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UNIFORM COMMERCIAL CODE–ATTEMPT BY SECURED CREDITOR UNDER ARTICLE 9 TO EMULATE TRUSTEE IN BANKRUPTCY

The Uniform Commercial Code,[1] through Article 9, covering secured transactions, seems designed to clarify and strengthen the position of the secured creditor. The drafters of that article attempted to provide the machinery and power necessary to resist the attack of the trustee in bankruptcy under sections 60,[2] 64,[3] 67,[4] and 70[5] of the Federal Bankruptcy Act.[6] This has been done in answer to the need for more extensive and unimpeachable credit in our economy. Such credit was not possible under the previous system where a creditor could have his security interest in an article defeated because he did not religiously follow the strict and cumbersome procedures required by law This attempt to improve the creditor's position will not go unchallenged. There are areas where the potential conflict with the trustee in bankruptcy is too great to allow success to be assumed. On the side of the trustee is the fact that any irreconcilable conflict will be decided in his favor.[7] Realizing this, a close examination will be made of those areas where the Code attempts to improve the secured creditor's position against the trustee in bankruptcy.[8]

AFTER-ACQUIRED PROPERTY

An important feature of article 9 is the extension of the after-acquired property clause to various types of security agreements. For example, the creditor's interest in proceeds,[9] fixtures,[10] accessions,[11] or

[1] Uniform Commercial Code (hereinafter cited as UCC in the footnotes and Code in the text).

[2] 30 Stat. 562 (1898), 11 U.S.C. §96 (1950).

[3] 30 Stat. 563 (1898), 11 U.S.C. §104 (1956).

[4] 30 Stat. 564 (1898), as amended, 11 U.S.C. §107 (1952).

[5] 30 Stat. 565 (1898), as amended, 11 U.S.C. §110 (1952).

[6] 30 Stat. 544 (1898), as amended, 11 U.S.C. (1958).

[7] Moore v. Bay, 284 U.S. 4 (1931).

[8] Although the Code became effective in Kentucky in 1960, the state had been behind most American jurisdictions in fragmentary codification of the newly developed law of chattel security. It had had no adequate treatment of conditional sales, except to subject them generally to the filing requirements in the chattel mortgage law. Nor did it have a trust receipt statute, a factor's lien statute or an accounts receivable statute. Knipke, *Kentucky Modernizes the Law of Chattel Security*, 48 Ky. L.J. 368 (1960). Also, it has been virtually impossible in Kentucky to obtain a lien that would shift and follow collateral as collateral changed in form and substance. Spivack, *Financing the Manufacturer: Article 9 of the Uniform Commercial Code*, 48 Ky. L.J. 397, 399 (1960). Not all of Kentucky's former piecemeal legislation on security interests has been expressly repealed. For possible conflicts and how the Kentucky court has handled them in at least one case, see *Whiteside & Lewis, Kentucky's Commercial Code–Some Initial Problems in Security*, 50 Ky. L.J. 61 (1961).

[9] UCC §9-306.

[10] UCC §9-313.

[11] UCC §9-314.

collateral under a floating lien,[12] depends in some part on the ability of the after-acquired property phase of the transaction to operate favorably To provide the backbone needed by these devices, the Code in section 9-204(3)[13] has expressly validated the after-acquired property clause. This section not only allows the creditor a security interest in after-acquired property, but it elevates the creditor s interest to the status of a legal lien good against third parties.[14] The main purpose of the section is obvious—to circumvent the powers of the trustee in bankruptcy contained in section 60 of the Bankruptcy Act. Under this section the trustee can set aside certain transfers (including secured financing agreements) as preferences, even though there has been strict compliance with the state law governing perfection, if the transfer was within four months of bankruptcy and in full or partial satisfaction of an antecedent debt.[15]

There has been considerable debate as to whether the after-acquired property provisions of article 9 could be defeated by a trustee in bankruptcy. One argument in the trustee's favor has been that under section 60 of the Bankruptcy Act on preferences, the actual transfer of the property subject to the security interest in after-acquired property occurs at a date subsequent to the security arrangement and when the debt is antecedent.[16] Another argument is that the after-acquired property clause might come within the condemnation of equitable liens under section 60a(6).[17]

When dealing with the first argument it becomes necessary to determine if the acquisition of a secured interest in after-acquired property under a security agreement becomes a transfer for an antecedent debt.[18] Standing alone, section 9-204(3) might tend to support

[12] UCC §9-205.

[13] If after-acquired property is contemplated as security this must be spelled out in the security agreement. Because the broad after-acquired property clause is meant to apply to the commercial transaction exclusively, article 9 does contain certain limitations on its use. An after-acquired property clause cannot create an effective security interest in consumer goods as additional security unless the consumer has acquired the goods within ten days after the secured party has made the loan to the consumer or advances other value. UCC §9-204(4)(a). "There are no limitations regarding the use of the after-acquired property clause in transactions involving a businessman or commercial debtor." Spivack, Secured Transactions 31 (1960).

[14] UCC §9-204, official comment 2.

[15] All other elements of a preference listed in §60a(1) also must be present. Also, under §60b, the trustee must prove that the creditor had actual knowledge or reasonable cause to believe that the debtor was insolvent.

[16] Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code; Some Problems Suggested by Articles 2 and 9*, 14 Rutgers L. Rev. 518, 546 (1960).

[17] Comment, 53 Nw. U.L. Rev. 411, 417 (1958).

[18] Subject to the exception provided in section 60a(7), a transfer, where the debtor received a new consideration at the time of his execution of the transfer

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the trustee s claim of antecedent debt based on a time difference in the passage of consideration to the debtor and the attachment of the security interest in after-acquired property But section 9-108[19] rescues the creditor by providing that the security interest in after-acquired collateral is deemed to be

> taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.[20]

The main objection to these two sections is that they resurrect the doctrine of relation back by which transfers, finally consummated within the four month period preceeding bankruptcy, escaped condemnation under section 60 because they were viewed as having occurred at an earlier time when the parties first made their agreement. The Chandler Act of 1938, as interpreted in *Corn Exchange Bank v. Klauder*,[21] eliminated the doctrine of relation back. True, a new subdivision was added to section 60 of the Bankruptcy Act[22] qualifying the *Klauder* interpretation by defining a grace period of twenty-one days within which perfection of a transfer in certain situations would be allowed without jeopardy to the contemporaneity of the consideration.[23] But this amendment in no way destroys the general principle that whether a debt is deemed antecedent to the

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but where the transfer was not perfected until some subsequent time, is one made for or on account of an antecedent debt. It is deemed to have been made only when perfected, and where the debtor s obligation to his transferee for the consideration previously received (at the time the transfer was executed between the parties) antedated the perfection of the transfer. 3 Collier, Bankruptcy §60.39 (14th ed. 1961) (hereinafter cited as Collier.)

[19] This section admittedly is designed to answer any charge of antecedent debt by the trustee. UCC §9-108, comment 1. See note 27 *infra* and accompanying text.

[20] It has been suggested that §9-108 is unnecessary and even dangerous. Friedman, *The Bankruptcy Preference Challenge to After-Acquired Property Clause under the Code*, 108 U. Pa. L. Rev. 194, 219 (1959). His contention is that §9-204 and other sections bearing on the perfection of security interests are effective by themselves to create the desired result—to raise the security interest under an after-acquired property clause to the state of a legal lien. See note 33 *supra*. He feels that §9-108 takes the appearance of a "suspender clause," and that it displays a lack of confidence on the part of the draftsmen in the effectiveness of the other provisions to stand alone.

[21] 318 U.S. 434 (1943).

[22] 30 Stat. 562 (1898), as amended, 11 U.S.C. §96 (1950).

[23] Under the Code, no time is stipulated, except in the case of a security interest in negotiable documents or instruments obtained pursuant to the provisions of §9-304(4), where a twenty-one-day grace period is given. It might be thought that the twenty-one-day limit of §60a(7) would apply to all after-acquired property clauses under the Code, or to none of them if they take on a legal color.

transfer must be determined as of the time the transfer becomes fully and completely perfected.[24]

The trustee's final point in this argument against considering the transfer of after-acquired collateral to have been given for new value, is that the Code itself prohibits a security interest from attaching to after-acquired collateral until the debtor acquires any rights in the collateral.[25] This is true even though a fully perfected security interest may pass automatically to the secured party as soon as the rights are acquired by the debtor. The chronology of the passage of the consideration and the transfer remains unaffected by such an automatic perfection. Of course the transfer can be considered complete before the acquisition of the collateral by relating the perfection back to the time of the debtor's receipt of the consideration. However, any attempt to escape the impact of section 60 by employing the doctrine of relation back is dangerous procedure.[26] The drafters of the Code counter by saying that "interests in after-acquired property have never been considered as involving transfers ... for antecedent debt merely because of the after-acquired feature, nor should they be so considered."[27] Perhaps the drafters' comment will be supported by other provisions in the Code.

It has been suggested that instead of considering after-acquired collateral as separate from the original security agreement, the Code might consider it to be security merely substituted for the original collateral.[28] Substitution of collateral, even within the four-month period, does not amount to a preferential transfer since there is no

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[24] Since a transfer of property which is inherently for an antecedent debt cannot be cured by any after-acquired property clause, every transaction attacked by the trustee as a transfer for antecedent debt must of necessity be tested on its time sequence. 3 Collier §60.39 (1950).

[25] "It should be kept in mind that the time of perfecting is not necessarily the time of filing or of change of possession; perfection occurs when the last of four events has happened. In some cases the last step may be filing or delivery of possession; in another case, the last step may be the making of the agreement, or the giving of the advance, or, particularly as to after-acquired property, the acquisition of rights by the debtor." Coogan, *Operating Under Article 9 of the Uniform Commercial Code Without Help or Hindrance of the "Floating Lien,"* 15 Bus. Law. 373, 383 (1960).

[26] Kennedy, *supra* note 16, at 549.

[27] UCC §9-108, comment 1.

[28] Comment, *supra* note 17, at 415. The strongest reliance the Code puts on the idea of a perfected security interest continuing into substituted collateral, is in its treatment of secured interests in returned or repossessed goods in §9-305(5). If the creditor has secured his interest in the goods by filing before the goods are sold, §9-306(5) allows the original security interest to continue in the returned goods. The security interest, as originally perfected, reattaches to the goods upon their return. It is clear that in the usual business transaction, sale of the goods in question would end the security interest in the goods and transfer it to the proceeds. And any security interest in the proceeds would end after ten days unless that interest was perfected before or after the sale. It then appears that

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depletion of the bankrupt's assets.[29] But this idea of substitution can operate effectively only after the debtor has acquired collateral with the money originally advanced by the creditor, thus avoiding a real conceptual hurdle against treating the money advanced as collateral.[30] The best possible retort found in the Code is that since the secured party's rights in the after-acquired collateral have in fact at all times been superior to those of a judgment lien creditor, the transfer of such security interest should be deemed to have been made at the time of the original agreement creating the lien, thereby avoiding the antecedent debt problem. But the strength of this argument depends upon the Code's success in answering the trustee's second argument against the after-acquired property clause, *i.e.*, can it escape the stigma of an equitable lien condemned by section 60a(6)?

Section 60a(6) announces the rule that "the recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of " section 60. This section, by its own terms, is applicable only when the creditor has neglected to employ available means required by state law for the perfection of a legal lien.[31] Under the Code, the recordation of the original security agreement is all that is required in order to perfect the interest in after-acquired property against all third parties other than buyers in the ordinary course of business.[32] Therefore, as long as the creditor does whatever is required by the Code for the perfection of a legal lien, his security interest in the after-acquired property is not subject to attack on the basis that it is only an equitable lien.

Since section 60a(6) cannot and does not apply to security interests in equitable assets, it is suggested that it must apply to equitable interests which arise out of the imperfect creation of intended legal interests.[33] Even if the Code creates an equitable lien as supplementary to a legal lien, if the creditor perfects both in

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goods, has revived a security interest rather than continued it. For the possible positions of the trustee against such a situation see Kennedy, *supra* note 16, at 534.

[29] 3 Collier §60.21 (1961).

[30] At that stage in the process the creditor is really no better off than an unsecured creditor. It is the initial substitution that makes him a secured creditor.

[31] Under §60a(2) of the Bankruptcy Act:

> [A] transfer of [personal] property shall be deemed to have been made when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.

[32] See UCC §9-204, comment 2.

the Code, by allowing the perfected security interest to reattach to the returned

[33] Hanna, *The Secured Creditor in Bankruptcy*, 14 Rutgers L. Rev. 471, 485

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accordance with all the requirements of the Code, then section 60a(6) cannot apply Since it does not apply and since his interest is superior to that of a judgment lien creditor, his interest must in fact be a legal interest.[34]

The Code's strength in rebutting the equitable lien argument can easily be the basis of refuting the argument that the debt was antecedent. The Code's effort to raise the after-acquired clause to a legal status may then be said to be effective.

PURCHASE MONEY SECURITY INTERESTS

All security interests, except the purchase money security,[35] must be perfected prior to the debtor's bankruptcy[36] in order to avoid the challenge of the trustee under sections 70c[37] and 70e.[38] Section 70c is the "strong arm" clause giving the trustee the standing of a hypothetical lien holder by legal proceedings as of the date of bankruptcy Under section 70e the trustee is afforded the assistance of law apart from the Bankruptcy Act, enabling creditors to avoid transfers made by the bankrupt. However, the purchase-money security interest may be perfected even after bankruptcy of the debtor-purchaser if done within ten days after the collateral comes into the possession of the debtor.[39] It should be noticed that the grace period of ten days operates to cut off *only* the interests of intervening lien creditors or bulk purchasers.[40] Other intervening interests would not be cut off by the filing.[41] Section 9-301(3) leaves no doubt about the Code's classi-

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(1960). In his treatment of the after-acquired clause under the Code, Hanna is careful not to term such an interest an equitable lien or a legal lien. He terms it a legal *interest*, skillfully avoiding the pitfalls of both under §60 of the Bankruptcy Act.

[34] This conclusion is also reached by Friedman, *supra* note 12, at 215.

[35] For the Code's definition of purchase money security interest, see §9-107.

[36] The creditor usually can perfect a security interest under the Code against the trustee by filing a financing statement. Section 9-302(1) exempts from the filing requirement certain transactions. For most types of property, taking of possession by the creditor is an alternative method of perfection. §9-305. But certain kinds of transactions have special perfecting requirements. Filing is the only method of perfecting accounts, contract rights, and other similar intangibles. §9-305, comment 1. Taking possession is the only method of perfecting security interests in instruments. §9-304(1). Instruments as used here include negotiable instruments and investment securities but not security agreements themselves, which are called chattel paper in §9-105. Security interests in chattel paper and negotiable documents of title (such as bills of lading and warehouse receipts) may be perfected by filing or taking possession. §§9-304, 9-305.

[37] 30 Stat. 565 (1898), as amended, 11 U.S.C. §110 (1952).

[38] *Ibid.*

[39] UCC §9-301.

[40] UCC §9-301(2).

[41] UCC §9-301(2) & comment 5. But the creditor-seller can receive protection against a subsequent security interest, created during or after the ten day period, by filing prior to the perfection of the subsequent security interest where filing is required for perfection. Spivack, Secured Transactions 97 (1960).

fication of the interest of the trustee in bankruptcy He is a lien creditor. Perfection within this ten day grace period relates back to the instant the buyer acquired the collateral. Despite the opposition of bankruptcy law and the policy considerations adverse to the doctrine of relation back,[42] there is no reason to doubt that the holder of a purchase-money security interest would prevail against the trustee if, and only if, the interest is perfected in the time specified by the Code.[43]

Despite this exclusive haven for the holder of a purchase-money security interest, two common pitfalls may trap the creditor-seller. Relying on misinformation he may think that bankruptcy is the date of cleavage. If this leads him to delay perfecting his interest after the insolvent debtor has filed for bankruptcy he may lose his purchase money security interest. To perfect this interest after the debtor files and beyond the ten day grace period would not be fatal under sections 70c and 70e, unless bankruptcy intervened before the perfection,[44] but it would be vulnerable to attack as a voidable preference under section 60. The purchase-money consideration would become antecedent by virtue of the effect of section 60a(2) to postpone the transfer until the date of perfection.[45]

Also, the creditor-seller may be misled by section 60a(7) of the Bankruptcy Act which allows a grace period of twenty-one days for perfecting a security interest. He may rely on this to delay his perfecting of the purchase-money security interest beyond ten days. Such a delay is not authorized since the twenty-one day period cannot exceed that provided by applicable state law Where the Code applies, the ten day grace period is the maximum available.

PROCEEDS

The Code recognizes the secured party's right to proceeds received by the debtor on disposition of the collateral.[46] A perfected security

[42] For development of the doctrine of "relation-back" in bankruptcy law, see note 20 *supra* and accompanying text.

[43] The validity of any security interest as against the trustee under §§70c and 70e ordinarily depends on state law. 4 Collier §70.82(3) (1959).

[44] While the holding in Constance v. Harver, 215 F.2d 571 (2d Cir. 1954) prevailed, the trustee might have intervened successfully if the purchase-money security interest were not perfected within ten days on the theory that under the "strong-arm" clause of §70c of the Bankruptcy Act, the trustee could upset security transactions entered into years before the bankruptcy as long as he could posit this right. But this rule was overturned recently by Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603 (1961), which held that the "strong-arm" clause gives the trustee the status of a hypothetical lien creditor as of the time when the petition in bankruptcy is filed—not a day sooner. See 2 B.C. Ind. and Com. L. Rev. 372 (1961).

[45] 3 Collier 917-20 (1961), MacLachlan, Bankruptcy, §266 (1956).

[46] UCC §9-206.

interest in the collateral continues in the identifiable proceeds as a perfected interest for at least ten days.[47] At the end of that time the perfected interest in the proceeds ceases, unless the filed financial statement covering the original collateral also explicitly covered the proceeds. If not, the secured party must perfect his interest in the proceeds themselves by filing a new financing statement.[48]

The Code further provides that in the event of the debtor's bankruptcy, the secured party has a security interest in the debtor's cash and bank accounts, whether they are identifiable or non-identifiable. This interest is equal to the amount of cash proceeds received and commingled or deposited within the ten days before commencing bankruptcy proceedings, less the amount of cash proceeds received by the debtor and paid over to the secured party during that period.[49]

The real change in existing law relates to non-identifiable cash proceeds. Although essentially the same as section 10 of the Uniform Trust Receipts Act, section 9-306(4) of the Code attempts to improve the secured party's interest in the proceeds held by the bankrupt by designating it a "secured interest" instead of a "priority." While it is clear that the Uniform Trust Receipts Act intended the creditor's interest to be a secured interest, the careless use of the word "priority" gave the trustee an advantage which he successfully exploited under section 64 of the Bankruptcy Act.[50] The Code eliminates the trustee's attack under this section.

The secured party's position, however, may be vulnerable.[51] The trustee's strongest attack would appear to come from section 67 of the Bankruptcy Act, pertaining to statutory liens. This section attempts to regulate the extent to which state laws regarding priority of pay-

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[47] UCC §9-306(3).

[48] UCC §9-206(3), comment 2(b).

[49] UCC §9-306(4), comment 2(a).

[50] The trustee's success is somewhat in doubt lately. While it is still held by some that under §10 of the Uniform Trusts Receipts Act the creditor has no more than a priority on distribution, which is ineffective in bankruptcy, at least one court has held that the section gives rise to a technical lien valid against the trustee. In Re Crosstown Motors, Inc., 272 F.2d 224 (7th Cir. 1959). See also 69 Harv. L. Rev. 1343 (1956).

[51] It might be thought that the trustee could attack the creditor's interest in the proceeds as a preference not allowed under §60 of the Bankruptcy Act, much the same as after-acquired property transferred to satisfy an antecedent debt. But §9-306(3) of the Code counters by providing that the security interest in the proceeds is a continuously perfected interest stemming from the security interest in the original collateral. Comment 2(b) further strengthens this position by adding that the four-month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original collateral and not with the date of his obtaining control of the proceeds. In any event, no attack was ever made by the trustee against the proceeds under §60. Comment, 53 Nw. U.L. Rev. 411, 422 (1958). This may be true because the trustee was so successful under §64.

ment in bankruptcy proceedings will be subject to federal priorities specified in sections 64 and 67[52] A *valid* security interest, even though created by state statute, will escape the effect of section 67 So, the controversy will be reduced to the question of whether the creditor has a *valid* security interest or merely a state-created *priority* of distribution.[53]

The trustee will have several bases of contention that this interest is a statutory lien. First, the Bankruptcy Act does not define statutory lien. This label is attached only to certain state-created liens listed in section 67[54] Second, the Code's definition of a security interest in non-identifiable proceeds, necessarily appearing in a state statute, amounts to no more than one of the statutory liens not listed in section 67, thereby being reduced to the status of a mere priority under section 64. Third, the Code allows a security interest in non-identifiable proceeds only upon the debtor's insolvency[55] The inference is that since the creditor is unable to reach the non-identifiable proceeds in an action independent of bankruptcy proceedings, the Code constitutes state legislation in an area pre-empted by federal law.[56]

But the creditor can refute these arguments.[57] He first can argue that the Code expressly does not apply to statutory liens.[58] Then he may argue that section 9-306 creates an interest founded on a contract and is really a method of regulating the mode of enforcement of consensual liens.[59] This is consistent with section 67 of the Bankruptcy Act since the lien created or recognized by statute within the meaning of that section arises primarily from an economic relationship defined by the legislature and not from the terms of a contract providing for security Applying this meaning to "other classes of persons,"[60] the security interest under section 9-306 clearly is contractual rather than statutory, even though without the statute the agreement of the

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[52] An example of a statutory lien within the meaning of §67(b) is the priority of payment to an artisan's lien authorized by §9-310.

[53] 4 Collier §67.20 (1959).

[54] 30 Stat. 564 (1898), as amended, 11 U.S.C. §107 (1952).

[55] UCC §9-306(4)(d).

[56] Spivack, Secured Transactions 106 (1960).

[57] Litigation under §10 of the Uniform Trust Receipts Act will be of little assistance since the Act plainly allowed the creditor an interest in non-identifiable proceeds enforceable in any event. Compare UCC §9-306(4)(d) and UTRA §10(b).

[58] UCC §9-102(2).

[59] Kennedy, *supra* note 16, at 533.

[60] Section 67(b) of the Bankruptcy Act validates, against the trustee in bankruptcy, "statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons." It should be noted that another argument for not considering the security interest created in §9-306 as a statutory lien within the meaning of §67 are excluded from the general provisions of Article 9. See UCC §9-104(b).

parties would not have created a valid lien under non-bankruptcy law.[61]

Beyond this the creditor might contend that it is unnecessary in any event to make the distinction between identifiable and non-identifiable cash proceeds in actions independent of bankruptcy In fact, cash proceeds, identifiable or not, are mentioned only in section 9-306(4), which deals with the collection of proceeds in bankruptcy There is an obvious reason for this. If the solvent debtor is recalcitrant in honoring the creditor's perfected security interest in the cash proceeds, judicial relief would be available. If it appeared that there might be some difficulty in tracing the proceeds for the purpose of identification, the creditor could elect to forego the effort and stand as an unsecured creditor. Since the debtor is solvent, success would be assured in either situation. A provision in the Code that the security interest continued in the identifiable and non-identifiable cash proceeds collected by solvent debtors would have been superfluous.

So the security interest in non-identifiable cash proceeds is significant only when the debtor is insolvent. A judgment lien in that instance could easily be avoided by the trustee. Tracing the proceeds is tedious and sometimes based on fiction (although used with some success under the Uniform Trust Receipts Act.) Then it is important to recognize that the creditor has a perfected security interest which should be satisfied by cash proceeds resulting from the sale of his collateral, regardless of his ability to identify certain cash as that actually paid for the collateral. The creditor's claim is not for specific money, but for a portion of the cash receipts necessarily resulting from the sale. The correct way to think of the security interest is in terms of a res or a single entity continuously changing but always in existence.[62]

FLOATING LIEN

The term "floating lien" does not appear in the text of the Code, but there can be no doubt that it is the referent of section 9-205. The purpose of the section is to define and expressly validate the floating lien.[63] The Code treats the floating lien as a security interest in which the creditor permits the debtor to use, commingle and dispose of all or part of the collateral without having to account for the proceeds

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[61] 4 Collier §67.20 (1959). This interpretation is consistent with the clear legislative purpose to subject such forms of inventory financing to the provisions of §60 dealing with preferences. Countrymen, *The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act,* 16 Law & Contemp. Prob. 76 (1951).

[62] See notes 94-96 *infra* and accompanying text.

[63] UCC §9-205, comment 1.

or without having to replace the collateral with similar articles.[64] The lien floats from original collateral over to substituted collateral and is continuously in existence. This is essentially the definition as it has always been understood.[65]

The main feature of the floating lien is that the debtor may dispose of the collateral as he wishes without accounting to the creditor.[66] This lack of accountability led the courts to strike down the floating lien.[67] It was held to be fraudulent in law, without regard to the degree of perfection by filing or otherwise,[68] because of the deception of apparent ownership in the debtor by allowing him full dominion and control over the collateral.[69] Although this judicial treatment of the floating lien first was focused on mortgages of stock in trade,[70] it was quickly extended to all types of collateral used for security by the familiar decision in *Benedict v. Ratner*[71] Although that decision represented only the law of New York, many other courts followed its lead and it is still the majority rule.[72] Some courts extended the applicability of the rule of the *Benedict* case by holding such a lien valid only if the financier took "absolute dominion" over the collateral.[73] This meant that the entire lien was lost if the debtor was permitted to exercise any control over the collateral, original or substituted.[74] Even though some courts treated the floating lien in a far

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[64] UCC §9-205.

[65] Coogan, *supra* note 25, at 374. Mr. Coogan points out that there is no clearly defined meaning outside the Code, but emphasizes that the most essential element of the floating lien is the lack of accountability required of the debtor.

[66] Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 Harv. L. Rev. 388, 389 (1959).

[67] Benedict v. Ratner, 268 U.S. 353 (1925); Lukins v. Aird, 73 U.S. (6 Wall) 78 (1867).

[68] Cohen and Gerber, *Mortgages of Merchandise,* 39 Col. L. Rev. 1338, 1339 (1939).

[69] Benedict v. Ratner, 268 U.S. 353 (1925). Prof. Kennedy points out that this misleading nature of the floating lien brings it within the condemnation of the doctrine of reputed ownership and all that to which it applies. Kennedy, *supra* note 16, at 540.

[70] Cohen and Gerber, *supra* note 68, at 1340.

[71] 268 U.S. 353 (1925). This case also changed the theory of the rule by which floating liens were held invalid. Mr. Justice Brandeis concluded: "It rests not upon seeming ownership because of possession retained, but upon a lack of ownership because of dominion reserved. It does not raise a presumption of fraud. It imputes fraud conclusively because of the reservation of dominion inconsistent with the effective disposition of title and creation of a lien." 268 U.S. at 363.

[72] 4 Collier §70.77 (1959). Since the adoption of the Code by 18 states, as of June 1962, this majority may well be cut down to a minority, depending on how the courts accept the Code's treatment of the floating lien. Before the adoption of the Code, Kentucky's position was against the validity of the floating lien. Vogler, Wagner & Co. v. Smith, 10 Ky. L. Rep. 364 (1888), looked favorably on stock in trade mortgages when they applied to existing stock; but, Sandy Valley Grocery Co. v. Patrick, 267 Ky. 768, 103 S.W.2d 307 (1937), held such mortgages invalid as to after-acquired stock.

[73] Zydney v. New York Credit Men's Ass'n, 113 F.2d 986 (2d Cir. 1940).

[74] Kripke, *The "Secured Transactions" Provisions of the Uniform Commercial Code,* 35 Va. L. Rev. 577, 590 (1949).

more practical and favorable manner,[75] it was not enough to stem the wave of dissatisfaction among creditors that resulted in corrective legislation.[76]

These efforts did not completely achieve the intended result. The Factors Lien Acts offered the greatest potential but rendered the least service, either because most lawyers tended to use some other device or few of them understood it.[77] The other devices most often used were the conditional sale, the trust receipt and the chattel mortgage. But the very nature of these devices required the use of a multitude of security agreements and a continuous system of filing.[78] While this was done with the idea of giving the desired respectability to the floating lien, it resulted in nothing more than tracking the progress of one investment through a series of devices, any one of which could stand alone as a valid security interest.[79] This meticulous formality defeated the purpose of the floating lien, that is, to provide freely-flowing, continuing financing to a going business concern. The public interest is served by allowing the businessman to offer a continuously changing and current inventory To require strict application of the proceeds to the debt would make the business self-liquidating. Although the end result of a floating lien can be achieved by using the various pre-code devices, they actually drag down the lien s effectiveness by sheer weight of formality [80]

The Code not only nullifies the rule of the *Benedict* case, but also establishes a new method of executing what was in fact a floating lien. Section 9-205 provides that no security interest is invalid because of the "lack of accountability" to the creditor. This section announces the purpose of the Code, to establish the floating lien as a working and workable security device. But it is left to other sections to provide the machinery These other sections permit the following: (1) notice filing with respect to any kind of collateral by a brief finacial statement which does no more than give the signatures and addresses of the debtor and the secured party and indicates the types of property to be

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[75] 4 Collier §70.77 (1959). Collier points out that the rule of the *Benedict* case has received the most severe application in New York, and from the federal courts applying New York law. Other courts have displayed varying degrees of laxity, while some have refused to apply it at all.

[76] *Ibid.*

[77] Coogan, *supra* note 25, at 376.

[78] *Id.* at 377. Coogan points out that these technicalities of the various devices frequently prevented the parties from creating the particular kind of security interest for which they bargained.

[79] The various "single purpose" devices were probably allowed to develop because they "policed" what was really one transaction by requiring periodic checks by the creditor on the collateral, such as: daily accounting for collections, special bank accounts, custodians to receive collections. Kripke, *supra* note 74, at 591.

[80] Coogan, *supra* note 25.

covered;[81] (2) the debtor to use any or all of his personal property as collateral, including after-acquired property, and including the proceeds or new property substituted for the original collateral;[82] (3) the debtor to give present security for future advances;[83] (4) the debtor to exercise such dominion or control over the collateral as may be agreed upon between the parties;[84] (5) certain after-acquired property to be considered to have been given for present consideration rather than for an antecedent debt.[85] Section 9-205 ties together the possible use of these sections and gives added strength by openly approving the floating lien.

The combined effect of these sections is to bypass section 70e of the Federal Bankruptcy Act[86] which was employed by the trustee in bankruptcy to avoid the effects of a floating lien. This section declares null and void any agreement which is held fraudulent by federal or state law for any reason. But the floating lien as established by the Code may not escape entirely the attack of the trustee. The main attack might come under section 60a, with the trustee contending that the floating lien creates a series of antecedent debts.[87] Since a floating lien contemplates substitution of collateral from time to time, it would appear that the secured party's consideration could not pass contemporaneously with the debtor's obligation to repay. Since this creates what is termed an antecedent debt,[88] and since a preference in bankruptcy must relate to an antecedent debt,[89] the floating lien would be subject to the full force of section 60 as a preferential transfer.[90] The trustee, in this connection, might point out that the Code itself does not consider a security interest to be perfected until the debtor has rights in the collateral.[91]

There are at least two possible answers to this argument. First, this is not one of the evils section 60 is intended to remedy. This section

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[81] UCC §9-402.

[82] UCC §§9-204, -306. See also text *supra*, AFTER-ACQUIRED PROPERTY, p. 154 and PROCEEDS, p. 160.

[83] UCC §9-204(5) & comment 8.

[84] UCC §9-205.

[85] UCC §9-108.

[86] 30 Stat. 565 (1898), as amended, 11 U.S.C. §110 (1952).

[87] Kennedy, *supra* note 16, at 541.

[88] In re Quaker City Sheet Metal Co., 129 F.2d 894 (3d Cir. 1942).

[89] MacLachlan, Bankruptcy §255 (1956).

[90] This argument is the familiar one applied to after-acquired property clauses, agreements concerning proceeds of the collateral, and so on. See text *supra*, AFTER-ACQUIRED PROPERTY, p. 154, and PROCEEDS, p. 160. Section 60a(7) of the Bankruptcy Act, passed in 1950, tended to ease the effect of the preference section by allowing the creditor twenty-one days to perfect his interest. But even prompt perfection cannot cure what was from the first an antecedent debt. *Id.* at §266.

[91] UCC §§9-204, -303.

is aimed at the situation where the creditor extends money without security and claims the collateral on an "after-acquired" basis.[92] Under the Code notice is required of the creditor who lends on a secured basis. As soon as the debtor has rights in the collateral, the security interest attaches. The creditor takes every step possible to secure a legal lien at the earliest possible time. Section 60a(6) implies that no preference is created in such a situation.[93] The second answer is more impressive. A shifting body of collateral may be treated as a single entity effectively hypothecated by the agreement and the act of notice-filing.[94] This idea is not new Over fifty years ago Williston remarked that it was desirable to think of stock in trade as having a continuous existence as an entity regardless of the articles which compose it.[95] Perhaps the best analysis of this idea was advanced by Judge Magruder in a case involving an application of the New Hampshire Factor s Lien Act.

> [T]he res which is the subject of the lien is the 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 So conceived, it 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 or business, without any obligation to account to the lien holder for the proceeds.[96]

The reasoning applied here would combat the trustee s argument that each new item must be treated as separate collateral. The collateral is the res in which the creditor can have only one security interest.

The issue presented to the trustee in bankruptcy by the floating lien has not been resolved legally by the courts applying the Code, nor has it been resolved academically in the periodicals. The Code leaves no doubt of its acceptance of the floating lien. The only question is whether the courts will consider the Code in conflict with federal law

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[92] Coogan & Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture,* 69 Yale L.J. 203, 244 (1959).

[93] The Bankruptcy Act, §60a(6) provides that "the recognition of equitable liens where available means of perfecting legal liens have not been employed is declared to be contrary to the policy of this section." Coogan & Bok, *supra* note 92, point out that the negative implications of this are that the Bankruptcy Act recognizes equitable liens where all steps have been taken to secure a legal lien, and from which a legal lien will follow. See note 33 *supra* and accompanying text.

[94] Hanna, *supra* note 33, at 486.

[95] Williston, *Transfers of After-Acquired Property,* 19 Harv. L. Rev. 557, 581 (1906).

[96] Manchester Nat'l Bank v. Roche, 186 F.2d 827, 831 (1st Cir. 1951). New Hampshire has since adopted the Code.