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**Goldie v. Bauchet Properties—California Uniform
Commercial Code: Division Nine’s
Application to Ownership Interests In Trade
Fixtures Acquired Under a Real Property Lease**

In California, security interests in personal property and fixtures are comprehensively regulated by Division Nine of the California Uniform Commercial Code (Code).¹ Whenever a contest arises between the holders of conflicting security interests in the same personal property or fixtures, with certain enumerated exceptions,² Division Nine of the Code specifically prescribes the law by which such disputes are to be governed.³ In keeping with its original scope, Division Nine does not apply “[t]o the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder.”⁴

Recently, in *Goldie v. Bauchet Properties*,⁵ the Supreme Court of California held that Division Nine of the Code does not apply to conflicts arising between one with a security interest in trade fixtures and another with an ownership interest in the same trade fixtures derived from an interest as owner and lessor in the real property to which the trade fixtures are affixed. Such disputes are to be governed by the California law relating to real property and fixtures.⁶ Since Division Nine’s application has always been limited to security interests in personal property and fixtures, the court’s holding is not surprising. However, the means by which the court reached its decision is of interest.

When presented with an alleged “interest in or lien on real estate” a court would be expected to utilize section 9104(j) of the Code in denying application of Division Nine to the conflict before it.⁷ Yet, in *Goldie*, where the court was presented with such an

1. CAL. COMM. CODE § 9101 *et seq.* (West 1964).

2. CAL. COMM. CODE § 9104 (West 1964).

3. CAL. COMM. CODE § 9102 *et seq.* (West (1964).

4. CAL. COMM. CODE § 9104(j) (West 1964).

5. 15 Cal. 3d 307, 540 P.2d 1, 124 Cal. Rptr. 161 (1975).

6. *Id.* at 317-18, 540 P.2d at 9, 124 Cal. Rptr. at 169.

7. Section 9104(j) is the general exclusion section of Division Nine with respect to interests in real estate, including leases. CAL. COMM. CODE § 9104(j) (West 1964).

interest, not only did the court fail to utilize 9104(j), but it indirectly held the section to be inapplicable.⁸ The court refrained from using 9104(j) of the Code although no alternative sections were directly on point. It was only after an extended analysis of the term "fixtures", resulting in an interpretation of the term "fixtures" in 9102(1)c to mean both "fixtures" and "trade fixtures", that the court was able to utilize 9102(1)c of the Code in denying application of Division Nine to the conflict before it.⁹

Since the application of either section 9104(j) or 9102(1)c leads to the same result (the denial of Division Nine's application to the conflict), and since the court in *Goldie* could have applied 9104(j) without having engaged in an extended analysis of the term "fixtures",¹⁰ it is not directly apparent why the court used 9102(1)c rather than 9104(j). The failure of the court to explain its decision not to utilize 9104(j) of the Code is likely to generate confusion as to that section's proper function. In order to appreciate the confusion which is likely to arise, a detailed presentation of the case is necessary.

Through two corporations of which he was the sole shareholder, Henry Kermin operated a frozen food business on real property which he owned. In November of 1966, Kermin sold the real property to a group of individuals (the defendants, Bauchet Properties) which immediately leased it to the Kermin corporations for twenty years. The lease was not recorded.

At the time of the sale and lease of the real property, one of the Kermin corporations owned an automatic packaging machine which it was using in the frozen food business. This machine was bolted to the cement floor, but could be removed without injury to the

8. The court did not specifically mention § 9104(j). Rather, it stated: "Section 9102 subdivision (1), provides in pertinent part that with exceptions not here applicable division 9 'applies . . .'" 15 Cal. 3d 307, 315, 540 P.2d 1, 7, 124 Cal. Rptr. 161, 167 (1975) (emphasis added). Section 9104(j) is one of those exceptions which without explanation the court held was "not here applicable".

Though there is no legal precedent which would directly compel the application of § 9104(j) to the facts in *Goldie*, neither is there precedent for declaring the section inapplicable. As the discussion to follow will demonstrate, the application of § 9104(j) would have enabled the court in *Goldie* both to avoid its strained analysis of § 9102(1)c and to issue a more comprehensive holding.

9. *Id.* at 314-18, 540 P.2d at 6-9, 124 Cal. Rptr. at 166-69.

10. Section 9104(j) applies when an interest in or lien on real estate is present, whereas § 9102(1)c requires, in addition to such an interest, the presence of a security interest in fixtures. CAL. COMM. CODE §§ 9102(1)c, 9104(j) (West 1964).

premises.¹¹ Article V of the lease granted a security interest in the packaging machine to the lessor defendants:

[L]essee hereby grants to Lessor a security interest in all its fixtures, machinery, equipment, furniture, furnishings, and the proceeds therefrom presently owned by Lessee and located at said demised premises Upon the default in the performance of any of the obligations of the Lessee as provided in Article XVIII, Lessor shall immediately have the remedies of a secured party under the Uniform Commercial Code.¹²

Article XII of the same lease further provided:

[T]hat if Lessee be in default, it shall not then have any right of trading in, replacing or removing of such trade fixtures, equipment, and other like property which it may have installed.¹³

In December of 1967 one of the Kermin corporate lessees borrowed \$10,000 from plaintiff Malcom Goldie and executed and delivered to plaintiff its demand promissory note in that amount. Interest was payable in monthly installments due on the last day of each month. The Kermin corporate lessees also granted plaintiff a security interest in the packaging machine through an executed and delivered security agreement. In February of 1968, plaintiff filed the security agreement on the packaging machine with the Secretary of State of California.

On September 1, 1969, the Kermin corporate lessees defaulted in the payment of rent due the defendants under the lease. On September 30, 1969 the lessees defaulted in the interest due plaintiff under the terms of the demand promissory note. The Kermin corporations surrendered the leased premises, including the packaging machine, to defendants on October 6, 1969. On November 25, 1969 plaintiff demanded and defendants refused to surrender possession of the packaging machine. Thereafter, plaintiff instituted an action against defendants for possession of the packaging machine.

The trial court concluded that the packaging machine was a trade

11. The trial court found and concluded on substantial evidence that the packaging machine was a trade fixture. The Supreme Court agreed with the trial court on this issue. 15 Cal. 3d 307, 313, 540 P.2d 1, 6, 124 Cal. Rptr. 161, 166 (1975); *Beebe v. Richards*, 115 Cal. App. 2d 589, 591, 252 P.2d 688, 690 (1953); see, *Horowitz, Fixtures in California*, 26 So. CAL. L. REV. 21, 40-45 (1952).

12. 15 Cal. 3d 307, 311 n.2, 540 P.2d 1, 4 n.2, 124 Cal. Rptr. 161, 164 n.2 (1975).

13. *Id.* at 311 n.3, 540 P.2d at 4 n.3, 124 Cal. Rptr. at 164, n.3.

fixture which is the equivalent of personal property in California.¹⁴ As personal property, the packaging machine was appropriate for use as collateral under a security agreement.¹⁵ Since plaintiff had perfected his security interest by filing with the Secretary of State, his interest prevailed over that represented by defendants' unfiled lease, entitling him to possession of the packaging machine.¹⁶

Before the Supreme Court, defendants asserted that the trial court had committed prejudicial error in basing its decision on the California Uniform Commercial Code (Code). Defendants claimed that the conflict between plaintiff and defendants was to be properly resolved only through application of the law of California relating to real property and fixtures.

The California Supreme Court held that the nature of defendants' claim to the packaging machine would determine which law was to apply.¹⁷ The court recognized that Article V, *supra*, of the lease between defendants and the Kermin corporations granted a security interest in the packaging machine to defendants.¹⁸ However, the court noted that the wording of Article VII, *supra*, was reasonably susceptible of two constructions. Either the loss of the right to remove the machine upon default was merely a protection of defendants' security interest, or it was declarative of an ownership interest in the defendants, separate and distinct from any security interest already possessed by them.¹⁹

The trial court had not ascertained the nature of defendants' interest, that is, whether it was a security interest or an ownership interest derived from defendants' interest in the real property as owners and lessors. Unable to make this determination as a matter of law, the California Supreme Court remanded the case to the trial court to make the necessary finding.

Anticipating either of two findings by the trial court, Justice Sullivan, speaking for the court, proceeded to set forth the applicable law in the alternative. If defendants possessed but a security interest, then Division Nine of the Code would be applicable.²⁰ In such event, plaintiff's perfected security interest in the personal property would prevail over defendants' non-perfected security interest.²¹

14. *Id.* at 312, 540 P.2d at 5, 124 Cal. Rptr. at 165, 3 WITKIN, SUMMARY OF CALIFORNIA LAW, Real Property § 469, at 2153 (8th ed. 1973).

15. 15 Cal. 3d 307, 312, 540 P.2d 1, 5, 124 Cal. Rptr. 161, 165 (1975).

16. *Id.*

17. *Id.* at 318, 540 P.2d at 9, 124 Cal. Rptr. at 169.

18. *Id.*

19. *Id.*

20. *Id.*

21. CAL. COMM. CODE §§ 9102, 9304, 9312 (West 1964).

However, if defendants' interest in the packaging machine was an ownership interest based on their position as owners and lessors of the real property, then the California law relating to real property and fixtures would be applicable.²² Under this law, "(w)here trade fixtures removable by the tenant under the terms of a lease are later encumbered by a chattel mortgage given to a third party, the 'rights of the chattel mortgagee are derivative.'"²³ "Thus, if the tenant has lost his right to remove the fixtures, the right of the chattel mortgagee is similarly affected."²⁴ Since plaintiff's security interest (chattel mortgage) in the packaging machine arose after formation of the lease between defendants and the Kermin corporations and after the machine had been affixed to the premises, the interest was derivative, and plaintiff could assert no greater right against the lessors than could the lessees.²⁵ When the Kermin corporations defaulted on the lease, their right to remove the packaging machine from the leased premises was forfeited. Therefore, under the California law of real property, defendant lessors would prevail over plaintiff for possession of the packaging machine, because plaintiff Goldie was bound to stand in the shoes of the defaulting lessees.²⁶

Assuming that the defendants' interest in the packaging machine was an ownership interest, derived from their interest in the real property as owners and lessors, it is quite interesting to examine the manner in which the court determined that the conflict between defendants and plaintiff was to be governed by the California law of real property and fixtures.

The entire focus of the court was on section 9102 of the Code. The pertinent subsections are as follows:

22. 15 Cal. 3d 307, 318, 540 P.2d 1, 9, 124 Cal. Rptr. 161, 169 (1975).

23. *Id.* at 313, 540 P.2d at 6, 124 Cal. Rptr. at 166; *Rinaldi v. Goller*, 48 Cal. 2d 276, 281, 309 P.2d 451, 455 (1957).

24. 15 Cal. 3d at 313, 540 P.2d at 6, 124 Cal. Rptr. at 166; *Rinaldi v. Goller*, 48 Cal. 2d 276, 281-82, 309 P.2d 451, 455 (1957); *Weisberg v. Loughridge*, 253 Cal. App. 2d 416, 426 61 Cal. Rptr. 563, 572 (1967); *United Pacific Ins. Co. v. Cann*, 129 Cal. App. 2d 272, 275-76, 276 P.2d 858, 861 (1954).

25. *Rinaldi v. Goller*, 48 Cal. 2d 276, 281, 309 P.2d 451, 455 (1957).

26. A different rule prevails where the tenant installs fixtures which are owned by a third party. Under these circumstances, a landlord seeking possession of the fixtures pursuant to terms of the lease on default by the tenant must stand in the shoes of the tenant. *Hendy v. Dinkerhoff*, 57 Cal. 3, 6-7 (1880).

(1) Except as otherwise provided in . . . section 9104 on excluded transactions, this division applies so far as concerns any personal property and fixtures within the jurisdiction of this State . . . (c) To any transaction (regardless of its form) which is intended to create a security interest in goods which are or later become 'fixtures' under the law of this State, but as against third parties having or acquiring an interest in or a lien on the real property, the rights are governed by the law of this State relating to real property and fixtures.²⁷

As was noted earlier, the court determined that section 9104(j) of the Code was inapplicable to the issue before it, although no reason was given for this determination. Section 9102(1)c, *supra*, became the object of an extended analysis by the court. As written, 9102(1)c is specifically restricted in application to "goods which are or later become fixtures." Initially the court indicated that "(t)rade fixtures" are goods determined not to be 'fixtures . . . and thus cannot come within the purview of section 9102 subdivision (1), subsection (c).'²⁸

However, the court eventually interpreted the term "fixtures" in 9102(1)c to encompass both fixtures and trade fixtures. This view was thought to be consonant with the Legislature's clear intent.²⁹ Such an interpretation resulted in the conflicting interests of plaintiff and defendants falling clearly within the parameters of 9102(1)c, thereby mandating an application of the California law relating to real property and fixtures.³⁰

The reasoning used to support the court's interpretation demands inspection. In 1963, when California adopted the Uniform Commercial Code, it deleted 9-313³¹ and added 9102(1)c, *supra*.³² The Legislature's clear purpose in so doing was, according to the court in *Goldie*, "[TO] immunize from the reach of the California Uniform Commercial Code the rights of holders of interests not only in real

27. CAL. COMM. CODE § 9102 (West 1964).

28. 15 Cal. 3d 307, 317, 540 P.2d 1, 8, 124 Cal. Rptr. 161, 168 (1975); Horowitz, *Fixtures in California*, 26 So. CAL. L. REV. 21, 40-45 (1952).

29. 15 Cal. 3d 307, 317, 540 P.2d 1, 8, 124 Cal. Rptr. 161, 168 (1975).

30. CAL. COMM. CODE § 9102(1)c (West 1964).

31. This section governs conflicts arising between those with interests in fixtures and those with interests in real property. The definition of what a fixture is, however, was left to be determined by state law. The draftsmen of the California Code, in support of the deletion of § 9-313, "[CONTENDED] that in leaving open the question of what a fixture is while merely stating the consequences that follow the definition of property as a fixture, the Code (UCC) misses the point that courts have traditionally made the decision of what a fixture is in terms of what legal results would follow from this determination." California Continuing Education of the Bar, 3 CALIFORNIA COMMERCIAL LAW § 4.66 at 225 (1966).

32. 15 Cal. 3d 307, 315, 540 P.2d 1, 7, 124 Cal. Rptr. 161, 167 (1975).

property but thereby also in property affixed to it."³³ It was this view of the Legislature's clear purpose which enabled the court in *Goldie* to construe the term "fixtures" in 9102(1)c to encompass both fixtures and trade fixtures.

The court's view of the Legislature's clear purpose appears to be accurate only if the phrase "property affixed to it", *supra*, is not extended beyond the term "fixtures" to encompass trade fixtures. Section 9-313 of the UCC (1962 version) as well as 9102(1)c of the Code make specific reference only to fixtures, not to trade fixtures.³⁴ Admittedly, both fixtures and trade fixtures are affixed to real property. However, it is suggested that this similarity alone is insufficient to support an inference from writings in which only the term "fixtures" was used that the writings were clearly intended to apply to both fixtures and trade fixtures. This view is reinforced by the fact that in California, trade fixtures, unlike fixtures, are treated as personal property.³⁵ The authorities cited by the court in *Goldie* do not evidence a contrary view.³⁶

Even assuming that the court's final interpretation of 9102(1)c was consonant with the Legislature's clear intent, this does not explain the failure of the court to address 9104(j) in the first instance. The words used to describe the real property interests in 9102(1)c ("an interest in or lien on the real property")³⁷ are virtually the same as those used in 9104(j) ("an interest in or lien on real estate").³⁸ Nevertheless, the court dismissed the applicability of 9104(j) outright, yet proceeded to engage in an extended analysis before it was able to place the conflict between defendants and plaintiff within the parameters of 9102(1)c.

Division Nine of the Code regulates security interests in personal property and fixtures. Asserted interests in real property are to be

33. *Id.* at 317, 540 P.2d at 8, 124 Cal. Rptr. at 168.

34. UNIFORM COMMERCIAL CODE § 9-313 (1962 version); CAL. COMM. CODE § 9102(1)c (West 1964).

35. See, 3 WITKIN, SUMMARY OF CALIFORNIA LAW, Security Interests in Real Property § 56, at 1663, Real Property § 469, at 2153 (8th ed. 1973).

36. California Continuing Education of the Bar, 3 CALIFORNIA COMMERCIAL LAW § 1.9 at 11-12, § 4.66 at 225-26 (1966); Note, 37 CAL. STATE BAR J. 119, 201 (1962); Report of Professors Marsh and Warren to the Senate Fact Finding Committee, 1 APPENDIX TO SEN. J. at 577-78 (1961 Reg. Sess.).

37. CAL. COMM. CODE § 9102(1)c (West 1964).

38. CAL. COMM. CODE § 9104(j) (West 1964).

left to the laws relating to real property. It is important to the efficient operation of the commercial process that those relying upon Division Nine of the Code be able to clearly ascertain to which conflicts the Division's rules will apply and to which they will not. The California Supreme Court's decision in *Goldie v. Bauchet Properties*³⁹ is likely to generate confusion as to the function which 9104(j) of the Code is to play in this process.

An example will help demonstrate this view. Assume there exists a commercial leasing relationship involving real property, with a provision of the lease stipulating that upon default, the landlord shall be considered the owner of all the tenant's equipment and furniture. For purposes of this example, the landlord's interest in the tenant's equipment shall be considered an ownership interest as that term was used in *Goldie*. Assume further that at the time the lease was signed the tenant had numerous typewriters in use on the premises. Later, the tenant borrowed money from a bank, giving a security interest (chattel mortgage) in the typewriters and other equipment. Thereafter, the tenant defaulted on the lease and then on the loan. According to *Goldie*, there is apparently no section of Division Nine which would relate to this problem. Section 9104(j), which appears as if it might apply due to the landlord's ownership interest in the typewriters derived from his interest in the real property as owner and lessor, might nevertheless be inapplicable for the same reason it was inapplicable in *Goldie*. Yet 9102(1)c would certainly be inapplicable because the typewriters in this hypothetical are neither fixtures nor trade fixtures.

It would seem reasonable to infer from the holding in *Goldie* that the court took a very narrow view of 9104(j)'s applicability. It is suggested that an opposite view would be more consistent with the intended function of that section⁴⁰ and would lead to a clearer

39. 15 Cal. 3d 307, 540 P.2d 1, 124 Cal. Rptr. 161 (1975).

40. Section 9104(j) has been amended to read: "This division does not apply . . . (j) to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder *and to any interest of a lessor and lessee in any such lease or rents . . .*" CAL. COMM. CODE § 9104(j) (West Supp. 1975) (emphasis added). The amendment became effective January 1, 1976. However, the Legislature specifically noted that the amendment to subdivision (j) of § 9104 "[SHALL] be deemed declaratory of the meaning of this code as it existed prior to January 1, 1976." CAL. COMM. CODE § 11108 (West Supp. 1975). Not only does this amendment give support to a broader view of this section, as advocated by this writer, but in addition, it suggests that § 9104(j) may have been originally intended to exclude from the application of Division Nine of the Code all security interests in personal property created under the terms of a real property lease. Of course, such a view would be in certain conflict with the holding in *Goldie*.

awareness among those who rely on Division Nine of the nature and scope of the interests in real estate to which the Division does not apply.

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