REVISIONS CONCERNING FEDERAL-STATE INTERFACE, INTELLECTUAL PROPERTY, AND CERTIFICATES OF TITLE

Reporters' Prefatory Note to October 1994 Draft

The following drafts of several sections of Article 9 with Reporters' Explanatory Notes deal with the interface between federal and state law and choice-of-law and perfection issues relating to goods covered by certificates of title.

Intellectual property is one of the most important types of collateral affected by the interface between state and federal law. As we reported to you in our memo of May 3, 1994, a task force within the ABA Section of Business Law, in conjunction with a comparable group from the ABA Section of Intellectual Property, is hard at work on draft revisions to federal laws dealing with copyrights, patents, and trademarks. These drafts leave perfection and priority issues to state law, for the most part.

The following drafts do not address generally the subject of rights and obligations of transferors (such as licensors) and transferees (such as licensees) of intellectual property. That subject is, in part, the focus of draft Chapter 3 of UCC Article 2 that presently is under consideration by the Article 2 Drafting Committee. Copies of pertinent portions of that draft are included in these materials as Attachment A. At some point, of course, it will become necessary for the Article 9 Drafting Committee to consider these issues.

These materials also do not address the issues concerning perfection and priority that arise when property becomes an accession to collateral that is covered by a certificate of title. A draft addressing those issues will be prepared sometime in the future.

§ 9-103. Perfection of Security Interest in Multiple State Transactions.

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(2) Certificate of title.

(a) This subsection applies to goods covered by a certificate of title. In this subsection:

(i) "certificate of title" means a certificate of title with respect to which ~~issued under~~ a statute ~~of this state or of another jurisdiction under the law of which indication of a security interest on~~

~~the certificate is required as a condition of perfection.~~ provides for the security interest in question to be indicated on the certificate as a condition or result of perfection, and

(ii) goods become "covered" by a certificate of title at the time when an appropriate application for the certificate and the applicable fee are delivered to the appropriate authority.

The absence of any other relationship between the jurisdiction under whose certificate the goods are covered and the goods or the debtor does not affect the applicability of this subsection to the goods.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of the security interest are governed by the law ~~(including the conflict of laws rules)~~ of the jurisdiction under whose ~~issuing the~~ certificate the goods are covered from the time when the goods become covered by the certificate until ~~four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate~~ the earlier of (i) the time when the certificate is surrendered [and cancelled by the issuing authority] or (ii) the time when the goods become covered subsequently by another certificate of title from another jurisdiction. After ~~the expiration~~

~~of that period,~~ that time, the goods are not covered by the certificate of title within the meaning of this section.

(c) ~~Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this state and thereafter covered by a certificate of title issued by this state is subject to the rules stated in paragraph (d) of subsection (1).~~

(c) A security interest in goods that is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this jurisdiction remains perfected until the earlier of (i) the time when the security interest would have become unperfected by the law of the other jurisdiction had the goods not become so covered or (ii) the expiration of four months after the goods become so covered. If it becomes perfected under Section 9-302(4) or Section 9-305 before the earlier of that time or the expiration of that period, the security interest continues perfected thereafter. If it does not become perfected under Section 9-302(4) or Section 9-305 before the earlier of that time or the expiration of that period, the security interest becomes unperfected and is deemed to have been unperfected at all times prior thereto[, but if insolvency proceedings are

commenced by or against the debtor before the earlier of that time or the expiration of that period, the security interest remains perfected until the insolvency proceedings are closed and thereafter for a period of sixty days].

(d) If, ~~goods are brought into this state~~ while a security interest ~~therein~~ in goods is perfected by ~~in~~ any method ~~manner~~ under the law of ~~the~~ another jurisdiction, ~~from which the goods are removed and~~ this state issues a certificate of title ~~is issued by this state and the certificate does not~~ that neither shows that the goods are subject to the security interest nor contains a statement that they may be subject to security interests not shown on the certificate, then:

(i) ~~the security interest is subordinate to the rights of~~ a buyer of the goods ~~who is not in the business of selling goods of that kind~~ takes free of the security interest to the extent that ~~he~~ the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest, and

(ii) the security interest is subordinate to a conflicting security interest in the goods that attaches, and is perfected in accordance with Section 9-302(4), after issuance of the certificate and without knowledge of the security interest.

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Reporters' Explanatory Notes

1. The existing choice-of-law provisions governing goods covered by a certificate of title statute (§ 9-103(2)) are quite complex. Those provisions apply, in the words of subsection (2)(a), to "goods covered by a certificate of title issued under a statute of this state or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection."

Existing subsection (2) contains both a choice-of-law rule and several substantive rules. Subsection (2)(b) is the choice-of-law rule; it determines the law applicable to perfection of security interests in goods covered by a certificate of title. Subsection (2)(c) contains a substantive rule governing cessation of perfection; specifically, it determines how the issuance of a certificate of title affects the perfected status of a security interest that was perfected in another jurisdiction otherwise than by notation on a certificate of title. Subsection (2)(d) also contains a substantive rule, governing the relative priority of competing claims to certain goods that are "brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed" and subsequently are covered by a certificate of title issued by "this state."

The draft follows the basic outline of existing subsection (2). In preparing the draft and the accompanying Explanatory Notes, we have been assisted greatly by the work of Frank Suarino, General Counsel of Associates Commercial Corporation. Mr. Suarino prepared a thorough memorandum for the Study Committee (the memorandum appears in the Appendix to the Report as Document F) and, with the help of John Berchild and Donald Rapson, more recently offered extensive, specific drafting suggestions for implementing the Study Committee's recommendations and for dealing with some of the other problems that the Study Committee was unable to consider in detail. We are sincerely appreciative.

The Study Committee's recommendations concerning § 9-103(2) are found in Section 10 of the Report. They focus on resolving a few discrete ambiguities that have arisen in the commentary and reported cases construing § 9-103(2)(a) and (b). The Study Committee did not discuss the substantive rules governing perfection and priority (subsections (2)(c) and (d)). The draft incorporates the Recommendations in Section 10 and makes certain other changes that seem to follow from those recommendations. The draft also revises the perfection and priority rules. The Drafting Committee may wish to consider whether these substantive rules (as well as substantive rules in other subsections of § 9-103) should be relocated elsewhere in the Article.

2. The draft works from the premise that, for goods covered by a certificate of title on which a security interest may be indicated, notation on the certificate is a more appropriate method of perfection than filing. The concept of perfection by notation is simple; however, certificate of title statutes are not. Unlike the Article 9 filing system, which is designed to afford publicity to security interests, certificate of title statutes were created primarily to deter theft. The need to coordinate Article 9 with a variety of non-uniform certificate of title statutes (discussed immediately below), the need to provide rules to take account of goods that are covered by more than one certificate, and the need to govern the transition from perfection by filing to perfection by notation all create pressure for a detailed and complex set of rules. In particular, much of the complexity arises from the possibility that more than one certificate of title issued by more than one jurisdiction can cover the same goods. That possibility results from defects in certificate of title laws and the interstate coordination of those laws, not from deficiencies in Article 9. So long as that possibility remains, the potential for innocent parties to suffer losses will continue. At best, Article 9 can identify clearly which innocent parties will bear the losses.

We strongly suspect that Article 9 could be made simpler and the Drafting Committee's work significantly reduced if perfection of security interests were divorced from certificate of title statutes. We encourage the Drafting Committee to consider having the normal filing rules apply to perfection of security interests in goods subject to a certificate of title statute, particularly goods other than automobiles.

Any revision of subsection (2) should take into account the fact that certificate of title statutes are not uniform in their coverage. For example, while all states subject automobiles and over-the-road trucks to their certificate of title statutes, the statutes differ substantially in their applicability to other property. Truck cranes, well drilling equipment, vehicles driven or moved upon a highway only for the purpose of crossing the highway from one property to another, trailers, semi-trailers, and other vehicles may or may not be covered. Construction equipment is subject to a certificate of title statute in some states, but not in many others. In some states, whether particular goods are covered depends on the use to which the goods are put or on their weight.

The nonuniformity in coverage is compounded by nonuniform substantive provisions applicable to perfection of security interests. For example, under some certificate of title statutes, a security interest becomes perfected upon the issuance of a certificate on which the security interest has been noted. Other statutes also contemplate notation but provide that perfection is achieved by delivery of designated documents to the appropriate public official. An early draft of the UCC contained

a complete certificate of title act (see Uniform Commercial Code, May 1949 Draft, Part 8, Vehicle Liens, 8 ELIZABETH S. KELLY, UNIFORM COMMERCIAL CODE, DRAFTS 189-99 (1984)), but later drafts abandoned the idea. Revised Article 9 could add provisions that supersede those of the relevant certificate of title act; however, we are inclined to include such provisions sparingly, if at all, notwithstanding our appreciation of the nonuniformity and attendant uncertainty of living under non-UCC law. Instead, we would prefer that each relevant section of Article 9 affecting certificates of title be accompanied by a Note recommending to legislatures how to conform their certificate of title acts to mesh well with Article 9. An example of a Note of this kind follows existing § 9-302.

3. Subsection (2)(a) has been revised in five respects. First, the term "certificate of title" has been defined in a manner suggested by Recommendation 10.C. The definition makes clear that subsection (2) applies not only to certificate of title statutes under which perfection occurs upon notation of the security interest on the certificate but also to those that contemplate notation but provide that perfection is achieved by other means, e.g., delivery of designated documents to an official. Second, the language "of this state or of another jurisdiction" has been deleted as superfluous.

Third, a new sentence has been added to specify that goods become "covered" by a certificate of title when an application for a certificate and the appropriate fee are delivered to the issuing authority. The time of coverage determines when subsection (2) begins to apply to perfection of security interests in the goods, and thus when the law of the jurisdiction under whose certificate the goods are covered will begin to apply. That subject is discussed below in Explanatory Note 4.

Fourth, following Recommendation 10.A., a new sentence has been added to paragraph (a) to make clear that subsection (2) applies to certificates of a jurisdiction having no other contacts with the goods or the debtor. This change comports with most of the reported cases on the subject and with contemporary business practices. The implications of the change are discussed in Explanatory Note 4 below.

Fifth, the limiting phrase in the draft ("that provides for a security interest to be indicated on the certificate as a condition or result of perfection") now applies not only to statutes of other jurisdictions but also to statutes of the forum state. This changes what White & Summers understand to be the "clear" meaning of the current limiting phrase ("under the law of which indication of the security interest on the certificate is required as a condition of perfection"). See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 22-22, at 1059 n.9 (3d ed. 1988). Those authors believe that the current limiting phrase "modifies only 'under the law of another jurisdiction.'" Id. The change

is necessary to prevent the plaintiff's selection of the forum from determining the result.

4. Paragraph (b) contains the basic choice-of-law rule: The law of the jurisdiction under whose certificate the goods are covered determines perfection and the effect of perfection or non-perfection of a security interest. The draft eliminates the existing reference to the conflict-of-laws rules. The import of and reason for this change is discussed in Explanatory Note 5 to draft § 9-103 (which was distributed with the September 2, 1993 Draft of Part 5 prior to the first meeting of the Drafting Committee and also is included in the distribution of these materials).

Normally, under the law of the relevant jurisdiction, the perfection step would consist of compliance with that jurisdiction's certificate of title statute and a resulting notation of the security interest on the certificate of title. See §§ 9-302(3), (4). In the typical case of an automobile or over-the-road truck, this rule presents few problems. A person who wishes to take a security interest in the vehicle can ascertain whether it is subject to any security interests by looking at the certificate of title. But, as noted above, certificates of title cover certain types of goods in some states but not in others. A secured party who does not realize this may extend credit and attempt to perfect by filing in the jurisdiction where the collateral or the debtor is located (depending on whether the goods were "ordinary goods" subject to § 9-103(1) or "mobile goods" subject to § 9-103(3)). If the goods had been titled in another jurisdiction, the lender would be unperfected. To the extent that only a few jurisdictions would require a certificate for the goods, and to the extent that the fourth sentence of draft subsection (2)(a) would change the law and validate the "random" certificate, this problem becomes worse.

There are several possible approaches for eliminating this potential "trap" for the secured party. One approach would be to limit the applicability of subsection (2) to goods covered by a certificate of title from a specific jurisdiction, such as the one in which the debtor or the collateral is located at a specified time. A certificate from another jurisdiction would be irrelevant to perfection of a security interest. Under a related approach, subsection (2) could be made applicable only when the law of a specified jurisdiction (say, where the debtor or collateral is located) says that the goods should be covered by a certificate of title. If, under the law of that jurisdiction (the "control jurisdiction"), goods of the kind require a certificate of title when put to the particular use, then one must perfect pursuant to a certificate of title statute; however, the statute needn't be a statute of the control jurisdiction. For example, if the control jurisdiction is the location of the debtor (Illinois), and Illinois law provides for the goods to be

covered by a certificate, then the secured party could perfect by compliance with the certificate of title statute of any jurisdiction. Potential lenders would be on notice that there may be a certificate outstanding on which is noted the security interest of a competing creditor. If the control jurisdiction does not provide for a certificate of title for the goods, then the ordinary rules for perfection by filing would apply.[1] A third approach would be to limit subsection (2) to goods covered by certificates of title from states having minimum contacts (however defined) with the debtor or the collateral.

We encourage the Drafting Committee to consider whether the risk that this "trap" imposes on secured parties is acceptable. Should a secured party be better able to predict whether it needs to comply with a certificate of title statute of a foreign jurisdiction? If so, how should predictability be obtained? In assessing the situation, the Drafting Committee should take into account the fact that the draft increases the existing risk only to the extent that the fourth sentence of draft subsection (2)(a) changes the law.

Other interpretive problems with the basic choice-of-law rule arise under statutes taking the approach of the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act ("Uniform C/T Act"). Under this approach, perfection generally occurs upon delivery of specified documents to a state official but may, under certain circumstances, relate back to the time of attachment. The problems are these: Does coverage by a certificate (within the meaning of § 9-103(2)) commence when an application for a certificate is filed, or only when the certificate actually issues? If the latter, what effect, if any, should be given to non-UCC statutory provisions under which perfection occurs before the certificate is issued? If the former, what effect, if any, should be given to non-UCC statutory provisions under which perfection relates back to a time before the application is filed? The following Examples, which derive from Lightfoot v. Harris Trust & Savings Bank, 357 So. 2d 654 (Ala. 1978), aff'g 357 So. 2d 651 (Ala. Civ. App. 1977), reveal some of the difficulties that may arise under existing law.

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[1] In a letter to the Reporters, Mr. Suarino, on behalf of himself, Mr. Berchild, and Mr. Rapson, suggested two alternatives for determining what we call the "control jurisdiction." Their Solution B draws on the existing distinction between §§ 9-103(1) and (3) to suggest that for mobile goods (other than consumer goods) used in more than one jurisdiction, the location of the debtor would be the control jurisdiction. For consumer goods and mobile goods used in only one jurisdiction, the control jurisdiction would be where the goods are kept. Their Solution C would use, as the control jurisdiction for consumer goods and single-jurisdiction mobile goods, the jurisdiction where the debtor or any permitted user is located.

Example 1: On November 11, Seller sells a motor vehicle to Fraud in Illinois subject to a purchase money security interest. The same day, Seller files an application for an Illinois certificate of title, listing the secured party. The following day, Fraud resells the vehicle in Alabama to Victim. On November 30, the Illinois Secretary of State issues a certificate showing the security interest. Under the Illinois certificate of title statute, perfection of the security interest dates from November 11. No certificate of title is required for the vehicle under Alabama law; filing and taking possession are the appropriate methods of perfection.

If Illinois law applies, then the security interest was perfected as of November 11. There had been compliance with the certificate of title statute on that date. See §§ 9-302(3), (4). Victim would take subject to the perfected security interest under § 9-306(2). Illinois law might apply pursuant to existing § 9-103(2) because the goods are "covered" by the Illinois certificate of title once the application is filed. Victim argues that the vehicle cannot be "covered" by a certificate until the certificate actually issues (i.e., until November 30).

Even if existing subsection (2) does not bring Illinois law into play until the certificate actually issues, Illinois law nevertheless might apply, as the following Example illustrates:

Example 2: Under the facts in Example 1, assume that the debtor (Fraud) is located in Illinois. Even if the goods are not "covered" by the certificate until it issues, Illinois law nevertheless would apply under § 9-103(3)(b) (assuming the vehicle is Fraud's equipment). Under Illinois law, the security interest would be perfected as of November 11.

Example 3: Under the facts in Example 1, assume that the debtor is located in Alabama. Even if the goods are located in Illinois, if they are not "covered" by the certificate of title until it issues, then Alabama law would apply. Under Alabama law, an application for title in Illinois would be of no effect; the security interest would be unperfected. However, once the certificate issued, Alabama's § 9-103(2) would provide that the governing law is that of Illinois. And once Illinois law governs, the security interest would become perfected. All this occurred on November 30. But Victim's rights arose on November 12, before the certificate issued. This presents the question whether, for purposes of determining Victim's rights, perfection dates from November 11, as the certificate of title statute provides, or from November 30, when Illinois law first governed perfection. Note that if, for some reason, the certificate never issued, then Illinois law would never apply and the security interest would not become perfected, notwithstanding that Illinois law provides that perfection occurs upon tender of the application.

Example 4: The facts are the same as in Example 3, except that the application for a certificate was not filed until November 18. Here Victim also argues that Illinois law does not apply until November 30, when the certificate issued. As of November 12, when Victim acquired rights, the application had not yet been filed. Under this analysis, Alabama law applies and the security interest was unperfected. Victim prevails under § 9-301(1)(c). The secured party argues that a certificate covering the goods had issued by the time of the litigation. That being the case, the goods are "covered" by a certificate of title, and the governing law is that of Illinois--the jurisdiction that issued the certificate. Under Illinois law, perfection dates back to November 11, and Victim takes subject to the perfected security interest under § 9-306(2).

To summarize: If the goods are not "covered" by the certificate (and consequently perfection is not governed by the law of jurisdiction issuing the certificate) until the certificate issues, then a secured party who complies with the certificate of title statute of any given state would be unperfected unless the choice-of-law rules in subsection (1) or (3), whichever is applicable, pointed to that state's law. On the other hand, applying a given state's law because an application for a certificate has been filed there may give rise to secret encumbrances.

Draft subsection (b) explains that the law of the jurisdiction whose certificate covers the goods applies "from the time when the goods become covered by the certificate." The third sentence of draft subsection (a) provides that goods become "covered" by a certificate of title when an application for the certificate and the applicable fee are delivered to the appropriate authority. The draft would apply to the facts of Example 1 as follows: The vehicle would become covered by the Illinois certificate on November 11, at which time Illinois law would begin to apply under draft § 9-103(2)(b). Under the Illinois certificate of title act, the security interest was perfected on November 11. The same analysis would apply to Examples 2 and 3. In each case, the security interest was perfected on November 11, even though no certificate issued until November 30.

Example 4 is more difficult. Because the application for an Illinois certificate was tendered on November 18, Illinois law does not begin to apply until that date. At the time Victim bought the vehicle (November 12), the law of the jurisdiction where the collateral was located (Alabama) or the law of the jurisdiction where the debtor was located (say, Illinois) would have governed, depending on how the vehicle was being used. Under the law of either jurisdiction, the security interest was unperfected as of November 12. But the secured party raises much the same argument under the draft as it does under the existing statute: Once the vehicle becomes covered by an Illinois

certificate of title (on November 18), the governing law becomes that of Illinois. Under Illinois law, perfection dates back to November 11, and Victim takes subject to the perfected security interest under § 9-306(2). And in each case, Victim would take subject to the security interest.

The draft does not resolve this problem, the principal cause of which is the relation-back feature of the certificate of title statute. Rather, we suggest including a Note recommending to legislatures that they remove any such relation-back provisions from certificate of title laws affecting security interests. In addition, the Drafting Committee may wish to clarify whether the relation-back rule of § 9-301(2), under which judicial liens that arise between attachment and filing sometimes are subordinated, applies equally to security interests perfected under a certificate of title statute. Explanatory Note 7 to draft § 9-302, below, discusses more generally the manner by which and the extent to which Article 9 provisions affecting filing should be made applicable to perfection under certificate of title statutes.

In considering the draft's resolution of the choice-of-law issue, the Drafting Committee may be influenced by whether perfection of a security interest in goods covered by a certificate occurs upon filing an application, in which case the determination of applicable law and perfection under that law would occur simultaneously, or whether perfection occurs upon issuance of the certificate, in which case there would be a temporal gap between "coverage" and perfection. The issue of perfection is considered below in Explanatory Note 6 to draft § 9-302.

5. Under existing § 9-103(2)(b), a security interest that has been perfected by compliance with a certificate of title statute of one jurisdiction may become unperfected if the goods are "registered" in another jurisdiction. The quoted term is undefined, and courts have been not been consistent in their construction of it.

Under current practices, it is possible to register some vehicles without applying for a new certificate of title. But serious impediments to secured lending would arise if registration alone were to result in the loss of perfection. The basic thrust of § 9-103(2) is to let perfection turn on compliance with a certificate of title statute when a certificate is or is about to become outstanding. Accordingly, consistent with the majority of reported cases and Recommendation 10.B., the draft would revise subsection (2)(b) to make clear that registration of the goods in another jurisdiction would not of itself result in loss of perfection.

Recommendation 10.B. recommends the foregoing revision "[a]t least insofar as [§ 9-103(2)] relates to automobiles and other

motor vehicles." We are inclined against limiting the application of subsection (2)(b) to vehicles in the absence of evidence that its application in other contexts would be problematic.

6. Existing § 9-103(2)(b) provides that the law of the jurisdiction issuing the certificate ceases to apply upon "surrender" of the certificate. In the case of automobiles, certificate of title statutes generally require tender of any outstanding certificate as a condition for issuance of a new certificate. See, e.g., Uniform C/T Act § 6(c)(1). This tender is the "surrender" to which existing section (2)(b) refers. This rule reflects the idea that notation of a security interest on a certificate of title affords notice to third parties only so long as the certificate is outstanding. Official comment 4(c) indicates that "[s]ince the secured party ordinarily holds the certificate, surrender thereof could not occur without his action in the matter in some respect." In some states, however, the debtor holds the certificate and has the power to surrender it and thereby render the secured party unperfected. And when more than one security interest is noted on a single certificate, the certificate may be surrendered with the consent of one, but not the other, secured party.

One way in which to address this situation would be to provide, as the draft does in brackets, that the law of the issuing jurisdiction applies until the occurrence of both surrender of the certificate and its cancellation by the issuing jurisdiction. This section might be accompanied by a Note recommending that legislatures amend their certificate of title statutes to provide that certificates will not be cancelled without the consent of secured parties of record. In determining whether to include the bracketed reference to cancellation, the Drafting Committee should note that the Uniform C/T Act refers to cancellation of a certificate only with respect to vehicles that are scrapped, dismantled, or destroyed; other statutes may not use the term at all. If the Drafting Committee concludes that perfection should continue even after the certificate is surrendered until it is cancelled, the Committee should consider subordinating the security interest noted on the out-of-circulation certificate to subsequent good-faith purchasers, who would have no convenient means of discovering the security interest. On the other hand, unless a new certificate of title has been issued that affords the purchaser priority under subsection (d), discussed below in Explanatory Note 9, it might be more appropriate to subordinate the rights of one who purchases following a surrender.

7. Existing § 9-103(2)(b) provides that once a certificate has been issued, the law of the issuing jurisdiction governs perfection for at least four months after the goods are removed from that jurisdiction. (Surrender of the certificate cuts short the four-month period. See Explanatory Note 6, above.) Under

this rule, even if the goods have been retitled in the new jurisdiction, the security interest will remain perfected for four months (provided that the original certificate remains outstanding). The following Examples illustrate the operation of existing § 9-103(2)(b).

Example 5: State A issues a certificate showing SP-A's security interest. SP-A takes possession of the certificate. The debtor, seeking to defraud SP-A, takes the collateral to State B on July 1. On September 1, State B issues its certificate of title on which SP-A's security interest is not shown. State A's certificate remains in SP-A's possession. Under existing § 9-103(2), the law of State A applies to the State A certificate until November 1. Under that law, SP-A holds a perfected security interest.

Example 6: Assume the facts of Example 5, except that the debtor has possession of the certificate issued by State A, alters it to erase the notation of SP-A's security interest, and tenders it to State B when requesting a clean State B certificate. Existing § 9-103(2)(b) provides that upon surrender of the certificate (on September 1), State A's law no longer applies. Accordingly, SP-A's security interest, which was perfected in accordance with the law of State A, becomes unperfected unless it is perfected in some other way.

Example 7: State A issues a certificate showing SP-A's security interest. SP-A takes possession of the certificate. The debtor, seeking to defraud SP-A, takes the collateral to State C on July 1. The certificate of title statutes of State C do not cover the collateral. The collateral remains in State C for several years. Under existing § 9-103(2)(b), the law of State A, which issued the certificate, continues to apply. The certificate has not been surrendered, and the goods have not been registered in another jurisdiction. SP-A's security interest remains perfected.

Like the four-month rule of § 9-103(1)(d), the rule of subsection (2)(b) is designed to give the perfected secured party who holds the certificate a period during which it can discover the facts and correct the public record. At least in theory, purchasers in the new jurisdiction can protect themselves by refusing to purchase goods that have been in the jurisdiction for less than four months without first seeing a certificate from the old jurisdiction. And subsection (2)(d), discussed below in Explanatory Note 9, provides additional protection to non-merchant buyers in situations where the goods have been retitled in the new jurisdiction and the new title does not suggest the existence of any encumbrances. The extent to which purchasers can protect themselves in practice, however, is an open question, particularly with respect to goods as to which titles are not required by many states.

The reference to removal from one jurisdiction to another suggests the paradigm upon which existing subsection (2) is based: normally there is some relationship between the jurisdiction whose certificate covers the goods and the location of the goods. The revision to paragraph (a) makes clear that a certificate of title law even from a jurisdiction in which the collateral never has been located can govern. The Drafting Committee should decide how to treat cases that depart from the paradigm, e.g., those in which the goods are covered by a certificate from a jurisdiction in which the collateral never was located. These cases can arise under existing law, as the following Example suggests.

Example 8: A debtor titles vehicles in the state in which the debtor's home office is located (Pennsylvania), even though the goods are used elsewhere. Under existing law, the law of the jurisdiction issuing the certificate (Pennsylvania) governs perfection until four months after the goods are removed from that jurisdiction. § 9-103(2)(b). Existing law is unclear about when the applicability of Pennsylvania law ends if the goods never arrive in Pennsylvania in the first instance.

If the Drafting Committee chooses to address this problem in the statute, one possibility would be to provide that the four-month clock never begins to run. Under that approach, the security interest would remain perfected and retain its priority as long as the original certificate remained outstanding, even if the goods became covered by a new certificate. This approach would work to the disadvantage of third parties who relied on the new certificate, but the statute could protect them to the extent thought appropriate. Cf. § 9-103(2)(d) (protecting certain good-faith purchasers; discussed below in Explanatory Note 9). Another possibility would be to eliminate the four-month period, so that immediately upon becoming covered by a new certificate--no matter how soon that were to occur--the law of the state issuing the original certificate would cease to govern and the security interest, if not perfected under the law of the new jurisdiction, would become unperfected. This has obvious potential disadvantages for the secured party.

A third possibility would be to provide that the four-month period begins to run upon an event other than removal, e.g., becoming covered by the original certificate of title or by the new certificate. This approach would afford the secured party a period during which it would remain perfected (provided that the certificate on which its security interest has been noted is not surrendered). The draft takes a fourth approach, which is somewhat of a blend of the second and third approaches. Under draft subsection (2)(b), the law of the jurisdiction under whose certificate the goods are covered ceases to govern perfection once the goods are covered by a certificate from another jurisdiction. However, the law of the other jurisdiction (subsection (2)(c) of the draft) would provide that the security

interest would remain perfected under some circumstances. The following Example shows the basic approach of the draft.

Example 9: State A issues a certificate showing SP-A's security interest in a vehicle located in State C. SP-A takes possession of the certificate. The debtor, seeking to defraud SP-A, applies for a certificate of title from State B on September 1. The application does not disclose SP-A's security interest. State A's certificate remains in SP-A's possession, and the vehicle remains in State C. Under draft § 9-103(2)(b), the law of State A would cease to apply as of September 1; however, the security interest would remain perfected until January 1 under State B's version of subsection (2)(c) (discussed below in Explanatory Notes 8 and 9).

The draft does not attempt to distinguish between situations in which the goods are covered by a certificate from the state where the collateral is located and those in which the certificate is from another jurisdiction. Rather, as the following Example illustrates, the movement of goods from one jurisdiction to another would be irrelevant under the draft.

Example 10: State A issues a certificate showing SP-A's security interest in a vehicle located in State C. SP-A takes possession of the certificate. The debtor, seeking to defraud SP-A, takes the collateral to State B on July 1. On September 1, the debtor applies for a State B certificate of title without disclosing SP-A's security interest. State A's certificate remains in SP-A's possession. Under draft § 9-103(2)(b), the law of State A would cease to apply as of September 1; however, the security interest would remain perfected until January 1 under State B's version of subsection (2)(c). Compare the result here with the result under existing law (Example 5 above).

Removal of collateral from one jurisdiction to the other would be irrelevant under draft subsection (2). However, the existing rules that turn on removal may have worked well for certain types of goods covered by that subsection. The Drafting Committee should consider whether the movement of the collateral should continue to determine the law governing the run-of-the-mill cases in which the goods are titled by the state in which they are located and, if so, whether it is feasible to distinguish the cases where movement is relevant from those where it is not.

8. In the normal course of affairs, only one certificate of title will be outstanding at a time. Sometimes, however, fraud or error will result in the issuance of a second certificate. The existing statute does not deal particularly well with this situation, and the case law construing it is not-uniform.

Example 11: State A issues a certificate of title showing SP-A's security interest. The debtor removes the goods from

State A to State B on July 1. On September 1, the debtor applies for a State B certificate without disclosing the security interest. State B issues a clean certificate, and the State A certificate remains outstanding.

Under existing § 9-103(2)(b), because State A issued the certificate, the law of State A would continue to govern perfection for four months after removal (i.e., until November 1). Upon the expiration of that period, State A's law no longer would apply. Accordingly, SP-A, who perfected under the law of State A, would have a perfected security interest until November 1. But State B also has issued a certificate covering the goods. Accordingly, the law of State B would apply. Under State B's law, perfection is to be accomplished by notation on a State B certificate.

The draft addresses at least part of the problem by providing that the law of the jurisdiction whose certificate covers the goods ceases to apply no later than the time when the goods become covered by a certificate of title from another jurisdiction. Thus, in Example 11, the law of State A would cease to apply on September 1, at which time application of the law of State B would commence.

Once the law of State B applies, another secured party (SP-B) could perfect a security interest by compliance with State B's certificate of title statute. If State B were to adopt draft § 9-103(2)(c), SP-A's security interest would remain perfected until the expiration of four months after the goods became covered by a State B certificate (i.e., until January 1). SP-A could remain perfected after that period by perfecting under the law of State B. Under the basic priority rule of § 9-312(5), as long as SP-A's security interest remained perfected, SP-B's security interest would be junior. However, SP-B would become senior if SP-A fails to perfect under the law of State B before the four-month period expires, see draft subsection (2)(c), or if SP-B qualifies under draft subsection (2)(d). Draft subsections (2)(c) and (2)(d) are discussed more fully in the Explanatory Note immediately following.

In evaluating the proposed change to subsection (b), the Drafting Committee should consider also a subsequent secured party who relies on the original certificate issued in State A (which, by hypothesis, is still outstanding) and attempts to perfect by complying with State A's certificate of title law. If the compliance involves an application for a new State A certificate, draft subsection (b) would shift the governing law back from that of State B to that of the State A, the original jurisdiction. In effect, the governing law is the law of the jurisdiction where the most recent application for a certificate of title has been submitted.

Much of the confusion arising out of existing subsection (2)(b) results from the last sentence, which indicates that, after a specified period expires, the goods are not covered by "the certificate." (The last sentence of our draft subsection (b) retains that phraseology.) We understand existing law to have the following meaning: Assume the security interest is noted on a State A certificate of title and then the goods are removed to State B, which issues a State B certificate of title. The law of State A applies for four months after removal. After that time the goods no longer are covered by "the certificate" of title (i.e., the State A certificate of title). They are, however, covered by a certificate of title (i.e., the State B certificate). Under the draft, the application for the State B certificate calls off State A's law. As of that moment the goods no longer are covered by the State A certificate, but they are "covered by a certificate of title" within the meaning of the scope provision (subsection (2)(b)), so that the law of the jurisdiction under whose certificate of title the goods are covered (State B) governs. We are inclined not to attempt further clarification of this point in the statute. Instead, we believe that the official comments should explain the proper interpretation.

9. Existing subsection (2)(c) contains a rule governing the effect of the issuance of a certificate of title for goods in which a security interest has been perfected other than by notation on a certificate of title. The following Example illustrates how the existing rule works.

Example 12: On July 1, while the goods are subject to SP-A's security interest perfected by filing under the law of State A, the goods are brought into State B. State B issues a certificate of title covering the goods on September 1. Under the rule of existing subsection (c), the four-month rule of subsection (1)(d) would apply. That is, so long as the filing in State A does not lapse, SP-A would remain perfected for four months after the collateral is brought into State B (i.e., until November 1). If SP-A (re)perfects under State B's law before November 1, then perfection is continuous. If the four-month period elapses without such (re)perfection, then the security interest is deemed to have been unperfected as of removal from State A. Thus, anyone who purchases the goods after July 1 (e.g., buys them or takes a security interest in them) normally would prevail over the secured party.

Existing subsection (2)(d) is an exception to this rule. It enables a non-merchant buyer who is likely to have relied on the certificate (i.e., who "gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest") to take free even of security interests that remain perfected. The following Example illustrates how the existing rule works.

Example 13: Goods subject to SP-A's security interest perfected under the law of State A by notation on a certificate of title are brought into State B on July 1. State B issues a certificate of title covering the goods on September 1, but the certificate issued by State A is not surrendered. Thus, under existing § 9-103(2)(b), the law of State A continues to apply, and SP-A's security interest remains perfected, until November 1. (This is Example 5, above.) If the new (State B) certificate does not show SP-A's security interest and does not indicate that the goods may be subject to security interests not noted on the certificate, then a qualifying non-merchant who buys after September 1 takes free of the security interest under existing subsection (2)(d). However, a secured party who perfected under the law of State B would be junior, at least until November 1 (when the four-month period of existing subsection (2)(b) elapses), at which time the law of State A no longer would apply and SP-A's security interest would become unperfected.

The rule in existing subsection (2)(c), like the rule in subsection (1)(d) to which it refers, is designed to afford a secured party who has perfected its security interest sufficient time to discover that its perfection step has become unlikely to provide effective notice of its security interest. Both those two subsections, as well as the exception in existing subsection (2)(d), are triggered by the movement of goods from one state to another. As with draft subsection (b), discussed in Explanatory Note 7 above, draft subsection (c) would make movement of the goods irrelevant. We found it necessary to completely rewrite the subsection to accomplish this result. In particular, the reference to subsection (1)(d), which itself refers to removal of the goods, has been deleted. It has been replaced by a rule modeled upon that subsection but which does not refer to removal. Instead, the four-month period would begin to run when the goods become covered by another jurisdiction's certificate of title. The following Example shows how the new rule would operate.

Example 14: On July 1, while the goods are subject to SP-A's security interest perfected by filing under the law of State A, the goods are brought into State B. An application for a State B certificate of title is submitted on September 1. From this point forward, State B's law governs perfection. SP-A has not perfected in accordance with State B's certificate of title statute. Nevertheless, if the law of State B includes draft subsection (c), then SP-A's security interest would remain perfected for four months after the goods become covered by the State B certificate, i.e., until January 1 (assuming that perfection does not lapse under the law of State A before that time). If SP-A (re)perfects under State B's law before January 1, then perfection is continuous. If the four-month period elapses without such (re)perfection, then the security interest is deemed to have been unperfected as of September 1, when the application for a State B certificate was tendered. To compare

the results under the draft with those under existing subsection (2)(c), see Example 12, above.

In addition to changing the time when the four-month period begins to run, draft subsection (2)(c) would make another substantive change: The subsection would apply whenever the goods covered by a certificate of title are subject to a security interest perfected under the law of a different jurisdiction, regardless of the method by which the security interest was perfected. The following Example illustrates this point.

Example 15: On July 1, while the goods are subject to SP-A's security interest perfected by notation on a certificate of title issued by State A, the goods are brought into State B. Debtor applies for, and State B issues, a certificate of title covering the goods on September 1. Existing subsection (2)(c) would not apply to this case; however, assuming the State A certificate was not surrendered, the law of State A presumably would continue to apply, and the security interest presumably would remain perfected, for four months after removal (i.e., until November 1) under subsection (2)(b). In contrast, draft subsection (b) provides that State A's law would cease to govern when the goods become covered by State B's certificate (i.e., on September 1). However, the security interest would remain perfected by virtue of draft subsection (c) (assuming it was enacted in State B). If SP-A did not (re)perfect the security interest within the four-month period commencing on September 1, then the security interest would become unperfected and be deemed to have been unperfected at all times prior thereto.

Draft subsection (2)(c) determines whether a security interest is perfected and, thus, whether it would take priority under § 9-301(1)(b) and survive in the debtor's bankruptcy. Draft subsection (2)(d) contains priority rules that work in favor of certain buyers and secured parties. Normally, the priority rule in subsection (2)(d) will have its bite when the security interest remains perfected under subsection (2)(c). However, it is possible that a security interest would become unperfected under subsection (2)(c) and also be subordinate under subsection (2)(d). If so, subsection (2)(d) may be redundant. The buyer or secured party would prevail because the competing security interest is unperfected under subsection (2)(c); there would be no need to rely on subsection (2)(d).

The draft revises subsection (2)(d) by expanding the class of persons who prevail over a perfected security interest whose actual or potential existence is not disclosed by the most recent certificate of title. The theory behind the exception in existing subsection (2)(d) is that consumer buyers are not sophisticated enough to realize that goods covered by a local certificate of title showing no security interests nevertheless may be encumbered by a security interest noted on another outstanding certificate. Merchant-buyers and secured parties

were thought to be better able to discover these other certificates. Some have questioned whether this assumption is accurate. The draft probably would reduce the risk to third-party purchasers: Rather than ascertain when the goods arrived in the jurisdiction, they could act on the basis of the date of issuance of the certificate, which ordinarily would not be earlier (and may be later) than the application date. (There remains the risk that the goods became covered by a third certificate after they became covered by the one being shown to the secured party.) In any event, we are inclined to enable merchant-buyers and secured parties to gain some (albeit incomplete) comfort by relying on a recently issued certificate.

The draft reflects our inclination. It would extend the protection of subsection (2)(d) beyond consumer buyers to all buyers who give value and take delivery of the goods after issuance of the certificate and without knowledge of the security interest. The existing language ("is subordinate to") has been changed to make clear that a qualifying buyer takes free of the security interest. Cf. PEB Commentary No. 6 (construing § 9-301, which contains the same language). In addition, the draft would subordinate a security interest perfected under the law of another jurisdiction to a conflicting security interest that is perfected under the law of the jurisdiction issuing the certificate after issuance of the certificate and without knowledge of the security interest. The draft is designed to protect only those purchasers who are likely to have acted in reliance upon the new certificate. Accordingly, to qualify for protection, a buyer must give value and a security interest must attach and become perfected after the certificate actually has issued. The following Examples illustrate the operation of draft subsection (2)(d).

Example 16: Applying the draft to the facts in Example 13, upon tender of an application for a State B certificate (no later than September 1, the date of issuance), the law of State A would cease to govern under draft subsection (2)(b). However, under draft subsection (2)(c) (assuming it was enacted in State B), SP-A's security interest would remain perfected under the law of State B. Under draft subsection (2)(d), a qualifying merchant-buyer would take free of SP-A's security interest. Similarly, if SP-B took a security interest and perfected it in accordance with the law of State B (i.e., by notation on the State B title) after the State B certificate was issued and without knowledge of SP-A's security interest, then SP-B's security interest would be senior to SP-A's.

Example 17: Under the facts in Example 13, assume that the application for a State B certificate was tendered on August 22, but the certificate did not issue until September 1. Assume also that SP-B took a security interest in the goods on August 25. SP-A's security interest would remain continuously perfected until four months after the goods became covered by the State B

certificate (i.e., until December 22), even though State A's law ceased to apply once the State B certificate covered the goods (i.e., on August 22). Thus, SP-B's security interest, even if ultimately noted on the State B title, would be junior to SP-A's under the first-to-file-or-perfect rule of § 9-312(5). Because SP-B's security interest did not attach after State B issued its certificate (even though it attached after State B's law applied), SP-B would not benefit from the subordination provisions of draft subsection (2)(d). SP-B's security interest would become senior, however, if SP-A's security interest becomes unperfected on December 22 by virtue of SP-A's failure to (re)perfect under the law of State B before that time.

Although it covers situations in which two different jurisdictions have issued certificates covering the same goods, the draft does not deal explicitly with the effect of the issuance of a second certificate by the same jurisdiction that issued the original. If a second certificate is merely a duplicate or replacement for the original, we would not expect its issuance to constitute the issuance of a new certificate. On the other hand, if the issuance of a second certificate arises out of a new transaction, such as the transfer to a new owner or the addition of a secured party, we would expect the issuance to constitute the issuance of a new certificate. The Drafting Committee may wish to consider whether this should be made explicit in the statute, should be treated in the official comments, or should be addressed in the certificate of title statutes.

Draft paragraphs (c) and (d) of subsection (2) retain the references to "this state" found in the existing versions. As noted above in Explanatory Note 1, these are substantive provisions dealing with perfection and priority; they are not choice-of-law rules to be applied, as such, by a court in the forum jurisdiction. As substantive rules that happen to be located in § 9-103 as enacted by the jurisdiction whose laws apply under the choice-of-law rule in paragraph (b), once we turn to the law of that jurisdiction references to "this state" are accurate. If the Drafting Committee agrees, it may wish to consider whether the references to "this state" in § 9-103(1) should be retained as well.

Note that draft subsection (2)(c) follows analogous provisions of draft § 9-103 in providing that the retroactive unperfection would take effect as against all persons, not only as against persons who become purchasers after removal. If the Drafting Committee decides to adjust the other provisions, then subsection (2)(c) should be conformed. Those provisions also provide that the commencement of insolvency proceedings (as defined in § 1-201) tolls the four-month (re)perfection period. Section 204 of the Bankruptcy Reform Act of 1994 would permit a secured party to continue or maintain the perfected status of its security interest without first obtaining relief from the

automatic stay. The Drafting Committee should consider whether the tolling provision remains necessary (or even effective) in the light of this amendment to the Bankruptcy Code.

10. As if the subject were not complex enough, another set of problems arises from the fact that compliance with a certificate of title act generally is not the method of perfecting security interests in inventory. Pursuant to both the existing and draft § 9-302(3) (below), a security interest created in inventory held by a person in the business of selling goods of that kind is subject to the normal filing rules; compliance with a certificate of title act is not necessary or effective to perfect the security interest. (Most certificate of title acts are in accord.) The relationship between this rule and the choice-of-law rules in both the existing and draft § 9-103(2) is subtle. Consider the following examples.

Example 18: Goods are located in State A and covered by a certificate of title issued under the law of State A. The State A certificate of title is "clean": it does not reflect a security interest. Owner takes the goods to State B and sells (trades in) the goods to Dealer in State B. As is customary, Dealer retains the duly assigned State A certificate of title pending resale of the goods. Dealer's inventory financer obtains a security interest in the goods under its after-acquired property clause.

Under § 9-302(3) of both State A and State B, Dealer's inventory financer, SP-B, must perfect by filing instead of complying with a certificate of title law. If under § 9-103(2)(b) the law applicable to perfection of SP-B's security interest is that of State A, because the goods are covered by a State A certificate, SP-B would be required to file in State A under State A's § 9-401. That result would be anomalous, to say the least, since the principle underlying § 9-302(3) is that the inventory should be treated as ordinary goods. We would read both the existing version and the draft of § 9-103(2) as providing that the law of State B, not State A, would apply. Under the draft, a court that looked to the forum's § 9-103(2) would find that the subsection applies only if two conditions are met: (i) the goods were "covered" by the certificate within the meaning of subsection (2)(a), i.e., application had been made for a state (here, State A) to issue a certificate of title covering the goods and (ii) the certificate is a "certificate of title" as defined in subsection (2)(a), i.e., a statute of that state "provides for the security interest in question to be indicated on the certificate as a condition or result of perfection." Stated otherwise, subsection (2) applies only when compliance with a certificate of title act, and not filing, is the appropriate method of perfection. Under the law of State A, for purposes of perfecting SP-B's security interest, the proper method of perfection is filing--not compliance with State A's certificate of title act. For that reason, the second condition

is not met (the goods are not covered by a "certificate of title"), and § 9-103(2) does not apply to the goods. Instead, subsection (1) applies, and the applicable law is that of State B, where the collateral is located.

We have considered various approaches for making the result we reach more explicit in the statute, such as providing that subsection (2) does not apply to inventory. However, we are inclined to favor the more subtle approach taken in the draft. For example, in order to reach the proper result under the facts of Example 18, it would be necessary to make an exception to the exclusion of inventory from subsection (2). We suspect that any such language would be cumbersome as well as imprecise.

Example 19: Goods are located in State A and covered by a certificate of title issued under the law of State A. Owner (who is not a dealer) grants a security interest in the goods to SP-A, who perfects by complying with State A's certificate of title act. Owner then becomes a dealer and the goods become inventory.

Although existing law does not explicitly address the effect of this change in the collateral's status, one would hope that a court would follow the policy of existing § 9-401(3) to conclude that SP-A's security interest continues to be perfected by the earlier compliance with the certificate of title law. A prospective inventory financer should be aware of the possibility that goods may have been owned by its debtor before the debtor entered into the business of selling goods of that kind. Draft § 9-302(4) provides expressly that SP-A's security interest would remain perfected under the facts of this Example.

Example 20: Goods are located in State A and covered by a certificate of title issued under the law of State A. Owner (who is not a dealer) grants a security interest in the goods to SP-A, who perfects by complying with State A's certificate of title act. Then Owner takes the goods to State B and sells (trades in) the goods to Dealer in State B.

Again, the result under existing law is not altogether clear. For the same reasons explained in connection with Example 19, however, we believe that SP-A's earlier-perfected security interest remains perfected pursuant to State A's certificate of title act, applied through the forum jurisdiction's § 9-103(2)(b), but subject to the cut-off rules of that paragraph and subject to any subordination pursuant to State B's § 9-103(2)(d). Although the goods became inventory in Dealer's hands, SP-A's security interest was perfected in Owner's non-inventory goods under State A's § 9-302(4) and certificate of title act. Under draft § 9-103(2)(c), SP-A's security interest likewise would remain perfected until the earlier of the time of surrender [and cancellation] of the State A certificate or four months after the time that a new certificate is issued by another jurisdiction.

Note that because SP-A's security interest was perfected, Dealer bought the goods subject to the security interest. See § 9-306(2); draft § 9-306(b). If the goods also became subject to the security interest of Dealer's inventory financer (SP-B), SP-A's security interest would be senior pursuant to draft § 9-312(v)(a) (found on page 108 of the July 1, 1994, Draft), which addresses the "double debtor" scenario. Because the goods are inventory in Dealer's hands, however, SP-B's security interest could be perfected by filing by virtue of State B's § 9-302(3).

§ 9-104. Transactions Excluded From Article.

This Article does not apply

[Alternative 1]

~~(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~~

[Alternative 2]

(a) to a security interest subject to any statute or treaty 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 treaty preempts this Article; or

* * *

Reporters' Explanatory Note

The Study Committee recommended that "the Drafting Committee . . . revise § 9-104(a) or the official comments to state that Article 9 applies to . . . security interests to the extent permitted by the Constitution and should revise § 9-302(3) and the official comment to clarify the applicability of the subsection." Recommendation 2.A., Report at 50. The problem with the current version of § 9-104(a) is that it some may read it (erroneously) to suggest that Article 9 defers to federal law even when federal law does not preempt Article 9. The alternative draft versions of § 9-104(a) respond to that concern. The first alternative deletes paragraph (a) from § 9-104. If federal law preempts Article 9 in any way, it does so on its own

terms and without the aid of Article 9. The first alternative reflects the view that paragraph (a) is unnecessary because the law would be exactly the same with or without it; it has no effect. The second alternative would recognize explicitly in the statute that Article 9 defers to federal law only when it must--i.e., when federal law preempts Article 9. A modified § 9-104(a) might prove useful in providing a section number under which research tools such as case digests might index relevant cases.

Reporters' Prefatory Note to § 9-203

Section 9-203(1)(a) contains one of the three requirements for attachment of a security interest: a security agreement, evidenced either by a signed writing describing the collateral or by the secured party's possession of the collateral. A statute or treaty of the type described in § 9-302(3) may limit descriptions of collateral that appear on a certificate of title or in a registry. Those statutes or treaties override the otherwise applicable Article 9 filing (perfection) rules. We propose to revise the official comment to § 9-203 to make it clear that the description of collateral in the security agreement controls for purposes of determining whether a security interest has attached. The revised comment would be along the following lines:

§ 9-203. Attachment and Enforceability of Security Interest; Proceeds; Formal Requisites.

Official Comment

* * *

3. One purpose of the formal requisites stated in subsection (1)(a) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is in the debtor's possession; customarily, of course, as a matter of business practice the written record will be kept, but, in this Article as at common law, the writing is not a formal requisite. Subsection (1)(a), therefore, dispenses with the written agreement-and thus with signature and description-if the collateral is in the secured party's possession.

<u>One should distinguish the evidentiary functions of the formal requisites of attachment and enforceability (such as the requirement that a security agreement contain a description of the collateral) from the more limited goals of "notice filing" for financing statements under Part 4, explained in § 9-402, comment 3. When perfection is achieved by compliance with the</u>

requirements of a statute or treaty described in § 9-302(3), such as a federal recording act or a certificate of title act, the manner of describing the collateral in a registry imposed by the statute or treaty may or may not be adequate for purposes of this section and § 9-110. However, it is the description contained in the security agreement, not the description in a public registry or on a certificate of title, that is controlling for those purposes.

§ 9-302. When Filing Is Required to Perfect Security Interest; Security Interests to Which Filing Provisions of This Article Do Not Apply.

(1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under Section 9-305;

(b) a security interest ~~temporarily~~ perfected in goods under Section 9-103[(1)], [(2)], or [(3)], in instruments or documents without delivery under Section 9-304(4) or (5), or in proceeds ~~for a 10 day period~~ under Section 9-306[(c)];

(c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) a purchase money security interest in consumer goods; but subsection (4) applies to consumer goods that are subject to a statute or treaty described in subsection (3)[, a filing is required for priority over a buyer to the extent provided in Section 9-307(2), ~~a motor vehicle required to be registered;~~ and a fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-313];

(e) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;

(f) a security interest of a collecting bank (Section 4-208) or in securities (Section 8-321) or arising under the Article on Sales (see Section 9-113) or covered in subsection (3) of this section;

(g) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder;

(h) a security interest in investment property which is perfected without filing under Section 9-115;

(i) a security interest in property subject to a statute or treaty described in subsection ([3]).

(2) If a secured party assigns a perfected security interest, no action ~~filing~~ under this Article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing of a financing statement ~~otherwise required by this Article~~ is not necessary or effective to perfect a security interest in property subject to

(a) a statute or treaty of the United States under which the exclusive method of perfecting a security interest is (i) compliance with the requirements of ~~provides for~~ a national or international registration system or a national or international certificate of title system

or (ii) filing at an office that is ~~which specifies a place of filing~~ different from the office ~~that~~ specified in this Article for filing of a financing statement ~~the security interest~~; or

(b) the following statutes of this state; [list any certificate of title statute covering automobiles, trailers, mobile homes, boats, farm tractors, or the like, that provides for a security interest to be indicated on the certificate as a condition or result of perfection, and any non-UCC central filing statute]; but during any period in which collateral is inventory held for sale or lease or leased by a person who is in the business of selling or leasing goods of that kind, the otherwise applicable filing provisions of this Article (Parts 3 and 4) apply to a security interest in that collateral created by that person ~~him~~ as debtor[; or

(c) a certificate of title statute of another jurisdiction that provides for a security interest to be indicated on the certificate as a condition or result of perfecting the security interest ~~under the law of which indication of a security interest on the certificate is required as a condition of perfection (subsection (2) of Section 9-103)~~.]

(4) Compliance with the requirements for perfecting a security interest provided in a statute or treaty described in subsection (3) is equivalent to the filing of a financing

statement under this Article. ~~, and~~ Except as provided in Section 9-103(2)(c) and Section 9-305 for property covered by a certificate of title, a security interest in property subject to a ~~the~~ statute or treaty described in subsection (3) can be perfected only by compliance with the requirements for perfecting a security interest provided in the statute or treaty and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral ~~therewith except as provided in Section 9-103 on multiple state transactions~~. Except as provided in Section 9-103(2)(c), duration ~~Duration~~ and renewal of perfection of a security interest perfected by compliance with the requirements for perfecting a security interest provided in the statute or treaty are governed by the provisions of the statute or treaty. In ~~; in~~ other respects the security interest is subject to this Article.

Reporters' Explanatory Notes

1. Section 9-302(1) establishes a central Article 9 principle: Filing a financing statement is necessary for perfection unless that subsection specifies otherwise. Draft subsection (1) retains that principle, although it includes several clarifying revisions. Draft paragraph (b) is expanded to refer to the perfection rules in § 9-103. Draft paragraph (d) eliminates the confusing reference to filing for consumer goods that are registered motor vehicles and, instead, makes it clear that the automatic perfection rule for purchase money security interests in consumer goods does not apply to goods covered by a statute or treaty described in subsection (3). The draft also adds a reference to the priority rule of § 9-307(2) that parallels the existing reference to fixture filing in § 9-313. Both references are in brackets, however, to indicate our view that they should be deleted. Both §§ 9-307(2) and 9-313 contain priority rules, but do not contain exceptions to the requirement that filing is required for perfection. New paragraph (i) excepts from the filing requirement property covered by a statute or treaty described in subsection (3)(a). See the discussion of draft subsections (3)(a) and (4) in Explanatory Notes 3 and 6-8

below. (Paragraph (h) was added as a conforming amendment in connection with Revised Article 8.)

2. Draft subsection (2) substitutes "action" for the term "filing," thereby extending to security interests perfected under subsection (4) the benefits of the existing rule that no assignment need be filed for continuation of perfection against an underlying debtor.

3. Draft subsection (3)(a) provides explicitly that the Article 9 filing requirement defers only to statutes or treaties that provide that compliance therewith is the exclusive method of perfection. This clarification responds to Recommendation 2.A., which recommends that the applicability of § 9-302(3) be clarified. We recognize that the language we have chosen is not perfect, in that § 9-303 provides that "perfection" requires compliance with applicable actions under Part 3 and draft subsections (3) and (4) refers to "perfecting" a security interest under a different statute. Ideally, of course, the applicable statutes and treaties would be refined to eliminate any confusion. Proposed reforms to the federal laws that deal with copyrights, patents, and trademarks, for example, would achieve that goal. But even with respect to non-UCC law that is not so refined, we believe that draft subsections (3) and (4) are adequate, particularly if it is amplified by the Official Comments. In particular, we suggest that an Official Comment explain that, as used in draft § 9-302(3) and (4), "perfecting" means acquiring priority over a subsequent lien creditor. Cf. § 9-301(1)(b).

4. The description of certificate of title statutes in draft paragraph (b) of subsection (3) has been revised to track the language of draft § 9-103(2). Draft paragraph (b) also expands the exclusion for inventory to encompass inventory held for lease as well as inventory held for sale. It takes account of the fact that dealers, particularly of automobiles, often do not know whether a particular item of inventory will be sold or leased. Under existing law, a secured party who finances a dealer may need to perfect by filing for goods held for sale and by compliance with a certificate of title statute for goods held for lease. In some cases, this may require notation on thousands of certificates. Under the draft, notation would be both unnecessary and ineffective. The filing provisions of Article 9 apply to goods covered by a certificate of title only "during any period in which collateral is inventory held for sale or lease or leased." If the debtor takes goods out of inventory and uses them, say, as equipment, a filed financing statement would not remain effective to perfect a security interest.

The phrase "held for sale or lease or leased by a person who is in the business of selling or leasing goods" is intended to include inventory in the possession of a lessee from a dealer. The definition of "inventory" (§ 9-101(4)) contains a similar

phrase, but omits any reference to goods that are "leased." The draft contemplates that the definition of inventory will be conformed to draft § 9-302(3)(b) by including a reference to "leased" goods. See also § 9-103(3)(a), which seems to distinguish goods "leased" and goods "held for lease."

5. Draft subsection (3) retains paragraph (c), with appropriate revisions to conform that paragraph to draft § 9-103(2). However, we have put paragraph (c) in brackets because we suspect that draft § 9-103(2) makes the paragraph unnecessary. Assume that we are applying § 9-302 as enacted in State B. If goods are covered by a State A certificate of title and State B has not issued a certificate, State A's law, including its § 9-302(3)(b), will apply. Once State B issues a certificate, State B's law will apply, including State B's §§ 9-103(2)(c) and 9-302(3)(b). There seems to be no room for a security interest to be perfected under the law of State B through compliance with State A's certificate of title act. Note, however, that State B's 9-103(2)(c) does terminate perfection if perfection would have lapsed under the law of State A.

6. The draft clarifies subsection (4). Compliance with the perfection requirements, but not other requirements, of a statute or treaty described in subsection (3) is equivalent to filing and is sufficient for perfection. Mr. Suarino suggested similar revisions.

The Study Committee recommended that Article 9 preempt non-UCC law in this regard and provide that perfection occurs "upon receipt by appropriate state officials of a properly tendered application for a certificate of title on which the security interest is to be indicated." Recommendation 22.A. We are inclined against including such a preemptive rule in Article 9 itself. We recognize that, in jurisdictions where perfection occurs upon issuance of a certificate, the absence of a preemptive rule may create a gap between the time that the goods are "covered" by the certificate under draft § 9-103(2) and the time of perfection and also may result in turning some unobjectionable transactions into avoidable preferences under Bankruptcy Code § 547. (The preference risk arises if more than ten days pass between the time that a security interest attaches and the time when the it is perfected.) We suggest that the Drafting Committee consider, instead, including a Note that instructs the legislature to amend the applicable certificate of title act to reflect the result urged by the Study Committee. Unless adjustments were made to a certificate of title act itself, conflicting rules in the act and Article 9 could create confusion and uncertainty.

7. Both existing and draft § 9-302(4) provide that compliance with a statute or treaty described in § 9-302(3) "is equivalent to the filing of a financing statement." The meaning of this phrase currently is unclear, and many questions have

arisen concerning the extent to which and manner in which Article 9 rules referring to "filing" are applicable to perfection by compliance with a certificate of title statute. We believe that there are at least three separate approaches for applying Article 9 filing rules to compliance with other statutes and treaties. First, as discussed in Explanatory Note 6 above, there are rules such as the rule establishing time of perfection (§ 9-403(1)) that we believe should be determined by the other statutes themselves. Second, some Article 9 filing rules can be applied to perfection under other statutes or treaties by revisions to the Article 9 text. Examples are draft § 9-302(2), discussed in Explanatory Note 2 above, and draft § 9-408 (below). Other Article 9 rules may be made applicable to security interests perfected by compliance with another statute through the "equivalent to . . . filing" provision in the first sentence of § 9-302(4). We suggest that the third approach be reflected for the most part in the official comments. For an example of this approach, see the Explanatory Note to § 9-306, below. Similar comments could be added to reflect the applicability of other "filing" provisions when perfection is accomplished under § 9-304(4), such as § 9-402(8) (concerning errors that are not seriously misleading). In addition to or instead of section-by-section comments, the Drafting Committee may wish to consider whether the comment to § 9-302 should be expanded to explain the "equivalent to . . . filing" concept as making applicable to the other statutes and treaties all references in Article 9 to "filing," "financing statement," and the like.

8. The facts of Examples 12 and 15 in Explanatory Note 9 to draft § 9-103, suggest the predicament that can face a secured party who has perfected a security interest under the law of State A in goods that subsequently are covered by a State B certificate of title. Ordinarily, the secured party will have four months under State B's § 9-103(2)(c) in which to (re)perfect by having its security interest noted on a State B certificate. This procedure is likely to require the cooperation of the debtor and any competing secured party whose security interest has been noted on the certificate. Official comment 4(e) to existing § 9-103 observes that "that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party." According to the comment, "[t]he only solution for the out-of-state secured party under present certificate of title laws seems to be to reperfect by possession, i.e., by repossessing the goods." But, as the Report observes, the "solution" may not work. Report, 176. Existing § 9-302(4) provides that a security interest in property subject to a certificate of title statute "can be perfected only by compliance therewith." The Report does not suggest a better solution; it recommends only that the conflict between the statute and the comment be resolved. Recommendation 10.C.

We propose to resolve the conflict by revising §§ 9-103(2)(c), 9-302(4), and 9-305 to provide that a security interest that remains perfected solely by virtue of § 9-103(2)(c) can be (re)perfected by the secured party's taking possession of the collateral.

§ 9-305. When Possession by Secured Party Perfects Security Interest Without Filing.

A security interest in written letters of credit ~~and advices of credit (subsection 2(a) of Section 5-116)~~, goods, instruments ~~(other than certificated securities)~~, money, negotiable documents, or chattel paper may be perfected by the secured party's taking possession of the collateral. A security interest in property covered by a certificate of title issued by this state may be perfected by the secured party's taking possession of the collateral only in the circumstances described in Section 9-103(2)(c). If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without a relation back and continues only so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.

Reporters' Explanatory Notes

1. The changes relating to letters of credit were approved by NCCUSL at its August 1994 Annual Meeting; the ALI has not yet approved them. The deletion of the parenthetical reference to certificated securities is necessary to conform the section to Revised Article 8, the revised definition of "instrument" in § 9-

105, and new § 9-115; however, the draft of Revised Article 8 approved by NCCUSL overlooked it. We have informed the Chair and the Reporter for the Article 8 Drafting Committee.

2. The new sentence is necessary to effect the changes described in Explanatory Note 8 to draft § 9-302.

Reporters' Prefatory Note to Draft § 9-306

The following draft subsections (c), (d), and (e) of § 9-306 appear on pages 75-77 of the July 1, 1994, Draft and do not reflect the most recent deliberations of the Drafting Committee. These sections are reproduced here to establish the context for the recommended changes to the official comments (see the Explanatory Note below).

§ 9-306. "Proceeds"; Secured Party's Rights in Proceeds ~~on Disposition of Collateral~~.

* * *

(~~d~~ c) The security interest in proceeds is a ~~continuously~~ perfected security interest if the interest in the original collateral was perfected. ~~but it~~ The security interest in proceeds ceases to be a perfected security interest and becomes unperfected ~~ten days~~ on the twenty-first day after the security interest attaches to the proceeds ~~receipt of the proceeds by the debtor~~ unless:

(~~a~~ 1) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash ~~proceeds,~~ collateral, the description of collateral in the financing statement indicates the type~~s~~ of property constituting the proceeds; or

(~~b~~ 2) ~~a filed financing statement covers the original collateral and~~ the proceeds are identifiable cash proceeds; or

(~~c~~ 3) the security interest in the proceeds is perfected before the twenty-first day after the security interest attaches to the proceeds. ~~expiration of the ten day period.~~

Except as provided in this subsection, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this Article for original collateral of the same type.

(d) Where a filed financing statement covers the original collateral, a security interest in proceeds that remains perfected under subsection (c)(1) or (2) becomes unperfected when the effectiveness of the filed financing statement lapses (Section 9-403) or is terminated (Section 9-404), but in no event before the twenty-first day after the security interest attaches to the proceeds.

(e) Where the security interest in the original collateral is perfected by a method other than by filing, a security interest in identifiable cash proceeds that remains perfected under subsection (c)(2) becomes unperfected when the security interest in the original collateral becomes unperfected, but in no event before the twenty-first day after the security interest attaches to the proceeds.

* * *

Reporters' Explanatory Note

We suggest that the official comments be revised to include a statement along the following lines:

> Section 9-302(4) provides that compliance with the perfection requirements of a statute or treaty described in § 9-304(3) "is equivalent to the filing of a financing statement." It follows that collateral subject to a security interest perfected by such compliance under § 9-302(4) is covered "by a filed financing statement" within the meaning of paragraphs [(1)] and [(2)] of subsection [(c)] and subsection [(d)] of § 9-306. Those provisions apply to the proceeds of collateral so perfected.

§ 9-408. Filing and Compliance with Other Statutes and Treaties for Consignments, Leases, Bailments and Other Transactions ~~Financing Statements Covering Consigned or Leased Goods~~.

A consignor, ~~or~~ lessor, bailor [or seller] of property ~~goods~~ may file a financing statement or may comply with a statute or treaty described in Section 9-302(3) using the terms "consignor," "consignee," "lessor," "lessee," "bailor," "bailee," "owner," "registered owner"[, "seller," "buyer"] or the like instead of the terms "debtor" and "secured party." ~~the terms specified in Section 9-402.~~ The provisions of this Part shall apply as appropriate to such a financing statement and to such compliance, which is equivalent to filing a financing statement under § 9-302(4), but neither the ~~its~~ filing nor compliance shall ~~not~~ of itself be a factor in determining whether or not the consignment, ~~or~~ lease, bailment[, sale] or other transaction creates a security interest ~~is intended as security~~ (Section 1-201(37)). However, if it is determined for other reasons that the consignment, ~~or~~ lease, bailment[, sale] or other transaction creates a security interest ~~is so intended~~, a security interest

held by ~~of~~ the consignor, ~~or~~ lessor, bailor, owner [or seller] that ~~which~~ attaches to the collateral ~~consigned or leased goods~~ is perfected by the ~~such~~ filing or compliance.

Reporters' Explanatory Notes

1. The proposed revision provides the same benefits for compliance with a statute or treaty described in § 9-302(3) that existing § 9-408 provides for filing in connection with the use of terms such as "lessor," consignor," etc. It also expands the rule to embrace more generally other bailments and transactions. We intend the references to "owner" and "registered owner" to address, for example, the situation where a putative lessor is the registered owner of an automobile covered by a certificate of title and the transaction is determined to create a security interest. Although the draft provides that the security interest is perfected, it may be advisable or necessary to amend the relevant certificate of title act in order to ensure that this result will be achieved. The bracketed language would encompass sales transactions, primarily sales of general intangibles. Whether the bracketed language is appropriate will depend on the Drafting Committee's ultimate decisions about the scope of Article 9.

2. The last two sentences of the section substitute the concept of "creation" of a security interest for the existing "intention" standard. We also expect to revise the definition of "security interest" in § 1-201(37) by deleting all references to the "intention" standard.

§ 9-504. Disposition of Collateral After Default.

* * *

(k) A transfer of the record or legal title to collateral to a secured party is not of itself a disposition of collateral under this Article and does not relieve the secured party of its duties under this Article if the transfer is effected in a registration system or certificate of title system and if the transfer is a [commercially reasonable] step relating to a disposition of collateral under this Article].

Reporters' Explanatory Note

Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If, as often is the case, the record owner is the debtor and the debtor refuses to cooperate, the secured party may have great difficulty disposing of the collateral. Applicable non-UCC law (e.g., a certificate of title act, federal registry, or the like) may provide a means by which the secured party obtains record or legal title for the purpose of a subsequent disposition of the property under § 9-504.

Draft § 9-504(k) deals with "title-clearing" transactions. It acknowledges that such transactions merely put the secured party in a position to provide to a purchaser good legal or record title. Under the draft, the secured party retains its duties as such and the debtor retains its rights as well. The Drafting Committee should consider whether the bracketed language in draft § 9-504(k) is necessary or useful. We are inclined to omit it.

Draft § 9-504(k) does not itself provide a title-clearing mechanism; it would apply only when other law provides such a mechanism. The Drafting Committee may wish to consider whether Article 9 itself should provide a means by which an Article 9 secured party could dispose of collateral and afford good legal or record title to the purchaser. An Article 9 section to that effect might look something like the following:

> (a) A "transfer statement" is a sworn statement, made by on behalf of a secured party, stating that: (i) the debtor has defaulted in connection with a secured obligation, (ii) the secured party has exercised its post-default rights with respect to the collateral securing the obligation, and (iii) by reason of such exercise, the person identified is the transferee of the rights of the debtor in such collateral.
>
> (b) A transfer statement shall be sufficient to entitle the identified transferee to the transfer of record of all rights of the debtor therein shown of record in any official filing, recording, registration, or title certificate system covering record ownership of such collateral. If a transfer statement is presented with the applicable fee to the official responsible for the maintenance of such system, the official shall accept the transfer statement and promptly file, record and/or issue a new title certificate in accordance therewith for the benefit of the identified transferee. A transfer statement shall be deemed to satisfy

all otherwise applicable requirements of any statute or regulation relating to such system.