The Factor's Lien on Merchandise—Part II

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By the nature of its subject matter, a security interest in merchandise raises certain special problems. A security interest in a res over which the borrower is given extensive disposal power—a power which may be necessary if the borrower is to continue in business—may seem to be at least anomalous, and possibly a contradiction in terms. The sight of a merchant disposing of goods in the normal course of business should not, perhaps, suggest that he ostensibly sells as unencumbered owner, especially in these days when wholesale financing and consignment arrangements are familiar practices in many lines of business. But the basic idea of a security interest that would be good against some third parties and not against others—good against general creditors, and subsequent mortgagees and pledgees of the borrower, but not good against buyers in the ordinary course of business—was difficult for common law to grasp. It was the basic idea of the semi-security interest. Legislative fiat was sometimes required to surmount the "logical" objections of common law. The factor's lien acts of the twentieth century are examples of legislative intervention to supply asserted business needs which common law had, on the ground of logic and precedent, been unable or unwilling to supply.

Fundamental to the factor's lien acts is provision for publicity of the lien. The technical aspects of publicity requirements established by statutes are inescapable. The practicing lawyer knows that it is best to dot the *i* and cross the *t* when it comes to meeting the terms of legislative filing provisions. Short of literal compliance, he runs the risk of having seemingly harsh results visited upon a secured interest claimant whom he represents. There are, of course, policy questions: To what extent should literal compliance with filing or other publicity provisions be required to give effect to a security interest? And what measure of publicity should be required?

Publicital Requirements

Posting

In all states, the efficacy of the statutory factor's lien *vis-a-vis* the borrower's creditors is dependent upon compliance with publicity requirements if the borrower remains in possession of the merchandise.

In some states the publicity requirements are double—posting and filing. In others filing alone suffices. Wisconsin is in the latter group.

The posting requirement provided by some statutes originates with the New York Act of 1911. The inclusion of the posting requirement in this act may have been inadvertent or the result of excessive caution. An earlier bill, passed by the New York Assembly in 1910, had provided for publicity *only* by posting. Governor Hughes vetoed this bill on the ground that the provision for publicity was insufficient. A substitute bill of 1911 added a filing requirement to meet the Governor's objection, and retained the posting requirement as well. This bill became section 45 of the Personal Property Law.

Is the additional requirement of posting necessary or helpful? To the uninitiated, a legend which reads "Jefferson Jones, Factor," posted at the entrance to the borrower's premises, is cryptic. The officer of one factoring company recalled with some amusement the time when an acquaintance of his, having seen the company's name outside a textile establishment, had called him on the phone and asked for a discount, on the supposition that the company was engaged in selling dry goods. To the "trade," of course, the sign would be meaningful.

The posting requirement entails some uncertainties. In the first place, it is not enough that the sign be properly posted. It must stay posted. The lender may supervise the posting of the sign. He may even take photographs. But he cannot be on the premises of the borrower all of the time. A dishonest borrower may remove the sign in his absence. Unannounced visits must be made to check and recheck. In the second place, accidents can happen. The sign may not be put in the proper place for the public to see. New York factors are still talking about the time a million dollar lien was lost because the factor's sign was concealed behind an entrance door when the door was kept open during the business day.[1]

To the extent that information of the filing of factor's liens is disseminated by credit reporting agencies and consulted before credit is extended, the posting requirement would seem to be surplusage. Possibly posting may serve to notify some people who would otherwise be in the dark.

There is now a concerted movement to delete the posting requirement from factor's lien acts. The movement has already been successful in several states, including New York, and it may be that

[1] See Silverman, *Factoring: Its Legal Aspects and Economic Justification*, 13 LAW & CONT. PROB. 593, 604 (1948).

before the end of the present year this requirement will have virtually disappeared.[2]

The posting requirement of the New York Act was made to seem somewhat ridiculous by the decision of the Court of Appeals in

[2] I am indebted to Commercial Investment Trust for the following statement in support of deletion:

To date so-called Factor's Lien Statutes, which permit manufacturers, wholesalers, and others, to obtain loans and advances on the security of a general lien on merchandise inventory, have been enacted in twenty-two states. As in the case with chattel mortgages, trust receipts, conditional sales statutes and similar security devices, all of the Factor's Lien Statutes require that a document be filed with the clerk of the county or other appropriate filing officer as a condition to the effectiveness of the lien and as constructive notice of the lien to the creditors of the borrower.

As originally enacted, approximately half of the Factor's Lien Statutes specified that, in addition to public filing, a sign containing the name of the lien holder be posted at the entrance to each place where the merchandise subject to the lien would be located. For the reasons mentioned later, many of the states which initially required the posting of a sign subsequently dispensed with this requirement by an appropriate amendment to the statute. To be specific, although the statutes of Massachusetts, New Hampshire, New Jersey, New York and Pennsylvania as originally enacted required the posting of a sign, subsequent legislation has been adopted repealing this requirement. Of the twenty-two states in which a Factor's Lien Statute is in effect, only six states still require the posting of a sign. Next January when the legislatures convene in Connecticut, Maine, Missouri, North Carolina, Texas and West Virginia, bills will be introduced in each state for the purpose of repealing the sign requirement. If all of such bills are enacted, Virginia, whose legislature does not meet for another year, will be the sole state to retain the sign requirement.

This requirement found its way into the statute not through any intent to give added publicity to the lien arrangement, for certainly it does not establish that, but rather for historical reasons. When initially introduced in 1911, the New York Bill, which was the forerunner of this type of legislation, merely required the posting of sign. The bill was vetoed on the ground that it should contain provisions for public filing as in the case with mortgages. After the requirement for public filing was inserted, the measure became law in New York, but many states in enacting statutes patterned after the New York law automatically adopted the posting provision without giving any particular thought to the efficacy of the sign requirement. Most of the states, however, scrutinized the New York statute in detail and in addition to improving the draftsmanship, dispensed with the sign requirement as pointless and unnecessary.

The sign requirement is unrealistic. It presupposes that credit investigators make a personal examination of the premises of borrowers for the purpose of ascertaining what liens, if any, are outstanding. This is hardly the case, however, for even to those most skilled in the credit field, the posting of a sign with the factor's name on it conveys nothing. It does not state in any way that anyone claims a lien on property within the building, nor does it indicate in any way that the owner has pledged part of its assets. As a matter of practice, banks and other credit grantors rely exclusively upon financial statements, reports issued by credit agencies, and, of course, on the examination of the public offices in which the notices of lien must be filed.

In many small cities and towns and especially in rural communities, the posting of a sign by a manufacturer gives rise to rumors among the employees of the plant that some sort of trouble exists, that the plant is being taken over by a new management or by a bank or factors. Obviously, such a situation does not exist if the filing of a public notice is the sole requirement, for in that case no one has any knowledge of the lien other than those who may be legitimately interested in it.

The sign requirement is also objectionable because to some degree it makes the validity of the lien dependent upon the borrower's cooperation in maintaining

Utica Trust & Deposit Co. v. Decker.[3] From 1922 to 1924 the plaintiff company financed 244 cars of an automobile dealer, covering the cars by a series of 58 chattel mortgages. A term in the mortgages stipulated that the dealer would not sell or use any of the cars covered by the mortgage "for other than exhibition purposes, until the same has been released from this mortgage." The mortgages were filed under section 230 of the Lien Law—chattel mortgage filing provisions. While in the aggregate the cars covered by this series of mortgages may have been a substantial share of the dealer's total inventory, the plaintiff did not post the dealer's premises, as required under the New York Factor's Lien Act.[4] The plaintiff sought to enforce the mortgages on two cars which had been sold by the dealer to innocent buyers. The dealer had not obtained the release of the cars from the plaintiff. There was no evidence that the plaintiff had in the past permitted sale of cars without prior release. The innocent buyers as defendants contended that the plaintiff's failure to post the premises as required under section 45 defeated the plaintiff's claim. (The defendants also argued that the plaintiff, by consenting to exhibition of the cars, was estopped to assert his interest.) The Court of Appeals dismissed the defendant's contentions and gave judgment for the plaintiff.

The *Decker* case is interesting from several angles. The decision demonstrated that systematic financing of a dealer by chattel mortgages may be done without posting under section 45, although the effect may be to cover as much inventory as a factor's lien could. If the purpose of posting is to prevent creditors from being deceived, posting should be required in all situations where all or a substantial part of a dealer's merchandise is covered by a lender's interest. But here as elsewhere it seems too much to expect consistency.

The opinion in the *Decker* case contains observations on the

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the sign as initially posted. Some instances have occurred where a borrower, without the lender's knowledge, has removed the sign or placed it in a less conspicuous location. It is also possible that the sign could be removed or obliterated or obstructed by vandals or natural causes such as storms or the growth of vines and shrubs. Conceivably, a court can hold the entire lien invalid because the sign was not continuously posted as required by the statute.

The sign requirement is unique and finds no counterpart in other statutes providing for liens on personal property, e. g., no such requirement is found in the various chattel mortgage, trust receipt and conditional sales statutes nor does the Uniform Commercial Code make provision for it.

[3] 244 N.Y. 340 (1927).

[4] N. Y. Personal Property Law § 45. This statute, as well as the New Hampshire and Wisconsin Factor's Lien Acts, appears in full in Appendix B, at the end of this article.

applicability of section 45 to the situation involved. The court decided that there was nothing in the statutory language to compel the plaintiff to comply with section 45. But might the plaintiff have utilized section 45 had it desired? (The discussion on this point is really obiter dicta.) Grave doubt was expressed. The plaintiff's security was in the form of a chattel mortgage. The lien right provided by section 45 did not fit the case:

> If we apply the common-law concept of a chattel mortgage we will have no difficulty in making the distinction. Thus . . . the following definition is given: "A chattel mortgage is a present transfer of the title to the property mortgaged, subject to be defeated on payment of the sum or instrument it is given to secure." . . . Chattel mortgages are in no sense "liens upon merchandise or the proceeds thereof" for they are not liens at all. They are not "created by agreement." They are not given to secure "the payment of commissions or other charges." A mortgagee named therein could in no true sense be designated "as lienor, factor or consignee" in a sign to be posted as required by section 45 of the Personal Property Law.[5]

The *Decker* case raises the question whether a security agreement worded in the language of title and defeasance may appropriately be brought within the requirements and advantages of a factor's lien act. The dicta in the *Decker* case may be discounted to some extent because the arrangements involved were obviously intended by the parties to function as chattel mortgages, and because of the narrow view the court took to the Act of 1911. The dicta may not be intended to suggest a factor's lien agreement may not use title and defeasance language in purporting to create a security interest in a dealer's entire stock, with after-acquired clauses, particularly if intended by the parties to operate under the factor's lien act.

Nevertheless, the language warns us that draftsmen of factor's lien agreements had best stay close to the lien language of the act, and avoid words of title and defeasance. Unless the agreement clearly provides for a lien and not a security title arrangement, the lender may see scholasticism come to life, reawaken the semantic distinction between title and lien which has troubled the law of secured transactions. He may see his case depend upon the answer to a subtle question which, in the words of Learned Hand (referring to the distinction between pledge and chattel mortgage agreements) "floats

[5] 244 N.Y. 340, 346-347.

nebulously in that fog, 'the intent of the parties' out of which the courts are so apt to evoke what they most want."[6]

There is also the possibility that a particular security arrangement may qualify for filing under a factor's lien act and under some other act as well. (The possibility is suggested in the *Decker* case.) If the secured party has an election, his filing choice may determine the extent to which he may enforce rights granted by the security agreement. It would be a case of mechanics determining substance.[7]

In any event, there may be nothing to prevent a borrower giving a lender both a chattel mortgage and a factor's lien on his merchandise. As events develop, the lender possessed of such double security may choose to act under one or the other. In a letter to the writer, the representative of one large Texas lender stated:

> In instances where we obtain a factor's lien, it is customary for us to create the lien in our loan agreement, which is a written contract entered into by and between the borrower and this bank. We then file the Notice of Factor's Lien as required by the Statute. It is also our practice to take a Chattel Mortgage covering this merchandise which is the subject of the Factor's Lien. We do not ordinarily record the Chattel Mortgage, but hold it as a device by which we may foreclose upon the security in the event such a course should become necessary. The filing of the Notice protects our lien. We have not, up to this time, found it necessary to enforce our Factor's Liens and there is a possibility that if the time should come when it is necessary for us to do so, we will use the Chattel Mortgage as a matter of expediency but will also proceed through court action.[8]

Filing

All of the factor's lien acts make provision for filing. Filing under the acts is at the county level, in contrast with UTRA, where filing is at the state level. Typically filing is in the county where the merchandise is located. As in the case of UTRA, a simplified notice ful-

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[6] *In re* German Publication Society, 289 Fed. 509, 510 (S.D. N.Y. 1922). See 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 484 n. 68 (rev. ed. 1940) (citing this case). See 1 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES § 6 (6th ed. 1908). The Commercial Code would discard distinctions based on title v. lien in the field of personal property secured transactions. UNIFORM COMMERCIAL CODE § 9-202. As to the Wisconsin position on chattel mortgages (lien v. title), see Midland Nat. Bank & Trust Co. v. Peterson, 229 Wis. 19, 281 N.W. 683 (1938).

[7] It may be possible for a tranaction worded as a factor's lien transaction to qualify under UTRA, without filing, for the secret security interest contemplated by UTRA, if the factor gives new value for the acquisition by the borrower of incoming merchandise described by a writing or, in Illinois and Wisconsin, gives new value against the security of old stock.

[8] Quoted from letter by W. E. Daly, General Attorney, Houston Bank for Cooperatives, dated February 11, 1952.

fills the filing requirement. The basic lending agreement is not filed. Statements of merchandise received and covered by the lien are not filed. The gist of the typical notice provision calls for the filing of a statement setting forth the names and addresses of borrower and lender, the general character of the merchandise subject to the lien, and the period of time during which loans and advances will be made under the agreement.[9] The precise provisions of the statutes, however, vary widely.

The language of the statutes would seem to permit a very generalized description of merchandise. It may be supposed that a court would make short shrift of most challenges based upon insufficiency of description. The purpose of a description should be to give reasonable notice to creditors who read the record before dealing with the borrower, and to identify the subject matter of the lien. It would therefore seem to be the exercise of reasonable caution to specify the particular kinds of commodities or fabricated goods which are involved and their locations. If the borrower is a manufacturer, and the basic agreement subjects all of his inventory to the lien, the notice should specify that the merchandise includes raw materials, goods-in-process and finished goods. It would probably be wise for the notice to specify that the lien includes after-acquired merchandise, and the proceeds from the sale of merchandise. These are merely hazarded guesses as to the sort of description which may suffice to meet the requirements of a factor's lien act. The practicing attorney must form his own judgment, based on the state statute before him. He knows full well how troublesome the homely problem of sufficiency of description has been when the subject matter of a security interest has no identifying number, stamp or survey points.[10] Particularly when the subject matter is loose and changing. But if the notice specifies (in accordance with the agreement) that *all* of the borrower's merchandise at a particular location is included, it would seem that it is a fairly easy task to write a sufficient description.

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[9] The Wisconsin version, for example, provides:
Notice of the creation of a factor's lien shall be signed by the factor and the borrower, shall be filed as hereinafter provided, and shall contain the following information: The name and address of the factor, and the name under which the factor does business, if an assumed name; the name and address of the borrower; the general character of merchandise subject to the lien, or which may become subject thereto, together with the place or places where such merchandise is or will be situated; and the date of the written agreement between the factor and the borrower and the period of time, not exceeding one year from the date of filing the notice, during which loans or advances may be made against merchandise under the terms of said agreement. WIS. STAT. § 241.145(3) (1953).

[10] See, by way of analogy, the discussion of description of livestock in Hannah, *Farmer Financing Problems: Legal Aspects of Short Term Financing*, 42 ILL. BAR J. 751 (1954).

Provision for filing at the county level is in accord with tradition. County level filing is ostensibly for the convenience of local citizenry. It makes fundamental good sense in the case of real estate, but less sense where the subject matter is goods which can be moved about from place to place.[11] Some statutes require that the filing be made in the county where the goods are located and in the county of the residence of the borrower. Even so, what assurance is there in some cases that a credit searcher has consulted the proper county records? In the case of automobile security interests, there seems to be a tendency to change from county to state filing. UTRA is in accord with this tendency. Automobile registration statutes making registration of liens with the state motor vehicle departments followed by notation on the title certificate, the only way to perfect the interest are also in accord. But there is still strong resistance to state level filing of all security interests in goods.[12]

[11] Where the secured interest is in a fleet of trucks operating interstate, filing problems are aggravated to the extreme. To protect the security interest against the claims of acting creditors of the borrower, it could be, under the laws of some states, that filing would be necessary in every county of every state through which the trucks passed. Where the collateral is mobile, there are strong arguments for centralized filing and a conflicts rule which would make filing in one state enough. Section 9—103 (2) of the Uniform Commercial Code, considered in context with 9—401 (1) (a), would enormously simplify filing problems for security interests in mobile equipment. For a terse discussion of such filing problems, and the advantages of the Code in this respect, see UNIFORM COMMERCIAL CODE, SUPPLEMENT No. 1, at 79-80.

[12] Localized filing tends to increase the risks of filing, as well as the risks of the record searcher. From the security interest holder's point of view, it increases the chance of fatal error through misfiling or imperfect filing. Local filing provisions may vary, depending on the secured interest involved, and the variations, not being founded on compelling common sense, increase the technicalities in the law of personal property secured transactions. The situation in Wisconsin, while not as complicated as that in some other states, is illustrative. Conditional sales contracts or copies thereof must be filed in the office of the register of deeds of the county in which the goods are first kept for use by the buyer after the sale. WIS. STAT. § 122.06 (1953). Special provisions govern sales of fixtures and rolling stock. Chattel mortgages or copies thereof must be filed in the office of the register of deeds of the county in which the personal property is situated. WIS. STAT. § 241.10 (1953). Notices of factor's liens must be filed in the office of the register of deeds of the county in which merchandise subject to or to become subject to the lien is or will be situated. WIS. STAT. § 241.145(4) (1953). Notices of trust receipt financing must be filed in the office of the Secretary of State. WIS. STAT. § 241.43 (1953). But provision is made for election between filing statutes. WIS. STAT. § 241.46 (1953). Assignments of accounts receivable are not filed. WIS. STAT. § 241.28 (1953). Filings of conditional sales, chattel mortgages and notices of factor's liens are valid for three years, and various provisions are made for the filing of renewals. Filing of notice of factor's lien protects advances made for only one year. Chattel mortgage and factor's lien filing is the race-for-the-record kind, but a ten-day period of grace is given for conditional sales. Notice of factor's lien must be filed within fifteen days after the execution of the written agreement. WIS. STAT. § 241.145(4) (1953). Presumably chattel mortgages and conditional sales filed more than 21 days after creation may be attacked as preferential under § 60a of the Bankruptcy Act as amended in 1950. There are special provisions for the filing of follow-up statements in the case of mortgages on stock in trade, WIS. STAT. § 241.14 (1953), and consignment arrangements, WIS. STAT. § 241.26

Provision for filing at the county level may limit the reach of the factor's lien. The Wisconsin act provides, "Notice of the creation of a factor's lien shall be filed in the office of the register of deeds of the county in which the merchandise subject to or to become subject to the lien is or will be situated." Filing in this county would seem to suffice to attach the lien to merchandise in transit, shipped to the borrower with title passing to him at the point of shipment, even before such merchandise reaches the county where the notice is filed. Some dealers, however, conduct a part of their business on a "drop shipment" basis. They may direct their suppliers to fill a customer's order by shipping directly to the customer. By direction the consignor may ship the goods to the dealer as consignee, at the address of the customer. In a case like this, title may pass to the dealer at the point of shipment. Can such merchandise be included within a factor's lien? County filing requirements apparently in many cases could prevent attachment of the lien to drop shipped goods. Where drop shipments are a substantial part of a borrower's business, the lender may desire to supplement his protection by insisting upon assignments of the accounts receivable arising.[13]

Some of the statutes set a time within which the notice must be filed. The Wisconsin act, for example, prescribes that "such notice of the creation of a factor's lien shall be filed, as hereinafter provided, within 15 days after the execution of the written agreement . . . ."[14] The act does not specifically state what consequence will ensue from a delayed filing. The fifteen days are not a period of grace, such as the ten-day provision of the Conditional Sales Act. A race-for-the-record type of recording seems to be contemplated. Under the Wisconsin act it seems clear that the filing of a factor's lien notice within fifteen days of the written agreement will not relate the lien back to the time of the agreement so as to defeat the rights of intervening attaching creditors. The lien is to be effective "from and after the date of

(1953). The filing of notice of trust receipting is good to protect transactions which are within one year of the date of the filing, with provision for renewal. Wis. Stat. § 241.43(4) (1953). When conditionally sold chattels are transported from the county where the contract is filed to another county, refiling must be made in the county where the property is relocated within ten days after the seller has received notice of the county to which the goods are removed. Wis. Stat. § 122.14 (1953). If a chattel mortgage is involved, the original filing suffices to protect, Peterson Cutting Die Co. v. Bach Sales Co., Inc., 269 Wis. 113, 68 N.W.2d 804 (1955), at least up to such time as the mortgagee is apprised of the removal. The situation in Wisconsin, while complicated by the variety of special filing provisions, appears simple when compared with the New York situation. See Uniform Commercial Code, Supplement No. 1, at 185-88.

[13] The special risks and procedures involved in financing drop shipments are set forth in Seidman, *Finance Companies and Factors*, National Conference of Commercial Receivable Companies, Inc. 47 (1949).

[14] Wis. Stat. § 241.145(4) (1953).

filing."[15] Thus the effect of delayed filing under the act must be something other than the loss of relation-back rights. The likeliest interpretation is that delayed filing will be ineffective as to all creditors, at least as to creditors who extended credit between the time of the agreement and the time of filing of the notice.

In view of the differences of decisions as to the effect of a delayed filing of a chattel mortgage,[16] it is unfortunate that the factor's lien acts sometimes do not spell out with particularity the results intended. This is merely one more illustration of the fact that brevity and generality in statutes do not always make for clarity.

The formal publicital requirements need not be met where the factor has possession of the merchandise. The New York statute provides: "When any factor or other lienor, or any third party for the account of any such factor or other lienor, shall have possession of goods and merchandise, such factor or other lienor, shall have a continuing general lien . . . without filing the notice and posting the sign provided for in this section."[17] The provision was incorporated in 1935.[18] (It was probably a reaction to the decision of the New York Court of Appeals in *Irving Trust Co. v. Linder & Bro., Inc.*[19] That decision should be read for laughs, for it shows how the 1931 amendment to the New York act[20] overreached. The immediate purpose of the amendment, to give new-style factors the relation back advantages of the equitable pledge doctrine, is now ancient history).

Provisions such as that in the New York statute are prevalent in the factor's lien acts. This language makes possession the equivalent of filing. It would seem that if a factor takes possession of merchandise within twenty-one days of the time when he extends new value on the security of the merchandise, his lien will not, to the extent of the new value thus extended, be preferential under the 1950 amendment to the Bankruptcy Act.[21]

The possession-equals-filing provisions may be particularly useful where the merchandise is in the hands of a third party.[22] In the textile industry, it is frequent practice for goods to be placed in the hands of a bailee for dying or finishing. Presumably the factor upon agree-

[15] WIS. STAT. § 241.145(6) (1953).
[16] 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES §§ 501-505 (Rev. ed. 1940).
[17] N.Y. PERSONAL PROPERTY LAW § 45.
[18] N.Y. Sess. Laws 1935, c. 690.
[19] 264 N.Y. 165, 190 N.E. 332 (1934).
[20] N.Y. Sess. Laws 1931, c. 766.
[21] 64 STAT. 24 (1950), 11 U.S.C. § 96 (1952), amending 30 STAT. 562 (1898).
[22] See Silverman, *Factoring: Its Legal Aspects and Economic Justification*, 13 LAW & CONT. PROB. 593, 600 (1948).

ment with his borrower could acquire a lien on his borrower's goods in the hands of the bailee by simply notifying the bailee.[23]

It may happen that a factor will couple his factor's lien with a field warehousing arrangement, or some other system of control whereby he acquires a possessory interest in merchandise on his borrower's premises. In such case, compliance with publicital requirements would serve only as a double precaution or to protect goods not in the warehouse or otherwise in the lender's possession. The factor may resort to field warehousing if the borrower's position deteriorates and firmer control over the merchandise seems warranted. In the event of the borrower's bankruptcy, there are certain advantages in having a possessory interest in the security.

Bulk Sales Acts

A few words on the subject of Bulk Sales Acts and the question of their applicability to the factor's lien. As a measure of protection against unscrupulous dealers who make bulk sales of their merchandise and fiee to parts unknown without paying their creditors, a wave of statutes in varying language has set up procedures which must be followed in making bulk sales of merchandise. The tendency of the courts is to hold that these statutes do not apply to bulk mortgage transactions.[24] In some cases the decision on the question was made to turn upon the determination of whether under the law of the state a chattel mortgage gave the mortgagee security title or a lien.[25] Considering the mischief to which the statutes are addressed, a persuasive argument can be made that a bulk mortgage not in the ordinary course of business is within the purview of the statutes.[26] It may be that a mortgagee of merchandise in bulk should be under some kind of duty to see that the funds he supplies are used by the borrower to clean up debts. Certainly some limitations

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[23] There exists a division of authority as to whether or not the consent of the bailee is necessary in such case. The better view is that consent is unnecessary: otherwise the bailee is given "an arbitrary power of affecting the interests of the other parties." RESTATEMENT, SECURITY, comment *a* at 24 (1941).

[24] See Aristo Hosiery Co. v. Ramsbottom, 46 R.I. 505 (1925). As to whether or not Wisconsin's statute applies to a bulk mortgage transaction, there are no decisions to date. It is not clear whether the Wisconsin Supreme Court would consider the chattel mortgage a title transfer tranaction for this purpose. See Midland National Bank and Trust Co. v. Peterson, 229 Wis. 19, 281 N.W. 683 (1938).

[25] See Miller, *The Effect of the Bulk Sales Article on Existing Commercial Practices*, 16 LAW & CONT. PROB. 267, 272 (1951). With regard to the background of the bulk sales acts, see Billig, *Bulk Sales Laws: A Study in Economic Adjustment*, 77 U. OF PA. L. REV. 72 (1928).

[26] See the dissenting opinion in Markwell & Co. v. Lynch, 114 F.2d 373, 374 (9th Cir. 1940). Several states, *e.g.*, New York, Michigan and Louisiana, have bulk mortgage laws.

in the nature of a bulk sales law could reasonably be imposed upon the creation of bulk mortgages on merchandise for an antecedent debt.[27]

The decisions on bulk mortgages indicate that in the majority of states the bulk sales act would not be applied to a statutory factor's lien on merchandise. It may also be argued that a factor's lien act is intended to provide a publicital means sufficient in itself for the perfection of the bulk lien obviously contemplated by the act.[28] The argument supposes that the factor's lien act is later than the bulk sales act.

Publicital requirements are part of the adjective law of the factor's lien. But one cannot think long on the subject without seeing their substantive aspects. The nature of the lien, its scope and effect, are circumscribed by the mechanics of perfection. There is not too much difference between this topic and the one that follows.

The Reach of the Factor's Lien

While the statutes generally give the factor's lien a boarding house reach, there are outside limits. If the borrower does not own the merchandise, the lien does not attach to it, short of situations of estoppel and apparent authority. It seems clear that goods delivered to the borrower under consignment or conditional sale arrangements do not, to the extent of the supplier's interest, become subject to the factor's lien, unless for failure to post, file or otherwise the supplier is prevented from asserting his title. The case of a supplier who takes a purchase money mortgage to secure the balance of the purchase price is not as clear.[29] Wisely, the Wisconsin statute specifically deals with this case.[30] Any statute which authorizes a lien with an after-acquired clause should deal specifically with situations such as the above.[31]

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[27] At one stage, the Commercial Code put a bulk transfer for the purpose of securing an antecedent debt within the bulk transfer provisions. UNIFORM COMMERCIAL CODE § 6—103(1) (Official Draft 1952). This position was vacated in a last minute move to reduce opposition.

[28] See the approach of the opinion in Heffron v. Bank of America Nat. Trust & Savings Ass'n., 113 F.2d 239 (9th Cir. 1940). Bulk Sales Act held inapplicable to factor's lien in Colbath v. Bank, 96 N.H. 110, 70 A.2d 608 (1950).

[29] OSBORNE, MORTGAGES (1951) states at 556-57 that the purchase money mortgage prevails over the claim of an after-acquired clause (citing cases), "because such clauses operate only to create equitable mortgages and consequently cover only the property as it lies in the hand of the mortgagor." But see Hickson Lumber Co. v. Gay Lumber Co., 150 N.C. 282, 63 S.E. 1045 (1909). The after-acquired interest created by a factor's lien act is presumably a *legal* interest. Should this make a difference?

[30] WIS. STAT. § 241.145 (5)(c) (1953).

[31] Article 9 of the Commercial Code treats purchase money interests, seller's and lender's, on the same basis. § 9—107. Note that Supplement No. 1 (1955) deletes 9—107 (3).

A statute authorizing a lien on merchandise should make specific reference to the rights of buyers who acquire merchandise from the borrower in the ordinary course of business. Some of the factor's lien acts expressly protect such third parties.[32]

The extent to which a lender on inventory should be allowed to assert his security interest against buyers in the ordinary course of business is controversial. If the lender takes possession of the security and effectively deprives the borrower of power to sell, there is, of course, no real problem. But if he permits his borrower, the dealer, to remain in possession, can he by stipulations in the lien agreement effectively restrict the power of the dealer to confer clear title upon an innocent buyer in the ordinary course of business? (The provisions of the agreement may run the spectrum from prohibiting any activity of the borrower looking to sale, to full permission to the borrower to sell the goods. Some agreements may permit the borrower to exhibit the goods for sale, but not to sell them without obtaining prior release from the lender.)

It may be, as stated in *Levi v. Booth*, that "it is very clear . . . that the *bare possession* of goods by one, though he may happen to be a *dealer* in that class of goods, does not clothe him with power to dispose of the goods as though he were owner, or as having authority as agent to sell or pledge the goods, to the preclusion of the right of the real owner. If he sells *as owner* there must be some other *indicia* of property than mere possession. There must . . . be some act or conduct on the part of the real owner whereby the party selling is clothed with the apparent ownership, or authority to sell, and which the real owner will not be heard to deny or question to the prejudice of an innocent third party dealing on the faith of such appearances. If it were otherwise, people would not be secure in sending their watches or articles of jewelry to a jeweler's establishment to be repaired, or cloth to a clothing establishment to be made into garments."[33]

Does this language fit the case of the wholesale financer who entrusts his borrower with the possession of merchandise? His borrower has the beneficial interest in the goods. The lender should not be permitted to the coquettish, to tease prospective buyers by authorizing the dealer to place the goods in his exhibition room, or to exhibit the goods for sale, and still assert his interest against unwitting buyers

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[32] See, *e.g.*, WIS. STAT. § 241.145(5) (1953).

[33] 58 Md. 305, 314-315 (1882).

who acquire the goods without obtaining their release from the lender.[34] But there are some decisions like the *Decker*[35] case which hold that permitting the dealer to exhibit merchandise for sale will not estop a lender from asserting his security interest against a buyer in the ordinary course who has failed to obtain the lender's release as stipulated in a security agreement filed of record. Decisions like this are to be deplored.

The mores of the community seem increasingly opposed to the position taken in the *Decker* decision. It is doubtful that today any *reputable* wholesale financer of cars would attempt to assert rights against a buyer in the ordinary course of trade. The attorney for one of the largest automobile wholesale financers informed the writer that in his opinion the *Decker* case is bad law.[36] UTRA negates it.[37] As a matter of fact, the writer believes that it should not matter whether or not the buyer knows of the existence of a wholesale security interest in a car at the time he purchases it. He should be privileged to assume that a dealer in possession of the car and offering to sell it to him has actually full authority to accept the purchase price on behalf of the lender, regardless of the written agreement between dealer and lender.[38]

Some of the factor's lien acts protect the buyer in clear terms. For example, the Missouri act provides: "When merchandise [subject to the lien provided by this act] is sold in the ordinary course of the business of the borrower, such lien, *whether or not the purchaser has knowledge of the existence thereof*, shall terminate as to the merchandise so sold and shall attach to any obligation to pay for the same and to any other proceeds of such sale in the hands of the borrower."[39] (Italics supplied)

In protecting the knowing buyer, provisions like these take us to

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[34] One of the most controversial changes that would be introduced by the Commercial Code is incorporated into § 2—403. This section would uphold the title of a good faith purchaser as against one who had "entrusted" goods to a merchant who deals in goods of that kind, where the merchant sells without authority.

[35] See Whitehurst v. Garrett, 196 N.C. 154, 144 S.E. 835 (1928), 42 HARV. L. REV. 573 (1929).

[36] See Boice v. Finance and Guaranty Corp., 127 Va. 563, 102 S.E. 591 (1920); Gump Investment Co. v. Jackson, 142 Va. 190, 128 S.E. 506 (1925); OSBORNE, CASES ON PROPERTY SECURITY 950, 953 (1940).

[37] UTRA § 9(2)(c).

[38] See, for example, the comments of the New York Law Revision Commission regarding the conditional sale for resale: "The object of a conditional sale for resale is to permit the buyer to pass title to a purchaser. Under ordinary principles of agency the conditional seller should be bound by the conditional buyer's transfer of title to the goods in the ordinary course of business without regard to the purchaser's knowledge of the terms of the conditional sale contract. Report of the N. Y. Law Revision Commission 242 (1941).

[39] MO. REV. STAT. § 430.290(2) (1949).

the very end of a development which Grant Gilmore has recently described:

> The triumph of the good faith purchaser has been one of the most dramatic episodes in our legal history. In his several guises, he serves a commercial function: he is protected not because of his praiseworthy character, but to the end that commercial transactions may be engaged in without elaborate investigation of property rights and in reliance on the possession of property by one who offers it for sale or to secure a loan. As the doctrine strikes roots in one or another field, the "good faith" component tends to atrophy and the commercial purchaser is protected with little more than lip service paid to his "bona fides."[40]

The whether-or-not language of the Missouri act is even in advance of UTRA,[41] and foreshadows section 9-307(1) of the Commercial Code.[42] Similar language may be found in some other factor's lien acts.[43] While the protection is given to "purchasers" rather than "buyers," the context usually indicates that pledgees and mortgagees do not fall within the definition. In the Wisconsin version, however, it is not clear that the term "purchasers" refers only to buyers. A problem of interpretation is raised. If, under the Wisconsin act, subsequent mortgagees and pledgees though actually knowing of a perfected factor's lien could acquire an interest in the borrower's merchandise superior to that of the factor, there would be not much sense to the factor's lien. It would be unreasonable to interpret the Wisconsin act to permit this result.

Another class of third persons, somewhat analogous to buyers in

[40] Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L. J. 1057 (1954).

[41] "Buyer in the ordinary course of trade" is defined as one "to whom goods are sold and delivered for new value and who acts in good faith and without knowledge of any limitation in the trustee's liberty of sale . . . ." WIS. STAT. § 241.31(1) (1953). WIS. STAT. § 241.39(2)(c) (1953), provides that "if the entruster consents to the placing of goods subject to a trust receipt transaction in the trustee's stock in trade or in his sale or exhibition rooms, or allows such goods to be so placed or kept, such consent or allowance shall have like effect as granting the trustee liberty of sale." Does a factor's lien transaction under a factor's lien act imply like liberty of sale? On the meaning of "in ordinary course" see Heindl, *Trust Receipt Financing Under the Uniform Trust Receipts Act*, 26 CHI-KENT L. REV. 197, 246 (1948).

[42] "In the case of inventory, and in the case of other goods as to which the secured party files a financing statement in which he claims a security interest in proceeds, a buyer in ordinary course of business takes free of a security interest even though perfected and even though the buyer knows of the terms of the security agreement." 9—109(4) defines "inventory" as goods that are "held or are being prepared for sale . . . ."

[43] WIS. STAT. § 241.145(5)(a) (1953): "Purchasers for value in the ordinary course of the business of the borrower shall take the merchandise free and clear of the factor's lien provided for herein, whether or not they have knowledge of the existence of such lien." Minnesota, South Carolina and Virginia have similar provisions.

the ordinary course of trade, is very generally accorded rights superior to the lien. The factor's lien is subordinated to "specific liens for processing, warehousing, or shipping the merchandise in the usual course of the borrower's business preparatory to sale," to use the words of the Wisconsin statute.[44] In the textile industry, where much of the work on goods is done by third party contractors, these words deal with vital matters. It would disadvantage both the borrower and the factor if the factor's lien obstructed the readying of goods for the market. The provision calls to mind that much litigated question: may an artisan have a lien on a chattel for work done at the behest of a chattel mortgagor, superior to the prior security interest of the mortgagee? (A similar question arises in respect to conditional sales and bailment leases.)[45] Where the artisan is charged with actual or constructive notice of the existence of the prior interest, the tendency is to treat his claim as inferior except where the mortgagee is found to have expressly or impliedly consented to hav-

[44] The specific liens which are made superior to the factor's lien may be common law or statutory. The common law categories of specific possessory liens (see RESTATEMENT, SECURITY c. 2) have been frequently redefined in statutory form, and many additional lien rights have been recognized by statute. In Wisconsin, specific liens which may attach to "merchandise" as defined by the factor's lien act would seem to include: mechanic's lien, WIS. STAT. § 289.41 (1953); lien of keepers of livery stables, garages and pastures, WIS. STAT. § 289.43 (1953); lien of factors, brokers, etc., for commissions, etc., WIS. STAT. § 289.45 (1953); lien for labor in quarry, WIS. STAT. § 289.40 (1953); mining lien, WIS. STAT. § 289.35 (1953); log lien, WIS. STAT. § 289.18 (1953); cook's lien, WIS. STAT. § 289.31 (1953); camp supplier's lien, WIS. STAT. § 289.24 (1953); jeweler's lien, WIS. STAT. § 289.46 (1953); lien of owner of breeding animal or services, WIS. STAT. § 289.49 (1953); lien for threshing, husking and baling, WIS. STAT. § 289.50 (1953); lien for cleaning, dyeing, repairing and glazing of wearing apparel, WIS. STAT. § 289.71 (1953); warehouseman's lien, WIS. STAT. § 119.29 (1953); common carrier's transportation and storage lien, WIS. STAT. § 171.07 (1953); It would also seem that the lien for taxes on personal property would be superior. In Wisconsin, statutory lien provisions are a hodge-podge. The position of the lien claimant *vis-a-vis* third party interests (*e.g.*, chattel mortgages) is not always clearly defined. The provision of the factor's lien act seems to clarify a situation that might otherwise be controversial. The mechanic's or artisan's lien is subordinated for charges in excess of $150 to prior chattel mortgages and conditional sales, unless the prior interest holder has expressly consented to the charges. WIS. STAT. § 289.41 (1953). Where the subject matter is inventory requiring further fabrication to fit the goods for sale, a mechanic performing such fabrication should not have to seek the express consent of the holder of a prior security interest in the goods. But it would require really elastic statutory interpretation to protect him in some cases. What is the meaning of "express" consent? The provision in the factor's lien act eliminates the problem. The warehousemen's lien of the *Uniform Warehouse Receipts Act* is generally made inferior to the claims of a prior secured interest. 3 ULA § 27. But not so where a chattel mortgagee has expressly or impliedly consented to the storage of the goods by the mortgagor. Zahner Mfg. Co. v. Harnish, 224 Mo. App. 870, 24 S.W.2d 641 (1930). Again the provision in the factor's lien act clarifies the situation.

[45] See Lee, *Power of Possessor of Personal Property to Create Lien for Repairs and Storage Charges Superior to Existing Interests of Others*, 90 U. OF PA. L. REV. 910 (1942).

ing the work done. Some courts have gone far to find an implied consent. Where merchandise is the subject of a security interest, there should be little difficulty in finding that the security interest holder impliedly consented to having the debtor in possession contract for work, storage and transportation necessary to market the goods. The express provisions of the factor's lien acts subordinating the factor's lien to liens for such services probably state a result the courts would have arrived at without statutory help.

The run-of-the-mill creditors of the borrower, except such as have obtained a lien on the merchandise before notice of the factor's lien is filed, are in the cold. The factor may argue that they really benefit from the arrangement, because the funds he supplies will expectably be used by the borrower to pay them. If the borrower becomes bankrupt, unpaid general creditors may have reason to conclude that they have been not merely simple creditors, they have been simple-minded creditors. Some may feel that the law of distribution of an insolvent's assets is unjust. But that is the nature of the beast; the nature of the law of secured transactions. The security of one creditor may be the insecurity of another. The allocation of a borrower's assets implicit in the law of secured transactions does not necessarily coincide with the degree to which claimants have contributed to the value of the assets. A supplier on open account may provide assets. Another creditor may obtain a security interest in the assets. If there is any economic foundation to the law of secured transactions, it is the importance of upholding freedom of contract, and distributing a debtor's assets in accordance with the risks which were consciously or unconsciously assumed in dealing with him on a credit basis. That is the importance of bargaining as an economic institution.

A borrower with a factor's lien on his merchandise may find it difficult to obtain unsecured credit from a bank. He may also find that some of his suppliers will hesitate to do business with him on open account. (The supplier could request the factor to waive his lien to the extent of the supplier's claim.) These results might ensue, despite the fact that the borrower's credit rating might not be impaired, might actually be improved, as a result of his arrangements with the factor.[46]

[46] With regard to the effect on credit standing of the pledging of inventory, an official of an important credit rating firm has written to me as follows under date of January 14, 1952:

I would say that if our practice could be reduced to a few words, I think it would best be expressed as follows:

Pledged Assets: The fact that certain assets are pledged, in itself, is not sufficient to modify the Credit Rating. The circumstances surrounding the

After-Acquired Merchandise

The statutes provide that the factor's lien may include after-acquired merchandise. This legislative authorization of a consensual lien on future assets is one more illustration of the way in which an ancient edifice of the common law is being dismantled stone by stone. Once there was virile vitality to the proposition that a man may

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pledge, the nature of the assets pledged, the manner of the pledge, the extent of pledged assets and the size of the liabilities so secured, are factors which must all be considered in relation to the credit position as a whole.

A concern with adequate net working capital, reasonable current liabilities, and a moderate mortgage debt against real estate may be, and often should be considered to be in high standing.

A concern in favorable credit standing which pledges marketable securities or assets not used in the business as collateral for bank loans in order to obtain a better interest rate, and which maintains a well balanced financial condition also may be and often should be considered high credit.

As with all features relative to ratings, sound judgment of individual cases plays an important part in rating decisions when pledged assets enter the picture. In general, however, a concern which finds it necessary to pledge an important part of its merchandise and receivables in order to obtain necessary loans, obviously is a less desirable credit risk than the concern with current assets unencumbered.

Whenever a pledge of assets is known to exist, full information regarding all of the circumstances which give rise to this situation should be obtained. Then, and only then will the basis exist for a sound decision regarding the credit standing.

I can only state what we recently said to the vice president of one of the larger concerns that does accounts receivable financing. He asked us what our attitude and the attitude of credit men in general is to the pledge of receivables or inventory? We said that every case stands on its own merits and must be judged accordingly. In our experience, we have found some concerns that were very materially helped because they have been able to get loans on inventory. Furthermore, there are certain classes of business that could hardly exist without pledging inventory, unless huge amounts of capital could be raised. I have in mind such concerns as cotton dealers, wholesalers and manufacturers of canned goods, dealers in cocoa, coffee and other commodities. As a matter of fact, commodity loans are quite usual.

On the other end of the scale you find concerns which are quite weak. Such concerns may be helped by making loans against inventory. If I am a general creditor, I may be very happy when a concern which has otherwise been slow pay is able to increase cash income or more effectively make use of working capital through use of an inventory loan.

In brief, I would like to say that there is no such thing as "rules" that we have been able to find that exists among credit men which say that the mere existence of a loan against inventory is enough in itself to indicate that the credit position has weakened.

With regard to the effect of inventory liens on unsecured creditors and selling on open account, Mr. W. Randolph Montgomery under date of January 21, 1952, has written me as follows:

For what my opinion may be worth, I might say in answer to your questions: The basis for the extension of unsecured credit is the net current assets of the buyer. Next to cash, the most liquid current asset is accounts receivable, and next on the list is inventory. If the inventory has been pledged to a lender, the unsecured creditor must rely principally upon accounts receivable as the basis for the extension of credit. (Cash is a variable and fluctuating item upon which little reliance can be placed). If, therefore, inventory is pledged, the basis for unsecured credit is inevitably restricted. I do not believe that there is a transition away from open account and unsecured credit.

mortgage only what he now has, and not what he will have.[47] The tenet is not dead yet: indeed in Wisconsin it has still dynamic expression.[48] But everywhere in differing extent the old words have been subjected to a modifying gloss. The doctrine of potential existence[49] and an expansive functionalized test of "fixtures" have approved of the attachment of security interests to certain kinds of after-acquired assets. Since the equity decision of *Mitchell* v. *Winslow*,[50] inconstant suasions of circumstance have sometimes caused courts to impose equitable liens on after-acquired assets, of varying efficacy against notified purchasers and judgment creditors. Gone is confident generalization.

In state after state, the present situation seems rife with schizophrenic contradition.[51] Confused and distracted by the dissembling decisions, the law-analyst may become persuaded that there is no way out of the fen except by entire acceptance of a view that security interests in after-acquired assets should be enforced. Such, incidentally, is the solution proposed by the Commercial Code. But is there not something to be said for the common law? The ability to offer future assets as security may sometimes be of immediate advantage to a borrower. The price is that his future assets will be unfree. In an extreme case the borrower may find himself in a "some-

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> Statutes such as the Factor's Lien Act and laws regulating the assignment of accounts receivable, do not jeopardize the position of unsecured creditors, but have the opposite effect. Where public notice of such liens and assignments is required, the unsecured creditor is in a position to more accurately evaluate the free assets upon which unsecured credit may be granted. Of course, if all current assets are tied up, there is usually little or no basis for the granting of unsecured credit.

Mr. Robert M. Gardineer, Associate Director of Credit Research Foundation, Inc., wrote me under date of January 25, 1952:

> . . . [W]e have not seen any evidence of a transition away from open account credit, nor do we believe such a transition is taking place. I would say that any increase of inventory financing reflects the impact of current economic conditions on business psychology.
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> You raise the question as to whether suppliers are more hesitant when extending open account credit to customers who have pledged their inventory. I would not say they are more "hesitant," but they are more "cautious." If there is any reasonable basis on which unsecured credit can be granted, the supplier will extend unsecured credit, but he will watch the account closely for any signs of impending financial difficulty.

[47] "A man cannot grant or charge that which he hath not." PERKINS, PROFITABLE BOOK *15, quoted in OSBORNE, MORTGAGES 83 (1951).

[48] See Bunn, *Financing Dealers: Existing Wisconsin Law and the Uniform Commercial Code*, 37 MARQ. L. REV. 197 n.2 (1954).

[49] "A parson may grant all the tithewool that he shall have in a year; yet perhaps he shall have none; but a man cannot grant all the wool, that shall grow upon his sheep that he shall buy hereafter; for there he hath it neither actually nor potentially." Grantham v. Hawley, Hobart 132 (K.B. 1616). This case is "the parent of the fictitious doctrine of 'potential existence'," quoted from Cohen and Gerber, *The After-Acquired Property Clause*, 87 U. OF PA. L. REV. 635 (1939).

[50] 17 Fed. Cas. No. 9673 (C.C.D. Me. 1843).

[51] See Cohen and Gerber, *op. cit. supra* note 49.

what refined sort of peonage."[52] While he can always escape the mesh by paying off the loan, he may continue to need this fund. He may need more. Like the employee who owes the company store, he may and perhaps must keep coming back to the lender who has acquired the initial advantage. Consider also the general creditors of the borrower. Must they, in extending credit to the borrower, risk a fact which only an elaborate search of the records would reveal? If the borrower becomes insolvent, an operative after-acquired clause may scoop up assets which they supplied.

Consider the task of the record searcher who seeks to determine the title to land or goods. Legal recognition of the after-acquired clause may unduly magnify his difficulties. Much would depend upon the state of the county records. An interest in real estate claimed under an after-acquired clause is not readily discovered, unless the parcel to be acquired is specifically described in the security instrument. The record search for security interests in goods is usually shortened by statutory time limits on the record life of the lien and by the availability of card indexes. In the case of goods, the main problem may be to trace the chain of title, since the title to many kinds of goods is not a matter of public record.

Thus legal recognition of an after-acquired clause may increase the risks, and perhaps the costs, of title search. It must be noted, however, that there may be other kinds of title defects which would be equally hard to discover. In various ways a person may cause a title defect before he acquires title and has the deed recorded. Be that as it may, the fact remains that the risks of title search are increased, particularly in the case of real estate.

The writer would hesitate, therefore, to espouse a view that the common law position was without merit and foundation. The propriety may depend upon the kind of asset and transaction involved.[53] An after-acquired clause which simplifies the making of fresh advances over a limited time is one thing; an after-acquired clause to create additional security for an antecedent debt is another. The transactions of a merchant may deserve special treatment. If he wants to encumber his future assets with his eyes wide open, there seems little in social policy to oppose his choice, and by this time general creditors can hardly rely upon the ostensible ownership of a dealer in merchandise.

[52] LLEWELYN, CASES AND MATERIALS ON THE LAW OF SALES 577 (1930).

[53] Cohen and Gerber, *op. cit. supra* note 49, at 660, state that in their opinion "the type of property involved is the most important operative fact in the determination of whether property to be acquired in the future may be presently mortgaged." In the case of mortgages on merchandise, they feel that "the fact that after-acquired property is involved should not be an operative fact. . . ." The case should turn upon state policy toward a mortgage on a stock of goods. *Id.* at 657.

The factor's lien on merchandise presents a case where overriding business necessity may require a fully enforceable lien on after-acquired assets. A nonpossessory continuing lien on a dealer's entire stock in trade virtually presupposes an effective after-acquired clause, so that rights will attach to new merchandise as replacement for merchandise that is sold. In Wisconsin, the difficulties of the record searcher are kept within bounds by a provision setting a three-year duration to the life of a factor's lien. In some states there is no such time limit, and the difficulties may be greater. The Wisconsin provision seems desirable.

All factor's lien acts contemplate the creation of rights in after-acquired merchandise. Such rights, however, would be subject to a serious qualification if under a statute it was necessary for the borrower to perform some act appropriating merchandise to the lien after it was acquired. There would be a large loophole if the original agreement between the parties could not effectively place the lien upon future as well as present goods. The language of some of the statutes is not too clear on this point. The New York act, for example, provides for a consensual continuing general lien upon "all goods and merchandise from time to time consigned to or pledged with" the lender. Obviously the words do not require a physical transfer of possession,[53a] which would only be possible when the goods came into existence. The delivery of a writing reading like a consignment or pledge is contemplated. Construing similar statutory language, the Supreme Court of New Hampshire held in *Colbath* v. *Mechanicks National Bank*[54] that the parties could in their basic agreement subject to the lien without further ado merchandise that would be subsequently acquired. This is the nature of the "continuing general lien." Separate *in praesenti* writings were not required. "It seems improbable," the opinion observed, "that our Legislature intended that a general store borrower, for example, must separately consign each spool of thread, can of beans or package of gum to a lender bank in order to maintain the lien."[55] (It was in keeping with this attitude toward the statute that the court also decided that the bank did not lose its lien by permitting the borrower to sell goods in the usual course of business without requiring the borrower to account for the proceeds. Section 7 of the act, the court pointed out, "demands that it be 'construed liberally' ").[56]

The statute considered in the *Colbath* case also provided for the

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[53a] *In re* Comet Textile Co., 15 F. Supp. 963 (S.D.N.Y. 1936), *aff'd*, 91 F.2d 1008 (2d Cir. 1937).
[54] 96 N.H. 110, 70 A.2d 608 (1950).
[55] *Id.* at 113, 70 A.2d at 610.
[56] *Ibid.*

transfer of the lien on merchandise to the accounts receivable and other proceeds arising from the sale of liened merchandise. Did the pertinent language give like effect to the terms of a basic agreement purporting to subject after-acquired derivative accounts receivable to the lien? Or did the language require a further act of assignment or notice to the account debtor to perfect a lien upon an account after it was created? The question was before the Court of Appeals for the First Circuit in *Manchester National Bank* v. *Roche*.[57] It was held that the basic agreement could not avail to perfect rights in future accounts receivable. Such being the case, a belated notice to account debtors, given within four months of the filing of the borrower's petition in bankruptcy, would be an attempt to obtain a preference. (Further, it was held that the core of the rule of *Benedict* v. *Ratner* was impliedly preserved by the statutory language governing rights in accounts receivable, in view of the fact that one application of the rule—to returned merchandise—was expressly set aside. *Expressio unius est exclusio alterius*).

The decisions were consistent: it was the statute which was inconsistent. They dramatized that the New Hampshire statute, thanks to its New York parent, was an example of feeble draftsmanship. In 1951 the New Hampshire legislature enacted sweeping revisions designed to correct the inconsistencies which had been revealed and to equate account receivable financing with financing on the security of merchandise.[58]

These decisions cast some light upon the nature of the factor's lien on merchandise. How close is it to the English "floating charge"? It is the nature of the English "floating charge" that it "remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes."[59] A characteristic of this charge on company assets (frequently used in debenture financing) is that it shifts or flows, and is inchoate. It leaves the company free to deal with its assets in the ordinary course of business, to dispose of its assets by sale, to mortgage the assets, to pay dividends out of profits, without regard to the charge.[60] Even a levying or garnishing creditor of the company may secure an execution sale of company assets, unless the debenture holder acts to prevent the sale.[61] Thus, until it is galvanized by the occurrence of a condition, the English "floating charge" upon company assets floats

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[57] 186 F.2d 827 (1st Cir. 1951).
[58] N.H. Laws 1951, c. 218.
[59] 5 HALSBURY'S LAWS OF ENGLAND 480 (2d ed. 1932).
[60] *Id.* at 482.
[61] *Id.* at 485.

inchoately over changing company assets like a cloud over a river. The lien of the factor's lien acts, on the other hand, (and the comparable security interest provided by the Commercial Code) is not at all inchoate. It is there all the time: a fixed lien on the borrower's assets which have been subjected to the lien, with the exception that buyers in the ordinary course of business may take free of the lien. Subsequent mortgagees and pledgees of the borrower, as well as levying or garnishing creditors, are typically subordinated to a properly perfected factor's lien. Like the English charge, it may have a shifting or flowing characteristic: it disgorges into the broad channels of commerce assets sold to buyers in the ordinary course of business; it receives incoming assets as fresh supply. Liens like this remind John Honnold of "the paradox which Heraclitus saw in the river, which in one aspect was eternal and in another was constantly changing."[62] The smoothness and sureness of the transition to after-acquired assets will depend upon the factor's lien law of each state. If the basic agreement can confer rights in after-acquired merchandise without further appropriation (separate consignments) then the lien will flow smoothly and surely to later acquisitions. If the basic agreement can confer rights in future accounts receivable as proceeds without further assignment or notice to the account debtor, then the lien will flow smoothly and surely to the future accounts. We need to know the statute to say whether or not we have a real flowing or shifting lien.

Indebtedness Secured

Antecedent Debts

The scope of the factor's lien is to be tested in terms of the kind of obligations it may secure, as well as the kind of property it may include. "Obligations secured" is in a sense a subtopic of "The Reach of the Factor's Lien."

May a factor's lien be used to secure an antecedent debt? Or can it be used only to secure obligations arising at or subsequent to the creation of the lien? The very statement of these questions is fraught with difficulty. When is security given for an "antecedent debt"? Would any form of new consideration, such as an express or implied agreement to extend the period of a loan for a fixed or reasonable time, be sufficient to take the arrangement out of this class? Would the surrender of an old note and the giving of a new one be enough?

The difficulties in the distinction have not dissuaded UTRA

[62] Honnold, Cases and Materials on the Law of Sales and Sales Financing 515 (1950).

from making a valiant effort to define and emphasize "new value."[63] And the distinction is of crucial importance in determining the power of a trustee in bankruptcy to avoid transfers as preferential. Where far-reaching lien rights are given, there are strong reasons for limiting these rights to creditors who contribute substantial new values.

At common law, a factor could hold his principal's goods as security for obligations incurred prior to the acquisition of the goods, with the important proviso that the obligations must have arisen in connection with the relation of factor and principal. This was the nature of the "general lien."[64] But the scope of the general lien could be enlarged by agreement.[65] If the purpose of the factor's lien acts is to give eligible lenders the equivalent of the common law factor's general lien, it would seem that they would authorize a general lien to protect antecedent debts, if the parties so agreed. This assumption must, of course, yield to specific statutory provision to the contrary.

Precise statutory language on the point is hard to find. A statute may define the eligible lender as one who advances "money on the security of merchandise." Does this mean that all obligations for which the lien stands as security must have been contracted on the strength of it? Or can a factor's lien be taken to secure an antecedent debt in favor of a bank which either (a) lends to others on the security of merchandise, or (b) makes further advances to this borrower on the security of merchandise? The suggestions of the Wisconsin version are flabbier. The lender must be "in the business of lending or advancing money on the security of merchandise." Literally construed, a lender may be in that business and still not lend on such security in the particular case. In the Wisconsin version, the lien, if so agreed, shall secure the factor

> . . . . for all his loans and advances to, or for the account of, the borrower made within the time specified in a notice filed pursuant to the provisions . . . or of any amendment of notice filed . . . together with interest thereon, and all commissions, *obligations*, *indebtedness*, charges and expenses properly chargeable against

[63] Section 1 of UTRA defines "new value" as including "new advances or loans made, or new 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." 9A U.L.A. 285 (1951). The Wisconsin Act, in keeping with the Illinois version, defines "new value" as including "new advances or loans made, and the renewal and extension of such advances or loans, or new obligations incurred, or the release or surrender of a valid and existing security interest, or the release of a claim to proceeds under s. 241.10." Wis. Stat. § 241.31(7) (1953).

[64] Restatement, Security § 62(a).

[65] *Id.*, comment on clause (a) at 178.

> or due from said borrower, and for the amounts due or owing upon any notes or other obligations given or received by a factor for or upon account of any such loans or advances, interest, commissions, obligations, indebtedness, charges and expenses. (Italics supplied)[66]

The terms "loans" and "advances" apparently do not include antecedent obligations. But what about "obligations" and "indebtedness"? Certainly out of context these words are broad enough.[67] Under the *ejusdem generis* rule, would it be proper to interpret these words as not being intended to include antecedent debts?

An attorney in the business of giving advice to Wisconsin banks has stated that he would counsel banks against taking a factor's lien except as security for an antecedent debt—for what it is worth, so to speak. It may be that a bank would find that the lien is worth very little for that purpose.

Future Advances

It seems clear that under standard factor's lien language all of the merchandise, present and after-acquired, stands as security for future as well as present advances. Under this language the transaction may take on the status of a fenced-in preserve, more of a barricade, possibly, than in the case of a mortgage clause for future advances. A judgment creditor who levies on goods, or a second mortgagee may cut off the priority of discretionary advances of a mortgagee who holds a mortgage with a future advance clause, if the mortgagee receives actual notice of the intervening interest before advances are made.[68] But it is doubtful whether a subsequent levying creditor or a subsequent mortgagee can successfully invade the preserve of the factor's lien and cut off the factor's ability to make further discretionary advances to his borrower on the security of the merchandise. If future advances cannnot be thus levied the result is lender monopoly, ended only by the borrower paying off the factor, by bankruptcy or by statutory limits on the period during which the operation may continue. This fenced-in type of future advance agreement is not likely to win the sympathy of courts,

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[66] WIS. STAT, § 241.145(2) (1953).

[67] Statutory history may occasionally throw light. In New York, for example, the words "obligations, indebtedness" were added to the original phraseology by N.Y. Sess. Laws 1954, c. 594. The fact that the legislature took special amendatory action may suggest that the terms are important enough to include antecedent debts, despite the fact that the terms "factor" and "factors" are defined as meaning persons "who advance money on goods consigned to and/or pledged with them." While the holder of a factor's lien for an antecedent debt would not, strictly speaking, be a "factor" within this definition, he might qualify as a "consignee" or "other lienor" under the New York act.

[68] See OSBORNE, MORTGAGES §§ 113-124 (1951).

and it may be anticipated that they would be most reluctant to construe statutory language to permit the arrangement.

Goods in Process

In some kinds of manufacturing, a substantial part of the inventory may consist of goods in process—at various stages of conversion from raw materials to finished products. During this period, it may be hard to subject the inventory to control procedures implicit in the nature of field warehousing. In processing, the inventory must be handled directly by the borrower. While the trust receipt may be used, trust receipting may also break down when applied to goods in process,[69] unless all goods in process are trust receipted, or unless it is easy to trace the particular goods trust receipted through the stages of processing. Additions of values, changes in form and structure, incorporation into larger components may raise the kind of problems that is suggested by the names accession and confusion. Nevertheless, trust receipting is used—it would seem prevalently in the wool industry—probably appropriately where the loan is of the self-liquidating variety. The use of the trust receipt for release of goods to the borrower for a temporary purpose is no doubt widespread.

An important aspect of the factor's lien is that it may include within its sweep goods in process as well as raw materials and finished goods. Since it is an inclusive lien, no problems of control over or tracing goods during the period of processing are raised.

Lending on goods in process offers special risks. Some textile work in process may have little market value if the work is stopped before completion. The goods may in fact be less valuable than as raw materials.[70] In other kinds of processing (e.g., knitting operations) there is more opportunity for goods to gain in market value at stages before completion.

Complications may arise if the borrower is declared a bankrupt or is subjected to reorganization proceedings. Both the factor with a lien on the unfinished goods and the trustee in bankruptcy or reorganization may agree that it would be best for all concerned if the fabrication of the goods in process is completed. But they may not agree who should complete the goods and how the proceeds from eventual sale should be allocated.

It sometimes happens that the factor is in possession of the goods in

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[69] See Seidman, *Finance Companies and Factors*, National Conference of Commercial Receivable Companies, Inc. 74 (1949).

[70] An interesting example of a seller's right to protect himself under the circumstances by completing the manufacture of goods after a buyer's repudiation is furnished in Buchman v. Millville Mfg. Co., 17 F.2d 983 (2d Cir. 1927).

process at the time a petition in bankruptcy or reorganization is filed. In the *Waltham Watch* case[71] for example, the Reconstruction Finance Corporation, holding a factor's lien on the inventory and a mortgage on the borrower's real estate, had taken possession of the borrower's factory and watch parts. It would have been practicable, under the circumstances, for the RFC as lender to supervise the completion of the watches. The district court, however, was satisfied that the interests of all creditors would be best served by attempting to continue the business of the borrower as a going concern and that the security of the RFC would not be jeopardized by turning the goods over to the trustees. Accordingly it directed the RFC to turn over the assets to the trustee in reorganization. The trustee was authorized to complete the goods in process and to deduct the expenses of the processing from the proceeds of sale before applying the balance to the payment of the factor's lien. In this case a plan of reorganization had been approved by the court and there was a finding that the borrower was solvent.

In the ordinary case the goods in process are still in the possession of the borrower at the time the petition is filed. To salvage his claim the factor desires that the goods be finished, but they cannot be stripped from the looms without irreparable loss. They must be finished at the borrower's factory or not at all. In a sense, therefore, the factor's interests are at the mercy of the trustee in bankruptcy or reorganization, since a decision to reopen the factory is a matter of discretion with the trustee, subject to court review.

The chances are probably great that a trustee in reorganization will decide to reopen the factory, since otherwise the value of the debtor as a going concern could hardly be preserved. In such case, the first order of business would seem to be to complete the goods in process that are subject to the factor's lien. The unsecured creditors might prefer to have these goods stripped and work begun immediately on goods not covered by a lien. But a trustee in reorganization owes duties to secured as well as unsecured creditors, and it would not seem appropriate for him to commit economic waste upon the holder of a secured interest for the benefit of unsecured creditors.

The key question remains. Suppose the trustee in reorganization proceedings reopens the plant, uses money raised by the issuance of certificates to complete goods in process subject to a factor's lien, and then sells the goods. How are the proceeds of sale to be divided?

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[71] Reconstruction Finance Corp. v. Kaplan, 185 F.2d 791 (1st Cir. 1950). See Schimberg, *The Jurisdiction of the Bankruptcy Court Over Assets in Possession of a Secured Creditor*, 25 REF. J. 125 (1951).

Meinhard, Greeff & Co. v. Edens,[72] involving a reorganization proceeding affecting a South Carolina textile manufacturer, throws light on the question. The trustees completed the fabrication of cotton yarns which were subject to a factor's lien and sold them for $71,254. If the textiles had been stripped from the looms they would have been valuable only as waste. They were valued as such by one witness at less than $9,000[73] although there was evidence that $46,891 had been expended on them prior to the petition.[74] The factor's lien on the goods was for $62,886. Expenses of the trustees directly attributable to completing the goods were $25,406. After deducting the direct expenses[75] the Fourth Circuit gave the factor the entire balance, making the factor in effect the entire beneficiary of the efforts of the trustees in completing the goods. (The referee and the district court had felt that the net proceeds should be divided on a fifty-fifty basis between factor and unsecured creditors on the theory that the parties should be regarded as joint adventurers in the project.[76]) The Fourth Circuit decision indicates that the factor's continuing general lien applies to accretions in the value of goods in process derived from the efforts of reorganization trustees.[77] It is an extreme illustration of

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[72] 189 F.2d 792, 796 (4th Cir. 1951).

[73] Report of referee, Appendix to Appellant's Brief, p. 21.

[74] Exhibit P-24, Appendix to Appellant's Brief, p. 45.

[75] The referee had deducted from the selling price expenses totaling $45,192.66, which included items based upon depreciation due to allowing the mills to remain idle and the expense of starting them up. The Court of Appeals limited the deductions to direct expenses incurred in completing the fabrication of the yarns. 189 F.2d 792, 796 (4th Cir. 1951).

[76] See Order of J. Waties Waring, Appendix to Appellant's Brief, at p. 7.

[77] The result of the decision seems to be that 1,000 pounds of yarns were completed on the looms entirely for the benefit of the factor as a secured lender, and that the unsecured creditors of the borrower derived nothing from these operations of the mill, except the incidental benefit of clearing the looms for further work which would be beneficial to them. Judge Parker of the fourth circuit observed at page 796:

> We find no justification in the record for treating the yarn in process as waste. Not only had the value of the cotton been increased by the work which had been done upon it, but claimant upon intervening in the court proceeding had been assured that its security in the yarn in process would be protected. It was unquestionably proper for the court to authorize the trustees to start up the mills of debtor and thus maintain the value of the enterprise as a going concern. . . . And it was advantageous for the operation to go forward with the yarn which was then on the machines and which was subject to the lien of the claimant. To have required that it be stripped from the machines would not only have destroyed its value but, as the evidence shows, would have resulted in a less profitable operation of the machinery so far as the trustees were concerned. When they took over the property of debtor, including yarn in process, they took it *cum onere*, subject to the liens upon it and the equities arising out of contracts affecting it; and not only was the yarn in process subject to the lien of claimant but it was also subject to the equity arising out of the implied contract that its value would not be destroyed by tearing it from the machinery but that the process of manufacture which had been begun would be completed in accordance with usual standards.

the proposition that a factor's lien on goods in process grows as the goods grow.

Proceeds

A statute providing for a nonpossessory security interest in merchandise should have something to say on the subject of rights in proceeds of sale. The subject may be vital to the secured party. A right in proceeds may give him assurance that the debt for which the sold merchandise was security will be paid. A right in proceeds may be a lever for prying the entire business of financing the accounts receivable or customer paper obtained by the borrower as proceeds of sale.

A right in proceeds is a derivative or secondary right, and as such is a reasonable right. The res (proceeds) is created out of the liquidation of the original security. It may be fair to recognize that a security interest attaches to this substituted res—the new res to serve as collateral for the debt on the same basis as the old res whose sale created the new res.

The present topic is concerned with security rights in proceeds created by an agreement between a secured party and a borrower authorized to sell the prime collateral. The discussion is premised on this consensual arrangement. Where the secured party consents to the sale of collateral, upon such sale he loses his security interest in the thing sold.[78]

The need for statutory treatment of derivative security rights in proceeds is highlighted by the fact that case law on the subject is confusing. Suppose that a cattleman's stock is covered by a chattel mortgage. The time has come to sell the cattle. The mortgagee authorizes the cattleman to sell, on condition that when the cattleman receives the proceeds, he will pay over to the mortgagee as much of the proceeds as will be necessary to pay off the mortgage debt. The cattle are sold, but before the purchase price is paid, a judgment creditor of the mortgagor garnishees the buyer for the

[78] Under some circumstances a non-consenting secured party may be estopped to assert his interest upon a sale to a bona fide purchaser. Where merchandise is the security, consent and estoppel situations are frequent. In cases where the res is sold by the borrower without the consent of the secured party, and the secured party is not estopped, he may follow the res into the hands of an innocent buyer, and use an appropriate remedy, possibly replevin. Or the secured party may as an alternative elect to pursue the proceeds of sale. In this event he may claim he has a security interest in the proceeds, an equitable lien or a constructive trust. His claim would assert an interest in proceeds arising by operation of law. The interest, if recognized, would not be a consensually created interest. But see, as to recourse against an innocent buyer who has resold the goods before actual knowledge that they were subject to a chattel mortgage, Midland Nat. Bank & Trust Co. v. Peterson, 229 Wis. 19, 281 N.W. 683 (1938), representing the Wisconsin view on liability for conversion.

unpaid purchase price. Change the facts: suppose the mortgagor has received the proceeds, and the judgment creditor then attempts to reach them? Does the mortgagee have an interest in these proceeds which will be protected against the action of the creditor? There are some decisions that say no: all the mortgagee has is a personal claim against the cattleman—no equitable lien, no equitable assignment, no trust. What happened was simply an ineffectual attempt to assign a future res.[79] (It could have been a different case, had a contract for the sale of the cattle been already made at the time the mortgagee authorized the sale, or had the mortgagor and mortgagee agreed that when the property would be sold, the buyer should pay the purchase price directly to the mortgagee).[80] The majority of decisions seem opposed to this strict position.[81] But it is amazing that there is so much confusion and lack of certainty here. Possibly not really amazing, however, if viewed in perspective. The common law has a colossal collection of baffling uncertainties.

Developments in the law of Oklahoma may shed some light on the problem. In *Farmers State Bank of Alva* v. *Kavanaugh* (1924),[82] it appeared that Benton had given the bank a chattel mortgage on certain property to secure an obligation. The bank authorized Benton to sell the property at auction, and the clerk of the auction was directed that when the property was sold and he received the proceeds, he should remit the proceeds directly to the bank. The sale was held. A judgment creditor of Benton sought to garnish the fund in the hands of the clerk. It was held that he could not do so. The clerk was a trustee. Since the trust funds were to be applied "by him in conformity with his trust, it must follow that the performance of his trust cannot be defeated by creditors of the mortgagor through garnishee process."[83] The opinion indicated, however, that the result

[79] Maier v. Freeman, 112 Calif. 8, 44 Pac. 357 (1896); White Mountain Bank v. West, 46 Me. 15 (1858).

[80] McIntyre v. Hauser, 131 Calif. 11, 63 Pac. 69 (1900).

[81] See, *e.g.*, Great Northern State Bank v. Ryan, 292 Fed. 10 (8th Cir. 1923). See also Farmers State Bank of Petersburg v. Anderson, 112 Neb. 413, 199 N.W. 728, 36 A.L.R. 1374 (1924). The UNIFORM COMMERCIAL CODE, comment to § 9—306 at 758 states: "Whether a debtor's sale of collateral was authorized or unauthorized, prior law generally gave the secured party a claim to the proceeds. Sometimes it was said that the security interest attached to the 'property' received in substitution, sometimes it was said the debtor held the proceeds as 'trustee' or 'agent' for the secured party. Whatever the formulation of the rule, the secured party, if he could trace the proceeds, could reclaim them from the trustee in bankruptcy." In discussing the analogous question of the right of an entruster under a common law trust receipt to proceeds, Karl Frederick has no trouble in recognizing a trust in proceeds, even in the form of cash in the hands of the "trustee." Frederick, *The Trust Receipt as Security*, 22 COLUM. L. REV. 395, 546 at 554 (1922).

[82] 98 Okla. 118, 224 Pac. 525 (1924).

[83] *Id.* at 121, 224 Pac. at 527.

would be otherwise if the understanding had been that the clerk was to pay the proceeds of sale to Benton; the fund could then have been reached. *A fortiori*, it would seem, the creditor could have levied on such fund had it been turned over to Benton by the clerk in accordance with agreement. In *Mays* v. *State* (1926),[84] the defendant was prosecuted under a statute which made it a felony for any mortgagor to sell mortgaged property without the written consent of the mortgagee. It appeared that the prosecuting mortgagee had verbally or tacitly permitted the defendant mortgagor to sell at will cattle covered by its mortgages. Proceeds of past sales had been turned over to the bank to satisfy the mortgage debts, but sometimes the defendant had kept some of the proceeds for running expenses. In the transaction at issue, the defendant had sold 27 cattle and turned the proceeds over to another bank in payment of a debt. It appeared that at the time of this appropriation there was a dispute between defendant and bank as to the status of indebtedness. The defendant was convicted. Upon appeal, the judgment of the trial court was reversed. The appellate court observed that the mortgagee could be accused of ambushing the mortgagor. "This seems to be an attempt to force a monetary settlement by means of a criminal prosecution, a procedure not favored by the courts."[85] The trial court, in instructing the jury, had "ignored the fact that the person injured may have invited the injury, and that the defendant may not have been actuated by any felonious intent."[86]

Apparently these decisions led to a reanalysis of the nature of a mortgagee's rights in proceeds. Under what circumstances should a mortgagee's claim on proceeds be protected from the mortgagor's creditors? Under what circumstances should a mortgagor misapplying such proceeds be charged with a crime?

> The raising of cattle is an important industry in Oklahoma. It is a common practice for a mortgagor of cattle to sell the mortgaged cattle with the tacit consent of the mortgagee and remit to the mortgagee the proceeds of sale up to the amount of the mortgage indebtedness. It is desirable that the marketing of cattle be left to the mortgagor. After the two decisions last adverted to, this practice could no longer be followed with safety to the interests of the mortgagee."[87]

Chapter 4 of the Laws of 1927[88] seems to have been in response to these decisions.[89] Paragraph (1) declared that every chattle mort-

[84] 33 Okla. Crim. 185, 242 Pac. 580 (1926).
[85] *Id.* at 186, 242 Pac. at 581.
[86] *Ibid.*
[87] Midwest Production Co. v. Doerner, 70 F.2d 194, 196 (10th Cir. 1934).
[88] OKLA. STAT. tit. 46, §§ 71 and 72 (1951).
[89] See Midwest Production Co. v. Doerner, *supra* note 87 at 196.

gagor selling mortgaged property with the consent of the mortgagee, shall "be deemed and conclusively be held to be the trustee of the funds received from the sale thereof, for the benefit of such mortgagee . . . to the extent of the indebtedness secured thereby . . . ." Paragraph (2) reinforced the "trust" feature with criminal sanctions:

> If such mortgagor, being a person, or its officers or agents making such sale if a firm or corporation, shall, without the consent of the mortgagee or assignee, appropriate such funds to his own use, or to the use or benefit of such firm or corporation, or shall knowingly and wilfully, with the intent or effect of depriving such mortgagee or assignee thereof, secrete such proceeds, or any part thereof, or mix and mingle the same with his own or with the funds of such firm or corporation, or who after demand for the payment thereof refuses or neglects to pay same over to the mortgagee or assignee to the extent of the unpaid secured debt, or cause same to be done, or who shall put such fund to any other use inconsistent with such trust, shall be guilty of embezzlement . . . .

Paragraph (2) is broadly worded. Will it be applied in some cases to acts that are merely *mala prohibita*? (It may be necessary to provide for special mortgagor crimes. There is always the danger that the phraseology of a special statute may reach out to condemn acts that do not seriously offend good morals. At its worst, a sweepingly worded special statute defining secured transaction offenses can serve to make criminal justice a materialistic collection agency for private lenders.)[90]

There were still problems unsolved. In *Midwest Production Co. v. Doerner* (1934),[91] it appeared that a steel company, as security for a loan, had given a chattel mortgage on all of its present and future inventory. The mortgage provided that no part of the inventory would be sold by the mortgagor without the written consent of the

[90] The statute was interpreted in Kramer v. State, 97 Okla. Crim. 36, 257 P.2d 521 (1953). The defendant was charged with embezzlement of the proceeds of four cars covered by a sales finance company's chattel mortgages. It appeared that the defendant had used the proceeds to pay other debts of the dealer-company which was the mortgagor. He did not pay the sales finance company because that company had had a receiver appointed for his properties. The appellate court observed that if a proper conviction was based on these counts, the defendant "might possibly have been given a sentence of five years and a fine of $500 on each charge." *Id.* at 38, 257 P.2d at 524. The statute dealt with cases where the property was sold with the consent of the mortgagee. "Upon a retrial of the case, the court should clearly instruct the jury that if the sale of the automobiles was made without the consent of the mortgagee, the defendant would not be guilty of embezzlement under the statute under which the prosecution was instituted. The remedy of the State upon such a state of facts would be a prosecution under some other section of the statutes than the one under which the prosecution was instituted."

[91] 70 F.2d 194 (10th Cir. 1934).

mortgagee, except in the usual course of trade. The mortgage was duly filed. A separate unfiled writing provided that the mortgagor could sell its finished products in the usual course of trade, but would maintain a stated amount of finished inventory, and would apply upon the indebtedness one-fourth of all proceeds of products sold. Subsequently the steel company was adjudicated a bankrupt. Within four months of the adjudication the bankrupt had assigned certain accounts receivable to the mortgagee, apparently pursuant to its duties under the mortgage and separate writing. It was conceded that the validity of the assignment depended upon the validity of the mortgage. Did the mortgagee have an enforceable right in the inventory and accounts as against the trustee in bankruptcy? The Oklahoma Supreme Court had taken a strict position on mortgages on merchandise.[92] Did Chapter 4 of the Laws of 1927 expressly or by implication set aside this position? The Tenth Circuit held no. They were of the opinion that the statute was "not intended to apply to sales made by a mortgagor where the mortgagee consents that the mortgagor may make the sale and apply the proceeds to his own use, as in the instant case."[93] The mortgage being fraudulent, the mortgagee acquired no enforceable right in inventory. He had no rights in the accounts as proceeds. The assignments constituted a voidable preference.

The solution was to deal with mortgages on merchandise. The Act of 1947 provided:[94]

> No such mortgage or pledge shall be deemed to be fraudulent or void as to creditors of the mortgagor or pledgor because of any agreement between the parties thereto for the release from time to time of any of the goods from the lien thereof upon such terms as may be agreed upon, or permitting the mortgagor to sell the goods in the usual course of trade upon such terms and conditions as to the use and disposition of the proceeds of such sale as may be agreed upon; and the mortgagor in such event in case of any such sale shall promptly account and pay over to the mortgagee for application upon the debt secured all or such part of the proceeds of any such sale as may be required by such agreement to be paid to the mortgagee and shall be deemed and conclusively held to be the trustee of the funds received upon such sale to such extent for the benefit of the mortgagee.

The tortuous developments in Oklahoma show the emergence of legislation dealing with rights in proceeds against a background of realized need. Considering the reality of the problem, it is curious

[92] Turk v. Kramer, 138 Okla. 35, 280 Pac. 266 (1929).
[93] Midwest Production Co. v. Doerner, 70 F.2d 194, 196 (10th Cir. 1934).
[94] Okla. Sess. Laws 1947, tit. 46, c. 3, § 2.

that factor's lien statutes do not spell out in detail the incidents of a lien on proceeds; especially surprising to discover that a fair number of the statutes do not deal with the subject at all.

What would account for the total failure of some of the factor's lien acts to deal with proceeds? It is understood that this omission results from the fact that accounts receivable legislation was going the rounds at the same time factor's lien acts were being proposed. If that be the case, the decision to omit was not based upon a well-rounded view of the many forms that proceeds from the sale of merchandise may take. While accounts receivable are the usual form of proceeds in the textile industry, customer paper or other forms of proceeds of sale may predominate in other lines.

Proceeds from the sale of merchandise may consist of such varied items as: (1) cash—the most negotiable of things; (2) bank deposits; (3) negotiable instruments defined and governed by the N.I.L.—order and bearer notes, checks and drafts; (4) negotiable documents of title, such as order and bearer bills of lading and warehouse receipts; (5) non-negotiable notes and drafts receivable; (6) conditional sales contracts and other paper which may not be negotiable in form but are habitually or frequently assigned; (7) other obligations evidenced by a tangible token; (8) accounts receivable and rights under an executory contract; (9) goods, such as trade-ins received as part of the purchase price, returned and repossessed merchandise; (10) goods, such as automobiles, covered by officially issued certificates of title; (11) property held as collateral to secure a buyer's obligation; (12) miscellaneous. To enumerate the forms that proceeds may take is to run the gamut of possible interests in property. In turn, there may be proceeds of proceeds. The form that proceeds may take in a particular case is likely to depend upon trade custom and the kind of merchandise sold.

Professional lenders on inventory may sometimes express the thought that it is not particularly important that legislation accord a lien on proceeds as such. They may emphasize the prime importance of an efficient system of accounting and reporting. As merchandise is released and sold, the borrower should apply the proceeds to reduce the debt pro tanto. If the sale gives rise to an account, the borrower should assign the account, and the lender's advance on the account should to the extent necessary be applied to reduce the loan on the merchandise.[95] Even so, there may be an interval of time between sale of merchandise and payment to the lender, when the lender is

[95] Seidman, *Finance Companies and Factors*, NATIONAL CONFERENCE OF COMMERCIAL RECEIVABLE COMPANIES, INC., 80 (1949).

unprotected unless he may lawfully claim a derivative right in proceeds, for example, the accounts receivable before they are actually assigned. If an assignment *in praesenti* of a derivative account receivable is necessary to acquire security rights in it, there is the chance that a dishonest or careless borrower will transfer the account to a bona fide purchaser before the lender on merchandise learns of the sale and demands an assignment.[96] It would seem that an automatically operative lien on proceeds would reduce the chances of double financing.

In some cases the lender and borrower may not desire payment of the loan upon the sale of items. They may desire an arrangement where the loan continues without direct relation to the rise and fall of merchandise and accounts receivable.

In the factor's lien acts which expressly deal with the subject of proceeds, it is usual to find merely casual recognition of the power of the parties to include within the lien "accounts receivable or other proceeds arising from the sale of such merchandise." The Wisconsin Factor's Lien Act is an exception. It makes a serious effort to state the factor's rights in two kinds of proceeds—accounts receivable[97] and customer paper.[98]

Considering the variety of forms that proceeds may take, and the conflicts of interest that may arise, the vagueness of most of the statutes is unfortunate. UTRA is much more specific in dealing with the subject.[99] The Commercial Code shows by its intensity of treatment how much may be appropriately set forth.[100] As it is, we must assume that where a factor's lien act refers to rights in proceeds, it is probably the intent of the legislature to put those rights on the same footing as rights in merchandise, as far as the borrower's creditors and buyers in the ordinary course of business are concerned.

Even though expressly accorded, however, it would seem that a derivative right in proceeds may be cut off by application of principles of (1) identification, (2) estoppel and apparent ownership, (3) negotiability and (4) waiver.

The principle of identification may be treated briefly. The factor's claim is generally limited to the proceeds of merchandise covered

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[96] See, *e.g.*, State Factors Corporation v. Sales Factors Corporation, 257 App. Div. 101, 12 N.Y.S. 2d 12 (1939).

[97] Wis. Stat. § 241.145(9) (1953).

[98] Wis. Stat. § 241.145(5)(b) (1953).

[99] See Heindl, *Trust Receipt Financing Under The Uniform Trust Receipts Act*, 26 Chi-Kent L. Rev. 197, 256 (1948). For an analogous problem, the tracing of proceeds of trust receipted property, see Frederick, *The Trust Receipt as Security*, 22 Colum. L. Rev. 395, 546 at 554 (1922).

[100] Uniform Commercial Code §§ 9—306, 9—308.

by his factor's lien. (In New Hampshire he may use the act to establish a factor's lien over accounts receivable, whether or not proceeds, as well as merchandise.) The claim on proceeds being derivative, the factor must be prepared to show that a specific asset (e.g., an account) is in fact proceeds from the sale of merchandise covered by his lien. He is not given a priority right in the general funds of the borrower in the event of the borrower's insolvency, such as is given by section 10(b) of UTRA, and by section 9-306(b) of the Commercial Code.

The principle of waiver may also limit his claim. The lender may expressly or by conduct indicate his decision to release certain portions or all of the res from the lien. Under some statutes, the rule of *Benedict* v. *Ratner* will be applied to security interests in proceeds.[101]

In certain forms of proceeds, principles of negotiability and apparent ownership may have bearing on the rights of a factor *vis-a-vis* third party purchasers in good faith. Where the proceed received by a borrower consists of a negotiable note, check, draft or document of title, it seems obvious that a lien on such proceed accorded by a factor's lien act would be subordinated to the title of a holder in due course taking the paper from the borrower.[102] A good faith purchaser for value who takes the paper after maturity might also acquire superior rights. The factor's lien on proceeds having a negotiable form would probably be good against the borrower's creditors or a trustee in bankruptcy.[103]

Other kinds of proceeds may offer perplexing problems. In some mercantile businesses, conditional sales contracts not negotiable in

[101] For the analogous situation under account receivable statutes, see Vagliano, *Pitfalls in Accounts Receivable Filing Statutes*, 9 THE BUSINESS LAWYER No. 4, at 21 (July 1954).

> In more states than one would suppose, the doctrine of *Benedict v. Ratner* retains surprising vitality and one should be extremely wary of allowing the assignor to maintain complete dominion over the proceeds.
>
> This may be important in some circumstances where the financer wishes to carefully police the assignor and also to receive all proceeds of the assigned accounts in automatic reduction of the loan. However, where continuing financing is desired, the prohibition against the assignor's dealing freely with the proceeds may necessitate a complicated operation whereby the assignor promptly pays over to the assignee the proceeds he received and the financer in turn either releases them back to the assignor or applies them to the payment of the loan and then grants a new loan. *Id.* at 27.

[102] On the assumption that the specific language of a factor's lien act does not purport to affect the negotiability of negotiable instruments. UTRA § 9—1 (a) deals with this situation. See Heindl, *op. cit. supra* note 99 at 242.

[103] See UNIFORM COMMERCIAL CODE § 9—303, comment at 751. See Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1106 (1954). He questions the rights, *vis-a-vis* the dealer's trustee in bankruptcy, of the assignee of commercial paper left in the dealer's hands for collection on a non-notification basis.

form but customarily freely assigned are typical sales proceeds.[104] Does such paper (called "chattel paper" by the Commercial Code) have attributes of negotiability, so that a bona fide purchaser of the contract would take free of a factor's lien?[105] If proceeds take the form of a traded-in car, the dealer may acquire a title certificate endorsed to him in blank. The law of the locus may give this certificate an all-important significance as an indicium of ownership. The notation of a security interest on the certificate may in some states be the only effective way to maintain the interest in the car. Innocent third parties buying the car or acquiring a security interest in it may acquire interests free of a factor's lien duly perfected.

All in all, the subject of proceeds offers many areas for exploration. A statute dealing with liens on inventory should include a careful treatment of derivative rights. The factor's lien acts generally do not meet this standard.

Preferences

From a practical standpoint, the real strength of a security interest is tested in its ability to withstand the claims of the borrower's trustee in bankruptcy. The power of the trustee in bankruptcy to have fraudulent conveyances set aside, and his power to have preferences set aside, must be taken into account in any discussion of secured transactions.

The reach of the factor's lien to after-acquired merchandise may result in the factor acquiring as additional security lien rights for which he has not given new value. If within four months of such acquisition a petition in bankruptcy is filed by or against the borrower, and if at the time of the acquisition the borrower was insolvent and the factor knew or had reason to know that fact, there are apparently the elements of a voidable preference. But typically a factor's lien act purports to protect the factor's interest in after-acquired merchandise against subsequent interests. The question arises, can a state statute by specific provision protect an acquisition of a lien interest that would otherwise be preferential and avoidable?

Perhaps, it may be suggested, the incoming merchandise should not really be viewed as additional security for an antecedent debt.

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[104] On the negotiability of notes accompanied by conditional sales contracts, and negotiability by contract provisions in conditional sales contracts, see Gilmore, *op. cit. supra* note 103 at 1093.

[105] The general problem is discussed by Gilmore, *op. cit. supra* note 103 at 1102. See Imperial Finance Corp., Ltd. v. Fidelity Trust Co., K. B. Manitoba 4 D.L.R. 827, 2 W.W.R. 760 (1933); Stack v. Casperson, 71 Utah 68, 262 Pac. 294 (1927); Osborne, Property Security 657, n. 11 (2d ed. 1954); General Motors Ac. Corp. v. Assoc. Disc. Corp., 38 N.Y.S.2d 972 (1942), *rev'd on other grounds*, 48 N.Y.S. 2d 242 (1944).

The argument runs along these lines: a factor's lien act contemplates a lien upon a floating mass—a mass whose entity continues, though specific items come and go. The entity-view of the lien accords with the purpose of some of the acts—to authorize transactions where no effort need be made to correlate release of merchandise with payments on the loan, or to correlate acquisitions of new merchandise with new advances by the factor. Such an act may permit simplified bookkeeping.[106] If this entity theory is accepted, it should follow that there is no voidable preference as to items received within four months of the petition, though the factor knew of the insolvency of the borrower at the time of acquisition and did not extend new value then or thereafter.[107]

This view of the lien requires some imagination. To some it would seem to require the peculiar imaginative vision which enabled one court in effect to hold that a mine pump was a natural water course.[108]

[106] It may be that a great many new acquisitions are received by the borrower in substitution for sold merchandise, and are not acquisitions securing an antecedent debt; that an additional number of acquisitions are in fact acquired with the factor's money. The entity theory, therefore, in many applications merely simplifies the task of the security holder, and protects him from the necessity of having to offer involved proof to establish his rights by relating new acquisitions to new values he has given. But not so in all applications of the theory. The entity approach is stated in Manchester Nat. Bank v. Roche, 186 F.2d 827 (1st Cir. 1951). Magruder, J. at 831:

> . . . it is not without significance that in § 1 of C. 262-A the New Hampshire legislature specifically provided that the lien on merchandise would be valid from the time of filing the prescribed notice "whether such merchandise shall be in existence at the time of the agreement creating the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower." In other words, the *res* which is the subject of the lien provided in § 1 is the merchandise or stock in trade, conceived of as a unit presently and continuously in existence—a "floating mass," the component elements of which may be constantly changing without affecting the identity of the *res*. Cf. Hopkins v. Baker Bros. & Co., 1894, 78 Md. 363, 28 A.284, 22 L.R.A. 477; Pullman's Palace Car Co. v. Pennsylvania, 1891, 141 U.S. 18, 26, 11 S. Ct. 876, 35 L. Ed. 613 . . . . [I]t is not inconsistent with the existence of the lien or floating charge on the inventory, as it may be made up at any particular time, that the borrower is free to withdraw an item from stock for sale in the regular course of business, without any obligation to account to the lienholder for the proceeds. Colbath v. Mechanicks National Bank of Concord, 1950, 96 N.H. 110, 70 A.2d 608. By analogy it might be possible to treat a merchant's accounts receivable as a unit presently and continuously in existence, the component elements of which . . . may be constantly changing, without affecting the identity of the *res*; so that a general assignment by way of security of accounts receivable present and future might be deemed to create *in praesenti* a lien upon this enduring unit, the accounts receivable, which lien would persist as a floating charge upon such *res*, however much its component elements might change from time to time by the payment of old accounts and the creation of new ones.

[107] But see *infra* note 114.

[108] Pennsylvania Coal Co. v. Sanderson, 113 Pa. 126, 6 Atl. 453 (1886). See PA. STAT. ANN. tit. 12, § 31, n. 126 (1953). In discussion of Noonan v. Pardee, 200 Pa. 474, 50 Atl. 255 (1901) it is stated: "It is worthy only of a place beside

They would contend that the acquisition is obviously preferential, and no fair words can disguise the blunt fact. A decision of the Second Circuit supports this position.[109]

The factor has one other chance to save his after-acquired security interest. Does section 67b of the Bankruptcy Act save the interest? That section provides that section 60 is inapplicable to "statutory liens" in favor of employees, contractors, mechanics, landlords, or other classes of persons.[110] At least until the 1952 amendments this was an open question.

> Neither the Bankruptcy Act nor the courts have yet defined what 67b means by "statutory liens." No court which has discussed 67b has held any statutory device outside its terms. Security devices which 67b might conceiveably have saved have been struck down without express recognition of the section.[111]

The Ninth Circuit has held that a statutory banker's lien comes within the protection of section 67b.[112] A banker makes loans on the expectation of coming into possession of future assets of the borrower—at least, so it is asserted. In essence, there is little difference between the factor's lien and the banker's lien, except that the factor's lien statutes require a consensual basis. It is possible that section 67b can be called upon to save a factor's lien on after-acquired merchandise from being avoided as preferential. But the scope of the section is so much a matter of doubt that a definite statement cannot be made.[113]

Certainly matters of policy are involved. The after-acquired clause, authorized by state statute, reaches forward. The effect is to benefit the secured creditor. The power of the trustee in bankruptcy to

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the notorious [*Sanderson* case] . . . in which, as was said by one of the greatest lawyers this state ever produced, the court held a pump to be a natural water-course."

[109] Irving Trust Co. v. Commercial Factors Corporation, 68 F.2d 864 (2d Cir. 1934). See Seidman, *op. cit. supra* note 95, at 58-59.

[110] Specifically, 67c. The special treatment of statutory liens in 67c would seem to confirm the view that 67b is not intended to apply to a consensual lien such as the lien authorized by factor's liens acts. See COLLIER, BANKRUPTCY MANUAL § 68.17 (2d ed. 1954).

[111] Note, *Chasing the Lien Through 67b of the Bankruptcy Act*, 3 STAN. L. REV. 710, 715 (1951).

[112] Goggin v. Bank of America Nat. Trust & Sav. Ass'n., 183 F.2d 322 (9th Cir. 1950). For an interesting discussion of the nature of the banker's lien, see this case at 324, n. 2.

[113] The writer of the note in the Stanford Law Review (*supra* note 111) suggests that factor's liens could be considered as included if 67b is construed to give states a special right to protect "debts created for the price of goods." 3 STAN. L. REV. 710, 726 (1951). He is probably referring to a statutory version of the common law factor's lien. See Hanna, *Foreword*, 33 CALIF. L. REV. 40, 44 (1945); Hanna, *Preferences as Affected by Section* 60c *and Section 67b of the Bankruptcy Law*, 25 WASH. L. REV. 1, 11 (1950).

avoid preferences reaches backward. The effect is to benefit the general creditors. Where should the equation be struck? In bankruptcy matters, Congress has the power to decide that question. Of course, it may make the negative decision to leave such questions to the state legislatures. While the congressional position is still not clear, the 1952 amendments seem to suggest that section 67b does not protect this type of lien from section 60b.

A provision of the Commercial Code raises the question sharply. Section 9-108(2) with the 1954 change 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 such new value and not as security for a pre-existing claim if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made within a reasonable time after the making of the security agreement and pursuant thereto.

A comment tells us: "This subsection codifies the case law as it has developed in the Bankruptcy Act cases."[114] But does it? Or does it rather, under the guise of "codification" rubberbandize the concept of "new value" to include many acquisitions to secure antecedent debts?[115] Is this an instance of trying to use a state statute to wag the National Bankruptcy Act? We would like to know more of this "case law" that the section purportedly codifies. The best authority that comes to mind are cases in which a bank has been permitted to set off deposits within the four-month period made in the usual course of the depositor's business, but those are set-off cases governed by a special section of the Act.[116]

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[114] UNIFORM COMMERCIAL CODE § 9—108, comment at 715. In Supplement No. 1 to the Code it is stated at 182:

> The majority of the Committee feel that the after acquired property provision in Section 9—204(3) is in accord with the preferable present statutory law, that within the limits specified in Section 9—108(2), the acquisition of a security interest in after acquired property as being for new value is in line with the cases holding under Section 60 of the Bankruptcy Act that the substitution of collateral is not preferential as a transfer for an antecedent debt. . . .

But is it not true that this provision is not limited to cases where the new acquisition may be reasonably viewed as received in substitution for released collateral that it can be applied to acquisitions where there is no demonstrable relationship between the release of existing collateral and the new acquisition?

[115] For a discussion of this section in relation to the Bankruptcy Act, see Kupfer, *Accounts Receivable, Trust Receipt and Related Types of Financing Under Article 9 of the Uniform Commercial Code*, 36 BULLETIN OF THE ROBERT MORRIS ASSOCIATES 107, 110-111, 9 THE BUSINESS LAWYER No. 3, at 14, 17-18 (Apr. 1954).

[116] COLLIER, BANKRUPTCY MANUAL § 68.11 (Killiher ed. 1949).

Conclusion

In one of his studies of accounts receivable legislation, Maximilian Koessler observed:

> Unfortunately, the drafters of the pertinent statutes, thus far enacted in twenty-four states, by concentrating their efforts on attempts to create a remedy against the impact of section 60 (a), seem to have neglected the more general, but not less important, need for uniformity of the law in the field. By too often going their independent ways in their ventures of individual draftsmanship, they have created a confusing legal mosaic rather than a unified legal picture.[117]

The same kind of remark may be made of factor's lien legislation. Lawyers and lenders engaged primarily in intrastate business may not be overly concerned that the factor's lien acts display a tantalizing diversity. And yet if they make use of a factor's lien, they will probably find themselves ere long scratching their heads over extrastate law problems. For an example, an account receivable may be claimed as proceeds from the sale of merchandise covered by a factor's lien. They may find a conflict of laws riddle in this case.[118]

Certainly interstate lenders and the lawyers who advise them must experience much frustration in shifting attention from the law of one state to the law of another. They may feel the over-riding need for uniform legislation. Why not a uniform factor's lien act? Or why not adopt the Commercial Code?

The increasing ramifications of commercial law, and for that matter, law in general, are compelling lawyers, for the sake of their own sanity, to reconsider (a) the advisability of leaving so many matters of critical importance to the case-by-case determination of the common law, and (b) the advisability of having the law of each state go its own prima donna way without regard to the law of any other state. Of the making of many law reports there is no end. Codification, taking the form of uniform state legislation, is in the air. It is to be hoped that this movement toward uniformity will not be stifled by the difficulties the Commercial Code is encountering in New York State.

Article 9 of the Commercial Code would transform existing law of secured transactions involving personal property. The inventory

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[117] Koessler, *New Legislation Affecting Non-notification Financing of Accounts Receivable*, 44 MICH. L. REV. 563, 604 (1946). See also Koessler, *Assignments of Accounts Receivable*, 33 CALIF. L. REV. 40 (1945).

[118] Vagliano, *Pitfalls in Accounts Receivable Filing Statutes*, 9 THE BUSINESS LAWYER No. 4, at 21, 24-26 (July 1954). See also Koessler, *op. cit. supra* note 117, at 604.

security provisions of the article seem to be the child of the marriage of UTRA and the factor's lien acts. The child, however, has grown up in the home of foster parents. It may be that some of the diversification and individual approach of state action in the factor's lien field have stimulated the thinking of the draftsmen of the Code to fresh approaches.

Article 9 of the Code authorizes the use of a full-fledged floating charge. In so doing it would bring the law of secured transactions to the destination to which it has been trending for several decades. The development of the factor's lien of merchandise shows the trend. The draftsmen explain their recommendations as follows:

> This Article rejects the doctrine—of which the judicial attitude toward after-acquired interests was an 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 shifting stock.... The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a 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 the 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 has not been effective. In the past fifty years there has been a multiplication of security devices to avoid the floating charge rule: field warehousing, trust receipts, "factor's lien" acts and so on. The cushion of free assets has not been preserved. In almost every state it is now possible for the borrower to give a lien on everything he has or will have. There has no doubt been sufficient economic reasons for this change. This Article, in expressly validating the floating charge, merely recognizes an existing state of things. The substantive rules of law set forth in the balance of this Article are designed to achieve the protection of the debtor and the equitable resolution of the conflicting claims of creditors which the old rules no longer give.[119]

While in many states "it is now possible for the borrower to give a lien on everything he has or will have," there still appear to be a substantial number (perhaps a minority) in which this is not so. And even within these many states where it is possible, not all borrowers and not all goods may be eligible. Under the Code, a floating charge may be placed on all kinds of goods: they need not be merchandise or accounts, though obviously, the floating charge will fit these cases best.

[119] UNIFORM COMMERCIAL CODE § 9—204, comment 3 at 728. For further defense, see Supplement No. 1 to the Code at 182.

The Code carries to an absolute destination a trend which is in various degrees of progress in the forty-eight states. The policy behind the floating charge is still a live question, still challenges us to fresh thinking.[120]

In this survey of the factor's lien on merchandise, the writer has continually felt a need to know more facts. The law of the cases and the statutes is like the exposed part of an iceberg; there is so much more below the surface. If we are to understand the nature of our law, if we are to direct its course intelligently, we must know much more than its written expression in appellate opinions and statutes. We must see it in action, relate it to practice. Our ideas of justice frequently spring from the stereotypes of our minds. "All Cretans are liars." At one time California law-makers believed that all Indians were liars; hence it followed that their testimony should not be used to convict a white man of murder.[121] Since men are human, much of the behavior of courts and legislatures in formulating law is based upon the tacit assumptions of stereotyped situations. Herein lies the importance of legal research: not as the pursuit of the dusty antiquarian, but as a search and re-search for a wider view of facts to correct and refine the stereotypes upon which law makers depend in formulating legal standards for group behavior. If, for example, we knew that in 99 of 100 cases, lenders on inventory permit a borrower in possession of merchandise to sell first and then settle with the lender, if they do not practice what a security agreement may purport to require—prior release by the lender—we would have a factual basis for saying that a buyer in the ordinary course of trade could assume that the agreement does not mean what it says, and could take free of the lien even though he knew of the express terms of the agreement. Our knowledge could serve the quest of the law for justice.

As elsewhere in the law, the law of secured transactions is disturbed by the passions, prejudices and self-seeking of men. It will always be difficult to write a truly just law of secured transactions. That would require the perfect equilibrium of the rightful claims of secured parties, general creditors, and borrowers, with attention paid to the public welfare. In actuality, we may expect that differing times and occasions will tend to over-emphasize the claims of one group or the other. The best that can be hoped for in a mundane world is that we may muddle our way to approximate justice through a better knowledge of facts than heretofore, and motivated by the higher law of the Golden Rule.

[120] For policy comment, see Kupfer, *op. cit. supra* note 115, at 110-113.

[121] People v. Hall, 4 Calif. 399 (1854).

We take leave of our friend the factor and his lien on merchandise. He is now dressed in the conservative, but tasteful attire of the banker. They say he can finance the inventory of his client from the cradle to the grave. No doubt he performs many a useful function. Like the laborer, he is worthy of his hire. May his charges be reasonable, so that his clients will be grateful, not regretful.

APPENDIX A

COMPARISON OF WISCONSIN FACTOR'S LIEN ACT AND UNIFORM COMMERCIAL CODE, ART. 7

SUBJECT	WISCONSIN FACTOR'S LIEN ACT WIS. STAT. § 241.145 (1953)	UNIFORM COMMERCIAL CODE, ART. 9 (1955)
Who may acquire lien on inventory	Limited to those who engage in the business of lending or advancing money on the security of merchandise. Lien Act (1)(a)	Available generally; not restricted to those in the business.
Property subject to lien	"Merchandise"—defined as personal property intended for sale, either before or after manufacturing or processing, or in the process thereof, and exluding machinery, equipment, trade fixtures and motor vehicles. Lien Act (1)(b)	Inventory—broadly defined as goods held or being prepared for sale or materials used or consumed in a business. 9-109(4)—motor vehicles not excluded—equipment and fixtures may also be included in the lien.
Nature of lien	A continuing general lien on present and future merchandise from time to time described in written statements, and on proceeds thereof, if so agreed. Lien Act (2)	A continuing general lien on present and future personal property and proceeds thereof if so agreed.
Kind of filing required	Statement of notice of the creation of factor's lien. Amendments of notice may be filed. Lien Act (3) (a) (b). Possession by lender equivalent to filing. Lien Act (11)	A financing statement is sufficient. 9-402 Possession by lender equivalent to filing. 9-305
Duration of filing; time during which advances may be made	Lien may secure advances made for one year and for additional yearly periods covered by amendments. Lien shall expire 3 years from date of filing of notice of creation, unless prior to expiration, lender files sworn statement that debt is unpaid. Lien Act (3) (a), (b), (8)	Lien may last as long as five years to secure any advances made during that time. Continuation statement may be filed. 9-403
Buyers in ordinary course	Purchasers for value in ordinary course of business take merchandise free of lien, even though they know of lien. Lien Act (5) (a)	Buyers in the ordinary course of business take free of lien, even though they know terms of lien. 9-307

SUBJECT	WISCONSIN FACTOR'S LIEN ACT Wis. Stat. § 245.145 (1953)	UNIFORM COMMERCIAL CODE, ART. 9 (1955)
Rights against creditors: in general	If unfiled, void against creditors. If filed, good against all unsecured creditors and subsequent liens of creditors, except specific liens for warehousing, processing and shipping, preparatory to sale. Lien Act (6)	If unfiled, ineffective against lien creditors and subsequent secured parties as described, and other enumerated classes. 9-303. If filed, generally valid against creditors. 9-303. Liens for materials and services take priority. 9-310
Suppliers of borrower	Purchase money chattel mortgage for merchandise filed within 20 days after receipt of goods by borrower has priority. Factor's lien does not attach to merchandise supplied on consignment under Sec. 241.26. Lien Act (5) (b)	Purchase money security interest in inventory has priority over claim under after-acquired clause if before debtor receives goods, interest is perfected and the purchase money party notifies lender. 9-312 (3)
Rights in proceeds	Lien may attach to accounts receivable representing proceeds of sale of merchandise. Lien Act (9). Conditional sales contracts and chattel mortgages for part of purchase price may be sold or assigned in ordinary course of business by borrower free of factor's lien, even though purchaser knows of lien. Lien Act (5) (b)	Lien attaches to proceeds of sale of collateral. 9-306. Special provision for subordination of lien on proceeds consisting of chattel paper to rights of transferee of chattel paper for new value in ordinary course of business. 9-306 (5). Special rights to cash proceeds. 9-306 (3)
Effect of acts of dominion by borrower	*Benedict v. Ratner*, 268 U.S. 353 (1925), rule in effect abolished. Lien Act (10)	Same. 9-205
Additions to inventory as possibly voidable preferences under 60 (b)	Possibility of voidable preference as to additions to stock received within four months of petition in bankruptcy if, at time of receipt of goods by borrower, factor is charged with knowledge of insolvency and does not give new value. *Irving Trust Co. v. Commercial Factors Corp.* 68 F2d 864 (1934)	Effort made to protect such additions under definition of "new value." 9-108 (2)
Use of lien to secure antecedent debt	Possibly excluded. Lien Act (2)	Lien may be given for antecedent debt.
Remedies	Foreclosure, as in case of chattel mortgage, or in such other manner as may be agreed. Lien Act (7)	Spelled out in detail, with certain compulsory requirements. Part 5

APPENDIX B

Factor's Lien Acts of Wisconsin, New York and New Hampshire

Wis. Stat. § *241.145* (*1953*).

241.145 **Factor's lien.** (1) Definitions. (a) "Factor" means any person, firm, bank or corporation, their successors or assigns, engaged in whole or in part in the business of lending or advancing money on the security of merchandise whether or not they are employed to sell such merchandise.

(b) "Merchandise" means any personal property intended for sale, either before or after manufacturing or processing, or in the process thereof, except motor vehicles as defined in section 218.01 (1) but shall not include machinery, equipment or trade fixtures of the borrower which is not intended for sale.

(c) "Borrower" means the owner of the merchandise, or his agent, who creates a lien in favor of a factor.

(2) Continuing Lien. If so provided by any written agreement with the borrower, a factor shall have a continuing lien upon all merchandise of the borrower generally described in such agreement, or any separate written statements thereafter signed by the borrower and delivered to the factor, regardless of whether or not such merchandise is in the constructive, actual or exclusive occupancy or possession of the factor, or whether such merchandise shall be in existence at the time of creating the lien or at the time of filing the notice hereinafter referred to, or shall come into existence subsequently thereto or shall be acquired by the borrower thereafter, and upon any accounts receivable or other proceeds resulting from the sale or other disposition of such merchandise, and to the extent provided for in said written agreement or separate written statement such lien shall secure the factor for all his loans and advances to, or for the account of, the borrower made within the time specified in a notice filed pursuant to the provisions of subsections (3) and (4), or of any amendment of notice filed pursuant thereto, together with interest thereon, and all commissions, obligations, indebtedness, charges and expenses properly chargeable against or due from said borrower, and for the amounts due or owing upon any notes or other obligations given or received by a factor for or upon account of any such loans or advances, interest, commissions, obligations, indebtedness, charges and expenses.

(3) Execution of Lien; Contents; Amendment of Notice. (a) Notice of the creation of a factor's lien shall be signed by the factor and the borrower, shall be filed as hereinafter provided, and shall contain the following information: The name and address of the factor, and the name under which the factor does business, if an assumed name; the name and address of the borrower; the general character of merchandise subject to the lien, or which may become subject thereto, together with the place or places where such merchandise is or will be situated: and the date of the written agreement between the factor and the borrower and the period of time, not exceeding one year from the date of filing the notice, during which loans or advances may be made against merchandise under the terms of said agreement.

(b) Amendments of the notice signed by the factor and the borrower may be filed from time to time in the same manner to record any changes in the information contained in the original, subsequent or amended notices, and to record any extension of the time, not exceeding one year from the date of filing such amendment of notice, during which advances may be made under the terms of said written agreement, or any separate written statements signed by the borrower and delivered to the factor subsequent to the original agreement.

(4) Notice, filing of. Such notice of the creation of a factor's lien shall be filed, as hereafter provided, within 15 days after the execution of the written agreement between the factor and the borrower providing for the creation of said lien; and no factor's lien created pursuant to this section shall be valid or enforceable against creditors of the borrower until the notice provided for in sub. (3) has been so filed. Notice of the creation of a factor's lien shall be filed in the office of the register of deeds of the county in which the merchandise subject to or to become subject to the lien is or will be situated in the manner provided in s. 241.10 for chattel mortgages.

(5) Purchases and liens for value. (a) Purchasers for value in the ordinary course of the business of the borrower shall take the merchandise free and clear

of the factor's lien provided for herein, whether or not they have knowledge of the existence of such lien.

(b) Any conditional sales contract or chattel mortgage for part of the purchase price, executed in connection with such a sale as last above described, may be sold or assigned for value in the ordinary course of business by the borrower, free and clear of the factor's lien provided for herein, whether or not the purchaser or assignee of such conditional sales contract or chattel mortgage had knowledge of the existence of such factor's lien.

(c) Any chattel mortgage on merchandise acquired by the borrower and executed by the borrower for money or credit extended to the borrower in the usual course of business, in payment in whole or in part of the purchase price of said merchandise, shall, if properly filed within 20 days after the receipt of said merchandise by the borrower, have priority over the factor's lien provided for herein whether or not the mortgagee had knowledge of the existence of such factor's lien, and the factor's lien provided for herein shall not attach to merchandise received under consignment pursuant to section 241.26.

(6) EFFECTIVENESS OF FACTOR'S LIEN; EXCEPTIONS. Any factor's lien created pursuant to this section shall from and after the date of filing of the notice of creation of the factor's lien be effectual upon, and attached to, the merchandise from time to time described in the written agreement or separate written statements as against all claims of unsecured creditors of the borrower, and as against subsequent liens of creditors, except that notwithstanding the prior perfection of the lien of the factor under the provisions of this section specific liens for processing, warehousing, or shipping the merchandise in the usual course of the borrower's business preparatory to sale shall be superior to the lien of the factor on said merchandise, but this section shall not obligate the factor personally for any debts secured by such superior lien.

(7) FORECLOSURE. Any factor's lien created pursuant to this section may be foreclosed, the property sold, and redemption made in the same manner as provided for foreclosure, sales or redemption under chattel mortgages, or in such other manner as may have been agreed in writing between the borrower and factor.

(8) PAYMENT; SATISFACTION; CERTIFICATE; TIME LIMITATION. Upon payment or satisfaction of the indebtedness secured by any factor's lien, the factor, upon the request of the borrower, shall furnish to the borrower a certificate or certificates signed by the factor stating that such indebtedness has been paid or such lien satisfied, or both. When such certificate or certificates are filed with the officer with whom the original notice of lien has been filed, such lien shall be deemed discharged. Failure of the factor to deliver any such certificate or satisfaction within 10 days after any such request shall subject the factor to double damages at the suit of any person injured by such neglect. All liens shall be deemed to have expired 3 years from the date of filing of the notice of creation thereof unless prior to the expiration of such 3-year period the factor files a statement under oath that the indebtedness secured by said factor's lien has not yet been paid in full or otherwise discharged, and upon the filing of such statement the said lien shall be deemed to continue for one year from the date of such filing or until the prior payment of the indebtedness.

(9) ACCOUNTS RECEIVABLE; ASSIGNMENTS. The lien of the factor upon any accounts receivable resulting from the sale or other disposition of the merchandise subject to the lien provided for herein, shall be governed as far as applicable by the provisions of section 241.28 provided however, that unless the factor and the borrower shall agree otherwise, the delivery by the borrower to the factor of a written agreement or separate written statement as hereinbefore provided for designating the merchandise which will be subject to the lien, shall operate as an assignment of the accounts receivable which will result from the sale or other disposition of such merchandise with the same effect as if an assignment thereof by the borrower to the factor had been duly perfected under said section 241.28 immediately after such sale or other disposition.

(10) ACTS THAT DO NOT INVALIDATE. No one or more of the following acts shall impair, invalidate or render void the factor's lien on any such merchandise or any other merchandise remaining subject to such factor's lien nor the factor's right to or lien upon any balance remaining owing on any such account receivable or on any other account receivable resulting from the sale of any other merchandise

which is subject to such factor's lien irrespective of whether the factor shall have consented to or acquiesced in any of the following acts:

(a) The return to or recovery by the borrower of merchandise sold and the subsequent dealing with said merchandise by the borrower as his own property; or

(b) The granting of credit allowances or adjustments by the borrower to the person purchasing such merchandise; or

(c) Failure of the factor to require the borrower to account to the factor for the proceeds of merchandise sold, or to account to the factor for moneys received on any account receivable resulting from the sale of merchandise covered by any factor's lien.

(11) EFFECT OF POSSESSION. When any factor, or any third party for the account of any such factor, shall have possession of any merchandise, such factor shall have a continuing general lien, as set forth in subsection (2), without filing the notice provided for in this section. Nothing herein shall be construed as affecting or limiting any other existing or future lien or right of the factor, at common law or by statute, or any transaction falling within the provisions of law requiring or permitting filing, recording, consent, publication, notices or formalities of execution of instruments creating chattel mortgages or other liens of any nature.

(12) CONSTRUCTION. This section is to be construed liberally to secure the beneficial interests and purposes thereof. A substantial compliance with its several provisions shall be sufficient for the validity of a lien and to give jurisdiction to the courts to enforce the same.

N. Y. Pers. Prop. Law § 45

§ 45. Notice of liens upon merchandise or the proceeds thereof to secure loans or advances

If so provided by any written agreement with their principals, consignors or employers (hereinafter called the person creating the lien), all factors, consignees and commission merchants shall have a continuing general lien upon all goods and merchandise from time to time consigned to or pledged with them, whether in their constructive, actual or exclusive occupancy or possession or not and upon any accounts receivable or other proceeds resulting from the sale or other disposition of such goods and merchandise, for all their loans and advances to or for the account of the person creating the lien, together with interest thereon, and also for the commissions, obligations, indebtedness, charges and expenses properly chargeable against or due from said person creating the lien and for the amount due upon any notes or other obligations given to or received by them for or upon account of any such loans or advances, interest, commissions, obligations, indebtedness, charges and expenses and such lien shall be valid from the time of filing the notice hereinafter referred to, and whether such merchandise shall be in existence at the time of the agreement creating the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the person creating the lien, provided that a notice of the lien is filed, stating:

1. The name of the lienor, the name under which the lienor does business, is an assumed name; the principal place of business of the lienor within the state; and if the lienor is a partnership or association the names of the partners, and if a corporation the state under whose laws it was organized.

2. The name of the person creating the lien, and the interest of such person in the merchandise, as far as known to the lienor.

3. The general character of merchandise subject to the lien, or which may become subject thereto, and the period of time during which such loans or advances may be made under the terms of the agreement providing for such loans or advances and for such lien.

Such notice must be verified by the lienor or his agent, to the effect that the statements therein contained are true to his knowledge. It must be filed with the officer designated in section two hundred and thirty-two of the lien law, in every town or city where the merchandise subject to the lien, or any part thereof, is or at any time shall be located, kept or stored, and also in the town or city where the principal office or place of business of the lienor within the state is or at any time shall be located. Such officers shall file every such notice presented to them for that purpose and shall endorse thereon its number and the time of its receipt. They shall enter in a book provided for that purpose, in separate columns, the names of the parties named in each notice so filed under the head of "owners" and "lienors," the number of such notice and the date of the filing thereof, and the general character of the merchandise as therein stated. The names of the persons creating the liens, as stated in the notice, shall be arranged in alphabetical order under the head of "owners." Such officers at the time of filing such notice shall upon request issue to the person filing the same a receipt in writing, containing the substance of the entries made or to be made as hereinabove provided. Such officers shall be entitled to receive for their services hereunder, fees at the same rates as provided in section two hundred and thirty-four of the lien law.

Such notice may be filed at any time after the making of the agreement, and shall be effectual from the time of the filing thereof as against all claims of creditors in or against such merchandise thereafter arising. Upon the payment or satisfaction of indebtedness secured by any lien specified in this section, the lienor or his legal representative, upon the request of any person interested in the said merchandise, must sign and acknowledge a certificate setting forth such payment or satisfaction. The officer or officers with whom the notice of lien is filed must, on receipt of such certificate or a copy thereof certified as required by law, file the same in his office and write the word "discharged" in the book where the notice of lien is entered opposite the entry thereof, and the lien is thereby discharged.

If any agreement provides for a right to or lien upon accounts receivable or other proceeds resulting from or which may result from a sale or sales of merchandise whether or not such merchandise or a part thereof is subject to the lien, such right or lien upon such accounts receivable or the proceeds shall not be void or ineffectual as against creditors or otherwise, by reason of failure to make or deliver a further assignment of any such account, provided a bill, invoice, statement or notice shall be mailed, sent or delivered to the person owing such account receivable stating in substance that the account is payable to the lienor, and such mailing, sending or delivery of such bill, invoice, statement or notice shall have the same effect as a formal assignment of such account to the lienor named therein. Provided, moreover, that the making and delivery of any such further or formal assignment shall, in and of itself, give to the assignee, a right to or lien upon the account receivable assigned and to the proceeds thereof, effectual as against all claims of creditors of the assignor, irrespective of whether or not such bill, invoice, statement or notice shall be mailed, sent, or delivered to the person owing such account receivable, stating in substance that the account is payable to the lienor or assignee. If merchandise sold, or any part thereof, is returned to or recovered by the assignor from the person owing the account receivable and is thereafter dealt with by him as his own property, or if the assignor grants credits, allowances or adjustments to the person owing an account receivable, the right to or lien of the lienor or assignee upon any balance remaining owing on such account receivable and his right to or lien upon any other account receivable assigned to him by the assignor shall not be invalidated, irrespective of whether the assignee shall have consented to, or acquiesced in, such acts of the assignor.

All notices of liens heretofore filed pursuant to section forty-five of the personal property law and not satisfied by filing a certificate setting forth payment or satisfaction thereof shall be deemed to be and remain in full force and effect under this act without further or other filing.

When any factor or other lienor, or any third party for the account of any such factor or other lienor, shall have possession of goods and merchandise, such factor or other lienor, shall have a continuing general lien, as set forth in the first paragraph of this section, without filing the notice and posting the sign provided for in this section.

The terms "factor" and "factors" wherever used in this section include any consignee or consignees, pledgee or pledgees, who advance money on goods consigned to and/or pledged with them, whether or not such consignees or pledgees are employed to sell such goods and their successors in interest.

This section is to be construed liberally to secure the beneficial interests and purposes thereof. A substantial compliance with its several provisions shall be sufficient for validity of a lien and to give jurisdiction to the courts to enforce the same. Nothing in this section shall be construed as affecting or limiting any existing or future lien at common law or any rights at common law. Added L.1911, c. 326, § 1; amended L.1931, c. 766; L.1905, c. 690; L.1943, c. 635, eff. April 19, 1943.

N. H. Rev. Stat. c. 262-A

1. Factors Liens. If so provided by any written agreement, all factors shall have a continuing general lien upon all merchandise from time to time consigned to or pledged with them, whether in their constructive, actual or exclusive occupancy or possession or not, and upon any accounts receivable or other proceeds resulting from the sale or other disposition of such merchandise, whether or not such merchandise is subject to the lien and upon accounts receivable resulting from any other transactions, for all their loans and advances to or for the account of the person creating the lien (hereinafter called the borrower), together with interest thereon, and also for any obligations, indebtedness, commission, charges and expenses properly chargeable against or due from said borrower and for the amount due upon any notes or other obligations given to or received by them for or on account of any such loans or advances, interest, obligations, indebtedness, commission, charges, and expenses, and such lien shall be valid from the time of filing the notice hereinafter referred to, and whether such merchandise or accounts receivable shall be in existence at the time of the agreement creating the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower; provided, that a notice of the lien is recorded, as hereinafter provided, stating:

a. The name of the factor, the name under which the factor does business, if an assumed name; the principal place of business of the factor within the state, or if he has no place of business within the state, his principal place of business outside of this state; and if the factor is a partnership or association, the names of the partners, and if a corporation, the state under whose laws it was organized.

b. The name of the borrower, and the interest of such person in the merchandise, or accounts receivable, as far as is known to the factor.

c. The general character of merchandise or accounts receivable subject to the lien, or which may become subject thereto, and the period of time, whether definite or indefinite, during which such loans or advances may be made under the terms of the agreement providing for such loans or advances and for such lien. Amendments of the notice may be recorded from time to time specifying any changes in the information contained in the original or prior notices.

2. Record. Such notice shall be signed and verified under oath by the factor or his agent and by the borrower or his agent to the effect that the statements therein contained are true to the best of their knowledge. It shall be recorded in the office of the town clerk where the borrower resides, if the borrower is a resident of this state, otherwise in the office of the town clerk where such merchandise is located. The clerk of said town shall, when such notice is filed or left for record, endorse thereon a certificate of the date and time of day of its reception and shall record in a book kept for records of mortgages of personal property any such notice, amendments of notice, transfer or discharge thereof. The names of the factor and borrower shall be indexed in the same manner as, and along with, the index of mortgagors and mortgagees of personal property.

3. Effect of Record. Such notice may be recorded at any time after the making of the agreement and shall be effectual from the time of the recording thereof as against all creditors of the borrower except (a) holders of prior valid common law or statutory liens or other encumbrances of such merchandise and (b) holders of subsequent valid common law or statutory liens arising from work or services on such merchandise and (c) in respect to accounts receivable, holders of prior valid common law or statutory liens or other encumbrances on accounts receivable or assignees of existing accounts receivable acquired prior to the time of such recording by valid assignment pursuant to the provisions of Chapter 263-A of Revised Laws as inserted by Chapter 19, Laws of 1945.

4. Discharge. Upon the payment or satisfaction of indebtedness secured by any lien specified in this chapter, the factor or his legal representative, upon the request of any person interested in the said merchandise or accounts receivable, must sign and acknowledge a certificate setting forth such payment or satisfaction. The town clerk or clerks with whom the notice of lien is recorded must, on receipt of such certificate, record the same and write the words "discharged" or "partially discharged," as the case may be, in the index book where the notice of lien is entered, opposite the entry thereof and of each amendment thereof, and the lien is thereby discharged. He shall record the certificate itself, or make a reference to the record thereof, in the margin of the record of the original notice. All notices of liens recorded pursuant to this chapter and not satisfied by recording a certificate setting forth payment or satisfaction thereof shall be deemed to be and remain in full force and effect under this chapter without further or other recording.

4. a. Assignment, Foreclosure. A lien on merchandise created in accordance with the provisions of this chapter may be assigned, redeemed or foreclosed in the same manner as mortgages of personal property or in such manner as is provided for in the written agreement between the factor and the borrower.

5. Lien on Accounts Receivable. If any agreement provides for a right to or lien upon accounts receivable whether then existing or thereafter coming into existence or other proceeds arising out of the performance of work, labor or services or resulting from or which may result from a sale or sales or merchandise, whether or not such merchandise or a part thereof is subject to the lien, such right or lien upon such accounts receivable or the proceeds shall not be void or ineffectual as against creditors or otherwise, except as against the rights of assignees of existing accounts receivable as determined by Chapter 263-A of Revised Laws acquired prior to the date of recording of a notice of lien hereunder, by reason of failure to make or deliver a formal assignment of any such account receivable or to notify the person owing such account receivable or by reason of the faet that the borrower, with the factor's assent, retains dominion over any such account receivable and the proceeds or any portion thereof. If merchandise sold or any part thereof is returned to or recovered by the assignor from the person owing the account receivable and is thereafter dealt with by him as his own property, if the assignor with the factor's assent retains dominion over any account receivable or the proceeds thereof or any portion thereof, or if the assignor with or without the assent of the factor, grants credits, allowances or adjustments to the person owing an account receivable, the right to or lien of the factor upon any balance remaining owing on such account receivable and his right to or lien upon any other account receivable shall not be invalidated thereby.

6. Common Law Lien. When any factor, or any third party for the account of any such factor, shall have possession of goods and merchandise, such factor shall have a continuing general lien, as set forth in section 1 of this chapter, without recording the notice and posting the sign provided for in this chapter.

7. Construction. This act is to be construed liberally to secure the beneficial interest and purposes thereof. A substantial compliance with its several provisions shall be sufficient for the validity of a lien and to give jurisdiction to the courts to enforce the same. Nothing in this chapter shall be construed as affecting or limiting any existing or future lien at common law or any rights at common law, or any right given by any other statute or provisions of the Revised Laws.

8. Application. As to any transaction falling within the provisions both of this chapter and of any other law requiring filing or recording, notice, consent, or formalities of execution, the factor shall not be required to comply with both, but by complying with the provisions of either, at his election, may have the protection given by the law complied with.

9. Definitions. The terms "factor" and "factors" wherever used in this chapter, mean persons, firms, banks and corporations, and their successors in interest, who purchase or lend on the security of accounts receivable or who advance money on the security of merchandise, whether or not they are employed to sell such merchandise.

The term "merchandise" wherever used in this chapter shall mean any and all goods, materials, wares and merchandise, raw, wrought or in process.