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Resolving Priority Disputes Between the IRS and the Secured Creditor Under Revised UCC Article 9: And the Winner is ...?

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RESOLVING PRIORITY DISPUTES BETWEEN THE IRS AND THE SECURED CREDITOR UNDER REVISED U.C.C. ARTICLE 9: AND THE WINNER IS . . . ?

Timothy R. Zinnecker*

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*We enter with some trepidation the tortured meanderings of federal tax lien law, intersected now by the somewhat smoother byway of the Uniform Commercial Code.*¹

I. INTRODUCTION

Judge Goldberg's observation still rings true today: one does not wander through the tax lien provisions of the Internal Revenue Code without some anxiety and uneasiness.² Moreover, the degree of dread and apprehension may induce mind-numbing trauma and uncontrollable tremors if one's journey into the Internal Revenue Code also requires a side trip through another statutory labyrinth, Article 9 of the Uniform Commercial Code ("U.C.C."). But such a pilgrimage must be undertaken when a priority dispute erupts between the IRS and a secured creditor, with each party claiming a superior property interest in the limited assets of a delinquent taxpayer.³

In an article published in 1996, I used a series of hypotheticals to analyze priority disputes between the IRS and the Article 9 secured creditor.⁴ Since that time, the rewriting of U.C.C. Article 9 has been completed, and the revised version has been enacted into law in every state.⁵ Many of the revisions have a result-changing impact on the resolution of priority disputes between the IRS and the Article 9 secured creditor.

1. *Tex. Oil & Gas Corp. v. United States*, 466 F.2d 1040, 1043 (5th Cir. 1972).

2. Other robed visitors to the Internal Revenue Code have echoed Judge Goldberg's sentiments. *See, e.g., Plymouth Savings Bank v. I.R.S.*, 187 F.3d 203, 206 (1st Cir. 1999); *Randall v. H. Nakashima & Co.*, 542 F.2d 270, 271 (5th Cir. 1976); *Cooper Indus., Inc. v. Compagnoni*, 162 F. Supp. 2d 702, 706 (S.D. Tex. 2001); *In re Estate of Harless v. United States*, 98 F. Supp. 2d 1337, 1340 (S.D. Ala. 2000); *Miller v. Conte*, 72 F. Supp. 2d 952, 956 (N.D. Ind. 1999); *Adco Serv., Inc. v. Graphic Color Plate*, 347 A.2d 549, 551 (N.J. Super. Ct. 1975).

3. One textbook notes that "[a]t any given time, delinquent taxes total some \$30 billion owed by about 4.5 million taxpayers." LYNN M. LOPUCKI & ELIZABETH WARREN, *SECURED CREDIT: A SYSTEMS APPROACH* 760 (2d ed. 1998).

4. *See Timothy R. Zinnecker, When Worlds Collide: Resolving Priority Disputes Between the IRS and the Article Nine Secured Creditor*, 63 TENN. L. REV. 585 (1996).

5. *See* U.C.C. § 9-701 (2001). The uniform version of revised Article 9 has an effective date of July 1, 2001. *Id.* Every state adopted this date as its effective date except Connecticut (October 1, 2001) and Alabama, Florida, and Mississippi (January 1, 2002). *See* UNIFORM COMMERCIAL CODE REPORTING SERVICE ("State U.C.C. Variations" Volume) xxv-xxvi (2001).

Throughout this article I refer to provisions of (i) the Internal Revenue Code, codified at Title 26 of the U.S. Code, as "I.R.C. § xxxx", (ii) revised U.C.C. Article 9 as "revised § 9-xxx", (iii) former, or pre-revised, U.C.C. Article 9 as "former § 9-xxx", and (iv) U.C.C. provisions outside of Article 9 as "U.C.C. § x-xxx."

Part II of this article describes how a federal tax lien is created in favor of the IRS. Part III examines the applicable priority rules codified in the Internal Revenue Code ("I.R.C.") and Article 9. Part IV uses a series of hypotheticals to analyze priority disputes between the IRS and the Article 9 secured party, focusing attention on changes under revised Article 9 that trigger a result different from the outcome under former Article 9. The article concludes that the changes wrought by revised Article 9 tend to favor the secured party more than the IRS in a priority dispute.

II. THE FEDERAL TAX LIEN⁶

A tax lien is not created in favor of the IRS until the tax is assessed and the taxpayer fails or refuses to make payment following demand.⁷ If a taxpayer acknowledges the tax liability on a return, assessment occurs when liability is noted on a list in the office of the IRS district director.⁸ Otherwise, assessment does not occur until (i) a tax audit reveals the deficiency, (ii) the IRS notifies the taxpayer of the deficiency, and (iii) the taxpayer admits liability or exhausts its "opportunities for administrative review."⁹

After assessment, the IRS must promptly send to the taxpayer a deficiency notice.¹⁰ If the taxpayer then fails to pay the deficiency, a lien—in an amount equal to the unpaid tax plus any additional taxes and related interest charges, penalties, and costs¹¹—becomes enforceable against the taxpayer,¹² with an effective date that relates back to the date of

6. The discussion of federal tax liens in Part II borrows heavily from my previous article. See Zinnecker, *supra* note 4, at 588–90.

7. I.R.C. § 6321 (2000) ("If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien . . ."); I.R.C. § 6322 (2000) ("[T]he lien imposed by section 6321 shall arise at the time the assessment is made . . .").

"By far the most common source of federal tax liens is payroll taxes, in the form of federal withholding taxes and social security contributions owed by employers to the U.S. government." LOPUCKI & WARREN, *supra* note 3, at 760. See also JOHN O. HONNOLD ET AL., SECURITY INTERESTS IN PERSONAL PROPERTY 534 (3d ed. 2001) ("Examples of this misconduct include . . . failing to remit sums withheld from workers for income and social security taxes.").

8. See I.R.C. § 6203 (2000); 26 C.F.R. §§ 301.6201-1, 301.6203-1 (2001).

9. DAVID G. EPSTEIN & STEVE H. NICKLES, DEBT: BANKRUPTCY, ARTICLE 9 AND RELATED LAWS 518 (1994).

10. I.R.C. § 6303 (2000).

11. I.R.C. § 6321.

12. See I.R.C. § 6331(a) (2000) (authorizing the IRS to levy on the taxpayer's property if the taxpayer "neglects or refuses to pay [its tax liability] within 10 days after notice and demand").

assessment.¹³ The lien encumbers all of the taxpayer's real and personal property,¹⁴ including property acquired by the taxpayer after assessment.¹⁵

The tax lien becomes enforceable against the taxpayer without the necessity of any filing, so its existence may come as a surprise, not only to the taxpayer but also to its creditors. In response to this so-called "secret lien," Congress added a provision to the tax laws in 1928 that protected certain parties from the adverse effects of the tax lien if the IRS had not filed a notice of its tax lien.¹⁶ That provision was the forerunner to I.R.C. § 6323(a), which states: "[t]he lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof . . . has been filed by the Secretary."¹⁷

If the lien encumbers real estate, the IRS must file its notice in the office designated by the laws of the state where the property is located.¹⁸ If the lien encumbers personal property, the IRS must file its notice in the office designated by the laws of the state of the taxpayer's residence.¹⁹ If a state has not designated a recording office for tax lien filings, then the IRS must file its notice with the federal district court for the judicial district in which the encumbered property is located.²⁰ If the encumbered property is located

13. I.R.C. § 6322 (2000) (stating the lien "shall arise at the time the assessment is made").

14. I.R.C. § 6321. State law dictates whether property "belongs" to the taxpayer and is thus subject to the tax lien. See *Aquilino v. United States*, 363 U.S. 509, 512-13 (1960); *United States v. Davenport*, 106 F.3d 1333, 1335 (7th Cir. 1997). But federal law provides a taxpayer with a list of applicable exemptions. The exemptions are codified at I.R.C. § 6334 (2000).

15. 26 C.F.R. § 301.6321-1 (2001) ("The lien attaches to all property and rights to property belonging to such person at any time during the period of the lien, *including any property or rights to property acquired by such person after the lien arises.*") (emphasis added). See also *United States v. McDermott*, 507 U.S. 447, 448 (1993); *Plymouth Sav. Bank v. I.R.S.*, 187 F.3d 203, 206 (1st Cir. 1999).

16. DOUGLAS G. BAIRD & THOMAS H. JACKSON, *SECURITY INTERESTS IN PERSONAL PROPERTY* 629 (2d ed. 1987). See also Lance Staricha, *Giving and Taking Notice: The Relative Priority and Enforceability of the Federal General Tax Lien Versus the State's Specific Real Property Tax Lien*, 21 *HAMLIN L. REV.* 469, 481 (1998) ("Because the federal general tax lien arises immediately upon the neglect or refusal by a federal taxpayer to pay an overdue liability, it has been referred to as the federal government's secret lien.").

17. I.R.C. § 6323(a) (2000). The IRS annually files approximately 1.5 million tax lien notices. LOPUCKI & WARREN, *supra* note 3, at 761.

18. I.R.C. § 6323(f)(1)(A)(i), (2)(A) (2000). This article does not analyze priority disputes in real property because Article 9 excludes from its scope the debtor's transfer of an interest in real property (other than fixtures). See U.C.C. § 9-104(j) (1995) (amended 2001); U.C.C. § 9-109(d)(11) (2001).

19. I.R.C. § 6323(f)(1)(A)(ii), (2)(B) (2000).

20. I.R.C. § 6323(f)(1)(B) (2000).

in Washington, D.C., then the IRS must file its notice with the Recorder of Deeds for the District of Columbia.²¹

The notice is effective for a period of ten years and thirty days (which commences on the assessment date, not the filing date).²² The IRS may extend the effectiveness by refileing the notice during the last year of that period.²³

III. THE PRIORITY RULES OF THE I.R.C. AND U.C.C. ARTICLE 9

The general rule for resolving priority disputes between a U.C.C. Article 9 secured party and the IRS is found in I.R.C. § 6323(a), which states: “[t]he lien imposed by section 6321 shall not be valid as against any . . . holder of a security interest . . . until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary.”²⁴

If the statute is read literally, the IRS enjoys priority over a secured creditor as soon as the IRS files its tax lien notice (at which time the tax lien becomes “valid”). But that is an incorrect interpretation.

[O]ne must read into [I.R.C. § 6323(a)] something it does not say: Tax liens and third party interests rank in the order in which they become “valid” within the meaning of the Federal Tax Lien Act. The idea of “first in time, first in right” is so basic that the drafters of I.R.C. § 6323 did not even consider it necessary to mention.²⁵

For a secured party to have any hope of winning a priority battle with the IRS, the secured party must hold a “security interest” as defined by the I.R.C.

The term “security interest” means any interest in property acquired by contract for the purpose of securing payment or performance of any obligation or indemnifying against loss or

21. I.R.C. § 6323(f)(1)(C) (2000).

22. I.R.C. § 6323(g)(1), (3) (2000).

23. I.R.C. § 6323(g)(3)(A) (2000).

24. I.R.C. § 6323(a) (2000). One court has described I.R.C. § 6323(a) as a “blueprint” for a secured creditor that seeks priority over the competing lien of the IRS. *Valley Bank of Nev. v. City of Henderson*, 528 F. Supp. 907, 911 (D. Nev. 1981).

25. LOPUCKI & WARREN, *supra* note 3, at 769. See also HONNOLD ET AL., *supra* note 7, at 269 (Teacher’s Manual) (“Although the phrase, ‘not valid . . . until notice . . . has been filed,’ is infelicitous, to say the least, it is not read to subordinate retroactively security interests that existed prior to the filing of a notice.”); James M. Wallace, Jr., *Commercial Transactions, Annual Survey of Texas Law Part I*, 45 Sw. L. J. 1419, 1457 n.285 (1992) (“This language [of I.R.C. § 6323(a)] has been interpreted to mean that a tax lien primes security interests (and the other enumerated interests) coming into existence after, *but not before*, the time that notice of the tax lien has been properly filed.”) (emphasis added).

liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.²⁶

The definition requires the secured creditor to satisfy five elements (two in the first sentence, and three in the second sentence).

Under the first sentence of the definition, a secured creditor's property interest in the taxpayer's collateral must (i) arise contractually and (ii) secure payment or performance of an obligation or indemnify a party against loss or liability. A creditor with an enforceable property interest²⁷ under Article 9 will satisfy the I.R.C.'s contractual requirement because the debtor must agree to the creation and transfer of that property interest.²⁸ And under Article 9, a secured creditor's property interest "secures payment or performance of an obligation."²⁹

Under the second sentence, (i) the collateral must exist at a particular time; (ii) at that time the secured party must have parted with money or money's worth; and (iii) at that time the secured party's property interest must be protected under local law against a subsequent judgment lien arising out of an unsecured obligation. *When read together with I.R.C. § 6321(a), the second sentence requires the secured creditor to satisfy these three elements at the moment when the IRS files its tax lien notice.*³⁰

26. I.R.C. § 6323(h)(1) (2000).

27. The U.C.C. also defines "security interest." U.C.C. § 1-201(b)(35) (2001). But the federal definition controls under the Supremacy Clause of the United States Constitution. See U.S. CONST. ART. VI, § 2. To avoid confusion, this article refers to a creditor's Article 9 security interest as a "property interest."

28. See U.C.C. § 9-203(b)(3) (2001) (stating that a secured party does not have an enforceable property interest in collateral until (i) "the debtor has authenticated a security agreement" that describes the collateral and, where appropriate, any land concerned, (ii) the secured party possesses collateral (other than a certificated security) "pursuant to the debtor's security agreement," (iii) the secured party has taken delivery of a certificated security "pursuant to the debtor's security agreement," or (iv) the secured party has control of "deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights . . . pursuant to the debtor's security agreement"); U.C.C. § 9-203(1)(a) (1995) (amended 2001) (stating that a secured party does not have an enforceable property interest in collateral until (i) the secured party possesses the collateral "pursuant to agreement," (ii) the secured party controls investment property "pursuant to agreement," or (iii) the debtor signs a "security agreement" that describes the collateral and, where appropriate, any land concerned). Both former and revised Article 9 define a "security agreement" as an agreement that "creates or provides for a security interest." U.C.C. § 9-102(a)(73) (2001); U.C.C. § 9-105(1)(f) (1995) (amended 2001). See also U.C.C. § 1-201(b)(3) (2001) (defining "agreement"); U.C.C. § 1-201(b)(12) (2001) (defining "contract").

29. U.C.C. § 1-201(b)(35) (2001).

30. See 26 C.F.R. § 301.6323(h)-1(a)(1) (2001) (stating that "a security interest must be in existence . . . before a notice of lien is filed" in order to enjoy priority under I.R.C. § 6323(a));

The secured party can prove that "property is in existence" because its Article 9 property interest does not arise until "the debtor has rights in the collateral."³¹ Also, the creditor often can satisfy the "money or money's worth" requirement because its Article 9 property interest does not exist until the creditor has given "value."³² But how does the secured party prove

Litton Indus. Automation Sys., Inc. v. Nationwide Power Corp., 106 F.3d 366, 368 (11th Cir. 1997) ("Therefore, for Highlander's interest to take priority over the tax lien, Highlander must have been the holder of a 'security interest,' as that term is defined in the [Federal Tax Lien Act of 1966, 26 U.S.C. § 6323], on July 3, 1986 [the date on which the IRS filed its tax lien notice].").

This timing requirement prevents a secured party from enjoying any priority with respect to collateral acquired by the taxpayer, or advances funded by the secured party, after the IRS files its tax lien notice. The secured party does receive limited protection for post-notice collateral and post-notice advances under I.R.C. § 6323(c) and (d). This post-notice protection is analyzed in Zinnecker, *supra* note 4, at 620–64. Other than provisions of revised Article 9 discussed *infra* in Part IV of this article that affect analysis of the "protected under local law against a subsequent judgment lien" requirement of I.R.C. § 6323(h)(1) (the definition of "security interest"), revised Article 9 does not affect the resolution of priority disputes involving post-notice collateral and post-notice advances.

Because I.R.C. § 6323(c)(1) extends protection to post-notice "accounts receivable" but not general intangibles, and as revised Article 9 redefines "account" in § 9-102(a)(2) in a manner that now includes many rights to payment that were "general intangibles" as defined in former § 9-106, one might conclude that revised Article 9 improves the secured party's priority position against the IRS if both creditors claim an interest in the taxpayer's post-notice accounts receivable. Alas, that is not the case because the Article 9 definition of "accounts" is irrelevant. The scope of the secured creditor's post-notice protection is constrained by the narrow definition of "accounts receivable" found at 26 C.F.R. § 301.6323(c)-1(c)(2)(ii) (2001) ("An account receivable is any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper.").

31. U.C.C. § 9-203(b)(2) (2001); U.C.C. § 9-203(1)(c) (1995) (amended 2001). "Under [U.C.C. § 9-204], there can be no UCC security interest in property if the debtor at the time of its purported creation has no rights therein. It would seem that subsection 6323(h)(1) is trying to say the same thing in the words 'property is in existence.'" Peter F. Coogan, *The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code*, 81 HARV. L. REV. 1369, 1383 (1968).

32. See U.C.C. § 9-203(b)(1) (2001); U.C.C. § 9-203(1)(b) (1995) (amended 2001). I say "often can satisfy" rather than "always can satisfy" because "value" under U.C.C. § 1-204 (2001) means more than just "money or money's worth." But a creditor that sells an item or provides a service to the taxpayer on credit, or a lender that advances funds to the taxpayer, has given "value" under the U.C.C. and parted with "money or money's worth" under the I.R.C.

For purposes of [I.R.C. § 6323(h)(1)], the term "money or money's worth" includes money, a security (as defined in paragraph (d) of this section), tangible or intangible property, services, and other consideration reducible to a money value. Money or money's worth also includes any consideration which otherwise would constitute money or money's worth under the preceding sentence which was parted with before the security interest would otherwise exist if, under local law, past consideration is sufficient to support an agreement giving rise to a security interest. A relinquishing or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of

that its property interest is “protected under local law” against a judgment lien?

For the secured party, the applicable “local law” is the U.C.C.,³³ particularly any provision of Article 9 that resolves a priority dispute between the secured party and the holder of a judgment lien. Former Article 9 codified such a priority rule at § 9-301(1)(b).³⁴ Under that rule, a “lien creditor”³⁵ enjoyed priority if its property interest arose before the secured creditor perfected its property interest. Rephrased, the secured creditor enjoyed priority if its property interest was perfected no later than the moment when the lien creditor acquired its competing property interest in the debtor’s assets.³⁶ To be perfected under former Article 9, a secured

dower or curtesy, or of other marital rights is not a consideration in money or money’s worth. Nor is love and affection, promise of marriage, or any other consideration not reducible to a money value a consideration in money or money’s worth.

26 C.F.R. § 301.6323(h)-1(a)(3) (2001).

33. See *Slodov v. United States*, 436 U.S. 238, 257 n.22 (1978) (“The local law applicable is . . . the Uniform Commercial Code (UCC) . . .”); *Citizens State Bank & Trust Co. v. Motor Serv. Co.*, 902 F. Supp. 1435, 1436 n.2 (D. Kan. 1995) (same); *In re Dorrough, Parks & Co.*, 173 B.R. 135, 138 n.5 (Bankr. E.D. Tenn. 1994) (“The applicable local law is Tennessee’s version of Article 9 of the Uniform Commercial Code.”); Olivia F. Gallo, *Conflict Between the Uniform Commercial Code and the Federal Tax Lien Act*, 7 WHITTIER L. REV. 1009, 1028 (1985) (“protected under the local law, i.e., perfected pursuant to the Uniform Commercial Code . . .”).

34. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

35. I.R.C. § 6323(h)(1) (2000) refers to a “judgment lien,” but former § 9-301(1)(b) refers to a “lien creditor” (defined at former § 9-301(3) as “a creditor who has acquired a lien on the property involved by attachment, levy or the like”). The difference in terminology is irrelevant. See *In re Haas*, 31 F.3d 1081, 1087 (11th Cir. 1994) (“In interpreting the phrase ‘protected under local law against a subsequent judgment lien,’ courts and commentators have determined the phrase is equivalent to being protected against a ‘lien creditor’ as defined in U.C.C. § 9-301(3).”); *First Nat’l Bank of Valdosta v. Elgin*, 570 F. Supp. 849, 852 (N.D. Fla. 1983) (citing cases); Coogan, *supra* note 31, at 1382–83 (“Although the two phrases are not the same, we can assume that, for purposes of subsection (a), subsection 6323(h)(1)’s ‘protected against’ the holder of a ‘subsequent judgment lien’ means substantially the same as ‘protected against’ section 9-301(3)’s ‘lien creditor.’”).

36. This general priority rule was subject to an exception that applied if (i) the lien creditor’s property interest arose after the secured party’s property interest attached and before it became perfected; (ii) the secured party’s property interest was a purchase money security interest (defined at U.C.C. § 9-107 (1995) (amended 2001)); and (iii) the secured party perfected its property interest by filing a financing statement no later than ten days after the debtor took possession of the collateral. See U.C.C. § 9-301(1) (1995) (amended 2001) (“Except as otherwise provided in subsection (2)”); U.C.C. § 9-301(2) (1995) (amended 2001) (discussed *infra* at Part IV.A.3.b.).

The typical purchase money security interest (often referred to as a PMSI) arises when (i) a seller retains a property interest in goods sold on credit to secure repayment of the unpaid purchase price or (ii) a lender retains a property interest in goods purchased by a buyer with the lender’s money.

party had to prove that its property interest had become enforceable against the debtor (i.e., “attached”) and the creditor had taken any other applicable step required by Article 9 (e.g., filing a financing statement).³⁷ So for its property interest to be protected “under local law against a subsequent judgment lien” (and therefore be a “security interest” as defined by the I.R.C.) under former Article 9, the secured party had to prove that its property interest was perfected no later than when the IRS filed its tax lien notice.

Revised Article 9 has amended the rule governing priority disputes between a secured party and a lien creditor.³⁸ Under revised § 9-317(a)(2), a secured creditor continues to enjoy priority over the competing claim of a lien creditor if the secured creditor’s property interest is perfected when the lien creditor’s property interest arises.³⁹ This rule is no different than the predecessor rule in former Article 9. But, under an alternative test, revised Article 9 also awards priority to a secured creditor that has satisfied two requirements no later than when the lien creditor’s property interest arose. First, the secured party must have filed a financing statement against the collateral.⁴⁰ Second, the secured party must have satisfied one of the four conditions of revised § 9-203(b)(3):⁴¹ (1) “the debtor has authenticated a security agreement” that describes the collateral and, if applicable, the land concerned;⁴² (2) the secured party possesses collateral other than a certificated security;⁴³ (3) “the collateral is a certificated security in registered form,” that “has been delivered to the secured party;”⁴⁴ or (4) the secured party has control of the collateral consisting of “deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights.”⁴⁵ This revision effectively awards priority to a secured party who is

37. See U.C.C. § 9-303(1) (1995) (amended 2001). Filing a financing statement is the most common, but not the exclusive, method of perfecting a security interest. Subject to relevant statutory requirements, a creditor can perfect its security interest by taking possession of collateral, taking control of collateral, or complying with a federal or state registration scheme. In a few instances (most notably purchase money security interests in consumer goods), a security interest becomes automatically perfected at the moment of attachment. See generally statutes cited in U.C.C. § 9-303(1) (1995) (amended 2001).

38. Revised Article 9 makes no change to the definition of “lien creditor,” now found at U.C.C. § 9-102(a)(52) (2001).

39. U.C.C. § 9-317(a)(2)(A) (2001).

40. U.C.C. § 9-317(a)(2)(B) (2001).

41. *Id.*

42. U.C.C. § 9-203(b)(3)(A) (2001).

43. *Id.* § 9-203(b)(3)(B).

44. *Id.* § 9-203(b)(3)(C).

45. *Id.* § 9-203(b)(3)(D).

unperfected when the lien creditor's property interest arises solely because the secured party has not yet given value.⁴⁶

Does the revised priority rule aid a secured party in a priority dispute with the IRS? Not at all. Notwithstanding the secured party's ability to prove that its property interest is protected under local law against the competing property claim of a lien creditor, the secured party still must satisfy all of the other elements of the I.R.C.'s definition of "security interest." One of those elements requires the secured party to part with "money or money's worth."⁴⁷ A secured party that has yet to give "value" under the U.C.C. has not yet parted with "money or money's worth." Therefore, the secured creditor does not yet have a "security interest" under the I.R.C. and would not enjoy priority in a property dispute with the IRS (even though the secured party might enjoy priority under revised § 9-317(a)(2) against any *other* lien creditor).

Because the revised priority rule of revised § 9-317(a)(2)(B) fails to aid a secured party that is involved in a priority dispute with the IRS, the secured party's degree of protection under local law against a lien creditor is identical under both former and revised Article 9: to enjoy priority, the secured creditor's property interest must be perfected no later than when the lien creditor's property interest arises.⁴⁸

Under both former and revised Article 9, the secured creditor will not enjoy priority over the competing claim of the IRS unless the secured creditor has perfected its property interest no later than the moment when the IRS files its tax lien notice. As revised Article 9 has not changed the priority rule, one might conclude that the resolution of every priority dispute between the IRS and the secured party should render an identical result under both former and revised Article 9. But as Part IV reveals, that conclusion is erroneous.

46. See U.C.C. § 9-317 cmt. 4 (2001) (explaining purpose for changing priority rule); see also U.C.C. § 9-203(b)(1) (2001) (stating elements of enforceability, including "value has been given"); U.C.C. § 9-308(a) (2001) (requiring attachment as a predicate to perfection); U.C.C. § 9-203(a) (2001) (indicating "[a] security interest attaches . . . when it becomes enforceable").

47. I.R.C. § 6323(h)(1) (2000).

48. See U.C.C. § 9-317(a)(2)(A) (2001); U.C.C. § 9-301(1)(b) (1995) (amended 2001). As noted earlier, former Article 9 provided an exception applicable to purchase money security interests. See *supra* note 36. Revised Article 9 has a similar, although not identical, exception. See U.C.C. § 9-317(e) (2001). This exception under both former and revised Article 9 is discussed *infra* at Part IV.A.3.b.

IV. CHANGING THE RULES, REVERSING THE RESULTS

The priority rule that resolves a dispute between the Article 9 secured party and the IRS is identical under both former Article 9 and revised Article 9. If the secured party is perfected when the IRS files its tax lien notice, the secured party has priority. If the secured party is not yet perfected when the IRS files its tax lien notice, the tax lien is superior.⁴⁹

One cannot apply the priority rule without knowing the perfection rules. Although the *priority* rules of revised § 9-317(a)(2) and former § 9-301(1)(b) are uniform (at least when the IRS is the opposing creditor), the *perfection* rules are not. Moreover, many of the changes reverse the priority enjoyed by the secured party or the IRS under former Article 9.

Most of the result-altering changes have been made to the filing rules of Article 9 and are analyzed in Part A. A few of the changes that reverse priority have been made to the non-filing rules of Article 9 and are analyzed in Part B. The analytical format is consistent throughout Parts A and B. A specific perfection rule of former Article 9 is introduced, followed by a discussion of any problems that the secured party encountered under the rule. Then the relevant perfection rule of revised Article 9 is stated, with an explanation of how the successor rule addresses the problems raised by its predecessor. The former and revised rules are then applied to resolve a hypothetical dispute between the IRS and the secured creditor, the outcome of which illustrates that the change in rules also has changed the priority.

A. *Changes to the Filing Rules*

Four changes that affect the contents of a financing statement are analyzed in Section 1. Two changes that concern the filing location are examined in Section 2. Three other filing-related changes are reviewed in Section 3.

1. Content-based filing revisions

a. *Debtor's name*

A financing statement must provide the name of the debtor.⁵⁰ Because the filing clerk records the financing statement by the debtor's name,⁵¹

49. See generally, *supra* Part III.

50. U.C.C. § 9-502(a)(1) (2001); U.C.C. § 9-402(1) (1995) (amended 2001).

51. U.C.C. § 9-519(c)(1) (2001); U.C.C. § 9-403(4) (1995) (amended 2001).

accuracy in stating the debtor's name is paramount. Otherwise, the filing may not accomplish its goal of providing notice to searchers.⁵²

Occasionally a secured party erroneously records the debtor's name when preparing the financing statement. For example, the debtor's name may be reflected on the filing as "Bois Clair Corporation" instead of the legal name of "Boisclair Corporation,"⁵³ or "Voyager Trading Co." instead of the legal name of "Voyageur Trading Co."⁵⁴ Also, the secured party may accurately reflect the debtor's name on the financing statement, but during the term of the loan the debtor may change its legal name (e.g., from "Sharbill, Inc." to "Falk Interiors, Inc.,"⁵⁵ or from "Bass Plumbing, Heating and Cooling, Inc." to "Bass Mechanical Contractors, Inc."⁵⁶). What effect does an initial mistake or a subsequent name change have on the effectiveness of the financing statement (and the secured party's perfection)?

Under former Article 9, an initial financing statement that erroneously stated the debtor's name was ineffective to perfect a security interest if the error was "seriously misleading."⁵⁷ If a debtor subsequently changed its name in such a manner that the initial financing statement became "seriously misleading," the financing statement was ineffective "to perfect a security interest in collateral acquired by the debtor more than four months after the [name] change."⁵⁸ But former Article 9 made no attempt to define "seriously misleading," leaving the task to judicial resolution. Not surprisingly, the courts failed to adopt a uniform standard, resulting in inconsistent (and perhaps even irrational) holdings.⁵⁹

Revised Article 9 also adopts a "seriously misleading" test against which errors and name changes are measured.⁶⁰ But unlike its predecessor, revised Article 9 provides a standard against which the nature of an error or name change can be measured:

52. See *ITT Commercial Fin. Corp. v. Unlimited Auto. Inc.*, 166 B.R. 637, 641 (Bankr. N.D. Ill. 1994) (stating that "[t]he purpose behind the filing provisions is to provide notice to subsequent creditors"); Lois R. Lupica, *Asset Securitization: The Unsecured Creditor's Perspective*, 76 TEX. L. REV. 595, 617 n.114 (1998) ("The purpose of the filing requirement is to provide notice to the public and to the debtor's other creditors of the status of the transferred assets taken as collateral or sold.").

53. *Chem. Bank v. Title Serv., Inc.*, 708 F. Supp. 245 (D. Minn. 1989).

54. *Corporate Financers, Inc. v. Voyageur Trading Co.*, 519 N.W.2d 238 (Minn. Ct. App. 1994).

55. *In re Falk Interiors, Inc.*, 61 B.R. 720 (Bankr. W.D. Wis. 1986).

56. *In re Bass Mech. Contractors, Inc.*, 84 B.R. 1009 (Bankr. W.D. Ark. 1988).

57. U.C.C. § 9-402(8) (1995) (amended 2001).

58. U.C.C. § 9-402(7) (1995) (amended 2001).

59. See Zinnecker, *supra* note 4, at 594-95 n.42, 598-99 n.62 (summarizing cases).

60. U.C.C. § 9-506(a)-(b) (2001); U.C.C. § 9-507(c) (2001).

If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a), the name provided does not make the financing statement seriously misleading.⁶¹

In other words, a financing statement is seriously misleading if a search against the debtor's correct name fails to disclose the filing.

The following example illustrates how this change in law may adversely affect a secured party involved in a priority dispute with the IRS.

Hypothetical #1

On March 1, Bank loaned \$100,000 to Thriftway Auto Supply, Inc. The loan was secured by an enforceable security interest in Thriftway's present and future inventory and accounts. That same day, Bank filed with the appropriate clerk a financing statement, naming the debtor as "Thriftway Auto Stores." The IRS filed a tax lien notice against Thriftway on October 1.

In a dispute between Bank and the IRS concerning Thriftway's inventory and accounts as of October 1, whose interest enjoys priority if a search against "Thriftway Auto Supply, Inc." does not reveal the filing against "Thriftway Auto Stores"?

Under the I.R.C., Bank has priority if it holds a "security interest" in the collateral when the IRS filed its tax lien notice.⁶² In order to hold a "security interest" under the I.R.C., Bank's interest must enjoy priority under the U.C.C. against a lien creditor as of October 1.⁶³

Under former Article 9, whether Bank's property interest in the collateral is perfected turns on whether the erroneous statement of the debtor's name on the filing has rendered the filing "seriously misleading."⁶⁴ In the case in which a secured party made the identical error, the court held that the error was not "seriously misleading" (even though a search against the debtor's legal name failed to reveal the filing) and, as a result, the secured party was

61. U.C.C. § 9-506(c) (2001). Revised § 9-503(a) provides rules for determining the "debtor's correct name." The rules vary with the nature of the debtor (e.g., a "registered organization" as defined in revised § 9-102(a)(70), a decedent's estate, a trust or trustee, and all others—including partnerships and individuals).

62. I.R.C. § 6323(a) (2000).

63. I.R.C. § 6323(h)(1)(A) (2000).

64. U.C.C. § 9-402(8) (1995) (amended 2001).

perfected.⁶⁵ Armed with this precedent, a court could hold that Bank is perfected and its property interest is protected against the competing claim of a lien creditor as of October 1.⁶⁶ Therefore, Bank would enjoy priority under former Article 9 because Bank had a “security interest” under the I.R.C. on the filing date of the tax lien notice.⁶⁷

Under revised Article 9, Bank’s perfected status also turns on whether its financing statement is “seriously misleading.”⁶⁸ Bank’s financing statement is “seriously misleading” because a search against the debtor’s legal name failed to reveal the filing.⁶⁹ Because Bank’s security interest is unperfected, its property interest is subordinate to the competing property interest of a lien creditor.⁷⁰ Therefore, the federal tax lien is superior under revised Article 9 because Bank did not hold a “security interest” under the I.R.C. as of October 1.⁷¹

b. Addresses of parties

Former Article 9 required a financing statement to provide “a mailing address of the debtor” and “an address of the secured party from which information concerning the security interest may be obtained.”⁷² A filing that lacked either piece of information might be rejected (hopefully prompting the secured party to refile a corrected financing statement). The clerk also might record the defective filing. Even so, some courts held that omission of either party’s address rendered the filing ineffective, leaving the secured party unperfected (absent perfection by some other means).⁷³

65. See *In re Thriftway Auto Supply, Inc.*, 159 B.R. 948, 953–54 (Bankr. W.D. Okla. 1993) (noting the difference between the two names was “slight,” and holding that the creditor’s search against only the legal name “was not reasonably diligent” when a slightly broader search—e.g., against “Thriftway”—would have revealed the earlier filing).

66. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

67. I.R.C. § 6323(a) (2000).

68. U.C.C. § 9-506(a) (2001).

69. U.C.C. § 9-506(c) (2001); see also G. Ray Warner, *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, 9 AM. BANKR. INST. L. REV. 3, 36 (2001) (suggesting that the new standard “will make it easier . . . to attack financing statements with errors in the debtor’s name”).

70. U.C.C. § 9-317(a)(2)(A) (2001).

71. I.R.C. § 6323(a) (2000).

72. U.C.C. § 9-402(1) (1995) (amended 2001).

73. See, e.g., *In re Permian Anchor Servs., Inc.*, 649 F.2d 763, 766 (10th Cir. 1981) (concluding absence of debtor’s address was fatal error); *In re Keefer*, 26 B.R. 597, 598 (Bankr. D. Idaho 1983) (concluding absence of debtor’s address was fatal error); *In re L & K Transp. Co.*, 8 B.R. 921, 923 (Bankr. D. Mass. 1981) (concluding absence of debtor’s address was fatal error); *Strevell-Paterson Fin. Co. v. May*, 422 P.2d 366, 369–70 (N.M. 1967) (concluding omission of secured party’s address was fatal). Some courts refused to adopt a per se rule, instead preferring to review the particular facts of the case to determine whether the defect

Under revised Article 9, a filing officer “shall refuse to accept” a financing statement that omits either party’s address.⁷⁴ Notwithstanding the non-discretionary nature of the duty to reject, the filing clerk may, however, record the financing statement. If recorded, the financing statement is effective,⁷⁵ even though the filing fails to provide an address for the debtor or the secured party.⁷⁶

The following example illustrates that this change may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #2

Bank loaned \$100,000 to Dealer on March 1, taking an enforceable security interest in Dealer’s existing and future inventory. That same day, Bank submitted a financing statement to the appropriate clerk. Although the filing omitted Dealer’s mailing address, the clerk recorded the financing statement.

Bank also loaned \$20,000 to Clinic on March 1, taking an enforceable security interest in Clinic’s existing and future equipment. That same day,

undermined the notice function of the filing. *See, e.g., In re Fowler*, 407 F. Supp. 799, 805 (W.D. Okla. 1975) (“Clearly, the view that the omission of a debtor’s address from a financing statement does not prevent it from perfecting a security interest is the better view.”); *Riley v. Miller*, 549 S.W.2d 314, 316 (Ky. Ct. App. 1977) (concluding omission of both addresses was not fatal in absence of evidence that omission was prejudicial).

74. U.C.C. § 9-520(a) (2001) (cross-referencing “reason[s] set forth in Section 9-516(b)”); U.C.C. § 9-516(b)(4) (2001) (describing a financing statement that “does not provide a . . . mailing address for the secured party of record”); U.C.C. § 9-516(b)(5)(a) (2001) (describing a financing statement that fails to “provide a mailing address for the debtor”).

75. *See* U.C.C. § 9-520(c) (2001). A secured party’s interest that is perfected by the filing may nevertheless be subordinate to the competing interest of another secured party if (i) the filing contains erroneous information required by revised § 9-516(b)(5) and (ii) the other secured party gave value in reasonable reliance on the erroneous information. U.C.C. §§ 9-520(c), -338(1) (2001). A lien creditor is not a party protected by revised § 9-338. Subsection (1) protects a holder of a “conflicting perfected security interest” and subsection (2) protects a “purchaser” (a party to a “voluntary transaction creating an interest in property”). U.C.C. §§ 9-338, 1-201(b)(29) (2001) (emphasis added).

76. Unlike former Article 9, revised Article 9 does not require the financing statement to provide addresses for the debtor and the secured party. *See* U.C.C. § 9-502(a) (2001) (requiring the debtor’s name, the name of the secured party or its representative, and a collateral description). But the filing clerk has the statutory authority to reject such a filing (in addition to other filings described in revised § 9-516(b)) under revised § 9-520(a) because:

[t]he information required by Section 9-516(b)(5) assists searchers in weeding out “false positives,” i.e., records that a search reveals but which do not pertain to the debtor in question. It assists filers by helping to ensure that the debtor’s name is correct and that the financing statement is filed in the proper jurisdiction.

U.C.C. § 9-520 cmt. 3 (2001).

Bank submitted a financing statement to the appropriate clerk. Although the filing omitted Bank's mailing address, the clerk recorded the financing statement. The IRS filed a tax lien notice against Dealer and Clinic on October 1.

In a dispute between Bank and the IRS concerning inventory that Dealer acquired before October 1, whose interest enjoys priority? In a dispute between Bank and the IRS concerning equipment that Clinic acquired before October 1, whose interest is superior?

Under the I.R.C., Bank has priority if it holds a "security interest" in Dealer's inventory and Clinic's equipment when the IRS filed its tax lien notice.⁷⁷ In order to hold a "security interest" under the I.R.C., Bank's interests must enjoy priority under the U.C.C. against a lien creditor as of October 1.⁷⁸

Under former Article 9, Bank's property interests in Dealer's inventory and Clinic's equipment might be unperfected because Bank's financing statements omit an address of one of the parties.⁷⁹ If Bank's property interests are unperfected, its interests in the inventory and equipment are subordinate to the interests of a lien creditor.⁸⁰ Accordingly, the IRS would enjoy priority in Dealer's inventory and Clinic's equipment under former Article 9 because Bank did not have a "security interest" under the I.R.C. as of October 1.⁸¹

Under revised Article 9, Bank's property interests in Dealer's inventory and Clinic's equipment are perfected because a financing statement that omits a mailing address of either party is effective upon filing.⁸² Because Bank's property interests are perfected before October 1, its interests in Dealer's inventory and Clinic's equipment enjoy priority over the competing claims of a lien creditor.⁸³ Therefore, Bank's property interest in Dealer's inventory and Clinic's equipment is superior under revised Article 9 because Bank holds a "security interest" under the I.R.C. as of October 1.⁸⁴

77. I.R.C. § 6323(a) (2000).

78. I.R.C. § 6323(h)(1)(A) (2000).

79. U.C.C. § 9-402(1) (1995) (amended 2001).

80. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

81. I.R.C. § 6323(a).

82. U.C.C. § 9-520(c) (2001).

83. U.C.C. § 9-317(a)(2)(A) (2001).

84. I.R.C. § 6323(a).

c. Collateral description

Under former Article 9, a financing statement had to “reasonably identify” the collateral by item or type.⁸⁵ To describe collateral by “type,” creditors used one or more generic terms defined by and used in Article 9 to describe collateral (e.g., “accounts,” “equipment,” and “inventory”). But case law consistently held that a supergeneric description—such as “all of the debtor’s assets” or “all of the debtor’s personal property”—was overly broad or too vague and failed to reasonably identify the collateral by type, rendering the financing statement ineffective and the secured party often unperfected.⁸⁶

Like its predecessor, revised Article 9 also requires a financing statement to “reasonably identify” the collateral.⁸⁷ While revised Article 9 continues to prohibit supergeneric collateral descriptions in a security agreement,⁸⁸ it expressly approves the use of supergeneric collateral descriptions in a financing statement.⁸⁹

85. U.C.C. § 9-110 (1995) (amended 2001) (indicating a collateral description is sufficient “if it reasonably identifies what is described”); U.C.C. § 9-402(1) (1995) (amended 2001) (requiring a financing statement to contain “a statement indicating the types, or describing the items, of collateral”).

86. See, e.g., *In re Boogie Enters., Inc.*, 866 F.2d 1172, 1174–75 (9th Cir. 1989) (holding “personal property” insufficient to perfect interest in settlement proceeds); *Lehigh Press, Inc. v. Nat’l Bank of Ga.*, 389 S.E.2d 376, 378 (Ga. Ct. App. 1989) (ruling “all personal property” failed to describe debtor’s accounts); cf. *In re Legal Data Sys., Inc.*, 135 B.R. 199, 201 (Bankr. D. Mass. 1991) (“One of the basic words in English is ‘all.’ It is actually easier to understand ‘all’ than a compilation of all of the U.C.C. generics. Why must a security document state 1+1+1 when 3 is easily understood?”).

87. U.C.C. § 9-108(a) (2001) (indicating a collateral description is sufficient “if it reasonably identifies what is described”); U.C.C. § 9-502(a)(3) (2001) (“[A] financing statement is sufficient only if it . . . indicates the collateral covered by the financing statement.”). Unlike its predecessor, revised Article 9 does not require a description only by “item” or “type.” Examples of reasonable identifications are found in revised § 9-108(b). One example permits a description by “type,” subject to narrow exceptions. U.C.C. § 9-108(b)(3), (e) (2001).

88. U.C.C. § 9-108(c) (2001) (“A description of collateral as ‘all the debtor’s assets’ or ‘all the debtor’s personal property’ or using words of similar import does not reasonably identify the collateral.”).

89. U.C.C. § 9-504(2) (2001) (“A financing statement sufficiently indicates the collateral that it covers if the financing statement provides . . . an indication that the financing statement covers all assets or all personal property.”). The Official Comments moot any argument that the prohibition in revised § 9-108(c) against supergeneric collateral descriptions applies to financing statements. See U.C.C. § 9-108 cmt. 2 (2001) (“[S]ubsection (c) . . . follows prevailing case law and adopts the view that an ‘all assets’ or ‘all personal property’ description for purposes of a *security agreement* is *not* sufficient. Note, however, that under Section 9-504, a *financing statement* sufficiently indicates the collateral if it ‘covers all assets or all personal property.’”).

The following example illustrates that this change in law may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #3

Bank loaned \$100,000 to Debtor on March 1, taking an enforceable security interest in all of Debtor's personalty. The security agreement, which included an after-acquired property clause, described the collateral as "accounts, chattel paper, documents, equipment, general intangibles, instruments, inventory, investment property, and letter-of-credit rights."⁹⁰ That same day, Bank took possession of Debtor's instruments⁹¹ and filed with the appropriate clerk a financing statement against "all of Debtor's personal property." The IRS filed a tax lien notice against Debtor on October 1.

In a dispute between Bank and the IRS concerning the collateral acquired by Debtor prior to October 1 and not in Bank's possession, whose property interest is senior?

Under the I.R.C., Bank enjoys priority in the non-possessory collateral if it holds a "security interest" when the IRS filed its tax lien notice.⁹² In order to hold a "security interest" under the I.R.C., Bank's interest must enjoy priority under the U.C.C. against a lien creditor as of October 1.⁹³

90. Under revised Article 9, a secured party taking an interest in all of the debtor's personalty will add two other generic types of collateral excluded from the scope of former Article 9: deposit accounts and commercial tort claims. U.C.C. § 9-104(k) (1995) (amended 2001) (excluding tort claims); U.C.C. § 9-104(l) (1995) (amended 2001) (excluding deposit accounts except as provided with respect to proceeds and priorities in proceeds); U.C.C. § 9-109(d)(12) (2001) (excluding tort claims "other than a commercial tort claim"); U.C.C. § 9-109(d)(13) (2001) (excluding "an assignment of a deposit account in a consumer transaction"); *see also* U.C.C. § 9-102(a)(13) (2001) (defining "commercial tort claim"); U.C.C. § 9-102(a)(29) (2001) (defining "deposit account"); U.C.C. § 9-108(e) (2001) (indicating that mere reference to a "commercial tort claim" is an inadequate description); U.C.C. § 9-204(b)(2) (2001) (stating that a security interest in a commercial tort claim will not attach under an after-acquired property clause).

91. Under former Article 9, the only method of perfecting a security interest in instruments was possession. *See* U.C.C. § 9-304(1) (1995) (amended 2001). Although revised Article 9 permits a secured party to perfect its security interest in instruments by filing, *see* revised § 9-312(a), possession will enhance the secured party's priority against selected claimants. *See, e.g.,* U.C.C. § 9-330(d) (2001) (awarding priority to a purchaser of an instrument who takes possession); U.C.C. § 9-331(a) (2001) (awarding priority to a "holder in due course" (who, as a "holder" under U.C.C. § 1-201(b)(21)(A) (2001), must have possession)).

92. I.R.C. § 6323(a) (2000).

93. I.R.C. § 6323(h)(1)(A) (2000).

Under former Article 9, Bank's non-possessory interest is unperfected because Bank's financing statement failed to reasonably identify the collateral.⁹⁴ Because Bank is unperfected, its security interest is subordinate to the interest of a lien creditor.⁹⁵ The IRS would enjoy priority under former Article 9 because Bank did not have a "security interest" under the I.R.C. as of October 1.⁹⁶

Under revised Article 9, Bank's non-possessory interest is perfected by the financing statement because a supergeneric collateral description is sufficient to reasonably identify the collateral.⁹⁷ Because Bank's security interest is perfected before October 1, its interest takes priority over the competing claim of a lien creditor.⁹⁸ Therefore, Bank has a superior property interest under revised Article 9 because Bank holds a "security interest" under the I.R.C. as of October 1.⁹⁹

d. Debtor's signature

Former Article 9 required a debtor to sign the financing statement.¹⁰⁰ The clerk might reject a filing that lacked the debtor's signature (hopefully prompting the secured party to timely remedy the defect). The clerk also might record the defective filing. But even if the defective statement was recorded, omission of the debtor's signature rendered the filing ineffective and the secured party unperfected (unless perfected by some other means).¹⁰¹

In an effort to better accommodate electronic commerce and facilitate paperless filing, revised Article 9 no longer requires a debtor to sign a financing statement.¹⁰² To be effective, the debtor must authorize the

94. See *supra* note 83 and accompanying text.

95. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

96. I.R.C. § 6323(a).

97. U.C.C. § 9-504 (2001).

98. U.C.C. § 9-317(a)(2)(A) (2001).

99. I.R.C. § 6323(a).

100. U.C.C. § 9-402(1) (1995) (amended 2001).

101. See, e.g., *Sommers v. Int'l Bus. Machs.*, 640 F.2d 686, 689 (5th Cir. 1981) (holding absence of debtor's signature rendered financing statement defective); *In re Ace Sports Mgmt.*, L.L.C., 271 B.R. 134, 155-56 (Bankr. E.D. Ark. 2001) (holding absence of debtor's signature rendered financing statement defective); *Guardian State Bank v. Lambert*, 834 P.2d 605, 607-08 (Utah Ct. App. 1992) (holding absence of debtor's signature rendered financing statement defective). Courts consistently refused to excuse the signature omission under former § 9-402(8). See, e.g., *In re Garrow*, 50 B.R. 799, 800 (Bankr. D. Vt. 1985) (concluding that the signature omission is a failure of substantial compliance and seriously misleading); *Southwest Bank of Omaha v. Moritz*, 277 N.W.2d 430, 435 (Neb. 1979) (holding that "the filing of a financing statement which is not signed by the owner of the collateral . . . is insufficient to perfect the security interest").

102. U.C.C. § 9-502(a) & cmt. 3 (2001).

filing.¹⁰³ But the debtor's execution or other authentication of the security agreement constitutes authorization to file a financing statement against collateral described in the security agreement.¹⁰⁴

The following example illustrates that these changes in law may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #4

Bank loaned \$20,000 to Clinic on March 1, taking an enforceable security interest in Clinic's existing and future equipment. That same day, Bank submitted a financing statement to the appropriate clerk. Although Clinic did not sign the filing, the clerk recorded the financing statement. The IRS filed a tax lien notice against Clinic on October 1.

In a dispute between Bank and the IRS concerning equipment that Clinic acquired before October 1, whose interest enjoys priority?

Under the I.R.C., Bank has priority if it holds a "security interest" in the equipment when the IRS filed its tax lien notice.¹⁰⁵ In order to hold a "security interest" under the I.R.C., Bank's interest must enjoy priority under the U.C.C. against a lien creditor as of October 1.¹⁰⁶

Under former Article 9, Bank's interest in Clinic's equipment is unperfected because its financing statement is defective: it is not signed by Clinic.¹⁰⁷ Because Bank's property interest is unperfected, its interest in the equipment is subordinate to the interest of a lien creditor.¹⁰⁸ The IRS would enjoy priority in Clinic's equipment under former Article 9 because Bank did not have a "security interest" under the I.R.C. as of October 1.¹⁰⁹

Under revised Article 9, Bank's interest in Clinic's equipment is perfected because Clinic need only authorize, rather than sign, the financing statement, and the necessary authorization is found in Clinic's authentication of the security agreement.¹¹⁰ Because Bank's property interest is perfected before October 1, its interest in Clinic's equipment is superior to the competing claim of a lien creditor.¹¹¹ Therefore, Bank

103. U.C.C. § 9-509(a)(1) (2001).

104. U.C.C. § 9-509(b)(1) (2001).

105. I.R.C. § 6323(a) (2000).

106. I.R.C. § 6323(h)(1)(A) (2000).

107. U.C.C. § 9-402(1) (1995) (amended 2001).

108. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

109. I.R.C. § 6323(a).

110. U.C.C. § 9-509(a)(1), (b)(1) (2001).

111. U.C.C. § 9-317(a)(2)(A) (2001).

enjoys priority in Clinic's equipment under revised Article 9 because Bank holds a "security interest" under the I.R.C. as of October 1.¹¹²

2. Location-based filing revisions

a. *Interstate transactions*

A debtor may have a nexus with more than one state. For example, a corporate debtor may be chartered under Delaware law, operate plants in Texas, Florida, and California, and have its chief executive office in New York. A lender that intends to make a secured loan to such a debtor must ask itself: Where should I file my financing statement(s)?

Former Article 9 adopted rules that varied with the type of collateral. For example, a "collateral location test" applied if the collateral included "documents, instruments, letters of credit, and ordinary goods" (e.g., inventory and equipment),¹¹³ and a "debtor location test" applied when the collateral consisted of accounts, general intangibles, and mobile goods.¹¹⁴ Other rules governed goods covered by a certificate of title, chattel paper, minerals, and investment property.¹¹⁵ These rules raised a host of concerns for the secured party:

1. Q: When is a good "ordinary" (and subject to a collateral location test), rather than "mobile" (and subject to a debtor location test)?

A: Goods are ordinary unless they are covered by a certificate of title, mobile, or minerals.¹¹⁶

Q: When are goods mobile?

A: Goods are mobile if they are "of a type normally used in more than one jurisdiction, . . . are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title."¹¹⁷

112. I.R.C. § 6323(a).

113. U.C.C. § 9-103(1)(a), (b) (1995) (amended 2001).

114. U.C.C. § 9-103(3)(a), (b) (1995) (amended 2001).

115. U.C.C. § 9-103(2), (4), (5), (6) (1995) (amended 2001) (respectively).

116. U.C.C. § 9-103(1)(a) (1995) (amended 2001).

117. U.C.C. § 9-103(3)(a) (1995) (amended 2001).

Q: Does the debtor's actual use, or an industry standard, dictate whether goods are "of a type normally used in more than one jurisdiction"?

A: An industry standard.¹¹⁸

2. Q: Where is a debtor located for purposes of the debtor location test?

A: "A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence."¹¹⁹

Q: What is a "chief executive office"?

A: Although undefined, it does not mean the place of incorporation (e.g., Delaware in the example above).¹²⁰ But the statute offers some guidance. "[I]t means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information"¹²¹

Q: Is the "main part" of a debtor's business calculated by revenues, profit, number of employees, or some other information?

A: There is no statutory answer, "but it would be rare that there could be more than two possibilities. A secured party in such a case may easily protect himself at no great additional burden by filing in each possible place."¹²²

118. See U.C.C. § 9-103 cmt. 5(b) para. 3 (1995) (amended 2001); *In re Dennis Mitchell Indus., Inc.*, 419 F.2d 349, 358 (3d Cir. 1969); *In re Organic Conversion Corp.*, 259 B.R. 350, 359 (Bankr. D. Minn. 2001); Cory L. Collins, *How Secure Are You? The Effects of Perfection and Non-Perfection Under Article 9 of the Uniform Commercial Code*, 66 MO. L. REV. 507, 514 (2001).

119. U.C.C. § 9-103(3)(d) (1995) (amended 2001).

120. U.C.C. § 9-103 cmt. 5(c) (1995) (amended 2001).

121. *Id.*

122. *Id.* For a sample of cases that have examined the meaning of "chief executive office," see *In re Nemko Inc.*, 209 B.R. 590, 600-08 (Bankr. E.D. N.Y. 1997), *In re Astrocade, Inc.*, 31 B.R. 245, 248-51 (Bankr. S.D. Ohio 1983). See also Kevin White, *O' Give Me a Home: Determining the Location of the Debtor's Chief Executive Office Under Section 9-103 of the UCC*, 18 REV. LITIG. 207 (1999).

3. Q: What happens to the effectiveness of a financing statement if a debtor moves its collateral or its location (e.g., its chief executive office) to a jurisdiction where the creditor has not filed a financing statement?

A: A creditor that fails to refile in the new jurisdiction within four months after the debtor relocates itself or the collateral becomes unperfected thereafter.¹²³

4. Q: If a creditor files against inventory located in State A, will its perfection extend to accounts if the debtor's chief executive office is located in State B, where the creditor has not filed a financing statement?

A: Yes, but only for ten days after the debtor generates the accounts. Thereafter, the automatic perfection of identifiable proceeds terminates and, unless the creditor has filed in State B, its security interest in the accounts becomes unperfected.¹²⁴

These issues reveal that a secured party had to avoid many pitfalls in order to enjoy continued perfection and priority. Did the creditor request a U.C.C. search report from every possible jurisdiction? Did it file in every possible jurisdiction? Did it correctly identify the type of collateral? Is it

123. U.C.C. §§ 9-103(1)(d)(i), -103(3)(e) (1995) (amended 2001); *In re Specialty Contracting & Supply, Inc.*, 140 B.R. 922, 924 (Bankr. N.D. Ga. 1992) (holding creditor's failure to timely refile in Georgia after debtor relocated its business from Texas to Georgia rendered security interest unperfected); *see also In re Nemko, Inc.*, 209 B.R. at 599-608 (concluding creditor's security interest in debtor's accounts became unperfected when creditor failed to timely refile in New York after debtor relocated its chief executive office from New Jersey to New York); *Gennet v. Fason*, 178 B.R. 888, 890-92 (S.D. Fla. 1995) (holding creditor took necessary steps to continue perfection of security interest in inventory relocated by debtor from Florida to Missouri and Kentucky).

The four-month period was not absolute. If the effective period (normally five years under former § 9-403(2)) of the financing statement lapsed during the four-month period, the secured party had to refile in the new jurisdiction before the lapse. Alternatively, the creditor could obtain the benefit of the full four months by timely filing a continuation statement in the same office where the initial financing statement was recorded.

124. *See* U.C.C. § 9-306(3) (1995) (amended 2001). The creditor cannot invoke the protection afforded by subsection (a) because the filing office for inventory is State A under former § 9-103(1) and the filing office for accounts is State B under former § 9-103(3). Subsection (a) applied only if the filing office for proceeds was the same filing office for the original collateral. *See* U.C.C. § 9-306(3)(a) (1995) (amended 2001) ("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 . . ."); U.C.C. § 9-312 cmt. 8 (ex. 8) (1995) (amended 2001) ("If the filings as to inventory were not effective under subsection (6) for filing as to accounts because a filing for accounts would have to be in a different filing office under Section 9-103(3), these inventory filings would nevertheless be effective for 10 days as to accounts.").

confident that it knows where the debtor and all of its assets are located? How does the creditor protect itself against the risk that the debtor will relocate itself or its assets to a new jurisdiction?

As noted by others, revised Article 9 has significantly overhauled, and reduced the complexity of, the filing rules in multi-state transactions.¹²⁵ Unless the collateral consists of goods covered by a certificate of title, deposit accounts, investment property, or letter-of-credit rights, a secured party will file its financing statement where the “debtor is located.”¹²⁶ The location of the collateral is irrelevant. The following rules dictate a debtor’s location:

1. A “registered organization” organized under the law of a state is located in that state.¹²⁷ The term is defined as “an organization organized solely under the law of a single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized.”¹²⁸ The term includes corporations, limited partnerships, and limited liability companies, but excludes general partnerships.¹²⁹

125. Jean Wegman Burns, *New Article 9 of the UCC: The Good, the Bad, and the Ugly*, 2002 U. Ill. L. Rev. 29, 39 (suggesting that “no change in new Article 9 deserves greater applause and accolades than the change in the where-to-file rules”); Ingrid Michelsen Hillinger & Michael G. Hillinger, 2001: *A Code Odyssey (New Dawn for the Article 9 Secured Creditor)*, 106 COM. L. J. 105, 128 (2001) (“Revised Article 9 significantly reduces both the hazards and risks of initial filings and the need to re-perfect postfiling.”); Robert M. Lloyd, *The New Article 9: Its Impact on Tennessee Law (Part I)*, 67 TENN. L. REV. 125, 131 (1999) (“The most significant change in Revised Article 9 is the change in where a financing statement is filed.”); See, e.g., Warner, *supra* note 69, at 41 (“The revised Act greatly simplifies the filing rules.”); Elaine A. Welle, *An Introduction to Revised Article 9 of the Uniform Commercial Code*, 1 WYO. L. REV. 555, 570 (2001) (“Revised Article 9 radically changes the choice-of-law rules. The most significant change is to where financing statements are filed.”).

126. U.C.C. § 9-301(1) (2001). For rules applicable to goods covered by a certificate of title, deposit accounts, investment property, and letter-of-credit rights, see revised § 9-303, revised § 9-304, revised § 9-305, and revised § 9-306, respectively.

127. U.C.C. § 9-307(e) (2001).

128. U.C.C. § 9-102(a)(70) (2001). For those who think that the revised filing rules will significantly increase filing revenue in Delaware at the expense of the other forty-nine states, think again. See Lynn M. LoPucki, *Why the Debtor’s State of Incorporation Should Be the Proper Place for Article 9 Filing: A Systems Analysis*, 79 MINN. L. REV. 577, 638–45 (1995) (discussing what the author calls “The Delaware Issue”); cf. David Ley Hamilton & Michael Houghton, *A New Article 9 Secures Those Loans*, BUS. LAW TODAY, 58 (March/April 2002) (noting that “[f]iling and search volumes [in Delaware] rose 30 percent in both 1999 and 2000 [and] [v]olumes reached record growth of 200 percent in the second half of 2001”) (quoting Rick Geisenberger, Delaware’s Assistant Secretary of State)).

129. U.C.C. § 9-102 cmt. 11 (2001).

2. An organization that is not “registered” is located at its place of business.¹³⁰ If it has more than one place of business, it is located at its chief executive office.¹³¹
3. An individual is located at his or her principal residence.¹³²
4. The United States is located in Washington, D.C.¹³³

The following example illustrates how this change in law may favor a secured party involved in a priority dispute with the IRS.

Hypothetical #5

Debtor is a corporation chartered under Texas law. It sells furniture through its stores located in Houston, Texas and Tulsa, Oklahoma. Its chief executive office is located in Houston.

130. U.C.C. § 9-307(b)(2) (2001). A “‘place of business’ means . . . a place where a debtor conducts its affairs.” U.C.C. § 9-307(a) (2001).

131. U.C.C. § 9-307(b)(3) (2001). As under former Article 9, revised Article 9 does not define “chief executive office” but does offer guidance. The term “means the place from which the debtor manages the main part of its business operations or other affairs. This is the place where persons dealing with the debtor would normally look for credit information. . . .” U.C.C. § 9-307 cmt. 2, para. 4 (2001). If doubt exists, a secured party should file in every possible jurisdiction. *Id.*

132. U.C.C. § 9-307(b)(1) (2001). Revised Article 9 does not define “principal residence.” The issue often is irrelevant. Frequently when the debtor is an individual the collateral will be consumer goods. If the creditor’s property interest in the consumer goods is a purchase money security interest, the creditor’s interest is automatically perfected under revised § 9-309(1). But even so, the purchase money creditor may desire to file a financing statement to protect itself in a priority dispute with an individual who buys the consumer goods from the debtor. *See* U.C.C. § 9-320(b) (2001). The location of the principal residence also becomes relevant if the creditor cannot rely on automatic perfection because either the collateral is not consumer goods or the security interest does not qualify as a purchase money security interest. If the individual debtor has multiple residences, the secured party should file in each jurisdiction where the “principal residence” may be located.

133. U.C.C. § 9-307(h) (2001). *Cf.* THE NEW ARTICLE 9, at VII (Corinne Cooper ed., 2d ed. 1999) (“I was never very good at geography, but this will certainly be news to many who were. (Those who have worked to free Congress of its beltway mentality will certainly lose heart to learn of this.)”). Revised Article 9 does not define “United States.” Nor is the term defined in the general definitions section of U.C.C. Article 1. *See* U.C.C. § 1-201 (2001). But in the context of revised § 9-307(h), the term presumably refers to any “debtor” that is an agency, bureau, department, or other unit of federal government.

Revised § 9-307 also provides rules that apply when the debtor is a foreign debtor, an agency or branch of a bank, a registered organization organized under federal law, or a foreign air carrier. *See* U.C.C. §§ 9-307(c), (f), (i), (j) (2001).

On March 1, Debtor borrowed \$1,000,000 from Lender. Debtor granted to Lender a security interest in Debtor's existing and future inventory, wherever located. On March 1, Lender filed a financing statement with the appropriate Texas clerk. On June 1, Debtor opened a store in New Orleans (with furniture from Texas and Oklahoma) and relocated its chief executive office to Louisiana. On November 1, the IRS filed a tax lien notice against Debtor in Texas, Oklahoma, and Louisiana.

In a dispute between Lender and the IRS concerning inventory and accounts that Debtor held on November 1, whose interest is superior?

Under the I.R.C., Lender enjoys priority if it held a "security interest" in the collateral when the IRS filed its tax lien notice.¹³⁴ In order to hold a "security interest" under the I.R.C., the interest must enjoy priority under the U.C.C. against a lien creditor as of November 1.¹³⁵

Under former Article 9, Lender's property interest in Texas inventory is perfected because Lender filed in Texas.¹³⁶ But Lender's property interest in Oklahoma and Louisiana inventory is unperfected because Lender never filed in those states.¹³⁷ And because Lender never filed in Louisiana within four months after Debtor relocated its chief executive office, Lender's property interest in the accounts is unperfected.¹³⁸ Lender's property interest in the Texas inventory is superior to the competing claim of a lien creditor that arose on November 1, but Lender's property interest in Oklahoma inventory, Louisiana inventory, and all accounts is subordinate to the interest of a lien creditor that arose on November 1.¹³⁹ As to the Texas inventory, Lender would enjoy priority over the IRS because Lender held a "security interest" in the Texas inventory on November 1.¹⁴⁰ But the IRS would enjoy priority in the Oklahoma and Louisiana inventory and all accounts because Lender did not have a "security interest" under the I.R.C. on November 1.¹⁴¹

134. I.R.C. § 6323(a) (2000).

135. I.R.C. § 6323(h)(1)(A) (2000).

136. U.C.C. § 9-103(1)(b) (1995) (amended 2001) (requiring Lender to file where the collateral is located).

137. *Id.*

138. U.C.C. § 9-103(3)(b) (1995) (amended 2001) (requiring Lender to file where Debtor is located); U.C.C. § 9-103(3)(d) (1995) (amended 2001) (indicating Debtor is located in the jurisdiction of its chief executive office because it has more than one place of business); U.C.C. § 9-113(3)(e) (1995) (amended 2001) (stating Lender becomes unperfected if it fails to refile in Louisiana within four months after Debtor relocates its chief executive office from Texas to Louisiana).

139. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

140. I.R.C. § 6323(a) (2000).

141. *Id.*

Under revised Article 9, Lender's property interest in the Texas, Oklahoma, and Louisiana inventory, and all accounts, is perfected because Lender filed its financing statement where Debtor, a registered organization, was located: i.e. Texas.¹⁴² The location of Debtor's inventory is irrelevant. The location of Debtor's chief executive office is irrelevant. Debtor's relocation of its chief executive office and inventory is irrelevant. Because Lender's property interest in all of the inventory and accounts is perfected as of November 1, its property interest is superior to the competing claim of a lien creditor that arises on that date.¹⁴³ Therefore, Lender enjoys priority in Debtor's inventory and accounts held by Debtor on November 1 because Lender holds a "security interest" under the I.R.C. as of that date.¹⁴⁴

b. Intrastate options

A secured party that desires to perfect its security interest by filing a financing statement must determine the state in which to file. Under former Article 9, the secured party then had to determine whether to file centrally (often with the office of the secretary of state), locally (i.e., at the county level), or both, depending on which of three filing options the state had enacted.¹⁴⁵ The first option required a local filing against certain realty-related collateral (e.g., fixtures, certain timber, minerals, and mineral-related accounts) and a central filing against all other collateral.¹⁴⁶ The second option required a local filing against the same realty-related collateral and also consumer goods, crops, and farm products and farm-related collateral (e.g., farming equipment); all other collateral required a central filing.¹⁴⁷

142. U.C.C. § 9-301(1) (2001) (stating Lender should file where "debtor is located"); U.C.C. § 9-307(e) (2001) (indicating a registered organization is located in the state of organization).

143. U.C.C. § 9-317(a)(2)(A) (2001).

144. I.R.C. § 6323(a).

145. Policy reasons for permitting states to choose among the three options are provided in the official comments. See U.C.C. § 9-401 cmts. 1-4 (1995) (amended 2001); see also Hillinger & Hillinger, *supra* note 125, at 138, observing that:

local/central regimes and dual filing requirements . . . had no commercial utility and the original drafters knew it when they proposed three alternative sets of filing rules. They also knew local clerks were powerful and a proposed law that proposed to take away their revenues might not become law. The original drafters bowed to political reality.

146. U.C.C. § 9-401(1) (1995) (amended 2001) (first alternative). States that adopted this option in some form included: Connecticut, Delaware, Hawaii, Idaho, Iowa, Maine, Nebraska, Utah, Vermont, and Washington. See WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES ("Local Code Variations" Volume), Art. 9, Pt. 5, at 1-28 (2001).

147. U.C.C. § 9-401(1) (1995) (amended 2001) (second alternative). States that adopted this option in some form included: Alabama, Alaska, Arizona, Illinois, Indiana, Kansas,

The third option mirrored the second option, subject to a significant exception. The third option required a central *and* a local filing if the debtor had a place of business in only one county within the state or the debtor had no place of business within the state but resided in the state.¹⁴⁸

The second and third options occasionally created problems for a secured party. For example, a secured party might file its financing statement against consumer goods at the county level, only to discover later that it was unperfected because the collateral was equipment (requiring a central filing).¹⁴⁹ And in a state that had adopted the third option, a secured party that failed to file centrally *and* locally would be unperfected if the debtor either did business only in one county within the state or had no place of business within the state but resided within the state.¹⁵⁰

These intrastate filing problems vanish under revised Article 9, which dictates central filing for *all* collateral, other than fixtures, as-extracted collateral, and timber to be cut.¹⁵¹

Maryland, Michigan, Montana, New Jersey, New Mexico, New York, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, and Wisconsin. See HAWKLAND, *supra* note 146.

148. U.C.C. § 9-401(1) (1995) (amended 2001) (third alternative). States that adopted some form of this option included: Arkansas, Massachusetts, Mississippi, Missouri, Nevada, New Hampshire, North Carolina, Ohio, Pennsylvania, and Virginia. See HAWKLAND, *supra* note 143.

The following states adopted a non-uniform version of former § 9-401(1) that defied categorization: California, Colorado, Florida, Georgia, Kentucky, Louisiana, Minnesota, North Dakota, Oklahoma, Oregon, West Virginia, and Wyoming. *Id.*

149. See, e.g., *In re Pipes*, 116 B.R. 154, 156 (Bankr. W.D. Mo. 1990) (holding mechanic's tools were equipment, not consumer goods, rendering secured party unperfected because it failed to comply with the dual filing requirement applicable to business property); *In re Ware*, 59 B.R. 549, 552 (Bankr. N.D. Ohio 1986) (concluding two pipe wrenches, socket set, hand truck, two angle grinders, and a utility trailer were equipment, not consumer goods, leaving secured party that failed to comply with dual filing requirement unperfected); cf. *In re Coed Shop, Inc.*, 435 F. Supp. 472, 474 (N.D. Fla. 1977) ("If, for example, a creditor made only a central filing which purported to perfect an interest in equipment and consumer goods, section 679.401(2) makes it clear that such a filing would perfect the equipment interest, which requires central filing, but not the consumer goods interest, which requires local filing.").

150. See, e.g., *In re Fox*, 229 B.R. 160, 166-67 (Bankr. N.D. Ohio 1998) (concluding security interest in air conditioning equipment was unperfected because creditor failed to comply with dual filing requirement applicable to debtor with place of business in only one county); *In re Geary's Bottled Liquors Co.*, 184 B.R. 408, 410-12 (Bankr. D. Mass. 1995) (ruling security interest was unperfected because creditor failed to file continuation statement at both the state and county level); *Abramovitz v. Kew Realty Equities, Inc.*, 652 N.Y.S.2d 737, 738 (N.Y. App. Div. 1997) (affirming trial court's decision that creditor's security interest in partnership interest was unperfected because it failed to comply with dual filing requirement applicable to debtor with place of business in only one county).

151. See U.C.C. § 9-501 (2001); Harry C. Sigman, *The Filing System Under Revised Article 9*, 73 AM. BANKR. L.J. 61, 62-63 (1999) (noting that revised § 9-501 "simplifies the rules at the intrastate level" and should "reduce the number of potential 'wrong filing office'").

The following example illustrates how the adoption of a uniform intrastate filing scheme may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #6

On March 1, Dealer sold an electric keyboard to Consumer on credit, retaining a security interest in the keyboard. Assuming that the keyboard was a consumer good in the hands of Consumer, Dealer filed a financing statement against the keyboard with the appropriate county clerk of State A on March 5.¹⁵² Consumer is using the keyboard primarily to teach piano lessons to neighborhood children (making the keyboard “equipment” under Article 9).¹⁵³ State A had adopted the second alternative of former § 9-401 (requiring a local filing for consumer goods, but a central filing for equipment).

Also on March 1, Dealer sold a grand piano to Hotel on credit, retaining a security interest in the piano. Hotel does business in only one county within State B. Dealer filed a financing statement against the grand piano with the secretary of state’s office in State B on March 5 but made no local filing. State B had adopted the third alternative of former § 9-401 (requiring a central and a local filing if the debtor has a place of business in only one county within State B). On October 1, the IRS filed a tax lien notice against Consumer in State A and Hotel in State B.

In a dispute between Dealer and the IRS concerning the keyboard and the grand piano, whose interests are superior?

Under the I.R.C., Bank enjoys priority if it holds a “security interest” in the musical instruments when the IRS filed its tax lien notice.¹⁵⁴ In order to hold a “security interest” under the I.R.C., Bank’s interests must enjoy priority under the U.C.C. against a lien creditor as of October 1.¹⁵⁵

situations and . . . litigation of this issue”); *see also* U.C.C. § 9-102(a)(6) (2001) (defining “as-extracted collateral”); U.C.C. § 9-112(a)(41) (2001) (defining “fixtures”).

152. If the keyboard was indeed a consumer good, then Dealer is not required to file a financing statement to perfect its security interest. Dealer has a purchase money security interest in the keyboard under former § 9-107 and revised § 9-103(a) & (b)(1). As a general rule, a purchase money security interest in a consumer good is automatically perfected on attachment under former § 9-302(1)(d) and revised § 9-309(1). Nevertheless, Dealer may wish to file a financing statement to avoid losing a priority dispute with a person that buys the keyboard from Consumer under former § 9-307(2) and revised § 9-320(b).

153. *See* U.C.C. § 9-102(a)(33) (2001) (defining “equipment”); U.C.C. § 9-109(2) (1995) (amended 2001) (defining “equipment”).

154. I.R.C. § 6323(a) (2000).

155. I.R.C. § 6323(h)(1)(A) (2000).

Under former Article 9, Dealer's interest in the keyboard is unperfected because it filed its financing statement at the local level, rather than centrally.¹⁵⁶ Dealer's interest in the piano is unperfected because it failed to file its financing statement both centrally and locally.¹⁵⁷ Because Dealer is unperfected, its property interests are subordinate to the interests of a lien creditor.¹⁵⁸ The IRS would enjoy priority under former Article 9 because Dealer did not have a "security interest" under the I.R.C. as of October 1.¹⁵⁹

Under revised Article 9, Dealer's interest in the keyboard is perfected because financing statements filed against consumer goods and equipment are filed in the same central office.¹⁶⁰ Dealer's interest in the grand piano is perfected because a single central filing is sufficient; revised Article 9 eliminates the possibility that a creditor must file both centrally and locally against a debtor.¹⁶¹ Because Dealer's property interests are perfected before October 1, its interests enjoy priority over the competing claims of a lien creditor.¹⁶² Therefore, Dealer's property interest is superior under revised Article 9 because it holds a "security interest" in both musical instruments under the I.R.C. as of October 1.¹⁶³

3. Other filing revisions

a. *Effect of lapse*

A filed financing statement is effective for five years.¹⁶⁴ The effectiveness lapses unless the secured party files a continuation statement within the last six months of the five-year period.¹⁶⁵ Upon lapse, the

156. See U.C.C. § 9-401(1) (1995) (amended 2001) (second alternative).

157. See U.C.C. § 9-401(1) (1995) (amended 2001) (third alternative).

158. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

159. I.R.C. § 6323(a).

160. See U.C.C. § 9-501(a)(2) (2001).

161. See *id.*

162. U.C.C. § 9-317(a)(2)(A) (2001).

163. I.R.C. § 6323(a).

164. U.C.C. § 9-515(a) (2001); U.C.C. § 9-403(2) (1995) (amended 2001). Query whether revised Article 9 extends the effective period an extra day. Under former Article 9, the five-year period ran "from the date of filing." U.C.C. § 9-403(2) (1995) (amended 2001). Under revised Article 9, the five-year period runs "after the date of filing." U.C.C. § 9-515(a) (2001).

165. U.C.C. §§ 9-515(c), (d) (2001); U.C.C. §§ 9-403(2), (3) (1995) (amended 2001). Cases decided under former Article 9 repeatedly held that continuation statements filed prematurely were not effective, even if recorded by the clerk. See, e.g., *In re Isringhausen*, 151 B.R. 203, 206-07 (Bankr. S.D. Ill. 1993) (holding ineffective a continuation statement filed four days before commencement of the six-month refiling period); *Banque Worms v. Davis Constr. Co.*, 831 S.W.2d 921, 923 (Ky. Ct. App. 1992) (same—two days); *NBD Bank, N.A. v.*

creditor's property interest becomes unperfected, absent perfection by some other means.¹⁶⁶ The *prospective* effect is that a secured party will be unperfected against any secured party or lien creditor whose property interest arises after the lapse. But what is the *retroactive* effect, if any, on the secured party's priority against competing property interests that arose before the lapse? Perhaps rephrased, if Secured Party #1 ("SP#1") enjoyed priority over the competing property claim of Secured Party #2 ("SP#2") and Lien Creditor ("LC") before SP#1's financing statement lapsed, will SP#1 continue to enjoy the same priority after the lapse?

Under former Article 9, a property interest that became unperfected upon lapse was "deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse."¹⁶⁷ Therefore, SP#1's interest would be subordinate to the competing property interests of SP#2¹⁶⁸ and LC after the lapse, even though SP#1 enjoyed priority prior to the lapse. But under revised Article 9, a security interest that becomes unperfected upon lapse "is deemed never to have been perfected as against a purchaser of the collateral for value."¹⁶⁹ Noticeably absent is any reference to lien creditors.¹⁷⁰ Therefore, after lapse, SP#1's security interest becomes subordinate to SP#2's interest¹⁷¹ but continues to enjoy priority over the property interest of LC.¹⁷²

Timberjack, Inc., 527 N.W.2d 50, 53 (Mich. Ct. App. 1994) (same—five days). Revised Article 9 removes any contrary doubt. See U.C.C. § 9-510(c) & cmt. 4 (2001).

166. U.C.C. § 9-515(c) (2001); U.C.C. § 9-403(2) (1995) (amended 2001). For a discussion of the methods of perfection, see *supra* note 37, and U.C.C. § 9-308(a) (2001).

167. U.C.C. § 9-403(2) (1995) (amended 2001).

168. SP#2 is a "purchaser." See U.C.C. § 1-201(32) (1995) (amended 2001) (before being revised as part of the Article 9 revision process, defining "purchase" as "taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property"); U.C.C. § 1-201(33) (1995) (amended 2001) (defining "purchaser" as "a person who takes by purchase").

169. U.C.C. § 9-515(c) (2001).

170. Unlike its predecessor, revised § 9-515(c) refers to a "purchaser . . . for value." An Article 9 creditor with an enforceable property interest in the debtor's collateral should have no difficulty with the "value" requirement. To have an enforceable security interest, the creditor must give value under revised § 9-203(b)(1). The value need not be "new value," a term used elsewhere in former and revised Article 9 and defined in revised Article 9. See U.C.C. § 9-312(e) (2001); U.C.C. §§ 9-330(a), (b), (e) (2001); U.C.C. § 9-102(a)(57) (definition) & cmt. 21 (2001) (elaboration); U.C.C. § 9-108 (1995) (amended 2001); U.C.C. § 9-308 (1995) (amended 2001).

171. When Article 9 was revised, the drafters also revised the definition of "purchase" by inserting "security interest" after "lien," thus "mak[ing] explicit what formerly was implicit." U.C.C. § 1-201 cmt. 32 (1999) (post-revision version). The implicit understanding derived from the following language in the pre-revised definition: "'Purchase' includes taking by . . . mortgage, pledge, lien . . . or any other voluntary transaction creating an interest in property." See *Evergreen Marine Corp. v. Six Consignments of Frozen Scallops*, 4 F.3d 90, 95 (1st Cir.

The following example illustrates that this change in law may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #7

Dealer sold an MRI machine to Clinic on March 1, retaining an enforceable property interest in the machine. That same day, Bank filed with the appropriate clerk a financing statement against Debtor's assets. Repayment terms required quarterly payments for seven years. Four years later, the IRS filed a tax lien notice against Clinic. Litigation ensued between Bank and the IRS after Bank's financing statement had lapsed.

In a dispute between Bank and the IRS concerning the MRI machine, whose interest is superior?

Under the I.R.C., Dealer enjoys priority if it holds a "security interest" in the collateral when the IRS filed its tax lien notice.¹⁷³ In order to hold a "security interest" under the I.R.C., Dealer's interest must enjoy priority under the U.C.C. against a lien creditor.¹⁷⁴

Under former Article 9, Dealer's interest in the machine became unperfected when its financing statement lapsed.¹⁷⁵ The lapse has a retroactive consequence: Dealer was never perfected against the I.R.C., which became a lien creditor before the lapse.¹⁷⁶ Because Dealer was never perfected, its property interest is subordinate to the property interest of a

1993) (noting that "an Article 9 secured party is a 'purchaser' of the debtor's interest in the collateral" under U.C.C. § 1-201); *In re Arlco, Inc.*, 239 B.R. 261, 268 (Bankr. S.D.N.Y. 1999) (observing that "the definition of purchaser [in U.C.C. § 1-201] is broad enough to include an Article 9 secured party").

172. The official comments confirm this result. See U.C.C. § 9-515 cmt. 3 (2001). Presumably this change was made because a lien creditor takes the debtor "as is" and does not rely on the filing system. Therefore, a secured party that enjoys priority over a lien creditor should not lose that priority merely because its financing statement has lapsed.

To a considerable extent, current law reflects the view that buyers and secured parties are "reliance" parties who part with value in exchange for an interest in specific property, whereas judicial lien creditors are "nonreliance" parties who have bargained for the right to enforce a judgment against whatever property the debtor may have on hand at the time.

Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2059 (1994).

173. I.R.C. § 6323(a) (2000).

174. I.R.C. § 6323(h)(1)(A) (2000).

175. U.C.C. § 9-403(2) (1995) (amended 2001).

176. See *id.*

lien creditor.¹⁷⁷ The IRS would enjoy priority under former Article 9 because Dealer never had a “security interest” under the I.R.C.¹⁷⁸

Under revised Article 9, Dealer’s interest in the machine became unperfected when its financing statement lapsed.¹⁷⁹ But the lapse has no adverse retroactive effect on the priority that Dealer enjoyed over the I.R.C. prior to the lapse.¹⁸⁰ Dealer’s property interest was perfected before the filing date of the tax lien notice, so its interest enjoyed priority over the competing, but subsequent, claim of a lien creditor.¹⁸¹ This priority is not adversely affected by the subsequent lapse of Dealer’s financing statement.¹⁸² Therefore, Dealer’s property interest in the machine is superior under revised Article 9 because it held a “security interest” under the I.R.C. as of the filing date of the tax lien notice and thereafter.¹⁸³

b. PMSI grace period

Under former Article 9, a secured party’s property interest was subordinate to the competing property interest of a lien creditor if the secured party’s interest was unperfected when the lien creditor’s property interest arose.¹⁸⁴ This rule was subject to one exception. A secured party that perfected its interest *after* the lien creditor’s interest arose enjoyed priority over the lien creditor if (i) the secured party’s interest attached¹⁸⁵ before the lien creditor’s interest arose; (ii) the secured party’s interest was a purchase money security interest (“PMSI”);¹⁸⁶ and (iii) the secured party filed its financing statement no later than the tenth day after the debtor received possession of the collateral.¹⁸⁷

Revised Article 9 adopts a similar, although not identical general rule for resolving priority disputes between a secured party and a lien creditor. The

177. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

178. I.R.C. § 6323(a).

179. U.C.C. § 9-515(c) (2001).

180. *Id.* The IRS cannot argue that it was a “purchaser for value” because the IRS acquired its property interest involuntarily, not voluntarily. See U.C.C. § 1-201(b)(29) (2001) (defining “purchase” in terms of a voluntary transaction between the debtor and a purchaser).

181. U.C.C. § 9-317(a)(2)(A) (2001).

182. U.C.C. § 9-515(c).

183. I.R.C. § 6323(a).

184. See U.C.C. § 9-301(1)(b) (1995) (amended 2001) (discussed *supra* at Part III).

185. See U.C.C. §§ 9-203(1), (2) (1995) (amended 2001) (discussing elements of attachment).

186. See U.C.C. § 9-107 (1995) (amended 2001) (defining “purchase money security interest”).

187. See U.C.C. § 9-301(2) (1995) (amended 2001). The general priority rule of former § 9-301(1)(b) is expressly subject to the PMSI exception in former § 9-301(2). See U.C.C. § 9-301(1) (1995) (amended 2001) (“Except as otherwise provided in subsection (2) . . .”).

secured party has priority if, before the lien creditor's property interest arose, (i) the secured party was perfected or (ii) the secured party had filed its financing statement and its security agreement was in place.¹⁸⁸ Like its predecessor statute, this general priority rule is subject to an exception that applies if the lien creditor's property interest arose between attachment and perfection of a PMSI.¹⁸⁹ But revised Article 9 extends the post-possession filing period, requiring the secured party to file its financing statement no later than the *twentieth* day after the debtor receives possession of the collateral.¹⁹⁰

The following example illustrates that this filing extension may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #8

On March 1, Seller sold a photocopier to Debtor on credit, retaining an enforceable property interest in the item to secure repayment of the unpaid purchase price. Seller delivered the photocopier to Debtor on March 10. The IRS filed a tax lien notice against Debtor on March 15. On March 25, Seller filed with the appropriate clerk a financing statement against the photocopier.

In a dispute between Seller and the IRS, whose interest in the photocopier is superior?

Under the I.R.C., Seller enjoys priority if it holds a "security interest" in the photocopier when the IRS filed its tax lien notice.¹⁹¹ In order to hold a "security interest" under the I.R.C., Seller's interest must enjoy priority under the U.C.C. against a lien creditor as of March 15.¹⁹²

Under the general priority rule of former Article 9, Seller's interest would be subordinate to the property interest of a lien creditor because Seller perfected its security interest on March 25, several days after the lien creditor's property interest arose on March 15.¹⁹³ Although Seller's

188. See U.C.C. § 9-317(a)(2) (2001) (discussed *supra* at Part III).

189. See U.C.C. § 9-317(e) (2001); see also U.C.C. § 9-103(a) (2001), (defining "purchase-money security interest"); U.C.C. § 9-203(a), (b) (2001) (discussing elements of attachment). The general priority rule of revised § 9-317(a)(2) is expressly subject to the purchase-money exception in revised § 9-317(e). See U.C.C. § 9-317(a)(2) (2001) ("except as otherwise provided in subsection (e) . . .").

190. See U.C.C. § 9-317(e) (2001). Prior to enacting revised Article 9, many states had made non-uniform amendments to former § 9-301(2) that extended the post-possession filing deadline to twenty days. See HAWKLAND, *supra* note 146, at Art. 9, Pt. 3, at 1-6.

191. I.R.C. § 6323(a) (2000).

192. I.R.C. § 6323(h)(1)(A) (2000).

193. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

property interest attached before March 15 and qualified as a PMSI,¹⁹⁴ Seller cannot invoke the PMSI exception to the general priority rule because Seller filed its financing statement on March 25—more than ten days after Debtor took possession on March 10.¹⁹⁵ Therefore, Seller's interest is subordinate to the interest of a lien creditor.¹⁹⁶ As a result, the IRS would enjoy priority under former Article 9 because Seller did not have a "security interest" under the I.R.C. as of March 15.¹⁹⁷

Under the general priority rule of revised Article 9, a lien creditor's property interest arising as of March 15 ranks ahead of the competing property interest of Seller because Seller was not perfected on March 15.¹⁹⁸ But Seller's property interest, a PMSI,¹⁹⁹ attached before the lien creditor's property interest arose. Therefore, Seller can invoke the PMSI exception to the general priority rule because it filed its financing statement on March 25, within twenty days after Seller delivered the photocopier to Debtor. As Seller timely filed its financing statement, its interest enjoys priority over the competing claim of a lien creditor.²⁰⁰ Therefore, Seller's property interest is superior under revised Article 9 because it holds a "security interest" under the I.R.C. as of March 15.²⁰¹

c. Instruments

Former Article 9 required a secured party to take possession of an instrument in order to perfect a property interest in it.²⁰² This requirement created problems for a secured party in at least three situations. First, a secured party, thinking an item of collateral was an instrument, would take possession of the item but not file a financing statement. A court might conclude that the item was an account or a general intangible, rather than an instrument, leaving the secured party unperfected.²⁰³ Second, a secured

194. Seller's security interest qualifies as a PMSI under former § 9-107(a).

195. See U.C.C. § 9-301(2) (1995) (amended 2001).

196. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

197. I.R.C. § 6323(a) (2000).

198. U.C.C. § 9-317(a)(2) (2001).

199. See U.C.C. §§ 9-103(a), (b)(1) (2001).

200. U.C.C. § 9-317(e) (2001).

201. I.R.C. § 6323(a) (2000).

202. U.C.C. § 9-304(1) (1995) (amended 2001) (stating that a property interest in instruments "can be perfected *only* by the secured party's taking possession," except in limited cases of temporary perfection) (emphasis added).

203. See, e.g., *In re Newman*, 993 F.2d 90, 92–95 (5th Cir. 1993) (concluding annuity contract in possession of creditor was general intangible, leaving non-filing creditor unperfected); *In re Holiday Intervals, Inc.*, 931 F.2d 500, 502–03 (8th Cir. 1991) (holding land sales contracts in creditor's possession were general intangibles, leaving non-filing creditor unperfected).

party, believing that an item of collateral was an account or general intangible, would file a financing statement but leave any writing in the debtor's possession. A court might conclude that the item was an instrument, leaving the non-possessor creditor unperfected.²⁰⁴ Third, a secured party with a perfected interest in collateral such as inventory, equipment, and accounts became unperfected in proceeds thereof in the form of an instrument unless the secured party took possession of the instrument.²⁰⁵ But these problems disappear under revised Article 9, which permits a secured party to perfect its security interest in an instrument by filing.²⁰⁶

The following example illustrates that this change in law may aid a secured party involved in a priority dispute with the IRS.

Hypothetical #9

Bank loaned \$100,000 to Borrower on March 1, taking an enforceable security interest in Borrower's assets, including several notes that remained

204. See, e.g., *In re Kelly Group, Inc.*, 159 B.R. 472, 477–81 (Bankr. W.D. Va. 1993) (observing that even if creditor had a security interest in the note, its financing statement would not perfect the non-possessory interest because the note was an instrument); *In re Coral Petroleum, Inc.*, 50 B.R. 830, 837–41 (Bankr. S.D. Tex. 1985) (holding promissory note was an instrument, leaving non-possessor creditor that filed financing statement unperfected); *Berkowitz v. Chavo Int'l, Inc.*, 544 N.Y.S.2d 569, 572–73 (N.Y. 1989) (concluding secured party could not rely on financing statement covering "receivables" to perfect security interest in promissory note held to be an instrument); *Belke v. M & I First Nat'l Bank of Stevens Point*, 525 N.W.2d 737, 738 n.1 (Wis. Ct. App. 1994) ("With exceptions not pertinent here, a security interest in an instrument is perfected only by the secured party's taking possession, not by filing at the secretary of state's office.").

205. See e.g., Burns, *supra* note 125, at 41–42; Peter F. Coogan, *The New UCC Article 9*, 86 HARV. L. REV. 477, 515–16 (1973); W. David East & Susan Byerly, *Continuous Perfection of Security Interests in Proceeds of Credit Sales of Inventory*, 1986 COLUM. BUS. L. REV. 115, 124–25; R. J. Robertson, Jr., *Rights and Obligations of Buyers with Respect to Goods in Their Possession After Rightful Rejection or Justifiable Revocation of Acceptance*, 60 IND. L.J. 663, 717 (1985); see also U.C.C. § 9-306(3) (1995) (providing for automatic perfection of a security interest in identifiable proceeds that lapses after ten days unless one of four rules applies); cf. *Citicorp (USA), Inc. v. Davidson Lumber, Co.*, 718 F.2d 1030, 1032–33 (11th Cir. 1983) (concluding creditor did not have continuing perfected security interest in certificate of deposit more than ten days after debtor received certificate as proceeds of other collateral). A handful of states adopted a twenty-day grace period. See HAWKLAND, *supra* note 146, at Art. 9, Pt. 3, pp. 33–9. Revised Article 9 adopts a twenty-day grace period. U.C.C. § 9-315(d) (2001).

206. U.C.C. § 9-312(a) (2001) ("A security interest in . . . instruments . . . may be perfected by filing."). Although perfected by filing, a secured party may lose a priority dispute with a purchaser of the instrument that gave value and took possession of the instrument in good faith and without knowledge that the purchase violated the rights of the secured party. See U.C.C. § 9-330(d) (2001). The secured creditor could suffer the same priority loss in a dispute with a possessor that qualifies as a holder in due course. See U.C.C. § 9-331(a) (2001).

in Borrower's possession. That same day, Bank filed with the appropriate clerk a financing statement against Borrower's assets (including "instruments").

Bank also loaned \$100,000 to Dealer on March 20, taking an enforceable security interest in Dealer's existing and future inventory. That same day, Bank filed with the appropriate clerk a financing statement against Dealer's inventory. On June 1, Dealer sold an item of inventory to a customer that executed a negotiable promissory note payable to Dealer (the "Note"). Dealer retained possession of the Note, an "instrument" under Article 9. The IRS filed tax lien notices against Borrower and Dealer on October 1.

In a dispute between Bank and the IRS concerning (i) instruments acquired by Debtor prior to October 1 and (ii) the Note held by Dealer, whose interest is superior?

Under the I.R.C., Bank's property interests rank ahead of the federal tax lien if Bank holds a "security interest" in the instruments and the Note when the IRS filed its tax lien notice.²⁰⁷ In order to hold a "security interest" under the I.R.C., Bank's interests must enjoy priority under the U.C.C. against a lien creditor as of October 1.²⁰⁸

Under former Article 9, Bank's interest in the instruments is unperfected because Bank did not possess the instruments.²⁰⁹ And although Bank's interest in the Note was perfected upon Dealer's receipt of the Note, the automatic perfection lapsed ten days later.²¹⁰ Because Bank is unperfected, its interests in the instruments and the Note are subordinate to the interests of a lien creditor.²¹¹ The IRS would enjoy priority under former Article 9 because Bank did not have a "security interest" in the instruments and the Note under the I.R.C. as of October 1.²¹²

Under revised Article 9, Bank's interest in the instruments is perfected because Bank can perfect its interest by filing a financing statement against the instruments.²¹³ Bank's interest in the Note remains perfected beyond

207. I.R.C. § 6323(a) (2000).

208. I.R.C. § 6323(h)(1)(A) (2000).

209. U.C.C. § 9-304(1) (1995) (amended 2001).

210. U.C.C. § 9-306(3) (1995) (amended 2001). Subsection (3)(a) is inapplicable because a security interest in the Note cannot be perfected by filing. *See* U.C.C. § 9-304(1) (1995) (amended 2001). Subsection (3)(b) is inapplicable because the Note is not "cash proceeds" as defined in former § 9-306(1). Subsection (3)(c) is inapplicable for the same reason, and also because the original collateral was inventory, rather than investment property. Subsection (3)(d) is inapplicable because Bank failed to take any action within the ten-day period to extend perfection (e.g., possess the Note).

211. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

212. I.R.C. § 6323(a).

213. U.C.C. § 9-312(a) (2001).

the automatic, but temporary, twenty-day period following Dealer's possession because (i) a filed financing statement covered the original collateral of inventory; (ii) a property interest in the Note can be perfected by filing a financing statement in the same office as a filing against Dealer's inventory; and (iii) the Note was not acquired with cash proceeds.²¹⁴ Because Bank's property interests in the instruments and the Note are perfected before October 1, its interests enjoy priority over the competing claims of a lien creditor.²¹⁵ Therefore, Bank enjoys priority in the instruments and the Note under revised Article 9 because Bank holds a "security interest" under the I.R.C. as of October 1.²¹⁶

B. Changes to the Non-Filing Rules

This section analyzes three non-filing changes that may have a result-reversing effect on the resolution of a priority dispute between the IRS and the Article 9 creditor.

1. Third-party possession

Former Article 9 permitted a secured party to perfect its property interest in certain assets by possession.²¹⁷ If the collateral was held by a bailee, then the secured party was "deemed to have possession from the time the bailee receive[d] notification of the secured party's interest."²¹⁸ Former Article 9 rejected the common law rule that the bailee must "attorn to the secured party or acknowledge that" it holds the collateral for the benefit of the secured party.²¹⁹ But under revised Article 9, a secured party is not deemed to have possession of collateral held by a third party until the third party has authenticated a record in which it acknowledges that it holds, or will hold, collateral on behalf of the secured party.²²⁰ The third-party

214. U.C.C. § 9-315(d)(1) (2001).

215. U.C.C. § 9-317(a)(2) (2001).

216. I.R.C. § 6323(a) (2000).

217. U.C.C. § 9-305 (1995) (amended 2001) (limiting application to "goods, instruments [other than certificated securities], money, negotiable documents or chattel paper").

218. *Id.*

219. *Id.* cmt. 2. Nevertheless, courts occasionally held that a party cannot be involuntarily conscripted into serving as an agent for a secured creditor. See, e.g., *In re Coral Petroleum, Inc.*, 50 B.R. 830, 839 (Bankr. S.D. Tex. 1985); *In re Kontaratos*, 10 B.R. 956, 967 (Bankr. D. Me. 1981).

220. U.C.C. § 9-313(c) (2001). "Authenticate" and "record" are defined in revised § 9-102(a)(7) and revised § 9-102(a)(69), respectively. The rule covers collateral other than certificated securities and goods covered by a document. U.C.C. § 9-313(c) (2001). An interest in goods held by a bailee and subject to a nonnegotiable document can be perfected merely

possessor is under no obligation to acknowledge that it holds, or will hold, collateral for the secured party.²²¹ And absent any acknowledgment, the secured party cannot rely on third-party possession as a means of perfecting its security interest.²²²

The following example illustrates that this change in law may adversely impact a secured party involved in a priority dispute with the IRS.

Hypothetical #10

Bank loaned \$100,000 to Debtor on March 1, taking an enforceable security interest in Debtor's instruments and chattel paper, all held by a third party ("Custodian"). On March 5, Bank mails a letter to Custodian, informing Custodian that Bank has taken an enforceable security interest in the instruments and chattel paper, which Custodian shall hold on behalf of Bank. Custodian receives the letter but never expressly agrees to comply with Bank's request. The IRS filed a tax lien notice against Debtor on October 1.

In a dispute between Bank and the IRS concerning Debtor's instruments and chattel paper held by Custodian on October 1, whose interest is superior?

Under the I.R.C., Bank has priority if it holds a "security interest" in the instruments and chattel paper when the IRS filed its tax lien notice.²²³ In order to hold a "security interest" under the I.R.C., Bank's interest must enjoy priority under the U.C.C. against a lien creditor as of October 1.²²⁴

Under former Article 9, Bank's interest in the instruments is perfected by Custodian's possession.²²⁵ Custodian must merely receive Bank's directive, not consent to it.²²⁶ Because Bank is perfected, its security interest ranks ahead of a competing claim of a lien creditor arising on October 1.²²⁷

upon the bailee's receipt of the creditor's notice of its interest; the bailee need not consent. U.C.C. § 9-312(d)(2) (2001).

221. U.C.C. § 9-313(f) (2001).

222. A secured party that relies merely on the custodian's receipt of notice for its perfection under former Article 9 is given one year after revised Article 9 becomes effective in which to obtain the custodian's acknowledgment. During that one-year period, the secured party remains perfected. But unless the secured party obtains the requisite acknowledgment, its security interest will become unperfected after the one-year period ends. U.C.C. § 9-703(b) & cmt. 2 (2001).

223. I.R.C. § 6323(a) (2000).

224. I.R.C. § 6323(h)(1)(A) (2000).

225. See U.C.C. § 9-305 cmt. 2 (1995) (amended 2001).

226. *Id.*

227. U.C.C. § 9-301(1)(b) (1995) (amended 2001).

Therefore, Bank's interest in the instruments and chattel paper enjoys priority over the IRS because Bank held a "security interest" under the I.R.C. when the IRS filed its tax lien notice.²²⁸

Under revised Article 9, Bank's interest in the instruments and chattel paper is unperfected because Custodian never acknowledged, in an authenticated record, that Custodian would hold the collateral for Bank's benefit.²²⁹ Because Bank's interest is unperfected on October 1, its interest is subordinate to the competing claim of a lien creditor.²³⁰ Therefore, the lien held by the IRS in the instruments and chattel paper ranks ahead of Bank's property interest because Bank did not hold a "security interest" under the I.R.C. when the IRS filed its tax lien notice.²³¹

2. PMSIs

An issue that occasionally arose under former Article 9 was whether a PMSI was converted into a generic security interest if (i) the security agreement included an after-acquired property clause or a future advance clause or (ii) the purchase-money debt was refinanced (or consolidated with nonpurchase-money debt).²³² Some courts held that the inclusion of an

228. I.R.C. § 6323(a) (2000).

229. U.C.C. § 9-313(c) (2001). Under revised Article 9, the prudent creditor will not rely solely on third-party possession as its means of perfection. The creditor also will file a financing statement against the instruments and chattel paper, a permitted means of perfecting an interest in both types of collateral. U.C.C. § 9-312(a) (2001).

230. U.C.C. § 9-317(a)(2) (2001).

231. I.R.C. § 6323(a) (2000).

232. A secured creditor prefers that its property interest qualifies as a PMSI because a PMSI often enjoys special favor over a generic security interest. For example, the general priority rule applicable to a dispute between a secured creditor and a lien creditor is subject to a PMSI exception. U.C.C. §§ 9-317(a), (e) (2001); U.C.C. §§ 9-301(1), (2) (1995) (amended 2001). Also, creditors with a PMSI in goods are entitled to super-priority over pre-existing secured parties that otherwise enjoy priority under the first-to-file-or-perfect rule. U.C.C. §§ 9-324(a), (b) (2001); U.C.C. § 9-312(3), (4) (1995) (amended 2001). And a secured party's property interest is automatically perfected in most consumer goods if the property interest is a PMSI. U.C.C. § 9-309(1) (2001); U.C.C. § 9-302(1)(d) (1995) (amended 2001). Furthermore, a consumer debtor in bankruptcy can avoid certain "nonpossessory, nonpurchase-money security interest[s]" that impair an exemption. 11 U.S.C. § 522(f)(1)(B) (2000).

Scholarship on the contours of purchase money security interests abounds. See, e.g., Russell A. Hakes, *According Purchase Money Status Proper Priority*, 72 OR. L. REV. 323 (1993); Robert M. Lloyd, *Refinancing Purchase Money Security Interests*, 53 TENN. L. REV. 1 (1985); Juliet M. Moringiello, *A Tale of Two Codes: Examining § 522(f) of the Bankruptcy Code, § 9-103 of the Uniform Commercial Code and the Proper Role of State Law in Bankruptcy*, 79 WASH. U. L.Q. 863 (2001); Paul M. Shupack, *Defining Purchase Money Collateral*, 29 IDAHO L. REV. 767 (1992-1993); Mark B. Wessman, *Purchase Money Inventory Financing: The Case for Limited Cross-Collateralization*, 51 OHIO ST. L.J. 1283 (1990).

after-acquired property clause or a future advance clause “transformed” a PMSI into a generic security interest.²³³ Other courts (often relying on the “to the extent” language of former § 9-107) concluded that the inclusion of such clauses did not destroy the purchase money nature. Instead, the security interest enjoyed a “dual status,” whereby the relationship between an item and its purchase price remained a PMSI, and the relationship between an item and other debt did not enjoy PMSI status.²³⁴ Decisions also reflect similar disagreement on the effect of debt refinancing and debt consolidation on a property interest that began its life as a PMSI. Some cases held that the debt restructure destroyed a PMSI,²³⁵ while others concluded that the property interest remained a PMSI to some extent.²³⁶

Revised Article 9 resolves these issues in favor of the PMSI creditor.

In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if: (1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation; (2) collateral that is not purchase-money collateral also secures the purchase-money obligation; or (3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.²³⁷

The following example illustrates how the dual-status rule may aid a secured party involved in a priority dispute with the IRS.

233. See, e.g., *Southtrust Bank of Ala., NA v. Borg-Warner Acceptance Corp.*, 760 F.2d 1240, 1243 (11th Cir. 1985); *In re Delta Res.*, 162 B.R. 562, 566–68 (Bankr. N.D. Ala. 1993); *In re Jones*, 5 B.R. 655, 657 (Bankr. M.D. N.C. 1980).

234. See, e.g., *In re McAllister*, 267 B.R. 614, 620–21 (Bankr. N.D. Iowa 2001); *In re Weigert*, 145 B.R. 621, 623–24 (Bankr. D. Neb. 1991); *In re Griffin*, 9 B.R. 880, 881 (Bankr. N.D. Ga. 1981).

235. See, e.g., *Dominion Bank of Cumberland Islands, NA v. Nuckolls*, 780 F.2d 408, 413 (4th Cir. 1985); *In re Mathews*, 724 F.2d 798, 800 (9th Cir. 1984); *In re Keeton*, 161 B.R. 410, 412 (Bankr. S.D. Ohio 1993).

236. See, e.g., *In re Billings*, 838 F.2d 405, 409 (10th Cir. 1988); *In re Pristas*, 742 F.2d 797, 801 (3d Cir. 1984); *In re Short*, 170 B.R. 128, 134 (Bankr. S.D. Ill. 1994).

237. U.C.C. § 9-103(f) (2001). See also U.C.C. § 9-103 cmt. 7a (2001) (“[T]his Article approves what some cases have called the ‘dual-status’ rule . . . [and] rejects the ‘transformation’ rule adopted by some cases . . .”); Hillinger & Hillinger, *supra* note 125, at 145 (“In large part, Revised Article 9’s rules represent a dedicated attempt to refute, reject, override, eliminate, eradicate and otherwise kill the transformation rule in a commercial debtor context.”).

Whether the “dual status” rule or the “transformation” rule applies in consumer-goods transactions (defined at U.C.C. § 9-102(a)(24) (2001)) is left to the discretion of the court. See U.C.C. § 9-103(h) & cmt. 8 (2001).

Hypothetical #11

On March 1, Seller and Debtor execute a master purchase agreement, under which the parties contemplate that Debtor will buy one or more pieces of office equipment from Seller over time. The agreement creates a security interest in any item sold and includes a future advance clause and an after-acquired property clause. On April 1, Seller sold and delivered a photocopier to Debtor. On April 8, Seller sold and delivered a fax machine to Debtor. On April 20, Seller filed with the appropriate clerk a financing statement against the photocopier and the fax machine. The IRS filed a tax lien notice against Debtor on April 15.

In a dispute between Seller and the IRS concerning the photocopier and the fax machine, whose interest ranks ahead of the other?

Under the I.R.C., Seller's property interest is superior if it holds a "security interest" in the two items of office equipment when the IRS filed its tax lien notice.²³⁸ In order to hold a "security interest" under the I.R.C., Seller's interest must enjoy priority under the U.C.C. against a lien creditor as of April 15.²³⁹

Under the general priority rule of former Article 9, Seller's interest is subordinate to the property interest of a lien creditor because Seller perfected its property interest five days after the lien creditor's property interest arose on April 15.²⁴⁰ Moreover, in a jurisdiction that has adopted the transformation rule, Seller cannot invoke the PMSI exception of former § 9-301(2) because the inclusion of an after-acquired property clause and a future advance clause in the agreement prevents Seller from claiming a PMSI in the two items.²⁴¹ Without a PMSI, Seller's interest in the two items is subordinate to the interest of a lien creditor.²⁴² As a result, the IRS would enjoy priority under former Article 9 because Seller did not have a "security interest" under the I.R.C. as of April 15.²⁴³

Under the general priority rule of revised Article 9, a lien creditor's property interest arising as of April 15 ranks ahead of the competing property interest of Seller because Seller was not perfected on April 15.²⁴⁴ But Seller can invoke the PMSI exception of revised § 9-317(e). Seller's

238. I.R.C. § 6323(a) (2000).

239. I.R.C. § 6323(h)(1)(A) (2000).

240. See U.C.C. § 9-301(1)(b) (1995) (amended 2001).

241. *Southtrust Bank of Ala., NA v. Borg-Warner Acceptance Corp.*, 760 F.2d 1240, 1243 (11th Cir. 1985) ("A PMSI requires a one-to-one relationship between the debt and the collateral.").

242. See U.C.C. § 9-301(1)(b) (1995) (amended 2001).

243. See I.R.C. § 6323(a) (2000).

244. See U.C.C. § 9-317(a)(2) (2001).

property interest in the two items attached under revised § 9-203 no later than the delivery dates, each before the lien creditor's property interest arose. And Seller filed its financing statement on April 20, within twenty days after Debtor took possession of the first item on April 1. Because revised Article 9 has adopted the dual-status rule, Seller can claim that its interest in each item is a PMSI to the extent of its purchase price.²⁴⁵ To that extent, Seller's interest enjoys priority over the competing claim of a lien creditor.²⁴⁶ Therefore, and (but limited) to the same extent, Seller enjoys priority under revised Article 9 because it holds a "security interest" under the I.R.C. as of April 15.²⁴⁷

3. Deposit accounts

Transfers of interests in deposit accounts as original collateral were excluded from the scope of former Article 9.²⁴⁸ This exclusion did not prevent parties from agreeing that a debtor's deposit accounts would secure repayment of an obligation. But it did require the parties to comply with law other than Article 9, usually a state's common law, and this posed problems. "The common law is nonuniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence,

245. To illustrate the extent of Seller's PMSI in each item, assume that the photocopier cost \$1,000, the fax machine cost \$500, and Debtor has not made any payments. Because the agreement includes cross-collateralization clauses, the photocopier and the fax machine each secure repayment of \$1,500. The security interest in the photocopier enjoys PMSI status in the amount of its unpaid purchase price (\$1,000) and non-PMSI status in the amount of the unpaid purchase price of the fax machine (\$500). The security interest in the fax machine enjoys PMSI status in the amount of its unpaid purchase price (\$500) and non-PMSI status in the amount of the unpaid purchase price of the photocopier (\$1,000).

Debtor may have paid off some of the debt by the time the priority dispute is resolved. Assume that Debtor has paid \$700 to Seller and the agreement requires Seller to apply payments to obligations in the order incurred. (U.C.C. § 9-103(e) (2001) governs payment application.) Now each item secures total debt of \$800, and the security interest in the photocopier enjoys PMSI status only to the extent of its unpaid purchase price (\$300).

246. See U.C.C. § 9-317(e) (2001).

247. See I.R.C. § 6323(a) (2000).

248. U.C.C. § 9-104(f) (1995) (amended 2001). Former Article 9 defined a "deposit account" as "a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit." U.C.C. § 9-105(1)(e) (1995) (amended 2001). A few states (including California and Illinois) enacted non-uniform amendments that brought deposit accounts within the scope of former Article 9. See Warner, *supra* note 69, at 45 n.238.

debtors who wished to use deposit accounts as collateral sometimes were precluded from doing so as a practical matter."²⁴⁹

Familiarity, and compliance, with the common law has become irrelevant, as revised Article 9 extends the scope of its coverage to include transfers of interests in deposit accounts (except in consumer transactions).²⁵⁰

The following example illustrates how this scope expansion may aid a secured party involved in a priority dispute with the IRS.

249. U.C.C. § 9-109 cmt. 16 (2001). Numerous scholars have echoed similar sentiments. See, e.g., Jason M. Ban, *Deposit Accounts: An Article 9 Security Interest*, 17 ANN. REV. BANKING L. 493, 494 (1998).

Because they are not governed by the U.C.C., secured transactions collateralized by deposit accounts are currently governed by "a hodgepodge of common law and non-uniform amendments," while, "the legal uncertainty surrounding these arrangements probably reduces the availability of credit because of the inability to give the lenders the degree of assurance that a secured lender typically seeks."

Id. at 494 (footnotes omitted); Vincent Paul Cardi, *Preserving Existing Security Interests Under Revised Article 9 of the Uniform Commercial Code: A Concise Summary of the Transition Rules and Some Recommendations for Secured Parties*, 103 W. VA. L. REV. 289, 294 (2001) (noting the "existing, often unclear, common-law rights" of a secured party in a deposit account); Alvin C. Harrell, *Revised UCC Article 9: Introduction to the Symposium*, 54 CONSUMER FIN. L.Q. REP. 140, 144 (2000) (noting, under former Article 9, that a creditor's claims against deposit accounts "are governed by non-UCC law, often involving an amorphous relationship between vague common law principles and a diverse array of other laws"); Mark J. Volow & C. Mark Laskay, *Revised Article 9: What Banks Need to Know*, 118 BANKING L.J. 99, 100 (2001) (observing that common law principles "can lead to ambiguity as to the validity and priority of the secured party's interest in the collateral and thereby diminish its value in the secured lending market"); Steven O. Weise, *U.C.C. Article 9: Personal Property Secured Transactions*, 56 BUS. LAW. 1835, 1836 (2001) (referring to "antiquated common law concepts" underlying a court's conclusion that a secured party did not have a perfected property interest in the debtor's deposit account). For a general discussion of deposit accounts as collateral under the common law, see Dwight L. Greene, *Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection – the Common Law is Alive and Well*, 39 DRAKE L. REV. 259 (1989–1990), and Gerald T. McLaughlin, *Security Interests in Deposit Accounts: Unresolved Problems and Unanswered Questions Under Existing Law*, 54 BROOK. L. REV. 45 (1988).

250. U.C.C. § 9-109(d)(13) (2001); U.C.C. § 9-102(a)(26) (2001) (defining "consumer transaction"). Revised Article 9 defines a "deposit account" as "a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument." U.C.C. § 9-102(a)(29) (2001). For a general discussion of deposit accounts as collateral under revised Article 9, see Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963 (1999).

Hypothetical #12

Bank loaned \$100,000 to Debtor, a corporate entity, on March 1. Bank and Debtor agreed, in writing, that Debtor's bank accounts maintained with Bank would serve as collateral. The agreement required Debtor to maintain a minimum balance in the accounts but otherwise permitted Debtor to deposit and withdraw funds during the term of the loan. The IRS filed a tax lien notice against Debtor on October 1.

In a dispute between Bank and the IRS concerning Debtor's deposit accounts maintained with Bank, whose interest is superior?

Under the I.R.C., Bank enjoys priority if it holds a "security interest" in the deposit accounts when the IRS filed its tax lien notice.²⁵¹ In order to hold a "security interest" under the I.R.C., Bank's interest must have priority over a lien creditor's interest arising as of October 1.²⁵²

Under the common law, Bank cannot claim a property interest in the deposit accounts because Bank does not have exclusive and unfettered control of the deposit accounts.²⁵³ The IRS would enjoy priority under the common law because Bank did not have a "security interest" in the deposit accounts as of October 1.²⁵⁴

After revised Article 9 becomes effective, the common law no longer applies. Because Debtor maintains its deposit accounts with Bank, Bank has "control" of the deposit accounts.²⁵⁵ Under revised Article 9, Bank's control results in perfection of its property interest.²⁵⁶ Unlike the common

251. I.R.C. § 6323(a) (2000).

252. I.R.C. § 6323(h)(1)(A) (2000).

253. *See e.g.*, *Miller v. Wells Fargo Bank Int'l Corp.*, 540 F.2d 548, 563 (2d Cir. 1976) (holding bank's failure to prove exclusive control over overseas deposit account prevented bank from claiming security interest); *Ellefson v. Centech Corp.*, 606 N.W.2d 324, 334 (Iowa 2000) (concluding creditor did not have interest in two bank accounts because creditor did not have "absolute, unequivocal, and exclusive possession and control of the accounts"); *All Am. Auto Salvage v. Camp's Auto Wreckers*, 679 A.2d 627, 631 (N.J. 1996) ("Although First Fidelity intended to create security interests through the deposit agreements, it lacked exclusive possession and control over the accounts. Consequently, it did not hold security interests in the accounts.").

254. I.R.C. § 6323(a) (2000).

255. U.C.C. § 9-104(a)(1) (2001). If the secured party is not the bank that maintains the deposit account, then the secured party can achieve "control" in one of two ways: (1) "the debtor, secured party, and bank" execute an agreement in which the bank agrees to "comply with instructions" from the secured party to liquidate the account without the debtor's consent; or (2) "the secured party becomes the bank's customer" on the account. *See* U.C.C. § 9-104(a)(2)-(3) (2001). For an example of a three-party control agreement, *see* Markell, *supra* note 250, app., at 1029.

256. U.C.C. § 9-314(a) (2001) (indicating a security interest in a deposit account may be perfected by control under revised § 9-104); U.C.C. § 9-312(b)(1) (2001) (stating "a security interest in a deposit account [as original collateral] may be perfected only by control").

law, revised Article 9 does not require Bank to have absolute and exclusive control. Bank has control sufficient to perfect its property interest “even if [Debtor] retains the right to direct the disposition of funds from the deposit account[s].”²⁵⁷ As Bank’s property interest in Debtor’s accounts is perfected before October 1, its interest enjoys priority over the competing claim of a lien creditor.²⁵⁸ Therefore, Bank enjoys priority in Debtor’s deposit accounts because Bank holds a “security interest” under the I.R.C. as of October 1.²⁵⁹

V. CONCLUSION

Many persons are surprised to learn that the IRS does not always win every priority dispute. Perhaps greater shock comes from the fact that Congress seems in no hurry to rewrite the federal tax code in a manner that assures victory for the public purse. Instead, the federal tax laws permit the Article 9 creditor to enjoy priority in the limited assets of a delinquent taxpayer if its property interest is protected under local law against a judgment lien arising as of the moment when the IRS files its tax lien notice. Under both former and revised Article 9, this protection is afforded to a secured party that has perfected its property interest no later than when the lien creditor’s interest arises in the taxpayer’s assets. Although the basic priority rule remains the same under former and revised Article 9, the perfection rules have changed. In a priority dispute between the secured party and the IRS, several of these changes may reverse the result reached under former Article 9. The overwhelming number of the potential reversals favors the secured party, illustrating that revised Article 9 offers an edge over its predecessor. In a priority dispute with the IRS, any edge is welcome.

257. U.C.C. § 9-104(b) (2001). *See also* David Frisch, *Revised Article 9: A Primer for the General Practitioner*, 35 U. RICH. L. REV. 813, 827 (2001) (“The debtor need not give up his right to direct disposition of the funds in the account; as long as the secured party is able to do so, the secured party will have control.”); Warner, *supra* note 69, at 47 (“Although the control agreement could be drafted to restrict the debtor’s use of the account, the debtor may retain full rights . . . to use the account without destroying the secured party’s control.”); Welle, *supra* note 125, at 565 (“A secured party has control over a deposit account even if the debtor retains the right to access the account or direct disposition of the funds.”).

258. U.C.C. § 9-317(a)(2) (2001).

259. I.R.C. § 6323(a) (2000).