of government rather than an instrumentality through which a given activity is conducted. *See* 4 Anderson, Uniform Commercial Code § 9-104:4(m) (1973-74 Com. Supp.).

Definition of the second term, "transfer" involves case law more directly. For example, New York courts have taken an expansive view of the term "transfer," defining it as "a transaction where one surrenders his interest so that it vests in another," Loeb v. State, 176 Misc. 970, 29 N.Y.S. 2d 464 (1941) (176 Misc. at 973, 29 N.Y.S. 2d at 466) and as " 'an act *** by which the title to property is conveyed from one living person to another'." Hatfield v. Buck, 193 Misc. 1041, 85 N.Y.S. 2d 613 (1948) (193 Misc. at 1042, 85 N.Y.S. 2d at 614). Perhaps the most extensive examination of the term was made by the New York Court of Appeals in Phelps-Stokes Estates v. Nixon, 222 N.Y. 93, 118 N.E. 241 (1917). In construing §§ 270, 272, and 278 of the New York Tax Law to determine whether something more than a theoretical change of title had taken place, the court summarized then-existing case law definitions as follows:

A transfer is defined in the Century Dictionary as "The conveyance of right, title or property, either real or personal, from one person to another, either by sale, by gift or otherwise."

In Bouvier it is said that a transfer is "The act by which the owner of a thing delivered it to another person with the intent of passing the rights which he has in the latter."

In *Hendrick v. Daniel* (119 Ga. 358-361) a transfer "Covers any act by which the owner of anything delivers or conveys it to another with intent to pass his rights therein."

In *Pearre v. Hawkins* (62 Tex. 434) a transfer is said to be "An act or transaction by which the property of one person is by him vested in another."

In *People ex rel. Hatch v. Reardon* (184 N.Y. 431) the constitutionality of the Stock Transfer Act was in question. There is no definition given as to the meaning of the word "transfer." But the language of Judge Vann's opinion seems to involve the idea that a transfer within the meaning of the statute necessitates some act, such as a sale on the part of the transferor.

In *People v. Duffy-McInnerney Company* (122 App. Div. 336, 337) the question arose whether the issue by a corporation of its original shares was a transfer. The Appellate Division of the third department said that the statute was to be strictly construed, and that a sale or transfer cannot, except by forced interpretation, include an original issue of certificates. "Until those certificates are once issued they cannot be made the subject of such sale or tranfer as to bring them within the provisions of the act requiring them to pay the tax."

In the opinions of the attorney-general for September 30, 1914, it was said that where, when trustees named in a will and who as such hold title to stock, either die or resign and a successor is appointed in accordance with the provisions of the will, the title to the trust property including the stock, passes to and vests in the substituted trustees; and that such a passing of title is not a transfer within the meaning of the act.

"The title to the stock immediately vests in the substituted trustees, not by virtue of any sale or transfer within the ordinarily accepted meaning of these terms, but by operation of law."

The word "transfer" has been used in other sections of this law. Article 10 relates to what was known as "taxable transfers" in cases of death. Section 243 defines the word "transfer" to include "the passing of property or any interest therein in possession or enjoyment, present or future, by inheritance, descent, devise, bequest, grant, deed, bargain, sale or gift, in the manner herein prescribed."

In *Matter of Gould* (156 N.Y. 423–428) it is said that the word "transfer" in the statute is used "according to its ordinary legal signification, which is that the owner of a thing delivers it to another person with the intent of passing the rights which he has in it to the latter."

This definition is not made applicable to transfers of stock provided for in article 12, but it has some bearing upon what was in the mind of the legislature when it used the word "transfer."

(222 N.Y. at 100-101, 118 N.E. at 243). These definitions suggest the sort of foundation on which a case law definition could rest; they also suggest that such a definition would be so inclusive as to strip the term "transfer" of any utility in limiting the impact of the exclusion in the amended § 9-104(e).

38. Amendments such as

"This Article does not apply . . .

(e) To those transfers by a government or governmental subdivision or agency which are governed by special provisions of law;"

or

"This Article does not apply . . .

(e) To a transfer by a government or governmental subdivision or agency unless such transfer is not governed by special provisions of law;"

could accomplish this purpose.