

FILED

DEC 26 1984

CLERK SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

**STATE SAVINGS BANK OF HORNICK,)
IOWA,**

Plaintiff-Appellant,)

vs.)

**ONAWA STATE BANK OF ONAWA,)
IOWA,**

Defendant-Appellee.

Filed December 26, 1984

4-440
84-380

600

Appeal from the Iowa District Court for Monona County-Dewie J. Gaul,
Judge.

Plaintiff bank appeals from judgment for defendant bank in an action seeking an accounting for the proceeds of a sale of secured collateral, asserting: (1) that the evidence was insufficient to support a finding that it had knowledge of the contents of a financing statement showing defendant's security interest; and (2) that any security interest shown by defendant's misfiled financing statement lapsed when a continuation statement was also misfiled. **AFFIRMED.**

Craig A. Raby, of Crary, Huff, Clem, Raby & Inkster, P.C., Sioux City, for plaintiff-appellant.

Donald H. Capotosto of Morrow, Allen & Capotosto, Onawa, for defendant-appellee.

Heard by Oxberger, C.J., and Donielson and Sackett, JJ.

SACKETT, J.

L. Statement of Facts

Plaintiff-Appellant, State Savings Bank of Hornick, has made claim that Defendant-Appellee, Onawa State Bank, converted to its own use proceeds from certain collateral in which Hornick Bank claims a perfected security interest with priority over any interest of Onawa State. The matter was tried to the court and judgment was returned in favor of Defendant-Appellee, Onawa State Bank. The State Savings Bank of Hornick appealed from said judgment.

From 1953 to 1981, Roy F. Johnston operated a construction business in and near Monona County. Prior to getting involved in the construction business Johnston was engaged in a farming operation. During his years as a farmer he conducted his bank business with the Hornick Bank. The Hornick Bank suggested that he seek financing with Onawa State when he started a construction business, as they would not be able to support such an endeavor. Onawa State financed Johnston's construction operations. The construction business involved the use of heavy equipment, including bulldozers, scrapers, graders, disks, tractors and related items.

In May of 1972, Johnston borrowed money from Onawa State. As part of this transaction, a UCC-1 financing statement was filed in the office of the Woodbury County Recorder. The intent of this filing was to effectuate a "perfection" of the security interest that Onawa State Bank had in Johnston's construction equipment, as well as other business assets. From 1953 to 1976 Johnston did all his business financing with Onawa State but continued to make personal loans at the Hornick Bank. Roy Johnston, when testifying under oath, stated that he dealt with a Mr. Delperdang at the Hornick Bank prior to 1976. He also stated that Mr. Delperdang was aware that assets of the construction business had been pledged as collateral for a loan obtained from Onawa State, that "[Delperdang] knew [Johnson's] business from one end to the other."

In 1976, the Hornick Bank loaned Johnston \$8,000 for the purpose of paying income tax. In the course of completing the transaction, Johnston executed a security agreement for the business assets covered by the Onawa State UCC filing. The Hornick Bank filed their the financing statement with the Secretary of State. Johnston informed the Hornick Bank loan officer, Mr. Wagner, about his financial involvement with Onawa State, though he didn't actually show Mr. Wagner a copy of Onawa State's financing statement. In 1976 and thereafter, Johnston dealt with Mr. Wagner and under oath Johnson stated he was at all times prepared to show any documents relating to his finances, but was never asked for same. Evidence suggests that Wagner was aware of Johnston's dealings with Onawa State and the business assets pledged as collateral. The Hornick Bank, however, claims it has an interest superior to that of Onawa State because of the improper filing made with the county recorder by Onawa State officials.

II. Scope of Review

This is an action at law and our standard of review is not de novo. Iowa R. of App. P. 4 (1983). We stand as a court for the correction of errors at law. Id. Findings of fact in a law action are binding on us if supported by substantial evidence. Iowa R. of App. P. 14(f)(1)(1983).

III. Law and Application

A. Code section 554.9401(2) and the operation of the "saving clause."

This appeal involves Iowa Code section 554.9401. The pertinent portion of that statute reads as follows:

"1. The proper place to file in order to perfect a security interest is as follows:

a. ***

b. ***

c. In all cases, [such as the circumstances which concern this appeal] in the office of the secretary of state.

2. A filing which is made in an improper place or not in all of the places required by this section. . . is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of the financing statement. ****"

Code of Iowa §554.9401 (1983).

Subsection (2) of section 554.9401 operates as an escape clause so that an improper filing will nonetheless work to maintain a priority security interest as against a subsequent proper filing by another creditor. It is for us to decide if the trial court properly applied subsection (2) to the facts of this case in arriving at a judgment for the Defendant-Appellee, Onawa State Bank. If it is true, as the trial court ruled, that the Hornick Bank had knowledge of the improperly filed financing statement, then an affirmance is in order. The kind of "knowledge" we are concerned with is knowledge such as was contemplated by the legislature for purposes of the statute.

The Uniform Commercial Code, as adopted by the Iowa legislature, is found at Chapter 554 of the Iowa Code. The term "knowledge" is defined in section 554.1201(25). This particular subsection reads as follows:

25. A person has "notice" of a fact when
- a. he has actual knowledge of it; or
 - b. he has received a notice or notification of it; or
 - c. from all the facts and circumstances known to him at the time in question he has reason to know that it exists. A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this chapter.

Code of Iowa §554.1201(25)(1983). There is, however, no case law from Iowa cited in the briefs or discovered during our research that construes the phrase "actual knowledge" for the purposes of this particular statute. It appears, therefore, that this is an issue of first impression in this state.

Hornick Bank urges us to adopt a definition such that a second, subsequent creditor must have actually seen an improperly filed financing statement with his (her, its) eyes before being imputed with actual knowledge. As authority for this proposition they cite to the treatise of Professors White and Summers entitled Handbook of the Law Under the Uniform Commercial Code. Professor White

acknowledges that different meanings to the phrase "knowledge of the contents of such financing statement" are possible. One extreme described would involve mere constructive knowledge by a subsequent creditor. J. White and R. Summers Handbook of the Law Under the Uniform Commercial Code §23-15, at 949 (2nd ed. 1980). At the other end of the spectrum of possible definitions would be the requirement where "a searcher [of a filed financing statement] actually eyes the maverick financing statement." Id. The author also appreciates the fact that many fact situations fall between these two points. He states as follows his reading of the troubling phrase:

The creditor may know a security interest exists but lack knowledge of its perfection; he may seriously suspect that the secured party has filed; he may know that a financing statement exists but lack knowledge of its detail; or he may know every particular contained in a misfiled financing statement, but suspect that it has lapsed. A number of valid reasons favor narrow application of 9-401(2). Support for a stingy construction emerges from the history of the provision. The question of the effectiveness of a misfiled mortgage or deed has been with us for years. The second sentence of Comment 5 to 9-401 tells us that the drafters at least had those cases in mind when they were preparing subsection (2): "The subsection rejects the occasional decisions that an improperly filed record is ineffective to give notice even to a person who knows of it." Under prior versions of 9-401(2) knowledge of "the filing" sufficed. In 1956, however, the current requirement of "knowledge of the contents" of the financing statement was substituted. This amendment, in our view, justifies an "eyeing the document" test. Another factor supporting this interpretation lies in the drafter's words. Section 9-301(1)(b) of the 1962 Code shows us the drafters knew how to say "knowledge of the security interest" when that was what they meant to say. The able drafters of Article Nine are entitled to the benefit of our presumption that the language in 9-301(1)(b), "knowledge of the security interest," has a different meaning from the seemingly more exacting phrase, "knowledge of the contents of such financing statement."

Id. at 950.

To underscore the troublesome nature of the phrase, the two authors of the treatise do not agree on a schematic reading of section 9-401(2). While Mr. White believes history, language selection and the race filing system of filing require a narrow, strict reading of the provision, Professor Summers believes that such a

reading is not mandated by the generalized purposes of the U.C.C. Summer's outlook on the construction of the saving clause of 9-402(2) is found in the following excerpt from their book:

Practically the first words out of the mouths of the drafters (1-102(1) proclaim that the Code "shall be liberally construed and applied to promote its underlying purposes and policies." Also, the Code embraces equitable principles in 1-103. Section 9-401(2) is a "saving clause"—a backward-looking provision that allows the judge to clean up a mess after the fact. Certainty and uniformity are not independent values to the exalted above all others. Certainty and uniformity facilitate the lawyer's efforts to plan a proper course of conduct. No lawyer in his right mind would rely upon 9-401(2) to refrain from filing in an arguably proper location. Thus certainty-centered policy arguments should carry little cargo here. Mistakes are inevitable in a system where the proper location for filing hinges upon such factors as classification of goods, location of the debtor, the proper time to determine status, place of business, and status of the debtor. The draftsmen wisely recognized that, despite their best intentions, pitfalls await the hapless traveller through the UCC. They provided a saving clause in 9-401(2), and judges should construe it in accord with its spirit.

Id. at 950-51.

We are persuaded by the comments of Professor Summers. The fact situation before us does not demand the narrow construction of Iowa Code section 554.9401 that Mr. White would urge us to adopt. We are faced with two creditors who were aware of each other's existence as regarded this particular debtor. These creditors were located in close geographical proximity to each other. Roy Johnston ran a construction company with only local business dealings. We are not faced with a situation where state-wide creditors of Johnston's were probable.

We hold that the phrase "knowledge of the contents of such financing statement" as this language is found in Code section 554.9401(2) means that a subsequent creditor have a reasonable idea of the subject matter covered by the financing statement. An "eyeing of the maverick financing statement" is not required. A second creditor needs to know what assets of the debtor are being financed by the initial creditor.

-6-

We find support for this holding from a case out of Michigan - Franklin Nat. Inv. Corp. v. American Swiss Parts Co., 11 U.C.C. Rep. 877, 42 Mich. App. 211, 201 N.W.2d 673 (1972), a case markedly similar in its factual setting. Here, although plaintiff's financing statement had been filed only in the local filing office and not also with the office of the Secretary of State as required by the Michigan dual filing rule, its local filing was effective under §9-401(2) so as to entitle plaintiff's security interest in two screw machines to priority as against the properly perfected security interest claimed by the intervenor in the lawsuit, a subsequent creditor of the defendant-debtor. Id. at 818, 42 Mich. App. at ___, 201 N.W.2d at 674. The evidence in this cited case supported the trial court's finding that the intervenor had actual knowledge, as required by the statute, where it was aware that the machines were being financed by the initial creditor-plaintiff. The Michigan appeals court found the intervenor, therefore, had knowledge of the contents of the financing statement filed by the defendant. Id.; 42 Mich. App. at ___; 201 N.W.2d at 674-75.

A federal appeals court has stated "[i]t is evident that for purposes of the [Uniform Commercial] Code [section 9-401(2)] knowledge so far as pertinent here means actual knowledge or reason to have such actual knowledge, not constructive knowledge in any broader sense." United States v. Ed Lusk Constr. Co., Inc., 504 F.2d 328, 331 (10th Cir. 1974)(emphasis added).

The trial court found that as a matter of fact the Hornick Bank had actual knowledge of the contents of the financing statement which had been filed, albeit improperly, by Onawa State. We find that evidence produced at trial and during the debtor's evidentiary deposition support such a finding. Mr. Johnston testified that in his course of dealing with Hornick Bank he dealt with three different men. A Mr. Fitzgerald, Mr. Delperdang, and most recently Mr. Wagner. Johnston testified that all three were aware that he received his financing for his

equipment from Onawa State, and that the equipment was pledged as collateral for the loan. Mr. Fitzgerald first encouraged the debtor to seek financing in Onawa, Iowa, as Hornick Bank was unable to support such a sizeable business loan. Clifford Young, president of the Onawa State, testified that he had phone conversations with representatives of the Hornick Bank regarding Johnston's business financing. Young testified that a representative of the plaintiff told him that she was aware of Onawa State's priority to the business assets of the debtor.

Hornick Bank makes absolutely no argument to suggest that it was in any way misled by the improper filing of the Onawa State's financing statement. Likewise, there is no evidence that they even checked with the office of the Secretary of State to see if a financing statement had been filed with regard to the above-described collateral. The arguments of Professor White, which Hornick Bank relies on for authority in support of a strict reading of 554.9401(2) are of little persuasive value when plaintiff made no attempt to benefit from such a narrow interpretation. Our holding is made pursuant to the goals and ambitions of the code as espoused by its drafters.

B. "Continuation" under Code section 554.9403(2).

Perfection of financing statements lapses at the expiration of a five (5) year period unless a continuation statement is filed prior to the lapse. A filed continuation statement has the practical effect of extending the perfection of the security interest of creditors. Section 554.9403(2) of the Iowa Code provides:

2. [a] filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five-year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty days or until expiration of the five-year period, whichever occurs later. Upon lapse the security interest becomes unperfected,

unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

Onawa State filed a continuation statement within the statutory time limitation. However, like the financing statement, Onawa State filed the continuation statement in the office of the county recorder. Iowa Code section 554.9403(2) does not mention a proper location for filing. Hornick Bank would urge us to adopt a position that the office of the Secretary of State is the only proper place to file the continuation statement; without the "saving clause" available to allow Onawa State to escape the consequences of an improper filing (i.e. lapse). We find the following language to be pertinent to this issue:

"Nowhere, either in the Uniform Commercial Code itself or in its voluminous commentary, has a word been spoken of the place to file a continuation statement. The void is not without a certain significance of its own, however, for it strongly suggests that continuation statements are to be filed in the place specified in §9-401, which provides the sole clue to be found anywhere in the code as to the place to file either a financing statement, a continuation statement or a termination statement. The draftsmen of the Uniform Commercial Code . . . [apparently] presumed that continuation and termination statements would be filed in the place where the financing statement they continue or terminate was filed . . . Inasmuch as the filing number assigned to the original financing statement is the only indicator essential to be found on a continuation statement by which the two statements can be connected, it seems uncontrovertible that the identification of the original filing office would also have been made a formal requirement of any sufficient continuation statement. . ."

In Re Barnes, 15 UCC. Rep. 956, 959-60 (D.C.D.Me., 1974). The court in Barnes goes on to state that:

"[t]he proper place to file in order to perfect a security interest is the proper place to file a continuation statement extending the effectiveness of the original financing statement." Id.

The Onawa State filed a continuation statement so as to extend the perfection of their security interest in the construction equipment and other business assets of Roy Johnston. Hornick Bank was aware of the original financing

-9-

statement so as to make its perfection effective against them. We hold that the continuation statement filed with the county recorder is also effective to deny Hornick Bank a preferred position in the proceeds of the collateral.

AFFIRMED.