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SECURED TRANSACTIONS

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THIS PORTION of "The Survey of Illinois Law" will consider Article 9 of the Uniform Commercial Code through a discussion of some constitutional problems and a brief survey of the highlights of recent Illinois decisions relating to that article as well as the proposed amendments.

CONSTITUTIONAL ISSUES

In *Sniadach v. Family Finance*¹ petitioner attacked a Wisconsin prejudgment garnishment provision as violative of the due process requirement of the fourteenth amendment. In its opinion, the Court surveyed the plight of the poor person who is enticed into an oftentimes easy credit plan and subsequently subjected to wage garnishment for non-payment of the debt plus collection charges. Analyzing the problem, the Court cautioned that due process may be violated when summary procedures are used in extraordinary circumstances and noted that Wisconsin's statute was drawn too broadly to evidence consideration of such circumstances. The Court then spoke of wages as "a specialized type of property presenting distinct problems in our economic system."² Thus, recognizing such prejudgment garnishment as a taking of property, the Court concluded "that absent notice and a prior hearing this prejudgment procedure violates the fundamental principles of due process."³

Sniadach spawned two approaches in subsequent decisions dealing with the problem of such summary prejudgment remedies as confessions of judgment, wage garnishments, and replevin statutes.

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1. 395 U.S. 337 (1969).
2. *Id.* at 340.
3. *Id.* at 341-42.

One line of decisions held that *Sniadach* called for an analysis of (1) the type of property involved, *i.e.*, is the property essential or nonessential for day-to-day living? and (2) the statutory language *i.e.*, is the statute drawn to meet special circumstances? Under both analytical methods, prejudgment garnishment of wages was found to be a denial of due process.⁴ The second line of decisions applied *Sniadach* solely to situations involving prejudgment garnishment of wages without recognizing the two-pronged analysis perceived by the other courts.⁵

The United States Supreme Court apparently resolved the dichotomy in *Fuentes v. Shevin*⁶ when it reviewed the decision of a three-judge district court which had upheld the constitutionality of a state statute authorizing the summary seizure of goods under a writ of replevin issued to anyone who claimed a right to the property and posted a security bond. Responding to those courts which required a hearing only prior to deprivation of "necessary" property, the Supreme Court denied any basis in *Sniadach* and, indeed, in the Constitution for such a distinction. It declared that the "Fourteenth Amendment speaks of 'property' generally"⁷ and it is not within the province of the courts to determine the categories of property which due process will protect.

The Court granted that in some circumstances failure to provide notice and a hearing before repossession was justified, but noted that such an extraordinary situation was one where the "seizure . . .

4. *Adams v. Egley*, 338 F. Supp. 614 (S.D. Cal. 1972); *Collins v. Viceroy Hotel Corporation*, 338 F. Supp. 390 (N.D. Ill. 1972); *Santiago v. McElroy*, 319 F. Supp. 284 (E.D. Pa. 1970); *Laprease v. Raymours Furniture Co.*, 315 F. Supp. 716 (N.D. N.Y. 1970); *Klim v. Jones*, 315 F. Supp. 109 (N.D. Cal. 1970); *Randone v. Appellate Dept. of Sup. Ct. of Sacramento Co.*, 5 Cal. 3d 536, 96 Cal. Rptr. 709, 488 P.2d 13 (1971); *Blair v. Pitchess*, 5 Cal. 3d 258, 96 Cal. Rptr. 42, 486 P.2d 1242 (1971); *Larson v. Fetherston*, 44 Wis. 2d 712, 172 N.W.2d 20 (1969); *Jones Press v. Motor Travel Services*, 286 Minn. 205, 176 N.W.2d 87 (1970).

5. *Reeves v. Motor Contract Co. of Ga.*, 324 F. Supp. 1011 (N.D. Ga. 1971); *Black Watch Farms, Inc. v. Dick*, 323 F. Supp. 100 (D. Conn. 1971); *American Olean Tile Co. v. Zimmerman*, 317 F. Supp. 150 (D. Hawaii 1970); *Young v. Ridley*, 309 F. Supp. 1308 (D.C. 1970); *Termplan, Inc. v. Superior Ct. of Maricopa Co.*, 105 Ariz. 270, 463 P.2d 68 (1969); *300 W. 154th Street Realty Co. v. Department of Buildings*, 26 N.Y.2d 538, 311 N.Y.S.2d 899, 260 N.E.2d 534 (1970); and last, but not least, *Fuentes v. Faircloth*, 317 F. Supp. 954 (S.D. Fla. 1970), *rev'd sub nom. Fuentes v. Shevin*, 407 U.S. 67 (1972).

6. 407 U.S. 67 (1972). See Swygert, 22 DEPAUL LAW REVIEW (1972).

7. *Id.* at 90.

[is] directly necessary to secure an important governmental or general public interest.”⁸ Therefore, to preserve their constitutionality, state statutes would have to be drawn so that their “special circumstances” met this standard.

To the contention that one who holds property under an installment contract does not have full title and is therefore not entitled to a hearing prior to its seizure, the Court declared that the fourteenth amendment’s protection extends “to any significant property interest.”⁹ Lack of full title, then, does not preclude notice and a hearing before repossession of property.

Finally, where a secured party contends that a debtor has signed a waiver of his constitutional rights to notice and a hearing prior to seizure of his property, the Court insisted that such a waiver “must, at the very *least*, be clear.”¹⁰ In order to be effective, then, a waiver of notice and hearing must be stated in very clear terms.

Noting that this constitutional right to be heard prior to seizure of property was intended “to protect [one’s] use and possession of property from arbitrary encroachment,”¹¹ the Court concluded that the prejudgment replevin statute in question deprived the possessors’ of their property without due process of law and was therefore unconstitutional. Further, the Court added that the quality of a hearing must be such that it is “aimed at establishing the validity, or at least the probable validity, of the underlying claim of the alleged debtor.”¹²

Turning to Article 9,¹³ it is apparent that self-help, summary repossession of collateral upon default by a secured creditor without a breach of the peace, is authorized by UCC 9-503, but may be as unconstitutional as the indiscriminate prejudgment replevin scheme

8. *Id.* at 91.

9. *Id.* at 86.

10. *Id.* at 95.

11. *Id.* at 81.

12. *Id.* at 97.

13. Recently the case of *Mojca v. Automatic Employees Credit Union*, 72 C 686 (N.D. Ill.) was filed in federal district court in Illinois and assigned to a 3-judge panel. This case seeks a declaration of invalidity with respect to the Illinois statutes (Ill. Rev. Stat. ch. 26, §§ 9-503, 504) insofar as they allow the repossession and sale of a debtor’s automobile without notice to the owner-debtor and a pre-repossession opportunity to be heard. Whether the court will follow the reasoning in *Fuentes* and strike down these repossession statutes remains to be seen.

denounced in *Fuentes*. Both deprive the debtor of property rights without a hearing and may be included in the initial security agreement to be cursorily approved by the unsuspecting buyer. At this writing, three federal district courts have faced the constitutional problems of self-help with varying results.

In *Adams v. Egley*,¹⁴ the southern California district court found self-help to be unconstitutional by an extension of *Sniadach* toward the same type of conclusion in *Fuentes*—seizure of property without a hearing is *contra* the fourteenth amendment. The northern California district court, however, dismissed an action involving the same issue for lack of subject matter jurisdiction in *Oller v. Bank of America*.¹⁵ The court held that for jurisdiction to lie, some sort of “state action” depriving the plaintiff of his property must be shown¹⁶ whereas the court in *Adams* had no difficulty finding such “state action” in UCC 9-503.

Ultimately, the United States Supreme Court will consider the constitutional problems in self-help. The *Adams* pro-*Sniadach* arguments appear to be valid; but the *Oller* argument against the presence of “state action” may prevail, especially in light of *Moose Lodge No. 107 v. Irvis*,¹⁷ handed down the same day as *Fuentes*, which declined to find a “state action” in the licensing of a private club that discriminated against a Negro guest. Speculation may suggest that the Court may similarly refuse to find “state action” in self-help when *Adams*, or a case like it, is brought before it. In the meantime, *several leading finance houses have ceased repossession.*

RECENT CASES

This past year has seen some interesting Illinois cases concerning deficiency judgments, blank spaces on contracts, automobile certificates of title, and secured party rights against a bankrupt debtor.

14. 338 F. Supp. 614 (S.D. Cal. 1972).

15. 10 UCC REP. SERV. 877 (Dist. Ct. N.D. Cal. Feb. 28, 1972); *accord* McCormick v. First National Bank of Miami, 322 F. Supp. 604 (S.D. Fla. 1971).

16. 28 U.S.C. § 1343(3) (1969). Accordingly the fourteenth amendment provides, *inter alia*, “nor shall any State deprive any person of life, liberty, or property, without due process of law.”

17. 407 U.S. 163 (1972). *See* Messenger v. Sandy Motors, Inc., 121 N.J. Super. 1, 295 A.2d 402 (1972).

*Northern Trust Co. v. Kuykendall*¹⁸ involved § 247 of the Retail Installment Sales Act.¹⁹ The Illinois appellate court ruled that the failure of a secured party to notify the defaulting buyer of the proposed sale of repossessed collateral renders the secured party unable to recover a deficiency judgment after the sale.

Obviously, the secured party is severely penalized by a forfeiture of his right to a deficiency judgment, but the statute was presumably enacted to elevate the buyer to an equal position with the seller, inducing both parties to comply with the laws applicable to secured transactions or face a financial loss. Otherwise, the secured party could sell the collateral without notice to the debtor and still collect the deficiency, notwithstanding the protestations of the debtor whose interests were not protected at the sale.

When § 247 was repealed, the controlling statute on the subject became Illinois Revised Statutes ch. 26, § 9-507. "If the disposition has occurred the debtor . . . has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part." The apparent meaning of this section is that should a sale of collateral worth \$500, bringing in only \$100, occur without notification of the debtor, the secured party would be liable for the \$400 difference—the loss caused by the failure to give notice because had the debtor had the opportunity to be present at the sale, a fair price would have been presumably offered. A problem arises if, in this transaction, a balance of \$300 should remain on the debt and the secured creditor attempts to recover the deficiency balance. A strict reading of the section suggests that the deficiency balance is recoverable, but many courts and writers²⁰ have interpreted the

18. — Ill. App. —, 273 N.E.2d 526 (1971).

19. The transaction occurred in 1967 and was governed by ILL. REV. STAT. 1965 ch. 121½, § 247 (repealed laws, 1967, eff. Jan. 1, 1968). "If the holder does not resell the goods within a reasonable time after retaking, he shall be deemed to have elected to retain the goods and release the buyer from any further obligations under the contract." "Resale" is considered to be a proper resale according to the law, including notice. 273 N.E.2d at 528.

20. *Atlas Thrift Co. v. Horan*, 27 Cal. App. 3d 999, 104 Cal. Rptr. 315 (1972); *Dynalelectron v. Jack Richards Aircraft Co.*, 337 F. Supp. 659 (W.D. Okla. 1972); *In re Bro Cliff, Inc.*, 8 UCC REP. SERV. 1144 (Ref. W.D. Mich. 1971); *Skeels v. Universal C.I.T. Credit Corp.*, 222 F. Supp. 696, (W.D. Pa. 1963), *modified on other grounds*, 335 F.2d 846 (3d Cir. 1969); *Foundation Discounts, Inc. v. Serna*, 81 N.M. 474, 468 P.2d 875 (1970); *Braswell v. American National Bank*, 117 Ga. App. 699, 161 S.E.2d 420 (1968); *One Twenty Credit Union v. Darcy*, 40

Code to mean that compliance with the notice requirements is a condition precedent to recovery of a deficiency judgment. In accord with the latter interpretation, the Illinois appellate court in *Morris Plan Co. of Bettendorf v. Johnson*²¹ held that a violation of the UCC notice requirements prior to resale has "the legal effect of extinguishing the obligations of the defendants on their note."²²

*Zimmerman Ford Co. v. Cheney*²³ looked into the purpose of the statute that prohibits enforcement by the seller of a retail installment contract which is blank when signed by the buyer.²⁴ The Illinois appellate court found that the statute was adopted to prevent excessive charges or other fraud by a seller who would fill in blanks in an unauthorized manner but noted that the document in the instant case was completed according to the agreement of the parties. Holding that the statute could "not be applied in a manner which would give a party a windfall,"²⁵ the court declared the contract fully enforceable.

*Town House Motel, Inc. v. Ward*²⁶ involved an action wherein a judgment plaintiff levied on the defendant's automobile. The mortgagee bank intervened. The automobile was purchased in Illinois by a serviceman stationed in Illinois, but was registered in Ohio,

Mass. App. Dec. 64, 5 UCC REP. SERV. 792 (1968); *Cities Service Oil Co. v. Ferris*, 9 UCC REP. SERV. 899 (Mich. Dist. Ct. 1971); *Leasco Data Processing Equipment Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1089, 323 N.Y.S.2d 13 (1971); 4 ANDERSON ON THE UNIFORM COMMERCIAL CODE § 9-504:28, § 9-504:30 (1971); 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 449.4 (1965); Clark, *Default, Repossession, Foreclosure, and Deficiency: A Journey to the Underworld and a Proposed Salvation*, 51 ORE. L. REV. 302, 318-22 (1972); Kennedy, *Secured Transactions*, 27 BUS. L.J. 755, 772-73 (1972); Note, *Debtor's Rights Against a Deficiency Judgment Under Article 9*, 16 HOW. L.J. 148, 151 (1970). *Contra*, *Universal C.I.T. Credit Co. v. Rone*, 248 Ark. 665, 453 S.W.2d 37 (1970); *Weaver v. O'Meara Motor Co.*, 452 P.2d 87 (Alas. 1969); *Conti Causeway Ford v. Jarossy*, 114 N.J. Super. 382, 276 A.2d 402 (1971); *Investors Acceptance Co. v. James Talcott, Inc.*, 454 S.W.2d 130 (Tenn. Ct. App. 1970); *Grant County Tractor Co. v. Nuss*, 496 P.2d 966 (Wash. App. 1972); Hogan, *Pitfalls in Default Procedure 2* UCC L.J. 244, 257 (1970); Comment, *The Damage Award for Improper Distribution of Collateral Under the Uniform Commercial Code*, 49 ORE. L. REV. 65, 68-70 (1969).

21. — Ill. App. —, 271 N.E.2d 404 (1971).

22. *Id.* at 408.

23. — Ill. App. —, 271 N.E.2d 682 (1971).

24. ILL. REV. STAT. ch. 121½, § 229 (1965), (now ILL. REV. STAT. ch. 121½, § 515 (1965)).

25. 271 N.E.2d at 685.

26. 2 Ill. App. 3d 699, 276 N.E.2d 809 (1971).

where the mortgagee's security interest was noted on the Ohio Certificate of Title. After obtaining a judgment, plaintiff levied on the serviceman's automobile. Prior to the subsequent sale, the judgment creditor checked the local county Recorder of Deeds office and did not find any record of liens. The president of Town House Motel was the only bidder, and subsequent to purchase he obtained an Illinois title. The issue presented was whether the mortgagee was required to have a certificate of title issued by the State of Illinois with its security interest noted therein, in order to protect its lien and security interest, as against the motel.²⁷ The motel contended that the bank failed to perfect its lien in Illinois as prescribed in the Illinois Vehicle Code.²⁸ However, the appellate court pointed out that the Illinois Vehicle Code states that a certificate of title need not be obtained for "a vehicle owned by a non-resident of this state and not required by law to be registered in this state." The original purchaser was a serviceman stationed in Illinois.²⁹ Further, the

27. The court considered ILL. REV. STAT. ch. 26, § 9-103(4): ". . . if personal property is covered by a certificate of title issued under a statute of this state or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction, which issued the certificate."

28. ILL. REV. STAT. ch. 95½, § 3-202 (1971), "(a) Unless excepted by Section 3-201, a security interest in a vehicle of a type for which a certificate of title is required is not valid against subsequent transferees or lienholders of the vehicle unless perfected as provided in this Act.

(b) A security interest is perfected by the delivery to the Secretary of State of the existing certificate of title, if any, an application for a certificate of title containing the name and address of the lienholder and the date of his security agreement and the required fee. It is perfected as of the time of its creation if the delivery is completed within 21 days thereafter, otherwise as of the time of delivery.

(c) If a vehicle is subject to a security interest when brought into this State, the validity of the security interest is determined by the law of the jurisdiction where the vehicle was when the security interest attached, subject to the following:

1. If the parties understood at the time the security interest attached that the vehicle would be kept in this State and it was brought into this State within 30 days thereafter for purposes other than transportation through this State, the validity of the security interest in this State is determined by the law of this State.

2. If the security interest was perfected under the law of the jurisdiction where the vehicle was when the security interest attached, the following rules apply:

(a) If the name of the lienholder is shown on an existing certificate of title issued by that jurisdiction, his security interest continues perfected in this State."

29. It is not unusual for a soldier on temporary military assignment in one state to maintain vehicle registration in another state. In fact, this is the basis for the Soldiers & Sailors (and Airmens) Civil Relief Act.

motel contended that the Uniform Commercial Code cannot apply because the Illinois Motor Vehicle Act provides the exclusive method in Illinois for perfecting security interests in motor vehicles.³⁰ The court concluded that the motor vehicle in question was not subject to the Illinois Motor Vehicle Act. They noted:

Where two statutes are enacted which have relation to the same subject, the earliest continues in force unless the two are clearly inconsistent with and repugnant to each other or unless in the latest statute some express notice is taken of the former plainly indicating an intention to repeal it, and where two acts are seemingly repugnant, they should, if possible, be so construed that the later may not operate as a repeal of the former by implication. . . .

The basic structure of Article 9 of the Uniform Commercial Code was to provide for the creation of a security interest with an established priority and a means of giving notice of that interest to third parties. . . . The Bank did establish its priority and notice of that interest was given to third parties, including the Motel. The Motel knew the automobile was bearing Ohio license plates and thus knew that some registration or application for license was filed in that state. The Motel also knew that Major Ward was in the military Since the evidence is undisputed that the Bank did perfect its lien in Ohio, we hold that the provisions of Section 9-103 (4) of the Uniform Commercial Code apply to the present action.³¹

30. ILL. REV. STAT. ch. 95½, § 3-207 (1971), reads: "The method provided in this act of perfecting and giving notice of security interests subject to this act is exclusive."

31. 2 Ill. App. at 704, 276 N.E.2d at 813. Similarly, this past year the Texas Supreme Court handed down an interesting decision affecting automobile titles *vis-a-vis* perfection in foreign jurisdictions, *Phil Phillips Ford, Inc. v. St. Paul Fire & Marine Ins. Co.*, 465 S.W.2d 933 (Tex. 1971). An Oklahoma dealer sold a car, assigned its security interest to Security Investment Corporation (SIC), and the latter filed in the county in which the buyer was domiciled. (This is sufficient for perfection under Oklahoma law as notation on the certificate of title itself is not required). The buyer, signing the reverse side of his title certificate, transferred the automobile to one Dignan. Dignan then received an Oklahoma certificate of title in his own name and removed the car to Texas, where he obtained a Texas certificate of title. Thereafter, Dignan sold the automobile to Phil Phillips Ford, Inc., executing a power of attorney authorizing an officer of the corporation to transfer the title. Meanwhile, the original buyer defaulted in payments so SIC repossessed the car from Ford's lot and brought it to Oklahoma. Ford sued for conversion in a Texas court and SIC received a summary judgment. Ford appealed.

Relying on UCC 9-103(d), the court noted "that if the property is, at the time of a transaction, covered by a certificate of title issued under a statute which requires notation on the title to perfect a security interest, perfection will be determined under the law of the state which issued the certificate" (at 937). Therefore, a bona fide purchaser and transferee of Dignan's Texas certificate would have received a clear title. However, the plot thickened. Ford had not exercised Dignan's power of attorney until after SIC repossessed the car. Further, the Texas Certificate of Title Act states that title to a motor vehicle cannot be passed except by a transfer of the certificate—requiring an affidavit by the transferor that there are no liens against the vehicle except those shown (Vernon's Ann. P.C. art. 1436-1, § 33). Therefore, while the sale between the parties (Dignan and Ford) may have been valid, it

And finally, *Avco Finance Co. v. Erickson*³² involved a secured creditor attempting to recover allegedly converted collateral from an adjudicated bankrupt debtor. At the hearing, the debtor raised the affirmative defense of discharge in bankruptcy, and the court ruled for the debtor because the creditor failed to file a reclamation petition for the collateral. The Illinois appellate court reversed this ruling because the debtor's discharge in bankruptcy is personal to him and does not act "as a release of liens or security interests in property owned by him."³³ A reclamation petition is needed only if possession of the bankrupt's property rests in a court-appointed officer, which was not the case here. Therefore, the secured creditor could bring an action in conversion against the bankrupt debtor for the collateral, or the proceeds³⁴ from its sale.

PROPOSED CHANGES IN ARTICLE 9

In late December 1971, the Permanent Editorial Board for the Uniform Commercial Code finalized proposals for changes in Article 9 of the UCC and related changes in other articles. Finalization came with the approval of last minute changes by both drafting organizations, The American Law Institute and the National Conference of Commissioners on Uniform State Laws.

Bills incorporating these proposed changes have already been and/or are shortly expected to be introduced in most codal jurisdictions (all states have adopted the Code, except Louisiana) including Illinois. Enactment of the proposed changes by all codal jurisdictions is anticipated within the next two years.

The areas of revision, both major and minor, are broad indeed—affecting conflict of laws,³⁵ filing,³⁶ priorities,³⁷ and default.³⁸ Obviously, a detailed explanation of the codal changes is beyond the

was void as to third parties. In this light, SIC's interest, although unperfected, was superior to Phillips Ford's interest, so SIC's repossession was not a theft, and Ford could not prevail against its loss insurer, the defendant insurance company.

32. — Ill. App. —, 270 N.E.2d 111 (1971).

33. *Id.* at 112.

34. UNIFORM COMMERCIAL CODE § 9-306 (1969).

35. UNIFORM COMMERCIAL CODE §§ 1-105, 9-102 and 9-103.

36. UNIFORM COMMERCIAL CODE §§ 9-103, 9-302, 9-401, 9-402 and 9-403.

37. UNIFORM COMMERCIAL CODE §§ 9-301, 9-307 and 9-312.

38. UNIFORM COMMERCIAL CODE §§ 9-501, 9-502, 9-504 and 9-505.

scope of this survey.³⁹ The major flaw in the revisions, however, should be noted. They do not take into consideration the recent constitutional problems. Although, of course, these cases postdate the revisions, one shall have "seen the handwriting on the wall."

CONCLUSION

Any, even hasty, consideration of secured transactions will result in at least one conclusion. Increasingly the commercial lawyer has the obligation of dissecting Supreme Court opinions. No longer can he rely on the Uniform Commercial Code as "The Bible." The UCC is obviously no more immune from attack than is a perfected security interest.

39. See 27 BUS. LAWYER 321 (1972); 27 BUS. LAWYER 1465 (1972).