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Financing the Dealer's Inventory

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FINANCING THE DEALER'S INVENTORY

The principal objective of inventory financing is to provide the dealer with a line of credit to carry on his business. To achieve this objective, it is necessary that the dealer have power to sell the collateral, and to apply the proceeds to the purchase of other goods. Since a sale of the collateral by the dealer to a bona fide purchaser destroys the creditor's security interest in those goods,[1] he obviously will not permit such disposition unless given protection in some other way Therefore, to satisfy the demands of both the dealer and the financier, the security instrument must create what is termed a *floating lien.* This device simply allows the creditor's security interest to transfer from the old goods to the newly-acquired inventory. As subsequent discussion indicates, this method of financing presented many legal problems before the adoption of the Uniform Commercial Code, and ultimately resulted in an unfriendly judicial attitude toward inventory financing. In attempting to alleviate this hostile attitude, the drafters of the Code have adopted the general philosophy that all security transactions should be made as simple and legally safe as possible. In this respect, the single and simple security provided by the Code is similar to that established by prior Kentucky law. Before the Code, Kentucky recognized the essential sameness of purpose of all the varied security devices, and treated almost all security transactions under chattel mortgage law [2]

I. FINANCING A DEALER'S INVENTORY PRIOR TO THE CODE

To show the importance of the changes made by the Code in this field of security transactions, it is necessary to explore the prior law upon which article 9 of the Code is based. The first part of this note, therefore, is devoted to a summary analysis and evaluation of the different devices previously used for financing a dealer's inventory

Pledge

The parent of all devices for lending upon security of personal property was the simple pledge.[3] The use of this device required that the debtor (pledgor) deliver possession of the goods to the creditor (pledgee), that title to the goods remain in the debtor, and

[1] Uniform Commercial Code §9-307. The Code [hereinafter cited as UCC] has been enacted into law as Chapter 355 of the Ky. Rev. Stat. Hereinafter this note cites only the section number of the Code, omitting Ky. Rev. Stat.

[2] Knpke, *Kentucky Modernizes the Law of Chattel Security,* 48 Ky. L.J. 369 (1960).

[3] Kentucky has long recognized the use of the pledge device. *E.g.,* Bogard v. Tyler's Adm'r., 119 Ky. 637, 55 S.W 709 (1900); Thomas v. Southland, 32 Ky. 475 (1834).

that possession be relinquished by the creditor when the debt was discharged. For three reasons, the requirement of possession in the pledgee seriously limited the usefulness of this device for financing inventory. The transportation of the goods from the pledgor to the pledgee and back was expensive to the borrower; the main purpose of the dealer's financing was destroyed when he relinquished possession of the goods; and on many occasions it was impractical for the pledgee to take possession, especially if it happened to be a bank or finance company. This last reason was eliminated somewhat by the modern documentary pledge,[4] but the inability to overcome these other inadequacies led to a search for better devices for financing inventory.

Chattel Mortgage

A chattel mortgage was simply a conveyance of title to the lender to secure the debt until paid. Possession remained in the borrower, and title revested in him when the debt was discharged. The fact that the borrower could retain possession made this device superior to the pledge for purposes of financing a dealer's inventory. But even with this the chattel mortgage did not work well for the financing of goods-in-motion. Its failure was caused mainly by two judicially-created rules of law. The first originated in *Benedict v. Ratner*.[5] In this case the United States Supreme Court held that if a creditor failed to exercise dominion over the proceeds from the sale of his collateral, he would lose not only his security interest in the proceeds, but also his interest in the unsold goods and uncollected accounts. The Court of Appeals of Kentucky adopted this rule.[6] The effect was that the dealer, without the use of the proceeds, was unable to replenish his inventory. The second judicially-created rule, which invalidated all after-acquired property clauses, further limited the effectiveness of the chattel mortgage for financing a dealer's inventory.[7] An after-acquired property clause permitted the creditor's security interest to transfer to the newly acquired goods.[8] With these clauses invalid by

[4] Warehouse receipts and bills of lading are examples of the documentary pledge. With this device possession of the goods is taken by a bailee who issues documents representing them. The goods are released by the bailee only on presentation of these documents. The transfer of the document is equivalent to investing possession in the pledgee and is sufficient for formation of a valid pledge. Kentucky has recognized this as a security device. *E.g.*, General Motors Acceptance Corp. v. Sharp Motor Sales Co., 233 Ky. 290, 25 S.W.2d 405 (1930); Douglas v. People's Bank of Ky., 86 Ky. 176, 5 S.W. 420 (1887).

[5] 268 U.S. 353 (1925).

[6] Sandy Valley Grocery Co. v. Patrick, 267 Ky. 768, 103 S.W.2d 307 (1937).

[7] *E.g.*, Sandy Valley Grocery Co. v. Patrick, *supra* note 6; Loth v. Carty, 85 Ky. 591, 4 S.W. 314 (1887); Ross v. Wilson, Peter & Co., 70 Ky. 29 (1869).

[8] To achieve this purpose, an after-acquired property clause provides that the security interest presently created shall attach to goods acquired subsequent to the agreement.

law, the creditor could not permit the dealer to sell the goods and retain the proceeds. In most states it was thought better to find more flexible security devices for financing a dealer's inventory

Trust Receipt

The trust receipt, under prior law, was considerably more complex than the chattel mortgage, primarily because it involved three parties--the seller; the dealer, called the trustee; and the finance company, called the entruster.[9] It involved the following procedure: (1) the manufacturer shipped the goods under a bill of lading, with a draft for the price attached; (2) the financier honored the draft, and took possession of the bill of lading; (3) the financier then transferred the bill of lading to the dealer upon the execution of two instruments, a note for the loan and a trust receipt in which the dealer acknowledged that the goods belonged to the entruster; and (4) the dealer presented the bill of lading to the carrier and obtained the goods. The trust receipt was very useful for the financing of inventories consisting of relatively expensive items, such as automobiles and home appliances. The manufacturers of such products usually demanded cash when the goods were shipped to the dealer. Only rarely could the dealer sell his stock to the consumer for cash. Faced with this dilemma, the dealer had to rely on a bank or a finance company for the necessary funds to purchase goods for resale. This prompted extensive use of the trust receipt. Kentucky recognized the use of this security device, but held that it was governed by chattel mortgage law[10]

As with the pledge and the chattel mortgage, there were certain limitations on the use of the trust receipt for financing inventory First, the trust receipt contemplated the purchase-money situation, and could not be used to finance goods already in the dealer's possession.[11] Because of this limitation, an automobile dealer could not finance his used cars with the trust receipt. In this respect the trust receipt was

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[9] Prior to the enactment of the Uniform Trust Receipts Act [hereinafter cited as UTRA], adopted in about 30 states, but not Kentucky, it was generally held that the trust receipt had to be a tri-partite transaction. If title went from the manufacturer to the dealer and then to the financier, rather than directly from the manufacturer to the finance company, the transaction was treated as a chattel mortgage and void against creditors, unless recorded. In re James, Inc., 30 F.2d 555 (2d Cir. 1929); In re A.E. Fountain, Inc., 282 Fed. 816 (2d Cir. 1922); Arena v. Bank of Italy, 194 Cal. 195, 228 P. 441 (1924). UTRA §2(1)(b)(ii) eliminated the requirement that title of the entruster had to be derived from someone other than the trustee.

[10] *E.g.*, C.I.T. Corp. v. Wilson, 58 F.2d 910 (6th Cir. 1932); General Motors Acceptance Corp. v. Sharp Motor Sales Co., 233 Ky. 290, 25 S.W.2d 405 (1930).

[11] UTRA §2(1)(a), adopting the common law rule, provided that the goods must have been delivered to the trustee by the entruster or some third person.

inferior to the chattel mortgage. A second limitation upon the trust receipt was that it could not contain an after-acquired property clause,[12] thus each new addition to the dealer's inventory required the issuance of a new trust receipt to the entruster.[13] The decision of *Benedict v. Ratner*[13a] governed this transaction also. If the entruster failed to exercise dominion over the proceeds, he could possibly lose his security interest.[14] In spite of these limitations the trust receipt was superior to the chattel mortgage for financing stock-in-trade.

Field Warehousing

Earlier it was stated that the pledge was inadequate for financing a dealer's inventory for three reasons: (1) the transportation costs were too expensive; (2) the dealer did not want to relinquish possession of the goods; and (3) the financier was usually unable to take possession. Public warehousing solved the last problem by eliminating the necessity of possession in the financier.[15] The other two reasons, however, were sufficient to impede the use of the pledge for financing inventory. To remedy this situation, there developed a method of financing called *field warehousing*.[16] This method required that the borrower set aside part of his building for a warehouse, to be controlled either by a third party warehouseman or by the lender. The dealer then delivered part of his goods to the "warehouse" and received warehouse receipts which he pledged to the bank for the loan. In other words, field warehousing involved two transactions, a bailment of goods with the warehouseman and a pledge of the receipts with the financier. At first glance it appeared that this device eliminated only the "transportation expense objection", removal of the goods by the dealer required presentment of the warehouse receipts

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[12] Cases cited note 7 *supra*.

[13] This problem was alleviated somewhat by the UTRA. Under this statute, the secured party, by filing a "statement of trust receipt financing" in the Secretary of State's office, could avoid the necessity of filing each individual receipt. UTRA §13(1)(4).

[13a] 268 U.S. 353 (1925).

[14] The UTRA also changed this rule. After the sale of the goods the entruster's lien attached to the proceeds, and he was entitled to prevail over creditors who were subject to his security interest prior to the trustee's sale. UTRA §10.

[15] See note 4 *supra*.

[16] See, *e.g.*, Union Trust Co. v. Wilson, 198 U.S. 530 (1905); Love v. Export Storage Co., 143 Fed. 1 (6th Cir. 1906); In re Wyoming Valley Collieries, 29 F. Supp. 106 (M.D. Pa. 1939). Although no cases have been reported in Kentucky directly upholding field warehousing as a security device, the Court of Appeals in Continental Can Co. v. Jessamine Canning Co., 286 Ky. 365, 150 S.W.2d 922 (1941), and Bell & Goggeshall Co. v. Kentucky Glassworks Co., 20 Ky. L. Rep. 1089, 48 S.W. 440 (Ct. App. 1889), implied that if there had been an independent warehouseman with exclusive control over the goods the transactions would have been upheld.

which were in possession of the bank. The most significant aspect of field warehousing, however, and the one which distinguished it from the documentary pledge, was that the dealer could remove the pledged goods from the "warehouse" at any time, simply by replacing them with other collateral of equal value. Thus the dealer, in effect, was not deprived of possession of his inventory

A primary requirement of field warehousing was that the warehouseman have exclusive, open, and notorious control over the goods in his possession. In *Security Warehousing Co. v. Hand*,[17] and in *Union Trust Co. v. Wilson*,[18] the Supreme Court of the United States established two factors which were necessary to constitute this control. First, there had to be some notice to innocent third parties that the goods were subject to a security interest, and second, the borrower had to be excluded from access to the warehouse.[19] Since this requirement of control by the lender, or by a third party, was characteristic of any pledge, it was necessary for the Uniform Commercial Code to continue the rule. The Code therefore provides that, "the requirements of possession [are not relaxed] where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee."[20] The official comments to this provision make it clear that this rule applies specifically to field warehousing.[21] The effect of this provision, from the dealer's point of view, is to reduce the usefulness of field warehousing for financing inventory Since the trust receipt now has all the advantages of the after-acquired property clause,[22] the necessity of moving the goods in and out of the warehouse as the dealer needs them can be eliminated. From the financier's point of view, however, field warehousing retains the advantage of permitting credit extension in many cases where adequate security otherwise would not be available. This is true because the field warehouse receipt bars effective disposition of the collateral by the borrower, whereas the chattel mortgage and trust receipt leave possession of the

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[17] 206 U.S. 415 (1907).

[18] 198 U.S. 530 (1905).

[19] Closely related to the problem of "control" was the question of whether the custodian of the warehouse could be an employee of the borrower. The courts were split on this question, but the majority held that the receipts were not invalid merely because an employee of the borrower was the warehouse custodian. *E.g.*, Philadelphia Warehouse Co. v. Winchester, 156 Fed. 600 (C.C.A.D. Del. 1907); Love v. Export Storage Co., 143 Fed. 1 (6th Cir. 1906). In Continental Can Co. v. Jessamine Canning Co., 286 Ky. 365, 150 S.W.2d 922 (1941), the Court of Appeals decided that the warehouseman had to be a bona fide, independent warehouseman, and that receipts issued by a custodian who was also the borrower's employee were invalid.

[20] UCC §9-205.

[21] UCC §9-205, comment 6.

[22] UCC §9-204(3).

collateral in the dealer, who, by selling to a buyer in the ordinary course of business,[23] can destroy the creditor's security interest.

The only limitation on field warehousing for purposes of financing inventory, both before and after the Code, is that it cannot be used effectively by a dealer who must have all his inventory available for sale at all times. It has been more useful to a dealer who deals in goods of a seasonable nature, where it is convenient for him to store part of his goods in the field warehouse during the off season, and replace them with other goods as the seasons change.

Conditional Sale

Before the adoption of the Code the conditional sale was frequently used to finance a dealer's inventory. This device was simply a sale in which the transfer of title depended upon payment of the purchase price at some fixed time in the future. Possession was transferred to the dealer at the time of the sale. The conditional sale was used only in transactions where parties standing in the actual relation of vendor and vendee desired to effect a credit sale. If used to finance goods already in the dealer's possession, or where there existed a third party lender, the courts applied chattel mortgage law,[24] which many times resulted in a loss to the secured party because of his failure to record.[25]

At first, Kentucky courts refused to recognize the conditional sale, and construed such contracts as passing title to the purchaser, leaving the seller with a lien for the unpaid consideration.[26] After adoption of

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[23] Under the common law, see, *e.g.*, Bank of America Nat'l Trust & Sav. Ass'n v. National Funding Corp., 114 P.2d 49 (Cal. Dist. Ct. App. 1941), and the UTRA, §9(2)(a), a purchaser, in order to qualify as a buyer in the ordinary course of business, had to take the goods without notice of the security interest and in good faith. The Code extends the protection afforded to a buyer in the ordinary course of business to include a person who has actual notice of the lender's security interest. Section 1-201(9) defines "buyer in the ordinary course of business" as one who buys in good faith and without knowledge that the sale is in violation of the security interest of a third person. Section 9-307(1) provides that a buyer in the ordinary course of business takes free of a security interest created by his seller even if he knows of its existence. Combining these two provisions, it follows that "the buyer takes free if he merely knows that there is a security interest which covers the goods, but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement not waived by the words or conduct of the secured party." UCC §9-307, comment 2. The basic policy behind this protection is that inventory is intended for sale to the consumer, and to facilitate commercial trade the secured party's interest is made subordinate to that of the buyer in the ordinary course of business.

[24] *E.g.*, In re James, Inc., 30 F.2d 555 (2d Cir. 1929); Hughbanks, Inc., v. Gourley, 120 P.2d 523 (Wash. 1941).

[25] *E.g.*, Bryant v. Swofford Bros. Dry Goods Co., 214 U.S. 279 (1909); Harkness v. Russell, 118 U.S. 663 (1886).

[26] *E.g.*, Taylor Motor Sales Co. v. Auto Ins. Co., 220 Ky. 6, 294 S.W. 773 (1927); Fry Bros. v. Theobold, 205 Ky. 146, 265 S.W. 498 (1924).

the Uniform Sales Act,[27] the courts recognized conditional sales contracts as instruments securing debts, and generally sustained their terms respecting the reservation of title and repossession on default. In spite of this fact, the conditional sale was given chattel mortgage treatment; recordation was required for protection against subsequent purchasers and creditors.[28]

II. FINANCING A DEALER'S INVENTORY UNDER THE CODE

Article 9 of the Code is not revolutionary legislation. It attempts to eliminate from the law of commercial transactions the traditional security devices, some of which have been described in the first part of this note, and to substitute in their place one very simple device called the *security agreement*.[29]

All the significant changes made by article 9 in the field of inventory financing are related to the validation of the floating lien by section 9-205. The floating lien is a continuing lien on the dealer's inventory which enables the borrower to sell the goods and to use the proceeds to replenish his inventory. Upon acquisition of the new goods the creditor's security interest "floats" from the old goods onto the new. The provisions of article 9 which make the floating lien possible are:

> 1. section 9-205, which eliminates the rule of *Benedict v. Ratner;*
> 2. section 9-204(3), which provides for the after-acquired property clause, and section 9-108, which provides that the security interest in the after-acquired property is taken for new value rather than for a pre-existing obligation;
> 3. section 9-204(4), which provides for future advances on present security; and
> 4. section 9-312(5), which establishes the first-to-file and the first-to-perfect priority rules.

Before the enactment of the Code, the floating lien was theoretically impossible, but the same result was accomplished with some difficulty and unnecessary expense. To create a floating lien a specified sum is loaned against the dealer's present and after-acquired inventory, with the dealer agreeing to keep the inventory-to-loan ratio at a certain figure. Since the borrower, under pre-Code law, had to account for all the proceeds immediately upon disposal of the goods, the loan was necessarily self-liquidating. To illustrate, suppose A agreed to finance X at the ratio of fifty per cent of inventory. A

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[27] Kentucky Acts 1928, ch. 148.

[28] *E.g.*, Denkins v. Humphreys, 310 Ky. 344, 220 S.W.2d 847 (1949); Fields Motor Co. v. Sturgill, 279 Ky. 47, 129 S.W.2d 1003 (1939); C.I.T. Corp. v. Short, 273 Ky. 190, 115 S.W.2d 899 (1938).

[29] UCC §9-105(1)(h).

loaned $2000 to X on a $4000 inventory On a certain day X sold for $2000 inventory costing him $1000. *Benedict v. Ratner* required that the financier take these proceeds,[30] whereupon the entire loan was liquidated. X was entitled to a new loan of $1500 on his remaining inventory of $3000. To secure this loan, the creditor had to file a new chattel mortgage or issue a new trust receipt. This achieved substantially the same result as the floating lien but with considerable inconvenience. The general policy of the Code in article 9 is to make the floating lien more simple and less expensive.

Elimination of the Rule of Benedict v. Ratner

The principal purpose of the *Benedict* rule was to prevent fraud by making all liens invalid where apparent ownership was "left" in the debtor. The rule was limited to those situations where the debtor remained in possession of the collateral. Under the Code, in all situations where the debtor retains possession of the collateral, recordation is required by the secured party in order for him to prevail over subsequent creditors and buyers not in the ordinary course of business.[31] This recordation provides a public record which is available for use by all prospective creditors. The possibility of fraud on subsequent creditors is eliminated by constructive notice, thus the reason for the *Benedict* rule no longer exists. The rule itself is expressly repealed in article 9.[32]

Notice that the repeal of this rule, however, does not necessarily eliminate the need for policing the debtor to prevent dissipation of all the collateral without liquidation of the debt. Section 9-205 does nothing more than allow the secured party discretion in supervising his collateral. This means that the security interest will not be invalid, by law, simply because the debtor is given unfettered dominion over the proceeds. When the financier gives possession of the collateral to the dealer, he must, to a great extent, rely upon the dealer s honesty and good faith. He must trust the dealer to comply with the contract provisions regarding the proceeds of a dissipation. If this trust is impractical, then the financier has only two alternatives. He can either refuse to extend credit to the dealer, or can impose strict control over the collateral.

After-Acquired Property

Before any security interest can be perfected in any type of collateral there are four requirements which must be satisfied: there

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[30] See text accompanying note 5 *supra*.
[31] UCC §9-302(1).
[32] UCC §9-205.

must be an agreement between the parties; the creditor must give value; the debtor must have rights in the collateral; and there must be an act of filing, unless excused.[33] This means that the secured party's interest in after-acquired property does not come into existence until the dealer has some rights in the inventory, *i.e.*, until he receives the goods. Aside from the fact that section 9-204(3) validates after-acquired property clauses in those jurisdictions which had not previously done so, what change does it make in prior law? The only significant change is the elimination of the necessity of filing a new chattel mortgage or of issuing a new trust receipt upon the purchase of new inventory. Under the Code the security interest comes into existence automatically upon receipt of the goods by the dealer.

The after-acquired property clause of section 9-204(3) does not give the prior secured party any substantial advantage over subsequent creditors. This is because the Code itself provides a definite escape route from the effects of this provision. By qualifying as a purchase money security holder,[34] the subsequent creditor can prevail over the prior security holder under section 9-312(3) as to the after-acquired property. The justification for this provision lies in the fact that it gives the dealer an opportunity to acquire new inventory even though he may have all his other property encumbered as collateral for other loans.

The possibility of fraud or surprise on the prior secured party is eliminated by section 9-312(3)(b). This provision requires the purchase money security holder, in order to prevail, to give any other secured party notice of his interest before the debtor receives possession of the new goods.[35] From this analysis, it follows that the purchase money security interest presents no great obstacle to financing the dealer by the floating lien, so long as the financier sufficiently polices the collateral and the proceeds from its sale. If he fails to do this, he may find his debtor's warehouse full of goods to which he has a subordinate security interest.

Before an after-acquired property clause can be used effectively,

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[33] UCC §9-204(1) provides that a security interest cannot attach until there is an agreement that it attach, value is given, and the debtor has rights in the collateral. After the interest has attached, UCC §9-303(1) provides for the additional step necessary for perfection.

[34] A purchase money security holder may either be a seller who takes the security for the price of the goods or he may be a person who merely advances money to the debtor to enable him to purchase inventory. The advanced money must actually be used to purchase inventory. UCC §9-107.

[35] The purchase money security holder is required to give notification only to those secured parties whose interest is actually known to him and those who have previously filed a financing statement covering the same type of inventory. UCC §9-312(3)(b).

the security interest in this property must be immunized against the risk that it will be deemed a preference in bankruptcy. Under section 60 of the Federal Bankruptcy Act[36] there is some question as to whether or not the interest in the after-acquired property is for a pre-existing debt, thereby constituting a preference. The Code attempts to eliminate this possibility by providing that the interest in after-acquired property shall be deemed to have been taken for new value.[37]

Future Advances

Article 9 provides that "obligations covered by a security agreement may include future advances."[38] The Code leaves some doubt of the possible effect of this provision. If it means that the security interest for the "future advance" takes priority from the time when the original security interest was perfected,[39] the future advances clause achieves its apparent purpose of putting everyone on notice that the financier intends to make future advances on the collateral described in the agreement. On the other hand, if the provision means that the priority will not take effect until the future advance is actually made,[40] the clause will prove of little advantage to the floor plan financier, except to eliminate the necessity of repetitious recordation every time a new advance is made. Since the four requirements necessary for perfection of a security interest are not satisfied until the advance is actually made,[41] the latter construction seems the better of the two. In addition, a security interest, by definition, is not created until an obligation of the debtor comes into existence.[42] Until the future advance is made, the debtor is not obligated to the creditor in any sense of the word.

Rules of Priority

There are two important rules of priority in regard to floor-plan financing of the dealer's inventory. The first provides that where two secured parties, each claiming an interest in the same collateral, perfect their interests by filing, the first to file prevails regardless of whether the other party was the first to make an advance or to complete an agreement.[43] In this situation the after-acquired property and

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[36] 30 Stat. 562 (1898), as amended, 11 U.S.C. §96 (1950).

[37] UCC §9-108. For a full discussion of the preference in bankruptcy problem, see Note, *Uniform Commercial Code—Attempt by Secured Creditor Under Article 9 to Emulate Trustee in Bankruptcy*, 51 Ky. L.J. 154 (1962).

[38] UCC §9-204(5).

[39] See Spivack, Secured Transactions 32 (1960).

[40] See Coogan, *Article 9 of The Uniform Commercial Code: Priorities Among Secured Creditors And The Floating Lien*, 72 Harv. L. Rev. 838, 852 (1959).

[41] See note 33 *supra* and accompanying text.

[42] UCC §1-201(37).

[43] UCC §9-312(5)(a).

the future advances clauses achieve their most effective result. Floor plan financing can be used, giving the financier a security interest for all present and future advances made on all the property, owned presently or to be acquired.

The second rule provides that unless both secured parties perfect by filing, the first to perfect prevails.[44] What effect can this have on the floor plan financier? This can best be shown by a simple illustration. Assume that A filed a financing statement against X's inventory four years ago, advancing at that time only $1000 but providing for a future advances clause. Assume now that B advances $50,000 to X on security of the same inventory and perfects his interest. Subsequent to B's advance, A advances $50,000 to X under the prior security agreement. If both parties perfect their interests by filing, A would have priority under section 9-312(5) (a) for the entire $51,000. However, if B does not perfect by filing but does perfect by some other method, the question of priority, with respect to the two $50,000 advances, depends upon the meaning to be given the Code's future advances provision. If the provision means that the security interest for the future advance relates back to the time when the original security interest was perfected, then A would again prevail. On the other hand, if the provision means that the security interest on the future advance does not come into existence until the future advance is actually made, B, being the first to perfect, would prevail. As stated earlier, the latter seems the better interpretation. This means that the Code has provided a very simple escape route from the future advances clause, just as it has done with the after-acquired property clause by use of the purchase money security interest. An intervening creditor, by intelligent practice under article 9, can circumvent both of these innovations of the Code, usually to the detriment of the floor plan financier.

CONCLUSION

The greatest contribution made by the Uniform Commercial Code in the field of inventory financing is the elimination of the sharp distinctions that previously existed among the various security devices. For instance, the conditional sale was used when the financier was the seller; the trust receipt could not be used in this situation. The chattel mortgage was used for financing inventory already owned by the dealer; the trust receipt was restricted to use for the purchase price of newly acquired inventory. The Code eliminates these distinctions by providing for only one type of security device, the *security agreement*.

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[44] UCC §9-312(5)(b).

The validation of the floating lien was also a substantial contribution. By its effective use, a financing agency can make available to a dealer all of his needed capital secured by the dealer's present and future inventory. Such a result can be achieved if the secured party uses the Code's flexibility, easing and strengthening his control over the collateral as the credit risks fluctuate. If the financier cannot be certain of the course of action his debtor might take, it is advisable that he exercise stringent policing procedures over his collateral, relying lightly upon the after-acquired property clause or the future advances clause for protection of his security interest.

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