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## THE UNIFORM COMMERCIAL CODE AND THE REAL PROPERTY LAWYER

ROBERT KRATOVIL\*

THE CODE, particularly Article 9, which deals with chattel security, abolishes much pre-Code terminology and many pre-Code distinctions. Any lien upon chattels, including chattels intended to be affixed to land as fixtures, is now created by means of a document called a *security agreement*. Instead of recording the security agreement, however, the Code provides for filing a notice of the existence of the security agreement. This is something of a novelty to the real property lawyer. In real property law nothing but the recording of the original instrument will satisfy our familiar recording law and serve to impart constructive notice.<sup>1</sup> Under the Code, however, it is not the original instrument that is recorded but rather a brief notice called a *financing statement* which gives notice of the existence of the security agreement. This should be a welcome innovation, for it means that all the "fine print" provisions can be eliminated from the public records. This method of filing is called *notice filing*.

This brings us to the place of filing and manner of indexing of this financing statement. The Code sets up a rather complex system of filing and indexing. If a financing statement affects a fixture, or an article that is to become a fixture, the law specifies that the financing statement must be filed in the office where a mortgage on the real estate would be filed,<sup>2</sup> but instead of being indexed in the grantor-grantee index or other real estate indexes, it is to be indexed in a separate Code index.<sup>3</sup> It seems that the Code, as drafted, calls for a

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<sup>1</sup> Herzer v. Dembosz, 19 Ill. 2d 446, 167 N.E.2d 210 (1961).

<sup>2</sup> U.C.C. § 9-401.

<sup>3</sup> To be sure, a number of states have deviated from the official Code. The official text of the Code with amendments may be found in 1 CCH 1966 INSTALLMENT CREDIT GUIDE (hereafter referred to as CCH). State deviations from the official Code accompany the text under the heading "Local Modifications."

system of filings distinct from filings theretofore existing under the recording laws, for it requires that all Code documents be marked with a consecutive file number,<sup>4</sup> and this could not be done if they were numbered in the same series of numbers that are traditionally stamped by the recorder on ordinary deeds and mortgages. This means that there is a new set of filings that impart constructive notice to those dealing in land. Any purchaser or mortgagee of land must therefore make a search of the index of documents filed under the Code, and if this search reveals the filing of a financing statement affecting an article that is or is to become a fixture, any purchaser or mortgagee of the land will take subject to the right of the creditor holding the fixture lien to remove the article if the debt is not paid. This concept is treated more fully later in this article.

Surprisingly, the statutory form financing statement does not require the financing statement to state the *amount* of the debt. No doubt this information is to be obtained from the secured party. A lien filing that does not state the amount of the debt is, again, something of a novelty to the real property lawyer, for under some decisions, a real estate mortgage that does not give the amount of the debt does not impart constructive notice.<sup>5</sup>

Section 9-402 sets forth a number of requirements that must be complied with when one seeks to file a financing statement. Naturally, questions will arise with respect to financing statements that do not comply with this section in one or more particulars. It has been held that where a financing statement was offered for filing, but it did not contain the *mailing address of the debtors*, as required by the Code, it was not entitled to be filed.<sup>6</sup> Hence, if filed, it would not impart constructive notice. In another case,<sup>7</sup> a financing statement was held invalid because it lacked the address of *the secured party*.

Another loose-leaf service, P-H CONSUMER & COMMERCIAL CREDIT INSTALLMENT SALES (hereafter referred to as P-H) provides a state-by-state survey of sales laws. State law divergences from the official text of the Code may be found under the section devoted to the appropriate state. One of the common deviations calls for filing in the grantor-grantee indexes any financing statement relating to a fixture. Deviations of this sort from the "uniform" Code provisions have led to the present re-study of Article 9, which will ultimately produce an improved version of Article 9.

<sup>4</sup> U.C.C. § 9-403.

<sup>5</sup> *Bullock v. Battenhausen*, 108 Ill. 28 (1883); *OSBORNE, MORTGAGES* 264 (1951).

<sup>6</sup> *In re Smith*, 205 F. Supp. 27 (E.D. Pa. 1962).

<sup>7</sup> *Strevell-Paterson Finance Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967).

Where a photocopy of a signed financing statement was filed, it was held that this was an ineffective filing and did not impart constructive notice.<sup>8</sup> This point is of importance because often the person filing a financing statement is in doubt as to whether or not the article in question is a fixture or a chattel. He may therefore wish to file the document both in the recorder's office and in the office or offices where chattel filings are made. This case appears to indicate that the document must be executed in duplicate or triplicate so that a signed original can be filed in each office.

Whether this idea, that the financing statement must bear an original signature in order to impart constructive notice, will generally be accepted is a difficult question to answer. Nothing in the Code requires a *manual* signature on a financing statement so long as the signer has accepted or adopted a printed signature or some other type of signature in question as his own. It is a matter of determining the intention of the signer. This problem of signature is no novelty. The Statute of Frauds demands that the memorandum required by the statute be signed, but the statute does not tell us how the signature must be affixed. The courts leave this up to the party signing the document. A printed signature has been held to be sufficient if there is an intention to adopt it as a signature.<sup>9</sup> Suppose, for example, that a subdivider subdivides a tract into 500 lots. He can print up a contract of sale with his signature on it, fill in the lot number and the purchaser's name and hand the purchaser this printed contract for his signature. This printed contract with the printed signature is enforceable because there is a clear intention on the part of the seller to adopt the printed signature as a signature.<sup>10</sup> This is plainly the rule under the Code. Section 1-201(39) provides that the word "signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing. The Official Text with Comments, under section 1-201(39), offers this comment:

The inclusion of authentication in the definition of "signer" is to make clear that as the term is used in this act a complete signature is not necessary. *Authentication may be printed, stamped or written: it may be by initials or by thumbprint.* It may be on any part of the document and in appropriate cases may be found in a bill-head or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these

<sup>8</sup> *In re Kane*, 55 Berks County L.J. 1 (1962).

<sup>9</sup> 37 C.J.S. *Frauds, Statute of* 697 (1943).

<sup>10</sup> *Id.*

matters. *The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.* (Emphasis supplied)

One feels misgivings, however, about a *photographed* document. If *A* signs a document and hands it to *B*, and *B* chooses to photograph it so that he can file it in two places, it can, with considerable force and logic, be argued that *A* signed only one document and had no intention of signing the other or of adopting the photograph as his signature.

As to the signature of the *secured party* on the financing statement, the courts are already rewriting the Code. In *Strevell-Paterson Finance Co. v. May*,<sup>11</sup> the court held the signature of the secured party not necessary (though section 9-402 expressly requires it), and in *Benedict v. Lebowitz*,<sup>12</sup> the court stated that it suffices if the name of the secured party is typed in the body of the instrument.

The mere presence on the public records of a perfected fixture financing statement does not establish the existence of a valid fixture security transaction. A filed financing statement not supported by an existing security agreement and lacking the essentials of a security agreement is void.<sup>13</sup> It is the security agreement that creates a security interest in the lender. Under the "notice filing" concept of the Code, a financing statement is only a notice of the existence of a security agreement. A security agreement, moreover, exists only "when value is given."<sup>14</sup>

Another problem under the Code relates to the matter of descriptions. Section 9-110 provides that any description of personal property or real estate is sufficient, whether or not it is specific, if it reasonably identifies what is described. Obviously, this section was intended to grant considerable latitude. It was intended to overrule some earlier cases holding that a chattel mortgage was not good as to third parties unless it gave a specific description of the chattels (for example, giving the serial numbers on the motors or appliances, if they bore a serial number). Under the Code we find financing statements which simply describe the property as "heavy duty knife grinders." This is perplexing. It is difficult to tell whether this is something that one can hold in one's hand or whether it is two stories high and is securely bolted to the floor of a plant. Undoubtedly one difficulty under the

<sup>11</sup> *Supra* note 7.

<sup>12</sup> 346 F.2d 120 (2d Cir. 1965).

<sup>13</sup> *American Card Co. v. H. M. H. Co.*, 97 R.I. 59, 196 A.2d 150 (1963).

<sup>14</sup> U.C.C. § 9-204(1).

Code, with respect to description of the property subject to the lien, stems from the fact that section 9-402 states that the financing statement is sufficient if it indicates the *types* or describes the items of collateral. The reason the law was phrased in this manner is evident when one considers that one purpose of the Code was to permit a financing statement to cover an indeterminate number of transactions involving the same types of collateral, covered, perhaps, by a series of security agreements.<sup>15</sup>

The Code provides that if the document affects articles which are affixed or are to be affixed to real estate, the document must contain a description of the real estate. The description required is one that reasonably identifies the real estate.<sup>16</sup> Probably a street address description would be sufficient, if it contains the city and state where the real estate is located.<sup>17</sup> To the extent that this rule appears to incorporate the requirements of the Statute of Frauds, it may incorporate the existing conflict of authority as to what constitutes a reasonably adequate description of land under the Statute of Frauds.<sup>18</sup>

As can be seen, a recurring problem arising under the Code stems from the fact that it is often difficult to determine whether articles are chattels or fixtures. This can be met by double or triple filing, one duplicate being filed as a fixture filing, the others being filed with the chattel filings.

With respect to the form of fixture filings, section 9-402(3) is applicable. It sets out a form for a financing statement with a separate paragraph set aside for the real estate description where the filing covers fixtures. A problem that the draftsmen of the Code did not foresee was that in adopting officially approved Code forms, many of the Secretaries of State throughout the country have ignored this section. The official printed Code financing statement in many states omits the Code paragraphing and leaves the fixture information to be inserted in a general box pursuant to instructions printed at the top of the form. These instructions are often ignored.<sup>19</sup>

<sup>15</sup> Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289, 328 (1962).

<sup>16</sup> U.C.C. § 9-110. This resembles the requirement of the Statute of Frauds. *Supra* note 9, at 670.

<sup>17</sup> *Heroux v. Romanowski*, 336 Ill. 297, 168 N.E. 305 (1930).

<sup>18</sup> KRATOVIL, REAL ESTATE LAW 114 (4th ed. 1964).

<sup>19</sup> *Financing Statements for Fixture Filing*, 23 BUS. LAW. 121 (1968).

Another problem presented by these sections is that they do not require the indexing of financing statements in the grantor-grantee index or in tract books in the states where these are official indexes. There is only the index of Code filings.<sup>20</sup> This problem is aggravated by the fact that in most states the Code does not require consumer goods filings to be segregated from fixture filings. The result is chaos in the big metropolitan areas, where each day's filings are a jumble of chattel and fixture filings on identical forms filled out in general language that could apply to either chattels or fixtures.

Some question has been raised as to whether a mortgagee of real estate must also insist upon receiving a security agreement and recording a financing statement in the recorder's office in order to acquire a good lien upon fixtures existing at the date of the mortgage. There is no doubt upon this score. A mortgage in the old-fashioned form recorded in the old-fashioned way in the recorder's office, in the land records, creates a good and valid lien upon the real estate, including the fixtures. This is the clear meaning of section 9-313, which provides:

The law of this state other than this act determines whether and when such goods become fixtures. This act does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.

Three distinct situations that present true fixture problems involving a real estate mortgage are:

(1) The fixture is installed *before* a mortgage is given. Here the problem is one of constructive notice.

*Example:* A installs a new furnace in his home in 1967 and a financing statement is filed in the Code fixture filings listing A as debtor. In 1968, A mortgages his home to B. B has *constructive notice* of the financing statement and takes subject to it. Of course, if no Code fixture filing has been made, the mortgagee is protected and

<sup>20</sup> The official Code simply says that a fixture filing shall be made in the "office" where a mortgage on real estate would be filed. U.C.C. § 9-401(1)(b). In a large metropolitan area such an office will have different windows or cages where different types of documents are presented. In Cook County, Illinois, and one presumes elsewhere, a separate window is provided for Code filings and Code document numbers are assigned in sequence with the prefix "UCC." As to indexing, there is no Code requirement that fixture filings be indexed in the real property records. Kripke, *Fixtures Under the Uniform Commercial Code*, 64 COLUM. L. REV. 44, 53 (1964). However, in a number of states the Code has been adopted with amendments that require indexing of fixture filings in the land records. See CCH and P-H (*supra* note 3).

no problem is presented.<sup>21</sup> Even the ten-day grace period for filing given under section 9-312(4) seems inapplicable to real estate interests.<sup>22</sup>

(2) The fixture is installed *after* the real estate has been mortgaged, but a construction loan is *not* involved.

*Example:* In 1967, *A* mortgages his home to *B*. In 1968, *A* replaces his old furnace with a new one purchased on credit. The credit seller has the right of removal. Under the old law the question was one of material injury. We will return to this thought later.

(3) A fixture is purchased on credit and installed while a construction loan is in the process of disbursement.

*Example:* *A* mortgages his vacant land to *B*, a construction lender, who disburses the loan proceeds as the building goes up. *A* buys on credit a furnace which is installed during the progress of construction. After all the construction money has been disbursed, the credit seller of the furnace seeks to remove it. *B* objects. *A* is insolvent.

Each of these situations offers its own peculiar problems.

Let us go back to situation (1), the constructive notice problem, and analyze the complications that may arise.

Suppose the collateral consists of one hundred hot water tanks purchased by a professional builder on credit and warehoused. He has no idea at the time where these tanks will ultimately be installed. That being the case, the creditor can only file the financing statement with the chattel filings, usually with the Secretary of State and additionally, in some states, where the debtor resides or has a place of business. What happens after the hot water tanks have been installed in various buildings throughout the state? Must any purchaser or mortgagee search the records of the Secretary of State to see whether or not financing statements were filed covering such hot water tanks? It is obvious that one of two innocent parties must suffer here. Where the building containing the hot water tanks is sold to an innocent purchaser, if he gets title free and clear of the financing statement, the creditor is hurt. If, on the other hand, the financing statement is good against the purchaser of the real estate, the purchaser is hurt. The correct view is that the purchaser of the real estate is protected. The reasons cannot be stated briefly.

One begins with the case law as it existed prior to 1904. At that time in most states provision was made for filing conditional sale

<sup>21</sup> U.C.C. §§ 9-302(1)(D), 9-313(4).

<sup>22</sup> Kripke, *supra* note 20, at 73.

contracts and chattel mortgages in a portion of the recorder's office usually called the "personal property records" or "chattel mortgage records." These records served their purpose admirably when one was dealing with ordinary chattels. A man who was about to buy a carriage could look at the records to see if there were any prior chattel liens on it.

Suppose, however, he was about to buy a house. Was it necessary for him to search the chattel records for liens on the furnace? The hot water heater? The oil burner? The sink? The tub? And so on. To ask the question is to answer it. The majority of our courts answered in the negative. If one buys chattels, he searches only the chattel records; if he buys land, he searches only the land records.<sup>23</sup> This was simple and logical, but it was a poor answer for the man selling on credit an article, like a furnace, that was certain to be affixed to land. He had no satisfactory way of protecting himself.

To resolve this predicament, the ancestor of the Code provisions relating to fixture filings was enacted in 1904 in New York. In that year New York passed a law providing that conditional sales of articles, that were attached to or were to be attached to buildings, must contain a brief description of the real estate and must be filed in the land records. Here is the first rational recognition of the fact that many articles sold as chattels are sold on credit, that they will become fixtures by installation in buildings, and that credit sellers of these articles are deserving of protection. Unlike the usual chattel security documents, these documents were required to contain an adequate description of the land; and they found their way into the traditional real estate indexes, the grantor-grantee indexes, since the document was left with the same recorder who took in deeds. Legislation similar in character was later enacted in Massachusetts, Pennsylvania, and Oregon.<sup>24</sup>

<sup>23</sup> Elliott v. Hudson, 18 Cal. App. 642, 124 P. 103 (1912); Trull v. Fuller, 28 Me. 545 (1848); Tibbets v. Horne, 65 N.H. 242, 23 A. 145 (1891); Merchants & Mech. Fed. S. & L. Assn. v. Herald, 201 N.E.2d 237 (Ohio App. 1964); XXth Century Heating & Ventilating Co. v. Home Owners' Loan Corp., 56 Ohio App. 188, 10 N.E.2d 229 (1937); Peoria Stone & Marble Works v. Sinclair, 146 Iowa 56, 124 N.W. 772 (1910); Williams v. Hyde, 98 Mich. 152, 57 N.W. 98 (1893); Kelvinator St. Louis, Inc. v. Schader, 225 Mo. App. 479, 39 S.W.2d 385 (1931); Phillips v. Newsome, 179 S.W. 1123 (Tex. Civ. App. 1915); Smith v. Waggoner, 50 Wis. 155, 6 N.W. 568 (1880); 1 JONES, CHATTEL MORTGAGES, § 134 (5th ed. 1894); 1 PATTON, TITLES 147 (2d ed. 1957); 1 THOMPSON, REAL PROPERTY, § 218 (1924); 4 AMERICAN LAW OF PROPERTY § 18.14 (1952).

<sup>24</sup> Kratovil, *Fixtures and the Real Estate Mortgages*, 97 U. PA. L. REV. 180, 195 (1948).

The Uniform Conditional Sales Act was later promulgated. This law, modeled after the New York law of 1904, provided in Section 7, in part, as follows:

If the goods are so affixed to realty at the time of a conditional sale or subsequently as to become part thereof but to be severable without material injury to the freehold, the reservation of property shall be void after the goods are so affixed as against subsequent purchasers of the realty for value and without notice of the conditional seller's title, unless the conditional sale contract, or a copy thereof, together with a statement signed by the seller briefly describing the realty and stating that the goods are or are to be affixed thereto, shall be filed before such purchase in the office where a deed of the realty would be recorded or registered to affect such realty.<sup>25</sup>

In giving the reason for the inclusion of this provision, George Bogert, then Dean of the Cornell University College of Law, observed:

The conditional seller of the fixture should not get protection by filing the contract with ordinary conditional sale contracts and making a record similar to that made in the case of chattel mortgages. It is unreasonable to ask purchasers and mortgagees of realty to search in the personal property records regarding every article connected with a building which might have been sold separately.<sup>26</sup>

It is important to assimilate the full import of this philosophy. While credit sellers of articles that will become fixtures are to be afforded an opportunity to protect themselves, it was considered unreasonable to ask purchasers or mortgagees of land to search the personal property records. This is the philosophy deeply embedded in the Uniform Conditional Sales Act. The decisions under that act fully support this view.

It is now time to turn to the Code itself. In the Uniform Commercial Code we find the requirement that security interest documents relating to articles that "are or are to become fixtures" must be filed "in the office where a mortgage on the real estate concerned would be filed or recorded."<sup>27</sup>

The Official Text makes this comment:

Fortunately there is general agreement that the proper filing place for security interests in fixtures is in the office where a mortgage on the real estate concerned

<sup>25</sup> 2 UNIFORM LAW ANN. 12 (1922).

<sup>26</sup> 2A UNIFORM LAWS ANN. 98 (1924). The decisions under the Uniform Conditional Sales Act also took this view. In re Brownsville Brewing Co., 117 F.2d 463 (1941); Schwartz v. Collett, 24 Wash. 2d 653, 166 P.2d 940 (1946); General Motors Acceptance Corp. v. Capital Associates, 108 N.J. Law 421, 158 A. 107; *affm'd* 110 N.J. Law 61, 164 A. 20 (1923); Kohler Co., Inc. v. Brasun, 249 N.Y. 224, 164 N.E. 31 (1928).

<sup>27</sup> U.C.C. § 9-401.

would be filed or recorded, and . . . subsection (1)(b) . . . so provide[s]. This provision follows the Uniform Conditional Sales Act. Note that there is no requirement for an additional filing with the chattel records.<sup>28</sup>

The comment to section 9-313 relates:

Under this article, as under the Uniform Conditional Sales Act the place of filing with respect to goods affixed or to be affixed to realty is with the real estate records and not with the chattel records.<sup>29</sup>

This means that under the Code, as under the Uniform Conditional Sales Act and the common law, purchasers and mortgagees of real estate need not concern themselves with those records that relate only to personal property, such as those that are filed under the Code with the Secretary of State. In other words, if there is no filing in the local recorder's indexes, there is no constructive notice. People dealing with land need not search the office where only chattel liens are filed.<sup>30</sup>

To sum up, under the case law that preceded the Code, an overwhelming majority of the courts held that purchasers or mortgagors of land need not search the chattel records. Under the state legislation enacted later in New York, Massachusetts, Pennsylvania and Oregon, the same rule was laid down. Under the Uniform Conditional Sales Act the same rule was also laid down. With respect to the Code, the official text with comments indicates that it was the desire of the draftsmen to adopt the philosophy of the Uniform Conditional Sales Act. There is not the slightest suggestion anywhere in the Code of the intention to make a change so revolutionary as to charge purchasers of land with notice of chattel filings in the Secretary of State's Office. In these circumstances, courts are not likely to hold that such chattel filings impart constructive notice to purchasers of

<sup>28</sup> OFFICIAL TEXT WITH COMMENTS U.C.C. § 9-401.

<sup>29</sup> OFFICIAL TEXT WITH COMMENTS U.C.C. § 9-313.

<sup>30</sup> The reliance placed on the Official Text with Comments is not misplaced. To be sure, as the entitlement of the volume suggests, the text is not the Official Text with Official Comments. Nevertheless the comments carry great weight, and what the comments omit is quite as important as what they include. Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 WISC. L. REV. 597. If a revolutionary departure from pre-Code law were intended, it is reasonable to suppose the comments would signal this development. Instead they give every evidence of a disposition to accord with pre-Code law on this score. See U.C.C. § 1-103.

land.<sup>31</sup> Statutes must always be interpreted to avoid absurd consequences,<sup>32</sup> and this would indeed be an absurd consequence.

Another problem of constructive notice exists under the Code where the filing of the financing statement is in the name of a debtor who has no interest in the real estate.

Section 9-403 of the Code provides:

The filing officer shall index the statements *according to the name of the debtor* and shall note in the index the file number and the address of the debtor given in the statement.

Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this article. (Emphasis supplied)

Where *the landowner* installs the article, and the financing statement lists his name as debtor, a name search of the Code index of fixture filings will reveal the financing statement. But where a building contractor, having no interest in the land, buys an article, such as a water heater, which he installs in the building, and the financing statement lists his name as debtor, a real problem presents itself, because a person searching the land records would have no information leading him to the name of the building contractor.

Let us consider the language of our old recording laws relating to deeds. They provide, in most states, for an official grantor-grantee index. They do not provide, in so many words, that a "wild" deed or mortgage does not impart constructive notice. The cases say so, but the statute does not. The recording law simply says that deeds, mortgages and other real estate documents shall be indexed according to the names of the parties. The courts took it from there, and evolved the notion that an orderly, chronological sequence of instruments was required with names therein sufficiently similar that they were deemed *idem sonans*.<sup>33</sup> This is the familiar chain of title theory. Under it a "wild deed," where the grantor is a stranger to the chain of title,<sup>34</sup> does not impart notice. Is there any reason to suppose that the court will not arrive at the same conclusion with respect to the provisions of the

<sup>31</sup> Coogan, *supra* note 15, at 328.

<sup>32</sup> 82 C.J.S. *Statutes* § 326, at 627 (1953).

<sup>33</sup> *Harris v. Reed*, 21 Idaho 463, 121 P. 780 (1912).

<sup>34</sup> PATTON, *TITLES* § 69 (2d ed. 1957).

Code? What possible reason would exist for requiring indexing in the name of the debtor, unless this had some significant relation to the land in question? In holding that purchasers of land need not search the personal property records and that "wild" deeds do not impart constructive notice, the courts, without benefit of any legislative crutch, took a practical, sensible approach to the problem.

With respect to chattel mortgages, it was well established that the chain of title theory was applicable. Thus in *New England National Bank v. Northwestern National Bank*, the court said:

The weight of authority is that a mortgage on personal property made by one who is not the owner of the property, or by the owner in a fictitious name, and placed on record, is not constructive notice to any one dealing with the owner in his true name. The reason of the rule is that such conveyances in fictitious names or in the name of an agent lie outside the chain of title, and therefore impart no notice. This is the rule always as to real property. . . . And so far as mortgages are concerned, the same rule must obtain as to chattels, if any efficacy is to be given to our registry acts. This is the doctrine that prevails elsewhere. . . . If conveyances from one stranger to another would be notice to all the world, miserable would be the situation of the purchaser.<sup>35</sup>

The same was true of conditional sale contracts.<sup>36</sup>

Thus although the statutes say a deed gives notice from the date it is filed, the courts say this is not so when the deed is a "wild" deed. The chattel mortgage statutes were construed the same way, and the conditional sales acts were construed the same way. Nothing in the Official Text with Comments indicates a disposition to depart from this inveterate and unbending interpretation of the law. Will the courts, therefore, take the literal language of the Code, so similar to that of our other recording laws, and from this contrive a truly revolutionary innovation in the law? This certainly seems unlikely.

In a decision of potential importance in this area, it was held that a Uniform Commercial Code filing under the name "Kapas" did not impart constructive notice as against a later financing statement to another party made under the correct name "Kaplan."<sup>37</sup> This is good "chain of title" theory. The "chain of title" theory has not, as yet, appeared by that name in the reports with respect to the Code. In-

<sup>35</sup> 171 Mo. 307, 71 S.W. 191 (1902).

<sup>36</sup> *Industrial Bank of Commerce v. Packard Yonkers Corp.*, 279 App. Div. 125, 108 N.Y.S.2d 249, *aff'd* 304 N.Y. 622, 107 N.E.2d 96 (1952).

<sup>37</sup> *Bank of America v. Bank of Nutley*, 94 N.J. Super. 220, 227 A.2d 535 (1967).

evitably, of course, it will. When and if it is established that the "chain of title" theory applies to the Code, the problem of the building contractor will disappear because his name does not appear in the chain of title.

In connection with this problem, a check of the loose-leaf services indicates that nearly half the states have departed from the Code by requiring the financing statement to contain the name of the record owner. Many of these states go on to require that the financing statement be thereupon indexed in the Code fixture filings in the name of the record owner and a lesser number require indexing in the grantor-grantee land records.<sup>38</sup>

We turn now to the second situation, the "material injury" problem. Where a security interest in a fixture attached prior to the time the fixture is installed as such, and the fixture is installed on mortgaged land, the situation is governed by section 9-313 of the Code. It provides that the secured party has the right to remove the fixture from the real estate if a default occurs in the payments due under the security agreement, although he must reimburse the real estate mortgagee *for the cost of repairing any physical injury to the building occasioned by such removal*. He need not pay for diminution in value of the real estate caused by the absence of the goods or the necessity for replacing them. Under the law prior to the Code, removal would not have been permitted in such circumstance if it would entail material injury to the freehold.<sup>39</sup> The reason why the existing rule was changed is not difficult to discern. The question of what constituted material injury to the freehold was one that presented great difficulty under the old case law and under the Uniform Conditional Sales Act. Even with respect to uncomplicated articles, like furnaces installed in single-family dwellings located on mortgaged land, the decisions were in conflict. A majority of the courts permitted removal of furnaces on the theory that removal would entail no material injury to the "freehold," meaning no material injury to the building. Other cases followed the institutional doctrine and prohibited removal on the theory that removal of a furnace makes a house untenable in winter.<sup>40</sup> All these problems are swept aside by the provisions of the Code permitting removal in all such cases, but

<sup>38</sup> *Supra* note 3.

<sup>39</sup> Kratovil, *supra* note 24, at 200.

<sup>40</sup> Kratovil, *supra* note 24, at 214, *et seq.*

requiring compensation to be made for the cost of repair of physical injury to the building.

Section 9-313 is modeled after a 1935 amendment to the Pennsylvania Conditional Sales Act. Prior to the enactment of this law, the Pennsylvania Act simply stated that where articles were sold under a conditional sales contract they could be removed by a conditional vendor if the removal would not constitute material injury to the freehold. As construed in Pennsylvania prior to 1935, material injury was present if removal of the articles would interrupt the *functioning* of the industrial plant or other establishment in which the articles were installed.<sup>41</sup> It was the purpose of the 1935 amendment to nullify this doctrine.<sup>42</sup>

This is the problem: Where one wrongfully causes an impairment of the security of a mortgage, this is a tort and such party is answerable to the mortgagee in damages. The Code allows removal in language that appears to make the removal perfectly valid, not tortious. Its language authorizes the chattel lienor to remove his collateral from the real estate, but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for "*any diminution in value of the real estate caused by the absence of the goods removed or by any necessity for replacing them.*" Suppose, then, that *A* mortgages to *B* an office building which is fully rented out to tenants. Thereafter *A* purchases from *C* under a chattel security arrangement automatic elevators which are installed. On default in the chattel security document *C* removes the elevators. All the tenants move out. All the "going concern" value, on which *B* relied in making his loan, has been destroyed. Is this a "diminution in value of the real estate" for which liability is excused under the Code? If the real estate mortgagee has no recourse for a destruction of the mortgage security, certainly the law seems unfair. And yet, it was precisely this unfairness that the Pennsylvania Supreme Court pointed out in 1934, and that the 1935 amendment to the Pennsylvania statute was intended to legalize. Since, as Professor Gilmore suggests, the Code draftsmen were aiming at an

<sup>41</sup> *Central Lithograph v. Eatmore Chocolate Co.*, 316 Pa. 300, 175 A. 697 (1934).

<sup>42</sup> Robinson, McGrough, & Scheinholtz, *The Effect of the Uniform Commercial Code on the Pennsylvania Industrial Plant Doctrine*, 16 U. PITT. L. REV. 89, 94 (1955); OSBORNE, MORTGAGES 594 (1951).

across-the-board rejection of the old Pennsylvania-New Jersey thinking, the Code means exactly what it says.<sup>43</sup>

One commentator on the Code senses the problem, sees the injustice, and suggests that the right of self-help should not exist in these situations, but that judicial foreclosure of the fixture lien should be mandated so that equity could protect the landowner and mortgagee:

Another example would be the attempted removal of an elevator from a skyscraper. Such removal would shockingly diminish the economic value of the remaining building for those having interests therein. . . . [T]herefore, the fixture secured party should be denied his right to remove; instead, he should be required to use judicial foreclosure proceedings. This will bring into play the full equitable powers of the court for the purpose of preserving the value of the real estate as an integrated economic unit and maximizing the recovery for all parties having an interest in the real estate. Limiting the right to remove in no way detracts from the fixture secured party's paramount security interest in his collateral. It merely requires him to enforce his security interest in a sensible and equitable fashion.<sup>44</sup>

This is not unlike a point of view expressed much earlier:

Mortgage loans on vacant buildings are rare. Where a mortgage loan is made to a businessman, it is the going concern with its going concern value on which the mortgage banker relies. Even a distressed property has going concern value, and indeed the compelling motive of an equity receivership is the preservation of this going concern value. When a credit vendor exercises his right of removal, leaving the walls of the building intact but disrupting operations, has he not occasioned a diminution of the going concern value of the security?<sup>45</sup>

If an attorney is rendering an opinion *to a mortgagee* at some date *after* the recording of the mortgage, and he encounters a fixture filing subsequent to such recording, he must raise this as an objection prior and superior to the mortgage, for the Code makes it so. Whether or not one agrees with the philosophy of the Code in this respect, the intention it expresses is unmistakably clear.

Another problem a mortgagee encounters with respect to additional optional advances he might wish to make *after* the initial disburse-

<sup>43</sup> 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 804 (1966).

<sup>44</sup> Shanker, *An Integrated Financing System for Purchase Money Collateral*, 73 YALE L.J. 788, 805 (1964). Other illustrations occur. Removal of heating or air-conditioning units could cause a tenant exodus. Sprinkler systems have been removed. *Bank of Republic v. Wells-Jackson Corp.*, 358 Ill. 356, 193 N.E. 215 (1934). This could result in loss of fire insurance coverage. Perhaps the answer here is that examples of this sort have not appeared with great frequency in the reported decisions, suggesting the possibility that they are relatively rare.

<sup>45</sup> Kratovil, *supra* note 24, at 217.

ment, is that fixture liens *after* the mortgage has been recorded, apparently need not be filed in order to be valid as against a prior mortgage.<sup>46</sup> This is because under section 9-313 a security interest which attaches to goods before they become fixtures has priority over the claims of persons who "have" an interest in the real estate. Thus Thomas Pfeiler of the United States Savings and Loan League suggests:

A mortgagee probably would be much more willing to extend leniency to a delinquent borrower if he were sure that his first mortgage is the only lien on the entire property; under these circumstances, he might even be induced to make an additional advance in order to help the borrower out of a temporary financial difficulty. However, under subsection (2) of Section 9-313, while a desperate borrower in bad financial straits might insist that the real estate is free of fixture liens, the real estate mortgagee (even by a search) would have no way of knowing whether or not a secret (and prior) lien upon that part of the real estate which is represented by a subsequently installed fixture actually is in existence by virtue of said section. The uncertainties created by virtue of the automatic (and secret) priority given to fixture-secured lenders, subsection (2) of Section 9-313 might well cause institutional mortgage lenders to take an across-the-board, hard-hearted approach regarding all loan delinquency cases in order to avoid all further detriment to their mortgage interest by virtue of the priority provision of Section 9-313(2).<sup>47</sup>

By similar reasoning, the Code does not protect a landowner paying his general contractor against unfiled security interests.<sup>48</sup>

The third situation, that of the construction loan, presents a difficult problem. Purely from the standpoint of policy, the two competing interests offer cases of equal strength. It is in the interest of our economy to encourage credit sales of appliances that are to be installed in buildings, and the Code bears witness to the enormous strength of this policy factor. It is also in the interest of the economy to encourage building construction, particularly residential construction, as witness the reams of federal legislation designed to accomplish this result. Reverting to the example given earlier,<sup>49</sup> who should bear the loss, the construction lender or the credit seller of the furnace? The Code contains no explicit answer to this question. Of the two eminent commentators who have given this matter earnest attention, one, Kripke would protect the credit seller of the fixture. His argument,

<sup>46</sup> Kripke, *supra* note 20, at 75.

<sup>47</sup> 29 LEGAL BULL. 201, 207 (1963).

<sup>48</sup> Kripke, *supra* note 20, at 69.

<sup>49</sup> *Supra* p. 107, third example.

reduced to its simplest terms, rests on two propositions, namely: (1) the language of section 9-313(4), since it protects a recorded mortgage as to advances made *before* a fixture lien is perfected by filing, seems to suggest that the mortgage is not protected if an advance is made thereunder *after* the fixture lien has been filed; and (2) more practically, the mortgagee can protect himself by making a search of Code fixture filings prior to each construction loan disbursement.<sup>50</sup>

Gilmore, although conceding that a serious problem is presented, advances potent arguments that favor the construction mortgagee. In the first place, he reasons, the construction lender typically brings himself within the protection of the rule that a mortgagee must be contractually obligated to disburse the construction funds to be fully protected against real property liens intervening during the construction period.<sup>51</sup> When he does this, the construction lender brings himself within the protection of section 9-313(4), which protects a mortgagee who has "contracted" to make future advances. Moreover, Gilmore argues, the pre-Code law, in recognition of the meritorious "new money" claims of the construction lender, protected him against fixture liens arising during the course of construction.<sup>52</sup>

A further argument could be marshalled in favor of the Gilmore position. In many states, contrary to the suggestion by Kripke, it is *not* the practice of construction lenders to search the records as construction goes forward. In these states the law provides that if the construction mortgage is recorded before construction begins, it has priority over mechanics' liens, and most lenders rely on this law.<sup>53</sup> Is it now

<sup>50</sup> Kripke, *supra* note 20, at 71.

<sup>51</sup> 2 GILMORE, *supra* note 43, at 831. This entire problem of "optional advances" and "obligatory advances" is fully explored in OSBORNE, MORTGAGES 295 (1951). It is vitally important to the construction lender to come under the umbrella of the "obligatory advances" doctrine in order to fend off claims by mechanics' liens arising during the course of construction. Annot., 80 A.L.R.2d 179, 191 (1961).

<sup>52</sup> 2 GILMORE, *supra* note 43, at 774, a view supported by well-reasoned decisions: Dauch v. Ginsburg, 241 Cal. 540, 6 P.2d 952 (1931); Swift Lumber & Fuel Co. v. Elwanger, 127 Neb. 740, 256 N.W. 875 (1934); King v. Blickfeldt, 111 Wash. 508, 191 P. 748 (1920). To these should be added Green v. Elkins, 134 Misc. 118, 235 N.Y.S. 438 (1929), which arose under the Uniform Conditional Sales Act. But other pre-Code decisions favor Kripke's viewpoint. Mississippi Valley Trust Co. v. Cosmopolitan Club, 111 N.J. Eq. 277, 162 A. 396 (1932); Rupp v. M. S. Johnston Co., 226 Md. 181, 172 A.2d 875 (1961); McCloskey v. Henderson, 231 N.Y. 130, 131 NE. 865 (1921).

<sup>53</sup> *E.g.*, Clark v. General Electric Co., 243 Ark. 399, 420 S.W.2d 830 (1967). Of course, the "obligatory advances" doctrine protects these construction lenders against judgments, junior mortgages, etc., arising during the course of construction. OSBORNE, MORTGAGES 295 (1951). Hence no search need be made for such liens.

their duty to search for Code filings during the course of construction when they need not search for filed mechanics' liens? If it is, the Code adds greatly to the cost of construction. There are areas of the country where official searches of Code filings are simply not procurable, so consequently the search must be made by an attorney. One doubts that the Code draftsmen intended this consequence. The practitioner, unable to choose between the views of these eminent commentators, may well choose to advise his construction lender clients to spend the money for Code searches during construction.

Despite some imperfections, the Code represents a giant step forward in American law. Moreover, a distinguished group of lawyers is presently engaged in preparing a clarification of Article 9 that will undoubtedly provide solutions to the problems that have come to light. Perhaps a major contribution these draftsmen could provide is an expansion of the "comments" that illuminate the thinking behind the text. Meanwhile, if courts and lawyers construe the Code sensibly in the light of history, sensible solutions will be found to most of the day-to-day problems that arise.