UNIFORM COMMERCIAL CODE STUDY COMMITTEE

Report to the Legislative Council
and the Members of the
Second Session of the Sixty-fifth General Assembly

State of Iowa
1974

FINAL REPORT

of the

UNIFORM COMMERCIAL CODE STUDY COMMITTEE

House Concurrent Resolution 72, introduced during the First Session of the Sixty-fifth General Assembly, requested that the Iowa Legislative Council establish a study of the 1972 Official Amendments to the Uniform Commercial Code, including those 1966 Official Amendments which were republished in 1972, as well as the 1965 Iowa nonuniform variations from the Official Text of the Uniform Commercial Code. The Legislative Council created a seven-member Study Committee and appointed the following legislative members:

Representative David M. Stanley, Chairman
Senator Earl M. Willits, Vice Chairman
Senator E. Kevin Kelly
Senator Ralph W. Potter
Representative William R. Ferguson
Representative Alvin V. Miller
Representative Stephen J. Rapp

Under the Legislative Council's nonlegislative member policy, Professor Richard F. Dole, Jr., of the University of Iowa College of Law of Iowa City, and Mr. Edgar H. Hansell, Attorney, of Des Moines, were approved as nonlegislative members of the Study Committee, and student assistance under the supervision of Professor Dole also was approved. University of Iowa law students William Kovacs and Peter Toft rendered valuable assistance to the Study Committee pursuant to this authorization.

Representative David M. Stanley was designated Temporary Chairman by the Legislative Council and was elected Chairman by the Study Committee. Senator Earl M. Willits was elected Vice Chairman. The Study Committee also voted to invite interested citizens and officials to attend its meetings as informal consultants to the Committee. The individuals who accepted this invitation to participate in the deliberations of the Committee included:

Mr. John McCabe, Legislative Director, National Conference of Commissioners on Uniform State Laws
Mr. Glenn Clark, Iowa Superintendent of Securities
Mr. Gifford Strand, U.C.C. Division, Office of the Iowa Secretary of State
Ms. Ramona Williams, Black Hawk County Recorder
Mr. Allen Buchanan, Iowa Land Title Association
Mr. John Burrows, Iowa Trust Association
Mr. Wendell Gibson, Iowa Bankers Association
Mr. Al Jordan, Iowa Credit Union League
Mr. Gary Plank, Iowa Credit Union League
Mr. Melvin Struthers, Mor-America Corporation
Ms. Betty Talkington, Iowa Consumers League
Mr. Ed Tesdell, Iowa Savings and Loan Association
Ms. Jeanne Tester, Iowa Consumers League

At its first meeting, the Study Committee endorsed the goal of fostering simplicity and clarity in the law, and adopted a rebuttable presumption in favor of conforming the Iowa Uniform Commercial Code to the 1972 Official Text and Comments of the Uniform Commercial Code (U.C.C.). The Committee also noted that both uniform 1972 section 9-203(4) and present Iowa Code section 554.9203(2) invite the General Assembly to subordinate the general U.C.C. Article 9 rules pertaining to security interests in personal property and fixtures to specialized consumer protection legislation. Thus, if the General Assembly should enact consumer protection legislation which restricts the rights of Article 9 secured parties, as the proposed Uniform Consumer Credit Code does, the General Assembly should correlate this consumer protection legislation with both the present text of Article 9 and the revisions in Article 9 proposed by the U.C.C. Study Committee. However, the 1966 and 1972 U.C.C. Amendments do not deal whatsoever with the legal rate of interest and there was perceived to be no inconsistency or general overlap between the subject matter of the U.C.C. Study and the subject matter of the Regulation of Consumer Credit Charges Study which would preclude either Study Committee from completing a fruitful, independent evaluation of its topic or which would preclude the General Assembly from enacting the recommendations of either or both Study Committees.

On the basis of six day-long meetings, the U.C.C. Study Committee finds that:

1. Iowa is one of 49 states which has adopted the 1962 Official Text and Comments of the Uniform Commercial Code, a comprehensive statute containing nine substantive articles which establish guidelines for most kinds of private commercial transactions.

2. The 1962 Official Text of the Uniform Commercial Code was drafted and promulgated by the National Conference of Commissioners on Uniform State Laws following years of study and evaluation, and enacted by the Iowa General Assembly in 1965.

3. In 1972, following evaluation of 10 years of experience under the 1962 Official Text, the Uniform Commissioners promulgated the 1972 Official Amendments to the Uniform Commercial Code, which include several Official Amendments initially approved in 1966.

4. In the first year since their promulgation, the 1972 Official Amendments have been enacted in at least Arkansas, Illinois, Nevada, North Dakota, Oregon, Texas, and Virginia, and seem likely to be adopted throughout the country in the foreseeable future.

5. In its 1965 enactment of the 1962 Official Text of the Uniform Commercial Code the General Assembly adopted the policy of establishing a law of commercial transactions which was as simple, clear, and modern as possible, Iowa Code section 554.1102(2)(a); in order to achieve this goal it is necessary and desirable for the General Assembly to enact the 1966 and 1972 Official Amendments to the Uniform Commercial Code, and to delete those 1965 Iowa nonuniform variations from the 1962 Official Text which do not constitute clear improvements in the Uniform Text.

On the basis of a line-by-line evaluation of the 1966 and 1972 Official Amendments and the 1965 Iowa nonuniform amendments to the U.C.C., the U.C.C. Study Committee recommends that:

1. The 1966 and 1972 Official Amendments to the U.C.C. should be adopted in toto.

2. The 1965 Iowa nonuniform amendments should be deleted, with occasional exceptions noted expressly in the bill proposed by the Study Committee.

3. Technical amendments should be made to such non-U.C.C. statutes as the certificate of title law in order to conform those statutes to the Iowa U.C.C.

Discussion

Illustrative of the desirability of the 1966 and 1972 Official Amendments are the 1972 section 9-313 fixture priority rules and the 1972 section 8-102(3) Amendment dealing with securities depositories.

A fixture is personal property that has been so affixed to real estate that property interests can exist in the personal property under real estate law as well as under personal property law. In Ottumwa Woolen Mill Co. v. Hawley, 44 Iowa 57 (1876), the Iowa Supreme Court adopted the so-called Teaff v. Hewitt tests for the identification of fixures:

> *The three requisites laid down in the case of Teaff v. Hewitt, as constituting a fixture, it is said, must all combine. The first, being physical attachment, all the cases hold is a very uncertain and unsatisfactory criterion, and in our opinion the only value to be attached to it is, in determining the intention of the owner of the freehold in making the annexation. If it be so affixed that its removal would materially injure the building, this is evidence of an intention to make it a permanent annexation.*

> *The second requisite, being application to the use or purpose to which that part of the realty with which it is connected is appropriated, is in this case fully met by the use of this machinery in a woolen mill, and without which the mill itself would be useless.*
>
> *The third requisite, being the intention of the party making the annexation to make a permanent accession to the freehold, is to our minds the controlling consideration in determining the whole question. (44 Iowa at 63)*

Although it is often doubtful whether particular personal property is a fixture, there is clear Iowa authority indicating that a home furnace usually is, e.g., Des Moines Improvement Co. v. Holland Furnace Co., 204 Iowa 274 (1927), and a home furnace example will be used to illustrate 1972 section 9-313's resolution of policy issues pertaining to fixtures.

First, 1972 section 9-313 refers to a state's non-U.C.C. law for the definition of "fixture", 1972 section 9-313(1)(a). The Ottumwa Woolen Mill test therefore will continue to be dispositive with respect to the applicability of 1972 section 9-313 in Iowa. However, a debtor's signing a U.C.C. "fixture filing" authorized by 1972 section 9-313(1)(b) will be evidence of the debtor's intent that particular personal property is to become a fixture, and the Ottumwa Woolen Mill test makes the intention of the debtor (i.e., the intention of the party making the annexation of personal property to land) the primary criterion of the existence of a fixture.

Second, an important facet of 1972 section 9-313 gives the holder of a perfected Article 9 security interest rights in a fixture superior to those of the holder of a prior real estate mortgage on the land to which the fixture has been affixed, provided that: (1) the Article 9 security interest is a purchase money security interest; (2) the secured party acquires an interest in the personal property before it becomes a fixture; (3) an Article 9 fixture filing is made within 10 days after the personal property is affixed to the land; and (4) the debtor is either in possession of the real estate to which the personal property is affixed or a record owner of that real estate, 1972 section 9-313(4)(a). Restated in terms of home furnaces, in order for a vendor or a lender to have superior rights in a furnace vis-a-vis the holder of a prior real estate mortgage on the home in which the furnace has been installed:

1. The furnace financer must have made a purchase money loan.

2. The debtor must have agreed to creation of a security interest prior to the installation of the furnace.

3. The furnace financer must have made a fixture filing within 10 days subsequent to the installation of the furnace.

4. The debtor must have been either a record owner of the real estate on which the furnace was installed or in actual possession of that real estate.

Some real estate financers object to this qualified purchase money priority on the ground that it could subject them to the removal of furnaces in Article 9 foreclosure proceedings and resulting depreciation of their real estate security. These real estate financers prefer the present Iowa nonuniform variation from the 1962 Official Text which provides: "Nothing in this chapter governs the priority between a security interest in goods which are or are to become fixtures and the claims of any person who has an interest in the real estate." Iowa Code section 554.9313. The effect of this 1965 Iowa nonuniform amendment is to give prior real estate mortgagees superior rights with respect to all furnaces which subsequently are installed on mortgaged real estate, whether or not a prior real estate mortgagee finances the acquisition of a furnace. Moreover, in instances in which a prior real estate mortgagee is not willing to finance the purchase of a new furnace, this Iowa nonuniform amendment reduces the willingness of other lenders and furnace vendors to make a purchase money advance that will be subject to the rights of a prior real estate mortgagee who was unwilling to engage in purchase money financing.

The Study Committee has concluded that, on balance, real estate mortgagees will be helped rather than hurt by 1972 section 9-313(4)(a) and that, in any event, real estate mortgagees have ample means to protect themselves against disadvantageous consequences. The value of real estate security is enhanced by the replacement of an old furnace with a new furnace no matter who finances the home improvement. Moreover, if a real estate mortgagee wishes to prevent another from gaining purchase money rights in a new furnace under 1972 section 9-313(4)(a), the real estate mortgagee can finance the acquisition of the new furnace itself. The real estate mortgagee also can make it a default of the real estate mortgage for the debtor to grant a section 9-313(4)(a) priority in a new furnace to another, and can take out insurance against any ultimate failure of the real estate security to satisfy the secured debt. The Study Committee concurs in Official Comment 8 to 1972 section 9-313, which states:

> *Real estate lending is typically long-term, and is usually done by institutional investors who can afford to take a long view of the matter rather than concentrating on the results of any particular case. It is apparent that the rule which permits and encourages purchase money fixture financing, which in contrast is typically short-term, will result in the modernization and improvement of real estate rather than in*

> *its deterioration and will on balance benefit long-term real estate lenders. Because of the short-term character of the chattel-financing, it will rarely produce any conflict in fact with the real estate lender. The contrary rule would chill the availability of short-term credit for modernization of real estate by installation of new fixtures and in the long run could not help real estate lenders.*

Significantly, only one of the forty-nine states which have enacted the 1962 Official Text has joined Iowa in rejecting 1962 section 9-313, and all seven states which have enacted the 1972 Official Amendments have adopted 1972 section 9-313 without material change.

The 1972 section 8-102(3) Amendment pertaining to securities depositories has been adopted by some 30 states, including California, Illinois, and New York. This Official Amendment permits banks and insurance companies as well as national stock exchanges to own stock in the clearing corporations authorized to operate securities depositories by present Iowa Code section 554.8320. After securities have been deposited with a clearing corporation further transfers of the deposited shares can be made through entries on the books of the clearing corporation, and the expense, delay, and theft-potential of physical transfer of securities thereafter eliminated. Federally regulated clearing corporations presently exist in at least California, Illinois, and New York, and the U.C.C. Study Committee believes that Iowa financial institutions should not be denied the privilege of utilizing these securities depositories. The Study Committee recommends a package of amendments which:(1) adopt 1972 section 8-102(3), in order to remove any doubt that Iowa financial institutions can utilize the services of the existing clearing corporations that allow banks and insurance companies to be stockholders; and (2) effectively limit this authorization to federally regulated clearing corporations in order to ensure that maximum precautions will be taken with respect to the deposited securities. This same concern underlies the 1972 Official Amendment to section 8-102(3) itself. Banks and insurance companies, which throughout the country hold large amounts of securities as fiduciaries, understandably are reluctant to deposit securities with a clearing corporation in the absence of a meaningful opportunity to ensure that the business policies adopted by the clearing corporation adequately will protect the interests of fiduciary depositors.

Illustrative of the general undesirability of the 1965 Iowa nonuniform variations is a series of nonuniform amendments pertaining to "feeder cattle". Iowa Code sections 554.1201(37), 554.2403(2), 554.9102(2), and 554.9307(1) contain nonuniform provisions which have the effect of declaring every bailment of cattle to be an Article 9 security interest that must be perfected

by the execution of an Article 9 security agreement and the filing of an Article 9 financing statement. In adopting these nonuniform amendments the Iowa General Assembly apparently believed that it was enhancing the rights of a cattle owner who arranges for a bailee to feed his cattle. However, these nonuniform amendments require every bailor of cattle to execute an Article 9 security agreement and to file an Article 9 financing statement. If these Article 9 formalities are not observed, and the Study Committee suspects that they frequently are not, a bailor of feeder cattle is placed in a worse position than he otherwise would have been in. For example, in the absence of the nonuniform amendments a bailor of feeder cattle who neither has executed an Article 9 security agreement nor filed an Article 9 financing statement can reclaim the bailed cattle or their proceeds from the bailee's trustee in bankruptcy, Cattle Owners Corp. v. Arkin, 252 F. Supp. 34 (S.D. Iowa 1966). However, under the existing Iowa nonuniform "feeder cattle" amendments, a bailor of feeder cattle who neither has executed an Article 9 security agreement nor filed an Article 9 financing statement loses his property rights to a bailee's trustee in bankruptcy. See Iowa Code section 554.9301(1)(b) and (3). Moreover, in the absence of the nonuniform "feeder cattle" amendments, a bailor of cattle who neither has executed an Article 9 security agreement nor filed an Article 9 financing statement has superior rights to a person to whom the bailee wrongfully grants a perfected Article 9 security interest in the bailed cattle, see Union Stock-Yards & Transit Co. v. Western Land & Cattle Co., 59 Fed. 49 (7th Cir. 1893). On the other hand, under the Iowa nonuniform "feeder cattle" amendments, a bailor of cattle who neither has executed an Article 9 security agreement nor filed an Article 9 financing statement loses his property rights to a person to whom a bailee wrongfully grants a perfected Article 9 security interest in the bailed cattle. See Iowa Code section 554.9312(5).

Because those bailors of feeder cattle who wish to secure a bailee's obligations under Article 9 are free to do so under the uniform text, the Study Committee concludes that the 1965 nonuniform "feeder cattle" amendments needlessly jeopardize the rights of owners of cattle who are unfamiliar with the technicalities of Article 9 security agreements and financing statements. These nonuniform amendments, like most of the 1965 Iowa nonuniform amendments, should be repealed.

This is not to say that the Study Committee recommends a slavish deference to uniformity. Among the 1965 Iowa nonuniform variations which should be retained are:

1. The omission of the four-year statute of limitations for breaches of contracts for the sale of goods, Iowa Code section 554.2725; Compare 1972 section 2-725.

2. The nonuniform requirement that Iowa banks give notice of the reason for dishonor or nonpayment whenever they revoke provisional payment of a demand item, Iowa Code section 554.4301(1)(b); Compare 1972 section 4-301(1)(b).

Insofar as the statute of limitations is concerned, the Study Committee believes that the Iowa ten-year statute of limitations for breaches of written contracts and the Iowa five-year statute of limitations for breaches of oral contracts, Iowa Code section 614.1(4) and (5), confer more adequate rights upon our citizens than the uniform four-year statute of limitations. With respect to the revocation of provisional payment of demand items by banks, the Committee believes that a person who deposits a check for collection and has the check returned unpaid is entitled to be told the reason for nonpayment. A "no account" reason, for instance, may warrant contacting the county attorney; whereas an "NSF" reason may lead to the check's being deposited for collection a second time.

Finally, the Study Committee has proposed a limited number of new nonuniform amendments which, in the Committee's opinion, improve the uniform text. For example, the Committee recommends a nonuniform amendment which makes clear that consistent Official Comments are guides to legislative intent in interpreting the Official Text. The Committee also recommends transfer to the state level of U.C.C. filings with respect to farm-related collateral that does not involve fixtures. The rise of the farm corporation plus the increasing size of individual farms can make it difficult to pinpoint the county within which local filing presently must take place with respect to farm-related collateral. Filing at the state level removes the need to ascertain the location of a farm corporation and the sometimes severe financial penalties for good faith misfiling in the wrong local office. It also removes the present compulsion to file in all of the conceivably pertinent local offices in order to play safe. Notwithstanding the desirability of this change in the place of filing, the Committee proposes careful and deliberate implementation. The Study Committee bill delays a state filing requirement with respect to farm-related collateral until January 1, 1976, and provides for the prior implementation of streamlined administrative procedures in order to guarantee the ready accessibility of information concerning all filings in the Secretary of State's office.

In addition to the foregoing, the Study Committee makes the following observations:

1. Present Iowa Code section 554.2502(1) states in part "is insolvent at the time of receipt of the first installment on their price or becomes insolvent within ten days thereafter". The Committee recommends deletion of this 1965 nonuniform variation and enactment of the comparable uniform text, which provides "becomes insolvent within ten days after receipt of the first installment on their price", in the conviction that the uniform text encompasses pre-existing insolvency that continues into

the 10-day period after a seller has received the first installment on the price of contract goods.

2. A 1962 nonuniform variation in Iowa Code section 554.4102(2) omits "In the case of action or non-action by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located". A similar 1965 nonuniform variation in Iowa Code section 554.4106 omits "branch or". These 1965 nonuniform amendments have been justified on the ground that Iowa does not permit branch banking. However, the omitted uniform text deals with choice of law and time computation and can aid in the resolution of disputes involving banks located in other jurisdictions which do permit branch banking. In proposing enactment of the omitted uniform text the Committee specifically observes that the uniform text does not authorize branch banking in Iowa and should not be interpreted to do so.

3. To the extent that the Iowa Supreme Court decision of Lisbon Bank & Trust Co. v. Murray, 206 N.W.2d 96 (1973), was influenced by the statement in Comment 3 to 1962 section 9-306 that "a claim to proceeds in a filed financing statement might be considered as impliedly authorizing sale or other disposition of the collateral" free of a security interest, the Committee notes that the 1972 Official Amendments to Article 9 do away with the necessity of claiming proceeds in a filed financing statement and that Comment 3 to 1972 section 9-306 states in part: "The right to proceeds, either under the rules of this section or under specific mention thereof in a security agreement or financing statement does not in itself constitute an authorization of sale".

4. It would be desirable for the General Assembly to do what the Commissioners on Uniform Laws did not do and develop a comprehensive statutory definition of "fixture" which would facilitate the application of 1972 section 9-313 as well as other Iowa statutory provisions and rules of common law which pertain to fixtures. However, the Committee concludes that this task is too time-consuming for it to undertake in addition to its review of past and proposed amendments to the nine substantive articles of the U.C.C.

5. Whenever Article 9 foreclosure by sale proceedings are instituted with respect to consumer goods collateral, the Committee has been urged that the holders of junior Article 9 security interests should be entitled to notice as of right. However, neither the 1962 nor the 1972

Official Text requires this notice and the tenor of the 1972 Official Amendments is to minimize procedural technicalities in the hope of maximizing the proceeds of foreclosure sale. For similar reasons, the Study Committee rejects this proposed nonuniform amendment.