



**Are Government Creditors Exempt from U.C.C. Article 9 Filing and Perfection  
Requirements?**

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**Introduction**

Article 9 of the Uniform Commercial Code (the "UCC") requires a creditor to perfect its security interests against its collateral in order to recover the creditor's priority in such collateral.<sup>1</sup> Former versions of the UCC that predate 2001 provided that the Article 9's perfection requirements did not apply "[t]o a transfer by a government or a governmental unit of the state."<sup>2</sup> This exception was eliminated from the UCC in 2001.<sup>3</sup> Thirty-two states, however, still have versions of the UCC that contain some version of this exception.<sup>4</sup> Within the states that still enforce this exception for governmental units, there are conflicting views as to how to interpret this language in cases where the governmental unit is a creditor.

The language, "transfer by this state or a governmental unit of this state," does not clearly establish whether the exception to the Article 9 perfection requirement applies when the governmental unit is a creditor or a debtor. While all courts generally agree that the exception

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<sup>1</sup>U.C.C. § 9-310(a) (2000)("Except as otherwise provided in subsection (b) and Section 9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.").

<sup>2</sup>U.C.C. § 9-104(e) (current version at U.C.C. § 9-109 (2002)).

<sup>3</sup>U.C.C. § 9-109 cmt. n.9 (2002)("Former Section 9-104(e) excluded transfers by governmental debtors. It has been revised and replaced by the exclusions in new paragraphs (2) and (3) of subsection (c).").

<sup>4</sup>U.C.C. § 9-109.

applies when the state or governmental unit is the debtor,<sup>5</sup> courts in several states have held that the exception does not apply to governmental unit creditors.<sup>6</sup> Courts in a minority of states, however, have held that the exception applies regardless of whether the governmental unit is the debtor or creditor.<sup>7</sup> The former position is the majority view amongst the states which still employ this exception, while the latter position is the minority view.

This Article will discuss both the majority and the minority view on the governmental exception to Article 9. Part I will discuss the majority view that the exception only applies to governmental unit debtors. Part II will discuss the minority view that the government exception to the UCC applies to government creditors as well as debtors. Part III will discuss the impact of this split of authority.

#### **I. A Majority of States Who Apply the Government Exception to Article 9 of the UCC Only Apply the Exception in Cases Involving Government Debtors**

Although the UCC has been revised to eliminate section 9-104's exception for state and governmental units, a majority of jurisdictions have retained the exception in their version of the UCC.<sup>8</sup> Among the thirty-two states that still contain some version the exception, there are several states whose courts had previously ruled that the exception does not apply to government creditors, including Alaska,<sup>9</sup> Colorado,<sup>10</sup> Illinois,<sup>11</sup> Mississippi,<sup>12</sup> and Washington.<sup>13</sup> In these states, the earlier case law still applies.<sup>14</sup>

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<sup>5</sup>U.C.C. § 9-109.

<sup>6</sup>See *infra* notes 9-30.

<sup>7</sup>See *infra* note 44.

<sup>8</sup>See *supra* note 4.

<sup>9</sup>ALASKA STAT. ANN. § 45.29.109(d)(14) (West 2000) (“This Article does not apply to... a government or governmental subdivision or agency.”).

<sup>10</sup>COLO. REV. STAT. ANN. § 4-9-109(e) (West 2001) (“...a security interest, lien, or pledge created by this state or a governmental unit of this state... and this article shall not apply to such a security interest, lien, or pledge...”).

A majority of jurisdictions that have adjudicated the meaning of the phrase “transfer by this state or a governmental unit of this state” have held that it does not create an exception for governmental unit creditors.<sup>15</sup> These courts have cited to the official comment to conclude that their determinations are consistent with the intents of the legislatures that enacted Section 9-104 of the former UCC. Official Comment 5 to Section 9-104 of the former UCC provided that “[c]ertain governmental borrowings include collateral in the form of assignments... Since these assignments are usually governed by special provisions of law, these governmental transfers are excluded from this Article.”<sup>16</sup> This comment seems to indicate that the exception was intended to exclude governmental debtors, not creditors, from having to comply with Article 9’s perfection provisions.<sup>17</sup> Indeed, federal and state courts in Colorado,<sup>18</sup> Illinois,<sup>19</sup> Mississippi,<sup>20</sup>

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<sup>11</sup>ILL. COMP. STAT. ANN. § 5/9-109(d)(13) (West 2002) (“This Article does not apply to... a government or governmental subdivision or agency.”).

<sup>12</sup>MISS. CODE. ANN. § 75-9-109(d)(13) (West 2002) (“This Article does not apply to... a transfer by this state or a governmental unit of this state.”).

<sup>13</sup>WASH. REV. CODE. ANN. § 62A.9A-109(d)(14) (West 2000) (“This Article does not apply to... a transfer by this state or a governmental unit of this state.”).

<sup>14</sup>In fact, the Washington legislature notes in its comment that “Until now, the official text of Article 9 has excluded coverage of transfers by governments and governmental units. The official text of Revised Article 9 eliminates that exclusion. However, Washington’s distinctive case law on municipal finance makes that elimination inappropriate in this state. Consequently, subsection (d)(14) has been added to continue the exclusion with respect to the State of Washington and its governmental units.” WASH. REV. CODE. ANN. § 62A.9A-109 cmt. 2.

<sup>15</sup>See supra note 6.

<sup>16</sup>*In re Altek Sys., Inc.*, 14 B.R. 144, 149 (Bankr. N.D. Ill. 1981).

<sup>17</sup>See *In re Brazier Forest Prod., Inc.*, 724 P.2d 970, n. 2 (Wash. 1986) (“The Official Comment to section 9–104, however, indicates that section 9–104(e) is intended to exclude transactions in which the government is a borrower.”).

<sup>18</sup>See *Bowlen v. Fed. Deposit Ins. Corp.*, 815 P.2d 1013, 1015 (Colo. App. 1991) (“The governmental subdivision or agency exclusion of § 4-9-104(e) covers only transactions in which the government is a debtor/borrower.”).

<sup>19</sup>See *Altek Sys.*, 14 B.R. at 149 (holding that the exception did not apply in that case because the governmental unit was not the borrower.).

<sup>20</sup>See *In re 20th Century Enterprises, Inc.*, 152 B.R. 119, 123 (Bankr. N.D. Miss. 1992) (stating that the exception “excludes transactions from coverage under the Uniform Commercial Code when the governmental agency is the debtor or borrower, not when it is the secured creditor.”).

Oklahoma<sup>21</sup> and Washington<sup>22</sup> have relied on this official comment as a reason to hold that the exception applies only to governmental debtors.

In some states, the legislatures explicitly provided that only government debtors would be exempt from Article 9's perfection provisions. For example, the Massachusetts legislature wrote a comment to their version of the UCC, which provided that "[a] new paragraph (e) has been added to make clear that this article does not apply to security interests created by *governmental debtors*."<sup>23</sup> Relying on this comment, the United States Bankruptcy Court of the District of Massachusetts, in *In re Dalcon, Inc.*,<sup>24</sup> held that the exemption did not apply to a creditor representing the Commonwealth of Massachusetts.<sup>25</sup> Similarly, in Alaska, a letter from the Alaska governor to the Chairman of the House Rules Committee of the Alaska State Legislature demonstrated the legislative intent to apply the exception only to governmental unit debtors.<sup>26</sup> The letter provided that "[i]t is impractical to expect public entities such as the state and its subdivisions to comply with the provisions of the Uniform Commercial Code when obtaining debt financing."<sup>27</sup> The Supreme Court of Alaska opined that this letter indicated that the exception to Article 9's perfection requirements is limited only to transactions where the governmental unit is the debtor.<sup>28</sup>

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<sup>21</sup>See *Farmers & Merchants Nat. Bank v. Fairview State Bank*, 766 P.2d 330, 332 (Okla. 1988) ("Because no government borrowing occurred, the provision is clearly inapplicable.").

<sup>22</sup>See *supra* note 17.

<sup>23</sup>*In re Dalcon, Inc.*, 120 B.R. 620, 623 (Bankr. D. Mass. 1990) (emphasis in original).

<sup>24</sup>*Id.*

<sup>25</sup>*Id.* ("Thus, the Court finds that the exemption is inapplicable and... the transaction in question is covered by the provisions of Article 9...").

<sup>26</sup>See *State, Div. of Agric. v. Fowler*, 611 P.2d 58, 60 (Alaska 1980).

<sup>27</sup>*Id.*

<sup>28</sup>*Id.* ("This letter clearly supports a reading limiting the statute to situations in which the state is a borrower.").

Other jurisdictions, however, do not have explicit language for courts to rely on when determining the scope of the governmental unit exception to Article 9’s perfection requirements. For example, in 2014, the Supreme Court of Kentucky became the latest court to hold that the governmental unit exception to Article 9 only applied to government debtors, not creditors.<sup>29</sup> In *Delphi Automotive Systems, LLC v. Capital Community Economic/Industrial Development Corporation*,<sup>30</sup> a governmental-agency creditor and a manufacturer entered into a “lease” covering certain equipment, which provided that the manufacturer would own the equipment upon making the final payment.<sup>31</sup> A private creditor subsequently extended credit to the manufacturer and perfected a security interest in all of the manufacturer’s personal property to secure the loan.<sup>32</sup> After the manufacturer defaulted on the loan, the private creditor filed an action to enforce its lien against all of the manufacturer’s personal property, including the “leased” equipment.<sup>33</sup> The governmental creditor opposed the private creditor’s action, arguing that KRS § 355.9-109(4)(q) (Kentucky’s version of Section 9-109) excused them from perfecting their security interest because the statute excluded “a transfer by a government or governmental subdivision or agency.”<sup>34</sup>

In the decision, the Supreme Court of Kentucky first held that the governmental-entity creditor’s “lease” was a disguised security interest.<sup>35</sup> After determining the nature of the “lease,”

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<sup>29</sup>See *Delphi Auto. Sys., Inc. v. Capital Cmty. Econ./Indus. Dev. Corp.*, 434 S.W.3d 481, 489 (Ky. 2014) (“Clearly, the General Assembly has not singled out governmental entities... for special treatment when it is a secured creditor so, like other creditors, it must comply with Article 9 in perfecting a security interest.”).

<sup>30</sup>*Id.*

<sup>31</sup>*Id.* at 483.

<sup>32</sup>*Id.*

<sup>33</sup>*Id.*

<sup>34</sup>*Id.* at 486; KRS § 355.9-109(4)(q).

<sup>35</sup>*Delphi*, 434 S.W.3d at 485 (using as authority KRS § 355.1-203 titled “Lease distinguished from security interest.”).

the *Delphi* court then held that KRS § 355.9-109(4)(q) did not excuse the governmental creditor from complying with Article 9’s perfection requirements because that section only applied where the governmental agency was a borrower, not a creditor.<sup>36</sup> The Supreme Court of Kentucky came to this conclusion by examining the legislative history of the exception.<sup>37</sup> The Supreme Court of Kentucky noted that the original UCC provision, upon which the Kentucky statute was based, “was universally understood to be applicable only to government debtors/borrowers.”<sup>38</sup> In addition, the Supreme Court of Kentucky noted that the Kentucky legislature’s comment to the section was more concerned with situations where the government or governmental entity was the debtor or borrower.<sup>39</sup> Additionally, the Supreme Court of Kentucky found that there was not a valid public policy rationale to allow a governmental agency’s unperfected security interest to have priority over a private creditor’s perfected interest.<sup>40</sup> In particular, the Supreme Court of Kentucky emphasized that “[t]here is nothing inherently wrong in requiring a government or governmental unit which takes a security interest . . . to comply with Article 9 by filing a financing statement as other creditors do.”<sup>41</sup> Therefore, the Supreme Court of Kentucky held that, in Kentucky, government creditors are not exempt from Article 9’s perfection requirements.<sup>42</sup>

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<sup>36</sup>*Id.*

<sup>37</sup>*Id.* at 486. (“looking at the history of Kentucky’s version of Article 9 underscores that KRS 355.9–109(4)(q) addresses governmental borrowers.”)

<sup>38</sup>*Id.*

<sup>39</sup>*Id.* (the comment stating “Whereas Kentucky state and local government issuers of debt are now subject to the perfection and filing requirements of the revised Article 9 of the Uniform Commercial Code and on July 1, 2002, will be required to comply with these requirements with respect to outstanding debt obligations, resulting in an increase in the burdens and costs of borrowing for these state and local governmental entities. . .”).

<sup>40</sup>*Id.* at 488.

<sup>41</sup>*Id.* at 488-89.

<sup>42</sup>*Id.* at 489.

Therefore, even though the original UCC provision was eliminated, a majority of jurisdictions that have decided on this issue hold that the language “transfer by a government or governmental unit” does not refer to government creditors.

## **II. Some States Apply the Government Exception to Article 9 of the UCC to Governmental Unit Creditors and Debtors**

In a few jurisdictions, however, courts have held that these jurisdictions’ versions of section 9-104 of the former UCC excused governmental creditors from complying with Article 9’s perfection requirements.<sup>43</sup> For example, the Supreme Court of Kansas and the United States District Court for the District of Arizona have held that governmental unit creditors were exempt from Article 9’s perfection requirements.<sup>44</sup>

The Supreme Court of Kansas, in *In re City of Moran*,<sup>45</sup> held that a governmental unit creditor did not have to comply with Article 9’s perfection requirements.<sup>46</sup> In *Moran*, the security interest at issue was a “lease-purchase agreement” that was authorized under Kansas’s Economic Development Revenue Bond Act,<sup>47</sup> which was passed before Kansas enacted the UCC.<sup>48</sup> One of the purposes of the Act was to “promot[e] the general welfare of the citizens of this state by authorizing all cities and counties of the state to issue revenue bonds.”<sup>49</sup> The Supreme Court of Kansas found that this created a public policy exception for governmental unit creditors that entered into a “lease-purchase agreement” under the Act, so as not to hinder the

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<sup>43</sup>See *In re City of Moran*, 238 Kan. 513, 521 (1986); *In re Allstate Life Ins. Co. Litig.*, No. CV–09–08162–PCT–GMS, 2013 WL 5161688, at \*1 (D. Ariz. Sept. 13, 2013).

<sup>44</sup>See *Moran*, 238 Kan. at 521; *Allstate*, 2013 WL at \*1.

<sup>45</sup>*Moran*, 238 Kan. at 513.

<sup>46</sup>*Id.* at 521.

<sup>47</sup>KAN. STAT. ANN. § 12-1740 (1981).

<sup>48</sup>*Id.* at 520–21 (finding that the legislature could have eliminated the lease-purchase agreements when it adopted the UCC, but did not).

<sup>49</sup>KAN. STAT. ANN. § 12-1740 (1981).

purpose of the Act.<sup>50</sup> In particular, the *Moran* court noted that the legislature intended that a “lease-purchase agreement” would not fall under Article 9 because “[t]o do otherwise would certainly discourage bondholders who would be dependent upon the city or the county to protect their interest by filing a financing statement.”<sup>51</sup>

Importantly, Kansas’s exemption of governmental creditors from Article 9’s perfection requirements has only been limited specifically to those governmental unit creditors that entered into “lease-purchase agreements” under the Economic Development Revenue Bond Act. Otherwise, since Kansas’s version of the UCC still provides that Article 9’s perfection requirements do not apply to “a transfer by a government or governmental agency or subdivision,” the exception may only apply to governmental unit debtors in transactions not involving “lease-purchase agreements.”<sup>52</sup> Kansas courts, however, have not yet interpreted that phrase outside of the limited *Moran* exception.

Likewise, the United States District Court for the District of Arizona, in *In re Allstate Life Insurance Company Litigation*,<sup>53</sup> held that, under Arizona law, a governmental unit creditor was excused from complying with Article 9’s perfection requirements.<sup>54</sup> The Arizona version of the UCC provided that “Article 9 does not apply to transfers, pledges, and similar actions *by this state or governmental unit of this state.*”<sup>55</sup> In *Allstate*, the party opposing the governmental unit

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<sup>50</sup>*Moran*, 238 Kan. at 521 (“Obviously, there were policy reasons the legislature intended that the transaction be characterized as a lease-purchase agreement and not subject to Article 9 of the UCC.”).

<sup>51</sup>*Id.*

<sup>52</sup>KAN. STAT. ANN. §84-9-109(d)(15).

<sup>53</sup>*Allstate*, 2013 WL at 1.

<sup>54</sup>*Id.* at 23.

<sup>55</sup>*Id.* (Emphasis in original); ARIZ. REV. STAT. ANN. § 47-9109(d)(14).



argued that the court should adopt the majority view when interpreting the statute.<sup>56</sup> The court, however, held that the UCC's language did not only apply to situations where the governmental unit was the debtor or creditor because Comment 5 to section 9-104 of the former UCC, the basis for the majority rule, had been replaced.<sup>57</sup> Therefore, the court held that, without an explicit bar within the UCC, a governmental unit creditor need not comply with Article 9's perfection requirements.<sup>58</sup> This decision by the Arizona District Court, however, is currently an outlier.

### III. Recommendations to State Legislatures and State Creditors

It is important to remember that only thirty-two states' versions of the UCC contain the governmental unit exemption from Article 9's perfection requirements.<sup>59</sup> In most of those states, Article 9's perfection requirements apply to situations where the state or governmental unit is the creditor.<sup>60</sup> Under the current version of the Article 9's perfection requirements apply to all secured transactions, including those in which the state or governmental unit is either a secured debtor or creditor. Importantly, in all thirty-two states, a creditor does not need to comply with Article 9's perfection requirements in secured transactions in which the state or a governmental unit is a debtor. Comment 9 to section 9-109 of the current UCC states:

Former Section 9-104(e) excluded transfers by governmental debtors. It has been revised and replaced by the exclusions in new paragraphs (2) and (3) of subsection (c). These paragraphs reflect the view that Article 9 should apply to security interests created by a State, foreign country, or a "governmental unit"... of either except to the extent that another statute governs the issue in question.<sup>61</sup>

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<sup>56</sup>*Id.* ("Plaintiffs cite to a number of cases where courts declined to apply the government exemption in Article 9 because the government was the grantor rather than the debtor in the transaction.")

<sup>57</sup>*Id.* ("However... these cases relied on a UCC comment that has since been replaced."); *See supra* note 8.

<sup>58</sup>*Id.*

<sup>59</sup>*See supra* note 4.

<sup>60</sup>*See supra* note 6.

<sup>61</sup>U.C.C. § 9-109 cmt. n.9 (2002)

Accordingly, the drafters of the UCC specifically removed the government exemption from Article 9 in order to give deference to the states' specific versions of the UCC and other state statutes with regard to government debtors and creditors. In these jurisdictions, all creditors should follow Article 9's perfection requirements in all secured transactions, including those in which the state or governmental unit is a creditor. This would limit the risk of confusion amongst creditors as well as the risk of a creditor losing their priority interest.

According to the majority of states that have enacted the governmental unit exemption, a governmental-entity creditor is held to the same standard as a private creditor. Therefore, in such a jurisdiction, a state or governmental unit that extends credit to a borrower should perfect its security interest in accordance with Article 9's perfection requirements for the particular collateral. Moreover, as *Delphi* demonstrates, the state or governmental unit should comply with Article 9's perfection requirements for the particular collateral even if the debtor is only "leasing" the collateral. Indeed, the process for perfecting a security interest is not difficult for most collateral, and perfecting its security interest will ensure that the governmental-entity creditor has priority over competing security interests. A governmental creditor should perfect their security interests in accordance with Article 9's perfection requirements so that the creditor maintains its priority over other creditors.

## **Conclusion**

Even though the current UCC eliminated the provision in 2001, thirty-two states still employ some version of the government exemption to Article 9. A majority of states hold that this exemption only applies when the government or governmental unit is the debtor in the transaction, not the creditor. However, there is competing precedent in some jurisdictions that applies the provision to government creditors as well as debtors. Whatever the jurisdiction, it

would be safest course of action for a government creditor to perfect their security interests so as not to risk their priority in their interests.