# SECURITY INTERESTS IN AFTER-ACQUIRED PROPERTY UNDER THE UNIFORM COMMERCIAL CODE*

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Twentieth-century U.S.A. has seen the emergence of many new types of business financing. High in priority of importance today is lending on the security of "fluid" assets—assets, such as inventory and accounts receivable, which are intended to be sold or collected and have a short life span per item, to be replaced by other similar items. Not too long ago custom and law raised objections to the full use of such assets as security.

Times have changed; our economy has changed; law and usage have changed. Today billions of dollars in loans are secured by inventory and receivables. Speak to almost any automobile dealer, and he will probably tell you that he "floor plans" his cars. Speak to a merchant, and he may tell you that he borrows on the security of his accounts receivable.[1]

The law has made its contributions. The Uniform Commercial Code[2] has created favorable legal conditions. For example, the use of inventory[3] and accounts receivable[4] as collateral would be im-

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1. For a current description of practices in lending on accounts receivable and the business of factoring (buying accounts receivable, etc.) see Reisman, *What the Commercial Lawyer Should Know About Commercial Finance and Factoring*, 79 COMM. L.J. 146 (May 1974).

2. The Uniform Commercial Code is now the law in forty-nine states and the District of Columbia. Article 9 deals with security interests in personal property and fixtures. In 1972 the sponsoring bodies approved amendments to article 9. For a treatment of these amendments, see Coogan, *The New UCC Article 9*, 86 HARV. L. REV. 477 (1973). All references to the Uniform Commercial Code, except where indicated, will be to the 1962 text [hereinafter cited as CODE]. From time to time reference will be made to the 1972 amendments. Note: Wisconsin has enacted the 1972 amendments with certain modifications. Ch. 215, [1973] Wis. Laws 669. The 1972 changes have little effect on the subject of this article.

3. "Inventory" is defined in CODE § 9-109(4):

> Goods are
>
> . . . .
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> (4) "inventory" if they are held by a person who holds them for

peded without a valid after-acquired property clause—a provision in a security agreement which grants to the secured party a security interest in property, of the kind described, which may be subsequently acquired by the debtor.

Section 9-204(3) of the Uniform Commercial Code provides that "except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement." The exceptions of subsection (4)—concerning security interests in consumer goods and crops—are inapplicable to the kind of business financing that now concerns us.[5]

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sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

4. The kind of "account receivable" referred to here comes within the definition of "account": " 'Account' means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper." CODE § 9-106. "Contract Right" is a separate category: " 'Contract Right' means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." *Id.* Section 9-106 (1972) drops "contract right," and defines "account" as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." For explanations of this among other 1972 changes, see PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REVIEW COMMITTEE FOR ARTICLE NINE OF THE UNIFORM COMMERCIAL CODE, A FINAL REPORT (April 25, 1971). Note: security interests in rights conditioned on the debtor's future performance are an important form of collateral in addition to accounts receivable.

5. Section 9-204(3) (1962) becomes section 9-204(1) (1972) and is restated: "Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." Section 9-204(4) (1962) becomes section 9-204(2) (1972), which drops the special treatment of after-acquired security interests in crops, leaving only the limitation applicable to consumer goods. Section 9-204(2) (1962) is dropped.

Point 2 to the comment to section 9-204 (1962 & 1972 *sembla*) states:

> Subsection (1) and (3) read together make clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. (To this general rule subsection (4) states two exceptions.) That is to say: the security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party—such as the taking of a supplemental agreement covering the new collateral—is required. This does not however mean that the interest is proof against subordination or defeat: Section 9-108 should be consulted on when a security interest in after-acquired collateral is not security for an antecedent debt, and Section 9-312(3) and (4) on when such a security interest may be subordinated to a conflicting purchase money security interest in the same collateral.

The comment to section 9-204 also observes:

> Notice that the question of assignment of future accounts is treated like any other case of after-acquired property: no periodic lists of accounts is required by this Act. Where less than all accounts are assigned such a list may of course be necessary to permit identification of the particular accounts assigned.

*Without* section 9-204(3) a truly "floating" security interest would be impossible. For it would then be necessary to make subsequent security agreements in order to include property acquired by the debtor at various times subsequent to the original security agreement.[6]

*With* this provision, it is possible to create a security interest which "floats"—*i.e.*, automatically attaches to after-acquired property instantly upon the debtor's acquisition. Further, prior filing results in automatic perfection upon attachment.

## I. THE FLOATING SECURITY INTEREST

### *A. General Nature and Usage*

A valid, enforceable after-acquired property clause is a key aspect of a modern, "inclusive" security interest in fluid assets—a security interest in all of the debtor's assets of a certain kind, including such of that kind of asset which the debtor may thereafter acquire.

This kind of security arrangement has been called a "floating lien"; using U.C.C. parlance, it may more properly be termed a floating security interest.[7] Its basic attributes seem to be: (1) a security interest in all of the debtor's property of a certain kind or kinds (usually fluid assets such as inventory or accounts). The inclusive security interest is to be distinguished from the "particular" security interest which is limited to one or more, but less than all of the debtor's assets of a certain kind. (2) Automatic attachment of the security interest to after-acquired assets of the kind covered by the security agreement. (3) Automatic carry-over of the security interest into proceeds received from the disposition of items of the collateral. (4) Instantaneous perfection upon acquisition of after-acquired collateral and proceeds by virtue of prior filing of an article 9 financing statement in the proper place or places.[8]

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6. This statutory provision, an application of the general validation provision of section 9-201, removed the cloud which in pre-Code days had hung over the after-acquired property security interest in some states. *See* Cohen & Gerber, *The After-Acquired Property Clause*, 87 U. PA. L. REV. 635 (1939). In Wisconsin, for example, the after-acquired property clause in a chattel mortgage was ineffective at common law: its efficacy depended on statutory authorization. *See* Skilton, *Tradition and Change: The Law of Mortgages on Merchandise*, 1963 WIS. L. REV. 359.

7. *See also* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 11.7, at 359-65 (1965) and 2 GILMORE, *supra*, § 45.7, at 1322-23.

8. It is not proposed to deal with the important subject of the proceeds security interest in this study. Under the 1962 version there is a question whether the security agreement (if a writing is required under section 9-203), must provide that proceeds are covered, or whether a security interest in proceeds attaches by operation of law. The 1972 version makes it clear that there need be no express provision. As to perfection of the proceeds security interest, filing as to proceeds is required under section 9-306(3) to continue perfection beyond 10 days after debtor's receipt. Under the 1972 version of section 9-306(3) no filing as to proceeds is required. However,

Financers taking inventory or accounts receivable as security seem to be relying more and more on an inclusive security interest, for example in all of the debtor's inventory, including after-acquired inventory. (Apparently they are finding financing on the security of individual items somewhat restrictive.)[9]

While this definition of a floating security interest does not require that the security interest be granted to protect future advances as well as initial indebtedness, such a security interest is an appropriate protection for open-end financing. If open-end financing is contemplated, the security agreement should provide that the property described, including after-acquired property, shall be security for future as well as present obligations of the debtor to the secured party. The current state of indebtedness—advances minus payments—may be correlated with the fluctuations in current value of the collateral. The addition of subsequently acquired property such as inventory and/or accounts (plus contract rights) together with a security interest in proceeds, aimed at preserving or enhancing the value of collateral which is subject to turn-over in the normal course of the debtor's business, is obviously important

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proceeds of cash proceeds must be identified by type in the financing statement, to continue perfection beyond 10 days. Further, the 1972 version places a ten day limit if the locus of the proceeds is not in the jurisdiction where filing has been made. (Wisconsin has not enacted such provisos. Ch. 215, §§ 42, 43, [1973] Wis. Laws 679-80).

As to the carry-over of the security interest into cash proceeds deposited by the debtor in his bank account, there are restrictions imposed by section 9-306(4)(d) in the event of insolvency proceedings. Fitzpatrick v. Philco Fin. Corp., 491 F.2d 1288, 14 UCC REP. SERV. 12 (7th Cir. 1974).

9. The secured party is faced with two sets of problems. (1) What collateral should be included in the financing statement, and how should it be identified there? (2) What collateral should be included in the security agreement, and how should it be described there? From the secured party's point of view, there is the danger of insufficiency.

A secured party with a floating security interest in inventory and accounts may find that although he has a broad range of security, he should have more. Thus, in United States v. Antenna Systems, Inc., 251 F. Supp. 1013, 3 UCC REP. SERV. 258 (D.N.H. 1966), the inclusivity of a security interest was spoiled by failure to include general intangibles consisting of engineering drawings, bids, proposals, etc. Therefore, some business values of the bankrupt company became available for general creditors. To catch all types of items not described, it has been recommended that words such as "all personal property owned by the debtor" be included in the financing statement. *See* KRIPKE, BRAUCHER, COOGAN, GILMORE & HAYDOCK, PROBLEMS OF LENDERS, BORROWERS AND SELLERS UNDER THE UNIFORM COMMERCIAL CODE 30 (1968) [hereinafter cited as PROBLEMS OF LENDERS, BORROWERS AND SELLERS]. *But see* In *re* Kirk Kabinets, Inc., 15 UCC REP. SERV. 746 (M.D. Ga. Ref. 1974).

We pause for a moment's meditation upon the possible dangers that may lurk in a clear case of overreaching, where there is no commercial reason for an extravagant assertion of a sweeping security interest, feeling that the taking of too much security may be a disadvantage in law to the secured party as well as in fact to the debtor, as conversely, taking too little security may be obviously disadvantageous to the secured party.

where the parties contemplate the making of further secured advances.

Thus, an after-acquired property clause, while important, is only one clause in the total security agreement in which it appears. There is always a danger in failing to consider the entire contractual relationship between the secured party and the debtor, as it may have bearing on rights *inter se* and as to third parties.

All things considered, an effective after-acquired clause is the *sine qua non*, the most necessary part of the celebrated "floating lien." It is the hull which keeps the vessel afloat, the sail which makes it move.

The draftsmen-craftsmen of article 9 dreamed: "We have a model; we shall design a vessel which the debtor may sail under agreement with the secured party . . . . Let them agree on the nature of the cargo. Inventory? Contract rights and accounts? General intangibles?—as they will; let the ship be fitted to take on new cargo, as well as the proceeds of cargo disposed of, so that the collateral will continue to be replenished; let the cargo be security for advances now made by the secured party or made in the course of the voyage. It should be a sturdy ship, able to ride out the seas of bankruptcy, though it cannot be made secure from every mischance. But with luck, it will get where it is steered to go."

> Through seas that are bleakest and winterest
> On floats the floating security interest.[10]

Point 3 to the comment to section 9-204 states:

> This Article accepts the principle of a "continuing general lien" which is stated in Section 45 of the New York Personal Property Law and other similar statutes applicable to "factor's lien". It rejects the doctrine—of which the judicial attitude toward after-acquired property interests was one expression—that there is reason to invalidate as a matter of law what has been variously called the floating charge, the free-handed mortgage and the lien on a shifting stock. This Article validates a security interest in the debtor's existing and future assets, even though (see section 9-205) the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. (See further, however, Section 9-306 on Proceeds and Comment thereto).

Of course, the fact that the security includes after-acquired property gives no assurance to substitute for constant surveillance by the secured party (policing) to keep informed as to the current state of collateral, to be sure that the collateral is there in fact. But such policing is left to the good sense of the secured party; no longer as a matter of law is a security interest invalidated by permission

10. The reader may prefer: Through seas that are bleakest and wintriest, on floats the floating security interest.

given to the debtor to apply some or all of the proceeds to his own purposes and not to reduction of the debt. By abolition of the rule of *Benedict v. Ratner*,[11] section 9-205 removes the traditional obstacles that had beset the mortgage on merchandise.

None of this matters if the debtor is solvent and pays. When the economic climate is good and the debtor smiles in the sunlight, whether the loan is adequately secured may not seem of much moment. Security is the lender's foul-weather friend. And today the storm signals are up. How seaworthy is your friendly bark, Mr. Secured Lender? In fact, as well as in law? Ever hear of Billy Sol Estes, vegetable oils and Equity Funding? There may be nothing behind those papers—those security agreements, warehouse receipts or insurance policies you are looking at. And even the most honest debtors can be overwhelmed by events.

Well, we cannot get into questions of security-in-fact, the reality behind the papers, however devastatingly important they may be. This is not a study written by a banker, accountant, or sleuth. How to guard against the chance that some crook has filled the hold with empty containers rather than valuable property is left for others to explain. How to police to give assurance that the value of collateral is maintained and the debt remains adequately secured is similarly left to others. This is an essay on legalities: what may be carried as cargo by the Good Ship Floating Lien. More specifically the function of the after-acquired property clause in a security agreement under article 9 of the U.C.C., that deals with security interests in personal property and fixtures.

This study deals primarily, but not exclusively, with the uses of that provision in an inclusive security interest in fluid assets such as inventory or receivables. An after-acquired property clause in a security agreement may also be important in transactions not involving inclusive security interests.

### *B. The After-Acquired Property Clause*

An effective after-acquired property clause in a security agreement,

(1) obviates the need to make a subsequent security agreement covering subsequent collateral of the kind covered by the after-acquired clause.

And, upon perfection by filing,

(2) avoids the question whether a single filing protects a series of security agreements at various times creating security interests in the same kinds of collateral as are covered by the single financing statement.

11. 268 U.S. 353 (1925).

EXAMPLE

On March 1, to secure a loan of $50,000 made then by Finn to Budd, car dealer, Budd and Finn enter into a written security agreement giving Finn a security interest in all of Budd's car inventory, present and after-acquired, and proceeds. Budd signs the security agreement. (section 9-203). Finn and Budd sign financing statements complying with the minimum terms of section 9-402(1) and (3). Budd's car inventory is at all times located in the state of Missala, U.S.A. (a U.C.C. state). Missala requires dual filing (central and local) for inventory security interests. (While Missala has a Motor Vehicle Title Certificate Act, that Act provides that security interests in car inventory are to be perfected by article 9 filings and not by notation thereof on title certificates, and section 9-302(3) as enacted in Missala ties in).[12] On March 1, the financing statements are filed in the proper places in Missala (see section 9-102) in accordance with section 9-401. On March 31, Budd buys additional car inventory, paying the manufacturer. Finn's security interest immediately *attaches* (value having been given—$50,000 loan; agreement so provides; the debtor (Budd) acquires rights—section 9-204(1)).[13] Finn's security interest is immediately perfected—section 9-303—by virtue of filings on March 1.

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12. This is assumed to be the situation in most states, both for new and used car inventory. *See* Howarth v. Universal C.I.T. Credit Corp., 203 F. Supp. 279 (W.D. Pa. 1962), where it was held that the secured party properly perfected his proceeds security interest in used car trade-ins by an article 9 filing, and was not required to have the dealer procure title certificates on which the lien would be noted. *See in re* Vaughan, 283 F. Supp. 730, 5 UCC REP. SERV. 63 (M.D. Tenn. 1968), where Tennessee law was construed not to require notation on title certificate to perfect security interest in used car inventory. Tennessee had adopted alternative A of section 9-302(3)(b).

13. The 1972 amendments merge section 9-203 (when writing required) and section 9-204(1), and create a new section 9-203 which provides:

> Attachment and Enforceability of Security Interest; Proceeds; Formal Requisites
>
> (1) Subject to the provisions of Section 4-208 on the security interest of a collecting bank and Section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless
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> (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; and
>
> (b) value has been given; and
>
> (c) the debtor has rights in the collateral.
>
> (2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.
>
> (3) Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by Section 9-306.
>
> (4) A transaction, although subject to this Article, is also subject

### 1. THE NEED FOR AN AFTER-ACQUIRED PROPERTY CLAUSE

To fully achieve its purpose, the security agreement must include language which will be construed to impose a security interest upon property subsequently acquired by the debtor of the kind described.[14]

If the security agreement is less than clear as to whether after-acquired collateral is covered, litigation that could have been avoided may result. To avoid questions, the after-acquired property clause in the security agreement should contain words of grant, purporting to create a security interest in after-acquired property, so that it *automatically* attaches upon the debtor's subsequent acquisition of the after-acquired property. A clause which gives the secured party a security interest in such after-acquired collateral as the debtor shall assign to the secured party from time to time

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> to ————————, and in the case of conflict between the provisions of this Article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein.

CODE § 9-203 (1972).

14. It would seem advisable for the security agreement to contain words of grant, purporting to give immediately a security interest in after-acquired collateral, as if such collateral were at the time of the agreement in existence and owned by the debtor.

In *In re* Goodfriend, 2 UCC REP. SERV. 160, 160 (E.D. Pa. 1964), a security agreement provided: "[I]nventory of merchandise to be maintained in an amount not less than $10,000, as per agreement of sale, at seller's wholesale cost, contained in the Kiddy and Women's Wear Shop." It was held (reversing the referee): "The language employed clearly created a security interest in the whole inventory. The provision that the inventory was 'to be maintained' at a certain value can only be read to mean that future items added to the inventory were to be included in the lien." *Id.* at 161.

It has been held that the need for an after-acquired clause in the security agreement is not supplied by a financing statement expressly covering after-acquired collateral. Tri-County Livestock Auction Co. v. Bank of Madison, 228 Ga. 325, 185 S.E.2d 393, *rev'g* 123 Ga. App. 767, 182 S.E.2d 687, 9 UCC REP. SERV. 1182 (1971). It has repeatedly been held that a short form financing statement does not qualify as a security agreement. *See*, e.g., Mosley v. Dallas Entertainment Co., Inc., 496 S.W.2d 237, 12 UCC REP. SERV. 735 (Tex. Ct. App. 1973) (citing cases).

*In re* Taylored Products Inc., 5 UCC REP. SERV. 286, 288 (W.D. Mich. 1968), it was held that the description of the collateral as "accounts and notes receivable and inventories of raw materials, work in process and finished goods, wherever located," was insufficient to include after-acquired property, and that parol evidence was not admissible to show that after-acquired property was intended to be covered by the security agreement. The referee slyly observed:

> Here we have two attorneys, both well acquainted with commercial law, and two veteran businessmen taking part in the negotiations. The papers were drafted by an officer of petitioner, an able lawyer, who a few months later would become Professor of Law at a leading midwest law school.

*Id.* at 291. Maybe the referee came down too hard. It would have been easy to hold that on its face the collateral description clause included after-acquired collateral, considering the nature of the collateral.

or as the secured party shall select, does not fill the bill.[15] The reason for this is clear. If such further act of assignment is a prerequisite to the attachment of the security interest, it follows that there may be an interval between the debtor's acquisition of collateral and the debtor's assignment of it during which the property may be exposed to the claims of others, such as a creditor of the debtor acquiring a lien.

But a provision for subsequent assignments by the debtor is *not necessarily* inconsistent with a floating security interest automatically attaching upon debtor's acquisition of collateral. It may be merely a backing-up provision for extra protection. In *O'Hara & Shaver, Inc. v. Empire Bituminous Products, Inc.*,[16] a judgment creditor of the debtor, who had garnisheed an account debtor, asserted priority over the party secured by the account receivable on the ground that the security interest did not, under the security agreement, attach automatically to after-acquired accounts, but rather the debtor's subsequent assignment was required. Analysis of pertinent terms of the security agreement persuaded the court to the contrary:

> I find from an examination of the agreement that there was no absolute requirement of a specific assignment of accounts receivable as a condition precedent to the coming into existence of an effective security interest. While the agreement referred to periodic assignments of receivables, it was for the convenience and at the discretion of Crompton as an accounting control and in keeping with the arrangement for a continuing security interest.[17]

Float on, floating security interest.

How explicit must the security agreement be? The bankruptcy litigation of *In re Fibre Glass Boat Corp.*,[18] puts the question to the test and gives one court's point of view. A financing

15. Such was the situation in DuBay v. Williams, 417 F.2d 1277, 1283-85, 6 UCC REP. SERV. 885, 892-95 (9th Cir. 1969) (Davis claim). *See* CODE § 9-204, Comment 4, note 5 *supra*.

16. 323 N.Y.S.2d 190, 9 UCC REP. SERV. 764 (N.Y. County Ct. Onondaga County 1971).

17. *Id.* at 192, 9 UCC REP. SERV. at 765.

In South County Sand & Gravel Co., Inc. v. Bituminous Pavers Co., 106 R.I. 178, 179, 256 A.2d 514, 515, 6 UCC REP. SERV. 901, 902 (1969), the security agreement gave the bank a security interest in all of the debtor's receivables "now existing and hereafter arising." It was observed:

> The assignment was executed because the security agreement expressly states that the respondent would deliver to the bank schedules of its accounts receivable and from time to time assign such accounts to the bank. While we believe that this assignment was unnecessary [citing 2 Coogan et al, *Secured Transactions Under the Uniform Commercial Code* § 15.08(2)(a) p. 1600] we cannot fault the bank's display of a superabundance of caution."

*Id.* at 181, 256 A.2d at 516, 6 UCC REP. SERV. at 903.

18. 324 F. Supp. 1054, 9 UCC REP. SERV. 118, (S.D. Fla.), *aff'd.*, 448 F.2d 781 (5th Cir. 1971).

statement, presumably in short form, had been filed. The only other writing consisted of a letter signed by the debtor, Fibre Glass Boat Corp., to the creditor-claimant:

> Pursuant to our telephone conversation. please find a duly executed copy of a financing statement received from your company, wherein the Fibre Glass Corp. agrees to guarangee [sic] all inventory used in the production of boats, limited in the amount of fifteen thousand dollars, in order to cover all merchandise that may be purchased from your company.[19]

Fulton, C.J., observed:

> In this case, a financing statement was filed with the proper State authorities in accord with Florida law. Both the creditor and the debtor signed it, and it contained a description of the collateral. Additionally, the debtor Fibre Glass sent a signed letter to Teleflex describing the collateral. These two instruments certainly create a perfected security interest. The three formal elements necessary to create a security interest—a writing, the debtor's signature, and a description of the collateral—are present in the letter, and the letter fulfills the requirements of § 9-204, attachment. The financing statement 'perfected' this interest.[20]

Next question: Did this "security agreement" serve to attach the security interest to the debtor's after-acquired inventory? Yes, holds the court:

> The second issue presented by the petitioner is whether this security interest creates a lien upon inventory used in the production of boats *after* entry into the agreement. Since neither the letter nor the financing statement contain an after-acquired property clause, it is urged by the petitioner that Teleflex has no rights in inventory acquired afterwards. Section 9-204(3), U.C.C. validates the use of after-acquired property provisions in financing transactions. *See* Official Comment 1, U.C.C. § 9-108. 'A security agreement *may* provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.' A debtor's intent to grant a security interest in after-acquired property must be judged from the language of the agreement. *National Cash Register v. Firestone & Co., Inc.*, 346 Mass. 255, 191 N.E.2d 471 [1 UCC REP. SERV. 460] (1963). According to *In Re Taylor Products, Inc.*, 5 U.C.C. Reporting Service 286 (W.D. Mich. 1968), to

19. *Id.* at 1055, 9 UCC REP. SERV. at 118.

20. *Id.* at 1055-56, 9 UCC REP. SERV. at 119-20. It is beyond the scope of this presentation to deal with the sufficiency of skimpy writings to pass muster as security agreements, or when a financing statement may do double duty and also serve as a security agreement qualifying under section 9-203. *See* Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109, 9 UCC REP. SERV. 769 (1971).

permit an interest in property acquired after the execution of the security agreement, the agreement must so provide.

However, the property secured in this case is inventory, goods held for sale and goods consumed in the business. Inventory by its nature and definition changes from day to day. In *Bank of Utica v. Smith Richfield Springs, Inc.*, 58 Misc.2d 113, 294 N.Y.S.2d 797 [5 UCC REP. SERV. 1197] (1968), it was held that the collateral 'motor vehicles' gave the creditor a security interest over after-acquired motor vehicles. Adding the words 'after-acquired' to the collateral's description was not necessary because the debtor, an automobile dealer, was obviously buying and selling cars in pursuit of that business. See also *In Re Goodfriend*, 2 U.C.C. Reporting Service 160 (E.D. Pa. 1964). Surely, the creditor would not enter into a financing arrangement secured by a collateral fixed on a particular date, when the collateral by its nature would be constantly changing. It would be straining the normal meaning of the word to find that inventory meant only that on hand on the particular day the contract was executed, and if a can of paint or the like were used, the collateral would be diminished to that extent. Certainly the parties contemplated that the inventory would be sold or used or replaced; that is what inventory means.[21]

On the other hand, beware: failure expressly to include after-acquired collateral in the security agreement may be disastrous, even when the intent to include seems obvious, as where the collateral is the debtor's "inventory" or "accounts receivable." That is the teaching of *In re Middle Atlantic Stud Welding Co.*[22] In that case the collateral was described in the security agreement as "all of Debtor's Accounts Receivable"; there was no express after-acquired property clause. Although the referee and the district court found the secured party and the debtor had intended to include as collateral after-acquired accounts receivable as well as those in existence on the date of the security agreement, it has held, in a 2-1 decision, that the failure to have an express after-acquired property resulted in limiting the security interest to accounts in existence at the outset. The majority opinion observed:

> [I]t is neither onerous nor unreasonable to require a security agreement to make clear its intended collateral. This position does not require the most exact and detailed description possible, but only a clear designation of any class of items intended to be collateral. The general prohibition in pre-Code law on including after-acquired property as collateral heightens the sense of such a rule because, commercial practice of including after-acquired property in

21. 324 F. Supp. 1054, 1056, 9 UCC REP. SERV. 118, 120 (S.D. Fla. 1971). *See also In re* Nickerson & Nickerson, Inc. 452 F.2d 56, 9 UCC REP. SERV. 1266 (8th Cir. 1971).

22. 503 F.2d 1133, 14 UCC REP. SERV. 1233 (3d Cir. 1974).

collateral notwithstanding, a subsequent lender might expect the parties to make explicit an intention to include this kind of property, both for precision and because of the law's historic hostility to such arrangements.

Further, a decision for appellant might well facilitate at least some abuse. Although it may be true that many, perhaps most, prospective lenders, on reading the present agreement, would obtain an unambiguous explanation of its full meaning from the secured party, some might be misled and proceed without inquiry. The ease with which a secured party could eliminate the danger of misleading any reasonable subsequent lender suggests that in administering the Code the courts should require him to do so.

A requirement that intended inclusion of after-acquired accounts receivable be unambiguously expressed will not significantly conflict with any important Code policies, and will support some. It will produce simpler, clearer and more certain law for all parties.

This appeal involves a question as yet infrequently adjudicated. Hence, our decision here cannot disturb any generally understood judicial interpretation of the Code. Affirmance will not require a return to the law of magic words. Neither will it go to the opposite extreme of flexibility urged by the appellant. It will be in keeping with the observation in the Comment to Sec. 1-102, supra, that a degree of strictness in construction, as well as flexibility has proper application under the Code.

Last, this decision respects reasonable commercial need and expectation. The validity of after-acquired property clauses is recognized. Only the implication of such a clause through ambiguous language is rejected. It is hard to see how much implication would promote satisfactory conduct of business affairs. Moreover, there is a logical trap regarding reasonable commercial expectation in this context: given the law's relatively recent hostility to after-acquired property clauses one might reasonably expect an express statement of any such intent and, in the absence of such a statement, might reasonably conclude that in the bargaining process the parties agreed not to encumber after-acquired accounts.[23]

While the decision seems harsh (see dissent) it may serve as a warning. It may be that a split in the courts of appeal is developing—the majority opinion takes cognizance of two other decisions which may be hard to reconcile.[24]

So, the security agreement as construed must provide that after-acquired collateral is covered, if the security interest created by

23. *Id.* at 1136-37, 14 UCC REP. SERV. at 1236-37.

24. *In re* Nickerson & Nickerson, Inc., 452 F.2d 56, 9 UCC REP. SERV. 1266 (8th Cir. 1971); *In re* Fibre Glass Boat Corp., 324 F. Supp. 1054, 9 UCC REP. SERV. 118 (S.D. Fla. 1971).

the agreement is to attach to property subsequently acquired by the debtor—and, to avoid dispute, it should indisputably, clearly, so provide.[25] Section 9-204(3) applies only where there is an agreement to that effect. Yes; but must the provision be in writing, where the security interest is nonpossessory? Here, we are not concerned with section 9-204, but rather with section 9-203, which requires that the description of the collateral be in writing, if the secured party is not in possession. If we say, as seems reasonable, that the after-acquired clause is part of the *description* of the collateral, the answer is yes. Let us hope that this question is purely academic.[26]

### 2. THE CLAUSE: HOW EXTENSIVE?

A question of construction is often involved in determining whether an after-acquired property clause embraces particular property of the debtor thereafter acquired. What kind of after-acquired collateral is claimed? The preliminary question is whether the collateral is adequately described, and here we turn to section 9-110, for what it is worth. Even so, a description of collateral may be adequate to pass muster under section 9-110, and yet the court may conclude that the parties did not intend to impose

25. It does not follow, however, that a *financing statement* in which collateral is identified by *type*, must specifically state that after-acquired collateral is included. In fact, where collateral is identified as "motor vehicles" (and proceeds) and the debtor is a dealer, the kind of collateral covered by the financing statement may well suggest (considering the fact that inventory is involved) the likelihood that the security agreement between the parties to the financing statement includes an after-acquired clause. Biggins v. Southwest Bank, 322 F. Supp. 62, 8 UCC REP. SERV. 1319 (S.D. Cal. 1971).

CODE § 9-204, Comment 4 (1972) states:

> The effect of after-acquired property and future advance clauses in the security agreement should not be confused with the use of financing statements in notice filing. The references to after-acquired property clauses and future advance clauses in Section 9-204 are limited to security agreements. This section follows Section 9-203, the section requiring a written security agreement, and its purpose is to make clear that confirmatory agreements are not necessary where the basic agreement has the clauses mentioned. This section has no reference to the operation of financing statements. The filing of a financing statement is effective to perfect security interests as to which the other required elements for perfection exist, whether the security agreement involved is one existing at the date of filing with an after-acquired property clause or a future advance clause, or whether the applicable security agreement is executed later. Indeed, Section 9-402(1) expressly contemplates that a financing statement may be filed when there is no security agreement. There is no need to refer to after-acquired property or future advances in the financing statement.

26. Perhaps in some cases the admissibility of parol evidence to prove that after-acquired property was intended as collateral may depend upon whether the dispute is between the parties or involves third parties. Rusch Factors, Inc. v. Passport Fashion, Ltd., 67 Misc. 2d 3, 322 N.Y.S.2d 765, 9 UCC REP. SERV. 507 (N.Y. City Super. Ct. 1971).

a security interest on some particular property. Thus, in *Mammoth Cave Prod. Credit Ass'n v. York*,[27] the security agreement covered *inter alia* "all farm equipment," and "all property similar to that listed above, which at any time may hereafter be acquired by the debtor including, but not limited to, all offspring of livestock, additions and replacements of livestock and poultry, and replacements of and additions to equipment and other personal property above described." It was held (rightly or wrongly) that a farm tractor later acquired by the debtor was not covered by the security agreement. It was observed: "In light of this vague provision it seems doubtful that it was really agreed that tractors and other large farm equipment were to be security for the loan."[28]

Perhaps the question posed in the case is whether an unusual subsequent acquisition by a debtor is within the contemplated collateral? While a tractor is farm equipment, and the language of the security agreement covered all farm equipment then owned or thereafter acquired by the debtor, the court nonetheless held that the parties did not intend to create a security interest in the tractor.

To put it mildly, the court gave a restrictive interpretation of the collateral clause, based upon its assumptions as to the intent of the parties. It would have had little to stand on if the security agreement had expressly included "all farm tractors, now owned or hereafter acquired." The generality of the language in the security agreement gave the court its chance to accomplish what it probably conceived to be, under the facts of the case, an equitable result.[29]

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27. 429 S.W.2d 26 (Ky. 1968).

28. *Id.* at 29.

29. In Goodall Rubber Co. v. Mens Ready Mix Corp., 7 UCC REP. SERV. 1358, 1361 (Wis. Cir. Ct., Milwaukee County 1970) Judge Decker presents some interesting material with special reference to Wisconsin on the subject of adequacy of description and adverts to *Mammoth Cave* and certain other decisions:

> From the court's reading of the cases, one can establish the rationale that where subsequent creditors have made specific and substantial personal property available to the debtor, the courts are less ready to find that a prior creditor's description of the collateral 'reasonably identifies' the after-acquired property to the prejudice of the hapless subsequent creditor. While this offers no *standard* of construction, it does offer an *explanation.* Such was the situation in the Kentucky case . . . .

As another example of strict-to-false construction, see Long Island Trust Co. v. Porta Aluminum Corp., 14 UCC REP. SERV. 833, 837 (N.Y. Sup. Ct. 1974):

> We do not interpret the general language in the after-acquired property clause of the security agreement to cover vehicles other than those therein specifically enumerated, unless they were given and accepted in replacement of specified vehicles (See UCC, § 9-110, 9-203, subdiv. [1], par. [b]; Matter of Laminated Veneers Co., 471 F.2d 1124, 1125 [11 UCC Rep. Serv. 911, 913]; but see, contra, J. White & R. Summers, Handbook of the Law under the Uniform Commercial Code 789, 1972).

Where, as in *Mammoth Cave*, the after-acquired property clause is a mere adjunct of the basic description of the collateral in the security agreement, the principal problem may be in the basic description, and not in the after-acquired property clause as such. "All farm equipment" left the court in disbelief that the parties meant "all" literally. Surely they didn't mean all—even the simplest hand tools? Would the court have recognized a security interest in the tractor if the farmer owned it at the time of the execution of the security agreement? Perhaps the problem would not have arisen—the tractor might then have been specifically listed, and the draftsman would have struggled with the *ejusdem generis* rule. "All farm equipment" may be vaguer as a basic description than "all inventory." Is it, standing alone, ineffectual?

A decision like *Mammoth Cave* exhibits a judicial disposition—how frequent cannot be said—to restrict the operation of an after-acquired property clause. A somewhat similar test of the attitude of a court can arise in other situations. For example, a security agreement may refer to one or more locations in describing the collateral; a question may arise as to whether collateral elsewhere located is also included.

In *In re Hardin*,[30] where the referee under the facts correctly construed the security agreement and financing statement as limited to inventory and fixtures at one location and not to include inventory and fixtures at a subsequently acquired store located elsewhere, the opinion adverted to decisions curbing "the indiscriminate application of a future advance provision" as approving a "relatedness" approach which should be applied by analogy:

> Applying these principles to the case before this court, the lien held by the Flygts on the inventory and fixtures in the drugstore in Park Falls was wholly unrelated to the inventory and fixtures in the drugstore at Mequon, Wisconson. They were two separate business ventures. This court holds that the after-acquired property clause in the security agreement is limited to the property acquired by a debtor for use in the particular business described in the notice. Possibly, the language in a security agreement could cover several business locations if the notice clearly described them, but the language in this case was clearly and specifically limited to the 'Flygt drug store in Park Falls'. . . .[31]

In rejecting the "dragnet" approach of the claimants, and limiting the security agreement plus financing statement to replacements at one location, the referee observed:

> The after-acquired property clauses in security agreements have often been described as 'floating liens.' Grain Mer-

30. 11 UCC REP. SERV. 392 (E.D. Wis. 1972).
31. *Id.* at 396.

> chants of Indiana, Inc. v. Union Bank and Savings Co., 408 F.2d 209 [6 U.C.C. Rep. 1] 7th Circuit (1969). The theory advanced is that the inventory in a retail business is like a river. It constantly flows or changes, and new items are added to replace the old items which are sold. Such liens were considered a fraud upon creditors prior to the Uniform Commercial Code. See the Law of Mortgages on Merchandise, 1963 WIS. L. REV. 359. However, under the Code a lien on after-acquired property is permitted and has been described as a 'floating lien.' To extend this floating lien theory to the facts of this case could more properly be described as a 'sinking lien' because the lien would be a noose around the debtor's neck which would forever hold him to the bottom of the mythical river.[32]

Cases like *In re Hardin* involve questions in construction: the determination of the scope of an after-acquired property clause. In retrospect, it is easy to fault the secured party's draftsmanship. But it was probably not anticipated that the debtor's original drugstore would be destroyed by fire; that the insurance proceeds would be insufficient to pay off the indebtedness; and that the debtor some months later would open up a new store and soon thereafter would be bankrupt.

When, in a doubtful case, the question of construction of the scope of the after-acquired clause is at issue, various factors may sway the court. It would be foolhardy to attempt to list all of the considerations that may enter, but among them is certainly a court's instinctive sense of fairness. Thus in *In re Hardin*:

> The new inventory was furnished by drug companies and other suppliers on open account, who have substantial claims as unsecured creditors in this bankruptcy proceeding. The claimants now contend that they should step ahead of all other creditors as secured creditors because the new inventory and fixtures are after-acquired property covered by their previous lien on the Park Falls drugstore.[33]

Under such circumstances, we should not be surprised to find a court indulging in an interpretation of an after-acquired clause contra to the secured party.

If the court finds that the parties did not intend the after-acquired clause to cover the property in question, that ends the matter.[34] So we should not be surprised if a court found that the parties did not intend an after-acquired clause to cover a debtor's

32. *Id.* at 395.
33. *Id.* at 394.
34. For other decisions, see Owen v. McKesson & Robbins Drug Co., 349 F. Supp. 1327, 11 UCC REP. SERV. 455 (N.D. Fla. 1972); *In re* Little Brick Shirthouse, Inc., 347 F. Supp. 827, 10 UCC REP. SERV. 1360 (N.D. Ill. 1972); *In re* Nickerson & Nickerson, Inc., 452 F.2d 56, 9 UCC REP. SERV. 1266 (8th Cir. 1971).

subsequent acquisitions of property which were unusual, not in the ordinary course of business, though the Code's only explicit limitation in this regard is found in section 9-108, which only goes to say that the later acquisition is not for "new value," if not in the ordinary course of business.[35]

### 3. RELATION OF AFTER-ACQUIRED PROPERTY SECURITY INTEREST TO PROCEEDS SECURITY INTEREST

They may overlap. The same property may be covered by the after-acquired property clause and also constitute proceeds of collateral.

The after-acquired property clause imposes an original security interest in the collateral, whereas the proceeds security interest is a derivative security interest.

Establishment of a proceeds security interest in property received by the debtor requires identification of that property as proceeds resulting from the disposition of property subject to a security interest (except for section 9-306(4)(d)), with the burden of proof on the secured party. An after-acquired property clause covering such property as part of an original security interest may serve a useful purpose by dispensing with the need to identify such property as proceeds. It may supply an alternative route to a security interest claim upon property subsequently acquired by the debtor.

Where one party has a proceeds security interest (for example, in an account arising from the sale of inventory) and another party has an original security interest in the same property (for example, the account) under an after-acquired property clause, a serious, debated priority question arises, which must be treated elsewhere.[36]

### 4. RELATION OF AFTER-ACQUIRED CLAUSE TO FIRST-TO-FILE RULE

Where conflicting security interests in the same collateral are involved, the traffic rules governing priority are supplied by section 9-312 and related sections; the ordinary priority rules (as distinguished from special priority rules) are set forth in section 9-312(5). The first-to-file rule of section 9-312(5)(a) (1962) says that as between two conflicting perfected-by-filing security interests in the same collateral, *the first filer* has priority, regardless of the order of attaching or perfection.[37]

35. "[O]r under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given." CODE § 9-108.

36. *See* note 59 *infra* and EXAMPLE 2 following note 85 *infra*.

37. It is beyond the scope of this presentation to go into the first-to-file rule in detail, or to consider possibilities of exceptions based on lack of good faith, estoppel, etc., or any decisions which may not be consonant with the rule. *See* PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 8, at 13-15. The first-to-file rule can be a trap for the unwary. The mere fact

EXAMPLE

On May 1, 1970, a financing statement naming B as secured party and A as debtor, meeting the terms of section 9-402(3), is duly filed in accordance with section 9-401. Collateral is identified as "refrigerators." (Notice filing.) No security agreement between A and B is executed at the time.

On May 3, 1970, A and C enter into a security agreement making A's refrigerators collateral for a non-purchase money loan by C to A of $50,000. A proper financing statement is filed the same day, in the proper place or places.

On May 4, 1970, A and B enter into a security agreement making the refrigerators collateral for a non-purchase money loan of $30,000 then made by B to A. (It will simplify matters if we say that B did not know of C's security interest at the time, although this may not matter.)

B's security interest has priority over C's under section 9-312(5)(a), although C's was the first to be perfected.

The dominant question is, who filed first?

Further, according to the prevailing view, a single notice filing will serve to perfect not just one security interest, but a whole series of separate security interests created by a series of subsequent agreements between the parties, if all involve the collateral covered by the filing.[38]

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that B has no security interest at the time should not encourage C to make his loan. C should obtain a subordination agreement from B, or a release of collateral, or require A to get the filing terminated. Moral: don't lend with an outstanding filing involving the collateral you intend to take. Question: suppose C gets A to get B to give a statement under section 9-208, declaring that there is no indebtedness? Can C rely and make the loan? Did B know what the purpose of the statement was? If so, is B estopped to claim priority on account of *subsequent* indebtedness secured by the collateral covered in his prior notice filing?

38. Wisconsin car dealers have been alerted to the fact that sweeping claims in a financing statement may be inhibiting. A letter to the author from Donald B. Milan, then Assistant Manager, Wisconsin Automobile Trade Association, dated April 4, 1970, calls attention to the following from the Wisconsin Automotive Trades Association August 4, 1965 Bulletin:

> *FINANCING STATEMENT (UCC-1 & 2).* This form, which has been in use since July 1, has caused some Wisconsin dealers financial problems. UCC-1&2 stands for the new Uniform Commercial Code "financing statement" that is filed by the finance company or bank who is doing the floor planning on your new car inventory.
>
> Many of the finance companies have included in their UCC-1&2 not only the dealer's new car inventory, but the used car inventory, the accessories, the parts inventory, and everything else they can get their hands on. Then when the dealer goes to his bank to borrow more money and put up either used cars or some other part of his inventory as collateral the bank immediately runs into the "financing statement" and refuses to loan any money because the property is already mortgaged.
>
> In simple terms, the *financing statement* (UCC1&2) merely puts all other interested persons on notice that someone has a lien on cer-

So, what's the importance of an after-acquired property clause in a security agreement?[39] (Besides obviating the need to make a subsequent security agreement to cover the subsequently acquired property.) First, as between conflicting security interests in the same collateral, an effective after-acquired property clause in a security agreement (with perfection by filing) eliminates the chance that another secured party may achieve priority in subsequently acquired collateral by taking possession (rather than by filing). Filing-without-more could not achieve priority here,—section 9-312(5)(b)—since the first-to-file rule applies only where both security interests are perfected by filing. (The 1972 Amendments change this, by supporting first-to-file over first-to-perfect in this situation).[40] Second, where a third party claimant other than a competing secured party is involved, there is all the difference in the

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tain of your assets, but unless you have signed a security agreement (chattel mortgage, trust receipt) on these assets, no one actually has a lien because the financing statement does not create a security interest in itself. The finance companies are going beyond the scope of their actual security interest by filing expanded notices which do not reflect the terms of the security agreements.

If you ask the finance companies or the banks to remove your used car inventory and other items from the financing statement UCC-1&2, it is most likely that they will do so . . . .

If you have any questions talk with your banker, with your financing agency and with your attorney. WATA is interested in learning the extent of this practice and any problems arising therefrom.

Mr. Milan remarks, "Frankly it must have done the trick because we have had no inquiries on the subject since that time." Letter from Donald B. Milan to Robert H. Skilton, April 4, 1970.

In business financing, the desire of the secured party for full protection can lead him to seek the most inclusive kind of floating security interest, and to sweeping claims in the financing statement. On the other hand, the debtor should hesitate before conceding. And the attorney for the debtor, mindful of the dog-in-the-manger effect of the first-to-file rule, and further, the inhibiting effect of a floating security interest upon the possibility of alternative sources of credit, may conclude that in representing the debtor he should: (1) seek to restrict the collateral claim in a financing statement; (2) seek to limit the collateral covered in the security agreement; and (3) where an after-acquired clause is agreed upon, with a resultant floating security interest, seek to limit the type or types of collateral subject to the floating security interest.

39. With respect to section 9-312 of the 1952 version, which was enacted only in Pennsylvania:

> The importance of the after-acquired property clause was overstressed in the Pennsylvania version of the Code. Section 9-312(4) protected the purchase-money financer in the event of a contest with a secured party claiming under an after-acquired property clause, disregarding the larger problem of a later security interest which gained priority because perfected through an earlier filing. The present Section 9-312 does not mention the after-acquired property clause. It is interesting to note that the California Bankers' counterpart of present Section 9-312 falls into the same trap as the Pennsylvania version.

Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the 'Floating Lien'*, 72 HARV. L. REV. 838 (1959).

40. CODE § 9-312(5)(a) (1972).

world. For example, a mere filing without more cannot prevent lien creditors of the debtor or persons buying from the debtor from acquiring incontestable rights. If they could prevail under section 9-301 in the case of unperfected *security interests*, a fortiori, they will prevail where no security interest in fact existed at the time. In fact, whether they knew of the prior filing should be irrelevant.

EXAMPLE 1

On May 1, 1970, a proper financing statement of the short form, notice type, naming A as debtor and B as secured party, is filed in the proper place or places. Collateral covered is A's refrigerators. On May 3, 1970, C, a judgment creditor of A, levies on A's refrigerators.

On May 4, 1970, A and B enter into a security agreement making A's refrigerators collateral for a loan of $10,000. C's lien creditor status has priority over B's security interest, since at the time C became a lien creditor, B had no security interest in A's refrigerators.

EXAMPLE 2

On May 1, 1970 a proper financing statement naming A as debtor and B as secured party is filed in the proper place or places. Collateral covered is A's refrigerators. On the same day A and B enter into a security agreement making all of A's refrigerators, now owned or thereafter acquired, security for a loan of $10,000 made by B to A. On May 5, 1970, C, a judgment creditor of A, levies on A's refrigerators, some of which have been acquired by A on May 4. Under applicable state law C becomes a lien creditor upon levy. B's security interest has priority over C's levy, as to all refrigerators, since B had a perfected security interest at the time C became a lien creditor.

5. PRIORITY PROBLEMS

The Code gives effect to the after-acquired clause, as above explained. This certainly means that it is effective against the *debtor*. Thus, for example, the secured party can, on the debtor's default, assert remedial security interest rights against after-acquired property covered by the security agreement (part 5, article 9). But what about the *priority* position where there are certain *third party* claims to the collateral?

41. I am indebted to Herbert Weingarten, Esq. of Detroit for going over a draft of the manuscript and for a good many penetrating ideas. In a letter dated April 5, 1974 to the author he wrote: "Incidentally, the quotation of Section 2-702 on page 16 omits the rights of the 'lien creditor' whose existence is still maintained in the 30 or more states which have not adopted the 1966 Amendment."

*a. Secured party versus seller of goods claiming under section 2-702(2).*

Section 2-702(2) provides that if goods are delivered to a buyer on credit, and the buyer is insolvent at the time of delivery, the seller may reclaim the goods from the buyer if the seller makes demand therefor within 10 days after buyer receives goods. (The ten day cut-off is inapplicable where the buyer makes written misrepresentation within three months prior to delivery.) However, subsection (3) provides that the seller's right to reclaim under subsection (2) is subject to the "rights of a buyer in ordinary course or other good faith purchaser under this Article. (Section 2-403)."[41]

In the case of *In re Hayward Woolen Co.*,[42] rights in wool deliveries which had been made to buyer, now bankrupt, were asserted by various sellers on unsecured credit or their assignees[43] under section 2-702(2). Counter claimant: a person having a perfected security interest in the debtor's wool inventory asserting his claim under an after-acquired clause in a security agreement. The opinion treats the after-acquired property security interest as if it were for an antecedent debt—despite the fact that the secured party had added to his original loan to the debtor a further advance of $25,000 more or less contemporaneously with the debtor's acquisitions of the wool in dispute. It was held that under section 2-403(1) the secured party prevailed, because he was a bona fide purchaser for value, and as such was protected by section 2-702(3). For, under sections 1-201(32) and (33) a secured party is a kind of "purchaser," and under section 1-201(44) taking for "value" includes an acquisition "as security for . . . a pre-existing claim."

Fireside equities may seem to favor the *seller* over the secured party who did not give new value in latching on to the after-acquired property. The secured party with the after-acquired property clause may seem to get a windfall at the expense of the sellers, who provided the property. But it is hard to quarrel with the decision as an application of statutory provisions. The result would have seemed harsher if the sellers had proved buyer's fraud-in-fact through misrepresentation in obtaining goods on credit, instead of simply showing that buyer was insolvent at the time of deliveries.[44]

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42. 3 UCC REP. SERV. 1107 (D. Mass. Ref. 1967).

43. In a carefully reasoned opinion, it was held that section 2-702(2) rights are not available to a financing agency acquiring the buyer's obligation from the seller, at least where reclamation claim is based on buyer's written misrepresentation not falling within the ten day limitation. *In re* Hardin, 458 F.2d 938, 941, 10 UCC REP. SERV. 517, 521 (7th Cir. 1972) (quoting Note, 68 YALE L.J. 751, 761 (1959).

44. Mr. Weingarten remarks in his letter, *supra* note 41:

> There seems to be a tendency on the part of some courts to deny priority under the after-acquired property clause where the seller of the goods can create some kind of contrary theory. As pointed out

The case illustrates the "voidable title" area. Title passes to buyer, but seller has a right to rescind the title, until a bona fide purchaser for value intervenes—that is the general restitutionary rule. Section 2-702 merely tinkers with it.

*b. Secured party versus consignor of goods-for-sale*

A somewhat similar problem arises when the goods are delivered to an agent for sale under a "true" consignment.[45] Here section 2-326 applies, and if the transaction does not fit within subsections (a), (b) or (c) of section 2-326(3), the case will be treated as a "sale or return," which would mean that the consigned goods are subject to the claims of the consignee's creditors while in his possession, under section 2-326(2). Since the term "creditor" as defined in section 1-201(12) includes secured creditor as well as unsecured, under section 2-326(2) goods held by the debtor on consignment would seem to be fair game for the reach of the after-acquired property clause, and it has been so held.[46] Thus, to protect his rights against such claim, the consignor in a true consignment situation had better file *before* making delivery. Should he also give notice to prior filers, as section 9-312(3) would clearly require, if the consignment were not a true consignment but is one intended as security? The cautious advice is, Yes: why take a chance?[47] The 1972 Amendment makes clear that a true consignor relying on filing for protection against a prior filer as to the debtor's inventory must notify the prior filer as well as perfect before making delivery under section 9-114 (1972).

In one case, (decided under the 1962 version of article 9) the court assumed that to prevail the secured party must give "new value"; although no fresh advance had been made by the secured party, the court turned to section 9-108 and was satisfied.[48] All this seems unnecessary: nothing in section 3-326 or article 9 denies priority in a case like this to a security interest in after-acquired property taken for an antecedent debt.

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by you, fireside equities would seem to favor the seller of goods who delivers shortly before bankruptcy over the holder of a security interest in after-acquired property. At least one court has gone to considerable length to give effect to these equities. See Samuels v. Co. (5th cir.) 13 U.C.C. 124; contra, First National Bank of Elkhart County v. Smoker, 11 U.C.C. 10 and 289.

45. It is beyond the scope of this study to deal with the vexed question of what criteria distinguish a "true" consignment for sale from a consignment which is, in the language of section 9-102(2) "intended as security."

46. *See, e.g.*, American Nat'l Bank v. Tina Marie Homes, Inc., 8 UCC REP. SERV. 281 (Colo. Ct. App. 1970); American Nat'l Bank v. Christenson, 8 UCC REP. SERV. 294 (Colo. Ct. App. 1970).

47. *See* 2 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 750-51 (1964).

48. First Citizens Bank & Trust Co. v. Academic Archives, Inc., 179 S.E.2d 850, 8 UCC REP. SERV. 1197 (N.C. Ct. App. 1971).

### 6. LIMITATIONS

#### *a. Effect of imperfections in the debtor's title upon secured party's rights*

While section 9-204(1) says a security interest does not attach before debtor has "rights" in property, the previous discussion shows that when attached, it is given priority over *some* persons with better rights than the *debtor*—for example, section 2-702(2) sellers and section 2-326 consignors.[49]

However, various imperfections in the debtor's rights in collateral existing at the time the debtor acquired the property may go to

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49. Wes Zulty, Esq., a Madison, Wisconsin attorney, in a conversation with the author, October 3, 1974, described two instances from his experience, where a party with a perfected security interest in after-acquired inventory of a supermarket seemed to have reaped an undue advantage at the expense of an unsecured creditor. In both instances, the secured party was in the role of supplier of some of the supermarket's inventory. In one instance, exercising its right under the security agreement the secured party had the supermarket's manager removed, and replaced with the manager's assistant. This was at a time when the secured party had good reason to believe that the debtor (the supermarket) was insolvent. Thereafter the secured party took possession of all of the debtor's inventory (exercising its rights on default (section 9-503)), but shortly before it did so, the new manager of the supermarket ordered and obtained delivery of a substantial amount—much larger than usual—of merchandise from another supplier, on unsecured credit. The secured party asserted its security interest in this merchandise. It further took the position that it was not liable to the unsecured supplier for the acts of the new manager (although it had been instrumental in his appointment) contending that when he placed the order he was acting as agent for the supermarket and not as its (the secured party's) agent. In this instance, the security agreement had further provided that all receipts from the debtor's business were to be deposited in a bank account as to which the secured party had sole power of withdrawal—so that whether suppliers on open account would be paid depended upon the secured party's decision to draw on that account. Quaere: under the circumstances: (1) Did the secured party qualify as a "bona fide purchaser" of the merchandise through the after-acquired property clause, so as not to take subject to the seller's reclamation rights under section 2-702? (2) Any chance of upsetting the transaction as a fraudulent conveyance? (3) Was the secured party correct in its assertion that the manager was not its agent so that it was not liable to the supplier for the purchase price?

No litigation ensued in this instance. But it contributed to attorney Zulty's attitude that the strategic position of the secured party with an after-acquired property clause can result in unfairness to suppliers on open account. Mr. Zulty commented on the difficulty of trying to show that an order for a large amount is not in the ordinary course of business. Excuses for making a large order can include a pending strike which could affect further deliveries of the merchandise ordered, or inflationary conditions making it advisable to place a large order now rather than paying more later.

The other instance that attorney Zulty recollects was substantially like the first, except that the secured party had not been instrumental in the transfer of the management of the debtor.

limit or curtail the position of a party having a security interest given by the debtor in the collateral.[50]

EXAMPLE 1

A's refrigerator needs repair. B, who sells refrigerators and also repairs them, agrees to repair A's refrigerator and takes it to his place of business. B has previously given C a security interest in all his refrigerators present and after-acquired. The security interest has been perfected by filing. C has no rights in the refrigerator superior to A's, except for the possibility that he may take the lien right that B may have for repair work. (B may have a lien under the state's lien statute or at common law.)

In general, article 9 does not deal with questions relating to the extent of the interest in property of the debtor. Section 2-403(1) states that, "[a] purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased." The secured party is a purchaser of a limited interest.

EXAMPLE 2

A has a perfected-by-filing security interest in all of B's inventory. D has a perfected-by-filing security interest in all of C's inventory, including after acquired. B without authority from A sells an item of inventory to C. Assume C does not qualify as a buyer in ordinary course of business (section 9-307(1)). C is a dealer, and buys the item as inventory. A's security interest continues notwithstanding sale (section 9-306(2)) and D's security interest is subordinate to A's, even though D may have filed first. Section 9-312(5) does not apply, because the security interests were not created by the same debtor.[51] See section 9-402(7) (1972).

*b. Purchase money security interests*

If, as already noted, "fireside equities" may seem to favor (though generally in vain) the seller of goods on unsecured credit over the secured party claiming under an after-acquired property clause, the equities would seem especially great if the seller reserved a security interest in the goods sold, rather than selling on open account. Indeed, in such case article 9 accords special priority to the purchase-money security interest.

The holder of a perfected floating security interest covering fu-

50. *See generally* Bunn, *Financing Farmers—Existing Wisconsin Law, The Green Giant Case and the Uniform Commercial Code*, 1954 WIS. L. REV. 357.

51. *See* Oldfather, *Floor Plan Financing Under Article 9 of the Uniform Commercial Code*, 14 KAN. L. REV. 571, 581-84 (1966).

ture as well as present collateral, for example inventory collateral, must take into account the possibility that his security interest in the debtor's after-acquired property may be subordinated to a purchase-money security interest in the incoming goods—either type (a) seller's type or (b) lender's type, as defined in section 9-107. That is, if the purchase-money party complies with section 9-312(3)[52]——in the case of inventory-collateral—or section 9-312(4)[53] in the case of collateral other than inventory. These subsections accord a special priority which supplants the normal priority rules of section 9-312(5).[54]

But suppose a conditional seller of equipment fails to perfect his security interest within 10 days after the debtor receives possession? Or suppose a conditional seller of inventory fails to file before delivery, or fails to notify prior filers before delivery? In such cases, the special priority provisions do not apply, and priority between conflicting security interests will be resolved under section 9-312(5), which should normally result in judgment for the secured party claiming under an after-acquired property clause, as the first filer (section 9-312(5)).[55]

But not in Florida. There the state supreme court in a 4 to 3

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52. CODE § 9-312(3) provides:

> A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if (a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and (b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and (c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

Note: the 1972 amendment to section 9-312(3) in making several changes does not affect the point made.

53. CODE § 9-312(4) (1962) provides:

> A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral [or its proceeds (1972)] if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

Questions may sometimes arise as to when the 10 day period of section 9-312(4) begins to run. *See* James Talcott, Inc. v. Associated Capital Co., 491 F.2d 879, 883, 14 UCC REP. SERV. 202, 206-07 (6th Cir. 1974) (distinguishing Brodie Hotel Supply, Inc. v. United States, 431 F.2d 1316, 8 UCC REP. SERV. 113 [9th Cir. 1970]). *See also in re* Ultra Precision Industries, Inc., 15 UCC REP. SERV. 281 (1974).

54. *But see* note 59 *infra.*

55. This subsection applies to "all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4)) . . . ." CODE § 9-312(5).

decision recently ruled that where a seller retaining a purchase-money security interest in equipment failed to file within 10 days after the debtor took possession, his interest was *not* subordinated to the claim of a party with a perfected-by-filing security interest in after-acquired property; the after-acquired property security interest took precedence only to the extent of the *debtor's* interest![56] "It would be abhorrent to equity and justice that the earlier creditor should acquire the subsequent *creditor's* property or 'interest' in this manner. Upon principles of equity and unjust enrichment, the limitation to the debtor's equity in after-acquired property appears to be the better and more logical rule."[57] To hold otherwise would result in a "windfall" to secured party with the after-acquired property clause, without any showing that he changed his position in reliance or was misled by the secured seller's failure to file—so argued the majority of the court, talking vaguely about "constitutional" requirements.

What we encounter in this decision is a bursting into flame of the fireside equities, to the point where a court acts in disregard not only of all decisions in other states but also of the rather clear language of section 9-312(5). The dissenting opinion by Carlton, C.J.,[58] seems to have the better of the argument. However sympathetic one may be toward the position of the purchase-money secured seller in a case like this, there is no warrant for distorting statutory language. If a remedy is to be found it should be through legislation.

Warning to *secured* sellers: Don't count on the Florida decision to attract a following. Be sure to comply timewise and otherwise with section 9-312(3) or section 9-312(4) as the case may be, to obtain special priority, in case there are prior filers as to the type of collateral.

Warning to *unsecured* sellers on credit smarting under the grasp of the after-acquired property clause: Should you change your

56. International Harvester Credit Corp. v. American Nat'l Bank, 296 So. 2d 32, 14 UCC REP. SERV. 19 (Fla. Sup. Ct. 1974), *rev'g* 269 So. 2d 726, 11 UCC REP. SERV. 682 (Fla. Dist. Ct. App. 1972). Judge Rawls had dissented to the position of the court below in colorful language:

> The law is an ass. [citing CHARLES DICKENS, OLIVER TWIST 399 (Oxford Press. 1961 ed.)]. This aphorism is especially applicable to the instant facts for by detailing various provisions of the Uniform Commercial Code the majority has reached an illogical result . . . . My question is: How did the Bank acquire as security for its debt property that the debtor did not even own? . . . The Bank's interest in this 'after-acquired property' was limited to Machek's equity in same. To permit the Bank under these facts to replevy the subject farm machinery from Florida Truck and Tractor Company and International Harvester Creditor Corporation, in my opinion, constitutes legal larceny.

269 So. 2d 726, 731, 11 UCC REP. SERV. 682, 690.

57. 296 So. 2d 32, 34, 14 UCC REP. SERV. 19, 23-24.

58. *Id.* at 35, 14 UCC REP. SERV. at 25.

practices? Confronted with the Code's validation of the floating security interest, with its grasp on the debtor's after-acquired assets, there is evidence that suppliers are swinging away from their traditional practice of selling on open account. Professor Kripke notes, "I have been hearing in New York stories to the effect people are using 9-312(3) because trade creditor suppliers have come in increasingly and said, 'Why should we be patsies and supply goods on open account if the banks and factors take inventory liens on what we supply?' "[59] Professor Fairfax Leary, with his ear to the ground in Philadelphia, confirms.

*c. Purchasers and lien claimants*

There is further the risk of loss or subordination of a perfected security interest to certain persons whose claims are specially protected under the Code. Section 9-307(1) protects a buyer in ordinary course of business against the claim of a party secured in the seller's inventory.[60] Section 9-309 protects holders in due course of negotiable instruments, bona fide purchasers of securities and persons to whom a negotiable document of title is duly negotiated. Section 9-308 gives priority to purchasers for new value of non-negotiable instruments and chattel paper under defined conditions. (The 1972 version of section 9-308 is expanded to include "instruments" as defined in section 9-105(1)(i).) Thus, as to certain kinds of bona fide purchasers taking certain kinds of collateral, the secured party risks the cutting off of his security interest, even though he has not authorized transfer of the collateral by the debtor.

A substantial threat to the smooth operation of the floating security interest lies in the possibility that a nonconsensual lien may be imposed upon the collateral on account of some liability of the debtor: see for example, section 9-310, dealing with priority of liens for services and materials.

In states where a landlord's right of distraint does not depend on contract but is a nonconsensual incident of the landlord-tenant

59. PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 9, 87-88. Mr. Coogan cautions, however, that the purchase-money party may lose priority in proceeds—in an account—to a prior perfected original security interest; that "the only thing he can count on in the event of bankruptcy is what inventory is on hand at that time. If he gets something from the account, well and good. But he cannot count on it. This is the present confusion as to priorities." *Id.* at 88. (The 1972 amendments confirm the Coogan cautionary note—CODE § 9-312(3) (1972).) *See The Priority Conflict Between a Purchase Money Security Interest and a Prior Security Interest in Future Accounts Receivable,* 22 VAND. L. REV. 1157 (1969).

60. For a case dealing with the difficult question as to when a buyer making advances on work in process may attain the status of buyer in ordinary course of business, see Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 208 N.W.2d 97 (1973). (In the *Adamatic* case the floating security interest prevailed.)

relation, the landlord may have a right to subordinate the interest of a secured party as to any property on premises leased by the debtor who owes rent, unless a statute provides for exemption.[61] Section 9-104 makes article 9 inapplicable to landlord's liens not dependent upon contract (terms of lease).

The possibility of a federal tax lien poses a definite threat to a security interest in after-acquired property. According to section 6323 of the Internal Revenue Code, where "commercial financing" is involved, there are two 45-day rules—exceptions to the basic rule that a perfected security interest prevails only to the extent of collateral and indebtedness in existence at the time the tax lien is filed. The first 45-day rule protects the security interest in property acquired by the debtor during that period. But acquisitions beyond this comparatively short time are not protected.[62] (The second 45-day rule deals with future advances.)

In *Texas Oil & Gas Corp. v. United States*,[63] a secured party held a security interest, perfected by filing on March 29, 1967, in collateral of the taxpayer-debtor consisting of "[a]ll accounts, contract rights, chattel paper, instruments, general intangibles and rights to payment of every kind now or at any time hereafter arising out of the business of the debtor; all interest of the debtor in any goods, the sale or lease of which shall have given or shall give rise to any of the foregoing."[64] Pursuant to a future advance clause in the security agreement, the secured party made loans to the debtor

61. *See* Universal C.I.T. Credit Corp. v. Congressional Motors, 246 Md. 380, 228 A.2d 467 (1967). The statement in the text is simply intended to alert the reader to the possibility that priority problems between a landlord asserting a lien right which is nonconsensual, conferred by common law or statute, and a secured party holding a security interest in property such as inventory of a tenant, are not governed by section 9-312. (*See* section 9-104(b), excluding such landlord's lien from article 9.) Chessport Millworks, Inc. v. Solis, 14 UCC REP. SERV. 793 (N.M. 1974). (Caveat: If the security interest is in a tenant fixture, the party secured in the fixture may generally prevail. CODE § 9-313(5)(b) (1972); R. BROWN, PERSONAL PROPERTY § 156 (2d ed. 1955).)

The humorous side was noted by Horace Skimpole, the loquacious ne'er-do-well in Dickens' *Bleak House*, in reflecting on the effects of his landlord's distraint for unpaid rent:

> 'The oddity of the thing is,' said Mr. Skimpole, with a quickened sense of the ludicrous, 'that my chairs and tables were not paid for, and yet my landlord walks off with them as composedly as possible. Now, that seems droll. There is something grotesque in it. The chair and the table merchant never engaged to pay my landlord rent. Why should my landlord quarrel with *him*? If I had a pimple on my nose which is disagreeable to my landlord's peculiar ideas of beauty, my landlord has no business to scratch my chair and table merchant's nose, which has no pimple on it. His reasoning seems defective.'

62. *See* Coogan, *The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code*, 81 HARV. L. REV. 1369 (1968).

63. 466 F.2d 1040, 11 UCC REP. SERV. 575 (5th Cir. 1972).

64. *Id.* at 1044 n.2, 11 UCC REP. SERV. at 579 n.2.

from time to time until October 15, 1970. On February 27, 1970 the United States had filed a tax lien notice against the debtor. Under a contract made in September of 1970, the debtor completed contract services to Texas Oil in September to November, 1970 and became entitled to payment. The secured party's claim to priority over the tax lien in the Texas Oil account was denied.[65]

The case illustrates the not inconsiderable threat the possibility of the filing of a federal tax lien makes to a secured party relying upon the debtor's acquisition of after-acquired collateral, and making further advances to the debtor on the strength of such acquisitions.

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65. The opinion observes that:

> [This] potential interest in future accounts receivable cannot pass muster under the traditional choateness doctrine and because the 1966 amendments to the tax lien statute do not appear to expand that choateness doctrine in any manner other than to extend the required time of receipt for 45 days past the filing of the tax lien, the bank lien is inferior to the federal tax lien.

*Id.* at 1053, 11 UCC REP. SERV. at 593.

The opinion further observed:

> The most substantial present interest which the bank could claim in "the accounts receivable at the time of the tax lien filing or within 45 days thereafter was that of a 'general intangible.'" *See* Tex. Bus. & Comm. Code Ann. § 9.106. But the legislative history of the 1966 amendments to the tax lien statutes expressly excludes 'general intangibles' from classification as 'qualified property' of commercial financing security.

*Id.* at 1050, 11 UCC REP. SERV. at 589.

The opinion concludes:

> Of course, we realize that this disposition does not afford the protection that commercial lenders who deal with after-acquired property might prefer. As the law appears to stand, the commercial lender must check the applicable records every 45 days or else seriously jeopardize his security under the varying degrees of rigor promulgated by the choateness doctrine. Even that 45-day grace period is probably of minimal efficacy. Commercial lenders might often be lulled into a false sense of security with debtors who are doing badly, for it might appear to the lender that such a debtor is unlikely to have any income to tax. Yet it is precisely in those circumstances that back taxes are likely to accrue. In addition, the lender would most likely not have the entire 45-day period in which to act unless he were lucky enough to discover the tax lien filing almost immediately after it was filed. Finally, there is often not a great deal that the lender can do to protect his advances even after he discovers the tax lien in time. Of course, he has little control over the actual receipt of after-acquired property by the taxpayer-debtor, which is usually subject to contracts and contingencies entirely within the authority of the taxpayer and various third-parties. The lender can attempt to substitute other existing collateral for his interest in after-acquired property if the taxpayer-debtor has substitutable assets and if there is sufficient time. Of course, however difficult the present amendments to the tax lien statutes might be to commercial lenders, the amendments offer greater protection to certain categories of lien holders and liens than were afforded by prior doctrines. But the whole genesis and historicity of Section 6323(c) appears to have been to give only a slight handicap (45 days) to a private lien holder. The bank did not establish its case under the choateness doctrine or under these statutory amendments, and the judgment of the district court awarding the accounts receivable fund to the Government by virtue of its tax lien, is affirmed.

*Id.* at 1053-54, 11 UCC REP. SERV. at 593-94.

The threat is all the more important since the tax assessments may be huge, and for any of many kinds of federal taxes. Thus, in the *Texas Oil & Gas Corp.* case, the tax lien was on account of the taxpayer-debtor's federal withholding and FICA liabilities.

In the *Texas Oil* case, the contract whose performance gave rise to the account involved in the litigation had not been entered into until after the 45-day period had expired. Suppose, however, that the debtor had made his *contract* with Texas Oil before or during the 45-day period (rather than later) and the contract right had matured by performance into an account, after the expiration of the period. Who has the better right to the account, the secured party or the Government? In *Continental Fin., Inc. v. Cambridge Lee Metal Co.*,[66] the New Jersey Superior Court held for the Government, reasoning that the security interest, as long as it was merely in a contract right, was contingent and "inchoate." While the Supreme Court of New Jersey affirmed, it did so on the narrow basis that the evidence revealed that there was no binding contract between the debtor and the third party obliging the debtor to perform. Hence there was no "contract right" under the facts.[67] Thus, there was

66. 100 N.J. Super. 327, 241 A.2d 853, 5 UCC REP. SERV. 317 (1968).

67. Continental Fin., Inc. v. Cambridge Lee Metal Co., 56 N.J. 148, 265 A.2d 536, 7 UCC REP. SERV. 903 (1970). The per curiam opinion observed:

> The Law Division's opinion dealt with the effect of tbe 1966 amendments on security interest in 'contract rights' (100 N.J. Super at 339) and the briefs before us were addressed primarily to that particular issue. Much financing is being done on the security of borrowers' valuable contract rights which may of course include purchase orders on work in progress and the like. Under the terms of the Uniform Commercial Code, lenders may appropriately acquire and record security interests in such contract rights which will, as against subsequent state lienors, have priority insofar as the contract rights and their proceeds are concerned. *See* N.J.S.A. 12A: 9-106, 12A: 9-204, 12A: 9-302; 12A: 9-306(1). Though the subject might have been handled with much more clarity and specificity, there are indications that, in the overall, the 1966 amendments contemplated that the security interests in such contract rights would have priority over subsequently filed federal tax liens. *See H.R. Rep. No.* 1884, *supra* at 42. On one approach or other [sic] substantially all in the academic field have taken the position that under § 6323, as amended in 1966, security interests in such contract rights are legally entitled to priority. *See* Creedon, "Assignments for Security and Federal Tax Liens," 37 *Fordham L. Rev.* 535, 561-565 (1969); *Coogan, Hogan and Vagts, Bender's Uniform Commercial Code Service, Secured Transactions* 1287-89 (1969); *Plumb & Wright, supra* at 93-94; Plumb, *supra*, 74 *Com. L.J.* at 229; Plumb, "The New Federal Tax Lien Law," 22 *The Business Lawyer* 271, 274-75 (1967).
>
> Stressing the priority afforded to the holder of a "security interest" in § 6323(a) and the breadth of the definition of "security interest" in § 6323(h)(1) along with the House Committee's reference to contract rights within the definition of "commercial financing security" in §6323(c)(2)(c). (*H.R. Rep. No.* 1884, *supra* at 42), some commentators have expressed general criticism of the law division's holding in the instant matter. *See* Creedon, *supra*, 37 *Fordham L. Rev.* at 568-69; *Plumb, supra*, 74 *Com. L.J.* at 229. However, more to the point is the treatment in *Coogan, Hogan & Vagts, supra* at 1289 n.67a. There the authors pointed out that if "what was assigned was present and future accounts receivable" then the federal tax lien was

no need to pass upon the merits of the lower court's opinion with reference to "contract rights."

Since the value of a security interest grows markedly when a contract right develops into an account through the debtor's performance, it may be understandable why the New Jersey Superior Court decided against the secured party's claim. The stated facts of the case are too skimpy for analysis on the merits. The equities of the Government's position would be especially strong if the account were generated through the debtor's expenditures in performing not financed by the secured party, if such performance took place after the 45-day period. Such expenditures would deplete the estate against which the tax lien had been filed, and deciding for the secured party under such facts would seem to result in a windfall to the secured party at the expense of the tax claim. Perhaps the correct decision would be to limit the secured party to the value of the contract right at the end of the 45-day period.[68]

*d. The trustee in bankruptcy*

A "lien creditor" subordinates only the unperfected security interest (section 9-301(1)(b)), and not the perfected interest (section 9-201). Thus, the after-acquired property security interest is safe from him, provided the security interest in after-acquired collateral is instantly perfected by prefiling with no unperfected interval where there is vulnerability to lien achieved by levy.[69]

*But* suppose a petition in bankruptcy is filed against the debtor. Enter the trustee in bankruptcy. Unless the security interest can hold up in the event of the debtor's bankruptcy, the "security-in-fact" of a secured transaction is shaky indeed.

He's a pretty powerful fellow, this trustee in bankruptcy. And the powers that federal law gives him when Congress acts under one of its enumerated powers, in this case, its power to establish

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clearly entitled to priority as against the claim of Continental Finance to the fund in question. The authors expressed the further view that if, on examination of the original documents, it appeared that what was actually assigned were "contract rights" held by Centre then Continental should have been preferred . . . .

*Id.* at 153-54, 265 A.2d at 538-39, 7 UCC REP. SERV. at 907-08.

68. Even the modest 45-day concession is unavailable where the Government makes a tax or other claim under section 3466, where it is applicable. *See* Plumb, *The Federal Priority in Insolvency: Proposals for Reform*, 70 MICH. L. REV. 3, 8-9 (1971).

Although the priority over a tax lien with respect to eligible property acquired within 45 days seems clear, the priority for further advances under the other 45 day rule was not so clear under the 1962 Code. *See* PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 9, at 45-49. Section 9-301(4) (1972) is designed to remove the uncertainty.

69. See Barocas v. Bohemia Import Co., Inc., 518 P.2d 850, 14 UCC REP. SERV. 191 (Colo. Ct. App. 1974).

uniform rules for bankruptcy, cannot be taken away by state law (article VI, United States Constitution).[70]

## II. BANKRUPTCY AND THE SECURITY INTEREST IN AFTER-ACQUIRED PROPERTY

The rights of the trustee include:

(1) Bankrupt's property rights (section 70a)

(2) More importantly, rights under the "strong-arm" clause of section 70c:

> The trustee shall have as of the date of bankruptcy the rights and powers of: . . . a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists.

However, in the present case the status of an ideal, hypothetical lien creditor will not aid the trustee in bankruptcy, provided the security interest was perfected at the date of bankruptcy—*i.e.*, the date when the petition was filed—section 1(13).[71]

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70. For penetrating and to some extent contrasting discussions of the trustee's powers under sections 70(e), 70(c), and 60 of the Bankruptcy Act, and the article 9 security interest under bankruptcy law, see 2 GILMORE, *supra* note 7, at ch. 45; Countryman, *Code Security Interests in Bankruptcy*, 75 COMM. L.J. 269 (1970). *See also* Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code*, 14 RUTGERS L. REV. 518 (1960).

71. An example of application of section 70c powers: To secure a loan of $10,000 made by B to A, B has a security interest in A's warehoused inventory, perfected because non-negotiable warehouse receipts issued by the warehouseman for this inventory in his possession have been assigned by A to B as security and the warehouseman has been notified of transfer (section 9-305). B instructs the warehouseman to release certain of the inventory to A (so that A may exhibit for sale) and A thus duly acquires possession of such inventory. No financing statements are filed. Thirty days later, while A is still in possession of such inventory, a petition in bankruptcy is filed against A. Trustee prevails over B as to inventory in A's possession (section 70c). A's security interest in such inventory has become unperfected (section 9-304(5)).

The trustee, in the above example, may also have rights under section 60. Section 60a(2) provides that:

> for the purposes of subdivisions (a) and (b) of this section . . . . If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

*See also* section 60a(7): the transfer is deemed for an antecedent debt, since not perfected within time allowed. The elements of section 60a(1) may be easily established ("immediately before the filing of such petition"), but there still remains the task of establishing that the secured party had "reasonable cause to believe that the debtor is insolvent" immediately before the filing of the petition. Section 70c is the clear-cut route for the trustee.

(3) Section 67d powers—federal fraudulent conveyance provisions. One year limit. Compare with Uniform Fraudulent Conveyance Act.

(4) Likewise section 70e powers. See Uniform Fraudulent Conveyance Act.[72]

(5) Provisions invalidating state-created priorities and some statutory liens (section 67c) while arguably applicable to

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72. (1) The trustee under section 70(e) of the Bankruptcy Act can have the rights of a creditor he represents in case a conveyance is fraudulent under state law. When a security interest may be a fraudulent conveyance is a subject not treated in this essay. The Uniform Fraudulent Conveyance Act (UFCA) (enacted in many states, *e.g.* WIS. STATS. ch. 242 (1971)) applies to security interests as well as to other "conveyances." If the secured party is a purchaser for a "fair consideration without knowledge of the fraud at the time of the purchase," he is protected under section 3(b) of the UFCA. Property is taken for a "fair consideration" if "received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property . . . ." Further, "A purchaser who without actual fraudulent intent has given less than a fair consideration for the conveyance or obligation, may retain the property or obligation as security for repayment." Section 9(2). These provisions do not seem to pose a serious threat to the floating security interest, even when taken for an antecedent debt.

(2) Section 67d powers. Professor Countryman, *supra* note 70, at 280, points out:

> But the bankrupcy trustee has an alternative to the Uniform Fraudulent Conveyance Act. The Chandler Act added a slightly revised version of it as § 67d of the Bankruptcy Act. And one of the revisions is significant. Section 67d(6) substitutes for the last-mentioned provision [section 9] of the Uniform Act a provision that the transfer may not be set aside as against a transferee for "*present* fair equivalent value" and that "such" transferee, "who without actual fraudulent intent has given a consideration less than fair . . . may retain the property . . . as security for repayment." Under another Section of the Bankrupcy Act enacted at the same time (§ 70d), the term "present fair equivalent value" has been held not to include antecedent debt.

Thus Professor Countryman sees section 67d as posing a greater threat to security interests for an antecedent debt than does the Uniform Fraudulent Conveyance Act.

(3) As to the trustee's powers under section 67d(3): this subsection hangs like a cloud, but I do not know when to expect the rain.

(4) Likewise, there may be some vague, ill-defined legal objection to a secured party's taking excessive security, at least in some states. *See* RIESENFELD, CASES AND MATERIALS ON CREDITORS' REMEDIES AND DEBTORS' PROTECTION 300-301 (1967) (quoted in SPEIDEL, SUMMERS & WHITE, COMMERCIAL AND CONSUMER LAW 184 (1974)): "The question as to whether and under what circumstances the grant of excessive security for a debt can be attacked as a fraudulent conveyance has puzzled courts and text writers."

(5) CODE 6-103(1) provides that transfers "made to give security for the performance of an obligation" are not subject to the Code's bulk transfer provisions of article 6. To same effect, CODE § 9-111.

(6) The *Moore v. Bay* area is beyond the scope of this presentation. *See* Kennedy, *The Trustee in Bankruptcy as a Secured Creditor Under the Uniform Commercial Code*, 65 MICH. L. REV. 1419 (1967).

some U.C.C. provisions, see for example section 9-306(4)(d), are seemingly not here pertinent.[73]

(6) There remains section 60! Under defined conditions, the trustee has roll-back powers—he can upset transfers, perfected before the filing of a petition, even though they are not fraudulent conveyances.

### *A. Operation of Section 60*

Section 60a(1) provides:

> Preferred Creditors. a (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

#### ILLUSTRATIVE HYPOTHETICAL CASE

On January 2, 1972, Lendo Bank makes a loan of $100,000 to Zee, a dealer, and takes as collateral a "floating" security interest in all of Zee's inventory consisting of refrigerators, which Zee then owns or may thereafter acquire, and proceeds thereof, under a written security agreement signed by Lendo Bank and Zee. A proper financing statement (short form, complying with section 9-402) is filed the same day in the proper place or places, and covers all of Zee's refrigerators, and proceeds. At this time (January 2) Zee owns $90,000 in refrigerators. Zee thereafter sells refrigerators in the ordinary course of business and from time to time replenishes his inventory. On November 10, 1972, a petition in bankruptcy is filed against Zee. On that date (November 10) Zee has $90,000 in refrigerators, $50,000 of which was acquired by Zee within the four months preceding the filing of the petition, at a time when Zee was insolvent. Zee still owes Lendo Bank the original $100,000. Zee's trustee in bankruptcy concedes that Lendo Bank's security interest is effective and enforceable as to refrigerators owned by Zee before July 10, 1972—the beginning of the four month period prior to the filing of the petition. But, invoking section 60 of the Bankruptcy Act, he contends that refrigerators acquired by Zee within four months of the petition ($50,000) are in a different category. He contends that the attaching of Lendo Bank's security in-

73. For discussion of arguments that various article 9 provisions, including those relating to after-acquired property, may, in bankruptcy proceedings, be inconsistent with bankruptcy provisions regarding statutory liens, priorities, equitable liens, etc., see Countryman, *supra* note 70; 2 GILMORE, *supra* note 7, at ch. 45.

terest to such refrigerators under the after-acquired property clause of the security agreement constituted a preferential transfer since at the time such inventory was acquired by Zee and became subject to Lendo Bank's security interest, Zee was insolvent and the obligation for which such inventory became security was then an antecedent debt. Alternatively, he argues that Lendo Bank's security interest in refrigerators acquired during the four month period was preferential to the extent that additions to inventory during the final four months improved Lendo Bank's security position. (Here, we would have to know what the value of the collateral was on July 10, 1972. If it was $70,000, the trustee's claim would be to the extent of $20,000.)

To give point to his claim, the trustee is able to show that at the time Zee acquired the $50,000 inventory in the final four months, Lendo Bank knew or had reason to believe that Zee was insolvent (section 60b).

To evaluate the trustee's contentions, it is important to determine: (1) *when*, for purposes of section 60(a), the security interest in the $50,000 refrigerators acquired by Zee in the final four months should be deemed transferred to Lendo Bank, and (2) whether at the time deemed transferred, Lendo's security interest in them should be deemed a transfer for an antecedent debt.

"Preference" is defined in section 60a(1) of the Bankruptcy Act—already quoted.

"Transfer" is defined in section 1(30) of the Bankruptcy Act to include transfers of security interests:

> "Transfer" shall include the sale and every other mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by the debtor.

For purposes of applying the tests of section 60a(1) to determine whether there is a preference, the time of transfer is the "deemed" time of transfer. This may be different from the actual time of transfer—in the case of a security interest, the time when the security interest was granted by the debtor to the secured party. Under section 60a(2), transfers of property other than realty are "deemed" to be made when they "become so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of

the transferee"[74]—the lien creditor test, as distinguished from the bona fide purchaser test, applicable to realty transfers. But section 60a(7) modifies the "deemed time" test to a certain extent, in case necessary steps to achieve protection against a potential lien creditor are delayed past the actual time of a transfer, if it is "for a new and contemporaneous consideration." As applied to an article 9 security interest, my reading of section 60a(7) is that if there has been perfection by filing or possession (where such step is required for perfection—section 9-302) within 21 days of the time of the actual transfer of the security interest, the transfer shall be "deemed" to occur when it occurred in fact, even though in the interval the security interest was in jeopardy under section 9-301 of being subordinated to a creditor's lien achieved by levy.[75]

Section 60a(7) continues:

> II. Where compliance with the law applicable to the transfer is not had in accordance with the provisions of subparagraph I, the transfer shall be deemed to be made or suffered at the time of compliance therewith, and if such compliance is not had prior to the filing of the petition initiating a proceeding under this Act, such transfer shall be deemed to have been made or suffered immediately before the filing of such petition.

Determining the "deemed time" of transfer is crucial in applying

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74. Section 60a(2) provides:

> (2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee. If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

75. But where the secured party conspires with the debtor to delay filing in order to deceive the debtor's creditors, there may be a fraudulent conveyance. *See In* re Buschman, 4 UCC REP. SERV. 260 (E.D. Wis. 1967).

Some commercial law experts have difficulty in construing section 60a(7). *See* PROBLEMS OF LENDERS, BORROWERS AND SELLERS *supra* note 9, at 95-100.

The 21 day limit of section 60a(7) seems to apply to the purchase-money security interest, as well as to the non-purchase-money security interest. Section 9-301(2) should not be construed to shorten the time to 10 days. Rather, it gives the purchase-money interest *additional* protection—superiority over attachment liens of creditors and bulk transfers "which arise between the time the security interest attaches and the time of filing." 2 GILMORE, *supra* note 7, § 45.8, at 1325-35, discusses problems.

Herbert Weingarten, Esq., in a letter to author dated April 5, 1974, states that he does not agree with the last paragraph in this footnote.

all of the elements in the test of what constitutes a preference under section 60a(1). Thus, the four months begins to run from the "deemed" time, and it is as of that time that the question of the insolvency of the debtor is to be resolved. Further, delayed perfection can result in a transfer of a security interest for new value being considered a transfer for an antecedent debt under section 60a(7).

Then section 60b provides: "Any such preference may be avoided by the trustee if the creditor receiving it or benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent."[76]

Back to the security interest of Lendo Bank in Zee's inventory, and the claim of the trustee in bankruptcy that Zee's acquisitions within four months of the petition constitute preferential additions to Lendo Bank's security interest. *When* did the security interest "transfer" occur, within the meaning of section 60? Does the Bankruptcy Act require that property be in existence and that the transferor have rights in it before a security interest "transfer" can take place?

Section 9-204 says that a security interest cannot "attach" until the debtor has acquired rights in the collateral. Can a security interest transfer be deemed to occur under section 60 of the Bankruptcy Act at a time before the security interest can "attach" under the U.C.C.?[77]

And, if the security interest transfer, under section 60, should

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76. Section 60c of the Bankruptcy Act provides:

> If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him . . . .

This subsection obviously applies to a case where a seller of goods has been selling to a buyer on unsecured credit, and during the four month period receives from the buyer payments which are preferential under section 60a and recoverable by the trustee under section 60b. If, however, the seller after such payments supplies more goods to the buyer on unsecured credit, the seller may, under section 60c, set off the amount thereof against his liability to the trustee.

Section 60c does not seem to apply to the floating security interest. It is specifically addressed to the unsecured transaction. If the secured party makes a further advance to the debtor during the four month period, it seems that to that extent his security interest is for new value, and is not preferential. Caveat: Further advances to an insolvent debtor are to an indeterminate degree discouraged by section 67d(3) of the Bankruptcy Act.

77. When does a "property" interest emerge? Can a "security interest" in a future "contract right" under article 9 be an immediate security interest in a "general intangible?" Can a security interest in future inventory be a security interest in a present general intangible? *See* 2 GILMORE, *supra* note 7, at 1305-09.

be deemed to take place no earlier than the time the debtor acquired rights in the collateral, is this transfer to be considered for an antecedent debt?

### *B. Section 9-108*

Not content to have section 60 of the Bankruptcy Act applied to security interests in after-acquired property without some assistance in the "right" direction, the draftsmen of article 9, mindful of the interests of the secured party, created a little breeze.

Section 9-108 provides:

> Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property, his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

Obvious ploy: To characterize security interests attaching within four months of debtor's bankruptcy under an after-acquired property clause in a security agreement as not being transfers for an antecedent debt in a broad range of cases and thus knock out section 60 roll-back.[78]

The thought is that what's good for secured party like Lendo Bank redounds to the ultimate benefit of most debtors, like Zee, and unsecured creditors of Zee—more confident lending generates

78. Section 9-108 was, of course, intended to apply in bankruptcy litigation involving section 60—to suggest, if it could not dictate, that within its scope acquisition of collateral by the debtor within four months of the petition did not result in a transfer of the security interest for an antecedent debt.

However, section 9-108 does not purport to apply solely to this situation. It seems to apply to all cases where it is important to determine that a security interest in after-acquired collateral is for "new value."

In two article 9 sections "new value" is explicitly important. Section 9-308 gives special priority to purchasers of chattel paper and non-negotiable instruments under defined conditions, where the purchaser gives "new value." (Section 9-308 (1972) expands the provisions to include all instruments). Section 9-304(4) provides for the temporary perfection without filing or taking possession of a security interest in instruments or negotiable documents "to the extent that it arises for new value given under a written security agreement." Curiously, in neither section does the comment or the references following the comment refer to section 9-108. The comment to section 9-108, however, seems to note its possible application to these two Code sections though its cross-references do not refer to them. Somehow, section 9-108 does not seem to fit the situations covered by these two sections. Section 9-308, for example, seems to focus upon the protection of a purchaser of paper who gives new value directly related to that paper, rather than new value under section 9-108.

funds to keep business going; to pay off unsecured creditors—*n'est-ce pas*?—more fair weather is stirred up than foul.

Be sure you have the top of the page up when reading section 9-108—it's tough enough as it is. Cryptic is the word. English? Translation, please!

Here goes, (for what it's worth):

(1) Section 9-108 does not apply unless there is a security agreement making after-acquired property, as described, collateral. I so interpret the phrase "gives new value which is to be secured in whole or in part by after-acquired property."[79] In doing so, I exclude from the scope of section 9-108 cases where subsequent to the acquisition of such property a security agreement is entered into making such property security for value previously given—in other words, cases where the original security agreement protecting the new value does not cover after-acquired property.

Thus, this reading of section 9-108 would exclude the case where the after-acquired property is made security by a security agreement executed by the debtor concurrently with or subsequent to its acquisition, to protect "new value" previously given, although looking back, the new value previously given in that case also was destined "to be secured in whole or in part by after-acquired property."

The analysis turns on the meaning of "to be secured." Perhaps section 9-108 is a "Serbonian Bog."[80]

(2) Section 9-108 says that if at any time *prior* to the debtor's acquisition of collateral covered by the after-acquired clause the secured party has given "new value" for which the after-acquired property is to be security, the *subsequently* acquired collateral shall be deemed as not taken by the secured party for an "antecedent" debt; but rather for "new value," by relating the acquisition back to the new value given under the security agreement.

(3) That is, provided, the debtor acquires such property "in the ordinary course of his business," or "under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

The last proviso has two prongs or clauses: (1) that relating to acquisitions "in the ordinary course of his business," (2) that relating to enabling advances. It suggests the rationale or purported justification for section 9-108. We are asked to accept the thesis that it is proper to assume that if new value was previously given

79. 1 GILMORE, *supra* note 7, § 11.7, at 362, seems to indicate that section 9-108 contemplates that the security interest in after-acquired property derives from an after-acquired property clause in a security agreement.

80. "A gulf profound as that Serbonian Bog betwixt Damiata and Mount Casius old, where armies whole have sunk . . ." J. MILTON, PARADISE LOST, Book II, 592.

by the secured party, it in some way enabled the acquisition of property subsequently acquired (and made collateral by the security agreement) if the collateral was acquired under one of two circumstances.

### 1. PRONGS OF SECTION 9-108

*a. First prong*

The provision in the first prong of section 9-108 relating to acquisitions "in the ordinary course of his business," rules out certain kinds of acquisitions, and uses language which calls for application on a case-by-case basis. It seems calculated, for example, to deny the secured party the advantage of "new value" treatment with respect to certain last-minute, eve-of-bankruptcy acquisitions by the debtor.[81]

In using this phrase, "in the ordinary course of his business," section 9-108 suggests that the usual application of this prong is to a case where the debtor is in a business where acquisition of after-acquired property is a matter of ordinary course—with some degree of regularity and frequency, perhaps. Obviously, the kind of debtor in the center of the stage is a merchant who deals in goods (inventory) or services, and whose business activities by their very nature generate assets in the form of receivables—for example, accounts—or acquisition of more inventory.[82]

If the after-acquired collateral is acquired by the debtor "in the ordinary course of his business," section 9-108 says you can carry your "new value" forward and apply it to the later acquisition.

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81. The comment to section 9-108 states that "this solution . . . gives other creditors the possibility, under the law of preferences, of subjecting to their claims windfall or uncontemplated acquisitions shortly before bankruptcy."

82. Gilmore suggests that sometimes equipment acquired by the debtor would meet the test:

> [N]ew equipment acquired in replacement of old equipment would also seem to be "in ordinary course," although here it would be possible to draw a distinction between an orderly, scheduled program for replacing old machines as they reach the end of their useful lives and an uncontemplated shift to an altogether different type of machine necessitated by discovery of a new technological process. Equipment used as part of a new venture, which had not been contemplated at the time the loan was made, would seem to lie well beyond the concept of "ordinary course." Section 9-108 also gives a new value status to equipment acquired "pursuant to the security agreement and within a reasonable time after new value is given" even though the acquisition is not made in "ordinary course." We may take the new venture case as an illustration. If the new venture was contemplated when the loan was made and the $100,000 was meant to be used for purchase of the necessary equipment, then the transaction is to be treated as one for new value provided that the actual purchase is not delayed for more than a "reasonable time." This is evidently purchase-money financing without the technical limitations of § 9-107 definitions of "purchase money security interest."

2 GILMORE, *supra* note 7, § 45.6, at 1314.

*b. Second prong*

As to collateral acquired "under a contract of purchase made pursuant to the security agreement,"—the enabling advances prong of section 9-108—the assumption that the new value contributed to the acquisition may be well founded. If the new value given was *actually* applied by the debtor to enable him to acquire rights in collateral he has contracted to purchase "pursuant to the security agreement," a purchase-money security acquisition is indicated (section 9-107). Even if it cannot be *shown* that the debtor applied the new value toward the acquisition, it may not be too much to assume that the acquisition was the result of new value given to the debtor in return for his promise to acquire the property.

### 2. CONCEPT OF NEW VALUE

What is this "new value" that triggers section 9-108?

"New value" is not defined, but examples are given—making an advance, incurring an obligation, releasing a perfected security interest.[83] A more comprehensive effort had been made by the predecessor Uniform Trust Receipts Act:

> 'New value' includes new advances or loans made, or obligations incurred, or the release or surrender of a valid and existing security interest, or the release of a claim to proceeds under Section 10, but 'new value' shall not be construed to include extensions or renewals of existing obligations of the trustee, nor obligations substituted for such existing obligations.

Failure to define "new value" in section 9-108 (or elsewhere in the U.C.C.) invites litigation.

Obviously the draftsmen of section 9-108 had in mind a case where, under a security agreement with an after-acquired property clause, new value, for example a loan, was made at the inception. But section 9-108 raises as many questions as it purports to answer.

(1) Suppose the security interest was given for an obligation which was entirely antecedent to the security agreement. As I read section 9-108, the security interest in after-acquired collateral is not for new value—nor, for that matter, is the security interest in collateral in existence at the making of the security agreement. But

83. Point 2 to the comment to section 9-108 states:
The term "value" is defined in Section 1-201(44) and discussed in the accompanying Comment. In this Section and in other Sections of this Article the term 'new value' is used but is left without statutory definition. The several illustrations of 'new value' given in the text of this section (making an advance, incurring an obligation, releasing a perfected security interest) as well as the "purchase money security interest" definition in Section 9-107 indicate the nature of the concept. In other situations it is left to the courts to distinguish between "new" and "old" value, between present considerations and antecedent debt.

wait—section 9-108 speaks of "new value" as including a case where the secured party "releases a perfected security interest." Suppose after-acquired collateral was considered to be acquired in exchange for the release of collateral already covered by this security agreement? Now do we have new value? If so, the parties would be able to pull themselves up by their own bootstraps.

Something seems amiss. The secured party should not be able to improve his position in this respect; he should have the same position with respect to substitute collateral as he had with respect to released collateral. If, for example, the secured party's position in released collateral was immune to section 60 challenge, his position in the substitute collateral should be likewise immune. Conversely, if his position in the released collateral was vulnerable to section 60 attack, his position in the substitute collateral should be equally vulnerable.

(2) Section 9-108 fails to state that the "deemed" new value associated with after-acquired collateral shall be limited to the amount of new value given pursuant to the security agreement. Suppose, for example, that a security interest is created partly on account of new value—a $50,000 loan made under the security agreement by the secured party—and partly on account of a debt of $50,000 that preexisted the security agreement. Should subsequently acquired collateral be treated as for new value only to the extent of $50,000?

(3) Section 9-108, obviously aimed at saving the after-acquired property security interest from attack as a preference, leaves us bewildered as to whether it should be applied to protect the secured party to the extent of improvement in collateral position in the critical four months before the filing of the petition in bankruptcy. If the collateral jumped from $30,000 to $50,000 in the last four months, and the debt secured was at all times $60,000—what then? If we read section 9-108 literally, the entire $50,000 collateral would be treated as for new value and immune to section 60 attack. But must this be? Is this the best reading?

Even the greatest admirers of terseness should insist that clarity go with brevity to achieve succinctness. Section 9-108 fails the test.

### 3. SECTION 9-108: ILLUSTRATIONS

Try out these examples:

#### EXAMPLE 1

On March 1, 1968, A, a car dealer, borrows $15,000 from B, his friend, on an unsecured basis, and agrees to pay B the sum with interest one year from date. On April 1, 1968, B has become restive, and induces A to give him a security interest in four of A's car inventory, which A now has, and in two which A has ordered, to

protect A's obligation to B. (Section 9-203 is complied with). Proper financing statements are filed the same day. On April 15, A receives the two cars from the manufacturer and pays for them. B has a perfected security interest in the two cars, acquired on April 15, but applying section 9-108, his security interest in them is not for "new value." As I read section 9-108, B never gave new value as "a secured party" since at the time the security interest was created the debt was antecedent. (Would it matter if the security agreement extended the time of the loan? To simplify, assume the security agreement gave no additional advantages to the debtor.) Sure, on March 1, A became indebted to B for a new value loan, but B did not give nor did A get new value for the creation of the security interest on April 1.

EXAMPLE 2

On March 1, 1971, to protect a loan of $100,000 made then by B to A (clothing wholesaler), A gives B a security interest in all of A's inventory, present and after-acquired (summer clothes, held by A for future sale). A proper financing statement is duly filed the same day. On April 4, 1971, while A still has, unsold, all of the original inventory worth $30,000, A acquires $20,000 additional inventory by paying clothing manufacturer cash. B has a perfected security interest in this inventory acquired on April 4, and it is for "new value," according to section 9-108, since new value—the $100,000 loan—was given by B on March 1.

4. JUSTIFICATIONS

Some applications of section 9-108 make good sense, seem to comport with realities—realities in substance, if not in form—by applying an irrebuttable presumption of "new value" in cases where the "reasonable man," endowed with that uncommon virtue called "common sense," would find results reasonably appealing.

Where, for example, collateral subsequently acquired by the debtor may *fairly be viewed* as collateral acquired in substitution for collateral exchanged for it, the new collateral can be viewed as acquired for "new value," at least to the extent that it is of no greater value than the collateral for which it has been exchanged.[84]

EXAMPLE 1

On March 1, B acquires a security interest (non-possessory) in certain collateral worth $10,000 owned by A to secure a loan of $10,000 made at the same time by B to A, and on the same day

84. *See* Countryman, *supra* note 70, at 277. I wish to express my appreciation for the stimulating ideas in HONNOLD, CASES ON SALES AND SALES FINANCING 580-84 (2d ed. 1962).

the security interest is perfected by filing. On March 15, B releases this collateral to A and in exchange A gives B a security interest in other goods worth $10,000 (also covered by the financing statement previously filed). On April 1, a petition in bankruptcy is filed against A. The acquisition of a security interest in the other goods on March 15 was for new value—quid pro quo exchange of collateral. Clearly new value in fact: substitution one for the other. But suppose B had *first* released the original collateral on March 15 and A on March 20 acquired the other goods and *then* gave B a security interest in the other goods? Substitution? Strictly, no. So what? says section 9-108—insistence on strict substitution procedure to establish new value for security interest in after-acquired property pays too much attention to technicalities, and adds costs to lending operations based on floating security interest. Why insist that A and B synchronize releases with acquisitions, or wait until A acquires new before B releases old? The mere fact that B released before receiving replacement collateral should be viewed as inconsequential.

Section 9-205 seeks to unshackle the parties from a legal requirement to follow strict exchange procedures. Accordingly, a relaxed substitution approach, supported by section 9-205, may be viewed as consonant with realities where *subtractions* (by dealer's sale of inventory, or disposal of other collateral) and *additions* to collateral balance out in value, or where additions are less than subtractions.[85]

EXAMPLE 2

Under a security agreement between A and B, covering all A's inventory and proceeds, B had a security interest in a certain item of inventory (and proceeds) perfected (by notice filing) more than four months prior to the filing of a petition in bankruptcy against A. Within the four-month period A sold this item, received cash proceeds and acquired another item of inventory (same value as first) as to which B's security interest attaches under the after-acquired clause in the security agreement. If B is able to show that this item was acquired by A through use of proceeds from the sale of the original item of inventory, B's security interest in the second item of inventory is for "new value"—exchange of collateral—at least to the extent of the value of the original collateral. Here, section 9-108 would simply make it unnecessary for B to trace proceeds into this new item of inventory.

EXAMPLE 3

On March 1, 1970, A gives B a security interest in all of A's in-

85. It seems the substitution-of-collateral theory is a root justification for section 9-108, although in terms it is not expressly limited to situations to which a relaxed substitution analysis would apply. *See* Skilton, *The Factor's Lien on Merchandise—Part II*, 1955 WIS. L. REV. 608, 648 n.114.

ventory, present and future, and proceeds, to secure a loan made at the same time by B to A of $50,000. The security agreement permits A to sell to buyers in ordinary course of business, and requires A to pay on the loan a proportion of receipts from sales. The security agreement also makes provision for discretionary future advances. Financing statements (covering inventory and proceeds) complying with section 9-402 are filed in the proper places (section 9-401). A reduces inventory by subsequent sales, makes payments on loan, acquires new inventory, and B makes further advances to A from time to time. B's last advance was on June 2, 1970. On December 12, 1970, a petition in bankruptcy was filed against A. Evidence established the following:

1. Value of inventory August 12, 1970: $40,000.
2. Sales from inventory in succeeding four months: $50,000.
3. Additions to inventory in succeeding four months: $50,000.
4. Value of inventory at time of filing petition: $40,000.

Section 9-108 steps in. It says the security interest in inventory collateral existing on date of bankruptcy was all for new value. As applied to the facts, relaxed substitution theory would explain the result.

Note further that all inventory collateral owned by A on August 12, 1970 (beginning of four-month period) was, of course, safe from section 60 attack. Question: was any of *this* inventory on hand December 12, 1970? If so, no problem *as to it.* But if the inventory items are not separately identifiable, it may be impossible to say *how much* of December 12 inventory was *August 12* inventory, and how much was inventory acquired subsequently. Section 9-108 would prevent the secured party's loss of right through failure to identify.

But who has to prove what? The trustee in bankruptcy cannot get off the ground and launch his attack unless *he* can establish what assets were acquired by the debtor during the four month period, according to Ford, J., in *Rosenberg v. Rudnick.*[86]

> Furthermore, assuming that there was a preference, plaintiff (the trustee in bankruptcy) has not been able to show with any reasonable certainty what the amount of the preference is. Concededly, insofar as the inventory taken over by defendant (the secured party) on October 24, 1962 consisted of items included in the inventory on April 30, 1962 or acquired by Boyle (the debtor) thereafter, *but more than four months before the filing of the petition, there was no preference* (emphasis supplied). On trustee's own theory there was a preferential transfer only as to items of inventory acquired by Boyle during the four month period. There was no evidence to show when any

86. 262 F. Supp. 635 (D. Mass. 1967).

item in the October 24 inventory was acquired. Plaintiff argues that here the court should consider the inventory as a whole rather than individual items, and that if it can be shown that there was an increase in the total value of the inventory between certain dates within the four month period this increase in value should be attributed to goods acquired during that period, and that a preference to the extent of the increased value of the inventory has been shown.[87]

(Held, that plaintiff's circumstantial evidence was not sufficiently probative: "these computations would not furnish an adequate basis for determining with any reasonable accuracy the amount of the preference which would exist if plaintiff's contentions were correct").[88]

The "relaxed substitution" view, if accepted, can take care of all cases where the aggregate value of items of collateral is no *greater* when the petition in bankruptcy was filed than it was at the outset of the prior four-month period to which section 60 applies—perhaps even though it can be shown that at some time in the four-month period the collateral had dipped toward zero and was subsequently increased.

But the "relaxed substitution" theory, even if accepted, may be unacceptable in some situations.

EXAMPLE 4

Suppose in example (3), immediately above, A's inventory had *increased* from $40,000 on August 12, 1970 to $50,000 on December 12, 1970: isn't the extra $10,000 more than substitution? Even the relaxed substitution rationale can take you so far and not further.

5. ENTITY THEORY

Sooner or later, in defense of section 9-108, we can expect reference to the "entity" theory of the floating security interest, *inclusively* covering a type or types of fluid assets—principally inventory and accounts. In creating a security interest in *all* the debtor's inventory, present and future, the parties to the security agreement perhaps are emphasizing the *oneness* of the collateral, and not the separateness of the individual items that from time-to-time constitute the mass. On this premise we are asked to see the forest and not be distracted by the trees.[89]

87. *Id.* at 640.
88. *Id.*
89. Judge Ford, writing the leading opinion in *Rosenberg v. Rudnick*, referred to the "entity theory." The metaphor-producing potency of the entity theory is demonstrated by Mr. Haydock's description of Judge Ford's opinion:

In support of this, he quoted Judge Magruder's statement in an earlier case in New Hampshire [Manchester Nat'l Bank v. Roche, 186

Changes in commercial law can bring about changes in business practices (and vice versa).

Under the permissive influence of article 9, notably section 9-205, there is evidence of changing practice in accounts receivable financing—a shift away from item-by-item treatment to bulk treatment:

> As pointed out in the amicus brief of the National Commercial Finance Conference, many lenders making loans secured by a revolving pool of collateral have dispensed with the assignment of individual receivables and the use of special cash collateral accounts for receiving and disbursing the proceeds therefrom. This flexible method of financing, with its minimum cost, is authorized by Section 9-205 of the Code, which abrogates the state law "debtor dominion" rule of Benedict v. Ratner, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 991, and would be jeopardized if financing institutions had to insist on individual assignment of after-arising accounts receivable.[90]

The point is that sometimes the entity theory comports with the way the parties conduct their financing relationship; other times, it may seem to some to be a poetic flight into things extraterrestrial.

Surrealistic or not, the entity theory seems to find its proper domain only where the security interest is an "inclusive" one, *i.e.*, in *all* of the debtor's assets of a certain kind or kinds. But on their face, the provisions of section 9-108 do not apply solely to inclusive security interests: the security interest may be in particular, less-than-all-of-a-kind, items of present and after-acquired property.

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F.2d 827 (1st Cir. 1951)] in which he had discussed the possibility that inventory and receivables might be regarded as an entity in which you had a continuing right—a single entity which, even though it was changing, was changing no more than a horse changes as far as the makeup of the horse over a period of time. So this is still the same inventory. On this Mississippi River or entity-type doctrine, Judge Ford bolstered his finding that the transfer occurred prior to the four month period.

PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 8, at 102. Observe how Mr. Haydock switches the metaphor from horse to river—you might say, changes horses in mid-stream. Indeed, reference to the entity theory magnet-wise attracts a superabundance of metaphorical posies, with delightful results from the minting of mixed metaphors.

My own piling up of metaphors in the above line may amount to gilding the lily—or should I say "painting the lily," which my colleague, Gordon Baldwin, reminds me comes from Shakespeare—(King John Act IV, Scene ii)

> To gild refined gold, to paint the lily,
> To throw a perfume on the violet,
> To smooth the ice, or add another hue
> Unto the rainbow, or with taperlight
> To seek the beauteous eye of heaven to garnish
> Is wasteful and ridiculous excess.

Does article 9 reject the entity theory? *See* 2 GILMORE, *supra* note 7, at 1307-08, discussing Gordon's views in 1 P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS, ch. 11 (1963).

90. Grain Merchants of Ind., Inc. v. Union Bank & Sav. Co., 408 F.2d 209, 216, 6 UCC REP. SERV. 1, 11 (7th Cir. 1969).

### 6. RELATION OF SECTION 9-108 TO SECTION 60 OF THE BANKRUPTCY ACT

None of the above justifications, however, was sufficient in the opinion of some law analysts to validate the broad-brush strokes of section 9-108 in its application to its principal target, section 60 of the Federal Bankruptcy Act.

They raised the following objections:

(1) The question of antecedent debt was strictly a federal question; section 60 did not look to state law for guidelines with respect to this concept.[91]

(2) Bankruptcy decisions had not recognized the "relaxed substitution" view, but on the contrary had insisted that release of collateral must succeed or be concurrent with acquisition of new collateral, to establish that the new acquisition was not for an antecedent debt.

(3) There was no authority in the Bankruptcy Act for the so-called entity theory. In fact, what authority there was was to the contrary.

(4) No transfer could take place within the meaning of section 60 before the debtor acquired rights in the property.

The controversy, pro and con, was aired in many law review articles. Pro-section 9-108 people came up with many ingenious arguments to combat all of the above points. Time has run out; it is idle now to rehash.

But looking back, the anti-section 9-108 people reckoned against the weight of probabilities. A new day was dawning. The U.C.C.'s sun was rising. It had become fashionable to be associated with a grand enterprise. Sure, article 9 was pro-secured party, anti-unsecured creditor. But here was a product of important people not only in financial circles and in the practice of law, but in law schools as well—should the courts stand in the way?

Yes, the anti-section 9-108 people lost in the litigation that ensued—but lost in a peculiar way. Lost, not because section 9-108 was found to be a valid interpretation of section 60 of the Bankruptcy Act, but because the courts (to date anyway) have reshuf-

91. Charging the draftsmen of article 9 with "delusions of grandeur," Professor Countryman contends that section 9-108 is a presumptuous attempt to dispose of the question of when a transfer is for an "antecedent debt," and that while in some instances the Bankruptcy Act looks to state law in applying its rules, the question of antecedent debt is a purely federal question. Countryman, *supra* note 70, at 276. This article may be viewed as one of the last salvos of the dissenters to section 9-108. It should be read as explanatory of all of the objections stated above in the text and more. *See also* Hogan, *Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing*, 53 CORN. L. REV. 553 (1967); Kennedy, *supra* note 70.

fled the deck, and have found reasons which had not been heretofore recognized, at least explicitly, in their decisions.

### C. *Avoiding Section 9-108: Judicial Treatment of Section 60*

And now for the decisions, and there have been a good many of them. How has section 9-108 fared in bankruptcy litigation? Answer: the section 9-108 transaction has fared well; courts have referred to section 9-108 deferentially, but have typically upheld the after-acquired property security interest in bankruptcy without depending on section 9-108.

Courts have held that the "deemed time of transfer" of the security interest in after-acquired property for purposes of section 60, dates back to the time of filing, for from that time on, no lien creditor of the debtor could have subordinated the security interest. Dating the transfer back to the time of filing has removed the deemed transfer point to a time before the four months, thus making section 60 inapplicable. Objections based on the argument that no "transfer" can take place before the debtor acquires rights in after-acquired assets have been dismissed.[92]

Additionally, courts have sometimes relied on an entity theory or relaxed substitution approach to find that a security interest in after-acquired assets was safe from section 60 as not being a transfer for an antecedent debt.

The obvious strategy is to avoid the need to pass upon the question whether section 9-108's new value concept conflicts with section 60.

#### 1. DUBAY V. WILLIAMS

*DuBay v. Williams*[93] was perhaps the most influential case in its reliance on the proposition that the deemed time of transfer occurred at the time (before the four-month period) when the filing took place, for it was then that the security interest in after-acquired property created by the security agreement became "so far perfected" that no subsequent lien creditor could subordinate it under state law. (section 60a(2) of the Bankruptcy Act).

These bankruptcy proceedings were the aftermath of "the short and turbulent life of the Portland Reporter," a newspaper started in 1960, owned and run by a publishing corporation newly organized by unions which had struck the two dailies which had occupied the field in Portland. On November 22, 1963, the publishing cor-

92. Referee Snedecor's opinion in the *Portland Newspaper* case turned out to be a last salute to tradition. 3 UCC REP. SERV. 209 (1966). *See also* Countryman, *supra* note 70, at 277, where he describes the dating back approach as "the Abracadabra, or the Transfer Occurred Before it Occurred Theory."

93. 417 F.2d 1277, 6 UCC REP. SERV. 885 (9th Cir. 1969).

poration granted a floating security interest to Rose City, another corporation owned by the unions, covering the newspaper's accounts receivable to secure a loan of $45,000 made on November 16, 1963, and another of $10,300 made on November 22, 1963. Perfection was achieved by filing on November 26, 1963. Subsequently, the publishing corporation entered into a security agreement with DuBay, also covering some of its accounts receivable, and Rose City consented to subordination. A financial crisis came in February 1964. In an effort to straighten out the problems a new publishing corporation, Portland Newspaper Publishing Co., Inc. (the bankrupt) was organized, and the former corporation was merged into it. The new corporation took over the assets and assumed the liabilities of the old. Another person, Davis, pumped money into the new corporation by buying shares until September 1964. He also guaranteed a bank loan to the new corporation, and was protected by a security agreement involving some of the accounts receivable of the newspaper. Again Rose City agreed to subordinate its interest, this time to Davis.

The end came in the last days of September 1964. The newspaper ceased publication. Rose City, DuBay, and Davis, acting in concert, collected $107,000 from the account debtors. Within four months bankruptcy proceedings were instituted.

After affirming the decision of the district court that the collections, as far as DuBay and Davis were concerned, were voidable preferences,[94] the Court of Appeals for the Ninth Circuit proceeded to consider Rose City's claim.[95]

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94. Because their security interests in after-acquired collateral did not attach automatically, but were dependent on the selection of collateral.

95. Objections of the trustee that these accounts receivable were generated by the *new* corporation, which had *not* entered into a security agreement with Rose City (though it *had* assumed the old corporation's obligations, which may have sufficed) and further, that no new financing statement had been filed against the new corporation as debtor, were dismissed because raised only on appeal.

Effect of change of debtor's name: the 1972 amendments add subsection (7) to section 9-402 providing, *inter alia*,

> where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time.

To implement this provision, the 1972 version provides that in such case a financing statement signed only by the secured party suffices (section 9-402(2)(d)). Under the 1962 version, a logical argument can be made that no new filing is required, since no provision is made in such case for a financing statement signed only by the secured party. As to collateral already owned by the debtor prior to change of name, the better view may be that no new filing is required. However, questions can arise, particularly when after-acquired collateral is involved, acquired by a debtor under a changed name. *See, e.g.*, Borg-Warner Acceptance Corp. v. Bank of Marin, 13 UCC REP. SERV. 939 (Cal. Ct. App. 1973); *In re* GAC, 11 UCC

This claim, it was found, was based on a perfected security interest in the accounts receivable and proceeds. The question, in the

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REP. SERV. 412 (W.D. Mich. Ref. 1972); *In re* The Grape Arbor, Inc., 6 UCC REP. SERV. 632 (E.D. Pa. Ref. 1969). *See also In re* Pasco Sales Co., Inc., 354 N.Y.S.2d 402, 14 UCC REP. SERV. 1059 (1974) where under the facts the secured party without further filing seems to have been protected, even as to collateral acquired after the change of name. One expert attorney meets the situation under the 1962 version by advising that in all cases where change of debtor's name is known to the secured party a new financing statement should be filed (assuming the debtor's signing can be obtained.) There are plenty of questions under the 1962 U.C.C. *If* some new filing is necessary, should it take the form of an amendment to the original financing statement, or a new U.C.C.-1? Or, is either okay? If some new filing is necessary, does it follow that, as to collateral acquired by the debtor in an interim period between date of change of name and date of new filing, the security interest is unperfected? This would seem a harsh result, especially where the secured party did not immediately know of the debtor's change in name. Sometimes a court can wriggle out by concluding that in a particular case the change of name was not seriously misleading. *See* Borg-Warner Acceptance Corp. v. Bank of Marin, *supra*. In any event, one can hardly be happy with the gap in the 1962 code—a gap which the 1972 version tries to fill. Robert Haydock, Jr., the expert attorney referred to above, states (letter to author, November 20, 1974):

> I think there is very little choice between amending the financing statement and filing a new one. I am confident that filing the new one gives one as much protection as filing an amendment, relying in particular on Section 9-303(2). If this is an ongoing financing arrangement, the new financing statement extends the period of the original filing and assures that a searcher will find a filing whether he searches under the old name or under the new name. He would receive further assistance if the new filing refers back to the original filing, so I would include such a reference even though I do not think it is required.
>
> On the issue of whether an amendment or a new filing is required at all, I enclose an excerpt from the brief of the Permanent Editorial Board in the *Dubay v. Williams* case, a brief of which I was the principal author.

This excerpt from the brief is must reading for attorneys concerned with the problem, and argues that there was certainly no need to refile under the facts of the case. Caution: wherever a novation is involved, substituting a new debtor for the original debtor, it would seem that a new filing is required against the new debtor. *In re* Vieth's Inc., 9 UCC REP. SERV. 943 (E.D. Wis. 1971). *But see* CODE § 9-402(7) (1972). More than a "change of name" may be involved, where the original debtor, a natural person (Kuhn, D.B.A. "Vieths") subsequently incorporates ("Vieths, Inc.") and transfers all of his assets to the corporation in return for stock. In such case, it has been held that a secured party, who knows of and consents to the transfer, "waives his lien," and must obtain a security agreement from the transferee, and file against the transferee, to have further protection. *In re* Vieth's Inc., *supra*. *See also* Burnett v. H.O.U. Corp. decided October 9, 1974 by the 6th circuit court of appeals, 43 U.S.L.W. 2163, holding that where at the time of the making of the security agreement the secured party knew that the debtor contemplated a certain change of name—"to protect his security interest, the secured party must insure that the filing not only discloses the current and correct name of the debtor, but also reflects the pending name changes" or, it seems, file an amended statement once the change occurs. *See also In re* Kalamazoo Steel Process, Inc., 15 UCC REP. SERV. 571 (6th Cir. 1974).

I am not too happy with this footnote, but am inclined to think that the 1962 U.C.C. is at least partly responsible for the fact that I am somewhat

view of the court, was when the transfer to Rose City of the security interest in the accounts arising within the four-month period should be deemed to have taken place, for purposes of applying section 60 of the federal Bankruptcy Act. While state law (the U.C.C.) provided that the debtor has no right "in an account until it comes into existence," (1962 version), and that a security interest cannot attach until the debtor has rights, the court declared these provisions not dispositive of the federal question. It was a matter of ascertaining the intent of Congress: the legislative history of section 60 revealed to the court that

> Congress intended to achieve two aims: (1) to prevent an insistent creditor from harvesting more than his fair share of the insolvent's assets by obtaining transfers from the debtor on the eve of bankruptcy, and (2) to discourage extension of credit to debtors under circumstances which concealed from general creditors the precarious financial condition of the debtor.[96]

With this in view, and convinced of the importance of "accounts receivable financing . . . to the business community, particularly small businessmen," it was declared that the deemed time of transfer provisions of section 60(a)(2) served to date the time of transfer for purposes of section 60 to the time when the filing had taken place (November 26, 1963), for from that time no lien creditor of the bankrupt could have obtained a superior right under state law (the U.C.C.).[97]

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confused by the bewildering set of problems that may fall within the loose heading of change in debtor's name.

Effect of change in debtor's business activities: suppose there had been a single filing with the Secretary of State, at a time when the debtor has two places of business in the state (alternative 3, section 9-401(1)(c)). Subsequently, before the acquisition of after-acquired property covered by the security agreement, the debtor abandons one location. Does this result in the security interest being unperfected as to the subsequently acquired property, by reason of failure to file at the county level? In other words, does the time of attaching determine the efficacy of the filing? *See* BENDER'S U.C.C. SERVICE, SECURED TRANSACTIONS 511, cited in *In re* Pelletier, 5 UCC REP. SERV. 327, 333 (D. Me. Ref. 1968), criticizing the time of attaching approach as unrealistic and harsh. Bender, recommending double filing at the outset to avoid this possibility, comments "[t]o the secured creditor double filing is a nuisance, but no more than a nuisance." Referee Cyr comments (*In re* Pelletier, 5 UCC REP. SERV. 327, 333 (D. Me. Ref. 1968):

> The fact is that a substantial part of the problem presented results from the failure of the Code, for any of several reasons, to provide for central filing exclusively. In some instances a system providing exclusively for central filing could present burdens to the searcher. However, there appears considerable reason to suppose that political considerations operated as an important factor in the widespread decentralization of filing in some jurisdictions. *E.g.*, Bender's U.C.C. Service, Secured Transactions 510.

96. DuBay v. Williams, 417 F.2d 1277, 1288, 6 UCC REP. SERV. 885, 898 (9th Cir. 1969).

97. *Id.* at 1289, 6 UCC REP. SERV. at 900.

To some critics, this application of section 60a(2) may seem ironic and surprising. They may have thought of section 60a(2) as a measure designed to move the deemed time forward from the actual time of transfer to the time of perfection—to make it clear that a relation-back theory may not be used to save a late-perfected security interest. Here we see the court moving the deemed time backward—well before the time of attachment of the security interest, which under the U.C.C. is the earliest time for perfection (section 9-303).

The opinion continues with arguments based on equities:

> Rose City's floating lien on accounts receivable was easily ascertainable by any creditor who cared to look at the financing statement. After the financing statement was filed, no creditor could reasonably have been misled into believing that Rose City's receivables could provide assets to which he could look to satisfy debts incurred for subsequent extensions of credit. Neither the Bankrupt nor Rose City took any affirmative action to obtain for Rose City a favored position over other creditors of its class during the four months before bankruptcy . . . .
>
> If we read Section 60a(2) the way the trustee asks us to do, we would defeat, not implement, Congress' intent, and we would impair, not promote, the intent of the draftsmen of the Uniform Commercial Code to make security transactions conform to the legitimate needs of commerce, rather than to the common-law lawyer's wish for conceptual nicety.[98]

In an interesting discussion of the case, Professor Henson defends the decision:

> Billions of dollars are outstanding in loans against accounts, and the loans are both legal and necessary. It was undoubtedly loans by friendly persons which kept the Portland Newspaper going as long as it did. That some security was necessary to obtain the loans is self-evident. The debtor in *Portland* could never have qualified for an unsecured bank loan, which the referee thought was a desirable business practice; nor could the debtor have acquired a place to publish the paper free and clear of mortgage debt, which the referee also approved as a cushion for claims. Times have changed and so have social policies; so has the law.[99]

A footnote to the opinion shows that the court believed that

98. *Id.* at 1289, 6 UCC REP. SERV. at 899-900. The same Ninth Circuit (another panel) was later obliged to eat some of its words. It upheld against preferential attack an after-acquired security interest in general intangibles, which was under a special California amendment to article 9 perfected without filing. *In re* Nunnemaker Transportation Co., 456 F.2d 28, 10 UCC REP. SERV. 468 (9th Cir. 1972).

99. R. HENSEN, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 178 (1973).

"[t]he intent of the draftsmen to insulate Rose City's security interest from preference attack is evidenced by § 9-108 of the Uniform Commercial Code."[100] In other words, the court considered that its decision was consistent with section 9-108. Whether it was correct in so concluding will be considered soon: the point now emphasized is that *DuBay v. Williams*, in the mind of the court, was backed up by section 9-108.

However, the route the court took that made it unnecessary to determine whether security interest acquisitions during the final four months were for "new value," as says section 9-108 in certain cases, was a dangerous route. Its backdating rationale, *i.e.*, "transfer" occurs at the time of filing, seemed to contain no restriction on improvement in the collateral position of the secured party in the final four months. In fact, it could conceivably be applied to uphold the after-acquired property security interest in situations obviously not condoned by section 9-108, as where a security interest was *created* in the final four months to secure a theretofore unsecured antecedent debt.

A recent case, *In re Wilco Forest Machinery, Inc.*[101] seems to carry the "logic" of *DuBay v. Williams* to its ultimate and beyond. During the final four months before the filing of a petition in bankruptcy, a creditor of the bankrupt, exercising its voting power as shareholder in the bankrupt corporation, achieved the issuance of secured debentures to itself, thereby transforming a previously unsecured debt of $617,000 owed by the bankrupt to it, into a secured debt. This security interest was perfected by a filing which had been made more than a year previously. Was there a preference? No, held the Court of Appeals for the Fifth Circuit:

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100. By holding that the DuBay and Williams claims were invalidated by section 60, sufficient assets were made available to pay priority claimants in full. Thus the wage claimants seem to have been taken care of. The view expressed by Referee Snedecor that upholding the security interests would be inequitable because it would be at the expense of wage claimants seems to have lost its operative force as applied to the case.

Perhaps Rose City won a hollow victory.

The opinion states:

> The validation of Rose City's security interest and the invalidation of the claimed security interests of Dubay and Davis to which Rose City's security interest had been expressly subordinated raises the questions: (1) Did Rose City and the Bankrupt intend that accounts theretofore assigned to Dubay and Davis would become part of Rose City's security if either or both of the DuBay and Davis security interests were invalid? (2) To what extent, if at all, may the trustee preserve the senior DuBay and Davis claims for the benefit of the estate? Neither of these questions was decided below. The questions were raised before the Referee, but they were not resolved, because the Referee's invalidation of all three claims made the decision of the questions moot. The questions are to be resolved upon ultimate remand to the Referee.

DuBay v. Williams, 417 F.2d 1277, 1289, 6 UCC REP. SERV. 885, 900-01 (9th Cir. 1969).

101. 491 F.2d 1041, 14 UCC REP. SERV. 849 (5th Cir. 1974).

> (The transfer of a security interest) is "equated with the Act by which priority over later creditors is achieved and not with the event which attaches or perfects the security interest in a specific item of property." 446 F.2d at 730. Therefore, the transfer of a security interest in after-acquired property occurs when the secured party completes the filing requirements under the Code. In this case, that occurred on April 15, 1970, which is more than four months before the filing of the petition for bankruptcy on July 17, 1971. Therefore, the statutory requirements for a preference are not met here.[102]

As Vergil would have said, *Mirabile dictu*!

### 2. GRAIN MERCHANTS

The simplistic approach of *DuBay v. Williams* contrasts with the more cautious do-not-put-all-your-eggs-in-one-basket approach of the Seventh Circuit in *Grain Merchants of Ind. v. Union Bank & Sav. Co.*[103] Decided shortly before the *DuBay* case, *Grain Merchants* also did not rely on section 9-108 to achieve the result.

Grain Merchants was in the business of buying and selling grain and feed ingredients. Union Bank from time to time advanced up to 60 percent of the amount of Grain Merchant's accounts receivables, under a security agreement dated September 17, 1965, which gave Union Bank a security interest in all of Grain Merchant's accounts arising out of sales, to secure all loans which Union Bank might make. There was proper filing of a proper financing state-

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102. *Id.* at 1046-47, 14 UCC REP. SERV. at 856. No distinction was made as to collateral already owned by the debtor at the time of the issuance of the new debentures, and collateral subsequently acquired by the debtor. This would seem to be error. As to property already owned by the debtor at the time of the execution of the security agreements (*i.e.* the new debentures) the back-dating approach cannot be applied, because up to the time this property was made security, the property was subject to the reach of a lien creditor. A mere filing would not suffice. True, this property was already collateral under the old debentures, but creditors could reach the debtor's interest—section 9-311—and it was only when this was absorbed by the new debentures that the deemed time of transfer under section 60a(2) occurred. As to property acquired by the debtor after the issuance of the new debentures, the deemed time of transfer could be related back to the time of filing, since there never was a time with respect to such assets when a lien creditor could prevail.

The court went on summarily to dispose of another troublesome question:

> Gordon next argues that the transfer of WFM assets to Eaton is voidable as a fraudulent transfer under 11 U.S.C. § 107(d). Under the King-Porter case, however, the transfer involved here occurred when the filing requirements were met, which was over a year prior to the filing of the petition for bankruptcy. Therefore, it was too remote in time to constitute a fraudulent transfer under 11 U.S.C. § 107(d).

*Id.* at 1047, 14 UCC REP. SERV. at 856.

103. 408 F.2d 209, 6 UCC REP. SERV. 1 (7th cir.), *cert. denied*, 396 U.S. 827 (1969).

ment. Thereafter, Grain Merchants would deposit the collections from accounts in the Union Bank and Union Bank permitted withdrawals by Grain Merchants to take care of its business needs. On October 27, 1966, Grain Merchants filed a petition in bankruptcy. The trustee in bankruptcy sought to have Union Bank ordered to turn over all collections from accounts arising after September 20, 1966—the last time Union Bank had extended new value to Grain Merchants.[104] A total of $45,324.00 was involved. Union Bank had applied this amount to satisfy the debtor's obligations under the security agreement.

The Court of Appeals for the Seventh Circuit affirmed the district court's decision in favor of the Union Bank. Points made in the opinion, by Cummings, J.:

(1) "The transfer" (of the future accounts arising after September 20, 1966) "occurred a year before bankruptcy," *i.e.* in September 1965, when the security agreement was made and proper filing had occurred. At that time, the security interest in the future accounts "became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract would become superior to the rights of the transferee"—section 60a(2) of the Bankruptcy Act. Such interpretation, it was asserted, is in keeping with the policy and purpose of section 60.

(2) Alternatively, "the transfer was not for an antecedent debt." Herein, of the entity theory:

> In holding that the post September 20, 1966 accounts receivable were part of an entity, it follows that they were transferred when the financing statements were filed in September 1965. Since the transfer preceded the extension of credit with which we are concerned here, such transfer could not have been made "for or on account of an antecedent debt" under Section 60a(1) of the Bankruptcy Act.[105]

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104. *See id.* at 213-15, 6 UCC REP. SERV. at 9-11. On the total indebtedness for which the Bank claimed a security interest in the accounts, $100,596 was on account of an advance on September 20, 1966, and about $51,000 on account of advances in December 1965 represented by two notes. Since all collections on accounts in existence on September 20, 1966 were less than the $100,596 advanced on September 20, 1966, "[t]he Referee [in bankruptcy] held that because these accounts receivable arose on or before September 20, the bank's lien on these accounts receivable did not attach [for or] on account of an antecedent debt . . . ." *In re* Grain Merchants of Ind., Inc., 286 F. Supp. 597, 600, 5 UCC REP. SERV. 884, 887 (N.D. Ind. 1968).

As to collections from accounts arising subsequent to September 20, 1966, the Referee held that the transfers took place at the time they came into existence and were preferential, being for an antecedent debt, etc., and found that at the time of transfer the Bank had 'reasonable cause to believe' that Grain Merchants was insolvent. Hence, he ruled that the trustee had a better right to collections from such accounts. *Id.* at 600-01, 5 UCC REP. SERV. at 888-89.

105. Grain Merchants of Ind. v. Union Bank & Sav. Co., 408 F.2d 209, 217, 6 UCC REP. SERV. 1, 11 (7th Cir. 1969).

(3) "The substitution of collateral doctrine negates any preference here."

[7] Under the Bankruptcy Act, it is well settled that a transfer by an insolvent debtor within four months of bankruptcy is not a 'preference' where the transfer to the creditor is 'for a substantially contemporary advance.' Dean v. Davis, 242 U.S. 438, 443, 37 S. Ct. 130, 61 L. Ed. 419. If such a transfer does not deplete the estate, it is not made "on account of an antecedent debt," nor does it have the effect of enabling the creditor "to obtain a greater percentage of his debt than some other creditor of the same class." (Section 60a(1) of the Bankruptcy Act. 11 U.S.C. § 96(a)(1). See 3 Collier on Bankruptcy para. 60.20 (14th ed. 1968)).

[8] Here as existing accounts receivable were collected by Grain Merchants and deposited to its accounts at the Bank, the funds from previously collected accounts were made available to the debtor, enabling it to continue in business and obtain new accounts receivable. During the critical period from September 20 when the Bank last extended value until September 30 when Grain Merchants ceased doing business, the debtor's withdrawals appear generally to have been in line with the deposits from new accounts receivable. See Appendix to this opinion. Our study of this record shows that at the end of each of the four months preceding bankruptcy, there was an excess of collateral over secured debt, indicating that collateral was regularly transferred in substitution for other collateral without diminishing the bankruptcy assets available for creditors. Here the newly arising accounts receivable may be considered as having been taken in exchange for the release of rights in earlier accounts and for a present consideration. Since the relative positions of the Bank and the debtor were unaltered by the exchanges, the debtor's other creditors cannot be considered harmed by the transactions with the Bank. [footnote omitted].

As previously observed under Section 9-205 of the Commercial Code, it was unnecessary for the Bank to assume dominion over individual accounts receivable. Therefore, it is no longer appropriate to apply strict timing or value rules so long as at all relevant times the total pool of collateral, as here, exceeded the total debt. The trustee's purported distinction of In Re Pusey, Maynes, Breish Co. on this ground is thus unpersuasive. In this connection, it is noteworthy that amendments to Section 60 of the Bankruptcy Act have been submitted by a committee of the National Bankruptcy Conference so that transfers of receivables, pursuant to a security agreement, within four months of bankruptcy will not constitute preferences if they arose in the ordinary course of the debtor's business. But under a proposed two-point test, there will be a preference to the extent that the aggregate value of the receivables subject to the security agreement on the date of fil-

> ing the bankruptcy petition exceeds the aggregate value subject to the security agreement four months earlier. The preference is measured by reference to these two points of time regardless of the fluctuations of the collateral that might occur in the 4-month period. See Kohn, "Preferential Transfers on the Eve of the Bankruptcy Amendments," 2 Prospectus 259, 261 (1968). This two-point test does not require a detailed tracing of individual accounts receivable. Here the pool of accounts receivable was remarkably steady in aggregate value through the entire period of the security agreement (see Appendix), justifying the applicability of the substitution of collateral principle to these facts. Hence, for this additional reason we conclude that there was no forbidden preference.[106]

(4) "It is not necessary to decide whether Section 9-108 falls before the superior command of federal law as contained in Section 60a of the Bankruptcy Act."

> We would be reluctant to hold that the Congressional reference to state law in Section 60a does not encompass the provisions of the Code, now adopted in 49 states and enacted by Congress for the District of Columbia and which has been recognized to be a valuable source for determining federal commercial law (United States v. Wegematic Corp., 360 F.2d 674, 676 (2d Cir. 1966); United States v. National Optical Stores, 407 F.2d 754 (7th Cir. 1969)). However, there is no need to resolve any asserted conflict, for Section 9-108 is unnecessary to the result reached here. That Section merely attempts to codify as state law the substitution of collateral doctrine, which is implicit in the provisions of the Bankruptcy Act, with the additional safeguard that such substitution arise in the ordinary course of business.[107]

(5) A point made by the Permanent Editorial Board (amicus curiae brief) "is not considered, because not presented in the District Court" (quaere: is this a good reason for not considering it?).

> The Permanent Editorial Board for the Uniform Commercial Code asserts that the accounts billed after September 20, 1966, were proceeds of inventory owned by Grain Merchants on that date, and in which the Bank therefore (sic) held a non-preferential security interest. From this it is argued that the Bank's security interest in the proceeds of that collateral was also non-preferential.[108]

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106. *Id.* at 217-18, 6 UCC REP. SERV. at 11-13. *See also* Phelps v. National Acceptance Co., 7 UCC REP. SERV. 56 (M.D. Ala. 1969); *In re* Portland Newspaper Publishing Co., Inc., 271 F. Supp. 395, 3 UCC REP. SERV. 209 (D. Ore. 1967) as examples of placing stress upon the point that under the facts there was no substantial improvement in collateral position and that section 9-205 is in keeping with a relaxed substitution approach.

107. Grain Merchants of Ind. v. Union Bank & Sav. Co., 408 F.2d 209, 218, 6 UCC REP. SERV. 1, 13-14 (7th Cir. 1969).

108. *Id.* at 218, 6 UCC REP. SERV. at 14.

(Note on this quote: I was puzzled by the "therefore" in the quote, and concluded that this was a typographical-error way of saying "theretofore." Telephonic consultation with one of the persons on the Brief for the Permanent Editorial Board confirms my conclusion. Reconstructing the argument: we gather that the secured party held a perfected floating security interest *in inventory*, as well as accounts.[109] Two points can then be made: (1) the language of section 9-306(2), that the security interest "continues" in proceeds, leads to dating back the proceeds security interest to the deemed date of transfer of the security interest in inventory (September 1965); (2) in any event, acquisition of a proceeds right upon sale of inventory-collateral amounts to an exchange of collateral—a substitution—for new value,[110] and is protected as such from section 60, at least to the extent that the value of the secured party's security has not been increased by the attaching of his claim to the proceeds.

### 3. INFLUENCE OF THE PERMANENT EDITORIAL BOARD

This survey would not be realistic without noting the possibility that courts, in arriving at results often consistent with section 9-108 (though not, it is true, usually depending upon it), may be persuaded to the result through the interpositions of outsiders to the litigation with impressive credentials. An amicus brief filed on behalf of the Permanent Editorial Board of the Uniform Commercial Code may have tipped the scales in *DuBay v. Williams* and also in *Grain Merchants*. The influence of such appointed guardians of the mysteries of the Code may be gratefully and obeisantly received by courts suffering from an inferiority complex, struggling through a jungle of strange statutory language. Thus we observe that the Massachusetts Commissioners on Uniform State Laws filed a brief as amici curiae in *National Cash Register v. Firestone & Co., Inc.*[111] taking the position that "there need be no reference to after-

109. That this was so is revealed in the opinion of the district court: At the same time, Grain Merchants also executed in favor of Union Bank a second security agreement which granted the bank a security interest in inventory. *In re* Grain Merchants of Ind., Inc., 286 F. Supp. 597, 599, 5 UCC REP. SERV. 884, 886 (N.D. Ind. 1968).

110. *See* EXAMPLE 2 in text accompanying note 85 *supra*. In a 1974 decision, the Seventh Circuit held that the back-dating, substitution and entity theories approved in *Grain Merchants* could not protect a secured party, who in the final 10 days before the filing of a petition in bankruptcy had received payments out of cash proceeds deposited in the debtor's general bank account, in excess of cash proceeds received by the debtor in the last 10 days (section 9-306(4)(d)). Fitzpatrick v. Philco Finance Corp., 491 F.2d 1288, 14 UCC REP. SERV. 12 (7th Cir. 1974). The trustee made claim only for the overage received in the last 10 days. The secured party apparently retained unchallenged prior payments. Moral: The "floating lien" does not float smoothly into cash proceeds, at least where bankruptcy occurs.

111. 346 Mass. 255, 191 N.E.2d 471, 1 UCC REP. SERV. 460 (1963).

acquired property in the financing statement."[112] And in *Norton v. National Bank of Commerce*,[113] it is stated:

> we requested amicus curiae briefs from Joe C. Barrett and Harry E. Meek, for which we are grateful. Mr. Barrett states that the Permanent Editorial Board of the Uniform Commercial Code makes its services available to appellate courts when the interpretation of the Code is in issue. Members of the Permanent Board assisted Mr. Barrett in the preparation of his brief.[114]

*DuBay v. Williams* and *Grain Merchants* set the pace; from this time on, the chances of trustees in bankruptcy are dim.

Most decisions to date have concerned floating security interests in inventory or accounts.[115] In only one case so far decided (as

112. *Id.* at 258, 191 N.E.2d at 473, 1 UCC REP. SERV. at 463.

113. 240 Ark. 143, 398 S.W.2d 538 (1966).

114. *Id.* at 145, 398 S.W.2d at 539.

> Professor Braucher. This may be the place to mention the problem we have had, because the National Cash Register story is one of the first cases where the people who sponsored the Code actually went in and meddled in other people's lawsuits. People like the people in this panel had gone around Massachusetts saying that the answer was that you did not have to say in the financing statement 'now owned or hereafter acquired.'
>
> It looked as though the point were going to be given away by the private litigants in that case. At that point we filed 'a brief as a friend of the Court.'
>
> We caught a violent response: 'Stop meddling in other people's lawsuits.' I was very sympathetic with the response. The public interests come in and file a brief as a friend of the Court and, unless the Courts have lost their minds or something, that is the side that wins. That is what happened in that case. The private party with the opposite view did not have a chance.
>
> Now, the national sponsors have announced as a program that they are ready to come in and meddle in other people's lawsuits where interpretation of the Code is concerned. I regard it as a terribly dangerous thing. But in this particular case we had to do it, because otherwise they would have upset an important interpretation.
>
> Professor Kripke. I think it is awfully dangerous to meddle where facts are in dispute, but it seems to me, if the Code is to be uniform and worthwhile at all, that it is a legitimate function of the sponsors. I do not know how many times I have found an issue of the kind that was of greatest importance to me and my client, then all of a sudden two lawyers out in Ohio who did not see the issue were taking the case to the Circuit Court and producing an opinion that left everybody else in consternation. Peter [Coogan] and I are both thinking of when that happened in Ohio, and the issue was contractual subordination that had a tremendous effect on enormous financial interests in Boston and New York. I am sure the lawyers in Ohio did not have the faintest idea of the issues of the case they were briefing. I think that an amicus is a legitimate function, although I also see some dangers in it.

PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 9, at 13-14.

115. Cases involving the after-acquired property interest under article 9 versus section 60 include: Safeway Stores, Inc. v. Coss Fidelity Corp., 266 Ore. 1, 511 P.2d 345, 12 UCC REP. SERV. 1221 (1973); *In re* Nunnemaker Transportation Co., 456 F.2d 28, 10 UCC REP. SERV. 468 (9th Cir. 1972); Owen v. McKesson & Robbins Drug Store, 11 UCC REP. SERV. 455 (N.D. Fla. 1972); *In re* King-Porter Co., 446 F.2d 722, 9 UCC REP. SERV. 339 (5th Cir. 1971);

far as known) has the trustee been able to establish that additions in the section 60 four-month period resulted in a substantial increase in collateral over value of collateral at beginning of four month period (*In re World Wide Perfume, Inc.*).[116]

In upholding the security interest in after-acquired collateral, the courts have, of course, done so at the expense of unsecured creditors of the debtor—the second class citizens in bankruptcy distribution. Consider, for example, *Rosenberg v. Rudnick*[117] and *In re Portland Newspaper Publishing Co.*,[118] (which on appeal is *DuBay v. Williams*), the former involving, *inter alia*, a floating security interest in inventory, the latter in accounts.

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Biggins v. Southwest Bank, 322 F. Supp. 62, 8 UCC REP. SERV. 1319 (S.D. Calif. 1971), *modified*, 490 F.2d 1304, 13 UCC REP. SERV. 928 (9th Cir. 1974); *In re* World Wide Perfume, Inc., 7 UCC REP. SERV. 616 (M.D. Ala. 1969); Phelps v. National Acceptance Co., 7 UCC REP. SERV. 56, (M.D. Ala. 1969); Grain Merchants of Ind. v. Union Bank & Sav. Co., 286 F. Supp. 597, 5 UCC REP. SERV. 884 (N.D. Ind. 1968), *aff'd*, 408 F.2d 209, 6 UCC REP. SERV. 1 (7th Cir. 1969), *cert. denied*, 396 U.S. 827 (1969); *In re* White, 4 UCC REP. SERV. 972 (S.D. Ohio 1967); *In re* Portland Newspaper Publishing Co., Inc., 271 F. Supp. 395 (D. Ore. 1967), *aff'd, sub nom.* DuBay v. Williams, 417 F.2d 1277, 6 UCC REP. SERV. 885 (9th Cir. 1969); Rosenberg v. Rudnick, 262 F. Supp. 635 (D. Mass. 1967); *In re* Newkirk Mining Co., 1 UCC REP. SERV. 468 (E.D. Pa. 1962). *In re Nunnemaker* is notable for the fact that although perfection was in that case achieved without filing by virtue of a California amendment dispensing with filing for "general intangibles," the Ninth Circuit followed *DuBay v. Williams* and upheld the security interest in after-acquired property. The dissent contended that the collateral was not general intangibles but accounts, despite the fact that this point had not been raised. The *Safeway Stores* case applied the approach to after-acquired security interests in receipts from milk deliveries.

> A sidelight on the by-pass approach: the power of a lawyer's brief: "In the *Portland* case, which was decided after *Rosenberg v. Rudnick* and in which Judge Solomon had the benefit of that case, the credit for that decision goes to the man who wrote the brief in the *Rosenberg and Rudnick* case, because Judge Solomon accepted lock, stock and barrel the position that Judge Ford had taken. He went further, though, and discussed the question of substitution of collateral."

PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 9, at 103.

Perhaps Mr. Haydock is unduly modest: see Judge Solomon's compliment to him in *In re* Portland Newspaper Publishing Co., 271 F. Supp. 395, 403 (D. Ore. 1967).

116. 7 UCC REP. SERV. 616 (M.D. Ala. 1969). In this case it appeared that the secured party had reason to believe that the bankrupt was insolvent during the entire four-month period, and that during this time the secured party advanced only 55 percent of the value of accounts acquired by the debtor, using the other 45 percent to build up the reserve account, which had been depleted, thus improving his position during the four months to the extent of $38,869. Nevertheless, the secured party was held not to have received a preferential transfer. Reason: under the entity theory, the transfer took place (upon filing) prior to the commencement of the four-month period. *See* Kennedy, *Secured Transactions*, 26 THE BUS. LAW. 1211, 1221 (1971).

117. 262 F. Supp. 635 (D. Mass. 1967).

118. 271 F. Supp. 395 (D. Ore. 1967).

In *Rosenberg*, the unsecured creditors who suffered by the decision against the trustee apparently included unsecured suppliers of inventory to the bankrupt. It may have caused them vexation to see the assets they had supplied appropriated to the claim of a secured party under an after-acquired property clause. They were beneficiaries of the court's consoling advice that they could have reserved a security interest and obtained special priority under section 9-312(3). But *DuBay v. Williams* involved unsecured creditors including wage claimants who had section 64 priority claims totaling $43,000. The accounts involved were advertising and circulation accounts—generated through the activities of the wage claimants in running the newspaper. Even had they bargained for a security interest, they could not have obtained special priority, since they could not have acquired a "purchase money interest" in the accounts. Should respect for the floating security interest come ahead of concern for wage claimants?[119]

At least some unsecured creditors and trustees in bankruptcy cannot be expected to endure without complaint the sweeping protection accorded to a security interest in after-acquired property.

### *D. Section 9-108 Revisited*

Thus most courts to date have not been relying upon section 9-108, with its "new value" approach, but have found some other reason, such as backdating the deemed time of transfer under section 60a(2) of the Bankruptcy Act, to sustain the security interest in after-acquired property against section 60 attack. However, section 9-108 has obviously been on their minds. Though cleverly sidestepping the issues involved in section 9-108, they typically seem to derive real comfort from the belief that their decision arrives at the same result that would have been achieved by direct application of section 9-108. In other words, they seem pleased with the idea that they are "in good company." Behind that section was the weight of the Code and the large Code coterie, loudly proclaiming,

119. Wage claims are important in bankruptcy. *See* Countryman, *supra* note 70, at 269. Judge Snedecor, the referee, in ruling that the floating security interest in accounts held by Rose City was invalidated by section 60, had made a point of the fact that upholding it would be at the expense of wage claimants. R. HENSON, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 177-78 (1973) picks this up and states:

> This is the nub of the case. These transactions must be found to be invalid so that the erstwhile employees may get more money. But put in terms of a social problem, it was not quite so simple in the *Portland* case. The wage claimants were strikers who started the defunct newspaper in competition with their former employers, while Rose City Development Company, Inc., the principal Code secured party involved, happened to be a corporation formed by 88 labor unions to provide a building for the strikers to use. Moreover, part of the funds Rose City had lent on a secured basis perhaps went to pay the strikers-employees whose work generated the accounts, which secured the capital that may have paid the workers.

ala W.S. Gilbert's Lord Chancellor, that it is "the true embodiment of everything that's excellent." Would *Rosenberg v. Rudnick, DuBay v. Williams, et al.* have been decided in favor of the secured party, had it not been for section 9-108?[120]

Trouble is, once you take the position that the "transfer" is backdated to the date of filing (*DuBay v. Williams*)[121] so as to take it out of the four-month period, and thus sidestep direct resort to section 9-108, you may end up condoning some transactions which section 9-108 was not designed to protect.

### 1. THRUST OF SECTION 9-108

What is meant is this: section 9-108 describes a situation: (1) A security agreement involving personal property, with an after-acquired property clause. (2) New value given pursuant to the security agreement. (3) Property subsequently acquired, covered by the security agreement. (4) Acquisition either "in the ordinary course of business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given." This is the model of the section 9-108 transaction.

The strategy of section 9-108 for preserving this security interest in bankruptcy is to relate the "new value" previously given to the acquisition of the security interest in after-acquired property. But this is a rationale—it is not part of the model.

To the extent that a court refers to section 9-108 as supportive

120. The first case (and that makes it the leading case) taking the backdating route was *Rosenberg v. Rudnick*, 262 F. Supp. 635 (D. Mass. 1967)—Judge Ford's opinion in that case set the pace. After resting his decision in favor of the secured party on his construction of section 60a(2), the opinion continues:

> Another Section of the Uniform Commercial Code, § 9-108, presents a different approach to the problem. It provides [quoted]. This Section would produce the same result in the present case. Assuming that, as trustee contends, no transfer would take place until each specific item of inventory was acquired by the debtor, under § 9-108 it would be deemed to have been made for new value rather than as security for an antecedent debt and hence would not be a preferential transfer. The validity of this provision has been questioned. Under the Bankruptcy Act the definition of what constitutes an antecedent debt is not one to be determined by state law. The Bankruptcy Act itself does not define antecedent debt. In view of the fact that the Uniform Commercial Code has now been adopted by 48 states, it would seem that the definition of § 9-108 should be regarded as generally accepted and in accord with current business practice and understanding and hence applied in bankruptcy. In any event, even if the definition adopted by § 9-108 is not accepted, the section clearly shows that the intent of the Uniform Commercial Code is that a transfer such as the one involved here should not be considered a preferential one, and the Code's provisions as to perfection and attachment of security interests should not be interpreted to produce a different result.

*Id.* at 638-39. (Judge Ford also invoked the entity theory to support his decision.)

121. 417 F.2d 1277, 6 UCC REP. SERV. 885 (9th Cir. 1969).

of its decision—even if it only derives comfort from the idea that its decision is compatible with section 9-108—the spotlight shifts back to section 9-108. Let us now look at how *courts* are interpreting it, drawing comfort from it, as distinguished from the puristic question of how it *should* be interpreted.

The spotlight falls upon a foggy terrain.

Statutory provisions such as section 9-108 with a mystifying vagueness of language expectedly can engender equally mystifying applications.

Section 9-108 is hard reading. A court may feel that it has caught the spirit of section 9-108 without attention to niceties.

*When* a court will consider section 9-108 as bearing on the issue, and *how* it will interpret its language, cannot be predicted with a large degree of assurance.

### 2. PROBLEMS WITH IMPRECISE APPLICATIONS OF SECTION 9-108

Section 9-108 can create a climate; induce a judicial disposition of approval and acceptance of a secured party's claims upon after-acquired collateral which may tend to save the interest from section 60 attack, with little concern for the fact that section 9-108 may have certain built-in limitations.

For example, in *DuBay v. Williams*,[122] it appeared that Rose City had made a loan to the debtor corporation in the amount of $45,000 six days before it entered into a security agreement with the debtor. This was the major obligation, for which its security interest in after-acquired collateral was sustained. Although new value ($10,300) was given by secured party pursuant to the security agreement, the $45,000 loan was not. Perhaps a true reading of section 9-108 would endow the security interest in after-acquired property with new value only to the extent of $10,300. For at the time of the making of the loan of $45,000, as far as we know, this new value was not, in the language of section 9-108, "to be secured in whole or in part by after-acquired property," but was rather made on an unsecured basis. Perhaps, therefore, section 9-108 spreads its protective mantle over this security interest in after-acquired property only to the extent of $10,300.

The point that section 9-108 may not apply to the $45,000 advance was passed over in *DuBay v. Williams*.

Similarly, *In re White*[123] seemed to assume that section 9-108 applied to a security interest in subsequently acquired assets to protect a debt antecedent to the security agreement. It appeared that on November 8, 1965 the parties, SuperValue, a supplier, and White, a grocer, entered into a security agreement covering all of White's

122. *Id.*
123. 4 UCC REP. SERV. 972 (S.D. Ohio 1967).

inventory (groceries) and proceeds. At that time, White owed SuperValue $5,000 on previous bills, which amount he thereafter continued to owe. The necessary steps to perfect were taken. After November 8, (when the security agreement was signed) the parties went on a weekly cash basis and no new credit was extended to White. On June 4, 1966 all cash was taken from the debtor's cash registers (proceeds from the sale of inventory) and turned over to SuperValue.

Petition in bankruptcy was filed on August 10, 1966. The referee held that a preferential transfer had taken place on June 4, 1966.

> If the secured creditor be permitted to take the cash found in the cash register and apply it to a debt that existed seven or eight months prior, despite what it might be deemed to be under Revised Code 1309.06 [9-108] it is in fact and truth the application of money toward the payment of an antecedent debt.[124]

His ruling was reversed by the district court. The terse opinion observed "U.C.C. § 9-108 does not permit the evil which Section 60 seeks to prevent."[125]

But to the extent that the security interest protected the antecedent debt of $5,000, against which the cash proceeds were applied, where was the "new value" that section 9-108 requires?

(Of course, the secured party's collections resulting from cleaning out the cash registers two months before bankruptcy could have been held nonpreferential to the extent that such cash represented proceeds from the sale of collateral owned by the debtor prior to the four-month period, or acquired in the four months in substitution for such collateral. This would be so, despite the fact that the $5,000 obligation against which the collections were applied was at the time of the security agreement not for new value, but for an antecedent debt.)

In *Biggins v. Southwest Bank*,[126] it appeared a bank had acquired security interests in the dealer-debtor's used cars under a series of security agreements, each listing certain cars as security. Seven used cars were covered by security agreements executed *within four months* of the filing of the petition in bankruptcy.[127] These cars were repossessed and sold by the secured party *"on account of balances due prior to August 15, 1967"*[128]—the beginning of the four-month period (emphasis supplied).

The basis of the secured party's right to apply the proceeds from the sale of these cars to *prior* indebtedness is not explained in the

124. *Id.* at 975.
125. *Id.* at 974.
126. 322 F. Supp. 62, 8 UCC REP. SERV. 1319 (S.D. Cal. 1971).
127. *Id.* at 64 n.6, 8 UCC REP. SERV. at 1322 n.6.
128. *Id.* at 69, 8 UCC REP. SERV. at 1328.

opinion. There are two possibilities: (1) *Prior* inventory security agreements may have contained after-acquired property clauses, making the seven cars, as after-acquired property, collateral for the obligations (new loans in this case) covered by the prior security agreements. If such were so, section 9-108 would be clearly applicable. The execution of subsequent security agreements covering the seven cars *after* acquisition by the debtor might have simply been a needless carry-over of a pre-U.C.C. practice—confirming a security interest that had already been created. (2) The prior security agreements may not have had after-acquired property clauses. This would readily explain why the parties made a series of security agreements. If this was the case, (a subsequent inspection of the record in the case revealed that it was),[129] the after-acquired collateral would be security for prior obligations only because the subsequent security agreements creating the security interests in the seven cars *made these cars collateral for prior obligations.*

In other words, after-acquired property can be made security for a prior obligation in one of two ways: (1) by an after-acquired property clause in the original security agreement, or (2) alternatively, by a later security agreement made after the property is acquired, making it security for the preexisting obligation.

### 3. QUESTIONABLE EXTENSIONS OF SECTION 9-108

The second situation, it is submitted, is *not* within section 9-108. That section deals with the case when new value is given "which *is to* be secured in whole or in part by after-acquired collateral." A fair construction of this language refers to the case where the security agreement *under which the new value* is given provides that later acquisitions of the described collateral shall be security. This language should not be read to include the case where after-acquired property is made security *after* the new value has been given (the second situation).

And yet the district court in *Biggins* was perhaps not minded to make such distinction under the facts of the case. Rather, it seems to have taken the view that the series of security agreements should be treated the same in effect as if there were but one over-all security agreement, with the result that there was an over-all security interest in the debtor's inventory *as an entity.*

> Construing all of the documents together, and particularly the provisions of the dealer agreement, it is apparent that the security interests should be viewed as secured by a single entity, a floating lien. While each contract was

129. Thanks to the courtesy of William G. Ward, III, Esq., of San Diego, California, one of the attorneys in the case, I have seen the exhibits and confirmed the point that the security agreements were limited to listed automobiles and did not contain after-acquired property clauses.

> evidenced by a specific promissory note, there was a single debt covered by the security interest even though the items of property changed from time to time. Under Section 9-108 the security interest of the bank, upon the acquisition of each specific item of property by the debtor, would be deemed to have been made for new value rather than as security for an antecedent debt and hence would not be a preferential transfer.[130]

The court's summary of the "automobile dealer agreement" which launched the relationship does not refer to any language which would make subsequently acquired cars security for the inventory loans contemplated.[131]

*Biggins* perhaps exemplifies a not surprising judicial impatience with intricate problems of statutory construction raised by section 9-108, a tendency to fuzz over analytical refinements, where the substantive merits of distinction-making may not be readily apparent. A thought emerges from reading *Biggins*: some courts may view the conduct of the parties manifested by making a series of security agreements as adding up to a course of dealing which is the substantial equivalent of acting under an over-all security agreement. *Result*: Security interest in an entity—the totality of the debtor's inventory. No need to stress presence or absence of after-acquired property clause, if *entity* is the collateral.

If the district court opinion in *Biggins*[132] leaves one gasping, it is a symphony of clear thinking when compared with the Ninth Circuit's opinion on appeal. That opinion argued that since the filed financing statement "contemplated" the use of inventory as security, (the financing statement said "collateral" was "sales and service of new and used automobiles") the result was a "floating lien"—sanctioned by section 9-204 of the U.C.C., with its provisions

130. 322 F. Supp. 62, 69, 8 UCC REP. SERV. 1319, 1328-29 (S.D. Cal. 1971).

131. The court states:

> The provisions of this agreement are not essentially different from those contained in suggested Form 9:1310 entitled 'Agreement between Automobile Dealer and Bank under Which Dealer Guarantees Performance of Conditional Sale Contracts Purchased From It by Bank' in 'Uniform Commercial Code Forms and Materials' by Henson and Davenport, 5 U.L.A. 295.

*Id.* at 63 n.1, 8 UCC REP. SERV. at 1320 n.1.

> This form is for chattel paper financing not floor planning. I have examined a copy of the contract (Exhibit E-1) and find nothing in it providing for inventory financing or purporting to give the bank a security interest in the dealer's inventory. It was not until about two months later that a financing statement (construed by the court to cover car inventory) was filed (December 6, 1966). In light of their existing relationships, it is doubtful that the parties intended the financing statement to apply to inventory financing. The financing statement described the collateral as "sales and service of new and used automobiles." One could read this as covering the assignment of claims against customers arising out of the debtor's selling and servicing transactions—for example retail conditional sales contracts.

132. 322 F. Supp. 62, 8 UCC REP. SERV. 1319 (S.D. Cal. 1971). Appliance Distributors equals Mills Morris Company.

as to security interests in after-acquired property. Applying *DuBay*, the opinion seems to conclude, the "transfer" of the security interest in all of the dealer's cars inventory occurred on December 16, 1966—the date of the filing of the financing statement.[133] But there was in fact no floating lien, no security agreement covering after-acquired property. There was only a financing statement plus various security agreements on certain listed cars. The opinion's failure to distinguish between the function of a notice-type financing statement (such as the one in the case was) and the function of a security agreement makes the opinion useless or worse. It was the subsequent security agreements covering enumerated cars that created the security interests, *not* the financing statement. It was not enough that the financing statement gave notice to third parties of the *possibility* that the person named as secured party might have a security interest in all or some of the car inventory of the person named as debtor.[134]

133. 490 F.2d 1304, 1309-10, 13 UCC REP. SERV. 928, 935 (9th Cir. 1974).

134. The trustee's contention was that the Bank had not perfected its security interest in any cars held by the dealer as inventory because of the alleged insufficiency of the financing statement, in failing to identify inventory as being covered. This contention was rejected by the district court, whose position was sustained on appeal—the financing statement, it was held, adequately gave notice that cars might be covered. (No special contention was made by the trustee with respect to the seven cars, first made security in the last four months). In addition, the trustee specially contested the Bank's position with respect to six demonstrators, covered by conditional sales contracts assigned to the Bank, in which the dealer was both seller *and* buyer. How could any assignable security interest arise from such transaction, the trustee argued. But as to these cars, the opinion on appeal contends, the Bank could fall back on its prior position as holding a security interest in the dealer's inventory by virtue of its filed financing statement:

> The financing statement filed in December 1966 perfected a security interest in the inventory collateral set forth within the description, *and* in the "[p]roceeds of [the] above described original collateral in which a security interest was perfected." Therefore, any proceeds received in exchange for the disposition of the original collateral, including that which was received in exchange for the conditional sales agreements pertaining to the six demonstrator models, was subjected *to the continuously perfected security interest established in the original inventory collateral by the financing statement* [emphasis added]. The end result thus created a second security interest (a purchase money security interest) in favor of Southwest Bank, as the secured party, which, however, was subordinated to the prior security interest in the inventory collateral which continued notwithstanding the conditional sales agreements' dispositions.

*Id.* at 1311, 13 UCC REP. SERV. at 937-38. In vain did the petitioner expostulate in his request for a rehearing: "As part of the court's opinion, again dealing with the six demonstrators, it reasons from a beginning assumption that the six demonstrators came out of inventory. There is no factual basis for the court to draw that conclusion. In order for the six vehicles to become part of the inventory, there must be a security agreement creating that interest. The court refers [*Id.* at 1311, 13 UCC REP. SERV. at 937] to the fact that the December, 1966 financing statement initially referred to Peterson Ford's inventory, by implication. However, a security interest is not created by a financing statement. Financing statements only assist in

In summary: any attempt to fit the situation in *Biggins* into section 9-108, (as the district court tried to do) seems unwarranted. Protection of the Bank's interest in the seven automobiles which were first made security within the last four months on account of an antecedent debt must rest upon an unadorned (and perhaps fallacious)[135] application of the back-dating tactic in *DuBay v. Williams.*

Another case indicating the possibility/probability that courts will fuzz over refinements in section 9-108 is *In re King-Porter Co.*[136] It appeared that on February 14, 1969 a security agreement was entered into between Appliance Distributors, a distributor of air conditioners, and King-Porter, retail dealer, under the terms of which King-Porter gave Appliance a security interest in all of King-Porter's air conditioner inventory, present and future, to secure any and all obligations that might be owed by King-Porter to Appliance. The security interest was perfected by filing on February 25. From time to time, thereafter, Appliance made various sales to King-Porter on credit, and each time a sale was made, an agent of Appliance, acting under a power of attorney that had been conferred by King-Porter in the February security agreement, signed a note and trust receipt in the name of King-Porter. On June 5, 1969, a petition in bankruptcy was filed by the debtor. Soon, trustee in bankruptcy versus Appliance Distributors. Now this is what the case is all about: On March 28, 1969, during the four-month period before the date of bankruptcy, the debtor had bought *on open account* 112 air conditioners from Kelvinator, the manufacturer. Of course, Appliance's security interest attached to these conditioners, under the after-acquired property clause of the February 14, 1969 security agreement, and it was perfected as soon as it attached, by virtue of the earlier filing. And of course section 9-108 applied, since "new value" had been given (goods supplied by Appliance on credit at various times in the past). But as far as these extensions of new value were concerned, they were apparently already adequately secured or paid off; so on this state of affairs the trustee could have counted on the 112 air conditioners as being available for liquidation on behalf of unsecured creditors. Where collateral for which new value has been given remains intact and adequate to protect existing indebtedness, what does it matter how section 9-108 attempts to characterize additional after-acquired collateral? Secured party has only a security interest: when he's paid off, excess collateral is freed for benefit of unsecured creditors. So far so good for the trustee—*but.* On April 15, Kelvinator had appointed Appliance its sole distributor in Mississippi, and in return Appliance had assumed liability for all of Kelvinator's unpaid cus-

establishing priorities. The security interest must be created by a security agreement."

135. *See* note 102 *supra.*

136. 446 F.2d 722, 9 UCC REP. SERV. 339 (5th Cir. 1971).

tomer accounts in that state, including King-Porter's obligation to pay for the 112 air conditioners, and became an assignee of these accounts. Thus, King-Porter became indebted to Appliance as the assignee of this account, and for this indebtedness all of the debtor's inventory, including the 112 air conditioners, was security under the terms of the February 14, 1969 security agreement. Observe how an *unsecured* obligation (bankrupt's debt to Kelvinator) became a *secured* obligation upon assignment to a secured party with a floating security interest.

Appliance took possession of most of these 112 air conditioners shortly before bankruptcy. The trustee contested Appliance's rights in them. Reversing the district court, the Court of Appeals for the Fifth Circuit decided in favor of Appliance. Appliance had acquired, so it was held, a *purchase money security* interest in these 112 air conditioners, by becoming liable to Kelvinator on April 15 for the purchase price. This is certainly a highly controversial application of section 9-107, for the debtor had *already* acquired title to the air conditioners on March 28, 1969, when Kelvinator sold them on open account.

If Appliance *really* supplied the funds to enable the debtor to acquire the 112 air conditioners, Appliance's security interest rights in the conditioners would have been acquired for a most obvious form of "new value," and the transfer would have been immune from section 60. But what actually happened was merely a substitution of one creditor for another, in a transaction to which the debtor was not a party. Appliance stepped into the Kelvinator transaction to serve its own, and not the debtor's business purposes. Consideration flowed from Appliance to Kelvinator, and not to King-Porter. Debtor was no better off than before. A substantial amount of property which before April 12 was available for claims of general creditors, is now asserted to be beyond their reach. The policy and purpose of section 60 would have been supported if the transfer to Appliance had been treated as for an antecedent debt, *insofar as Appliance sought to apply the collateral toward the Kelvinator obligation.* Before April 15—assets available to trustee—112 air conditioners. After April 15—No 112 air conditioners—incoming funds—0.

Under certain conditions, it is a form of fraudulent conveyance for a person to lend money on a secured basis to an insolvent debtor for the purpose of enabling that debtor to prefer some creditor over others (section 67d(3) of the Bankruptcy Act). The *reason* behind that rule may perhaps be appropriate to what happened in *In re King-Porter.*[137]

Apparently not content to rest its decision solely on a holding

137. For discussion of King-Porter, see Kennedy, *Secured Transactions*, 27 THE BUS. LAW., 755, 769 (1972).

that Appliance had a purchase-money security interest in the air conditioners (hence no antecedent debt under section 60), the court invoked section 9-108:

> While it is true that transfers not made for present consideration are *generally* [emphasis supplied] classified as having been on account of an antecedent debt . . . [citing cases] . . . Section 9-108 of the Code provides . . . [quoting]. The critical issue then is whether the Bankruptcy Act collides with Section 9-108 of the Code.
>
> The Uniform Commercial Code has been adopted in all but one state. It should generally be considered as the federal law of commerce—including secured transactions . . . [citing cases]. Thus Section 9-108 should be read in harmony with the Bankruptcy Act if at all possible. Furthermore, Section 9-108 is generally accepted and in accord with current business practice and understanding and hence should be applied in bankruptcy proceedings. *Rosenberg v. Rudnick*, *supra* 262 F. Supp. at 639 [4 UCC REP. SERV. at 13]. There exists no legally valid reason, absent a contrary command in the Bankruptcy Act, why the disposition of creditors' claims in bankruptcy proceedings should not also be in accord with current business practice and understanding. As so aptly stated by Judge Solomon in *In Re Portland Newspaper Publishing Co.*, D. Ore. 1967, 271 F. Supp. 395 [4 UCC REP. SERV. 533]: "Good business practice should be good business law." *Id.* at 400 [4 UCC REP. SERV. at 538].
>
> In keeping with this view, the bankruptcy courts *must recognize the general validity of claims based on security interests created by after-acquired property clauses* [emphasis supplied]. Cf. *Irving Trust Co. v. Allen*, 7 Cir. 1959, 272 F.2d 197, 200. No inference can be drawn from the evidence in the record that the transfer favored claimant over other creditors. Claimant's security interest in the property was easily ascertainable by any creditor who examined either of the financing statements on file with the Mississippi Secretary of State and the Hinds County Chancery Clerk. After the financing statements were filed, no creditor could have been misled into believing that bankrupt's inventory could have provided assets with which to satisfy debts arising out of extensions of credit. *Dubay v. Williams*, *supra* at 1289. Moreover, potential creditors could have protected themselves, if they so desired, by perfecting a purchase money security interest under Section 9-312(3). [Could they? Depends on kind of creditor.][138]

In the *King-Porter* case, the court's suggestion that section 9-108 approves the result may miss the mark. The basis of section 9-108 is the giving of new value. It should follow that the attaching of a security interest to property acquired subsequent to the giving

138. 446 F.2d 722, 731-32, 9 UCC REP. SERV. 339, 352-53 (5th Cir. 1971).

of new value should be deemed as for new value only *to the extent of the new value* given. In *King-Porter*, the secured party's need for and claim upon the 112 air conditioners stemmed from this assumption of liability to Kelvinator, owner of an unsecured claim, and not on account of the fact that secured party had prior thereto given new value as a supplier of certain other items of inventory. Granted, the secured party's assumption of an obligation to Kelvinator to pay the price of the goods already supplied by Kelvinator to King-Porter on unsecured credit could be considered "new value,"[139] and granted, too, that new value given after the collateral was acquired by the debtor (as here) should stand on as good a footing at least as *new value* given *before* the acquisition of the collateral by the debtor, though it is only the latter that section 9-108 talks about. Still, there remains the question as to whether this type of barging-in activity of Appliance Distributors, whereby a previously unsecured obligation was switched to a secured obligation,—involving a "new value" of no apparent benefit to the debtor or to his estate—is the kind of transaction that section 9-108 condones.

Perhaps the most important question has been passed by in this discussion. Should the obligations clause of the security agreement be construed so as to cover an obligation so unrelated, it seems, to the purposes of the security agreement? The Wisconsin Supreme Court, for one, might hold that it should not.[140]

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This attempt to compare the courts' approach of by-passing section 9-108, with the kinds of transactions seemingly described by section 9-108, may seem without further explanation to be merely academic.

What difference does it make?

It may be presumed that section 9-108 emerged because the draftsmen had a certain set of values in mind, believed that their statute was grounded on economic and social values.

No doubt, it was perceived that if you clipped the last four months' acquisitions from a floating security interest, you might emasculate it. Thus, to give assurance to a certain kind of floating security interest in after-acquired property (as described in section 9-108), it should be immunized from section 60 attack.

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139. In fact, the comment to section 9-108 suggests that the section is confined to cases where the new value was at the "inception": "*First*, the secured party must, at the inception of the transaction, have given new value in some form." Perhaps this is too narrow a reading. It should suffice if the "new value" is given at any time prior to the acquisition of the collateral covered by an after-acquired property clause.

140. John Miller Supply Co., Inc. v. Western State Bank, 55 Wis. 2d 385, 199 N.W.2d 161 (1972).

Of course, we do not know whether the section 9-108 model transaction (which at best is dimly seen) represented the limits of the draftsmen's view of acceptability, or simply the area in which they believed they could operate to persuade a bankruptcy court.

The same economic and social considerations which presumably influenced the creation of section 9-108 were obviously in the minds of courts upholding the security interest in after-acquired property. The opinions in the critical cases, *DuBay v. Williams*,[141] for example, seem to rely upon such concepts of values as a final defense.

The by-pass route—that is, backdating the deemed time of transfer to take the transactions out of the four-month period—seems to be merely a means to an end: a convenient way to overcome a legal hurdle. If it were not for the asserted realistic justification, the idea that a "deemed time of transfer" could occur before specific property was acquired would seem to be a smoke screen to many more than it does now.

The basic question is, what are we trying to do? What kinds of transactions are to be supported by law? Are there times when the by-pass route should not be taken to uphold a security interest in after-acquired property?[142] Should exceptions be made?

### 4. IN SUM

1. Courts have generally not expressly relied upon section 9-108 in upholding the after-acquired property security interest under section 60 of the Bankruptcy Act.

2. However, there is little or no doubt that they would not have decided the way they did, save for section 9-108.

3. Being thus attentive to the ideas of section 9-108 they should have borne in mind that section 9-108 has two sides, its condoning side, and its noncondoning side.

4. Decisions to date seem to pay no attention to section 9-108's noncondoning side.

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141. 417 F.2d 1277, 6 UCC REP. SERV. 885 (9th Cir. 1969).

142. I think I find myself in good company. 2 GILMORE, *supra* note 7, § 45.6, at 1313-14 states:

> The point about § 9-108 is that it provides, as a rule of state law, that two types of interest in after-acquired property are not to be considered as security taken for an antecedent debt if the secured party did give new value at the inception of the security arrangement. These are acquisitions made by the debtor either 'in the ordinary course of his business' or 'under a contract of purchase made pursuant to the security interest [sic] within a reasonable time after new value is given.' By necessary implication § 9-108 says that after-acquired property interests of any other type are, as a matter of state law, antecedent debt transfers. We may assume that a transfer which, at the state law level, is stigmatized as being for an antedent debt would also be one at the federal law level.

*See also* 1 GILMORE, *supra* note 7, § 11.7, at 362.

5. This may be attributable to the broad overkill of some of the reasons used by the courts, or to the fact that section 9-108's limitations are not fully comprehended by the courts.

6. Courts cannot be blamed for slovenly reading of section 9-108, since its language leaves much to be desired.

Back to the drawing boards.

## III. SECTION 9-108 AND THE PROPOSED NEW BANKRUPTCY ACT

### *A. Background*

Roll back the calendar to the time before *Grain Merchants* and *DuBay v. Williams* set the pace in protecting the security interest in after-acquired property from the ravages of section 60 of the Bankruptcy Act. The U.C.C. had taken the state, and not the federal, route: it was not national legislation, and must exist under the shadow of the supremacy clause of the United States Constitution. The Bankruptcy Act was the final word. There was fear in security interest circles that section 60 would roll back the floating lien: anxiety was fueled by comments of more than one expert.

This fear led to a move to strike the threat at its source. A committee, chaired by Professor Gilmore, acting under the auspices of the National Bankruptcy Conference, convened to prepare a rewrite of section 60, reconciling it with the provisions of article 9, most especially section 9-108. But when decisions such as *DuBay v. Williams* gave sweeping protection, the heat was off, and the fundamental question shifted from "is the floating security interest vulnerable" to "is the floating security interest too invulnerable?" What should be left to those peons, the unsecured creditors? In 1970 the Gilmore Committee made its report.[143]

This report, like a rivulet, soon found its way into a larger stream—an entire rewriting of the Bankruptcy Act. Amending section 60 ceased to be an independent project. The task, among mightier ones, was taken over by the Commission on the Bankruptcy Laws of the United States charged by Congress with the drafting of a new Bankruptcy Law. The work has been completed; the proposed act now awaits the approval of Congress.[144]

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143. NATIONAL BANKRUPTCY CONFERENCE, REPORT OF THE COMMITTEE ON COORDINATION OF THE BANKRUPTCY ACT AND THE UNIFORM COMMERCIAL CODE (1970) [hereinafter cited as GILMORE REPORT].

144. S. 2565, 93d Cong., 1st Sess. (1973); H.R. 10792, 93d Cong., 1st Sess. (1973) (In the current session of Congress the Bill is H.R. 31, 94th Cong., 1st Sess. [1975]). *See also* COMMUNICATION FROM THE EXECUTIVE DIRECTOR, COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES TRANSMITTING A REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, JULY 1973, PART 1. H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973) [hereinafter cited as REPORT]. This REPORT is in two parts. For highlights on the proposed act, see Kennedy, *The Report of the Bankruptcy Commission: The First Five Chapters of the Proposed New Bankruptcy Act*, 49

A new section 4-607 would replace present section 60. This new section reflects in part the work of the Gilmore Committee—the preparatory work has made its contribution to a drastic rewriting of the present provisions of section 60.

### *B. Proposed New Preference Rules*

#### 1. PROVISIONS

First, the broad outline of section 4-607.

1. The fundamental principle that the trustee in bankruptcy should have roll-back powers to upset a voidable preference continues to be approved.[145] For the most part, elements of a preference would remain essentially the same: transfer for an antecedent debt,[146] while insolvent,[147] favoring one creditor over another. But it would no longer be necessary for the trustee to establish that a transferee of the debtor's property for an antecedent debt knew or had reason to believe that the debtor was insolvent at the time of transfer. Out goes the first sentence of section 60b.[148] The transferee, if not affiliated with the bankrupt, receives in trade-off a reduction of the time of vulnerability from four months to

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IND. L.J. 422 (1974). Professor Kennedy served as the Executive Director of the Commission on Bankruptcy Laws of the United States. Certain provisions of the Bill have been criticized by members of the Bankruptcy Bar and referees. *See* Seidman, *The Bankruptcy Act of 1973—A Critique*, 79 COMM. L.J. 297 (Aug. 1974).

145. Something like a "widow's exemption" is given by section 4-607(b)(1), which provides that a "trustee may not avoid a transfer under this section if (1) the aggregate value of all property so transferred to a creditor other than a member of the immediate family, a partner, an affiliate, a director, an officer, or a managing agent of or for the debtor, is less than $1000." REPORT (Pt. 2), *supra* note 144, at § 4-607(b)(1). The provision has dubious merit, because it carves out an exception to the principle of equality of distribution, and may encourage small creditors to run a race to seize an insolvent's assets, being sure that they confine their receipts to less than $1,000 in value. On the other hand, there is something to be said for it, to the extent that it protects a transferee who had no reasonable cause to believe that the debtor was insolvent at the time he received a modest payment.

146. Section 4-607(g)(1) defines "antecedent debt" as

> a debt incurred more than five days before a transfer paying or securing the debt. The term "antecedent debt" does not include (A) a debt for personal services; (B) a debt for utilities incurred within three months of the petition; (C) a debt for inventory paid for within three months of the delivery of the goods in the ordinary course of the debtor's business; or (D) an obligation to transfer ownership arising out of a contract for the sale of property owned by the debtor and in existence either at the date the contract was entered into or at a time more than three months prior to the petition.

*Id.* at § 4-607(g)(1).

147. *Id.* at § 4-607(f) provides: "Presumption of insolvency. A debtor is presumed to have been insolvent throughout the three-month period before the date of the petition."

148. Other parts of section 60b of the Bankruptcy Act find their place in sections 4-609, 4-610. *Id.* at §§ 4-609 & 4-610.

three months prior to the filing of the petition. Special provisions deal with transfers to persons affiliated with the bankrupt.[149]

2. The present bifurcated test for determining when a transfer is deemed to occur is continued: for transfers of personal property, the time when the transferee acquires rights superior to a subsequent lien creditor of the transferor; for realty, the time when the transferee acquires rights superior to a subsequent bona fide purchaser of the transferor.[150] But a question is cleared up: as to security interest in fixtures, the lien creditor test applies.[151]

3. Section 4-607 contains this qualification as to security interest transfers: if perfection (*e.g.* by filing) occurs within 10 days of the actual time of transfer, the time of transfer dates back to the time of actual transfer. And, if the perfection occurs later than 10 days, it dates from that later time and is for an antecedent debt, even though new value was originally given. This would simplify and clarify the present section 60a(7).[152]

4. Elimination of section 60b matter (no more need to show that the preferred transferee had reason to believe that the transferor was insolvent) results in merging section 67a matter into section 4-607.[153] The section applies to liens obtained by judgment or levy

149. Section 4-607(a)(2) gives the trustee the right to recover property in accordance with section 4-607(a)

> if the creditor was a member of the immediate family, a partner, an affiliate, a director, an officer, or a managing agent of or for the debtor, who had reasonable cause to believe the debtor was insolvent at the date the transfer occurred, within the period commencing one year before and ending three months before the date of the petition. The trustee shall have the burden of proving insolvency and reasonable cause to believe under clause (2) of this subdivision.

*Id.* at § 4-607(a)(2). *See* Comment, *Voidable Preferences: An Analysis of the Proposed Revisions of Section 60b of the Bankruptcy Act*, 1974 WIS. L. REV. 481.

150. REPORT (Pt. 2), *supra* note 144, at § 4-607(g)(6).

151. *Id.*

152. *Id.* at § 4-607(g)(7) would provide:

> A transfer occurs when it takes effect between the parties if perfected at that time or within ten days thereafter. If perfected after the ten days, the transfer occurs when perfection occurs. Unless perfected within ten days, a transfer not perfected before the filing of the petition dates from a time immediately preceding such filing. A transfer does not take effect before the transferor has acquired rights in the property.

153. The text and notes could be clearer on this point. The REPORT (Pt. 1), *supra* note 144, at 202 states:

> In light of the recommendations of the Commission to shorten the period of vulnerability from four months to three months and to eliminate the requirement of establishing reasonable cause to believe the debtor insolvent, the Commission recommends that a judicial lien be handled as any other preference. There no longer is a need for separate treatment [citing footnote 139].

*Id.* at 229 n.139, states:

> See § 4-607(a) of the proposed Act. See subdivision (e) of § 4-607 of the proposed Act for the protection of indemnifying transfers. The Commission's note following Section 4-607 contains no reference to Section 67a. However, the definition of "transfer" in Section

as well as consensually created security interests.

5. Section 60c is replaced, by enhancing and clarifying. Subsequent advances, secured as well as unsecured, made by a creditor receiving a preference, will reduce or negate the preference previously obtained.[154]

These are only some of the highlights; we must hasten on.

### 2. SIGNIFICANCE

In light of the subject of this essay, let us concentrate upon those provisions of section 4-607 which would have particular bearing upon after-acquired property security interests in personal property.

For present purposes, the most important point to note is that the draftsmen of section 4-607 have forthrightly saved, more or less intact, the transactions that U.C.C. section 9-108 was intended to save, while dispensing with contrived approaches: *e.g.* the by-pass backdating approach of *DuBay v. Williams*, and the "new value" approach of section 9-108.

The by-pass approach of *DuBay v. Williams* is disapproved—the interpretation of present section 60a(2) to backdate a transfer to the date of filing. It is provided that a transfer cannot take place until the debtor acquires rights in the property.[155] This would seem to mean that article 9 security interests in after-acquired property date from the time they attach, if they are then perfected [*i.e.*, if there has been a prefiling]..

The fresh-new-value-from-old-new-value approach of section 9-108 is likewise disapproved. Property acquired more than five days after the debt is incurred for which it is given is for an antecedent debt, except in situations for the most part irrelevant to the floating security interest.[156]

Stop at this point and the typical floating security interest in after-acquired property would be in grave danger of having its last three months clipped, except to the extent that further advances were made during this period. There are, however, two further provisions, which would preserve most transactions coming within section 9-108 from the trustee's power of avoidance.

First, acquisitions of after-acquired security interests pursuant to "enabling advances" are given special protection. Second, special protection is accorded to security interests in "inventory" and "receivables."

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1-102(46) includes judicial liens, and Section 4-607(a) is broadly worded to refer to any transfer. Section 4-607(a) gives the trustee a right to "recover a transfer."

154. *Id.* (Pt. 2) at § 4-607(c)(2). *See also id.* at 171-72.

155. *Id.* at § 4-607(g)(7).

156. *See* note 146 *supra.*

*a. Enabling advances*

Section 4-607(c)(1) would provide:

> (1) A security interest in property acquired by the debtor, if perfected when the debtor first acquires rights in the property or within ten days thereafter, is not voidable under this section to the extent that it secures new value previously given to enable the debtor to acquire the property.[157] In determining the amount of new value given for such security interest the value of any other security taken for it shall be deducted.

Enter the "enabling advances" theme—the idea that a special equity favors the "Founder of the Feast" (in the language of Dickens in *A Christmas Carol*). This provision in section 4-607 recalls the prong of section 9-108 which provides that "after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral . . . under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given." There are some subtle distinctions. An anxious concern for the protection of the secured party may have led to nonarticulation in section 4-607(c)(1) of the "reasonable time" limitation, present in section 9-108. Even so, the longer the time, the vaguer becomes the connection between an "enabling" advance and a later acquisition by the debtor. Another point: under section 9-108, there need be no direct tie-in between the new value given by the secured party and the later acquisition. It suffices that there be a contract of purchase made pursuant to the security agreement. It must, however, appear that the acquisition was the result of the contract of purchase, and that the secured party has given new value. We are told that the special protection given by section 4-607(c)(1) to a security interest "to the extent that it secures new value previously given to enable the debtor to acquire the property," does not require that the advance be in fact applied by the debtor to acquire the property in question; in other words, it is not required to meet the tests of the U.C.C. section 9-107(b) for a purchase-money security interest. Still, the language of section 4-607(c)(1) at a minimium requires some kind of a connection. Perhaps it will suffice if the security agreement requires the debtor to use the funds to acquire the property in question.

*b. Special protection for security interests in inventory and receivables*

The special protection thus accorded to security interests acquired

157. REPORT (Pt. 2), *supra* note 144, at § 4-607(g)(3) defines "new value":

> New value means money, or money's worth in goods, services, or new credit, or the release by a transferee of property previously transferred to him in a transaction which is not voidable, but does not include an obligation substituted for an existing obligation.

pursuant to enabling advances will not serve to save the typical security interest in after-acquired property from attack as a preference, since the typical security agreement does not stipulate that the funds made available to the debtor are to be used by him for the acquisition of after-acquired property. If section 4-607 had stopped at this point, the basic purpose of protecting the security interest in after-acquired property exhibited by U.C.C. section 9-108 and the judicial decisions would have been repudiated. For, as previously noted, section 4-607 declares that a transfer occurring more than five days after incurring the debt is a transfer for an antecedent debt (with certain exceptions). Transfer does not occur before perfection occurs, and is not to be considered backdated because filing has been previously made.

Accordingly, section 4-607 proceeds to declare another exception to its basic approach: a special provision saving the typical security interest in after-acquired personal property from attack as a preference.

Section 4-607(d) would provide:

> If inventory was acquired or receivables arose and became collateral covered by a security agreement, a perfected transfer of such inventory or receivables or the proceeds of either is not voidable except to the extent that the transferee has improved his position by an increase in the value of the security at the expense of the estate. The transferee has so improved his position if
>
> (1) the debt secured exceeds the aggregate value of all security for the debt three months before the filing of the petition or, if new value was first given under the security agreement during the three-month period, on the date new value was first given, and
>
> (2) the amount by which the debt exceeded the value of the security has been reduced or eliminated by the date of the petition. The trustee shall have the burden of proving an improvement in position by an increase in the value of security at the expense of the estate and the extent thereof.

We have come to the heart of the matter. The security interest in after-acquired property, so solicitously guarded by U.C.C. section 9-108 and decisions to date from challenges based on section 60 of the Bankruptcy Act, is to be preserved under the new act, subject, however, to certain points:

(a) The special protection is to apply only to security interests in "inventory[158] and receivables."[159]

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158. *Id.* at § 4-607(g)(2) provides:
"inventory" means personal property leased or furnished or held for sale or lease or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business. "Inventory" includes farm products such as crops or livestock held for sale.

159. *Id.* at § 4-607(g)(4) provides: "'Receivable' means any right to

(b) It is limited in that there is to be no improvement in the security position of the claimant in the final three months, if such improvement

(c) is "at the expense of the estate."

In so doing, the draftsmen of section 4-607 have adopted the views, and preserved the basics of, U.C.C. section 9-108 with certain editorial changes.[160]

The limitation of the special protection afforded by section 4-607 (d) to security interests in "inventory" and "receivables" is not much more restrictive than the first prong of U.C.C. section 9-108, which requires that the debtor acquire "his rights in such collateral . . . in the ordinary course of his business." As previously explained, this provision of section 9-108 seems naturally most applicable to after-acquired security interests in such fluid assets. Further, the definition of these two terms in section 4-607 is broad: "inventory" is defined to include farm products held for sale, and "receivables" conceivably can include not only "accounts," but also "instruments," "chattel paper," and some kinds of "general intangibles," as those terms are defined in article 9. Section 4-607 does not explicitly condition its special protection with a requirement that the acquisition be in the ordinary course of business; it speaks

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money for the transfer or use of property or for the furnishing of services, whether or not the right has been earned by performance."

160. This statutory formula is consistent with a relaxed substitution rationale. As to the place of a relaxed substitution approach to negate a challenge that an acquisition is for an antecedent debt in transaction *not* falling within section 4-607(d): *Id.* at § 4-607(c)(2) provides that "a transfer is not voidable to the extent of new value given *at the time* of the transfer or at *any time thereafter* . . . ." It seems to have nothing to say about "new value" given *prior* to the time of transfer. Thus, if the secured party releases collateral *before* the debtor acquires fresh collateral (release of collateral is a form of new value section 4-607(g)(3)), section 4-607(c)(2) does not apply. However, *id.* at § 4-607(g)(1) defines "antecedent debt" as "a debt incurred more than five days before a transfer paying or securing the debt." *Id.* at 170 n.7, interprets this: "The five-day grace period has eliminated any need to codify a 'relaxed substitution' rule. Thus, § 60a(4)(iii) of the Gilmore draft has been dropped. *See* GILMORE REPORT, *supra* note 143, at 9, 15." Quaere: the "debt," if by that is meant the debtor's obligation to pay, *e.g.*, to pay a loan, may have been "incurred" long before the secured party released the collateral. Thus, it is not patent in the text of section 4-607 that acquisitions by the debtor within five days after release of collateral are not to be classified as transfers for an antecedent debt. The present version seems a long way removed in clarity from section 60a(4) iii of the Gilmore draft, which provided:

> If a transferee has released or returned to the debtor property previously transferred to him in a transaction which was not voidable under paragraph a (3), then a transfer in substitution for the property released or returned is not voidable except to the extent that the value of the substituted property exceeds the value of the property released or returned. The release or return and the substitution need not take place simultaneously provided that the release or return is made in contemplation of the substitution and the substitution is made within a reasonable time after the release or return.

GILMORE REPORT, *supra* note 143, at 9.

rather in terms of types of collateral, and so, it seems, excludes after-acquired security interests in "equipment" from the special protection of section 4-607(d). But by and large, its special protection seems to coincide pretty much with the first prong of U.C.C. section 9-108.

However, the special protection is to be limited: There is to be no "improvement in position . . . at the expense of the estate in the final three months." This is a concession to the interests of unsecured creditors. In this respect it improves upon section 9-108, and puts to rest implications of the decision in *DuBay v. Williams*.

Generally, the limitation becomes meaningful only if, at the commencement of the three-month period, the secured party is *undersecured*, that is, if at that time the debtor owes more than the value of collateral. Section 4-607(d) gives the formula for a case like this. If the value of the collateral is $90,000 at the beginning of the period, and $100,000 at the time of the filing of the petition, and the debt remains constant at $100,000, the secured party has improved his position to the extent of $10,000, and the trustee is on the way to establishing a preference to that extent.[161]

There are obstacles in the way of the trustee. Section 4-607(d) puts the burden of proof upon him to show "an improvement in position by an increase in the value of the security at the expense of the estate and the extent thereof."[162] One can imagine many cases where proof of value at the two critical times may be quite difficult.

Between these two critical times—the beginning and end of the three-month period—the in-between state of affairs is to count only insofar as new advances by the secured party or payments by the debtor must be taken into account to determine the question of improvement in position, and not otherwise. For example, it may appear that two months before the filing of the petition, the debtor had reduced the collateral (inventory) from $90,000 to $40,000, and one month before the petition had built it up to $100,000. These matters are irrelevant under the formula: we look to the value

161. If the secured party can prove that the debtor was not insolvent at the time of the acquisition in question, it seems that the secured party is not subject to the limitation. In contrast, the Gilmore draft had provided: "To the extent that a transfer is voidable under this subparagraph IV, it is voidable without regard to whether the debtor was insolvent at any date prior to the date of filing the petition . . . ." *Id.* at 10. But note the Gilmore draft contained another exception—the relaxed substitutionary rule (subparagraph iii of Section 60a(4))—not subject to the above quote. *Id.* at 9.

162. In contrast, the Gilmore draft had provided: "The transferee has the burden of establishing that he had not improved his position under the rules above stated." *Id.* at 10. But note that the Gilmore draft contained another exception—the relaxed substitution rule—(subparagraph iii of Section 60a(4))—not subject to the above quote. *Id.* at 9.

of the inventory at the *beginning* of the three-month period: if it was $90,000, and the debt had remained constant at $100,000 throughout, the statutory improvement in position amounts to $10,000, assuming that the value of the collateral was $100,000 at the time of the petition.

*c. At the expense of the estate*

The subsection contains the further rather subtle qualification that the improvement in position must be "at the expense of the estate." The import of this phraseology is not entirely clear. We see the idea surface in action taken by the National Bankruptcy Conference on the report of the drafting committee to amend section 60. The committee was directed to reconsider its report in light of

> Conferee Kripke's suggestion that a formula be devised which would give the creditor the benefit of an improvement in his position during the four-month period if it arises from any of four types of situations which do not involve any overreaching or any unfairness to other creditors: (1) the harvesting of a crop; (2) the transformation of inventory from worthless work-in-process to finished goods; (3) the carrying of inventory from off-season to its seasonal selling peak; or (4) the conversion of inventory into more valuable cash and receivables.[163]

But do not all of these situations, in varying degrees, result in enhancement of the value of the collateral "*at the expense of the estate*"? For example: if "worthless work-in-process" is converted to "finished goods," that takes money and other resources supplied by the debtor—and presumably assets that would otherwise be available to unsecured creditors are diverted. Likewise, when inventory is sold and converted into proceeds with a higher value, increase in value is generated by selling activities which cost money. Where did it come from, but at "expense of the estate"?[164]

However, Professor Kripke explained his position more fully:

> In my opinion the creditor should keep the benefit of the improvements in the cases mentioned, so long as it is not at the expense of other parties interested in the estate. I think there is a formula for protecting the other parties against depletion of the estate for the benefit of the secured creditor in this respect. That formula is found in Meinhard, Greef and Co. v. Edens, 189 F.2d 792 (4th Cir. 1951) which I cited to Professor Gilmore as a model for

163. NATIONAL BANKRUPTCY CONFERENCE, 1971 ANNUAL MEETING, SUMMARY OF PROCEEDINGS AT WASHINGTON, D.C. OCTOBER 28-30, 1971, at 5, Resolution No. 1.

164. *See* Countryman, *supra* note 70, at 273: "Just as the unmortgaged grain fattens the mortgaged pig or calf, so the unmortgaged labor, managerial skills and capital fatten the mortgaged proceeds."

> this problem on May 31, 1966. The court was considering the problem of the allocation between the secured creditor and the estate of the value of goods which had been in process at the moment of bankruptcy and which had been finished by the trustee. The court held that the secured creditor was entitled to the entire value of the finished goods, less the costs expended by the trustee in finishing the goods. This of course was for operations which occurred after bankruptcy. There is no reason why the same principle may not be applied to expenditures by the bankrupt or debts incurred by the bankrupt within the four-month period.[165]

A reading of *Meinhard, Greef and Co. v. Edens*[166] may serve to reduce the matter to modest proportions. In that case, trustees of a bankrupt textile company in reorganization completed the manufacture of cotton-in-process which was subject to a perfected security interest, and in so doing brought the cotton to finished goods value ($71,000) by incurring expenses attributable to finishing ($25,000). The secured party was awarded the $71,000 less $25,000—$46,000. The trustee's contention that the secured party's claim should be limited to $14,000—the value of the cotton as waste before the manufacturing was completed—was rejected. The trustee's position in that case was extreme, considering that the cotton had not been in fact treated as waste stripped from the looms, but rather was converted into finished goods. *Since the award took into account expenses sustained in finishing the goods*, it is arguable that no harm was done to the bankrupt estate by awarding the secured party the entire *net* balance of the value of the goods, in a finished state. If we carry the principle of this decision over to the four situations posited by Professor Kripke, dealing with cases of enhancement in the value of original collateral or proceeds during the final three months prior to the filing of the petition, the result would be to deduct expenses sustained by the debtor attributable to the improvement in value, but otherwise, it seems, to give the secured party the entire benefit of enhancement in value.[167]

The *Meinhard* case involved post-petition action of trustees in reorganization in enhancing the value of the collateral. If the decision is correct, there would be even more reason to apply its principle to the prepetition action of the debtor himself in the ordinary course of business in the final three months. Note, however, the thrust of the decision is to emphasize final value and to deemphasize value at the outset: the award to the secured party was final

165. Letter from Professor Homer Kripke to the Gilmore Committee, September 17, 1970, appearing in REPORT (Pt. 1), *supra* note 144, at 210.

166. 189 F.2d 792 (4th Cir. 1951), cited in Professor Kripke's letter, note 165 *supra*.

167. With the record in the case before me, I criticized the decision in *The Factor's Lien on Merchandise*, 1955 WIS. L. REV. 609, 635-37.

value minus expenses of the trustees—the trustees did not otherwise participate in enhancement in value. The question posed by section 4-607 is, in a case like this, is such "net improvement in position" at the "expense of the estate"?

What does the Commission have to say? First, it quotes with seeming approval from the Gilmore Report:

> Let it be assumed that a secured party's collateral . . . [three] months before bankruptcy consists of raw material worth $10,000. On the date the bankruptcy petition is filed the raw materials have been converted into finished products worth $20,000. (Under Code § 9-315 the security interest in the raw materials carries through to the finished product.) Assuming an initial "deficiency" (the debt secured, let us assume, was at all times $25,000), the $10,000 increase in value is not protected . . . and goes to the trustee. If the final holding in Rockmore v. Lehman, 128 F.2d 564, rev'd on rehearing, 129 F.2d 892 (2d Cir. 1942) suggests the contrary conclusion, that holding is here overruled.[168]

So, it seems, if the goods were but raw materials at the beginning of the three-month period, trustee gets the entire benefit of enhancement in value resulting from converting the materials to finished goods in the final three months.

But suppose the goods were "in process" at the beginning? (One of Professor Kripke's points).[169] After thus quoting from the Gilmore Report, the Commission states:

> Improvement in position is alone not enough. The trustee must also establish that the improvement was at the expense of the estate. This is intended partially to meet Professor Kripke's criticism that increases in value

168. GILMORE REPORT, *supra* note 143, at 15-18.

169. A letter from Professor Kripke to author, October 9, 1974, states:

> Thanks for your letter of October 2. I think that you have correctly expressed my position as far as you have stated it. I might make a few more points.
>
> I see a perfectly solid distinction between goods which were in raw material stage at the beginning of the preference period and those which were in the "work-in-process" stage. Raw materials are typically excellent collateral. They can be resold for other purposes with only the usual discount for a forced sale. In contrast, work-in-process has usually been processed to a stage where, unless completed, it is good only for junk. This is true not only of wool on the loom or cloth which has been partially cut but not sewed into a garment, but also of sheet steel, copper wire partially assembled into a gadget, etc. It is in this kind of a situation that the secured party needs to get the goods finished and should not be penalized for getting the goods finished, nor lose the value of the improvement, especially where he took some substantial risk to keep the debtor going for a period. This should not be at the expense of the other creditors in the estate, because to the extent that the finishing involves the use of cash or incurring of liabilities, the estate should be reimbursed out of the finished product.

> of collateral due to, e.g., harvesting crops, completing work in process, sales of inventory, and seasonal fluctuations in value, would constitute improvement in position and be recoverable.[170]

And so, as matters stand, Professor Kripke's criticism, we are told, is "partially" met. In what way only "partially"? The mind boggles. Indeed, the entire area of present discussion excites the imagination to permutations and combinations. Have the draftsmen opted out of any real solution, feeling that it must be up to the courts to decide the cases as they come along?

*d. In sum*

In their restructuring of the law of preferences versus the after-acquired property security interest, the draftsmen of section 4-607 have given an assist to the orderly and rational development of law. But one cannot suppose that they have laid all questions to rest.

While protecting the after-acquired property security interest in "inventory" and "receivables" in the final three months from frontal assault as a voidable preference, they let in the trustee to the extent of "improvement in position," and in so doing raise fresh, or at least up to now sleeping, issues. For, as often happens, by the very words that settle old questions, new ones are generated.

### 3. THE IMPACT OF SECTION 4-607 ON PRIOR CASE LAW

The results of all decisions to date sustaining after-acquired property security interests in inventory and accounts, etc., from preferential attack seem to be approved, except for *In re World Wide Perfume, Inc.*,[171] and *In re King-Porter*,[172] and possibly *In re Newkirk Mining Co.*[173]

(a) Insofar as *In re World Wide Perfume, Inc.* involved a clear improvement in the secured party's position in the final four months (changed to three by section 4-607) the result would be disapproved. Definitely the improvement in that case is "at the expense of the estate."

(b) The problem in *In re King-Porter* is not within the compass of section 4-607, inasmuch as it involved the enforcement of the obligation that was tacked on during the preferential period. Section 4-607 says nothing with respect to the type of claim that may be given protection in bankruptcy under an "other obligations" clause in a security agreement. If the position of the court is to

170. REPORT (Pt. 1), *supra* note 144, at 209-10.
171. 7 UCC REP. SERV. 616 (M.D. Ala. 1969).
172. 446 F.2d 722, 9 UCC REP. SERV. 339 (5th Cir. 1971).
173. 1 UCC REP. SERV. 468 (E.D. Pa. 1962).

be disapproved, it must be by judicial engineering: without much aid from section 4-607 or any other section of the Act.[174]

(c) The maneuvers involved in *In re Wilco Forest Machinery, Inc.*[175] should, let us hope, not be successful under proposed section 4-607(d). In that case, the conversion of $439,000 in secured debentures to shares of stock served to reduce the secured position of EYTC from $900,000 to $461,000 during the final three-month period before the filing of the petition. By exercising its new power as controlling shareholder, EYTC achieved the switch of $617,000 in previously unsecured debts owed to it into secured debentures. Obviously in so doing EYTC improved its collateral position to the tune of $617,000.[176] There is, however, difficulty in applying the improvement-in-position test of section 4-607(d) to the case. At the beginning of the three-month period, it may well have been (applying this test) that "the debt secured [did not exceed] the aggregate value of all security for the debt," in the language of section 4-607(d). What is meant by "the debt secured"? The likely meaning is that unsecured debt is *not* included in the test. What then? If, as the facts suggest, the secured party was not undersecured at the outset, does it follow that there would be no statutory improvement in position, and that EYTC would prevail to the full extent of its debenture claims? One would hope not. One would hope that the test would be held not exclusive. Surely section 4-607(d) is not intended to approve the *creation* of security interests in inventory and receivables during the final three months for that part of a debtor's antecedent obligation which was theretofore unsecured, even though, in so creating, the debtor is fulfilling his contractual duties to the creditor. Part of my problem is that I have difficulty in reading section 4-607(d).

This is not quite a repeat of *In re King-Porter*, where some argu-

174. In a letter to author dated September 23, 1974, Professor Kennedy recognizes that proposed section 4-607 would not be clearly dispositive:

> The application of § 4-607(d) in a situation where the secured creditor acquires an additional claim after the date new value was first given without giving commensurate new value (at least directly) raises issues that the draft does not deal with directly. Homer Kripke sought to persuade the Gilmore committee to deal more explicitly with the problems generated by fluctuations of the debt as well as the quantity of collateral during the period of vulnerability before bankruptcy, but the committee was not able to arrive at any solution that was sufficiently satisfactory to justify further elaboration of what was already a rather complex provision. A court with the predisposition exhibited by the Fifth Circuit in *In re King-Porter* would undoubtedly come out in favor of Mills Morris if the same facts should arise under the proposed Bankruptcy Act, whereas a court with my predisposition would go the other way.

One basis for objecting to the transaction would no longer be possible if the new act is enacted; the new act would eliminate present section 67d(3).

175. 491 F.2d 1041, 14 UCC REP. SERV. 849 (5th Cir. 1974).

176. For to the extent that the debentures were converted into shares, it is assumed that the debtor's obligation was pro tanto reduced.

ment can be made that the secured party had given new value to Kelvinator, if not to the debtor. Here, the increase in secured claim did not involve the giving of any kind of new value for the switch in an obligation from unsecured to secured status. Therefore, except to the extent that EYTC could qualify his security interest represented by the $617,000 as acquired under section 4-607(c) relating to enabling advances, the secured party should not be protected from section 4-607's normal avoidance rule.

(d) *In re Newkirk Mining Co.*[177] (the first case involving section 9-108) applied section 9-108 to uphold a security interest in after-acquired *equipment* (office furniture, etc.) against section 60 attack. For some reason, perhaps because a floating security interest in equipment was considered to be off the beaten track, section 4-607 limits its special treatment provisions to "receivables" and "inventory." Thus, unless the secured transaction in *In re Newkirk Mining Co.* could qualify under the protection accorded enabling advances, acquisitions of equipment during the three-month period would come within the general rule that the security interest attaches at the time the debtor acquires rights, and if at that time the debtor was insolvent, the trustee could avoid, since the transfer of the security interest was for a debt antecedent to the acquisition.[178]

(e) The definition of "inventory" in section 4-707(g)(2) "includes farm products such as crops or livestock held for sale." In *Safeway Stores, Inc. v. Coos Fidelity Corp.*,[179] an inclusive security interest in dairy cows and products was involved. The litigation was solely concerned with the secured party's rights to accounts arising from the sale of milk, versus the dairyman's trustee in bankruptcy. Without much comment, the court sustained the secured party's claim, citing *DuBay v. Williams* and other decisions. Under proposed section 4-607 of the new Bankruptcy Act, these accounts would be classified as "receivables" and presumably the secured party would prevail. But the secured party's floating security interest in the *dairy cows* (perhaps the main collateral) would probably not be protected by section 4-607(d), since dairy cows are not "held for sale" and thus it seems do not fall within the definition of "inventory" in section 4-607. In the opinion of Glenn Coates,

177. 1 UCC REP. SERV. 468 (E.D. Pa. 1962).

178. REPORT (Pt. 2), *supra* note 144, at 171 n.14, quotes from the GILMORE REPORT:

> Each paragraph is available as a defense in a given case of preference attack: That is to say, a transferee seeking to immunize himself from an avoidance under . . . [subdivision (a)] can argue his case under any one of the . . . paragraphs. If he can win under any of the . . . paragraphs, [he] is home free. If there have been multiple transactions between transferor and transferee during the preference period, the transferee can split up the transactions among the . . . paragraphs as may be appropriate.

179. 266 Ore. 1, 511 P.2d 345, 12 UCC REP. SERV. 1221 (1973).

Esq., a leading expert in Wisconsin on farm financing, the draftsmen have unjustifiably discriminated against security interests in an important agricultural transaction, if the above analysis is correct.[180]

(f) The problem raised in *DuBay v. Williams*,[181] growing out of the fact that most of the loan was made six days before the security agreement and thus may not have been made pursuant thereto, is taken care of by defining "antecedent debt" as "a debt incurred more than five days before a transfer paying or securing the same." Thus, the secured party would have to fall back on the special protection of section 4-607(d).

It may be recalled that in *DuBay v. Williams* wage claimants with priority under section 64 were among the creditors represented by the trustee in bankruptcy, and that the decision awarded priority to the secured party, Rose City. The proposed section 4-607 would continue this policy of subordinating wage claimants to the floating security interest.

Charles D. Hoornstra, Esq., Assistant Attorney General, State of Wisconsin, fresh from his experiences in pressing the claims of Red Dot employees to severance, vacation, and back pay in a liquidation proceeding, comments:

> Whatever Article 9 hostility toward the unsecured creditor may be mitigated by the "at the expense of the estate" provision of proposed section 4-607, the plight of the wage claimant deserves expressly preferential treatment.
>
> First, the worker ordinarily is in no position to protect himself by ceasing an open account relationship, *e.g.*, by demanding payment hourly or daily. Second, it is his labor which frequently imposes the very value on the collateral which other lienors claim for themselves. Third, it is my experience that the beleaguerment of the business debtor pales in comparison to the harsh realities thrust on the unpaid worker: in addition to being unpaid, he typically has lost employment for an anguishingly uncertain time and fast becomes hounded as an unworthy debtor.
>
> I appreciate that a fair reconciliation of competing property and contract interests is esoteric. I would hope that it is not so arcane, however, as to prevent appreciation for the human despair which envelops groups of families of wage claimants. Specifically, I see no reason why the wage claimant should not be prior to any secured creditor, at least to the extent of priority under sec. 64(a)(2) of the Bankruptcy Act. Certainly his fireside equities equal those of the floating lienor as to after-acquired property.[182]

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180. Telephone conversation with author, October 1, 1974.

181. 417 F.2d 1277, 6 UCC REP. SERV. 885 (9th Cir. 1969).

182. Letter to author, November 19, 1974. For another view see note 100 *supra*. I am informed by John Suchier, Esq., of the Wisconsin Legislative

(g) Section 4-607(d) is probably broad enough to include the situation of *Biggins*,[183] where the property was made collateral for all obligations by a series of security agreements, some executed within the preference period, rather than by an after-acquired property clause in a security agreement executed prior to the preference period. In either case the question would be whether the net result would be an improvement in position.

(h) The view expressed in *Rosenberg v. Rudnick*[184] that the trustee has the burden of showing an improvement in the secured party's position is approved.

(i) In *Grain Merchants*,[185] collections on accounts in existence at the time the bank made its last advance (during the four-month period) were, under the facts, treated as not preferential, because they were not payments for an antecedent debt. Section 4-607(c)(2) expands present section 60c to provide that subsequent advances, secured as well as unsecured, will cure pro tanto a preference.

All in all, the proposed substitute for section 60, section 4-607, is consistent with the thrust and basic ideas of U.C.C. section 9-108, while departing in some particulars.

Some concessions, it is true, are made to the interests of unsecured creditors—*e.g.*, the no-improvement-in-position rule—but these concessions are modest, and the secured party with the after-acquired property security interest has little to complain about. But an accumulation of court decisions in his favor has already put him in the driver's seat, and so the new provisions, if unchanged, would do little more than ratify what had already been accomplished.

This plan for the treatment of the after-acquired property security interest under bankruptcy preference law seems to comport with certain basic justifications for the indulgent treatment in section 9-108:

(1) The relaxed substitution theme: a nontechnical view, supported by section 9-205, that if there is no net improvement in the secured party's position during the critical period (three months) the transactions should be treated as mere exchanges of collateral.

(2) The entity theory, as limited by the no-improvement formula; the claim that it is realistic, and consonant with practice, to regard a security interest as being in an aggregate. Application of the entity theory may have been deemed most appealing when confined to inventory and receivables, the usual kind of collateral for treatment en masse.

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Council, that a study is underway with respect to the feasibility and desirability of legislative changes to afford greater protection to wage claimants.

183. 322 F. Supp. 62, 8 UCC REP. SERV. 1319 (S.D. Cal. 1971).

184. 262 F. Supp. 635 (D. Mass. 1967).

185. 286 F. Supp. 597, 5 UCC REP. SERV. 884 (N.D. Ind. 1968).

(3) The purchase-money-enabling-advance theme—a special form of new value: the idea that one whose security interest arose in a transaction designed to assist the debtor in acquiring collateral should have the benefit of the doubt.

In the fundamental dispute between unsecured and secured creditors as to the extent of the trustee's roll-back powers, now before the Congressional forum, such arguments based on equities in defense of the plan of section 4-607 may be anticipated.[186]

Long live the security interest in after-acquired property!

Long live the spirit of section 9-108!

## IV. CONCLUSION

The preference provisions of the proposed new Bankruptcy Act

186. While I have confined my textual comments to the Commissioners' Bill, it should be noted that a rival Bill originating with the Referees in Bankruptcy has been introduced. H.R. 32, 94th Cong., 1st Sess. (1975). Section 4-607 of that Bill deals with preferences. Variations in section 4-607 of the Commissioners' Bill are described by Professor Kennedy in a letter to me dated, September 23, 1974.

> If you haven't seen the Bankruptcy Judges' bill, you will be interested in their proposed revision of § 4-607(a)(2). They eliminate any requirement that the creditor have reasonable cause to believe that the debtor was insolvent at the date of the transfer. Curiously the Bankruptcy Judges' bill imposes the burden of proving insolvency on the trustee under § 4-607(a)(1) but puts the burden on the transferee to prove solvency under § 4-607(a)(2). This anomaly is compounded by the fact that in their proposed § 4-607(g), they provide for a presumption of insolvency throughout the four-month period before the date of the petition.
>
> The Bankruptcy Judges also proposed a new subdivision (e) reading as follows:
>
> "EXCEPTION: UNPAID FOR COLLATERAL.—A perfected security interest is void as against the trustee or debtor to the extent that it covers collateral which the debtor acquired from third parties on credit during the four months' period before the filing of the petition and the price of which remains unpaid."
>
> The subtitle of this subdivision is misleading, since the provision seems to create a new ground of avoidance rather than an exception to the right of recovery prescribed by earlier subdivisions. Note too that this right of avoidance is available to the debtor as well as the trustee. I am baffled by the provision since it seems to invalidate many perfectly legitimate transactions that do not run counter to any bankruptcy policy that I can perceive. Thus, if I understand the provision, all of the following kinds of transactions would be invalid at the option of the trustee or the debtor:
>
> (1) any purchase-money security interest coming within § 9-107(b) of the Uniform Commercial Code;
>
> (2) all floating liens against inventory and after-acquired property insofar as they attach to property acquired on credit and not paid for, whether or not the seller or the financer of the purchase of such collateral took a perfected security interest;
>
> (3) mortgages on real estate acquired from a person other than the mortgagee.
>
> The only other changes made by the Bankruptcy Judges in their preference section are:
>
> (1) elimination of the $1,000 limitation in § 4-607(b)(1);
>
> (2) limitation of the exclusions from the definition of "antecedent debt" to "a debt for personal services entitled to priority under § 4-405(a)(3),"

rest on the premise that the floating security interest is entitled to the explicit protection of law—a premise in keeping with the plan of article 9 of the Uniform Commercial Code.

Should we take issue with this premise? Perhaps there is much to be said for the point of view of the draftsmen of article 9:

> The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors a cushion of free assets should be preserved. That inarticulate premise has much to recommend it. This Article decisively rejects it not on the ground that it was wrong in policy but on the ground that it was not effective.[187]

A pragmatic view. No need to make extensive claims that the floating security interest is a necessary or desirable device for social or economic reasons. No need to claim that it works out by and large to contribute to the greatest good for the greatest number.

Does this device help debtors, for instance small businessmen, by making their assets more readily available for borrowing purposes? Does this device also, indirectly, even help the unsecured creditors, by facilitating the inflow of funds which the debtor can use to pay them?

The answer to these questions is, sometimes yes, sometimes no.

Some debtors may be benefitted, perhaps rescued, by entering into the kind of continuing relationship with a financer which is facilitated by the floating security interest. On the other hand, some debtors may find that they have placed a millstone around their necks. It depends upon the particular debtor and his circumstances. It depends upon the particular financer. Among other things, it depends upon the costs to the debtor, including interest charges.

Likewise, some unsecured creditors of the debtor may count themselves fortunate, being paid by funds supplied by the financer. But in other cases the unsecured creditor may find that an inclusive security interest in the debtor's assets effectively places assets out of the reach of the unsecured creditor.

Being somewhat situationally oriented, this writer tends to think of the floating security interest as it may be applied to particular cases. At this level, the inclusive after-acquired property security interest must be considered in its relationship to all of the security agreement's provisions—it should not be treated out of context. At this situational level, I am reminded of what Judge Lord said in

187. CODE § 9-204, Comment.

considering one particular arrangement between an accounts receivable financer and a debtor subsequently involved in bankruptcy:

> The ultimate question . . . will be whether these contracts were, in the light of all the circumstances, reasonable commercial devices. Among the issues which may be explored . . . are the financial positions of the bankrupts at the time the agreements were entered into; the extent to which agreements of this kind are customary among lenders like Fidelity; the extent to which Fidelity's contracts vary with and reflect anticipated risks; the availability of other credit to the bankrupts, both at the time and after they entered into these agreements; the extent to which the various provisions were enforced by Fidelity or influenced the bankrupts' business conduct, particularly their ability to secure other funds; whether the terms of these contracts facilitated commerce by making funds available where they otherwise would not be or impeded commerce by precluding access to other sources of funds; and the effects of holding these contracts unenforceable in bankruptcy on the future financing of similar businesses in need of funds.[188]

Rising above individual situations to the over-all: can we generalize, and say that, by and large, in the aggregate, the device of the floating security interest helps many more than it hurts, and deserves the support of law for its net beneficial effect?

At this level, the writer begs off. If we are interested in such a fundamental question, others must be called upon to speak knowledgeably and to produce convincing evidence, if data are available.

Perhaps the time has passed, at least for the time being, for challenging the wisdom of a fait accompli. The burden of proof has shifted. And you may be hard put to show that there is fundamental error.

As the preference provisions of the proposed new Bankruptcy Act reveal, there is no intention to challenge the basic tenet that the floating security interest deserves the protection of law.[189]

In fact, it looks as if, under a favorable legal climate, the use of the device will grow. The critical task remains, however, of legislating the "model" floating security interest which should be entitled to law's protection.

188. *In re* Elkins-Dell Mfg. Co., 253 F. Supp. 864, 874 (E.D. Pa. 1966).

189. But see the stirrer-upper in the Judges' Bill re unpaid for collateral, note 186 *supra*. Perhaps matters are not quite settled after all.