A SINGULAR TEST FOR AUTOMATIC PERFECTION OF ACCOUNTS AND PAYMENT INTANGIBLES

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Article 9 grants automatic perfection to assignments of accounts and payment intangibles that do not constitute a significant amount of the assignor's outstanding accounts or payment intangibles. Although the concept of significance appears easy to implement, courts have created disparate tests to determine significance. Nevertheless, each of those tests either creates inefficiencies in application or is disjointed from the statutory text. This Article argues courts should interpret significance is a manner congruent with the first principles of Article 9 and hold that significance only exists when a transaction is either objectively or subjectively intended to further commercial financing.

TABLE OF CONTENTS

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INTRODUCTION

Since 1999, the Uniform Commercial Code has granted automatic perfection to assignments of accounts and payment intangibles that do not constitute a "significant part of the assignor's outstanding accounts or payment intangibles . . . ."[1] Nevertheless, with only a somewhat opaque reference in the Official Comments, the drafters provided little in the way of what that phrase means.[2] As a result, three tests have arisen to explain the phrase. More specifically, courts have created a ratio test;[3] a casual and isolated test;[4] and a coupling of those two tests.[5] And, although the problem has been recognized by various scholars, no resolution exists within the scholarly literature.[6]

This Article argues courts should interpret the phase "significant" in a manner consistent with the first principles of Article 9 — an assignment or series of assignments are "significant" if they individually or in the aggregate objectively or subjectively appear to be commercial financing. The Article proceeds in three parts. Part I will discuss the drafting history and overall purpose of both Article 9 and more specifically UCC 9-309(2). Part II will then discuss the various tests that have arisen to determine what constitutes a "significant" assignment. Part III will then discuss the proper interpretation of the phrase, using the first principles of Article 9 as a guide.

I. THE HISTORY AND PURPOSES OF BOTH ARTICLE 9 AND UCC § 9-309(2)

The overriding purpose of Article 9 was to create a uniform system for the attachment, perfection, and priority of security interests in personal property.[7]

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[1] U.C.C. § 9-309(2) (AM. L. INST. & UNIF. L. COMM'N 2002). In 1972, Article 9 was revised to include both the sale and assignment of accounts within its scope. *See* U.C.C. § 9-102(1)(b) (AM. L. INST. & UNIF. L. COMM'N 1972). In 2002, Article 9 was revised to include the sale and assignment of payment intangibles. *See* U.C.C. § 9-109(a)(3) (AM. L. INST. & UNIF. L. COMM'N 2002).

[2] *See* U.C.C. § 9-309 cmt. 4 ("The purpose of paragraph (2) is to save from *ex post facto* invalidation casual or isolated assignments — assignments which no one would think of filing.").

[3] *See, e.g., In re* Vigil Bros. Constr., Inc., 181 B.R. 453, 457 (Bankr. D. Ariz. 1995).

[4] *See, e.g., In re* Worden, 63 B.R. 721, 724 (Bankr. D.S.D. 1986).

[5] *See, e.g.*, K.A.O.P. Co. v. Midway Nat'l Bank of St. Paul, 372 N.W.2d 774, 777 (Minn. Ct. App. 1985).

[6] Scholars have discussed the problem at length. *See, e.g.*, 9 FREDRICK H. MILLER & CARL S. BJERRE, HAWKLAND AND UCC SERIES § 9-309:3 (updated 2022) (discussing the existence of the various tests); 1 ELDON H. RILEY, SECURITY INTERESTS IN PERSONAL PROPERTY § 4:8 (updated 2021) (same); JAMES J. WHITE, ROBERT S. SUMMERS & ROBERT A. HILLMAN, UNIFORM COMMERCIAL CODE § 31:16, at 210–17 (6th ed. 2021–22) (discussing the divergence as two tests). And, some scholars have proposed solutions to the problem. Still, those solutions are to either eviscerate the section altogether or to apply the ratio test; as discussed herein, the latter test leads to unpredictable results. For examples of the former, see WHITE, SUMMERS & HILLMAN, *supra* note 6. For examples of the latter, see Thomas E. Plank, *Assignment of Receivables Under Article 9: Structural Incoherence and Wasteful Filing*, 68 OHIO ST. L.J. 231 (2007) (arguing that filing requirement should be eviscerated for accounts and payment intangibles).

[7] *See* U.C.C. § 9-101 cmt. 1 ("This Article supersedes former Uniform Commercial Code (UCC) Article 9. As did its predecessor, it provides a comprehensive scheme for the regulation of security interests in personal property and fixtures.").

Nevertheless, the drafters of Article 9 were only interested in including security interests, and the like, that are involved in commercial financing.[8] Thus, Article 9's scope provisions only include transactions that the drafters perceived were regularly used in commercial financing.[9] Notwithstanding this limitation, the drafters included certain transactions within Article 9 that have the potential to be used in commercial financing but are not inherently so. UCC 9-309(2) is one of those provisions. By its terms, UCC 9-309(2) permits automatic perfection of certain types of assignments of accounts and payment intangibles, where those assignments are so insignificant that "no one would [believe] filing [was necessary]."[10] Or, thinking of it differently, the section permits automatic perfection where the underlying transaction is not colored with the hue of commercial financing.[11] Accordingly, at least in the general sense, UCC 9-309(2) can be discerned as a modified view of Article 9's overall intended scope: UCC 9-309(2) is only intended to require filing for assignments that are intended for commercial financing.

In the broad sense, the scope of Article 9 is only intended to include transactions for personal property that are used in commercial financing.[12] The hallmarks of that most basic premise are inlaid throughout Article 9's scope provision in UCC 9-109. For instance, although the sale of an account is within the scope provision of 9-109(a), certain types of sales are excluded under 9-109(d)(4)–(7).[13] Thus, the sale of an account will not invoke the scope of Article 9 if the sale is in connection with the sale of an entire business.[14] Similarly, a sale will not invoke the scope of Article 9 if the sale is for collection only.[15] Each of those exemptions are based upon the same basic premise — these types of transactions are excluded because they are not regularly used in commercial financing.[16] Thus, no reason exists to require parties to these types of transactions to comply with Article 9's perfection and priority rules.

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[8] *See* U.C.C. § 9-109 cmt. 12 ("In general this Article covers security interests in (including sales of) accounts, chattel paper, payment intangibles, and promissory notes. Paragraphs (4), (5), (6), and (7) of subsection (d) exclude from the Article certain sales and assignments of receivables that, by their nature, do not concern commercial financing transactions.").

[9] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:27, at 98 ("Most of the exclusions in subsection (d) can be justified on the ground that the transactions described do not involve [commercial] conventional secured loans."). *See also* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:4, at 19 ("[T]he Article was drafted only to 'regulate certain well-known and institutionalized types of financing transactions.'") (quoting 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 11.1, at 337 (1965)).

[10] *See* U.C.C. § 9-309 ("The following security interests are perfected when they attach: . . . (2) an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles . . . ."). *See also supra* text accompanying note 2.

[11] *See* U.C.C. § 9-109 cmt. 12.

[12] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:4, at 19.

[13] *See* U.C.C. § 9-109(a)(3).

[14] *See* U.C.C. § 9-109(d)(4).

[15] *See* U.C.C. § 9-109(d)(5).

[16] *See, e.g.*, U.C.C. § 9-109 cmt. 12. *See also* Architectural Woods, Inc. v. Washington, 562 P.2d. 248, 250 (Wash. 1977) (en banc) ("Under the Code, a financing statement must be filed to perfect sales or other assignments of 'accounts' or [payment intangibles]. However, the Code is intended to govern practical

Although the drafters were only interested in including transactions that have the flavor of commercial financing, the drafters nonetheless included certain transactions within Article 9's scope on the basis that, while not inherently used in commercial financing, the transactions are nevertheless regularly used. One of those transactions is the assignment of an account.[17] It goes without saying that assignments of accounts are regularly used in commercial financing. Indeed, that particular type of transaction is so common that commercial financers have a name for it: factoring.[18] Still, not every assignment of an account is used in commercial financing. Thus, the exclusions inlaid in UCC 9-109(d)(4)–(7).[19] Further complicating the matter, there are transactions that, because of their nature, could be used in commercial financing but are not necessarily so used. In those instances, the drafters included the transactions within the scope of Article 9 but provided special protections for parties engaged in those transactions to avoid Article 9 operating as a "gotcha" scheme.[20] One of those transactions is encompassed in UCC 9-309(2).[21]

UCC 9-309(2) provides automatic perfection to "an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles . . . ."[22] As stated earlier, assignments of accounts and payment intangibles are regularly used in commercial financing.[23] Hence, their inclusion.[24] Still, they are not all inherently used in commercial financing. For instance, a business could assign all of its accounts to a bank in exchange for a loan. That particular type of transaction is commonly used by businesses to generate liquidity and is, by its nature, commercial financing.[25] Nevertheless, if the same business assigned two of its 200,000 accounts to another business as payment for a debt, that transaction is, on its face, not commercial financing. And so, while the assignment of accounts and payment intangibles are regularly used in commercial financing, not every assignment inherently is. The problem then is how to include all of the former transactions within Article 9 — and subject them to Article 9's perfection and priority rules — while providing some protections for parties in the latter circumstance, where

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commercial transactions. In this area of intangible transfers, filing is intended to tie in with true financing transactions, *i.e.*, with the commercial financing of receivables."); *see also* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:27, at 98.

[17] For assignments of accounts, see U.C.C. § 9-109(a)(1). For sales of accounts, see U.C.C. § 9-109(a)(3). When Article 9 uses the word "assignment" it is intended to govern both sales and security interests. *See* U.C.C. § 9-102 cmt. 26.

[18] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:4, at 15 ("The 'factoring' or 'sale' of rights to payments by the person entitled to those payments to a third person has long been regarded as financing transaction."); *see also id.* § 30:6, at 24.

[19] *See supra* note 16.

[20] *Supra* note 2.

[21] *See* U.C.C. § 9-309(2).

[22] *See id.*

[23] *See* WHITE, SUMMERS & HILLMAN, *supra* text accompanying note 6.

[24] *See id.* § 30:4, at 13–15.

[25] *See id.* § 30:4, at 15.

"no one would [believe] filing [was necessary]."[26] The drafters chose to combat this problem by providing automatic perfection to the latter transactions.[27] But the language the drafters used has proven less than clear. More specifically, courts have interpreted the concept of "significance" differently. As a result, three tests have arisen to interpret the language.

II. THE VARIOUS TESTS FOR "SIGNIFICANT"

The phrase "significant" is not defined anywhere within Article 9.[28] As a result, courts have had to develop mechanics to determine which types of assignments give rise to automatic perfection and which types are relegated to the filing requirement. In that vein, courts have developed three different tests. First, courts have developed the ratio test.[29] Second, courts have developed the casual and isolated test.[30] Finally, courts have developed a test that couples both the ratio and casual and isolated tests.[31] Although each of the tests is attempting to interpret the concept of significance, each of the tests either gives rise to inefficiencies or is disconnected to the statutory text.

A. The Ratio Test

The most prominent of the tests is the ratio test.[32] The ratio test attempts to adhere to the strict language of 9-309(2) by assessing the total amount of the assignor's outstanding accounts or payment intangibles against the total amount of the assignment to the target assignee.[33] Although the ratio test conforms to the strict nature of the statutory language, its application is inherently conclusory, leading to both unpredictable results and the exact inefficiencies that automatic perfection was

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[26] *See* U.C.C. § 9-309 cmt. 4.

[27] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 31:16, at 210–11 ("New to Article 9 in 1999 was automatic perfection under 9-309(3) and (4) for the 'sale' of 'a payment intangible' and 'a promissory note.'").

[28] *See* U.C.C. § 9-102.

[29] *See, e.g.*, Park Ave. Bank v. Bassford, 205 S.E.2d 861, 863 (Ga. 1974) (applying a ratio test and summarily concluding significance); *In re* Vigil Bros. Constr., Inc., 181 B.R. 453, 457 (Bankr. D. Ariz. 1995) (holding, without analysis, that an assignment of 40% of the assignor's outstanding accounts was significant); *In re* Sun Air Int'l, Inc., 24 B.R. 135, 137 (Bankr. S.D. Fla. 1982) (holding a transfer of 14% of the assignor's outstanding accounts was insignificant).

[30] *See, e.g.*, Architectural Woods, Inc. v. Washington, 562 P.2d 248, 249–50 (Wash. 1977) (en banc) (holding a creditor was entitled to automatic perfection because the creditor did not regularly accept assignments); *In re* Worden, 63 B.R. 721, 724 (Bankr. D.S.D. 1986) (holding a creditor was not entitled to automatic perfection because the creditor regularly accepted assignments).

[31] *See, e.g., In re* Crabtree Constr. Co., 87 B.R. 212, 213–14 (Bankr. S.D. Fla. 1988) (holding the assignee satisfies both tests); *In re* Wood, 67 B.R. 321, 324 (W.D.N.Y. 1986) (adopting both tests and holding the assignee satisfied the casual and isolated test); Davidson v. Union Nat'l Bank of Little Rock (*In re* B. Hollis Knight Co.), 605 F.2d 397, 401 (8th Cir. 1979) (applying both tests and remanding the case for a factual determination on the ratio test).

[32] Sun Bank v. Parkland Design and Dev. Corp., 466 So. 2d 1089, 1092 (Fla. Dist. Ct. App. 1985) ("[M]ost courts in interpreting [§ 9-309(2)] follow the language of the statute rather than the comment . . . .").

[33] *See, e.g., Bassford*, 205 S.E.2d at 863.

intended to prevent. Furthermore, the yield of that inquiry is not always consistent with the purposes of Article 9. As a result, the ratio test forms an imperfect test.

As previously stated, 9-309(2), by its terms, only grants automatic perfection to assignments from an assignor to an assignee that individually or in the aggregate constitute an insignificant amount of the assignor's outstanding accounts or payment intangibles.[34] Courts adopting the ratio test have interpreted that language in a strict form. That is, courts adopting the ratio test have reviewed evidence purely for the purpose of comparing the total amount of the assignment(s) to the total amount of outstanding accounts or payment intangibles.[35] Hence, the ratio test. Notwithstanding the mathematical nature of the test, the test is at best imperfect, as the application of the strict language leads to conclusory, unpredictable results.

In theory, the ratio test should be relatively easy to apply; it is mathematical. However, as with most things, the devil is the details. More specifically, the problem is not in determining the ratio; it is instead in determining whether the yield of that inquiry is "significant."[36] In that vein, courts have tended to create the ratio and then, without analysis, summarily state that the ratio either is or is not "significant."[37] For instance, in *Robert E. Hickman Real Estate, Inc. v. The Capane Group, L.P.*, the Delaware Court of Chancery first concluded the total amount of the assignment was mathematically five percent.[38] The court then, without any analysis, summarily concluded the assignment was "obviously not a transfer of a significant part of the contract rights of the assignor."[39] Similarly, in *In re Vigil Brothers Construction, Inc.*, the court reviewed the applicable evidence, determined the ratio was forty percent, and then summarily stated: "The Court concludes that the Debtor's assignment of 40 percent (40%) of its accounts receivable to CECO was significant."[40] Finally, in some instances, courts have failed to even state the percentage before summarily concluding the significance or insignificance.[41] While perhaps that summary nature of these decisions, standing alone, is not particularly troublesome, the problem lies in two symptoms of it. First, the summary nature of courts' approach has led to unpredictable results, and second, the absence of predictability has led to the precise inefficiencies that automatic perfection was intended to alleviate.

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[34] *See* U.C.C. § 9-309(2) (AM. L. INST. & UNIF. L. COMM'N 2002) (granting automatic perfection to "an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles . . . .").

[35] *See supra* text accompanying note 29 for discussion of *In re Vigil Bros. Constr., Inc.* and *In re Sun Air Int'l Inc.*

[36] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 31:16, at 215–16 (noting the absence of predictability in the test).

[37] *See, e.g.*, Robert E. Hickman Real Est. Inc. v. Capano Grp., No. 5576, 1979 WL 4634, *8 (Del. Ch. Nov. 14, 1979).

[38] *Id.* at *3.

[39] *Id.* at *5.

[40] *In re* Vigil Bros. Constr., Inc., 181 B.R. 453, 457 (Bankr. D. Ariz. 1995).

[41] *See* Park Ave. Bank v. Bassford, 205 S.E.2d 861, 863 (Ga. 1974).

Although conclusory analysis, without more, is not inherently troublesome, the conclusory nature of the courts' approach in this context has led to unpredictable results, and those unpredictable results have led to the exact inefficiencies the automatic perfection rules were intended to prevent. For instance, courts have held that an assignment of fourteen percent of a party's outstanding accounts was insignificant and thus entitled to automatic perfection.[42] Similarly, courts have held that sixteen percent was insignificant.[43] But, in some instances, thirteen percent was significant.[44] In others, twenty percent is significant.[45] There is no analysis in any of the opinions to explain the distinction.[46]

The absence of distinction in the courts' application of the ratio test has led to the inefficiency that automatic perfection was intended to alleviate — unnecessary filing. In the absence of automatic perfection, a secured party can only perfect its security interest in accounts or payment intangibles by filing a financing statement.[47] In part, the automatic perfection rules of 9-309 were intended to avoid unnecessary filings — to avoid "cluttering" the filing system with filings regarding collateral that are unlikely to have any appreciable effect on commercial financing.[48] Nevertheless, the absence of a predictable test has led careful lawyers to do just that — when in doubt, lawyers follow the advice of the Official Comments and file.[49] Thus, the filing system is now encumbered by the precise problem its rules were intended to prevent. As a result, the ratio test, as currently configured, has proven an unmanageable test.

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[42] *See In re* Sun Air Int'l, Inc., 24 B.R. 135, 137 (Bankr. S.D. Fla. 1982).

[43] *See, e.g.*, Standard Lumber Co. v. Chamber Frames, Inc., 317 F. Supp. 837, 840 (E.D. Ark. 1970).

[44] *See, e.g., In re* Bindl, 13 B.R. 148, 150 (Bankr. W.D. Wis. 1981).

[45] *See, e.g.*, Miller v. Wells Fargo Bank Int'l Corp., 406 F. Supp. 452, 477 (S.D.N.Y. 1975), *aff'd*, 540 F.2d 548 (2d Cir. 1976).

[46] Courts have criticized the test on the basis that it is simplistic and ungoverned. *See, e.g., In re* Meridian Rsrv., Inc., No. 90-0131, 1994 WL 903895, *7 (Bankr. W.D. Okla. Oct. 7, 1994) ("But the percentage test will never have any certainty as various courts arbitrarily find certain percentages to be significant or not."); Architectural Woods, Inc. v. Washington, 562 P.2d. 248, 249 (Wash. 1977) (en banc) (noting inconsistencies in the application of the test).

[47] *See* U.C.C. § 9-310(a) (AM. L. INST. & UNIF. L. COMM'N 2002) (requiring a party to perfect by filing, unless some other method is permissible under U.C.C. §§ 9-308–315, inclusive). *See also* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 23-10, at 1215 ("Section 9-310(a) identifies filing as the norm, and except when they are proceeds, there is no other way to perfect a security interest in most accounts (as distinguished from deposit accounts) and general intangibles."). Two other methods exist for a secured party to perfect security interests in other types of collateral: possession and control. However, neither of those perfection methods may be used, where the collateral is accounts or payment intangibles. *See id.* at 1215–16.

[48] *See supra* note 16 for a relevant portion of *Architectural Woods, Inc. v. Washington*.

[49] *See* U.C.C. § 9-309 cmt. 4 ("Any person who regularly takes assignments of any debtor's accounts or payment intangibles should file.").

B. The Casual and Isolated Test

In contrast with the ratio test, the casual and isolated test does not attempt to adhere to the strict language of 9-309(2).[50] Instead, the casual and isolated test attempts to adhere to the Official Comments to that section.[51] As a result, the casual and isolated test functionally ignores the actual statutory language. Further exacerbating that problem, the casual and isolated test misaligns the target of the inquiry by focusing on the commercial status of the assignee instead of assessing the actual, target assignment. As a result, the casual and isolated test is also an imperfect test.

Unlike the ratio test, the casual and isolated test is not grounded in the statutory language. Instead, the casual and isolated test derives from the Official Comments to section 9-309.[52] More specifically, Official Comment 4 provides in pertinent part: "The purpose of paragraph (2) is to save from *ex post facto* invalidation casual or isolated assignments — assignments which no one would think of filing. Any person who regularly takes assignments of any debtor's accounts or payment intangibles should file."[53] Courts adopting this test focus their inquiry on the frequency of assignments or the status of the assignee, instead of whether the assignment is significant. As a result, the causal and isolated test ignores the actual statutory language.

Courts applying the casual and isolated test focus their inquiry on the frequency of assignments or the status of the assignee. For instance, and in terms of the former, in *Architectural Woods*, the court held a lumber company was entitled to automatic perfection because "it was not in the business of commercial financing or obtaining assignments."[54] In contrast, *In re Worden*, the bankruptcy court held a bank was not entitled to automatic perfection because the bank "regularly t[ook] assignments."[55] In both cases, the courts focused on the frequency with which the assignee generally accepts assignments.[56] Neither court focused its inquiry on the amount of the assignment(s) or the relative weight of those assignments to the total amount of the assignor's outstanding accounts or payment intangibles.[57] In a related vein, and in terms of the latter, the Supreme Court of Georgia has determined that banks who

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[50] Courts adopting the test acknowledge that the test does not conform to the statutory language. *See, e.g., Architectural Woods, Inc.*, 562 P.2d at 2509 ("While the casual and isolated test does not follow the literal language of the statute, it does meet the purpose stated in the official comment.").

[51] U.C.C. § 9-309 cmts. 1–8.

[52] *See id.* cmt. 4.

[53] *Id.* cmt. 4.

[54] 562 P.2d at 250.

[55] 63 B.R. 721, 724 (Bankr. D.S.D. 1986).

[56] *See Architectural Woods, Inc.*, 562 P.2d at 248–50 ("Though plaintiff has in the past few years occasionally taken an assignment as payment for materials supplied, it does not regularly take assignments of any debtors' accounts or contract rights . . . ."); *see also In re* Worden, 63 B.R. at 724 ("In the instant case, the Bank regularly takes assignments, and this was not a casual or isolated transaction.").

[57] *See Architectural Woods, Inc.*, 562 P.2d at 249–50; *see also In re* Worden, 63 B.R. at 722–24.

regularly engage in commercial financing are per se ineligible for automatic perfection under 9-309(2), irrespective of the size or significance of the target assignment and irrespective of the total amount of the assignor's outstanding accounts or payment intangibles.[58] Other courts have reached similar conclusions.[59]

At bottom, the casual and isolated test forms an imperfect test because it elevates the language of the Official Comments above the statutory language. Furthermore, it fails to achieve the actual purpose behind 9-309(2): to permit automatic perfection in instances where the assignment is insignificant and thus has no appreciable impact on commercial financing.[60]

C. The Coupling of the Tests

The third test is best understood as courts attempting to marry the ratio test with the casual and isolated test. That is, courts have applied this test where they could not harmonize the statutory language with the Official Comments and thus decided to apply both tests. Obviously, the coupled test suffers from the same inefficiencies that plague the individual tests. As a result, the coupling of the two tests also forms an imperfect test.

When confronted with the disparity between the statutory language and the Official Comments, some courts have elected to couple the two tests together and apply them both. Ordinarily, the inquiry ends when the court determines that the assignee bears the burden of proof, and the assignee cannot bear that burden under either test.[61] For instance, in *Sun Bank*, the court first notes the disparity in courts' interpretation of automatic perfection of assignments.[62] The court then states that the assignee bears the burden of demonstrating eligibility for automatic perfection.[63] Finally, the court holds that, in this case, the assignee failed to provide evidence of the outstanding accounts of the assignor and failed to provide evidence of the nature of the assignee's business.[64] Accordingly, the assignee failed to meet its burden.[65] Similarly, in *Rothschild*, the court held the assignee could not satisfy either the casual and isolated test or the ratio test.[66] Thus, in some sense, the coupling of tests has exacerbated the problems in both tests because it has made it more challenging to acquire automatic perfection, based in part on language that is disconnected from the statutory language.

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[58] *See* M. D. Hodges Enters. v. First Ga. Bank, 256 S.E.2d 350, 352 (Ga. 1979).

[59] *See, e.g.*, K.A.O.P. Co. v. Midway Nat'l Bank of St. Paul, 372 N.W.2d 774, 775 (Minn. Ct. App. 1985) (affirming the trial court's finding that filing was required because the bank regularly engaged in commercial financing).

[60] *See infra* Section III.

[61] *See supra* text accompanying note 31.

[62] *See* Sun Bank v. Parkland Design and Dev. Corp., 466 So. 2d 1089, 1092 (Fla. Dist. Ct. App. 1985).

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] *See* H. & Val J. Rothschild, Inc. v. Nw. Nat'l Bank of Saint Paul, 242 N.W.2d 844, 847 (Minn. 1976).

Because the third test is a composite of the first two tests, the third test suffers from the same inefficiencies that plague its colleagues. More specifically, the coupling creates filing inefficiencies due to the unpredictable nature of the ratio test and creates purpose-based inefficiencies by its inclusion of the causal and isolated test. Accordingly, the coupled test also proves an imperfect test.

III. THE PROPOSAL

The remedy for ameliorating the problem of both multifarious tests and the inefficiencies in those tests is to return to the first principles of Article 9: Article 9 is intended to regulate the attachment, perfection, and priority for security interests that involve commercial financing.[67] Thus, in determining what the word "significant" means for purposes of 9-309(2), courts should ground their analysis in whether the target transaction was objectively or subjectively intended to further commercial financing for the debtor. In the event the debtor objectively or subjectively intended the target transaction to further commercial financing, then the transaction is significant and is thus ineligible for automatic perfection. In the event the target transaction is not objectively or subjectively intended to further commercial financing, then the target transaction is insignificant and is eligible for automatic perfection. This test, if adopted, would serve the principle goals underlying both automatic perfection and the filing requirements because it would provide filing notice to future, potential creditors in the event the transaction involved commercial financing but would not require filing in the event the transaction does not involve commercial financing. Furthermore, this test would alleviate the unpredictable nature of the ratio test as well as ameliorate the inefficiencies of the casual and isolated test.

A. The Commercial Financing Test

The word "significant" lacks a statutory definition. Thus, accordingly to basic rules of statutory interpretation, the word should be construed using its plain, ordinary meaning. In its plain, ordinary meaning, the word "significant" means "important" or "noticeable".[68] Given the nature and purpose of Article 9, a transaction or series of transactions should only be construed as important or noteworthy, if they individually or in the aggregate are objectively or subjectively intended to further commercial financing.

Given the absence of a statutory definition for the word "significant", courts should apply the most basic rule of statutory construction: to adopt the plain, ordinary

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[67] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:4, at 19.

[68] *See Significant*, MERRIAM WEBSTER DICTIONARY 1159 (11th ed. 2014) (defining "significant" as "important"); *see also Significant*, CAMBRIDGE DICTIONARY, https://dictionary.cambridge.org/us/dictionary/english/significant (last visited Jan. 22, 2023) (defining "significant" as "noticeable").

meaning of the word.[69] In its plain, ordinary meaning, "significant" means "important" or "noticeable."[70] Admittedly, that, standing alone, does little to further the inquiry. Rather, it is at best tautological. But, the inquiry into the meaning of a statutory word is always subject to the overriding rule that statutes should be construed to determine the intent of the drafters.[71] Given the first principles of Article 9, the word should be construed to achieve the drafters' purpose, while remaining honest to the statutory language. As stated previously, Article 9, in the first instance, is only intended to regulate transactions that involve commercial financing.[72] And, assignments of accounts and payment intangibles were only included within the scope of Article 9 because, at least in certain instances, those assignments are used to further commercial financing. Still, the drafters recognized that some assignments — insignificant assignments — should be subject to the attachment and priority rules of Article 9 but should not be subject to the ordinary filing requirements of Article 9. Instead, they are eligible for automatic perfection.[73] Given Article 9's overriding purpose, coupled with the statutory language itself, the word "significant" should mean objectively or subjectively intended to further commercial financing.

Significance should be grounded in whether a particular transaction or series of transactions is intended to objectively or subjectively further commercial financing. In the event a transaction or series of transactions is intended to further commercial financing, automatic perfection is unavailable and filing is required. In contrast, where a transaction or series of transactions is not objectively or subjectively intended to further commercial financing, automatic perfection is available and filing is not required. If adopted, this test would both further the purposes of Article 9's filing and automatic perfection rules as well as ameliorate the inefficiencies of the other tests.

B. The Commercial Financing Test Furthers the Purposes of Article 9

Article 9's perfection and priority rules are largely premised upon the concept of notice.[74] But, in certain circumstances, Article 9 departs from the goal of notice to

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[69] *See, e.g.*, Food Mktg. Inst. v. Argus Leader Media, 139 S. Ct. 2356, 2362 (2019) (holding interpretation of statutes requires courts to examine "ordinary, public meaning of the statutory term"); Wis. Cent. Ltd. v. United States, 138 S. Ct. 2067, 2070 (2018) (same).

[70] *See supra* note 68.

[71] *See, e.g.*, Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 570 (1982) ("Our task is to give effect to the will of Congress, and where its will has been expressed in reasonably plain terms, 'that language must ordinarily be regarded as conclusive.'") (quoting Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980)); United States v. Fontaine, 697 F.3d 221, 227 (3d Cir. 2012) ("'A court's primary purpose in statutory interpretation is to discern legislative intent.'") (quoting Morgan v. Gay, 466 F.3d 276, 277 (3d Cir. 2006)).

[72] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 30:4, at 19.

[73] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 31:10, at 196 (stating the drafters compromised the concept of notice and permitted automatic perfection "where the cost of public notice appeared to outweigh the benefits of that notice").

[74] *See id.* ("Perfection generally requires some action, such as filing or possession, which would put a diligent searcher on notice of the secured party's claim.").

achieve other goals. Automatic perfection is one of those instances. If adopted, the proposal's test would further both the notice goals of Article 9 as well as the automatic perfection goals of Article 9. Normally, with only limited exceptions, a secured party can only perfect a security interest by engaging in some type of notice to future, potential creditors, alerting them that a particular asset may already be collateral for a security interest.[75] In the context of reified paper, that notice could exist by either possession or filing a financing statement.[76] In the context of deposit accounts, that notice can only exist by control.[77] In the context of accounts and payment intangibles, that notice can only be provided by filing a financing statement, unless the transaction is eligible for automatic perfection.[78] But, in any event, the goal of perfection is notice to future, potential creditors.[79]

The goals of automatic perfection are distinct from that basic Article 9 goal of notice. That is, the concept of automatic perfection is antithetical to concepts of notice and is instead intended to further other goals of Article 9. More specifically, the goals of automatic perfection are to avoid unnecessary filings and protect creditors in instances where "no one would think [to file]."[80] Hence, the Code permits automatic perfection of assignments of accounts and payment intangibles that are insignificant.[81]

If adopted, the proposal would serve the goal of notice for transactions where notice might matter, while preserving the goals of automatic perfection in instances where filing is unlikely to have any effect on any future, potential creditor. Thus, for example, assume a company seeks to assign its only two accounts with a total value of five hundred dollars to another business as payment for a pre-existing debt. That transaction is within the scope of Article 9,[82] but would not be eligible for automatic perfection under the ratio test, as the two accounts represent 100% of the debtor's outstanding accounts.[83] Still, that type of transaction is obviously not intended to further commercial financing. That is, no future, potential creditor is likely to be harmed by the absence of notice from the assignment of two accounts with a total value of five hundred dollars. They are unlikely to be harmed because, given these

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[75] *See In re* Hurst, 308 B.R. 298, 303 (Bankr. S.D. Ohio 2004) ("'[S]ecret liens' . . . are abhorrent to a significant purpose of Article 9 perfection requirements — to provide notice of a security interest to the world.").

[76] *Compare* U.C.C. § 9-313(a) (AM. L. INST. & UNIF. L. COMM'N 2002) (permitting perfection by possession for tangible negotiable documents, instruments, and tangible chattel paper, among other things), *with* U.C.C. § 9-310(a) (requiring a party to perfect by filing, unless some other method is permissible under U.C.C. §§ 9-308–315, inclusive). *See also* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 23:10, at 1215.

[77] *See* U.C.C. § 9-312(b) ("Except as otherwise provided in Section 9-315(c) and (d) for proceeds: (1) a security interest in deposit accounts may be perfected only be control under Section 9-314.").

[78] *See* U.C.C. § 9-310(a)–(b).

[79] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 31:10, at 196.

[80] *See* U.C.C. § 9-309 cmt. 4 ("The purpose of paragraph (2) is to save from ex post facto invalidation causal or isolated assignments — assignments which no one would think of filing.").

[81] *See* WHITE, SUMMERS & HILLMAN, *supra* note 6, § 31:16, at 214.

[82] *Compare* U.C.C. § 9-109(a)(3), *with* U.C.C. § 9-109(d)(7).

[83] *See supra* text accompanying note 23.

facts, it does not appear the debtor is attempting to further commercial financing or factoring by the transfer.[84] As a result, it is unlikely the debtor would seek to again transfer the same interest in a secondary assignment to a potential, future creditor.[85] And, even if the debtor did attempt such a secondary transfer, creditors involved in commercial financing would be constructively on notice that such a nominal assignment automatically perfects.[86] In contrast, assume a company wishes to generate liquidity by factoring sixteen percent of its total outstanding accounts, with sixteen percent representing approximately four million dollars' worth of value. Depending on the jurisdiction, sixteen percent would be insufficient to be significant under the ratio test. And, depending on the business of the assignee, the causal and isolated test would likely also find the transaction insignificant. Thus, under application of those tests, the debtor may not be required to file a financing statement. Still, four million dollars of factoring is significant in the context of commercial financing for two reasons. First, if the debtor is factoring, it is because the debtor is illiquid. Thus, there is a strong possibility that the debtor, after the initial transfer, would seek in the near future to factor more accounts (to generate more liquidity). Second, because of the value of the entire transaction, that transaction is the type of transaction that could be interesting for a future, potential creditor. Stated slightly differently, no creditor involved in commercial financing is interested in factoring accounts that have nominal value. But four million dollars is not nominal value. Thus, the latter transaction is the type of transaction that could catch a creditor unaware and should require a financing statement to perfect.

C. The Commercial Financing Test Ameliorates the Inefficiencies of the Other Tests

If adopted the commercial financing test would ameliorate the inefficiencies caused by the existing tests. More specifically, it would tie the test to the statutory language and reduce the absence of predictability present in the ratio test, ultimately leading to fewer unnecessary filings.

One of the chief problems of the casual and isolated test is that the test is unattached to the statutory language. As stated earlier, although the test is found within the Official Comments, the test does little to interpret or assist interpretation of the statutory language.[87] Instead, it seems to contemplate a completely different

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[84] *See In re* Bindl, 13 B.R. 148, 150 (Bankr. W.D. Wis. 1981) ("Several possible reasons for the exception suggest themselves. First, if the account or accounts transferred were small enough, there would be little or no anticipation of a subsequent transfer and the notice afforded by filing would never be utilized by a purchaser or transferee. Second, a subsequent transferee of accounts in a normal commercial accounts financing situation who was afforded notice might be reasoned to be unconcerned by the prior position of a competing transferee if the amount transferred was negligible.").

[85] Following the sale of an account, a debtor maintains the legal ability to transfer an interest in another party, until the buyer of the account perfects its security interest. *See* U.C.C. § 9-318(b).

[86] *See In re* Bindl, 13 B.R. at 150 (stating nominal assignments are unlikely to give rise to subsequent assignments and are thus insignificant in the context of Article 9's notice requirements for perfection).

[87] *See supra* text accompanying notes 53–55.

test — one focusing its inquiry on the status of the assignee rather than the amount or value of the target assignment or assignments. If adopted, the commercial financing test would resolve this problem. That is, the commercial financing test is in fact premised upon the statutory language itself because the test is intended to determine what types of assignments are significant. Furthermore, the commercial financing test has the added benefit of harmonizing the statutory language with the official comments. That is, when determining whether a particular assignment or series of assignments constitutes a transaction that objectively furthers commercial financing, courts could consider, as factors, both the status of the assignee and the frequency with which the assignee purchased assignments.[88] Thus, the commercial financing test is preferable to the casual and isolated test because it both does justice to the statutory language and reconciles the statutory language with the Official Comments.

In addition to ameliorating the problems within the casual and isolated test, the commercial financing test would also ameliorate the unpredictable nature of the ratio test. As stated earlier, the ratio test is subject to a lack of predictability because whether a particular assignment or series of assignments constitutes a significant amount appears untethered to any logical or mathematical process.[89] Instead, the analysis is always, at best, summary.[90] In contrast, the commercial financing test is grounded in the first principles of Article 9 and is relatively easy to apply in a uniform way. Specifically, courts need only review evidence to determine whether the specific assignee subjectively intended the assignment or series of assignment to further factoring or some other form of commercial financing. Assuming the answer is no, the court would then review the entirety of the transaction to determine whether, objectively, a reasonable creditor would view the assignment or series of assignments as transactions intended to further factoring or some other form of commercial financing. Because this test takes a holistic, rather than mathematical, approach to the problem, it is likely to be answered using trade usage evidence as well as best practices evidence — both of which are readily available to any party. As a result, the commercial financing test ameliorates the unpredictable nature of the ratio test and is likely to reduce unnecessary filings.

CONCLUSION

Both the notice and automatic perfection goals of Article 9 serve important purposes. Where possible, courts should interpret Article 9's provisions to meet both of those goals. Adoption of the commercial financing test would serve both goals,

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[88] *See, e.g.*, Architectural Woods, Inc. v. Washington, 562 P.2d 248, 249 (Wash. 1977) (en banc) (stating the status of the assignee and the frequency with which the assignee accepts assignments are factors to be reviewed in determining whether a transfer is significant).

[89] *See supra* text accompanying notes 35–38 ("[The ratio test's] application is inherently conclusory, leading to both unpredictable results and the exact inefficiencies that automatic perfection was intended to prevent.").

[90] *See supra* text accompanying note 44.

while eliminating the inefficiencies present in the other tests. Accordingly, courts should adopt it.