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COMMENT

COMMERCIAL LAW—SECURED TRANSACTIONS—Description of Collateral in a Financing Statement. — *In re Lehner*, 303 F. Supp. 317 (D. Colo. 1969), *aff'd*, 427 F.2d 357 (10th Cir. 1970).

ON August 18, 1967, Household Finance Corporation (HFC) made a loan to Lowell Louis Lehner of $827.33 which was secured by a tapedeck and a portable television set. Pursuant to the statutory requirement for perfecting security interests, HFC duly filed a financing statement in which the secured collateral was described only as "consumer goods." On November 6, 1967, Lehner filed a petition for voluntary bankruptcy. HFC sought leave to foreclose on its security interest. The referee ruled the lien invalid on the ground that the term "consumer goods" did not describe the secured collateral sufficiently to perfect HFC's interest in the television set and tapedeck. On petition to the U.S. District Court (D. Colo.), *held*, affirmed. The term "consumer goods" is too broad, general and meaningless to fulfill the demand of UCC § 9-402(1) that the financing statement describe the items secured, or at least indicate their type.[1]

I. NOTICE FILING UNDER THE UCC

Article Nine of the Uniform Commercial Code[2] provides three legal devices by which a security interest in personal property may be perfected,[3] *i.e.*, rendered impervious to defeat by a trustee in insolvency proceedings[4] or unsecured creditors in general. Of these, the most important is that of notice filing.[5] Indeed, § 9-302 provides that with certain specified exceptions, a financing statement *must* be filed to perfect a security interest in personal property.[6]

From a functional point of view, the filed financing statement serves to place a prospective creditor on inquiry notice

[1] *In re* Lerner, 303 F. Supp. 317, 320 (D. Colo. 169). On appeal to the Court of Appeals for the Tenth Circuit, the decision of the district court was affirmed per curiam. *In re* Lehner, 427 F.2d 357 (10th Cir. 1970).

[2] Unless otherwise indicated, all references to the Colorado Code will be designated "UCC" and will omit the complete statutory citation. Citation to "Comments" are those accompanying the 1962 Official Text.

[3] UCC §§ 9-302, 9-304, 9-305, 9-306.

[4] Federal Bankruptcy Act, 11 U.S.C. §§ 96, 1106 (1963); UCC § 9-301.

[5] UCC § 9-302.

[6] *Id.* § 9-302(1).

that the named secured party may have a security interest in the collateral described.[7] Further inquiry from the parties concerned is necessary to disclose the complete state of affairs.[8]

To be effective, a financing statement must contain, *inter alia*, "a statement indicating the types, or describing the items, of collateral."[9] For the purpose of this requirement, "any description of personal property . . . is sufficient whether or not it is specific if it reasonably identifies what is described."[10] In adopting this simple and flexible test for determining the sufficiency of a description, the Code has abandoned the highly technical and rigid formalities that unduly burdened secured transactions under pre-Code law.[11] Thus the Comment to § 9-110 states that in applying this test "courts should refuse to follow the holdings . . . that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called 'serial number' test."[12]

To date, the relatively few courts which have had occasion to pass on the sufficiency of description in a financing statement, have, for the most part, been willing to follow the admonition of the Code drafters. Adverting to the functional

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[7] *Id.* § 9-403, Comment 2.

[8] *Id.*

[9] *Id.* § 9-402(1).

[10] *Id.* § 9-110. It should be noted that Colorado has adopted a nonuniform amendment to § 9-110. The Colorado version, as found in COLO. REV. STAT. ANN. § 155-9-110 (1963), *as amended*, (Supp. 1969), reads as follows:

> For the purposes of this article, any description of personal property is sufficient if it specifically identifies and itemizes in the security agreement what is described as to consumer goods, and whether or not it is specific if it reasonably identifies what is described as to all other personal property.

Thus Colorado, in the interest of consumer protection, has stifled the Code's attempt to abolish the pre-Code formalities which required the security agreement to contain the most detailed and particularized description of collateral. However, as the Colorado amendment clearly applies only to the security agreement, it seems safe to conclude that the language of the Official Draft, as quoted in the text, still controls the sufficiency of a description in a financing statement. This conclusion is strengthened by the fact that the language of the Official Draft is reproduced in Comment 1 of § 9-402 as the proper determining test for the sufficiency of description under that section. Thus what follows in the text applies to Colorado as well as to those states which have adopted the uniform version of § 9-110.

[11] In Colorado, three statutes governed most transactions in personalty: they were the Chattel Mortgage Act, the Inventory Mortgage Act, and the Assignment of Accounts Receivable Act. Each of these statutes had its own formal requisites, differing means of perfection, and required elaborate and precise descriptions of collateral. The history of cases decided under such statutes is replete with examples of ostensibly perfected security interests set aside because of failure to comply with a minute, technical requirement of form.

[12] UCC § 9-110, Comment.

approach taken by the Code, they have generally permitted the use of broad, indefinite descriptions.[13] This trend has been particularly noticeable in the field of inventory and accounts receivable financing, where broad descriptions of collatteral are of particular utility. Thus, a financing statement containing the description, "all present and future accounts receivable submitted," was held sufficient.[14] Also, the word "inventory" was held not to be too vague to satisfy the requirements of § 9-402(1).[15]

While the floating lien and after-acquired property aspects of inventory and accounts receivable financing make mandatory the use and judicial validation of very broad descriptions where such financing is concerned, the same considerations are not applicable to consumer goods financing. Nevertheless, at least one court has refused to set a different standard of sufficiency for description of stable, as opposed to shifting, collateral. Thus it was held in *In re Trumble*[16] that the description "consumer goods" was sufficient in a financing statement utilized to perfect a security interest in household goods, two rifles and a shotgun. The court in *In re Trumble* acknowledged that the term "consumer goods" was possessed of broad, and to an extent, indefinite meaning, but concluded that since it was sufficient to do the job assigned to it, *i.e.*, to place a prospective creditor on inquiry notice, it was also sufficient to perfect the secured party's interest in the secured collateral.[17]

Outside of Colorado, *In re Trumble* is the only other reported case dealing with the precise issue before the court in the instant case.[18] Clearly, the two cases are irreconcilable. In what follows an attempt will be made to show where the Colorado court erred in not aligning itself with the decision in *In re Trumble*. The gist of the discussion is that requiring itemization in the financing statement militates against certain

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[13] *In re* Platt, 257 F. Supp. 478 (E.D. Pa. 1966); Security Tire & Rubber Co. v. Hlass, 246 Ark. 1084, 441 S.W.2d 91 (1969); National Cash Register v. Firestone & Co., 346 Mass. 255, 191 N.E.2d 471 (1963); Evans Products Co. v. Jorgensen, 245 Ore.362, 421 P.2d 978 (1966); Thompson v. O.M. Scott Credit Corp., 28 Pa. D. & C.2d 85 (1962).

[14] Industrial Packaging Products Co. v. Fort Pitt Packaging International, Inc., 399 Pa. 643, 161 A.2d 19 (1960).

[15] Thompson v. O.M. Scott Credit Corp., 28 Pa. D. & C.2d 85 (1962).

[16] Bankruptcy No. 88n, 5 U.C.C. Rep. 543 (W.D. Mich. 1968).

[17] *Id.* at 546.

[18] It should be noted that in rendering its decision in *In re Lehner*, the District Court was not exactly dealing with an issue of first impression in Colorado. *In re Bell*, Bankruptcy No. 68-13-658, 6 U.C.C. Rep. 740 (D. Colo. 1969), the referee came to precisely the same conclusion as the U.S. District Court with regard to the insufficiency of the term "consumer goods."

policies underlying Article Nine and does not safeguard any interest of the consumer.

II. *IN RE LEHNER* AND UNDERLYING CODE POLICIES

In reaching its decision in the instant case, the court stated that, "[w]hile the comment [to § 9-402] states that the financing statement is sufficient if it puts potential creditors on inquiry notice, the statutory language of § 155-9-402 clearly requires some specificity of description—the financing statement must indicate the *type* or describe the item of collateral."[19] It then concluded that "[t]he use of the term 'consumer goods' fails . . . to satisfy this section. It is too broad, general, and meaningless to fulfill the demand of § 9-402(1) that the financing statement at least reveal the 'types.' "[20]

The court distinguished those cases holding that the requirements of § 9-402(1) are satisfied by the use of such broad descriptions as "inventory" and "accounts receivable" on the ground that they involved commercial rather than consumer transactions. According to the court, those decisions were based on "the fact of commercial policy applicable to inventory financing which discourages the filing of new statements each time new inventory and accounts receivable are acquired — a consideration which is not present in an individual loan case like the present one."[21] The court here intimates, without stating, specific affirmative policy considerations in support of the proposition that a higher degree of specificity of description is required in the financing statement where a consumer, as opposed to a merchant, is the recipient of a loan.

As has previously been observed, the function of the financing statement is to put potential creditors on inquiry notice that the named secured party may have an interest in the described collateral.[22] To this end § 9-402(1) provides that "[a] financing statement is sufficient if it . . . contains a statement indicating the types, or describing the items of collateral."[23] Inasmuch as the language quoted uses the disjunctive *or* with respect to identification of the collateral, it is clear that the financing statement would be sufficient if it contained nothing more than an indication as to the *types* of collateral secured. The question then becomes, is the term "consumer

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[19] 303 F. Supp. 317, 318 (D. Colo. 1969).
[20] *Id.* at 320.
[21] *Id.*
[22] UCC § 9-402, Comment 2.
[23] *Id.* § 9-402(1).

goods" sufficiently descriptive of a "type" of collateral so as to meet the requirements of § 9-402(1)?

Section 9-109 provides that "goods are: (1) 'Consumer goods' if they are used or bought for use primarily for personal, family, or household purposes; (2) 'Equipment' . . . ; (3) 'Farm equipment' . . . ; (4) 'Inventory' . . . ."[24] In addition, the Comments to § 9-109 state that:

> [t]he classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory. In borderline cases—a physician's car or a farmer's jeep which might be either consumer goods or equipment—the principal use to which the property is put should be considered as determinative. Goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder.[25]

This language clearly indicates that it was the intent of the drafters that the term "consumer goods" have some functional meaning and content. The widespread use of the Code definition of the term, especially in recently proposed consumer oriented legislation,[26] indicates that the intent of the drafters has not been frustrated.[27] In light of this, it seems safe to conclude that the term "consumer goods" does indeed represent a *type* of goods for the purposes of § 9-402(1); and its use in a financing statement would thus be sufficient to place a potential creditor on inquiry notice as to the possibility of the existence of a prior interest in any collateral reasonably within the scope of the term. Clearly then, the financing statement filed by HFC in the instant case was sufficient to put potential creditors on inquiry notice as to the existence of a security interest in Lehner's tapedeck and television set.

If the above analysis is correct and the description "consumer goods" is sufficient to place a prospective creditor on inquiry notice, requiring any greater degree of description is not justified unless some overriding policy consideration demands greater specificity. It is true, as the court indicated, that inclusion of the notice filing concept, accompanied by use of broad descriptives, was motivated by a commercial need for

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[24] *Id.* § 9-109.

[25] *Id.* § 9-109, Comment 2.

[26] *Cf.* NATIONAL CONSUMER ACT § 1, 301(68) (1970 first final draft); UNIFORM CONSUMER CREDIT CODE § 3-104(1) (b) (1969 revised final draft), and TRUTH IN LENDING ACT § 103(h), 15 U.S.C. § 1602(h) (Supp. V, 1970).

[27] The court in *In re Trumble*, in deciding that the term "consumer goods" was sufficiently descriptive, adverted to the widespread use of the term in stating that it could not "close its eyes to the fact that this use of 'consumer goods' is now fairly common so this term must serve some purpose." 5 U.C.C. Rep. 543, 546 (W.D. Mich. 1968).

inventory financing.[28] However, the absence of those policy considerations in the consumer transaction does not seem to be an acceptable basis for differentiation; the UCC is a *uniform* body of law, applicable to all classes of goods, buyers, and sellers.[29] While use of notice filing may have been prompted by the needs of one segment of the commercial world, the Code clearly makes the device available in all kinds of transactions

The question becomes, then, does requiring itemization in the financing statement safeguard some interest of the consumer within the context of the individual loan case? It should be noted at the outset that the Code does not totally neglect consumers, although it is not designed primarily to protect consumer interests. The Code draws distinctions between consumers and merchants where it is felt strict application of a single rule would result in injustice and abuses.[30] No such distinction was included in those sections under discussion with respect to the degree of description required in a financing statement filed to perfect an interest in consumer goods. Also, it should be reiterated that the principal function of notice filing is to protect potential creditors by providing notice of the existence of a prior security interest in the debtor's property.

A possible argument in support of itemization is that consumers should be aware of the extent to which their personalty is encumbered. Of course, the extent of a security interest is not controlled by the financing statement no matter how broad the description, but by the security agreement.[31] The UCC, as enacted in Colorado, requires itemization in the security argeement where an interest is taken in consumer goods.[32] If the debtor is not aware of those items of his personalty subject to a lien, reference to the security agreement is possible.[33] In addition, the UCC provides means whereby a debtor may force a creditor to disclose the extent of the secured property.[34]

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[28] UCC § 9-402, Comment 2.

[29] I. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 15.3 (1965).

[30] UCC § 2-104, Comment 1.

[31] *Id.* § 9-203.

[32] COLO. REV. STAT. ANN. § 155-9-110 (1963), *as amended*, (Supp. 1969).

[33] FRB Reg. Z, 12 C.F.R. § 226.8(b)(5) (1970) requires a "clear identification" of property on the disclosure statement in which a creditor retains or acquires a security interest arising from a consumer credit transaction. Although this provision was not applicable to the transaction involved herein, promulgation of Reg. Sec. 226.8 would appear to weaken arguments for future application of the rule in the instant case. If disclosure of the extent of a security interest is required as an incident of a transaction, there would seem to be little reason for continuing to distort the function of the financing statement by requiring itemization.

[34] UCC § 9-208.

A more serious argument for requiring a higher degree of descriptive specificity with respect to consumer goods concerns monopolization of a particular debtor's credit by "first filing" creditors. Under the "first-to-file" rule of the Code,[35] where both security interests are perfected by filing, priority between conflicting security interests in the same collateral is determined by the order of filing, regardless of when the interests attached. A security interest may, under § 9-203(1), be perfected by a filing previous to attachment, although the interest is not perfected until attachment.[36] Therefore, where a prior security interest is perfected by filing a financing statement utilizing a broad description, the single filing is sufficient to perfect any later attaching security interests in property covered by that description. And such interests have priority under the first-to-file rule over security interests which may have attached earlier in point of time. There is nothing to prevent a second secured creditor from having his security interest subordinated to a later attaching security interest in the same property which was perfected by an earlier filing. It is argued that a debtor, faced with financial difficulties, may be tempted to borrow from creditor *A*, securing the loan with an item of personalty in which creditor *B* has a security interest. Under the provisions discussed above, if a debtor has previously engaged in secured transactions with *A*, who in perfecting his interests utilized a descriptive statement broad enough to include the item in which *B* has an interest, *A's* interest will have priority. Therefore, a subsequent creditor may be hesitant to extend credit to a debtor where previous creditors have filed statements describing collateral in such terms as "consumer goods."

This problem would not seem to pose as great a difficulty when the former debts are not outstanding. Under the UCC a debtor may compel a creditor to file a termination statement when the debt has been settled.[37] Where the loan is still outstanding, it is conceivable that the first-to-file rule would inhibit extension of credit by subsequent sources in the manner described. However, there is no empirical evidence indicating that monopolization of a debtor's business is a "real" problem; certainly, none was introduced in the instant case to support a conclusion that consumers are experiencing dif-

[35] *Id.* § 9-312(5)(a).
[36] *Id.* § 9-203(1).
[37] *Id.* § 9-404.

ficulty in obtaining credit from multiple sources because of broad descriptions in financing statements.[38]

Use of descriptions otherwise satisfying the requirements of § 9-402(1) should not be denied, absent a showing that requiring itemization in financing statements facilitates extension of consumer credit. Indeed, it is arguable that, even if monopolization of a consumer's credit were a real problem, this would not be sufficient grounds to require itemization. As Gilmore has noted, the same result could be obtained by a carefully drawn financing statement in which the collateral was described in the most specific terms.[39] Requiring itemization would not alleviate any burden upon the consumer which could not be imposed through some other legitimate application of Code provisions.

CONCLUSION

The ruling in *In re Lehner* denied use of a descriptive statement which appears to satisfy the requirement of § 9-402 that a description merely place a prospective creditor on inquiry notice. In requiring itemization in the financing statement, the court has misconstrued the function of the financing statement, denied use of common commercial parlance, dysfunctionally segmented varieties of commercial transactions, and introduced a needless technicality. Clearly this decision is antagonistic to the underlying Article Nine policies

[38] Information imparted by local counsel associated with the small loan industry indicates that the first-to-file rule does not *in fact* deter subsequent creditors from making loans to debtors who have entered into a prior secured transaction perfected by a financing statement containing a broad description of collateral. As a general rule, consumer finance companies require collateral in order to acquire "leverage" in the debt collection process, not to provide a pool of assets from which, upon default, a debt may be recouped. In addition, many of the loans granted by consumer finance companies are debt consolidation loans. Once the funds advanced have been used to liquidate outstanding debts, the debtor is requested to require prior creditors to file termination statements, cancelling financing statements by which a prior indebtedness was perfected.

[39] Gilmore, *Security Law, Formalism and Article Nine*, 47 NEB. L. REV. 659, 672 (1968). By way of illustration, local finance companies typically file a notice containing a descriptive statement which is aptly referred to as a "shotgun" financing statement. The statement describing the collateral consists of an exhaustive enumeration of specific items of consumer goods. These notices are used even though a present security interest is not taken in every item listed. Apparently, such shotgun financing statements have found favor with the local bankruptcy courts, as no reported cases have been discovered denying their use. Local counsel indicate that the "shotgun" financing statement has been tacitly approved on the ground that the UCC permits use of a single financing statement to perfect a security interest in personalty described therein attaching subsequent to a filing. In effect, it is permissable to set forth in the financing statement property which *may* be subject to future security agreements as well as property subject to a present security agreement. See UCC § 9-402(1), 9-303(1).

of functionalism and simplicity. This effect cannot be justified in terms of protecting some interest of the consumer. In fact, it would seem as if the only party who benefits by requiring itemization in the financing statement under Colorado law is the trustee in bankruptcy. The voided security interest is preserved for the benefit of the estate—the bankrupt's exemption under state law only attaches to his equity in the property. The instant decision effects a return to the state of affairs existing under prior security law; legitimate security interests are rendered susceptible to attack by a voracious trustee for failure to comply with a legal technicality serving no function. It is to be hoped that other jurisdictions look before imitating this misguided leap upon the consumer bandwagon.