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A Financing Statement as a Security Agreement Under the Uniform Commercial Code

Defendant Everett, in exchange for advances on crop production during 1969 on lands in two counties, delivered his promissory note for \$75,000 to plaintiff Evans. The note stipulated that it was "secured by Uniform Commercial Code financing statement of North Carolina." On the following day the plaintiff and the defendant filed identical financing statements in each county. The financing statements, signed by both parties, contained the name and address of the defendant as the "debtor" and of the plaintiff as the "secured party." The statements also listed the types of collateral covered, describing the collateral as the crops grown during 1969 on five specified farms and the farm machinery on the land. The description was followed by the language, "same securing note for advanced money to produce crops for the year 1969." The note and financing statements were the only documents signed by Everett indicating his indebtedness to the plaintiff. Everett, while still owing the plaintiff approximately \$25,000, sold the crops described in the financing statements to third parties. Plaintiff sued Everett and the third parties for the balance due on the note, and attempted to establish a security interest in the crops sold. All of the defendants except Everett and one of the third parties moved to dismiss the action for the failure to state a claim upon which relief could be granted. The motion was granted and the action against all of the other defendants was dismissed. The court of appeals affirmed the judgment.¹ *Held, reversed*: A financing statement containing the requirements of Uniform Commercial Code § 9-203² and manifesting an intention to grant a security interest is sufficient as a security agreement. *Evans v. Everett*, 10 N.C.2d 435, 183 S.E.2d 109 (1971).

I. SECURITY INTERESTS UNDER THE UNIFORM COMMERCIAL CODE

Creation, Attachment, and Perfection of a Security Interest. Before the development and adoption of article 9 of the Uniform Commercial Code, various security devices were in use.³ With certain exceptions⁴ the Code has replaced such devices with the "security agreement."⁵ Two documents are typically created. The written security agreement "creates or provides for a security interest,"⁶ and the financing statement, which is designed to give notice of a

¹ *Evans v. Everett*, 10 N.C. App. 435, 179 S.E.2d 120 (1971).

² As of Dec. 1, 1970, all states except Louisiana had adopted the Code. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK 313 (1970).

³ Pledges, trust receipts, chattel mortgages, and conditional sales contracts are examples. No particular form of words was necessary to create a lien or constitute a chattel mortgage. In fact, an oral mortgage was as sufficient "as if it had been in writing, provided, if reduced to writing, it would have been valid." *White Co. v. Carroll*, 146 N.C. 230, 232-33, 59 S.E. 678, 679 (1907); *accord*, *Kearns v. Davis Bros.*, 186 N.C. 522, 120 S.E. 52 (1923). This same pre-code law was present in other jurisdictions. See *Yeager v. Laredo Nat'l Bank*, 146 S.W.2d 796 (Tex. Civ. App.—El Paso 1940), *error dismissed*; *Gordon v. Ball*, 73 S.W.2d 890 (Tex. Civ. App.—El Paso 1934).

⁴ UNIFORM COMMERCIAL CODE §§ 9-104, 9-203(1).

⁵ Defined simply as an "agreement which creates or provides for a security interest." *Id.* § 9-105(1)(h).

⁶ *Id.*

possible prior security interest to potential creditors, generally must be filed to perfect that interest.

The security agreement is effective as evidence of a security interest if it (a) is written,⁷ (b) is signed by the debtor,⁸ and (c) contains sufficient information regarding the specific collateral involved to enable the collateral to be reasonably identified.⁹ Furthermore, when the security interest covers crops or oil, gas, or minerals to be extracted, or timber to be cut, a description of the land concerned must be included.¹⁰ Once these requirements are met, a valid security agreement has been properly executed. To be enforceable, however, the security interest must attach to specific property. Attachment occurs when a valid security agreement has been properly executed,¹¹ the secured creditor has given value,¹² and the debtor has some ownership rights in the collateral.¹³ The security agreement itself, however, is, in essence, only a contract between the parties, and in most situations¹⁴ does not protect the creditor from bona fide purchasers.

Perfection of the security interest is achieved by filing a financing statement¹⁵ in a public office.¹⁶ "This filing serves as constructive notice to all that a security interest in the collateral exists as between the parties who sign the statement. A financing statement may be filed in advance—before the security agreement is made or the security interest attaches."¹⁷

In North Carolina the secured party must file a financing statement in the county of the debtor's residence and also in the county where the land on which the crops are growing, or are to be grown, is located.¹⁸ The execution of a valid security agreement and the proper preparation and filing of a financing statement create and perfect the security interest.

Requisites of the Security Agreement. The security agreement, "which creates or provides for a security interest,"¹⁹ constitutes the written evidence of the

⁷ It has been stated that the agreement could be oral, written, or even implied. "However, an oral or implied agreement is insufficient except in those transactions in which the collateral, at the time of the agreement, is in possession of the secured party." J. RAPHAEL, UNIFORM COMMERCIAL CODE SIMPLIFIED 310 (1967).

⁸ A security agreement is valid without the secured party's signature. *See* Nat'l Dime Bank v. Cleveland Bros. Equip. Co., 20 Pa. D. & C.2d 511 (Dauphin Co. Ct. 1959). Thus, the debtor's signature only is sufficient, but it is advisable that both be included.

⁹ UNIFORM COMMERCIAL CODE § 9-203(1)(b).

¹⁰ *Id.*

¹¹ *Id.* § 9-204(1). *See also* Meek, *Secured Transactions Under the Uniform Commercial Code*, 18 ARK. L. REV. 30 (1964).

¹² UNIFORM COMMERCIAL CODE § 9-204(1). This causes problems in the case of the "floating lien." *See* Wyatt, *The Floating Lien Under the U.C.C.*, 5 AM. BUS. L.J. 293 (1967).

¹³ UNIFORM COMMERCIAL CODE § 9-204(1).

¹⁴ *See id.* § 9-302 for exceptions, including provisions of § 4-208 on security interest of collecting bank and § 9-113 on security interest arising under art. 2 ("Sales").

¹⁵ *See id.* § 9-402, stating that:

A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral.

¹⁶ *Id.* § 9-401.

¹⁷ J. RAPHAEL, *supra* note 7, at 328.

¹⁸ N.C. GEN. STAT. § 25-9-401(1)(a) (1965).

¹⁹ UNIFORM COMMERCIAL CODE § 9-105(1)(h).

security interest. It also will suffice as a financing statement if it meets the formal requisites of a financing statement.²⁰ The Code does not, however, specifically provide that a financing statement may serve as a security agreement.

In *American Card Co. v. H.M.H. Co.*²¹ a debtor corporation executed a promissory note to claimants. Later, a financing statement was properly filed in accordance with section 9-402 of the Code. Insolvency of the debtor followed and receivers were appointed. Claimants asserted a security interest in equipment designated as collateral in the financing statement. The Supreme Court of Rhode Island held that the financing statement was not a security agreement, and, therefore, was not enforceable under section 9-203 of the Code.²² "[I]t is not possible for a financing statement which does not contain the debtor's grant of a security interest to serve as a security agreement."²³

American Card provided guidelines for later cases in which a financing statement had been filed but there was no formally executed security agreement. In *In re Freeze* the court stated:

While Article 9 of the Code has stripped the formal requirements of a security agreement to the bone, certain minimal requirements must be observed. A security agreement signed by the debtor containing a description of the collateral (and in some instances real estate) is a must where the collateral is in the debtor's possession. Under Article 9 a financing statement may be filed by the parties in the anticipation of a loan, which is never consummated. The mere filing of a financing statement, therefore, does not necessarily indicate that a security interest exists.²⁴

In the relatively recent decision of *In re Nottingham* the court stated that "[t]here are no magic words that create a security interest. There must be language, however, in the instrument which when read and construed leads to the logical conclusion that it was the intention of the parties that a security interest be created."²⁵ This requirement of a granting clause has met with strong objection by some writers on the Code. One such commentator has noted that nothing in the Code requires that a security agreement contain such a clause.²⁶ However, as pointed out in *In re Walter Willis, Inc.*,²⁷ the prevailing case law

²⁰ *Id.* § 9-402.

²¹ 97 R.I. 59, 196 A.2d 150 (1963).

²² 196 A.2d at 152.

²³ *Id.*

²⁴ 2 U.C.C. REP. SERV. 656, 658-59 (E.D. Pa. 1964).

²⁵ 6 U.C.C. REP. SERV. 1197, 1199 (E.D. Tenn. 1969).

²⁶ G. GILMORE, SECURITY INTEREST IN PERSONAL PROPERTY § 11.4 (1965). Gilmore attacks the *American Card* decision, calling it "an unfortunate decision." Commenting on the granting clause issue, he states:

Certainly, nothing in § 9-203 requires that the 'security agreement' contain a granting clause. The § 9-402 financing statement contained all that was necessary to satisfy the § 9-203 statute of frauds as well as being sufficient evidence of the parties' intention to create a security interest in the tools and dies. No doubt the court would have upheld the security interest if the debtor had signed two pieces of paper instead of one. The § 9-402 provision that a short financing statement may be filed in place of the full security agreement was designed to simplify the operation. The Rhode Island court gives it an effect reminiscent of the worst formal requisites holding under the nineteenth century chattel mortgage acts.

Id. at 347-48.

²⁷ 313 F. Supp. 1274 (N.D. Ohio 1970). This case actually held that a security agree-

is in accord with *Nottingham*, requiring a granting clause for the existence of a security agreement.

A 1968 decision, *In re Center Auto Parts*,²⁸ dealt with a financing statement and promissory note, and focused on the question of what language was sufficient to grant a security interest. The court concluded:

[T]he Financing Statement, though it is signed by the debtors and contains a description of the property, does not standing alone allow a priority for a valid security interest since the financing statement filed in the office of the Secretary of State did not contain the debtor's grant of security interest. However, the note does in fact 'create and provide for a security interest.' Its language is clear that a security interest was to be granted by the execution of the note for it states, 'This note is secured by a certain financing statement.'²⁹

The importance of *In re Center Auto Parts* was its holding that such terse language would indicate a grant of a security interest. However, it should be recognized that both the note and financing statement were necessary in order to dispense with the formally executed security agreement.

II. EVANS V. EVERETT

The Supreme Court of North Carolina faced a case of first impression in *Evans v. Everett*, and took an analytical approach to the question of whether the "financing statement executed by plaintiff and defendant Everett [could] also serve as a security agreement."³⁰ To resolve the issue, the court considered the formal requisites and definitions of "security interest" and "security agreement,"³¹ the opinions of commentators, and the decisions in prior cases. The problem the court faced was to decide whether the language of the financing statement fulfilled the requirement of a grant of a security interest. This problem went to the basic question of what language is required to make a security agreement.

The plaintiff's argument rested simply on the contention that the language in the financing statements and accompanying note was sufficient to grant a security interest, and that this language, when coupled with the other requirements, evidenced a valid security agreement.³² The plaintiff argued that, as in *Center Auto Parts*,³³ the language in the financing statement and note manifested the intent of the parties to create a security interest.

Defendant based his argument on the statement in *American Card* that it "is not possible for a financing statement which does not contain the debtor's grant of a security interest to serve as a security agreement,"³⁴ and argued that

ment was present. The court's decision was distinguished from the other cases because a lease was involved, and the court thought that this fact made a substantial difference.

²⁸ 6 U.C.C. REP. SERV. 398 (C.D. Cal. 1968).

²⁹ *Id.* at 399.

³⁰ 10 N.C.2d 435, 183 S.E.2d 109, 111 (1971).

³¹ *Id.* at 112. The court noted that "the Code distinguishes between a security agreement and financing statement."

³² For the requirements of a security agreement, see text accompanying notes 7-10 *supra*.

³³ 6 U.C.C. REP. SERV. at 399, stating: "This note is secured by a certain financial statement."

³⁴ 196 A.2d at 152.

the language in the financing statement and note was insufficient as a grant of a security interest.

Justice Sharp, speaking for the court, held that the financing statement was sufficient to serve as a security agreement. In rejecting the defendant's argument, the court stated that the "Rhode Island court [in *American Card*] was of the opinion that technical words of conveyance from the debtor to the secured party were required to create a security interest."³⁵ The court did not accept this view, stating that "no magic words" were necessary to create such an interest.³⁶ The court accepted the plaintiff's argument and adopted the reasoning in *Center Auto Parts*. The court added that recent cases "uniformly hold that a financing statement does not ordinarily create a security interest. . . . [However,] a financing statement may double as a security agreement if it contains appropriate language which grants a security interest."³⁷ Having held that the financing statement contained language clearly manifesting the debtor's intent to grant, create, and provide for a security interest, the court held that there was a valid security agreement.

III. CONCLUSION

In reaching its decision the court warned that "this financing statement meets [only] the Code's *minimum* requirements," and that such draftsmanship will likely "produce litigation."³⁸ The court listed some other requirements for a security agreement which one commentator has suggested.³⁹ Such warnings are helpful to the creditor who has a security interest in property and wishes clearly and easily to establish the interest through a security agreement. Considering the decision in the case, a stronger warning should have been directed to the debtor and third party purchasers.

In a typical situation the debtor and creditor anticipate a security arrangement. Since a financing statement merely indicates that a security interest has been or will be created, and the Code allows the financing statement to be filed before the security interest is actually created, the debtor and creditor may decide to file a financing statement first. After filing, however, the debtor and creditor may have problems in negotiation and one party may decide not to enter into a formal security agreement. Following the court's decision in *Evans v. Everett*, the proposed creditor could possibly establish a security interest in the debtor's property based on a filed financing statement containing language merely referring to the proposed security interest.

A similar dilemma may be experienced by the innocent third party who

³⁵ 183 S.E.2d at 113.

³⁶ *Id.* The court cited *In re Nottingham*, 6 U.C.C. REP. SERV. 1197 (E.D. Tenn. 1969).

³⁷ 183 S.E.2d at 113 (emphasis by the court). See also Annot., 30 A.L.R.3d 9, 42-44, 46-48 (1970).

³⁸ 183 S.E.2d at 114 (emphasis by the court).

³⁹ *Id.*; see 25 U. PITT. L. REV. 619, 621 (1964): (1) The names and addresses of both the secured party and the debtor; (2) a description of the collateral; (3) a description of the underlying obligation for which the security was given; (4) a recital of the rights and liabilities of each party on default; (5) the signature of each party; and (6) any other provisions necessary to meet the exigencies of the individual transaction. See form suggested in MASSACHUSETTS BANKERS ASSOCIATION, BANKERS MANUAL ON THE UNIFORM COMMERCIAL CODE 168 (1958).