Michigan Law Review

Volume 60 | Issue 2

1961

Uniform Commercial Code - Motor Vehicles - Filing Requred to Perfect Security Interests

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UNIFORM COMMERCIAL CODE — MOTOR VEHICLES — FILING REQUIRED TO PERFECT SECURITY INTERESTS—In 1958 Kentucky enacted the *Uniform Commercial Code*[1] providing for the perfection of security interests in chattels by filing a financing statement,[2] and a motor vehicle Certificate of

1 KY. REV. STAT. ch. 355 (Supp. 1960). Kentucky adopted the UCC in 1958 to become effective on July 1, 1960. This two-year period is usually provided by states adopting the Code to allow practitioners to become acquainted with its provisions.

2 KY. REV. STAT. § 355.9-302 (1) (Supp. 1960). The financing statement replaces the usual provisions for the recording of chattel mortgages, conditional sales contracts,

Title Act requiring liens to be noted on the registration certificate covering the vehicle.[3] The Code excludes from its filing provisions security interests in property subject to a Certificate of Title Act[4] and provides that such interests can be perfected only by compliance with the requirements of the title act.[5] However, unlike the typical Certificate of Title Act, the Kentucky title act does not provide that the notation of the lien on the registration certificate is to be the exclusive method of perfecting security interests.[6] In an action for declaratory judgment, the trial court held that, the exemption provision notwithstanding, perfection is to be accomplished only by standard Code filing of a financing statement, although notation of liens on the registration certificate is also mandatory. On appeal, *held,* affirmed, one judge dissenting.[7] The legislature intended that motor vehicle security interests be perfected by standard Code procedures. *Lincoln Bank & Trust Co. v. Queenan,* 344 S.W.2d 383 (Ky. 1961).

The Code's exemption provision was originally adopted by the Commissioners because of the inconsistency between standard Code filing and the typical Certificate of Title Act provision for notation as the exclusive

factor's liens, trust receipts and similar security devices. See generally Kripke, *Kentucky Modernizes the Law of Chattel Security,* 48 KY. L.J. 369 (1960).

3 KY. REV. STAT. § 186.195 (1960): "(1) Whenever the owner of a motor vehicle, properly registered in this state, executes a lien thereon, he shall deliver the registration receipt to the secured party. The secured party shall, within ten days thereafter, present such receipt, together with the lien instrument and proper fees, to the county clerk of the county in which the motor vehicle is registered for recording. (2) The county clerk shall, within five days, mail the registration receipt with the lien recorded thereon to the owner, and shall also record the lien on the copy of the registration receipt on file in the county clerk's office . . . ."

4 KY. REV. STAT. § 355.9-302(3) (Supp. 1960): ". . . (3) the filing provisions of this article do not apply to a security interest in property subject to a statute . . . (b) of this state which provides for central filing of, or which requires indication on a certificate of title of, such security interests in such property."

5 KY. REV. STAT. § 355.9-302(4) (Supp. 1960): "A security interest in property covered by a statute described in subsection (3) can be perfected only by registration or filing under that statute or by indication of the security interest on a certificate of title or a duplicate thereof by a public official." For a complete discussion of the Code exemption provisions for motor vehicle security interests, see generally Comment, 47 CALIF. L. REV. 543 (1959); Comment, 70 YALE L.J. 995 (1961).

6 The Certificate of Title Acts of twenty-two states specifically provide that notation and compliance with the act are the exclusive methods of perfecting security interests in motor vehicles. See notes 15 & 18 *infra.* Section 25 of the *Uniform Motor Vehicle Certificate of Title & Anti-Theft Act* likewise provides that notation is the exclusive method of perfecting motor vehicle security interests. As of this date only Connecticut and Illinois have enacted § 25. CONN. GEN. STAT. ANN. § 14-190 (1958); ILL. ANN. STAT. ch. 95½, § 3-207 (Smith-Hurd 1958). The Kentucky act also differs markedly from the typical title act in that it does not provide for a separate certificate of title document, but rather makes use of the registration certificate issued by all states.

7 Judge Montgomery dissented on other issues involved in the case but did not express an opinion on the issue of perfection of security interests in motor vehicles, nor on the question of the effect of the notation statute.

method of perfecting an interest.[8] However, since the Kentucky title act does not provide that perfection is to be accomplished by notation, it is compatible with standard Code filing. Furthermore, three non-Code statutes enacted at the same time as the Code indicate a legislative intention that financing statements should be used in connection with motor vehicle security interests.[9] The court was faced, therefore, with the dilemma of either giving effect to the provision exempting motor vehicle security interests from standard Code filing, which would be inconsistent with the three non-Code statutes implying the use of financing statements, or finding standard Code filing applicable to motor vehicle security interests, thereby ignoring the plain meaning of the exemption provision. By electing the second alternative the court may have encroached upon the legislature's province. However, the evidence in the other statutes of legislative intention to use financing statements, together with the compatibility of the non-exclusive notation statute with standard Code filing, justify the result reached. In determining the intent of the legislature it is probably more reasonable to rely upon the three non-Code statutes than upon the exemption provision which may have been automatically adopted by the legislature when enacting the entire Code in its original form.

Since no specific penalty was provided for non-compliance with the notation statute, the court concluded that the legislature intended that the county clerk should refuse to record the financing statement in the absence of compliance.[10] The opinion also states that it is the filing of the financing statement alone which perfects the interest, regardless of the duties of the parties and county clerks under the notation statute.[11] However,

8 See Comment, 70 YALE L.J. 995, 999 (1961).

9 KY. REV. STAT. § 382.740 (Supp. 1960) provides that the "lien instrument" mentioned in the notation statute [KY. REV. STAT. § 186.195 (Supp. 1960)] shall be filed "in the same manner as financing statements are required to be filed by [the *Uniform Commercial Code*]." Although admitting that it is unclear, the court determined that a financing statement is a "lien instrument" within the intendment of the notation statute. The result is that a financing statement must be presented to the county clerk along with the registration certificate and that the former is to be filed as required under standard Code filing. KY. REV. STAT. § 382.770 (Supp. 1960) provides that if the collateral is an automobile or motor truck in the hands of a consumer the financing statement is to include specified additional information. The inference here is that a financing statement is required for motor vehicles. The court also relied upon the notation statute itself, which recognizes that a security interest may be recorded in a county other than the one in which it is registered. KY. REV. STAT. § 186.195 (3) (Supp. 1960).

10 The court held specifically that the notation statute was not applicable to registered motor vehicles in a dealer's inventory. The Code in effect provides for a floating lien whereby an inventory vehicle is automatically freed of a perfected security interest as it goes into the hands of a buyer in the ordinary course of business. KY. REV. STAT. § 355.9-307 (Supp. 1960). The court felt that the statute was incompatible with the floating lien system.

11 Principal case at 387.

if perfection is to be accomplished by filing, and if filing can be accomplished only by compliance with the requirements of the notation statute, it follows that notation also is a prerequisite of perfecting. The discrepancy between the language of the opinion and the logical result of requiring the clerk to refuse to record may present ambiguity as to whether or not a security interest has been perfected. For instance, the county clerk might inadvertently record a financing statement without the lien's having been noted on the registration certificate. Relying on the notation requirement, a court could logically hold that the interest was not perfected. Alternatively, applying the suggestion of the court in the principal case, it could hold that the filing of the financing statement alone perfected the interest.

In addition, by requiring notation as well as filing of a financing statement, the decision creates a system of double filing. There is no practical justification for a dual method of giving notice, and legal writers have expressed their disapproval of such a system.[12] The owner of the security interest must bear a greater recording expense, and, in view of the uncertainty shown above, the additional requirement of notation bestows no benefit on the general public since even where the registration certificate does not indicate a lien a search must nevertheless be made for a financing statement covering the chattel in order to be certain that the lienholder has not simply failed to comply with the notation statute. Rather than effecting a system of dual filing with ambiguity concerning the requisites of perfecting an interest, perhaps the court should have waited for the legislature either to provide a penalty for failing to comply with the notation statute, or to amend it to make it an exclusive type of title act.[13]

The problem of reconciling the Code's exemption provision with the non-exclusive type Certificate of Title Act is not confined to Kentucky. Of the twelve other states which have adopted the Code,[14] only six have the exclusive-type Certificate of Title Acts for which the exemption provision was designed.[15] Three do not have title acts and therefore require the use of standard Code filing.[16] However, three Code states have the non-exclusive type of statute and therefore face the problem which confronted Kentucky.[17] Among the thirty-seven states which have not adopted the

12 See Kripke, *supra* note 2; Comment, 54 MICH. L. REV. 680 (1956).

13 If the court left the notation statute without a penalty the statute would be ineffective. In view of the holding of the principal case the ideal solution for Kentucky would be to amend the notation statute to the usual exclusive form.

14 Arkansas, Connecticut, Illinois, Massachusetts, New Hampshire, New Mexico, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, and Wyoming.

15 ARK. STAT. ANN. § 75-161 (1957); CONN. GEN. STAT. ANN. § 14-190 (1958); ILL. STAT. ANN. ch. 95½, § 3-207 (Smith-Hurd 1958); N.M. STAT. ANN. § 64-5-2 (1960); OHIO REV. CODE ANN. § 4505.13 (Page 1953); PA. STAT. ANN. tit. 75, § 203 (1960).

16 Massachusetts, New Hampshire and Rhode Island.

17 OKLA. STAT. ANN. tit. 47, § 23.3 (1950) provides that notation of liens be made only on the application form for a certificate of title. The court in King-Godfrey, Inc.

Code, twelve have the non-exclusive type of Certificate of Title Act.[18] In these, as well as in the three Code states with non-exclusive title acts, amendments are needed to provide smooth integration with the Code and to avoid litigation and double filing.

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v. Rogers, 157 Okla. 216, 11 P.2d 935 (1932) held that the notation on the application form did not impart notice and that the chattel mortgage filing provisions controlled. The Oregon statute, like Oklahoma's, provides only that liens be noted on the application. ORE. REV. STAT. § 481.110 (1959). Thus standard Code filing should control. The Wyoming title act provides for notation on the certificate, but like Kentucky does not provide that such notation perfects the security interest. WYO. STAT. ANN. § 31-36 (1957).

18 DEL. CODE ANN. tit. 21, § 2333 (1953); IND. ANN. STAT. § 47-2501 (Supp. 1961); KAN. GEN. STAT. ANN. § 8-135 (Supp. 1959); MD. ANN. CODE art. 66½, § 28 (1957); MICH. COMP. LAWS §§ 257.222, .238 (a) (Supp. 1958); N.J. STAT. ANN. § 39:10-11 (c) (1961); N.C. GEN. STAT. § 20-57 (1953); N.D. CENT. CODE § 39-05-09 (1960); WASH. REV. CODE § 46.12.170 (1953); W. VA. CODE ANN. § 1721 (130) (Supp. 1960); WIS. STAT. ANN. § 342.10 (1) (b) (1958). The Texas Certificate of Title Act is also of the non-exclusive type. TEX. PEN. CODE ANN. art. 1436-1 (1953). However, it has been held to supersede the regular chattel mortgage recording provisions and would presumably be held to replace standard Code filing under the exemption provision if Texas were to adopt the Code. Higgins v. Robertson, 210 S.W.2d 250 (Tex. Civ. App. 1948). Sixteen non-Code states have the exclusive type title act for which the exemption provision was designed: ALASKA COMP. LAWS ANN. § 50-6-10 (6) (Supp. 1958); ARIZ. REV. STAT. ANN. § 28-325 (E) (1956); CAL. VEHICLE CODE § 6303; COLO. REV. STAT. ANN. § 13-6-19 (Supp. 1960); FLA. STAT. ANN. § 319.27 (1958); IDAHO CODE ANN. § 49-414 (1948); IOWA CODE § 321.50 (1958); LA. REV. STAT. ANN. § 32:710 (Supp. 1960); MO. ANN. STAT. § 443.480 (1952); MONT. REV. CODES ANN. § 53-110 (1954); NEB. REV. STAT. § 60-110 (1960); NEV. REV. STAT. § 482.450 (Supp. 1960); S.D. CODE § 44.0203 (Supp. 1960); TENN. CODE ANN. § 59-326 (1955); UTAH CODE ANN. § 41-1-87 (1960); VA. CODE ANN. § 46.1-71 (1958). The remaining nine non-Code states do not have Certificate of Title Acts and would therefore require the use of standard Code filing.