

FIXTURES, SECURITY INTERESTS AND THE NEW ARTICLE 9

When the Uniform Commercial Code¹ became effective in Iowa on July 4, 1966, section 9-313, which dealt with the priority of security interests in fixtures, had been eliminated.² Iowa was not alone, however, in its rejection of section 9-313 and the priorities which it established.³ In order to meet the critical reactions of state legislatures and academicians, the American Law Institute and the National Conference of Commissioners on Uniform State Laws last year recommended substantial revisions in Article 9 of the Code.⁴ The purpose of this Note is to compare the current Iowa law of priority of security interests in fixtures, the rejected section 9-313, and the newly-proposed section 9-313 and examine the effect each uniform provision would have on Iowa law if adopted.

I. DEFINING A FIXTURE

One of the most controversial aspects of the original section 9-313 was its failure to define fixture, preferring instead to leave that definition to local law.⁵ The original Code provided only that goods incorporated into a structure, *i.e.*, structural materials, were not fixtures for purposes of section 9-313.⁶ This lack of definition was the subject of almost unanimous criticism among legal writers.⁷ That criticism centered on the lack of uniformity which this approach engendered, in contradiction to the expressed objectives of the Code.⁸ The lack of a definition would not in itself have been critical if the fixture definitions of the various states had been relatively uniform. Unfortunately, this was not the case.

¹ Iowa adopted substantially the 1962 version of the *Uniform Commercial Code* [hereinafter cited as U.C.C. (1962)]. The U.C.C. appears at IOWA CODE § 554.1101 *et seq.* (1973).

² IOWA CODE § 554.9313 (1973) 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.

³ California rejected the section in its entirety and several other states amended the section substantially. For a complete listing of actions by the various enacting jurisdictions, see 3 U.L.A. § 9-313 (1968, Supp. 1972).

⁴ UNIFORM COMMERCIAL CODE 9-101 *et seq.* (1972) [hereinafter cited as U.C.C. (1972)].

⁵ U.C.C. § 9-313(1) (1962).

⁶ *Id.*, U.C.C. § 9-313, Comment 2 (1962). This provision parallels earlier uniform laws. See, e.g., *Uniform Conditional Sales Act*, 3 U.L.A. 495 (1968).

⁷ For a collection of such critical comments, see Note, *Toward a Satisfactory Fixture Definition for the Uniform Commercial Code*, 55 CORNELL L. REV. 477 (1970). But see, Cosway, *Fixtures Under the Uniform Commercial Code*, 21 SW. L.J. 713 (1967).

⁸ U.C.C. § 1-102(2)(a) (1962, 1972) states the purpose of the Code to be "to simplify, clarify and modernize the law governing commercial transactions" while § 1-102(2)(c) declares another objective to be "to make uniform the law among the various jurisdictions." See also Shanker, *An Integrated Financing System For Purchase Money Collateral: A Proposed Solution to the Fixture Problem Under Section 9-313 of the Uniform Commercial Code*, 73 YALE L.J. 788 (1964) [hereinafter cited as Shanker].

U.C.C. section 9-313 contemplated a tri-partite classification of goods,⁹ (1) goods which were used upon realty but in which no purchaser of realty would obtain an interest;¹⁰ (2) goods, such as structural materials, which were so closely connected to the realty as to become part of it, which thus were considered realty, and in which no security interest is available under the Code;¹¹ and (3) goods which are attached to realty in such a way as to become part of the realty, but which can be severed from the realty and returned to the status of chattels.¹² The third group of goods was considered by the U.C.C. to be fixtures, controlled by section 9-313. This tri-partite distinction is the essential treatment accorded to goods under Iowa law.¹³ The problem arises, however, in those states which recognize only two types of property, real and personal.¹⁴ In those states, section 9-313 was either not adopted, or created such confusion that it was soon altered.¹⁵

The proposed alteration in section 9-313 seeks to remedy the definition problem. Proposed section 9-313(1)(a) defines fixtures as goods "so related to particular real estate that an interest in them arises under real estate law."¹⁶ For the purposes of section 9-313, however, no security interest arises in "ordinary building materials."¹⁷

The essential problem of lack of uniformity, however, is not resolved by the new section 9-313.¹⁸ Primary reliance must still be placed on local law to determine how and when a fixture is created,¹⁹ *i.e.*, when it becomes so related to particular real estate that an interest will arise under real estate law. Under Iowa law, in determining whether a chattel has become a fixture, the intention of the annexor is the controlling consideration.²⁰ That intention is to be determined by the annexor's manifest acts and all the surrounding circumstances.²¹ Some circumstances which the Iowa court has from time to time considered relevant include: (1) the manner in which the chattel is actually

⁹ Note, *Toward a Satisfactory Fixture Definition for the Uniform Commercial Code*, 55 CORNELL L. REV. 477 (1970). Although this division was not expressly stated in the 1962 Code, it has been expressly incorporated in the revised Code. See U.C.C. § 9-313, Comment 3 (1972). This classification is not meant to deal with crops which are separately treated in a number of sections.

¹⁰ These goods are denominated personalty and are treated under other sections of Article 9. See, *e.g.*, IOWA CODE § 554.9301 (1973).

¹¹ See U.C.C. § 9-313(1) (1962) and U.C.C. § 9-313(2) (1972).

¹² See authorities cited at note 9, *supra*.

¹³ *Ottumwa Woolen Mill Co. v. Hawley*, 44 Iowa 57, 63 (1876); Note, *Fixture Security Interests Under the Uniform Commercial Code in Iowa*, 51 IOWA L. REV. 954 (1966).

¹⁴ *Coogan, Fixtures—Uniformity in Words or in Fact?*, 113 U. PA. L. REV. 1186 (1965).

¹⁵ See *Uniform Commercial Code*, 3 U.L.A. § 9-313 (1968, Supp. 1972).

¹⁶ U.C.C. § 9-313(1)(a) (1972).

¹⁷ U.C.C. § 9-313(2) (1972).

¹⁸ See U.C.C. § 9-313, Comment 2 (1972).

¹⁹ For another law review treatment of the nature of a fixture in Iowa, see Note, *Fixture Security Interests Under the Uniform Commercial Code in Iowa*, 51 IOWA L. REV. 954 (1966).

²⁰ *Ottumwa Woolen Mill Co. v. Hawley*, 44 Iowa 57 (1876).

²¹ *Walker v. Puck*, 236 Iowa 686, 8 N.W.2d 701 (1943).

or constructively affixed to the realty,²² (2) the purpose of the improvement as it related to the use of the land,²³ (3) the extent of damage that would result from the removal of the chattel,²⁴ and (4) in the appropriate case, the expectation of a reasonable purchaser.²⁵ In any event, the intent of the annexor is the controlling interest in Iowa law; and adoption of either the old or revised section 9-313 would not change Iowa law in this respect.

II. PRIORITIES AMONG SECURITY INTERESTS

A. *Priority of a Conditional Seller Over a Subsequent Purchaser of the Realty*

When a vendor has retained a security interest in a chattel which has become a fixture, and the realty is subsequently conveyed to a bona fide purchaser, a priority problem arises. Under Iowa case law, the subsequent purchaser who takes without notice of the chattel mortgage will prevail over the chattel mortgagee.²⁶

This same result was reached under the old section 9-313, if the security interest had attached to the goods before they became fixtures.²⁷ Certain exceptions were created, however, which might have modified Iowa law in a few instances.²⁸

Under the proposed section 9-313, the results are substantially the same. The chattel mortgagee is required to make a "fixture filing"²⁹ before an interest

²² See, e.g., *Marty v. Champlin Refining Co.*, 240 Iowa 325, 36 N.W.2d 360 (1949). That affixation may be by nothing more material than gravity, see *Comly v. Lehmann*, 218 Iowa 644, 253 N.W. 501 (1934).

²³ See, e.g., *Comly v. Lehmann*, 218 Iowa 644, 253 N.W. 501 (1934).

²⁴ *Id.* at 653, 253 N.W. at 505.

²⁵ *Rahm v. Domayer*, 137 Iowa 18, 114 N.W. 546 (1908).

²⁶ *Allis-Chalmers Co. v. City of Atlantic*, 164 Iowa 8, 144 N.W. 346 (1913); Note, *Fixture Security Interests Under the Uniform Commercial Code in Iowa*, 51 IOWA L. REV. 954 (1966).

²⁷ U.C.C. § 9-313(2) (1962) provides that "a security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4). Under the 1962 U.C.C., a security interest "attached" upon the occurrence of the last of three events: (1) an agreement that it attach, (2) the acquisition by the debtor of rights in the collateral, and (3) the giving of value. IOWA CODE § 554.9204 (1971). A security interest was "perfected" when a fourth step occurred, i.e., public notice by filing. IOWA CODE § 554.9303 (1973). For purposes of interests in fixtures, this distinction is no longer important. Interests must be perfected. See U.C.C. § 9-313(4) (1972). For a discussion of the distinction between attachment and perfection, see Coogan, *Security Interests In Fixtures Under the Uniform Commercial Code*, 75 HARV. L. REV. 1319 (1962).

²⁸ A subsequent purchaser for value of any real estate interest, a creditor with a lien obtained by subsequent judicial proceedings, and a creditor with a prior recorded encumbrance who makes subsequent advances are excepted from the priority rules of section 9-313 if their actions were undertaken without knowledge of the fixture interest and before it was perfected. U.C.C. § 9-313(4) (1962). No Iowa case law is directly relevant to these exceptions. The case of *Thomson v. Smith*, 111 Iowa 718, 83 N.W. 789 (1900), did hold that a purchaser in good faith without notice of the fixture interest takes all fixtures through a judicial sale.

²⁹ "Fixture filing" is defined as "the filing in the office where a mortgage on the real estate would be filed or recorded of a financing statement covering goods which are or are to become fixtures and conforming to the requirements of subsection (5) of Section 9-402." U.C.C. § 9-313(1)(b) (1972).

of an encumbrancer or subsequent owner of the realty is recorded.³⁰ If that condition is met, if the security interest had priority over all predecessors in interest of the encumbrancer, and if the debtor had a record interest in the realty or was in possession, the security interest will prevail.³¹ This would also be true if the subsequent interest were a lien obtained by judicial proceeding, if the security interest had been perfected in any manner provided by the U.C.C.³² Thus, the adoption of the old section 9-313 would not change existing Iowa law in this area except in a few minor exceptions, and the new section 9-313, which does not even create those exceptions, would not change Iowa law at all.

B. *Priority of Security Interest Obtained After Affixation to the Realty*

One Iowa case has dealt with the priority situation which arises when a security interest is taken in a "chattel" after it has become a fixture.³³ The court held that the fixture security interest could not be superior to any prior real estate interest or to a subsequent real estate interest taken without notice.³⁴

Under both the old and new section 9-313, this same result is reached.³⁵ Both sections, however, create an exception where the encumbrancer has consented to the security interest in writing or has disclaimed any interest in the goods as fixtures.³⁶ In addition, proposed section 9-313 creates an exception when "the debtor has a right to remove the goods as against the encumbrancer or owner."³⁷ This exception is only logical, for if the debtor could remove the goods, the secured seller certainly should be able to remove them also.³⁸ This situation seems most likely to arise where trade fixtures are involved.³⁹

C. *Priority of a Security Interest in a Fixture Placed on Mortgaged Realty*

A rather confusing priority problem arises where a security interest is retained in a chattel which is placed on already mortgaged property.⁴⁰ The Iowa

³⁰ U.C.C. § 9-313(4)(b) (1972).

³¹ *Id.*

³² U.C.C. § 9-313(4)(d) (1972). Thus, perfection by fixture filing would not be necessary. See U.C.C. § 9-313, Comment 4(c) (1972).

³³ Peoria Stone & Marble Works v. Sinclair, 146 Iowa 56, 124 N.W. 772 (1910).

³⁴ *Id.* at 58-59, 124 N.W. at 773.

³⁵ Compare U.C.C. § 9-313(3) (1962) with U.C.C. § 9-313(7) (1972). The result in the revised Code requires a reading of the entire section 9-313, since the situation is not specifically mentioned.

³⁶ Compare U.C.C. § 9-313(3) (1962) with U.C.C. § 9-313(5)(a) (1972).

³⁷ U.C.C. § 9-313(5)(b) (1972).

³⁸ There are of course problems of due process which must not be overlooked. See Fuentes v. Shevin, 407 U.S. 67 (1972); Thorp Credit, Inc. v. Barr, 200 N.W.2d 535 (Iowa 1972).

³⁹ A trade fixture is property placed on real estate by the lessee to further the business for which the land was leased, and may, as between the lessor and lessee, be removed by the lessee if it may be removed without substantial injury to the realty. See Winnike v. Heymann, 185 Iowa 114, 169 N.W. 631 (1918).

⁴⁰ Note, *Fixture Security Interests Under the Uniform Commercial Code in Iowa*, 51 IOWA L. REV. 954 (1966).

cases apply two basic rules to this situation. If the fixtures replaced a fixture which was on the property when the real estate interest was created, then the real estate interest will prevail.⁴¹ If the fixture was added to the real estate after the real estate interest arose, the Iowa court will apparently allow the chattel mortgagee to recover.⁴²

In attempting to combine these two rules into a workable guideline, the Iowa court has stated that the chattel mortgagee would recover only if enforcement of his rights would not substantially reduce the security of the prior real estate interest.⁴³ This is, in effect, a restatement of the old "material injury"⁴⁴ test which has been specifically disavowed by both the old and new section 9-313.⁴⁵

It seems clear that the adoption of either section 9-313 would work a substantial change in Iowa law. Under the old section 9-313, the secured vendor would have priority over any real estate interest provided the security interest attached prior to the affixation of the chattel to the realty,⁴⁶ with a few minor exceptions.⁴⁷ Under the proposed section 9-313(4)(a), the security interest will prevail over the prior real estate interest if (1) it is a purchase money security interest,⁴⁸ (2) it was perfected through a fixture filing either before or within 10 days after the good becomes a fixture, and (3) the debtor is in possession of or has an interest of record in the real estate.⁴⁹ The ten day exception is intended to bring section 9-313 into conformity with other U.C.C. sections.⁵⁰ Security interests in certain readily removable fixtures such as factory or office machines and replacements of domestic appliances which are consumer goods⁵¹ need only be perfected in any way provided by the U.C.C., not exclusively by fixture filing.⁵²

The proposed section 9-313, however, contains an exception to the general priority rules stated above. That exception exists where the real estate in-

⁴¹ *Comly v. Lehmann*, 218 Iowa 644, 253 N.W. 501 (1934); *Holland Furnace Co. v. Pope*, 204 Iowa 737, 215 N.W. 943 (1927); *Des Moines Improvement Co. v. Holland Furnace Co.*, 204 Iowa 274, 212 N.W. 551 (1927).

⁴² *First Nat'l Bank v. Elmore*, 52 Iowa 541, 3 N.W. 547 (1879).

⁴³ *Comly v. Lehmann*, 218 Iowa 644, 253 N.W. 501 (1934). This same test is used to govern removability of the fixture.

⁴⁴ *Uniform Conditional Sales Act*, 3 U.L.A. 495 (1968).

⁴⁵ Compare U.C.C. § 9-313, Comment 5 (1962) with U.C.C. § 9-313, Comment 9 (1972). See also the text accompanying notes 61-63, *infra*.

⁴⁶ See note 27, *supra*.

⁴⁷ See note 28, *supra*.

⁴⁸ A "purchase money security interest" is a security interest "(a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used." IOWA CODE § 554.9107 (1973).

⁴⁹ U.C.C. § 9-313(4)(a) (1972).

⁵⁰ See, e.g., U.C.C. §§ 9-301(1), 9-301(2) (1972). The problem of uniformity of section 9-313 with other sections is discussed at length in Shanker, *supra* note 8.

⁵¹ "Consumer goods" are goods "used or bought for use primarily for personal, family or household purposes." IOWA CODE § 554.9109(1) (1973).

⁵² U.C.C. § 9-313(4)(c) (1972).

terest is a "construction mortgage."⁵³ If the construction mortgage is filed before the goods become fixtures and the goods become fixtures before the end of construction, then the construction mortgage is prior to the fixture security interest.⁵⁴

The rationale for the priority given by the U.C.C. to fixture security interests as against prior real estate interests is clear. First, since fixture financing is usually short term, normally for less than five years,⁵⁵ it will seldom conflict with typically longer term real estate financing.⁵⁶ Second, the priority rule of the U.C.C. encourages economic growth and modernization by encouraging improvement of realty.⁵⁷ Third, the real estate mortgagee receives an automatic second lien on the fixture, a windfall which he in all probability could not have anticipated.⁵⁸ Finally, this policy of encouraging economic growth would seem to be further enhanced by the construction mortgage exception which encourages improvements on real estate by new construction and installation of fixtures.⁵⁹

Although it has been suggested that this priority of fixture interests over land interests might have been a reason for rejection of the original section 9-313⁶⁰ and hence the proposed section 9-313, it seems fair to urge that the legislature reconsider these priorities when next it considers the U.C.C.

III. REMOVAL OF FIXTURES

As mentioned above, the Iowa court, in formulating a rule for determining the priority between prior real estate interests and fixture security interests, has used a statement which is almost a restatement of the material injury test used to determine the removability of fixtures.⁶¹ Simply stated, the material injury test states that a fixture-secured mortgagee will be allowed to remove the fixture only if its removal will not result in material injury to the freehold.⁶² What constitutes a material injury is clearly open to debate, however, and the fixture-secured mortgagee could never be certain in advance if removal would be an option open to him.⁶³

⁵³ A "construction mortgage" is a mortgage that "secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates." U.C.C. § 9-313(1)(c) (1972).

⁵⁴ U.C.C. § 9-313(6) (1972).

⁵⁵ See Hensen, *Fixtures: A Commentary On The Officially Proposed Changes In Article 9*, 52 MARQ. L. REV. 179 (1968).

⁵⁶ U.C.C. § 9-313, Comment 8 (1972); Shanker, *supra* note 8, at 793.

⁵⁷ *Id.*

⁵⁸ Coogan & Clovis, *The U.C.C. and Real Estate Law*, 38 IND. L.J. 535 (1963).

⁵⁹ This statement has been criticized, however, as not presenting an overriding policy argument. See Hensen, *Fixtures: A Commentary On The Officially Proposed Changes In Article 9*, 52 MARQ. L. REV. 179 (1968).

⁶⁰ Note, *Fixture Security Interests Under The Uniform Commercial Code in Iowa*, 51 IOWA L. REV. 954 (1966).

⁶¹ See text accompanying notes 43-44, *supra*.

⁶² *Uniform Conditional Sales Act*, 3 U.L.A. 495 (1968).

⁶³ U.C.C. § 9-313, Comment 9 (1972); U.C.C. § 9-313, Comment 5 (1962). This problem was especially apparent in those jurisdictions which followed the "institutional test," i.e., prevented removal where the on-going economic value of the enterprise con-

Both the old and new 9-313 sections contain virtually identical provisions⁶⁴ which would amount to a substantial change in the existing Iowa law.⁶⁵ The U.C.C. provides that a fixture-secured seller may, if he is superior to all other owners and encumbrancers, remove his collateral.⁶⁶ The secured party must reimburse the holder of any other interest in the realty for any physical harm caused by the removal. However, he is not required to make reimbursement for any diminution in the real estate's value or to replace the removed goods.⁶⁷ The real estate claimant may demand that the removing party give adequate security for the removal damages, otherwise the real estate claimant may refuse permission to remove the fixture.⁶⁸

A number of criticisms had been levied against this section, obviously none of which were remedied.⁶⁹ It seems fairly obvious that in certain instances the removal of the fixture would virtually destroy the economic value of the realty, as, for example, the removal of an elevator from a skyscraper, or seriously endanger the health or welfare of occupants of the building, as, for example, the removal of a heating plant in the winter. In situations such as these, the secured party should be *required* to use judicial foreclosure, not removal.⁷⁰ Similarly, where the fixture is a replacement for another fixture which was in place when the realty interest arose, the removal of the fixture constitutes a significant economic harm to the real estate mortgagee.⁷¹ Avoidance of these situations seems to have been the clear intention of the Iowa court.⁷²

Such situations clearly cannot be allowed to occur, but clearly would occur if section 9-313 were adopted in its present form. The solution, rather than a rejection of section 9-313 in its entirety, should be an amendment of the offending subsection to solve the problems mentioned above. These changes should be statutory, rather than relying on common law remedies.⁷³

IV. FILING AND NOTICE

Another criticism leveled at the original section 9-313 derives from an entirely separate provision of Article 9.⁷⁴ The problem results from the require-

ducted on the land would be materially injured. See 5 AMERICAN LAW OF PROPERTY § 19.4 (Casner ed. 1952).

⁶⁴ Compare U.C.C. § 9-313(5) (1962) with U.C.C. § 9-313(8) (1972).

⁶⁵ See text accompanying notes 42-44, *supra*.

⁶⁶ This right is subject to the provisions of Part 5 of Article 9. See U.C.C. § 9-501 *et seq.* (1972).

⁶⁷ Compare U.C.C. § 313(5) (1962) with U.C.C. § 9-313(8) (1972).

⁶⁸ *Id.*

⁶⁹ Shanker, *supra* note 8, at 804-05.

⁷⁰ *Id.* at 806. The problem could also be avoided by use of a receiver. See also note 38, *supra*.

⁷¹ *Id.*

⁷² See text accompanying notes 39-44, *supra*.

⁷³ Authorities disagree on the availability of common law remedies. Compare Shanker, *supra* note 8, at 806-07 with Kratovil, *The Uniform Commercial Code and The Real Property Lawyer*, 18 DEPAUL L. REV. 101 (1968).

⁷⁴ See Kratovil, *The Uniform Commercial Code and The Real Property Lawyer*, 18 DEPAUL L. REV. 101 (1968).

ment of section 9-403(4) that a financing statement be recorded under the name of the debtor. While this presents no particular problem if the debtor is a holder of a record interest in the land, it does present a problem if the debtor holds no record interest in the land, since the financing statement cannot be found in the normal grantor-grantee index used in Iowa.⁷⁵ Thus, the subsequent purchaser would be without notice of the previously acquired interest. While there may be an equitable remedy available to protect the purchaser,⁷⁶ this obviously should not be left to chance.

Accordingly the proposed Article 9 has incorporated amendments to solve this problem. The financing statement must include a name of a record owner of the realty if the debtor is not such a person,⁷⁷ and the appropriate officer is required to index the financing statement in the same manner as a mortgage, showing the record title holder as the mortgagor.⁷⁸

V. CONCLUSION

While section 9-313 in its newly revised form is not yet free from certain defects, it is clearly an improvement over the original section 9-313. It seems clear that the Iowa legislature, with a few amendments or accompanying statutory provisions, should give serious consideration to the adoption of the new section 9-313. It will clearly represent a modernization of Iowa fixture law and constitute a significant commitment to the encouragement of economic growth. If the slogan is to be "Iowa—A Place to Grow," it seems fair to suggest the adoption of a statute which encourages, not discourages, growth, modernization and improvement.

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⁷⁵ IOWA CODE § 614.35 (1973).

⁷⁶ Kratovil, *The Uniform Commercial Code and The Real Property Lawyer*, 18 DEPAUL L. REV. 101 (1968).

⁷⁷ U.C.C. § 9-402(5) (1972).

⁷⁸ U.C.C. § 9-403(7) (1972).