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one of the proposed alternatives—preferably the latter—to insure that no borrower be unfairly misled.

W. LUNSFORD LONG, III

Uniform Commercial Code—Protection for the Purchase Money Secured Party Under Section 9-312

The basic section of the Uniform Commercial Code dealing with the problem of priorities among conflicting security interests in the same collateral is section 9-312. Subsection (4) extends special protection to purchase money security interests in collateral other than inventory by giving such an interest priority over a conflicting security interest "if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter." In the recent case of *Brodie Hotel Supply, Inc. v. United States*,¹ the Court of Appeals for the Ninth Circuit has unduly extended the scope of this protection.

In 1959 Brodie sold some restaurant equipment to a company that later went bankrupt. Brodie repossessed the equipment but left it in the restaurant. On June 1, 1964, Lyon took possession of the restaurant and equipment and began operating the restaurant while negotiating the price and terms under which he would purchase the equipment from Brodie. On November 2, 1964, Lyon borrowed seventeen thousand dollars from the National Bank of Alaska and gave the bank as security a chattel mortgage on the equipment. The bank assigned the mortgage to the Small Business Association (SBA), and on November 4, 1964, filed a financing statement showing the SBA as assignee. On November 12, 1964, Brodie gave to Lyon a bill of sale for the equipment, and Lyon gave Brodie a chattel mortgage on the equipment to secure the unpaid purchase price. Brodie filed a financing statement on November 23, 1964.² Thus the crucial dates in the case are the following: June 1, when Lyon took possession of the equipment; November 4, when the bank filed; November 12, when the debtor-creditor relationship was entered into by Brodie and Lyon; and November 23, when Brodie filed. Subsequently, the SBA sold the equipment to satisfy its mortgage,³ and Brodie sued to determine

¹ 431 F.2d 1316 (9th Cir. 1970). The court in this case applied the Alaska version of the Code. However, for ease of discussion, the general Code provisions, rather than the Alaska enumeration thereof, will be cited.

² All of the above facts are set forth in the opinion.

³ Brief for Appellant at 2, *Brodie Hotel Supply, Inc. v. United States*, 431 F.2d 1316 (9th Cir. 1970).

whether it or the SBA should have priority over the proceeds of the sale.⁴ The district court granted summary judgment without opinion for Brodie,⁵ and the United States appealed.⁶

The court of appeals, in affirming the summary judgment, held that where a party obtains possession of goods before becoming a debtor in a security agreement covering the goods, the ten-day period in section 9-312(4) dates from the time of the creation of the debtor-creditor relationship rather than from the time the debtor actually comes into possession. The court based its opinion on two grounds. First, it read into section 9-312(4) the code definition of "debtor"⁷ and held that Lyon was not a "debtor" within the meaning of section 9-312(4) until November 12;⁸ therefore, the filing by Brodie was within the ten-day period.⁹ Second, the court recognized the "specially favored position"¹⁰ given by the Code to the holder of a purchase money security interest and concluded:

The protection which the Code confers upon a purchase-money interest in non-inventory collateral is not unduly extended by a decision giving priority to Brodie's interest. Although it is true that Brodie could have filed a financing statement as soon as Lyon went into possession and thus protected itself, it is also true that the bank, SBA's assignor, could have protected itself by inquiring into Lyon's interest in the equipment before accepting his chattel mortgage. Due to the favored status given by the Code to the holder of a purchase-money interest in non-inventory collateral, we are not convinced that the trial court erred in refusing to impose this burden on Brodie.¹¹

In short, the court seemed to feel that its decision was based both on sound statutory interpretation and on a sound reading of the policies underlying the Uniform Commercial Code. The contention of this note is that the court improperly read section 9-312(4) and that, in so doing, it gave too

⁴ *Id.*

⁵ *Id.* at 5.

⁶ *Id.*

⁷ UNIFORM COMMERCIAL CODE § 9-105(1)(d) defines "debtor," in part, as "the person who owes payment or other performance of the obligation secured . . ."

⁸ 431 F.2d at 1319.

⁹ *Id.* There are eleven days between November 12 and November 23. However, ALASKA STAT. § 01.10.080 (1964) provides that in computing time, the first day is excluded and the last day is included unless the last day is a holiday, in which case it is excluded. Apparently the filing was timely under this statute.

¹⁰ 431 F.2d at 1319. For a detailed treatment of purchase money interest priority, see II G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 28.1-.7 (1965) [hereinafter cited as GILMORE].

¹¹ 431 F.2d at 1319.

much protection to, and imposed too little responsibility upon, a secured party with a purchase money security interest.

In fairness to the court, it should be noted that the language of section 9-312(4) is ambiguous since it refers to the "time the *debtor* receives possession."¹² It is not clear whether "debtor" is used merely to identify the party or whether it is also used to establish the time at which the ten-day period begins to run. However, the Code itself calls for construction of language so as to "promote its underlying purposes and policies."¹³ In attempting properly to construe section 9-312(4), therefore, it will be helpful to look first at the purposes and policies embodied by the section.

A long-standing problem in the area of chattel security law has been the possibility that a debtor could continue to get credit on property that he apparently owned but which, in fact, was subject to other security interests.¹⁴ Over the years, the development has been away from secrecy in secured transactions and toward a system providing notice to possible later creditors.¹⁵ "The modern tendency is to require formal public notice in an increasing number of situations, but there is a current relaxation in the requirements of formality in the notice given . . ."¹⁶ The fact that this modern trend is embodied in the Code was recognized in *National Cash Register Co. v. Firestone & Co.*,¹⁷ in which the court said, "The framers of the Uniform Commercial Code, by adopting the 'notice filing' system, had the purpose to recommend a method of protecting security interests which at the same time would give subsequent potential creditors . . . information and procedures adequate to enable the ascertainment of the facts they needed to know."¹⁸ In most cases this method involves withholding "perfected" status from security interests until a financing statement has been filed.¹⁹ However, in the case of purchase money security interests in non-inventory collateral, the Code in section 9-312(4) allows

¹² Emphasis added.

¹³ UNIFORM COMMERCIAL CODE § 1-102. The ensuing comment reiterates this point and adds that "the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved."

¹⁴ Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code*, 63 COLUM. L. REV. 1, 19 (1963).

¹⁵ Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289-90 (1962).

¹⁶ *Id.* at 290.

¹⁷ 346 Mass. 255, 191 N.E.2d 471 (1963).

¹⁸ *Id.* at 261, 191 N.E.2d at 474.

¹⁹ UNIFORM COMMERCIAL CODE § 9-303.

ten additional days during which the secured party may perfect. In his treatise on secured transactions, Professor Gilmore points out that this grace period was included in pre-1956 drafts, omitted in the 1956 draft, and then restored in the 1958 and subsequent drafts.²⁰ The reason for finally including the grace period, according to Gilmore, was to enable the purchase money financier to keep his priority even where the debtor-purchaser demands delivery of the goods immediately.²¹

Under the Code, filing may be done at any time²²—even before a security agreement is in existence²³—and the filing requirement may be met with an extremely simple financing statement.²⁴ Brodie could easily have filed a statement at any time after June 1, and this would have protected it against a subsequent creditor. Because of Brodie's failure to file, the bank had no notice of the existence of Brodie's interest. Furthermore, since the collateral consisted of some 159 separate types of items, ranging from a refrigerator and a dishwasher to spoons, forks, cups, ladles, pots, and other small items,²⁵ there was nothing the bank could have done to determine with absolute certainty whether Lyon was the owner of the items. Surely this is a ludicrously difficult burden of risk to place upon a party when the other party could both protect itself and give notice to later parties by the simple expedient of filing a statement.

Nevertheless, the court maintains that the bank "could have protected itself by inquiring into Lyon's interest,"²⁶ but it does not consider the difficulty—if not the impossibility—of such an inquiry and does not weigh against such an inquiry the ease with which the opposing party could have avoided the conflict in the first place. In addition, the court does not consider the purpose of the section stated by Gilmore—allowing for immediate delivery. This purpose is quite easily served by giving the seller ten days in which to file, but it hardly requires allowing the seller—as the court did here—more than four months in which to file, especially when the public, during this period, has no notice of the seller's interest in the goods.

The court's decision creates a considerable degree of unnecessary uncertainty with respect to all personal property. A potential secured party

²⁰ GILMORE § 29.5.

²¹ *Id.*

²² UNIFORM COMMERCIAL CODE § 9-402(1).

²³ *Id.*

²⁴ UNIFORM COMMERCIAL CODE § 9-402 requires only the signature and address of the debtor and secured party and the types of property covered by the statement.

²⁵ 431 F.2d at 1318.

²⁶ *Id.* at 1319.

cannot be certain—either through the possession of the goods by the potential debtor or through notice given him by a filed financing statement—that the goods are not subject to an arrangement that could later mature into a debtor-creditor relationship defeating the priority that the potential secured party would expect for his interest. It would seem, then, that the purposes and policies of the Code would better have been served by beginning the ten-day period on June 1 when Lyon took possession of the equipment rather than at the time the debtor-creditor relationship was entered into.

Even disregarding the Code policies, it is not at all clear that the court was correct in its reading of the actual language. The court ignored the fact that section 9-402(1), which sets forth the requirements for financing statements, also uses the term “debtor”; and its use of the term makes it clear that it is used solely for purposes of identification and *not* for any timing purposes. If the court were to read the Code definition of “debtor”²⁷ into section 9-402(1) as it did into section 9-312(4), it would mean that a financing statement would not be valid until a debtor-creditor relationship had been established. This reading of section 9-402(1) is clearly negated by the section itself, which contains a provision that a statement may be filed “before a security agreement is made or a security interest otherwise attaches.”²⁸ In section 9-402(1) it would appear that the term “debtor” merely refers to a person who expects to become a debtor, at least where the financing statement is filed before a security agreement is entered into. And the same meaning can just as well be applied to the term in section 9-312(4). Gilmore apparently agrees with the reading of “debtor” as merely a word of identification, since he states that “receives possession” in section 9-312(4) “is evidently meant to refer to the moment when the goods are physically delivered at the debtor’s place of business . . .”²⁹

One commentator has written:

A history of chattel security could well be written in terms of the 400-year struggle by debtors and their secured creditors to create security interests of various sorts in the debtor’s property without affording notice to buyers or other creditors, and the attendant demands

²⁷ See note 7 *supra*.

²⁸ This view is reinforced by UNIFORM COMMERCIAL CODE § 9-312(5) (a), which states that priority between conflicting security interests in the same collateral shall be “in the order of filing if both are perfected by filing, regardless of which security interest attached first . . . and whether it attached before or after filing.”

²⁹ GILMORE § 29.3.

by unsecured creditors generally for some kind of notice when all or part of the debtor's assets become subject to security interests. The parties favoring secrecy have, for the most part, been the losers . . .⁸⁰

In *Brodie* the party favoring—or at least practicing—secrecy emerged as the winner despite the fact that by a simple step he could have prevented the litigation from ever arising. In allowing this result, the court unnecessarily creates for a potential secured party an uncertainty that is difficult to justify either by the language or by the underlying policies of the Code.

LOUIS W. PAYNE, JR.

⁸⁰ COOGAN, *supra* note 15, at 289.