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Uniform Commercial Code—Accounts Receivable Financing: Secured Parties' New Doubts Under the "Casual and Isolated" Test—*Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 562 P.2d 248 (1977)

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UNIFORM COMMERCIAL CODE—ACCOUNTS RECEIVABLE FINANCING: SECURED PARTIES' NEW DOUBTS UNDER THE "CASUAL AND ISOLATED" TEST—*Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 562 P.2d 248 (1977).

Didco, a private construction company, contracted with defendant Evergreen State College to furnish dormitory rooms for \$144,953. Plaintiff Architectural Woods, a wood products wholesaler, sold Didco materials for the project. To finance the purchase, Didco assigned plaintiff all its rights under its contract with defendant, who was notified in writing of the assignments and who was instructed to make payments directly to plaintiff. Several months later, the National Bank of Commerce took a security interest in all of the accounts and contract rights of Didco's successor in interest,¹ which included Didco's contract with defendant. Defendant had made several payments directly to plaintiff in accordance with Didco's instructions, but for reasons unknown made its final payment to Didco's successor in interest rather than to plaintiff.² Didco's successor applied the payment it received from defendant to satisfy its debt to the National Bank of Commerce.

Plaintiff contended that the assignment from Didco entitled it to the final payment, but defendant asserted that the bank had a prior in-

1. After Didco had assigned its contractual rights to plaintiff, a company named Moduleader bought out Didco, including its contract with defendant. Brief of Appellant at 3-4, *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 562 P.2d 248 (1977). However, the distinction between Didco and Moduleader played no part in the court's reasoning and thus, to avoid confusion, the reader should consider Didco and Didco's successor as representing the same business.

2. The court noted that defendant did not explain why, with full knowledge of the assignment, it paid Didco's successor rather than plaintiff. *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 408, 562 P.2d 248, 249 (1977).

3. *Id.* Defendant contended that it could use the bank's priority for its own defense:

[I]t is well settled that when payment is made by the debtor to the creditor who no longer has the right to receive payment, the latter will hold the payment as *constructive trustee* for the person entitled thereto.

. . . [T]he most that appellant could hope would be to serve and act as constructive trustees [*sic*] for NBC which is entitled to payment due to its timely filing as required by the statute.

Brief of Respondent at 36, *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 562 P.2d 248 (1977) (emphasis in original).

Defendant apparently was relying on plaintiff's inability to show damages to preclude recovery, but because the court held that the bank did not have priority, it was unnecessary to consider this argument. *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 409, 562 P.2d 248, 249 (1977).

terest in the accounts and contract rights of Didco's successor.³ Defendant's assertion was based on plaintiff's failure to file a financing statement which, defendant claimed, was required by section 9-302 of Washington's Uniform Commercial Code.⁴ If plaintiff's security interest was not exempted from the Code's general filing requirement, then the bank, which filed a financing statement,⁵ would have a prior claim.⁶ Plaintiff contended that its assignment from Didco did not need to be perfected by filing because it fell within section 9-302(1)(e),⁷ which exempts an assignment not constituting a "significant part" of the assignor's outstanding accounts and contract rights.⁸

The Washington Supreme Court held, in *Architectural Woods, Inc.*

4. *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 408, 562 P.2d 248, 249 (1977). R.C.W. § 62A.9-302 requires filing of a financing statement for perfection of a security interest in all instances except those specifically enumerated in that section. WASH. REV. CODE § 62A.9-302 (1976).

The 1962 version of the Uniform Commercial Code is in effect in Washington. Variations between the 1962 and 1972 versions of a section will be noted if they are relevant to the issue being discussed. Although several changes were made in § 9-302, none related to accounts receivable financing. U.C.C. § 9-302 (1972 version).

5. *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 408, 562 P.2d 248, 249 (1977).

6. The only exception to the general filing requirement of U.C.C. § 9-302, which applies to accounts and contract rights, is § 9-302(1)(e). See H. & Val J. Rothschild, Inc. v. Northwestern Nat'l Bank, 242 N.W.2d 844, 847 (Minn. 1976). Washington adopted this subsection without change. WASH. REV. CODE § 62A.9-302(1)(e) (1976), quoted at note 7 *infra*. Plaintiff's security interest in Didco's contract with defendant was not perfected by filing and thus was unperfected unless the § 9-302(1)(e) exemption applied. The bank's security interest was perfected by filing and would take priority over plaintiff's unperfected interest under R.C.W. § 62A.9-301(1). See 242 N.W. 2d at 847.

7. *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 408, 562 P.2d 248, 249 (1977). The section states:

(1) A financing statement must be filed to perfect all security interests except the following:

(e) an assignment of accounts or contract rights which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor.

WASH. REV. CODE § 62A.9-302(1)(e) (1976).

8. For the purposes of this exemption, the distinction between accounts and contract rights is unimportant, 19 UCC Rep. Serv. 674 (1976) (editor's note); therefore, any reference in this note solely to "accounts" or to "accounts receivable" should not be interpreted differently from "accounts and contract rights."

In *H. & Val J. Rothschild, Inc. v. Northwestern Nat'l Bank*, 242 N.W.2d 844 (Minn. 1976), the court found the distinction between accounts and contract rights to be significant in determining the application of § 9-302(1)(e), *id.* at 847, but it is apparently the only court to have done so. Even in Minnesota, the distinction is no longer tenable because the 1972 amendments of the Code, which were adopted by the Minnesota legislature subsequent to the *Rothschild* decision, eliminate the distinction. 19 UCC Rep. Serv. 674 (1976) (editor's note).

9. 88 Wn. 2d 406, 562 P.2d 248 (1977).

10. The court agreed with plaintiff's contention that its security interest was auto-

v. *State*,⁹ that the assignment fell within section 9-302(1)(e) and that since plaintiff's security interest was thus automatically perfected,¹⁰ the bank's interest was subordinate.¹¹ In deciding that Didco's assignment to plaintiff fell within the section 9-302(1)(e) exemption from filing, the court was required to construe the language of that subsection¹² and its accompanying official comment.¹³ More particularly, the court considered the appropriate test for determining whether the assignment constituted a "significant part" of Didco's outstanding accounts and contract rights.¹⁴ This note will analyze the court's reasoning in adopting the "casual and isolated" test, compare opinions from other courts construing the same subsection, and argue that the court's reasons fail to support the result reached. Finally, it will propose a means of construing the exemption which is more consonant with both the literal statutory language and Article 9's dominant policy of protecting innocent creditors against secret transfers of collateral.¹⁵

I. THREE POSSIBLE TESTS

The court recognized three different tests which have been employed to determine whether an assignment of accounts and contract rights falls within the scope of section 9-302(1)(e).¹⁶ These three tests may be denominated the percentage test, the absolute amount test, and the casual and isolated test.

Under the percentage test, if the disputed assignment, either alone or automatically perfected at the time of the assignment, 88 Wn. 2d at 409, 562 P.2d at 249. For a brief explanation of automatic perfection, see J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE §§ 23-5, 23-6 (1972).

11. R.C.W. § 62A.9-312(5) provides: "(5) . . . priority between conflicting security interests in the same collateral shall be determined as follows: . . . (b) in the order of perfection unless both are perfected by filing"

Although § 9-312(5) was changed in the 1972 version of the U.C.C., plaintiff's security interest would still have priority.

12. WASH. REV. CODE § 62A.9-302(1)(e) (1976), quoted at note 7 *supra*.

13. The comment, Official Comment 5, reads in pertinent part:

The purpose of the subsection (1)(e) exemptions is to save from *ex post facto* invalidation casual or isolated assignments: some accounts receivable statutes have been so broadly drafted that all assignments, whatever their character or purpose, fall within their filing provisions. Under such statutes many assignments which no one would think of filing may be subject to invalidation. The subsection (1)(e) exemptions go to that type of assignment. Any person who regularly takes assignments of any debtor's accounts should file.

WASH. REV. CODE ANN. § 62A.9-302, Official Comment 5 (1966).

14. 88 Wn. 2d at 409, 562 P.2d at 249.

15. See note 34 *infra*.

16. 88 Wn. 2d at 409, 562 P.2d at 249.

or together with previous assignments to the same assignee, constitutes a significant part or percentage of the assignor's total outstanding accounts and contract rights, the assignment does not fall within the exemption and the assignee must file to perfect a security interest in those rights.¹⁷ The absolute amount test determines the significance of an assignment by its dollar amount without regard to the percentage of the outstanding rights which it comprises. It is unclear, however, that any court has employed this test.¹⁸ The casual and isolated test relies on an examination of the circumstances surrounding the assignment and on the assignee's financing experience.¹⁹ An isolated assignment, made to a nonprofessional buyer of accounts, is exempt from the filing requirements under this third test.²⁰

II. THE COURT'S REASONS FOR ADOPTING THE CASUAL AND ISOLATED TEST

In reversing the lower court's holding,²¹ the supreme court set forth several reasons for adopting the casual and isolated test. First, the

17. *Id. Accord*, Miller v. Wells Fargo Bank Int'l Corp., 406 F. Supp. 452 (S.D.N.Y. 1975), *aff'd*, 540 F.2d 548 (2d Cir. 1977); *In re Consolidated Steel Corp.*, 11 UCC Rep. Serv. 408 (N.D. Fla. 1972); *Standard Lumber Co. v. Chamber Frames, Inc.*, 317 F. Supp. 837 (E.D. Ark. 1970); *General Lithographing Co. v. Sight & Sound Projectors, Inc.*, 128 Ga. App. 304, 196 S.E.2d 479 (1973); J. WHITE & R. SUMMERS, *supra* note 10, § 23-8.

18. In the case which the Washington Supreme Court cited in discussing the absolute amount test, the Georgia Supreme Court apparently considered the assignment's proportional significance as well. *Park Ave. Bank v. Bassford*, 232 Ga. 216, 205 S.E.2d 861 (1974). The court in *Bassford* stated:

The trial court found, and the evidence clearly authorizes the finding, that the assignment from the contractor to the bank did transfer a significant part of the outstanding contract rights of the assignor. Therefore, the bank was required to file a financing statement in order to perfect its security interest.

205 S.E.2d at 863.

No case has been found which relies solely on the dollar amount of the assignment, and such a standard is not supported by the language of § 9-302(1)(e) or that of Official Comment 5. As a result, the absolute amount standard will not be further analyzed in this note.

19. 88 Wn. 2d at 409-11, 562 P.2d at 249-50. *See also In re First Gen. Contractors, Inc.*, 12 UCC Rep. Serv. 762 (S.D. Fla. 1971); *Abramson v. Printer's Bindery, Inc.*, 440 S.W.2d 326 (Tex. Ct. App. 1969); J. WHITE & R. SUMMERS, *supra* note 10, § 23-8, at 808.

20. The court stressed that plaintiff's inexperience in obtaining assignments was an important factor in determining the casual and isolated nature of the assignment. 88 Wn. 2d at 411, 562 P.2d at 250. *See In re First Gen. Contractors, Inc.*, 12 UCC Rep. Serv. 762, 763-64 (S.D. Fla. 1971).

21. The trial court had found that the assignments were casual and isolated but had "relied on a literal reading of the statute and found that the amounts of the assignments constituted a significant portion of the assignor's accounts and contract rights." 88 Wn. 2d at 411, 562 P.2d at 250. It thus found the exemption inapplicable.

court reasoned that an assignee would often be in a poor position to know whether an assignment constituted a significant part of the assignor's outstanding accounts and contract rights because the assignor might be hesitant to disclose this information.²² Furthermore, the casual assignee would be unlikely, in the court's view, to have sufficient motivation to determine the true status of the assignor's outstanding rights.²³ Thus, the assignee would not be certain whether a filing was required under the percentage test. The court noted that even if the assignee were able to determine the amount of the assignor's outstanding accounts and contract rights, the percentage test itself "will never have any certainty as various courts find certain percentages to be significant or not."²⁴

The court's second reason was derived from the widely accepted position that the party asserting the "significant part" exemption carries the burden of proving its applicability.²⁵ The court expressed the view that the casual and isolated nature of an assignment was "particularly susceptible of proof."²⁶ Third, the court relied on the espousal of the casual and isolated test by certain leading Article 9 experts.²⁷ Finally, the court justified its subordination of the literal Code language by reference to the general principle of statutory construction expressed in an earlier Washington case that a statute "is to be construed in a manner consistent with the general purpose thereof."²⁸

III. ANALYSIS OF THE COURT'S REASONS

None of these reasons, when analyzed in the light of the Code's

22. *Id.* at 410, 562 P.2d at 250.

23. *Id.*

24. *Id.* at 409, 562 P.2d at 249.

25. *Id.* at 410, 562 P.2d at 250. *Accord*, Consolidated Film Indus. v. United States, 547 F.2d 533 (10th Cir. 1977); *In re Uvesco, Inc.*, 13 UCC Rep. Serv. 957 (S.D. Fla. 1973); Citizens Nat'l Bank v. Chick Norton Buick Co., 8 UCC Rep. Serv. 1389 (Okla. Ct. App. 1971); Chattanooga Brick & Tile, Inc. v. Agnew, 18 UCC Rep. Serv. 1063 (Tenn. Ct. App. 1976); Craig v. Gudim, 488 P.2d 316 (Wyo. 1971). *But see In re Boughner*, 8 UCC Rep. Serv. 144 (W.D. Mich. 1970); *Abramson v. Printer's Bindery, Inc.*, 440 S.W.2d 326 (Tex. Ct. App. 1969).

26. 88 Wn. 2d at 410, 562 P.2d at 250.

27. *Id.* at 410, 562 P.2d at 249-50. The court cited 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 19.6 (1965), and Kripke & Felsenfeld, *Secured Transactions: A Practical Approach to Article 9 of the Uniform Commercial Code*, 17 RUTGERS L. REV. 168, 189-90 (1962). *But see* note 39 and accompanying text *infra* (Professor Kripke does not clearly espouse either test).

28. 88 Wn. 2d at 410, 562 P.2d at 250 (citing *Wilson v. Lund*, 74 Wn. 2d 945, 447 P.2d 718 (1968)).

broad policies, adequately supports the court's adoption of the casual and isolated test. The court implied that an assignee could be more certain about the need to file under the casual and isolated test than under the percentage test.²⁹ An assignee's inability to discover the amount of the assignor's outstanding accounts and contract rights undoubtedly would, under the percentage test, leave the assignee uncertain about the need to file. But the exemption was not intended to guide the assignee's attempt to determine whether he or she must file. On this, Official Comment 5³⁰ and the Article 9 authorities³¹ concur. Comment 5 specifies that the exemption is intended to prevent the "*ex post facto* invalidation" of assignments which no one would think of filing. Professor Gilmore, upon whom the court relied heavily, described the exemption as a line of defense in bankruptcy and noted that because of the inherent uncertainty of the exemption's application, assignees should routinely file.³² Because the exemption was intended to operate only after the fact to protect an assignment which no one would think of filing, the court's concern for the casual assignee's lack of motivation to discover whether the exemption applies is inappropriate.³³

The overriding purpose of Article 9's central filing provisions is the protection of innocent creditors against secret transfers of collateral.³⁴ The Code reflects no corresponding emphasis on protecting secured parties against uncertainty about filing requirements.³⁵

29. The court did not support its implicit conclusion that an assignee could be more certain under the casual and isolated test. 88 Wn. 2d at 409, 562 P.2d at 249.

30. The language of R.C.W.A. § 62A.9-302, Official Comment 5, is identical to that of U.C.C. § 9-302, Comment 5 (1962 version). For the relevant portion, see note 13 *supra*.

31. *E.g.*, 1 G. GILMORE, *supra* note 27, § 19.6.

32. *Id.*

33. *But see In re Boughner*, 8 UCC Rep. Serv. 144 (W.D. Mich. 1970) (the court, like the Washington Supreme Court, stressed the importance of defining the exemption in a way which would allow assignees to predict confidently whether a filing was required).

34. U.C.C. § 9-103, Official Comment 2 (1962 version) reads in pertinent part: "[T]he purpose of filing is to allow subsequent creditors of the *debtor-assignor* to determine the true status of his affairs . . ." In the 1972 version of the U.C.C., this statement appears in Comment 5(a). U.C.C. § 9-103, Official Comment 5(a) (1972 version). In *E. Turgeon Constr. Co. v. Elhatton Plumbing & Heating Co.*, 110 R.I. 303, 292 A.2d 230 (1972), the court stated: "The entire thrust of art. 9 is the protection of the innocent creditors from a secret transfer of substantial intangible assets upon which they relied." 292 A.2d at 233-34. *Accord*, [1977] U.C.C. REPORTER-DIGEST (Bender) § 9-106, at 2-1613 (1971).

35. At other places in the Code, the drafters, apparently hesitant to require universal filing, let a consignor's or a lessor's need to file turn upon uncertain factual determinations. As a result, consignors and lessors routinely file to eliminate their doubt.

As the court noted, the party claiming automatic perfection carries the burden of proving that an assignment falls within the exemption. The court suggested that the casual and isolated test was preferable since the casual and isolated nature of an assignment was "particularly susceptible of proof."³⁶

The proposition that an assignee can more easily prove an assignment casual and isolated than proportionally insignificant is somewhat speculative. As long as the assignor has maintained accurate business records, the percentage represented by the assignment at issue should not be difficult to establish. Nevertheless, the court's position that the casual and isolated nature of an assignment is more easily established than its proportional insignificance finds some indirect support in the case law. Several cases have been decided against the party asserting the exemption because the record failed to show the amount of the assignor's total outstanding accounts and contract rights at the time of the assignment.³⁷ The possibility that one test makes the exemption easier to establish, however, does not indicate

Uncertainty has tended to produce the same practical effect as an unexpected requirement to file and thus has effectuated the primary purpose of protecting subsequent secured parties. Under R.C.W. § 62A.2-326(3)(b), whether a person delivering goods to another on consignment must file a financing statement to perfect a security interest in those goods may depend on whether the person receiving them "is generally known by his creditors to be substantially engaged in selling the goods of others." WASH. REV. CODE § 62A.2-326(3)(b) (1976). In Comment 2, the drafters note that the consignor's uncertainty, together with a presumption favoring filing, advances the policies of the Code: "Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer." WASH. REV. CODE ANN. § 62A.2-326, Official Comment 2 (1966).

A lessor's position under the Code is analogous. Article 9 applies to a lease only if it is intended as security. However, as stated in R.C.W. § 62A.1-201(37), "Whether a lease is intended as security is to be determined by the facts of each case." The uncertainty of this factual determination causes the cautious lessor to file routinely to avoid the possibility of litigation.

36. 88 Wn. 2d at 410, 562 P.2d at 250.

37. See, e.g., *Consolidated Film Indus. v. United States*, 403 F. Supp. 1279 (D. Utah 1975), *rev'd*, 547 F.2d 533 (10th Cir. 1977). In *Consolidated Film*, the assignor corporation had dissolved, and evidence of its outstanding accounts and contract rights was unobtainable; therefore the court considered the circumstances surrounding the assignment. Finding the assignment casual and isolated, the court held that it was automatically perfected. 403 F. Supp. at 1285. The court of appeals reversed, holding that the lack of evidence about the assignor's accounts and contract rights was fatal to the claim of the party asserting the exemption because he or she bore the burden of proving the assignment was "not a significant part." 547 F.2d at 536. *Accord*, *In re Uvesco, Inc.*, 13 UCC Rep. Serv. 957 (S.D. Fla. 1973); *Chattanooga Brick & Tile, Inc. v. Agnew*, 18 UCC Rep. Serv. 1063 (Tenn. Ct. App. 1976); *Craig v. Gudim*, 488 P.2d 316 (Wyo. 1971).

which of the two was intended by the Code draftsmen and the Washington legislature.

The court emphasized that the casual and isolated test accorded with the views of Professor Gilmore and Professor Kripke, both acknowledged Article 9 experts.³⁸ Professor Kripke, however, did not clearly advocate either test. He saw the exemption as a means of ensuring that the Code would apply only to commercial transactions.³⁹ In describing the exemption's application, however, he cited the Code language, "a significant part of the outstanding accounts and contract rights," and not the "casual and isolated" language of the Comment.⁴⁰ Even if Professor Kripke's position could be interpreted as advocating the casual and isolated test, his concern for limiting the Code's application in the area of accounts receivable financing has not been widely followed by the courts.⁴¹

Professor Gilmore also believed the scope of the Code's application should be limited; he indicated that he had favored an earlier draft of section 9-102(1)(b), which stated that Article 9 applied to "any financing sale" of accounts rather than to "any sale," as was finally adopted.⁴² Professor Gilmore expressed the view that section 9-302(1)(e) was appropriate because of the Code's broad coverage of sales of accounts: "When the net is spread so wide, some strange fish may be caught."⁴³ However, the concluding sentence of Gilmore's discussion of section 9-302(1)(e) reveals that his view of the exemption's

38. 88 Wn. 2d at 410, 562 P.2d at 250 (citing 1 G. GILMORE, *supra* note 27, § 19.6, and Kripke & Felsenfeld, *supra* note 27, at 189-90).

39. Kripke & Felsenfeld, *supra* note 27, at 189-90.

40. *Id.* See note 13 *supra*.

41. See, e.g., *In re Boughner*, 8 UCC Rep. Serv. 144 (W.D. Mich. 1970), in which the district court noted that, in 1962, Professors Kripke and Felsenfeld believed that the exemption's purpose was to restrict the filing requirement to "classical commercial financing through assignments of accounts receivable." *Id.* at 150. The court went on to observe: "Although the learned counsellors [*sic*] may have grasped the intent of the drafters of the U.C.C., the Pennsylvania courts, which have been pioneers in construing the U.C.C., do not seem to have followed the above analysis." *Id.*

The narrow interpretation of Article 9's scope by some of the early writers spawned an argument often asserted in conjunction with the assertion of the § 9-302(1)(e) exemption—specifically, that an outright sale of accounts which is not intended as security falls entirely outside the scope of Article 9, thus no filing is required. *Spurlin v. Sloan*, 368 S.W.2d 314 (Ky. App. 1963); *Lyon v. Ty-Wood Corp.*, 212 Pa. Super. Ct. 69, 239 A.2d 819 (1969). Plaintiff Architectural Woods advanced this argument. Brief of Appellant at 8-9, *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 562 P.2d 248 (1977). The court, however, did not consider it in its opinion; therefore it is beyond the scope of this note.

42. 1 G. GILMORE, *supra* note 27, § 10.5, at 309.

43. *Id.* § 19.6, at 538.

proper scope does not accord with the casual and isolated test as applied by the Washington Supreme Court:

However, there is surely nothing wicked about paragraph (e); it is carefully drafted so that no assignee, engaged in a regular course of financing, will ever be tempted to rely on it in order to avoid a filing which ought to be made; cases may well arise in which it will accomplish its beneficent purpose of protecting assignees who are *both insignificant and ignorant*.⁴⁴

Gilmore's position appears to require satisfaction of both the Code language and the Comment's "casual and isolated" language. The casual and isolated test, as applied by the Washington Supreme Court, ignores the Code's "significant part" language.

Other Code authorities have also adopted positions inconsistent with the court's conclusion. Professors White and Summers favor the percentage test as a potentially more reliable measure of the exemption's applicability.⁴⁵ Professor Coogan opposes the exemption altogether as unnecessary and uncharacteristic of the Code as a whole.⁴⁶ Presumably, he would favor a much narrower reading than that given by the court.⁴⁷

The court's final rationale for adopting the casual and isolated test, even though the test does not comply with the literal language of the Code, was the axiom of statutory construction that "a statute is to be construed in a manner consistent with the general purpose thereof."⁴⁸ The court acknowledged that its holding emphasized the Comment

44. *Id.* (emphasis added).

45. J. WHITE & R. SUMMERS, *supra* note 10, § 23-8, at 809.

46. I P. COOGAN, W. HOGAN, & D. VAGTS, SECURED TRANSACTIONS UNDER U.C.C. § 10.03[8], at 1087 (rev. ed. 1977). Washington had no such exemption before the legislature adopted the Code in 1965. The comparable statute read:

No assignment of an account shall be valid as against present or future creditors of the assignor . . . unless there shall be on file in the office of the filing officer, at the time of the making of such assignment or within ten days thereafter, an effective and uncanceled notice signed by the assignor and the assignee
Act of Jan. 15, 1947, ch. 8, § 3, 1947 Wash. Laws 20.

47. Professor Coogan stated:

The language used, however, is surely not calculated to excuse from compliance with the notice-filing requirement an assignment to a bank of a single large claim simply because it is an isolated assignment. The key to the role of the exception is the content assigned to the expression, "significant part of the outstanding accounts or contract rights."

I P. COOGAN, W. HOGAN, & D. VAGTS, *supra* note 46.

48. 88 Wn. 2d at 410, 562 P.2d at 250 (citing *Wilson v. Lund*, 74 Wn. 2d 945, 447 P.2d 718 (1968)).

language over that of the statute itself,⁴⁹ but seemed to conclude that Official Comment 5 more accurately expressed the general purpose of the exemption.⁵⁰ However, the court's statutory construction rationale establishes only that the casual and isolated test is a possible construction of the exemption.⁵¹ The court made no effort to support its apparent assumption that Comment 5, rather than the statutory language itself, correctly expresses the exemption's purpose.

The source of the error in the court's reasoning was its initial assumption that its choice lay between two distinct tests. In early cases from other jurisdictions construing section 9-302(1)(e), the courts' analyses lacked clarity. These courts often considered pre-Code law or misread the Code or Comment language.⁵² Their occasional emphasis on the Comment language was in response to the facts of particular cases.⁵³ The different foci that emerged were later

49. The court observed: "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." *Id.* at 410, 562 P.2d at 250.

50. It is interesting to note that the court's attention was not drawn to the Washington Comments on the exemption nor to Official Comment 5. The Washington Comment reads in pertinent part: "Part (e) exempts casual assignments and in practical operation should mean that filing is necessary only in commercial financing." WASH. REV. CODE ANN. § 62A.9-302, Washington Comment 1 (1966). This comment supports the exclusive casual and isolated test more directly than does Official Comment 5. It was published by the Uniform Law Commission of the State of Washington after the legislature adopted the Code in an attempt to explain "the impact on Washington law of the enactment of the Washington Uniform Commercial Code." 62-62A WASH. REV. CODE ANN. at VII (1966) (foreword to Title 62A).

51. In a recent Tenth Circuit opinion, not presented to the Washington court in either the appellant's or the respondent's brief, the court of appeals took the position that any test which ignored the comparison of an assignment with the outstanding accounts and contract rights was inconsistent with the unambiguous language of the Code. *Consolidated Film Indus. v. United States*, 547 F.2d 533 (10th Cir. 1977). For further discussion of this case, see text accompanying note 63 *infra*.

52. A Florida federal district court followed pre-Code precedent and held that an assignment fell within § 9-302(1)(e) despite its proportional significance. The court held that the casual and isolated nature of the assignment was dispositive but conceded that its position required "reading between the lines of the statute." *In re First Gen. Contractors, Inc.*, 12 UCC Rep. Serv. 762, 764 (S.D. Fla. 1971).

In *In re Boughner*, 8 UCC Rep. Serv. 144 (W.D. Mich. 1970), the court emphasized the business status of the assignor but ignored that of the assignee. Official Comment 5 indicates the importance of the assignee's experience in accounts receivable financing but makes no reference to the assignor's experience.

In *Standard Lumber Co. v. Chamber Frames, Inc.*, 317 F. Supp. 837 (E.D. Ark. 1970), the court concluded that because the assignment, when added to the amount of the competing tax lien, was less than the outstanding accounts and contract rights, the assignment was not a significant part. The exemption concerns an assignment to a given assignee not in conjunction with competing security interests of other creditors but in conjunction with other assignments by the same assignor.

53. See, e.g., *Abramson v. Printer's Bindery, Inc.*, 440 S.W.2d 326 (Tex. Ct. App. 1969). An assignee was persuaded to buy accounts receivable by his accountant, who

labelled the percentage test and the casual and isolated test.⁵⁴ As is often the case, the labels began to replace the underlying reasoning.⁵⁵ When viewed from a two-test perspective, the cases construing the exemption are hopelessly confused, with many cases mixing elements of each test in the same analysis.⁵⁶

If section 9-302(1)(e) and Comment 5 are read as unconnected standards, they conflict irreconcilably. If read together, however, as Professor Gilmore seems to suggest,⁵⁷ they are consistent with both the Code's policy against secret transfers⁵⁸ and the weight of judicial⁵⁹ and scholarly authority.⁶⁰

also had an interest in the assignor's business. Because of the unusual factual situation, the court focused its discussion on the nonprofessional status of the assignee. *Id.* at 328. The Washington Supreme Court cited *Abramson* as supporting the casual and isolated test. 88 Wn. 2d at 409, 562 P.2d at 249. The holding in *Abramson*, however, was based on bankruptcy law, and the court's discussion of the casual and isolated test was entirely dictum.

54. Although not employing any specific labels, White and Summers identified what they perceived to be "two somewhat inconsistent tests for determining whether a given set of accounts is a 'significant part.'" J. WHITE & R. SUMMERS, *supra* note 10, § 23-8, at 807.

55. See generally Powers, *Formalism and Nonformalism in Choice of Law Methodology*, 52 WASH. L. REV. 27 (1976).

56. In the following cases, the courts considered elements from both tests: *In re Munro Builders, Inc.*, 20 UCC Rep. Serv. 739 (W.D. Mich. 1976); *City of Vermillion, S.D. v. Stan Houston Equip. Co.*, 341 F. Supp. 707 (D.S.D. 1972); *H. & Val J. Rothschild, Inc. v. Northwestern Nat'l Bank*, 242 N.W.2d 844 (Minn. 1976); *E. Turgeon Constr. Co. v. Elhatton Plumbing & Heating Co.*, 110 R.I. 303, 292 A.2d 230 (1972); *Sherberne Corp. v. Carter*, 133 Vt. 411, 340 A.2d 82 (1975). See *Consolidated Film Indus. v. United States*, 403 F. Supp. 1279 (D. Utah 1975), *rev'd*, 547 F.2d 533 (10th Cir. 1977), *discussed at note 37 supra*.

57. 1 G. GILMORE, *supra* note 27, § 19.6, at 538.

58. See note 34 *supra*.

59. Several courts, after concluding that the proportion of the accounts assigned was significant, have found the exemption inapplicable without any discussion of the casual and isolated nature of the assignment. *Miller v. Wells Fargo Bank Int'l Corp.*, 406 F. Supp. 452 (S.D.N.Y. 1975), *aff'd*, 540 F.2d 548 (2d Cir. 1977); *General Lithographing Co. v. Sight & Sound Projectors, Inc.*, 128 Ga. App. 304, 196 S.E.2d 479 (1973); *Chattanooga Brick & Tile, Inc. v. Agnew*, 18 UCC Rep. Serv. 1063 (Tenn. Ct. App. 1976). These cases could be read either as espousing the percentage test or as according with the Tenth Circuit's refusal to consider the circumstances surrounding the assignment unless it is shown to be proportionally insignificant. See note 37 *supra* and notes 62 & 63 and accompanying text *infra*.

Only two cases have been found which allowed the exemption solely on a finding of proportional insignificance. *In re Consolidated Steel Corp.*, 11 UCC Rep. Serv. 408 (N.D. Fla. 1972); *Standard Lumber Co. v. Chamber Frames, Inc.*, 317 F. Supp. 837 (E.D. Ark. 1970). Only one case allowed the exemption solely on a finding that the assignment was casual and isolated. *In re First Gen. Contractors, Inc.*, 12 UCC Rep. Serv. 762 (S.D. Fla. 1971).

60. See, e.g., 1 G. GILMORE, *supra* note 27, § 19.6, at 538 (an assignee must be "both insignificant and ignorant" to invoke the exemption).

IV. PROPOSED TEST

Section 9-302(1)(e) should be construed as a single exemption with a single two-tiered test. To apply the proposed test, the court would first apply the percentage test⁶¹ to determine whether the assignment represented a significant proportion of the assignor's accounts according to the literal statutory language. If, at this first stage of analysis, the court found the assignment to be significant,⁶² the exemption would not apply regardless of the circumstances surrounding the assignment. Only if the court found the assignment proportionally insignificant would the factors set out in the Comment concerning the assignee's inexperience and the casual and isolated nature of the assignment be considered. This second stage of analysis would function as a further narrowing of the exemption. Thus, to be automatically perfected under the proposed test, the assignment would have to be insignificant *and* casual and isolated.

The Tenth Circuit adopted this integrated view in reversing a Utah federal district court's finding in *Consolidated Film Industries v. United States*.⁶³ In the absence of any evidence establishing the amount of the assignor's outstanding accounts and contract rights, the district court considered the casual and isolated nature of the assignment and held that the exemption applied.⁶⁴ The Tenth Circuit reversed, holding that unless the party asserting the exemption could carry the burden of proving the insignificance of the assignment, no consideration of the circumstances surrounding the assignment, *i.e.*, its casual and isolated nature, was appropriate.⁶⁵ In other words, the Tenth Circuit relegated the factors set out in Comment 5 to a subsidiary role and adopted an analysis consistent with the proposed two-tiered test.

When the assignee is a nonprofessional, application of the casual and isolated test, as adopted by the Washington Supreme Court, could produce startling results. A court could find an assignment of almost all of an assignor's outstanding accounts and contract rights to

61. See text accompanying note 17 *supra* for a definition of the percentage test and note 17 itself for cases in other jurisdictions which have applied it.

62. As the court suggested, the numerical value which has been found to constitute a significant percentage has varied in different jurisdictions. 88 Wn. 2d at 409, 562 P.2d at 249. As White and Summers noted, however, a reliable standard is likely to emerge eventually. J. WHITE & R. SUMMERS, *supra* note 10, § 23-8, at 809.

63. 547 F.2d 533 (10th Cir. 1977), *rev'g* 403 F. Supp. 1279 (D. Utah 1975).

64. 403 F. Supp. at 1285.

65. 547 F.2d at 536.

be exempt from the Article 9 filing requirements.⁶⁶ Moreover, under the court's test, a prospective creditor cannot determine whether a third party has an automatically perfected security interest in a substantial portion of a prospective assignor's accounts. If the uncertainty of possible automatic perfection of a prior security interest in accounts receivable produces the same effect as have similar uncertainties in the area of farm equipment,⁶⁷ accounts receivable may become less valuable as collateral.

V. CONCLUSION

The Washington Supreme Court, in applying exclusively the casual and isolated test, has adopted a minority position⁶⁸ which ignores the literal Code language and infuses an unnecessary degree of uncertainty into accounts receivable financing. The casual and isolated test is inconsistent with the Code's policy of protecting creditors from secret transfers of collateral, and, in adopting it, the court may inadvertently have discouraged creditors from engaging in a type of financing which has gained respectability and widespread use in recent decades.⁶⁹

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66. In *Architectural Woods*, the unusual circumstances from which plaintiff's assertion of the exemption arose may have made the court's holding equitable. Defendant Evergreen State College did not know of the bank's security interest at the time of its final payment to Didco's successor in interest. Brief of Appellant at 13, *Architectural Woods, Inc. v. State*, 88 Wn. 2d 406, 562 P.2d 248 (1977). Under the contract assignment principles argued by plaintiff, and not reached by the court, defendant's payment to Didco's successor was apparently unjustified. *Id.* at 26.

The unusual circumstances may have obscured the broad policies underlying the exemption. Defendant was the account debtor and not a competing creditor as would normally be the case. Had the action been between plaintiff and the bank, the impact of the court's adoption of the casual and isolated test would have been clearer. Under the casual and isolated test, Didco could have assigned all of its accounts and contract rights to plaintiff, which, as a nonprofessional financier, would obtain an automatically perfected security interest. The bank, as a subsequent creditor, would have had no way of knowing of the plaintiff's security interest. Except where an assignor has made many proportionally insignificant assignments to different assignees, the percentage test would afford the subsequent secured party greater certainty that most of the assignor's accounts and contract rights were unencumbered.

67. The 1962 version of U.C.C. § 9-302(1)(c) reads: "(1) A financing statement must be filed to perfect all security interests except the following . . . (c) a purchase money security interest in farm equipment having a purchase price not in excess of \$2500" This exemption was deleted by the 1972 amendments because the possibility of an automatically perfected security interest in farm equipment had the practical effect of reducing farm equipment's value as collateral. U.C.C. § 9-302, Reasons for 1972 Change (1972 version).

68. See note 59 *supra*.

69. 1 G. GILMORE, *supra* note 27, § 8.1, at 251.