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ONE STATE'S ANSWER TO THE UCC ARTICLE 9 TRADE NAME ISSUE AND A GLIMPSE AT THE NON-UNIFORM AMENDMENT PROCESS

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I. INTRODUCTION

When it was enacted, the Uniform Commercial Code promised to simplify and make uniform the commercial law throughout the United States. In Section 1-102, the drafters state the lofty purposes and policies as “(a) to simplify, clarify and modernize the law governing commercial transactions; (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties; (c) to make uniform the law among the various jurisdictions.”¹ We have had, however, non-uniformity from the start² and, because the statute is enacted locally, constituents often ask legislatures to enact changes they believe desirable. The constituents have often been successful and the result over the years is that the Code has become

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1. UCC §1-201(2). An extended listing of the literature on the history of the Code appears in C. Mooney, *Introduction to the Uniform Commercial Code Annual Survey: Some Observations on the Past, Present, and Future of the U.C.C.*, 41 BUS. LAW. 1343, 1344 n. 4 (1986).

2. As of 1967, William A. Schnader reported some 775 amendments to the UCC. W. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1, 10 (1967) and at that time the Permanent Editorial Board noted 337 non-uniform amendments to Article 9 alone. Permanent Editorial Board for the Uniform Commercial Code Rep. (hereinafter “P.E.B. Report”) 3 (1967). Indeed, the tendency for state legislatures to amend the proposed drafts seems to have led in large part to the creation of the Board, see P.E.B. Report 1, XXVII, and motivated it later to adopt the 1972 Amendments, P.E.B. Report 3 (1967).

increasingly non-uniform.³ Non-uniformity, of course, may add legal transaction costs to economic activity⁴ and, in a general sense, runs counter to a major premise on which the Code was promulgated.

There is nothing new about all this.⁵ What seems different is that concern is rising over the general problem of complexity in commercial transactions and more specifically, over the non-uniform amendment process.

II. THE McBEE PROBLEM: TRADE NAME FILINGS

Texas Senate Bill 139 amends Section 9-402 of the UCC to provide that filing a financing statement under a trade name or assumed name alone is not sufficient to perfect a security interest.⁶ While Comment 7 to Section 9-402 of the Official Text makes it clear that filing in the individual name is "contemplated," courts have upheld under the "not seriously misleading" test⁷ a trade name filing where the debtor's trade name is either very similar, or is "well known." The problem that prompted the Texas action is that courts have occasionally upheld a "well known" trade name filing even though the trade name and the real name are completely dissimilar.

In *In re McBee*,⁸ Joe Ben Colley owned the "Oak Hill Gun Shop" as a sole proprietorship. A secured party took a security interest in the shop's inventory and filed under that trade name only. Subsequent secured creditors took security interests in the same collateral and filed under "Joe Ben Colley" as well as the trade name. The central issue for the Fifth Circuit was whether the filing solely under the trade name sufficed to perfect the first

3. One commentator noted that although there had been near universal adoption of the Code, local amendments and judicial interpretations resulted in "likeness rather than exactness." E. Taylor, *Recent Developments in Commercial Law, Forward: Federalism or Uniformity of Commercial Law*, 11 RUT. CAM. L. J. 527, 531 (1980).

4. While this may be the tendency, the matter is more complicated because non-uniformity may also contribute to commercial law that better coincides with local commercial practice and thereby reduces transaction costs. See generally S. Knippenberg and W. Woodward, *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519, 2521-2528 (1990).

5. The UCC literature that deals with non-uniformity and federalism issues is abundant and growing. See, e.g., R. Braucher, *Federal Enactment of the Uniform Commercial Code*, 16 LAW & CONTEMP. PROBS. 100 (1951); B. Clark, *U.C.C. Survey of Secured Transactions*, 42 BUS. LAW. 1333 (1987); F. Kennedy, *Federalism and the Uniform Commercial Code*, 29 BUS. LAW. 1225 (1974); S. Knippenberg and W. Woodward, *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519 (1990); C. Mooney, *Introduction to the Uniform Commercial Code Annual Survey: Some Observations on the Past, Present, and Future of the U.C.C.*, 41 BUS. LAW. 1343 (1986); W. Schnader, *The Uniform Commercial Code—Today and Tomorrow*, 22 BUS. LAW. 229 (1966); E. Taylor, *Uniformity of Commercial Law and State-by-State Enactment: A Confluence of Contradictions*, 30 HASTINGS L. J. 337 (1978); E. Taylor, *Recent Developments in Commercial Law, Forward: Federalism or Uniformity of Commercial Law*, 11 RUT. CAM. L. J. 527 (1980).

6. The statutory change became effective September 1, 1989.

7. U.C.C. §9-402(8).

8. 714 F.2d 1316, 36 UCC Rep.Serv. 1473 (5th Cir., 1983).

security interest. Concluding under the facts⁹ that “a reasonably prudent creditor—as we assume for purposes of the law is the trustee—certainly should have searched under the name ‘Oak Hill Gun Shop’ before extending a loan related to *that* business and collateralized by property of *that* business,”¹⁰ and relying on its own earlier decision in the similar case of *In re Glasco*,¹¹ the court found the filing sufficient.

III. THE NON-UNIFORM TEXAS SOLUTION

The Texas amendment addresses the McBee problem by inserting the language underlined below into the text of the UCC at Section 9-402:

(g) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or the names of the partners. Filing under a trade name or assumed name alone shall not be sufficient to perfect a security interest unless the trade name or assumed name filing would be discovered in a search of the filing officer's records pursuant to Subsection (b) of Section 9.407 conducted in response to a request using the legal name of the debtor. Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer.

The basic rationale for this amendment is apparent, but its evolution and the policy choices it represents warrant exploration.

The original Texas proposal called for a flat prohibition on filing under a trade name: “Filing under a trade name alone is *never* sufficient [emphasis added].” There were objections that this was out of tune with the Code’s notice filing scheme,¹² for example, with Texas Section 9-402(h)¹³ which provides: “A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.” While the provision first considered would have made a filing under “Oak Hill Gun Shop” inadequate to perfect a security interest given by “Joe Ben Colley,” it could also have made such

9. Ownership, while clearly in Colley, was superficially deceiving due to involvement of one McBee who inaccurately called herself Colley’s partner and who acutely applied for the loan. *Id.* at 1318.

10. *Id.* at 1324.

11. 642 F.2d 793, 31 UCC Rep.Serv. 16 (5th Cir.Fla., 1981).

12. “Subsection 8 [of UCC §9-402] is in line with the policy of this Article to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of such statutory [filing] requirements in which courts have occasionally indulged themselves.” UCC §9-402, Comment 9.

13. This provision is UCC §9-402(8) in the 1987 Official Text.

a filing inadequate to perfect a security interest in a corporation called "Oak Hill Gun Shop, Inc."

The reformers' second approach was to seek amendment of Section 9-402(7) to provide that "a financing statement that shows only a trade name of the debtor shall not be effective, except where such trade name is so similar to the actual name of the debtor that the financing statement is not seriously misleading."

There were also objections to this approach, on grounds that it would add uncertainty by using the terms "so similar" and "not seriously misleading." Those objecting argued that this test is already present in Code Section 9-402(8) and that the proposal would further complicate matters. Proponents of the second approach argued in response that the words "so similar" were needed so that courts could not use a creditor's actual or constructive knowledge that the debtor used a trade name to support a finding that the filing was "not seriously misleading." They apparently believed that it was bad policy for courts to consider a creditor's actual or constructive knowledge and without a "so similar" limitation, courts would still be free to find that the debtor's trade name was well known or perhaps even better known than his actual name, as when Joe Ben Colley does business as the "Oak Hill Gun Shop."

Proponents of the second approach argued that, as a matter of policy, the use of the trade name should not be permitted unless it actually resembles the real name, whether or not the trade name was known to the secured party or its agents or was so well known as to charge the world with constructive knowledge. Thus the second approach was an attempt to eliminate actual or constructive knowledge from the "not seriously misleading" test. However, as noted, the weakness of this approach is that "so similar" is already utilized as an element of the process courts use to determine whether or not the filing is seriously misleading.¹⁴

The third and final version of the Texas amendment addresses the policy concerns behind the second approach differently. Now the trade name filing is ineffective "unless the trade name or assumed name filing would be discovered in a search" To be effective, apparently the filing must be "so similar" that a filing officer, in response to a search request, would report it as a "match."¹⁵

IV. CONCERNS WITH THE TEXAS AMENDMENT

The Texas amendment, of course, injects non-uniformity into the UCC. Within the Fifth Circuit, a trade name filing that may suffice in Mississippi will be invalid in Texas. Lawyers thus may have to be more attentive to choice of law questions within their loan contracts and courts must be more

14. See, e.g. *Pongetti v. Deposit Guaranty National Bank*, 94 B.R. 898, 7 U.C.C. Rep.Ser.2d 1297 Bankr.N.D.Miss. 1988).

15. As we discuss below, it is by no means clear how the "would be discovered" language will work in actual practice.

sensitive to such questions when resolving disputes. We need not dwell here on the problems with non-uniformity;¹⁶ suffice it to say that the UCC is a little less uniform now than it was before.

If, however, the Texas amendment is meritorious, the UCC's Permanent Editorial Board may want to make the amendment a part of the Code and thereby eliminate this particular non-uniformity problem. Unfortunately, there are problems with the Texas approach.

Structurally, the issue addressed by the amendment is whether and when a trade name filing is a "minor error which [is] not seriously misleading," that is, this is a Section 9-402(8) problem, not a Section 9-402(7) problem. Section 9-402(7) tells us what will suffice, not what will not suffice for a filing; it doesn't speak to deviations from the requirements as does Section 9-402(8). Locating the corrective language in Section 9-402(7) gives trade names an unearned importance and could conceivably lead one to accord increased latitude to other filings addressed by Section 9-402(7) such as filings against partnerships and corporations.

But even if better located, the language would have difficulties. Once again, it would tend to elevate the trade name issue high above all the other "not seriously misleading" issues. Indeed, the specificity of the amendment seems out of place within the black letter of Section 9-402 and particularly within the very general language of Section 9-402(8).

Secondly, the very specific "would be discovered" test specified within the amendment has its own problems. Lenders obviously want to discover the debtor's real name, hand that to the filing officer, and be certain such a request will uncover all relevant financing statements. The language of the amendment codifies that desire. But some of the most perplexing problems with the approach emerge when one considers how it might work in practice. In litigation, is the secured party who has made only a trade name filing to produce a filing officer who will testify that she actually found the trade name in response to a "real name" request? Or is she to give her opinion that she *would have found* the financing statement? Is the litigant to produce all the filing officers or only the one that would have been on duty when the searcher would have searched?¹⁷ Might there even be litigation over whether the erroneous filing was in a "trade or assumed name" (yielding the amendment's litmus test) or some other erroneous filing (yielding the less determinative "not seriously misleading" test of Section 9-402(8))?

And how will lending practices respond to the amendment? Currently, no doubt, most lenders lending to the Oak Hill Gun Shop would search and file under that name whatever the legal name of the debtor. They would thereby minimize their risk and later conflicts with other lenders. This amendment seems to reduce somewhat the need for such initial caution because under

16. The literature is already extensive. *See supra* note 5.

17. Can we be confident that either litigant in a controversy of any size will put in an "ordinary" search request after the controversy has quickened? Or might a party with much at stake be tempted to send the filing officer the subtle message—either "if you don't get an *exact* match, I don't want it" or "bring me anything even remotely resembling this name."

the amendment, an “Oak Hill Gun Shop” filing would presumably be invalid and a lender need not look for it. If lenders stop searching under obvious but non-legal names, it might reduce initial search costs a bit. It’s not, however, altogether clear that reduced caution at the start of the lending process is a good thing.¹⁸

Finally, on this particular “not seriously misleading” question, the amendment converts what was, at best, a mixed question into a nearly-pure fact question. Under the amendment, each case may depend on who the particular filing officers were and the conditions of their files at some particular point in time. Again, this seems inconsistent with the Code’s approach on most issues. For filing errors outside of Texas, courts have some latitude under Section 9-402(8) to consider the underlying policy of the Code and to develop legal principles. Is the trade name problem really so special, widespread, or unique that it should be treated so differently from other misfiling problems within the Code? If this problem is special—and the attention given it by commentators as well as the Texas legislature suggests it might be—more than a non-uniform amendment should be forthcoming.

The underlying policy question is difficult. *McBee* and *Glasco* may err on the side of too much latitude for a secured party. If so, the Permanent Editorial Board can amend the Comments to identify the cases as wrongly decided. On the other hand, is the policy underlying the Texas amendment so clearly desirable that decisions like those of the Fifth Circuit can be called “wrong”? The Code’s current flexibility in permitting a *McBee* or a *Glasco* may, on examination, be good from a policy perspective. A definitive judgment on the central underlying policy question requires a broad discussion within the financing and academic communities.¹⁹

Such a dialogue is imperative here because pressure clearly has been building, at least in the Fifth Circuit, to resolve the trade name issue. Courts in Oklahoma and Georgia have also decided the issue consistently with *McBee* and *Glasco*²⁰ and there has been reported interest in Oklahoma in having its legislature overrule the *Glasco* approach through an Oklahoma amendment.

The question for those interested in maintaining the UCC’s ideal of uniformity is how might the local concern be redirected to provoke a wider

18. Even if the law is clear that the first filing is bad, that first lender will be motivated by its prospective (and perhaps unexpected) loss to attack the second lender’s security interest on whatever grounds it can find. Even successful litigation is costly and if we count that cost, then the presence of a defectively filed first security interest surely makes the second loan riskier than it would be without that first filing. In the Official Text, the Code’s flexibility on the trade name issue may make it likely that the second lender will exercise more caution at the start, accurately perceive this risk and thereby reduce later lending disputes.

19. Commentators divide on whether *Glasco* and its progeny are “right” or “wrong” See B. Clark, *The Law of Secured Transactions Under the Uniform Commercial Code*, Para 2.09[1][b] (2d Ed. 1988) (wrong); R. Duncan and W. Lyons, *The Law and Practice of Secured Transactions: Working with Article 9*, §3.04[2] at 3-27 - 3-30 (1987) (wrong); J. White and R. Summers, *Uniform Commercial Code* §22-18 at 1038 (3rd Ed. 1988) (right).

20. See, e.g. *Peoples Nat. Bank v. Uhlenhake*, 712 P.2d 75, 42 U.C.C. Rep.Serv. 1839 (Okla.App., 1985); *In re Simpson Motor Co.*, 101 B.R. 813, 9 U.C.C. Rep.Serv.2d 408 (Bkrtcy.N.D.Ga., 1989).

discussion of the substantive issue that will lead to a uniform resolution one way or the other. In the past, concerns about local decisions such as *McBee* combined with frustration about the cumbersome process of getting UCC amendment or commentary may have made the nonuniform amendment the course of least resistance. In part to counteract this tendency, the American Bar Association's Business Section's UCC Committee appointed a Subcommittee on Relation to Other Law which is charged, among other things, with studying the process by which the Uniform Text and Comments responds to local concerns and with fostering Code uniformity.

This group has alerted the UCC Permanent Editorial Board which has begun a study of Article 9²¹ so that the trade name issue will be aired, resolved, and appropriately codified if that is called for. Where local pressure for change is building on other issues, one would hope that persons concerned with overall UCC uniformity will arrive on the scene earlier than was the case with *McBee*. By channelling the issues and prompting discussion before local concerns develop into non-uniform amendments, we might slow creeping non-uniformity and help maintain a central goal of the Uniform Commercial Code.

21. See Minutes of Meeting, Permanent Editorial Board of the Uniform Commercial Code, September 23, 1989, Paragraph 3.