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The Modern World of Conflicts for Article Nine Security Interests, Part II: The Relationship Between State and Federal Law

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The Modern World of Conflicts for Article Nine Security Interests, Part II: The Relationship Between State and Federal Law

By Frank P. McEachern and Alvin C. Harrell

statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property.\[1\]

It is doubtful that the original drafters of Article Nine of the Uniform Commercial Code contemplated the extent to which such statutes would govern. Indeed, it is likely that, when the National Conference of Commissioners on Uniform Laws and the American Law Institute promulgated the Uniform Commercial Code, the members of these organizations looked forward to more uniformity and certainty in all areas of commercial law than has been achieved.

It is clear that the result of their labors has produced far greater uniformity and certainty than prevailed prior to the U.C.C.; however, all of the U.C.C. articles, Article Nine probably has enjoyed the least success in this respect. The drafters of most of the other Code articles had fairly clear and widely recognized precedents with which to commence, such as the Uniform Sales Act, the Uniform Negotiable Instruments Law, several Model Bank Collection Codes, the Uniform Stock Transfer Act and the Uniform Customs and Practice for Documentary Credits (popularity known as the “Havana Customs”). In these areas much uniformity preceded the Code.

In contrast, the law dealing with security devices was awash with pledges, chattel mortgages, conditional sales contracts, bailments, leases, collateral assignments of intangibles, Factor’s Acts, trust receipts, field warehousing arrangements and many other such concepts. Nearly all of these devices employed various fictions and illusions; for example the practice of designating the debtor as a “trustee” in trust receipt financing apparently was designed to facilitate tracing the proceeds of collateral.\[2\]

Most of the security devices had been the subject of diverse legislation in various states dealing with separate aspects (i.e., “pieces”) of particular types of security transactions, but very seldom did the solutions deal with the problem of secured transactions in its entirety. A case in point is the general acceptance of the chattel mortgage as capable of securing future loans and advances while the conditional sales contract generally was limited to securing only payment of the purchase price of the goods involved in that transaction.

Article Nine, in contrast, represented a comprehensive modernization and organization of the law of personal property security interests.\[3\] It created the concept of “perfection,” coupled with a system of priorities which permitted different degrees or stages of perfection and priority. For example, a secured creditor could perfect a security interest in chattel paper by employing the device of filing a financing statement which would protect the secured creditor against the dreaded “lien creditor” (including a trustee in bankruptcy),\[4\] but the Code also provided that the secured creditor who perfected by filing would lose “priority” against a purchaser of the chattel paper who gave new value and took possession of the collateral (the chattel paper) in the ordinary course of business.\[5\]

Article Nine recognized the concept of “proceeds” and attempted to unravel a host of mysteries and conflicts not theretofore intelligently articulated.\[6\] It dealt specifically with the concepts of after-acquired collateral and future advances and articulated the allowable procedures (and limitations) available to a secured creditor attempting to enforce a security interest following the debtor’s default.\[7\] In terms of advancement towards the goals of unifor-

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mity and consistency, the significance of Article Nine must be reasserted.

Nevertheless, even at this time Article Nine was drafted there already were numerous federal laws in effect dealing with private security issues and the regulations and interests in various types of personal property, such as ships mortgages, railroad rolling stock, patents, copyrights and trademarks. In addition, a number of federal statutes (as well as administrative regulations) have had some impact on the provisions of the Article Nine security practices.

II. The Food Security Act of 1985

One good example of recent federal legislation affecting security interests is the Food Security Act of 1985. Recent headlines in The Wall Street Journal and The New York Times have reported massive write-offs by the Farmers Home Administration of up to four billion dollars in loans plus another three and one half billion dollars in secured loans. The debt forgiveness we have included in this discussion (and liberal debt restructuring guidelines authorized by Congress in 1985) may be relevant, in part, for such write-offs, but the size of the write-offs also reflects the recent economic problems in agriculture. In view of these developments it is not surprising that additional legislative attention has been given to the financial problems in the farming sector and that many of the U.C.C. cases reported in recent years have been resolved in the Food Security Act of 1985.

The Food Security Act of 1985 is one result of these problems. Section 9-307(1) of the U.C.C. provides that a buyer in the ordinary course of business does not take free of a security interest in goods if the buyer was not a party to the security agreement. As Professor Craft pointed out, the use of the term "ordinary course of business" is "intentional" and to varying extents require alerting from state laws to give meaning to the federal provisions. Examples are provisions of the patent laws and copyright laws which provide mechanisms for transfers of patents and copyrights or interests therein. Statutes do not deal with questions of whether or how to determine the default procedures, effects of actual notice or notice of the other details specifically covered by the U.C.C.

This means that the relationships and conflicts between state and federal law represent a continuing challenge for Article Nine secured parties. There are numerous parallels in banking regulation and in consumer credit laws. This article seeks to survey some of these relationships, including some recent developments, and to discuss their potential impact on the provisions of the applicable state and uniform Article Nine security practices.

The Attorney General noted that section 9-307(4) precludes a security interest in farm products in a purchase "unless notice of the security interest is given to the buyer by the secured party." If the buyer, or the secured party, who had not released its security interest, Congress concluded that such exposure to the risk of a loss of the "inherent economic interest in the goods being sold" until the 90th day after the "pur- chase." This notice additionally must be given to the buyer by certified mail at the later of either the 90th day after the purchase or if the balance of the goods for which the notice is required is not delivered within a reasonable time after the goods are delivered. This provision also applies to the purchase of farm products by a person not subject to the security interest created by the debtor, including the amount of such products of which a change in status or failure to make the annual actual notice being delivered to the buyer.

The uncertainties that result from the Federal Food Security Act, or any other central filing system, self-implemented or central filing approach will mean that many lenders will be forced to treat farm products collateral in much the same way they treat inventory collateral, i.e., recognizing that a buyer in the ordinary course of business may be subject to the security interest. To some extent such concerns are even greater in this context because the agricultural finance may not have the protections against bulk sales of collateral that are accorded to unsecured creditors under U.C.C. Article 9. This significantly reduces the value and usefulness of agricultural collateral as a means of heisting the creditworthiness of a loan.
applied. In this regard, the Comptroller of the Currency issued a Banking Circular 30 which summarized the effects of the Power of Sale Section of the Fair Credit Billing Act and set forth the Comptroller’s policies regarding loans secured by farm equipment. The circular stated that the agricultural industry was “very sensitive to any change in the applicable state law and has made reasonable efforts to meet the requirements of the Fair Credit Billing Act. In view of the Comptroller’s position, it can be anticipated that many states will approve a central filing system which will operate with some degree of uniformity. The Fair Credit Billing Act. However, even when a state adopts a “central filing system,” litigation and uncertain interpretations of state statutes are likely to occur. Interpretation of the notice provisions of the Fair Credit Billing Act, the resultant priority rules, and their relationship to existing state law will be a part of the scene for quite some time. These problems add a new dimension to the agricultural financing equation.

III. Fair Labor Standards Act of 1938

A. Introduction

Section 215(a)(1) of the Fair Labor Standards Act provides in part that “[i]t shall be unlawful for any person—

(i) to cause or to permit any employee to work in violation of any existing Federal or State law regulating the amount of time spent by any person in the production of any goods in any such industry or of any other employments; or

(ii) to cause or to permit any employee to work in violation of any such existing law regulating the amount of time spent by any person in the production of any goods in any such industry or of any other employments.

As provided above, the Fair Labor Standards Act of 1938 (FLSA) prohibits “any person” from introducing into inter-state commerce goods produced in violation of any existing Federal or State law regulating the amount of time spent by any person in the production of any goods in any such industry or of any other employments.

The question presented by Citicorp is whether this provision of the FLSA applies to inter-state commerce in the case of a bank where the bank is acting as a factor in accounts receivable in a transaction which is not within the scope of the FLSA.

In 1983, CitiCorp entered into a financing arrangement with Qualities Corporation, a manufacturer and the corporate predecessor of the corporation which initiates the factor financing (collectively, Ely). Under the terms of the financing arrangement, CitiCorp agreed to make loans to Ely for working capital. In return, Ely granted CitiCorp a security interest in its inventory and accounts receivable. CitiCorp perfected this security interest under applicable state law. In the fall of 1983, Ely experienced financial difficulty and in January, 1985 stopped reporting to CitiCorp. On February 8, 1985, CitiCorp stopped advancing funds to Ely and demanded all funds due. At the request of Ely’s management, however, CitiCorp did not immediately foreclose. Instead, it agreed to continue its financing and to continue servicing the loans, but on the condition that Ely provide periodic statements of all balances and that CitiCorp be given the right at any time to inspect the plant and to have access to all relevant records. CitiCorp did not receive any payments until February 19, 1985. By this time, 19 days after the termination of Ely’s management, it had no inventory or accounts receivable.

The Supreme Court disagreed. The Supreme Court applied a strict test to its reading of the FLSA. In dismissing CitiCorp’s argument, the Court held that the FLSA is a device for allowing small creditors to have a better position than good faith purchasers, for whom Congress specifically added an exception. The Supreme Court further reasoned that secured creditors often monitor the operations of the debtor, and may be in a position to insist on compliance with the FLSA’s minimum wage and overtime provisions.

Did the Supreme Court indicate that the FLSA granted a priority position in the event a creditor was owed money and had not been paid in accordance with the FLSA? The answer is no, and the Supreme Court has not yet decided whether a similar position may be given to a secured creditor.

The Supreme Court held that the FLSA currently states extremely broad exceptions in such a way that a creditor may not be given a preference for any and all wrong acts of the debtor with regard to the collateral. In any event the creditor would like to draw comfort from the Supreme Court’s use of an example involving “inherently dangerous goods” such as gasoline, which is entirely any such comfort. “Hot goods” are not inherently dangerous goods, explained the Supreme Court, “but Congress has determined that they are contraband notethless. We see no reason for a different result merely because a different form of contraband is involved.”

Under the Supreme Court’s reasoning, it seems to be up to the creditor to prove that an article is not for sale. Instead, a lender must “monitor” or “control” its borrower over time in order to prevent the sale of the goods in question. This is a very difficult task, as it requires not only the ability to monitor the sale of the goods in question but also the ability to monitor the use of the proceeds of the sale. The Supreme Court noted that the FLSA does not require the borrower to certify periodically that all goods subject to the lender’s financing are in compliance with all laws. This might constitute the “written assurances from the producer” that must be present to trigger the “good-faith purchaser” exception.

IV. Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) is a federal law that requires responsible parties to pay for the cleanup of hazardous waste sites. The law was enacted to address the need for a comprehensive approach to dealing with the problem of hazardous waste. CERCLA provides a framework for identifying, investigating, and cleaning up hazardous waste sites, and for holding those responsible for generating and disposing of hazardous waste accountable for the costs of cleanup.

A. Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) is designed to provide a comprehensive approach to addressing the problem of hazardous waste. The law seeks to ensure that responsible parties are held accountable for the costs of cleanup and that the public is protected from the harmful effects of hazardous waste.

1. CERCLA’s Key Provisions

a. CERCLA requires that responsible parties be identified and held accountable for the costs of cleanup. Responsible parties can include anyone who generated, transported, or disposed of hazardous waste, or anyone who permitted the waste to be generated, transported, or disposed of.

b. CERCLA establishes a system of financial responsibility that requires responsible parties to pay for the cleanup of hazardous waste sites. This includes the costs of investigation, removal, and long-term monitoring.

2. CERCLA’s Impact on Hazardous Waste Sites

a. CERCLA has had a significant impact on the cleanup of hazardous waste sites. The law has helped to ensure that responsible parties are held accountable for the costs of cleanup, and has provided a framework for investigating and cleaning up hazardous waste sites.

b. CERCLA has also helped to raise public awareness of the hazards posed by hazardous waste and has encouraged responsible parties to take steps to prevent the generation and disposal of hazardous waste.

3. CERCLA’s Future

a. CERCLA is expected to continue to play a critical role in addressing the problem of hazardous waste. The law provides a comprehensive approach to dealing with the issue of hazardous waste and has helped to ensure that responsible parties are held accountable for the costs of cleanup.

b. As the country continues to grapple with the issue of hazardous waste, CERCLA is expected to be a key component of efforts to address this problem.
liability for clean-up costs against the responsible parties. Secured lenders of owners of contaminated sites are thus a "first in time" party to the lien created by the Act.44

Despite terminology that suggests "responsibility" for the loss as a factor, liability under CERCLA is not limited to the party responsible for the loss.45 Even though CERCLA does not specifically provide for strict liability, it states that the liability of a party is extended according to the standard of liability applied under the Clean Water Act of 1977, which has been interpreted to accord with the standard of liability applied under CERCLA.46

There are four classes of parties who may be responsible for clean-up costs in connection with the release of hazardous substances:

1. The "owner or operator" of a vessel or facility 47 on which a clean-up action takes place.
2. The "owner or operator" of a vessel or facility at the time of disposal of hazardous substances.
3. The generators of hazardous substances found at the particular site and
4. The transporters of hazardous substances to the site.48

Lenders face liability under CERCLA as current and former owners or operators of "facilities" under the Act.49 As hereinafter discussed, judicial interpretation of CERCLA has made it clear that a lender has a "financial institution" or a "bank," whether or not it is a "portfolio owner" or "portfolio owner of a facility" can be held liable for clean-up costs if the lender exercises control over a portfolio of any one or more of the following the definitions of "owner or operator" under the statute:

1. The "owner or operator" of a vessel or facility at the time of disposal of hazardous substances.
2. The "owner or operator" of a vessel or facility at the time of disposal of hazardous substances.
3. The generators of hazardous substances found at the particular site and
4. The transporters of hazardous substances to the site.48

The issue of lender liability under CERCLA revolves around the definition of "owner or operator" under the statute. While CERCLA defines "owner or operator" as "any person who owns or operates a facility," a lender may be held liable under CERCLA, particularly if it is a "financial institution" or a "bank," whether or not it is a "portfolio owner" of a vessel or facility. In this regard, the lender may be held liable under CERCLA if it has control over a vessel or facility, whether or not it is a "portfolio owner." The lender may also be held liable for clean-up costs if it is a "financial institution" or a "bank," whether or not it is a "portfolio owner" of a vessel or facility. In this regard, the lender may be held liable under CERCLA, particularly if it is a "financial institution" or a "bank," whether or not it is a "portfolio owner." The lender may also be held liable for clean-up costs if it is a "financial institution" or a "bank," whether or not it is a "portfolio owner."
be liable as an "owner or operator" of the vessel or facility.11

D. Can the EPA demand Cleanup Expenses From Secured Lenders?

A bankruptcy filing by a borrower certainly triggers a lender's ability to recover its investment. But to what extent that costs of a hazardous-waste cleanup exceed the value of the unencumbered estate, the EPA may have to look to the lender's collateral for reimbursement of cleanup costs. In In re T.P. Long Chemical Co., Inc. (debtor) operated a rubber recycling plant. The plant, including both the real and personal property, was valued for collateral purposes at a "market level" within the meaning of CERCLA. On May 29, 1981, the debtor filed for reorganiza-
tion under Chapter 11 of the Bankruptcy Code. The case was subsequently converted to Chapter 7.12 BankOhio held a perfected security interest in the accounts receivable, equipment, fixtures, inventory and other personal property of the debtor, as well as the proceeds thereof.

The bankruptcy trustee conducted an auction at which all of the personal property of the debtor was sold. The sole redemption offered in the auction was the surrender of certain drips containing various substances which, unknown to anyone except a peculiar of the debtor, had been buried on the rear of the rubber plant site. These drips contained hazardous substances, as defined by CERCLA. Also auctioned off at all of this was a tank containing a hazardous chemical. Shortly after the auction, a vandal opened a valve in the tank, releasing the hazardous chemical into the hazardous substance. The trustee refused to clean up the spill, and the EPA undertook to do so.

On the other hand, course of some activities, the buried drips containing hazardous material were discovered.

The question before the court was whether the EPA could recover the cost of removing the hazardous substance. BankOhio contended that since the unencumbered assets of the estate were insufficient to pay the administrative expense claim of the EPA, the EPA sought payment out of the funds subject to BankOhio's security interest. The EPA relied on section 506(e) of the Bankruptcy Code, which provides: "The trustee may receive from property securing an allowed secured claim the reasonable, necessary expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim arising from such preservation or disposition.

That authority did not allow BankOhio to receive any benefit from the cleanup. This decision rests on the inability of the EPA to show and benefit to BankOhio from the cleanup, although the efforts of the court to find such a benefit were obvious and exhaustive, because BankOhio apparently never had a security interest in the hazardous chemical drums, and there was no evidence that BankOhio attempted to control the business of its borrower. Nevertheless, it is important to note the court's thorough analysis of the EPA claims against BankOhio, even though the interests are more so.

E. EPA Versus the Shareholder.

A June 13, 1984 memorandum from the Office of Enforcement and Compliance Assurance (OEA) of the EPA deals with the liability of corporate shareholders and successor corporations under CERCLA. The questions raised are affected by the OEA's position that shareholders of defunct corporations owning assets with environmental problems cannot occupy such positions with impunity as to hazard-
ous substances.

Undoubtedly, in some cases in which the EPA will assert such an aggressive stance must be fact-intensive, as recognized in the memorandum.

As stated on page 2 of the OEA memorandum, "[t]he interests of public con-
venience, fairness and equity, EPA may disregard the corporate entity when the shareholder controlled or directed the activities of a corporation hazardous waste generator, transporter or facility. It is dif-
ficult to determine from studying the case whether or not the EPA would apply a different standard before imposing liability on the corporate share-
holders of a corporation whose stock was foreclosed on by a lender. For example, when the shareholder has knowledge of the potential value of the site—when it made the loan, or when it acquired the stock? What if the lender, learning of the condition also ownership, sold the stock? Will the share-
holders be prohibited from using the inno-


agreement in Otto Fabre itself merely contem- plated a change in condition to its own effective purposes it was indeed a strange and unlikely form of security interest. The claimant bankruptcy court, hence the conditional bankruptcy proceeding is not significant as reinstate- ment of the conspiracy in these areas. But Otto Fabre is likewise significant as esse- cially important because the court's decision was unav:ailable to anticipate any attempt to disrupt the court's decision as a whole.

The Patent Act is one of the federal statutes which, as to security interests in patents, gives the creditor in certain instances a prima facie right. This can be a serious obstacle in the creditor's efforts to collect on his rights. However, in a situation where security is available, a court can provide a security interest which is enforceable without full audit of the security agreement.

The cases illustrate the often strange interplay between two federal statutes, the Bankruptcy Code, on the one hand and the U.C.C. on the other. For secured lenders, the case can be recog- nized with the small number of other reported decisions, standing for the proposition that a security agreement and financing statement that purport to secure a federal party a security interest by assignment of an interest in the debtor's title would be valid. Thus, for example, a creditor could acquire a security interest in a Debtor's title to its inventory, either by: (1) providing a financing statement on the Debtor's inventory and financing statement on the Debtor's inventory; (2) providing a financing statement on the Debtor's inventory and financing statement on the Debtor's inventory; (3) providing a financing statement on the Debtor's inventory and financing statement on the Debtor's inventory. Since the security interest is perfected within the 90 day preference period, it will not be avoided as a preferential transfer. Thereafter, whenever rights would be available to a secured party with an unrecorded "assignment" in a real estate and tax lien on one of the myriad forms of liens created by various federal or state statutes. Again, these appear to be largely unanswered questions.

For those whose practice may involve financing of manufacturing or processing plants which employ patented equipment or processes as an important part of their operations, these are important issues. Such a creditor would be aware that if their client acquires the plants or equipment in fore- closure of a mortgage or a security agree- ment, the client or a purchaser acquiring such property at or subsequent to foreclosure or bankruptcy proceedings, the client or a purchaser acquiring such property at or subsequent to foreclosure or bankruptcy proceedings, the client or a purchaser acquiring such property at or subsequent to foreclosure or bankruptcy proceedings, the client or a purchaser acquiring such property at or subsequent to foreclosure or bankruptcy proceedings.

The case of In re Otto Fabre, Inc. 3, is illustrative of the interaction of state and federal law. The court, which confirmed a security agreement seeking to include parent rights in a financing package for a possible acquisition of a company by a creditor. The lien agreement, grant of conveyance in favor of any subsequent purchaser and for the benefit of the holder of a good and valuable consideration, unless it is recorded in the Patent Office and the Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage.

In re Otto Fabre, Inc. filed a bill to protect against third parties, including the debtor. Otto Fabre's bill, filed in the bankruptcy court, the issue of whether there was a security interest to that extent that the right in patents which in- cluded in the assignment of the security agreement and assignment, the bankruptcy court determined that the assignment of the patent under federal law, and not the prior security agreement, was the assignment in the transaction. The provisions of section 261, which provide for filing with the Patent and Trademark Office, were not to provide for an "adequate" filing system for the protection of the creditor. The court held that the assignment was made as an assignment to the assignee.

Similarly, the bankruptcy court in In re Otto Fabre, Inc. filed a bill to protect against third parties, including the debtor. Otto Fabre's bill, filed in the bankruptcy court, the issue of whether there was a security interest the Court of Appeals for the Sixth Circuit, not being convinced by the arguments of the parties, held the appeal was not in accordance with the assignment of the security agreement and assignment, the bankruptcy court ordered the debtor to transfer to the creditor, as the trustee, to take place outside the 90 day preference period, and noted that federal law does not require filing as a lien creditor such as the trustee in bankruptcy. However, as noted the court did not determine the issue of federal preference, concluding that this result was mandated by section 362 of the Bankruptcy Code.

In the case of Professor Clerk's elaboration of the Law of Secured Transactions, Professor Clerk criticized the Court's opinion in Otto Fabre, in explaining that the "court law of a state," the Circuit Court of Appeals for the Sixth Circuit, in holding that the patent statute does not require the creditor to protect the secured creditor against loss of its interest in the bankruptcy debtor's possession of any equipment which had been described by Professor Clerk. The Law of Secured Transactions, supra 3 of the 90-30-300 and that an Article Nine filing is displaced to the extent that the federal statute requires federal perfection, as well as with Article Nine of the bankruptcy code, the Law of Secured Transactions, supra.

The cases in Kansas were a part of the same set of facts which the court, in holding that the patent statute does not require a federal perfection of the security interest, held that the security interest is not a "lien" in a patent, that the security interest which had been described by Professor Clerk. The Law of Secured Transactions, supra, is not a "lien" in a patent.

The cases are legion distinguishing between an "interest" and a "right of action," in determining whether the security interest is protected in an action under the Code or in an action under the Code. The cases are legion distinguishing between an "interest" and a "right of action," in determining whether the security interest is protected in an action under the Code or in an action under the Code. The cases are legion distinguishing between an "interest" and a "right of action," in determining whether the security interest is protected in an action under the Code or in an action under the Code. The cases are legion distinguishing between an "interest" and a "right of action," in determining whether the security interest is protected in an action under the Code or in an action under the Code.

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able to perfect security interests in copyrights.

The most intriguing provision of the Copyright Act is section 106, which bars infringement liability for unauthorized transfers "until the instrument evidencing the transfer has been recorded." Copyright law would be substantially changed if this provision were changed to require registration, or even filing, of any transfer of copyright prior to bringing suit. The first question is whether the doctrine of exclusive ownership would be upheld under the new provision. Since exclusive ownership is a function of the registration system, the answer is in the affirmative. This provision is a major departure from the common-law rule that possession is equivalent to ownership.

A second question is whether the new provision will have any practical effect. The answer is probably yes, as copyright law is already a highly regulated area. The provision may have the effect of freezing transfers of copyrights, which are usually unauthorized. If the transfer is valid, the new provision will have no effect. If the transfer is invalid, the new provision will have no effect.

Section 106 of the Copyright Act is an interesting provision, and it is likely to have a significant effect on the copyright system. The new provision is a major departure from the common-law rule that possession is equivalent to ownership, and it is likely to have a significant effect on the copyright system. The provision may have the effect of freezing transfers of copyrights, which are usually unauthorized. If the transfer is valid, the new provision will have no effect. If the transfer is invalid, the new provision will have no effect.

62. See U.S. Copyright Act, § 106 (1990) ("The exclusive right of the author of a copyrighted work to distribute or to authorize the distribution of copies or phonorecords of the copyrighted work, to perform or to authorize the performance of the copyrighted work, and to make or to authorize the making of film copies or video tapes of the copyrighted work.")

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the Kerckhoff Food doctrine. The federal government as creditor also has had war debts to Mexico and the property of all persons and estates in Mexico and the United States. The federal government also has held certain trusts, and was entitled to override U.C.C. Sections 2-403, 2-507 and 2-702 in these circumstances.

XI. The Federal Trade Commission

A Federal Trade Commission (FTC) rule applies to consumer goods, stating:

"It is an unfair or unjust practice for a lessor or rental installation site directly or indirectly to take or receive from a consumer an obligation that... constitutes or contains a non-payment security interest in household goods other than a purchase money security interest." The Federal Trade Commission Improvement Act of 1974 in section 351(d) provides that:

[E]ach agency specified in paragraph (2) or (3) of this subsection shall establish a separate division of consumer affairs which shall receive and take appropriate action upon complaints with respect to such acts or practices by banks or savings and loan institutions described in paragraph (3) subject to its jurisdiction.

The regulations and rules promulgated under this subsection shall be enforced under section 8 of the Federal Deposit Insurance Act of 1933. The act of:

(A) national banks and, by... the division of consumer affairs established by the Board of Governors of the Federal Reserve System, and
(B) members of the Federal Reserve System...

is established by the Board of Governors of the Federal Reserve System, and

(C) banks insured by the Federal Deposit Insurance Corporation, by the division of consumer affairs established by the Board of Directors of the Federal Deposit Insurance Corporation.

Other FTC rules or their bank regulatory counterparts may impact Article Nine security interests in other ways. For example, the FTC holder-inourse rules may affect

assignees of consumer credit contracts. Regulations prescribed under this subsection must be in accordance with the Federal Reserve Act and the Home Owners Loan Act of 1933 (12 U.C.C. section 1404) with respect to federal savings and loan associations, section 407 of the National Housing Act (12 U.C.C. section 1738) with respect to insured state banks, sections 11(b) of the National Housing Act (16) and 17 of the Federal Home Loan Bank Act (12 U.C.C. sections 1426(a) and 1437(a)) with respect to Federal Home Loan Bank System, a Division of Consumer Affairs established by the Federal Home Loan Bank Board pursuant to the Federal Home Loan Bank Act (12 U.C.C. section 1402(a)) and the FTC rules specified above, adopted by the FTC, the Federal Reserve Board and the Federal Home Loan Bank Board, have considerably narrowed the scope of 9-204 of the U.C.C. as well as the holder in due course provisions of U.C.C. Article Three.

XII. Federal Ship Mortgages

The Federal Ship Mortgage Act, 46 U.S.C. sections 911-984, provides for ship mortgages upon "vessels of the United States" to the extent that the "vessel" is documented under the laws of the United States. Public Law 96-594, Section 343, is known as the Vessel Documentation Act. A ship or boat or barge or whatever is not a vessel of the United States and therefore not qualified to be the subject of a ship mortgage. A vessel is at least of "five net tons" to be eligible to register as a vessel of the United States. Pleasure craft otherwise meeting the net tonnage requirements and whose owners satisfy the citizenship requirements may be so registered.

Title 46 U.S.C. section 92(a) provides:

(a) No sale, conveyance, or mortgage which shall be made with the consent of the owner of the ship, or the owner’s personal representative, of the property, described in this section, or mortgage, is made, includes a vessel of the United States, or any other party shall become the owner of the property, sold, conveyed, or mortgaged shall be valid, in respect to

vessel, against any person other than the grantees or mortgagee, his heirs and assigns, and a person having actual notice thereof, unless conveyed, sold, conveying, or mortgage, or other obligations in the event of the collection of the custodian of the customs of the possession of any document of such vessel, as provided in subsection (b) of this section. One of the many governmental reorganization acts has resulted in the U.S. Coast Guard being substituted in the U.S., Customs and Indigences in respect to mortgaged for the Collector of Customs for purposes of the Ship Mortgages.

The Act gets a little more specific than those discussed supra because it states that no sale, conveyance, mortgage "shall be valid, in respect to such vessel, unless a person other than the grantee or mortgagee, his heirs or devisee, and a person having actual knowledge thereof, until such... mortgage is recorded." If the owner is shown to be a person protected by these Acts. Moreover, unlike some of the federal statutes previously discussed, there is no notice or protected time between execution and recording during which the unrecorded document may be effective.

In the case of the ship mortgage, R.C. Croft Limited vs. Ships of America Corp., all mortgages were perfected and the ship mortgage was confirmed document as a vessel of the United States at the time the mortgage was made. This appears to be the perfect actual holding which involved a vessel not constructed in the United States and therefore not qualified to be the subject of a ship mortgage. If a vessel is being constructed at a shipyard, and is ready for delivery to the buyer against payment and the buyer finances the purchase price with a preferred mortgage in favor of a lender, the language from this passage reads the mortgage could not be recorded until the vessel was registered after the vessel was registered. Hence, the shipbuilder is entitled to the shipyard to buyer, immediate registration of title. Some of the buyer, execution of the preferred mortgage and the recording of the preferred mortgage occurs in the same order. This may require a closing of all the rules of the Const. and a mortgage office in which registration takes place, or other equivalent arrangement.

Federal law also requires that a mortgagor, upon request of the mortgagee, if the execution of the preferred mortgage was obtained prior to the existence of any prior maritime lien, prior to the execution of the vessel that is to be mortgaged, knows the mortgagee, and thereafter that the mortgagee has not notice of all prior execution of such mortgage and before the mortgagee has had a reasonable time in which to take any action. Again, all the computations and indigences in respect were made feasible by the inclusion at section 9-104(d). It should be noted, however, that this same analysis would not be applicable to the more specific federal law rules on filing and foreclosure of federal ship mortgages.
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of the amount of the chattel paper with the F.A.A. in order to perform the security interest in that chattel paper (by delivering the proceeds from the rental payments). This is a question whether the chattel paper is not an aircraft and therefore the security interest in chattel paper should be governed by Article 3 of the Uniform Commercial Code rather than federal law. This was later recognized as a resolved case, which also reversed the lower court's judgment, and agreed that the leased aircraft was not an aircraft as defined in Article 3. The lower court concluded that an oral "option to purchase" converted the lease into a conditional sale contract, and the bank had the right to terminate the lease. The United States Court of Appeals for the Ninth Circuit reversed the lower court's decision, finding that the lease remained in effect until the lessee exercised the option to purchase, and that the bank did not have the right to terminate the lease under the circumstances.

The U.S. Supreme Court, however, disagreed, holding that the Illinois law applicable to chattel paper when collateralized was the Federal Aviation Act (F.A.A.) rather than the Uniform Commercial Code. The court held that the Illinois law was preempted by the Federal Aviation Act, and that the federal law governs the security interest in chattel paper. The court found that the security interest in chattel paper was governed by the Federal Aviation Act, and that the federal law did not preempt Illinois state law. The court held that the Illinois law was applicable to the security interest in the aircraft, and that the security interest in the aircraft was governed by Illinois law. The court noted that the Illinois law was consistent with the federal law, and that the federal law did not provide any different or additional protection for the parties to the transaction.

The lower court also held that the security interest in the aircraft was not valid because the lessee had not delivered the aircraft to the lessor. The court found that the aircraft was not in the possession of the lessor, and that the lessee had not satisfied the conditions for the security interest to be effective. The court held that the security interest was not valid because the lessee had not delivered the aircraft to the lessor, and that the lessee was not in possession of the aircraft.

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only fading memories. In 1967 the U.S. Treasury began printing book entry Treasury securities by using the paper of securities. Since that date the number and types of government securities no longer in use has increased. All T-Bills and short-term U.S. Treasury Notes are now issued in book entry form.

Book entry means that the investment—the obligation of the issuer to pay the debt—is not secured against a physical medium. It is stored in a complex "chip" on the computers of the U.S. Treasury and the Federal Reserve. Subpart O states that a "transfer or pledge of book entry securities is made by indorsing a certificate book entry account in name of a Reserve Bank (in its individual capacity or as fiscal agent of the United States) or to any transferee or pledgee eligible to maintain an appropriate book entry account in its name with a Reserve Bank. Such a transfer or pledge is effective and perfected, notwithstanding any provision of law to the contrary, by a Reserve Bank making an entry in its records of the securities transferred or pledged."

The making of such an entry shall be:

1. Have the effect of a delivery in bearer form of definitive Treasury securities [emphasis added];
2. Have the effect of a taking of delivery by the transferee or pledgee;
3. Constitute the transfer or pledge of the certificate book entry account; and
4. If a pledge, have the effect of a perfected security interest thereon in favor of the pledgee.

Another part of the statement that a transfer or pledge of the book entry securities affected under paragraph (a) shall have priority over any transfer, pledge, or other interest, thereafter or theretby affected under paragraph (b) of this section or in any other manner.

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security interest in the "mill support payments" as the "proceeds" which the debtor was to remit in the manner specified (which was the bank's collateral). The court relied on In re Schmeling 184 in concluding that the bank secured a security interest in the proceeds, and that the bank's lien extended to the milk support payments. The court added that under the laws in Weyland, the lien was not affected by the payment of the outstanding balance owed to the bank.

The court found that if the payment of the outstanding balance was made by the debtor, the bank's lien extended to the proceeds as well. The court concluded that the payment did not constitute a discharge of the debt, and that the bank's lien continued to attach to the proceeds. The court referred to the provisions of the Statutes of the State of Wisconsin, which provided for a secured creditor's right to a security interest in proceeds from the sale of collateral.

In re Schmeling 184 held that a security interest in proceeds extends to all future proceeds from the sale of collateral, even if the debtor makes a partial payment on the debt. The court in the present case relied on this principle to hold that the bank's lien continued to attach to the proceeds from the sale of the collateral.

The court also noted that the terms of the security agreement between the debtor and the bank did not provide for a discharge of the debt upon partial payment. The court concluded that the terms of the security agreement were clear and unambiguous, and that the bank's lien continued to attach to the proceeds from the sale of the collateral.

The court noted that the security interest in the proceeds was a continuing lien, and that the bank's lien continued to attach to the proceeds from the sale of the collateral. The court concluded that the bank's lien continued to attach to the proceeds from the sale of the collateral, and that the bank was entitled to a security interest in the proceeds from the sale of the collateral.

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result from such an intrusion, illustrate the possible effects, and increase awareness of the need to be alert to these issues.

Among the federal statutes not dealt with in this article are a few that traditionally have affected secured transactions: The Federal Tax Lien Act,148 the Federal Assignment of Claims Act,149 and of course the Bankruptcy Code,150 which was mentioned periodical in this article but was not covered in systematic or comprehensive fashion.151 Other important examples of preemption likewise have been de-emphasized: the authors have made no effort to a comprehensive analysis of preemption by means of federal common law,152 or the impact of preemption by federal banking laws,153 or federal limitations on creditor remedies.154 Nor have we dealt extensively with emerging issues relating to such things as copyright protection of computer programs or digital sounds.155 We have largely ignored the immense body of federal law governing or limiting consumer credit and sales transactions, and conflicts with other state laws.156 Even those areas covered are necessarily, dealt with in summary fashion. And yet the article is far too long. Perhaps this alone makes the point.

As Barkley Clark suggested (in far more subtle fashion), the zeal of Congress to extend federal preemption is in some cases exceeded only by the zeal of the judiciary in expanding that mandate.157 The result ultimately could undermine the salutary accomplishments of the Uniform Commercial Code in simplifying, clarifying, and modernizing the law of commercial transactions and encouraging the development of commercial practices through custom, usage, and agreement of the parties.158

151. For additional examples of preemption by the U.C.C. by bankruptcy law, see Tom, Section 3401(b) of the Bankruptcy Code (Herein the U.C.C., preceding this article). Carroll and Harrell, Creditor: Repossession of Security Interests and the Impact of Bankruptcy: 42 Collected Fin. L. Q. REP. 169 (1988).
154. Conflicts between Article Nite and other U.C.C. articles will be discussed in Part III(B) of this series, Conflict Within the Uniform Commercial Code, in a subsequent issue of the Quarterly Report.
155. See, e.g., Cate v. Anchor Oil Company, 495 P.2d 69 (1972).
156. See, e.g., U.C.C. § 1-203(2)(c) & (d).

Forum Conveniens

Forum Conveniens is a section devoted to responses of a substantive nature to issues covered in the Quarterly Report.

Professor Alvin C. Harrell Visiting Professor of Law University of Oklahoma College of Law 301 Timberdell Road Norman, OK 73019

Dear Professor Harrell:

Thank you for your courtesy in sending me the Summer 1988 issue of the Quarterly Report, containing your article on multi-state choice of law, which frequently cites my article on the "Last Event Test." I have been familiar with the Quarterly Report for many years and in fact wrote a couple of articles for it perhaps 30 years ago, and I once served as a judge for one of the Annual Arguments of the type which is featured at page 122 of this issue...[Currently I am largely devoting myself to writing some explanations of why Article 9 reads as it does for the benefit of the present Permanent Editorial Board and for revisors at some future time.

In that connection I am trying to draft a further comment on the "last event test" going beyond my article which you cite so frequently. While I still think that the test works and that my article defending it is correct, I have been much impressed by the fact that others do not see the statute as clearly as I do. Not only do people like Peter Coogan and Dave Henson misunderstand it, as I commented in my article, but my students do not seem to understand it. Indeed, I disagree with a couple of your comments which I will now briefly mention.

You say at page 156 and throughout your article that analysis of the choice of law problem on perfection must begin with the choice of law rule at section 1-105. I don't state that the draftsman of the 1972 amendments intended that at all. As I recall, and as I read section 1-105, its general rule set forth in subsection (1) is "except as provided hereafter in this section," and subsection (2) specifies section 9-103 as governing and in my opinion to the exclusion of any impact from section 1-105(1). The answers must be found entirely in section 9-103 and possibly in other principles not derived from section 1-105.

You discussed the "last event test" beginning at page 160. You there assumed that collateral is temporarily located in state A, but is expected to be shipped to state B and for that reason a filing occurs in state B, but the collateral never reaches state B. Put aside the possibility that state B had a special status under section 9-103(1)(c), which is not limiting assumption in your discussion. You nevertheless discuss seriously the possibility that the filing in state B could be a "last event" and that analysis should proceed from there. It seems to me that common sense tells us that if the collateral never reached state B, (again excluding any understanding under section 9-103(1)(c)), state B simply has nothing to do with the case. There is no way that filing could be a significant last event, anymore than if a dumb addressing by a secretary intended to reach a filing officer in state A inadvertently got addressed to state X and the financing statement was filed in state X. You ultimately reach this conclusion, but even to labor the point seems to me to be a failure to apply "the last event test" with necessary flexibility.

I have not yet decided entirely what I am going to do in my current discussion, but I am leaning toward the view that the "last event test" seems to present so much difficulty that it ought to be amended, without changing its basic rule, to make clear (for instance) that the "last event" could be a