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The Malformed Mouse Meets the LIBR: Secured and Restitutionary Claims to Commingled Funds

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THE MALFORMED MOUSE MEETS
THE LIBR*: SECURED AND RESTITUTIONARY
CLAIMS TO COMMINGLED FUNDS

HAROLD R. WEINBERG**

Wee, sleeket, cowran, tim’rous beastie
O, what a panic’s in thy breastie!
Thou need na start awa sae hasty,
Wi’ bickering brattle!
I wad be laith to rin an’ chase thee,
Wi’ murd’ring pattle!†

They mix about as easy as ile and water.‡‡

I. INTRODUCTION

The “malformed mouse” is section 9-306(4)(d) of the Uniform Commercial Code.1 It provides a formula that determines the extent to

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**"LIBR" is an acronym for the extra-Code tracing methodology known as the lowest intermediate balance rule.

***Alumni Professor, University of Kentucky College of Law. I would like to thank John Hetherington, Saul Levmore, John McCoid, Emily Sherwin, and the participants at the University of Virginia Faculty Workshop for their helpful comments on earlier drafts of this article. Excellent research assistance was provided by Timothy J. Conner, Class of 1988, University of Kentucky College of Law.

†R. BURNS, TO A MOUSE ON TURNING HER UP IN HER NEST, WITH THE PLOUGH, NOVEMBER, 1785, ST.1 (1785), IN POEMS AND SONGS 101 (J. KINSEY ED. 1969).

‡‡T. C. HALIBURTON, SAM: SAM SLICK’S WISE SAWs AND MODERN INSTANCES; OR WHAT HE SAID, DID, OR INVENTED 249 (N.P. 1853).

which an insolvent debtor's commingled bank account contains funds subject to a security interest. A special entitlement is necessary because it is impossible to physically distinguish this collateral after commingling. The label malformed mouse is appropriate if one agrees with critics who have questioned the mouse's statutory architecture and underlying rationale. The image of an elusive creature is also apt. The mouse continues to elude understanding, although it has been part of the Code for many years and the subject of uniform clarifying amendments. The "brattle" or clatter caused by section 9-306(4)(d) is disproportionate to the mouse's stature. In the breast of the malformed mouse is its drafters' concern that secured creditors recover at least some commingled funds in bankruptcy. The creature's ability to withstand the avoiding powers of bankruptcy trustees is a leitmotiv in this commentary. The malformed mouse's entitlement assumes that most of the funds in a bankrupt debtor's bank account are proceeds from the liquidation of original collateral.

The lowest intermediate balance rule and related restitutionary doctrine provide a second means for determining a secured creditor's entitlement to commingled funds. The LIBR assumes that collateral deposited in a commingled account is immiscible with and floats upon the other funds in the account. Oil floating upon water is an appropriate analogy.

Although there is authority to the contrary, the generally accepted view is that Article Nine provides an asymmetric constellation of entitlements to commingled funds. Extra-Code tracing principles, including the LIBR, may be employed to reach funds of the debtor when the debtor is not in insolvency proceedings. In these proceedings extra-

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3See Dunne, Editor's Headnotes: Commingled Proceeds—Clarification, Please!, 104 BANKING L.J. 3 (1987). The mouse's drafting history is discussed infra at text accompanying notes 91-112.

4See generally 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1338 (1965).

5See, e.g., Skilton, supra note 1, at 80-91.

62 G. GILMORE, supra note 4, at 1340. See Oesterle, supra note 2, at 214.

7See RESTATEMENT OF RESTITUTION § 212 (1937).

Code tracing is preempted by section 9-306(4)(d). There is uncertainty concerning the entitlement to commingled funds transferred by the debtor to a third party prior to bankruptcy.

This article analyzes the recovery of funds subject to a security interest in or out of bankruptcy. Part II considers the mechanics of section 9-306(4)(d) and restitutionary tracing rules, including the LIBR. Part III examines the roles envisioned for these entitlements by the Code drafters. It also considers remedial and priority issues in secured claims to commingled cash proceeds and offers a general perspective on the relationship between restitutionary theory and Article Nine. Part IV explores the wisdom of the drafters' entitlement scheme. It initially considers the reasons for providing any entitlement to commingled cash proceeds. It then isolates sources of credit cost that may be reduced by an entitlement, and incorporates them into an analysis of whether the malformed mouse or restitutionary tracing theory more closely approaches optimality. The article's conclusion weighs the merits of altering the Code's current asymmetric constellation of entitlements.

II. ANATOMY OF TWO ENTITLEMENTS

A. The Malformed Mouse

Section 9-306(4)(d) provides a formula for the recovery of proceeds in insolvency proceedings:

In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph is limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings...10

A secured party's recovery under the mouse's ten day formula is subject to set-off by the institution maintaining the deposit account containing the

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9See WHITE & SUMMERS, supra note 8, at 1014-15.
commingled funds,\textsuperscript{11} and must be reduced by certain other proceeds to which the secured party is entitled aside from the mouse.\textsuperscript{12} These limits have been the subject of litigation and critical commentary.\textsuperscript{13} For the purpose of this article, the language of the ten day formula is the most significant aspect of section 9-306(4)(d). The mouse has three littermates that also apply in insolvency proceedings, which permit the secured party to identify uncommingled cash proceeds.\textsuperscript{14} They are of interest only to the extent that they define cases to which the mouse is inapplicable because of a lack of commingling.

Understanding section 9-306(4)(d) requires a working familiarity with several key terms. The mouse is intended to apply only in the event of "insolvency proceedings.\textsuperscript{15} Federal bankruptcy is so clearly preeminent in this field that it will be treated as synonymous with "insolvency proceedings.\textsuperscript{16} Recovery pursuant to section 9-306(4)(d) is possible only if a security interest is "perfected." Unless otherwise indicated, this article assumes satisfaction of this requirement by an appropriate filing.\textsuperscript{17}

\textsuperscript{11}See id. § 9-306(4)(d)(i).
\textsuperscript{12}See id. § 9-306(4)(d)(ii).
\textsuperscript{13}See generally Skilton, supra note 1, at 70-74, 79-80 (providing analysis of litigation concerning extent to which secured parties may recover commingled funds under U.C.C. § 9-306(4)(d)).
\textsuperscript{14}See U.C.C. § 9-306(4)(a)-(c), which provides for the recovery of: (a) identifiable noncash proceeds; (b) separate deposit accounts containing only proceeds; (c) identifiable cash proceeds in the form of money that is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings; and (d) identifiable cash proceeds in the form of checks and the like that are not deposited in a deposit account prior to the insolvency proceedings.
\textsuperscript{15}See U.C.C. § 1-201(22) (defining "insolvency proceedings" as proceedings intended to liquidate or rehabilitate the estate of a debtor).
\textsuperscript{17}A security interest in cash proceeds such as checks, deposit accounts, or money may be perfected by proper filing against the original collateral. U.C.C. §§ 9-303(1), 9-306(3)(b). It also may be perfected automatically for ten days. Id. § 9-306(3)(c). See also In re Armstrong, 56 Bankr. 781, 787 (Bankr. W.D. Tenn. 1986). These rules are exceptions. Article Nine generally requires the secured party to take possession of checks and money in order to perfect its interest. See U.C.C. §§ 9-302(1), 9-304(1), 9-305.
A secured party’s most likely target under section 9-306(4)(d) is a “deposit account” of the debtor in which proceeds have been commingled with other funds. The size of the secured party’s recovery from a deposit account is determined by the amount of “cash proceeds” received by the debtor within ten days before bankruptcy. For example, a debtor may sell inventory collateral and receive payment in cash or by check within the ten day period. Some of these proceeds are then deposited in the debtor’s general business checking account. The money or check is cash proceeds. The checking account, also cash proceeds, is a deposit account.

The mouse requires the following elements: (a) The fact of proceeds; (b) the fact of commingling in a deposit account; and (c) the fact of receipt during the ten day period. These elements obligate a secured party to trace its entitlement under section 9-306(4)(d). As a practical matter, the evidence sufficient to establish these facts often will be a series of interrelated and temporally proximate events. Part of this burden consists of demonstrating that there is a deposit account of the debtor “in which

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18A deposit account is a demand, time, savings, passbook, or like account maintained with a bank or like organization; accounts evidenced by a certificate of deposit are not deposit accounts. U.C.C. § 9-105(1)(e). For purposes of this article, the most important type of deposit account is the checking account. A checking account is a relationship between a creditor (the customer maintaining the account) and a debtor (the bank). See id. §§ 4-104(1)(e), 4-401 to -407. See generally B. Clark, The Law of Bank Deposits, Collections and Credit Cards § 2.1 (rev. ed. 1981). Deposit accounts are excluded from the scope of Article Nine unless they are claimed as proceeds. U.C.C. § 9-104(l). Under the mouse, a secured party also may recover commingled proceeds in the form of cash. Id. § 9-306(4)(d).


20See U.C.C. § 9-306(1).

21See supra note 18.

22The secured party has the ultimate burden of persuasion with respect to its right to recover commingled cash proceeds. E.g., In re Conklin’s, Inc., 14 Bankr. 318, 323 (Bankr. D.S.C. 1981). See generally 3 Collier on Bankruptcy ¶ 502.02 (15th ed. 1980) [hereinafter Collier].
proceeds have been commingled with other funds.” Another part requires proof of the amount of “any cash proceeds received by the debtor” during the mouse’s ten day period.

It is always necessary to demonstrate that cash or checks are proceeds received upon the disposition of collateral and are themselves collateral. In the case of inventory financing, therefore, it is necessary to prove that cash or checks resulted from the sale of inventory subject to the financer’s security interest. A paper trail consisting of cash receipt journals, sales invoices, or bank statements, tied together by the debtor’s testimony, can establish this link. If the original collateral consists of accounts receivable, then comparable documentation may establish that some of the debtor’s receipts consist of payments made by account debtors. The proof that cash or checks are proceeds, as required by section 9-306(4)(d), is identical to that required to identify proceeds in cases where the mouse is inapplicable because there is no insolvency proceeding.

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24 Id.

25 See U.C.C. § 9-306(1) (“proceeds’ includes whatever is received upon the sale, exchange, collection, or other disposition of collateral or proceeds.”); Id. § 9-105(1)(c) (‘Collateral means the property subject to a security interest . . . ’). This requirement has been controversial. Arizona Wholesale Supply Co. v. Itule (In re Gibson Products), 543 F.2d 652, 657 (9th Cir. 1976), cert. denied, 430 U.S. 946 (1977), held that the words “any cash proceeds received by the debtor” in § 9-306(4)(d) refer to receipts from any source and are not limited by the definition of proceeds in § 9-306(1). This holding has been the subject of richly deserved criticism. See Skilton, supra note 1, at 70-72; Note, Bankrupting the Proceeds Section: Recent Interpretations of Section 9-306(4)(d) of the Uniform Commercial Code, 55 TEX. L. REV. 891, 899-901 (1977). Other cases have correctly required proof that cash proceeds be traceable to original collateral. See, e.g., Peoples State Bank v. San Juan Packers (In re San Juan Packers), 696 F.2d 707, 710-11 (9th Cir. 1983) (per curiam); Fitzpatrick v. Philco Finance Corp., 491 F.2d 1288, 1291-92 (7th Cir. 1974); In re Guaranteed Muffler Supply Co., 29 U.C.C. Rep. Serv. (Callaghan) 285 (Bankr. N.D. Ga. 1980).


28 See U.C.C. § 9-306(2) (“Except where this article otherwise provides, a security interest . . . continues in any identifiable proceeds . . . ”) (emphasis added). Identification requires the secured party to trace proceeds to original collateral. E.g., Norfolk Production Credit Assoc. v. Bank of Norfolk, 220 Neb. 593, 597-98, 371 N.W.2d 276, 279 (1985). Identification is necessary in insolvency proceedings to recover uncommingled proceeds. See U.C.C. § 9-306(4)(a)-(c).
The term "commingled" is not defined by the Code, but is used in its ordinary sense of "mixed together." Thus, cash proceeds deposited in a bank account will be commingled if they are mixed with funds resulting from either the debtor's disposal of noncollateral or from other sources. A secured party may initially elect to prove the absence of commingling, thereby opening the door to a recovery not limited by the mouse's ten day formula. Conversely, a bankruptcy trustee might seek to demonstrate both commingling and no receipt of proceeds during the ten day period.

The word commingled connotes nothing with respect to whether it is permissible to identify cash or checks deposited into an account by means of extra-Code tracing techniques. The LIBR has been successfully invoked by secured parties in noninsolvency cases involving commingled

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29 "Commingled" generally refers to the mixing of fungibles. See U.C.C. §§ 1-201(17), 7-207, 9-205, 9-207, 9-315. This is the intended usage when goods are involved. See Peoples State Bank v. San Juan Packers, Inc. (In re San Juan Packers), 696 F.2d 707, 710 (9th Cir. 1983) (interpreting U.C.C. § 9-315). Final credits in the debtor's bank account are not only acceptable commercial equivalents, i.e., fungibles, but are perfect economic substitutes. Accordingly, a third party seeking payment from the debtor would be equally satisfied by any credit in the account. See generally G. STIGLER, THE THEORY OF PRICE 31 (3d ed. 1966).

30 See In re Trans-Texas Petroleum Corp., 33 Bankr. 67 (Bankr. N.D. Tex. 1983); In re Gibson, 6 U.C.C. Rep. Serv. (Callaghan) 1193 (Bankr. W.D. Okla. 1969). Commingling might also result when hitherto uncommingled proceeds in a deposit account are designated by the debtor as belonging to a third party. See In re Jameson's Foods, Inc., 37 U.C.C. Rep. Serv. (Callaghan) 1381 (Bankr. D.S.C. 1983) (nonproceeds were also deposited in the account). Such "commingling by designation" arguably occurs when the debtor draws payroll checks against the account, but retains funds representing withheld income taxes in the account. These taxes might be viewed as belonging to the employee or the Internal Revenue Service. This is not the form of physical commingling envisioned by the drafters of Article Nine. See supra note 29.

A debtor's access to an account may bear on the question of whether the account is a "separate" deposit account containing only proceeds, which is not subject to the mouse. It may not be separate if the debtor has a right to draw checks. Cf. Salzer v. Victor Lynn Corp., 14 U.C.C. Rep. Serv. (Callaghan) 208 (N.H. Sup. Ct. 1974) (applying the 1962 Official Text of the Uniform Commercial Code). But see Skilton, supra note 1, at 66-70.


33 Equating "commingled" with "nonidentifiable" was part of the erroneous reasoning in Arizona Wholesale Supply Co. v. Itule (In re Gibson Products), 543 F.2d 652 (9th Cir. 1976). See supra note 25.
If section 9-306(4)(d) prohibits use of the LIBR in bankruptcy, it is because the security interest is "only in" commingled cash proceeds to the extent provided by the ten day formula.\(^{35}\)

The ten day formula limits the secured party's recovery to proceeds "received" by the debtor. Received is not defined by the Code. The mouse's drafters probably assumed that proceeds would be physically received. They were animated by a vision of a debtor who, on the eve of bankruptcy, is desperately selling inventory and obtaining cash proceeds in order to pay trade creditors, employees, taxes, and other debts.\(^ {36}\)

However, nothing in the statute rules out the possibility of constructive receipt.\(^ {37}\) Furthermore, nothing in the statute requires the debtor to make the deposit that results in commingling.

\(^{34}\)See infra note 43.

\(^{35}\)See, e.g., Coachman Indus. v. Security Trust & Sav. Bank of Shenandoah, 35 U.C.C. Rep. Serv. (Callaghan) 1012 (Iowa 1983). The words "only in" were added to the Code in 1972 to clarify that the claim to cash allowed by the mouse in insolvency is "exclusive of any other claim based on tracing." A.L.I. & NAT'L CONF. OF COMM'RS ON UNIFORM STATE LAWS, 1972 OFFICIAL TEXT AND COMMENTS OF ARTICLE 9 SECURED TRANSACTIONS AND CONFORMING AMENDMENTS TO RELATED SECTIONS WITH SUPPLEMENTARY TEXT SHOWING ADDITIONS AND DELETIONS AND STATEMENT OF REASONS FOR CHANGES MADE 214 (1972). This was stated to be the intent of earlier versions of U.C.C. § 9-306 (1977). See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, FINAL REPORT 221 (1971). The mouse's drafting history supports this conclusion. See infra text accompanying notes 92-113.

\(^{36}\)See 2 G. GILMORE, supra note 4, at 1339. Cf. U.C.C. § 2-103(1)(c).

\(^{37}\)The general rule is that a security interest "continues in any identifiable proceeds . . . received by the debtor." U.C.C. § 9-306(2) (1977) (emphasis added). A debtor's receipt is a condition to the continuation of a security interest in proceeds. However, the term is broadly defined so that it extends to transferees of collateral subject to a security interest. Id. § 9-105(1)(c), (d). See R. HILLMAN, J. MCDONELL & S. NICKLES, COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE ¶ 22.05[1][b] (1985). Constructive receipt is permissible under the general rule. See R. HENSON, supra note 8, at 227-28. Section 9-306(4)(d) is an exception to the general rule because it prohibits the identification of commingled proceeds. See supra note 35 and accompanying text. However, it too should be interpreted to encompass proceeds constructively received on behalf of the debtor by a third person. For example, proceeds wired directly to the debtor's checking account, which are available for withdrawal, surely have been received by the debtor even though the debtor never had physical possession of cash or a check. The issue of whether proceeds were received by the debtor may be coterminous with the issue of whether the funds were commingled in "deposit accounts of the debtor," as also required by
The mouse does not require the secured party to prove that proceeds received during the ten days were commingled. For example, assume the debtor receives ten thousand dollars of proceeds during the ten day period, one cent of which is deposited in an account, which thereby becomes commingled. (The account previously contained nonproceeds.)\(^3\) The secured party can recover up to ten thousand dollars from that account even if the debtor has dissipated the other \$9,999.99 of proceeds.\(^3\) If the account contained commingled proceeds and nonproceeds prior to the ten day period, the secured party can recover up to ten thousand dollars, even if none of the ten thousand dollars of proceeds is deposited.\(^4\)

**B. The LIBR**

The LIBR is an aspect of restitutionary tracing theory that provides a right to reimbursement from a bank account in which a person has wrongfully commingled funds of another with their own funds.\(^4\) The victim may also be entitled to restitutionary relief against funds transferred from the commingled account or their product.\(^4\) The LIBR enjoys judicial support as an extra-Code means to "identify" cash proceeds in nonbankruptcy cases.\(^4\) Identification in the context of cash

\(^3\)For purposes of § 9-306(4), once an account is commingled for the first time it can never be cleansed of commingling through the application of an extra-Code tracing methodology such as the LIBR. See infra notes 82-84 and accompanying text.

\(^4\)See 2 G. Gilmore, supra note 4, at 1339; Skilton, supra note 1, at 76-77.


\(^4\)See Restatement of Restitution, supra note 7, at §§ 209-13; Restatement (Second) of Restitution § 38 (Tent. Draft No. 2, 1984). The LIBR and related doctrine also are part of the law of trusts. See infra note 43.

\(^4\)See Restatement of Restitution, supra note 7, at § 211.

\(^4\)General principles of law and equity supplement Article Nine unless displaced by a particular Code provision. See U.C.C. § 1-103. Displacement may have to be "explicit." See id. at comment 1. One analytic route for invoking the LIBR and related doctrine is to reason that the term "identify" in U.C.C. § 9-306(2) incorporates extra-Code tracing principles or, at least, that it does not
proceeds means determining the dimensions of the security interest in the commingled account, in a transfer of funds from the account, or in assets purchased with the transferred funds. A creditor is secured to the extent that proceeds can be identified.\(^4\)

The wrongdoing requisite to restitutionary relief might be found in the debtor’s act of commingling cash proceeds. In addition, even if the secured party authorizes or acquiesces in the commingling, a subsequent unauthorized transfer of funds from the account may still amount to a wrongful misappropriation of the secured party’s property.\(^4\) In using restitutionary theory to identify cash proceeds, the requirement of a wrongful act should be considered in light of the special environment of secured financing. The secured party’s claim should be controlled by

\(^4\)Restitutionary methods and relief are available only to vindicate a misappropriated interest in property. See generally Oesterle, supra note 2, at 173, 177-80 (listing types of property and types of misappropriation which may trigger restitutionary relief). They may be employed to measure liability for misapplication of proceeds. See, e.g., Domain Indus. v. First Sec. Bank & Trust Co., 230 N.W. 2d 165, 168-69 (Iowa 1975). See generally D. Dobbs, supra note 43, at 421-23.

Article Nine and related case authority because they provide the governing framework for security interests. In general, this means that sufficient wrongdoing exists for a secured party to invoke the LIBR and related restitutionary doctrine if the debtor’s conduct with respect to the collateral was not authorized by the secured party.

Restitutionary tracing can define the size of a security interest in funds withdrawn from a commingled account or their product. The order of deposits into the account and the order of withdrawals from the account are irrelevant. Consider the following example:

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46 Article Nine validates security agreements that permit the debtor to commingle, use, or dispose of proceeds. See U.C.C. § 9-205. However, nothing in the Code requires the debtor to have physical access to proceeds or prevents a debtor from agreeing to restrictions upon its control over proceeds. Cf. id. §§ 1-102(3), 9-502(1). The scope of a debtor’s authority to transfer proceeds may be defined by the security agreement (e.g., a clause requiring the deposit of proceeds in a special account under the sole control of the secured party) or by conduct (e.g., given such a clause, the secured party acquiesces in the debtor’s use of a general account).

47 Authorization by the secured party to transfer proceeds in the security agreement “or otherwise” results in loss of the right to recover them. See U.C.C. §§ 9-105(1)(c), 9-306(2). Unauthorized dispositions frequently constitute acts of default under the security agreement and give rise to tort liability. See R. HILLMAN, J. MCDONNELL & S. NICKLES, supra note 37, at ¶ 22.01(1)(b). A person who has incurred tort liability as a result of conversion owes restitution. See RESTATEMENT (SECOND) OF RESTITUTION, supra note 41, at § 45 comment g. Whether a disposition of collateral was authorized can be a close question. See, e.g., Hedrick Savings Bank v. Myers, 229 N.W.2d 252 (Iowa 1975). The right to proceed also may be lost because of a priority rule. See infra text accompanying notes 117-22, 140-53. Extended or multiple failures to halt a debtor’s wrongful acts might give rise to claims of laches or estoppel. See U.C.C. § 1-103. See generally D. DOBBS, supra note 43, at 41-44. These defenses also must be assimilated to the special environment of Article Nine, see supra text accompanying notes 45-46, and often may prove insufficient against perfected secured claims. See R. HILLMAN, J. MCDONNELL & S. NICKLES, supra note 37, at ¶24.04(2).

48 See RESTATEMENT OF RESTITUTION, supra note 7, at § 211. This principle also provides a claim against funds remaining in the commingled account, which is displaced by the mouse in insolvency proceedings, but not in other cases. See U.C.C. §§ 9-306(2), 9-306(4)(d).

49 See RESTATEMENT OF RESTITUTION, supra note 7, at § 211 comments a, b. See generally DOBBS, supra note 43, at 427-29; 1 G. PALMER, supra note 43, § 2.16, at 201-07.
Deposit of debtor's funds $1,000
Deposit of proceeds 1,000
Balance 2,000
Transfer from the deposit account (1,500)
Balance $500

Provided that the transfer is not authorized by the secured party, the transferred funds are encumbered by the secured party's rights to the extent of one thousand dollars.\(^{50}\) Assets acquired with the funds by the transferee would be encumbered by the same amount.\(^{51}\)

The right to funds or their product defined by tracing is characterized by the law of restitution as an equitable lien securing reimbursement or as a constructive trust.\(^{52}\) Once imposed, these restitutionary rights may be judicially enforced. For example, an equitable lien may be enforced against a wrongdoer's bank account by a court order to pay the claimant out of the account.\(^{53}\) Therefore, through commingled fund tracing a secured party not only can identify funds as proceeds subject to a security interest, but also can enforce recovery from the account in the identified amount. It is important to note that security interests and equitable liens or constructive trusts are not equivalents. The former are specialized property rights governed by Article Nine.\(^{54}\) The latter consist of extra-

\(^{50}\)See Restatement of Restitution, supra note 7, at § 211.

\(^{51}\)See id.

\(^{52}\)Restatement of Restitution, supra note 7, at § 211(1), (2). The choice of remedy generally is left to the claimant. Id. § 211(2). If the debtor knew it was acting wrongfully, the secured party would be entitled to a proportionate share either of the part withdrawn or of its product measured according to a ratio between the proceeds and the whole amount of the account. Id. This amounts to the imposition of a constructive trust. Id. § 211 comment d. An equitable lien may be more appropriate when restitution is sought against property belonging only partly to the claimant, such as a bank account containing commingled cash proceeds. See Department of Natural Resources v. Benjamin, 41 Colo. App. 520, 587 P.2d 1207 (1978); D. Dobbs, supra note 43, at 249-50. See generally Restatement of Restitution, supra, at § 161 comment a; 1 G. Palmer, supra note 43, § 2.14, at 176-77, § 2.16, at 207-14; 5 A. Scott, supra note 43, at 3425-26, 3613-14.

\(^{53}\)See Restatement of Restitution, supra note 7, at § 161 comment b; 1 G. Palmer, supra note 43, at § 1.5(a).

\(^{54}\)Article Nine uses the term "lien" to describe interests that arise without the consent of the person against whom they are enforceable (e.g., judgment or artisans' liens). See U.C.C. §§ 1-201(37), 9-102(1), 9-301(3), 9-310. The term "security interest" describes consensual interests in personal property securing an obligation. See id. Liens generally are not governed by Article Nine, but security interests are. See id.
Code remedies available to claimants who can trace. A secured party may obtain an equitable lien or constructive trust because a security interest in identifiable proceeds can be foreclosed or enforced by any available judicial procedure, including those that result in a lien. This distinction is significant because it reinforces the primacy of Article Nine in deciding issues such as whether a security interest is perfected or has priority over a third party.

Secured parties that trace may encounter untraceable withdrawals and subsequent additions to a commingled account. The LIBR focuses on this problem by treating commingled proceeds as oil floating on top of nonproceeds that consist of water. All the nonproceeds drain from the bottom of the account before the proceeds are depleted. Consider the following new example:

| Deposit of debtor's funds        | $1,000 |
| Deposit of proceeds              | 1,000  |
| Balance                           | 2,000  |
| Untraceable transfer from the account | (1,500) |
| Balance                           | 500    |
| Deposit of debtor's funds        | 2,000  |
| Balance                           | 2,500  |
| Unauthorized transfer to X       | (1,000) |
| Balance                           | $1,500 |

If the secured party's rights are fixed at this point, its security interest against the bank account or the funds transferred to X cannot exceed the

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55See U.C.C. § 9-501(1), (5). Under the UCC, a defective security interest may not be salvageable on the theory that it is an equitable lien. See id. § 9-203 comment 5. However, a secured party armed with an enforceable and perfected security interest may employ equitable remedies against the debtor or third parties. See In re Atlantic Mortgage Corp., 69 Bankr. 321, 330 (Bankr. E.D. Mich. S.D. 1987). The details of these remedies are generally left to extra-Code law. See generally infra notes 123-32 and accompanying text.

56See infra notes 140-53 and accompanying text.


58Id.

59Rights will be fixed at the time an insolvency proceeding is instituted. See 1 G. Palmer, supra note 43, at 197 n.6; see also supra note 19 and accompanying text.
amount of the lowest intermediate balance, which is five hundred dollars.\textsuperscript{60} The untraceable transfer first drained one thousand dollars of nonproceeds, and then five hundred dollars of proceeds. The second deposit of the debtor's funds does not replenish the security interest unless the debtor manifests an intent to make restitution.\textsuperscript{61} Absent such an intent, the lien would be extinguished if the unrecoverable transfer was two thousand dollars because the lowest intermediate balance would be zero.\textsuperscript{62} A transfer may be untraceable because there is only sketchy evidence of where the money went. It also may be untraceable because it was received by a person with priority over the secured creditor.\textsuperscript{63} The LIBR protects the debtor's general creditors by placing a limit upon the right to restitution.\textsuperscript{64}

\textsuperscript{60}See Restatement of Restitution, supra note 7, at § 212. Many banks maintain a daily record of account activity, which could facilitate determining the lowest intermediate balance. See Zubrow, Integration of Deposit Account Financing into Article Nine of the Uniform Commercial Code: A Proposal for Legislative Reform, 68 Minn. L. Rev. 899, 918-19 (1984). See generally 1 G. Palmer, supra note 43, § 2.16, at 200-01. Day's end balances may be appropriate for applying the LIBR to active accounts. Restatement (Second) of Restitution, supra note 41, at § 38 comment d.

In permitting a victim to trace into the funds remaining in a commingled account, some courts justify the LIBR with the fiction that a wrongdoer first withdraws its own funds. This is the basis for the "oil and water" metaphor. See supra note 57 and accompanying text. Depletion of the victim's funds does not commence until the wrongdoer's funds are exhausted. See D. Dobbs, supra note 43, at 428. It may seem logical to apply this fiction in a case in which the victim seeks to recover funds withdrawn from the account or their product. See R. Hillman, J. McDonnell & S. Nickles, supra note 37, at ¶22.05(3)(a); Zubrow, supra, at 959. The victim would have no claim to withdrawn funds until the lowest intermediate balance in the account falls below the amount of the victim's funds deposited in the account. However, the Restatement of Restitution and a majority of American courts hold that withdrawn funds may be subject to the victim's restitutory rights regardless of the sequence of withdrawals. Restatement of Restitution, supra note 7, at § 211; 1 G. Palmer, supra note 43, § 2.16, at 203-07.

\textsuperscript{61}See Restatement of Restitution, supra note 7, at § 212 comment c.

\textsuperscript{62}See id. comment a. See generally 1 G. Palmer, supra note 43, § 2.16, at 205.

\textsuperscript{63}For example, a debtor might withdraw cash from the commingled account which is "used up" in the debtor's business. Even if the identity of all the transferees could be determined, they may be legitimate creditors entitled to priority over the secured party. See Mattson v. Commercial Credit Business Loans, Inc., 301 Or. 407, 415, 723 P.2d 996, 1001 (1986).

\textsuperscript{64}See generally 1 G. Palmer, supra note 43, § 2.14, at 182-86. The secured party should not be required to make an election between pursuing its restitutory rights against either the debtor's account or the transferred funds. See Restatement of Restitution, supra note 7, at § 147.
Two corollaries of the LIBR are worth mentioning. Starting with the previous example (in which the lowest intermediate balance is five hundred dollars), assume the following additional transactions occur before the secured party's rights are fixed:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account balance from previous example</td>
<td>$1,500</td>
</tr>
<tr>
<td>Deposit of proceeds</td>
<td>500</td>
</tr>
<tr>
<td>Interest credited to the account</td>
<td>10</td>
</tr>
<tr>
<td>Balance</td>
<td>2,010</td>
</tr>
<tr>
<td>Unauthorized transfer to Y</td>
<td>(1,000)</td>
</tr>
</tbody>
</table>

The size of the security interest in the funds transferred to X, the first unauthorized transferee, is not affected by the subsequent deposit of proceeds or the interest credit. The LIBR protects X's general creditors by limiting the size of the security interest in funds transferred to X. However, the secured party's rights against the debtor's bank account or Y are increased by the amount of the second deposit of proceeds and some of the interest. The security interest is not limited in size to the previous lowest intermediate balance when subsequent deposits to the account consist of proceeds. The secured party's potential recovery also should be increased by any profit earned by the account, such as interest credited by the depository institution, to the extent that it is attributable to funds identified with the security interest. The maximum that a secured party may identify by tracing cannot exceed the amount of the secured indebtedness.

Cases may arise in which the debtor commingles cash proceeds in its deposit account and then transfers funds from the account to a transferee. The debtor becomes bankrupt and the secured party claims that it is entitled to funds in the transferee's possession as well as funds in the bank account. It is generally accepted that Article Nine provides an asymmetric constellation of entitlements: Section 9-306(4)(d) applies in insolvency proceedings; restitutionary tracing, including the LIBR, applies in other cases.

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66 See supra note 64.
67 See 5 A. SCOTT, supra note 43, at 3636.
68 See RESTATEMENT OF RESTITUTION, supra note 7, at § 212 comment b; D. DOBBS, supra note 43, at 423.
69 See U.C.C. §§ 1-201(37), 9-105(1).
Assuming that neither the mouse nor the Bankruptcy Code cut off the secured party's right to identify the transferred funds, the mouse and restitutionary tracing can be applied to measure the secured party's recovery from the account and the transferee, respectively. There is no conflict between the two entitlements provided that the secured party is not permitted to recover twice on account of proceeds received during the mouse's ten day period.

For example:

_Premouse Period_

Employ the LIBR to determine the amount of proceeds (P) and nonproceeds (NP) in the account at the end of this period. This period commences upon the date of the first act of commingling relied upon by the plaintiff, and ends at the start of the mouse's ten day period. _See supra_ notes 41-64 and accompanying text. Assume P = $1,000 and NP = $1,000.

_The Mouse's Ten Day Period_

This is the ten day period in § 9-306(4)(d). P = $1,000 and NP = $1,000 at the start of this period. This example assumes that all proceeds received during the period are commingled in the account, although this is not required by the mouse. _See supra_ notes 39-40 and accompanying text. The mouse does not impair a secured party's right to identify proceeds transferred from the commingled account prior to bankruptcy to a non good faith purchaser. _See infra_ notes 108-14 and accompanying text.

<table>
<thead>
<tr>
<th>Balance</th>
<th>$2,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit of proceeds</td>
<td>1,000</td>
</tr>
<tr>
<td>Deposit of debtor's funds</td>
<td>1,000</td>
</tr>
<tr>
<td>Balance</td>
<td>4,000</td>
</tr>
<tr>
<td>Non-traceable transfer</td>
<td>(2,500)</td>
</tr>
<tr>
<td>Deposit of debtor's funds</td>
<td>1,000</td>
</tr>
<tr>
<td>Unauthorized transfer to Z</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Balance</td>
<td>500</td>
</tr>
</tbody>
</table>

Restitutionary tracing limits the secured party's maximum recovery from Z to $1,500—the lowest intermediate balance prior to the transfer. _See supra_ notes 57-59 and accompanying text. The secured party has no right to reach the debtor's bank account under restitutionary principles because they are displaced to that extent by § 9-306(4)(d). _See supra_ note 35 and accompanying text. The secured party's maximum recovery from the debtor's bank account is limited by the mouse to $1,000—the amount of proceeds received during the ten day period. _See supra_ note 36 and accompanying text. The secured party should not be given double recovery simply because the $1,000 of proceeds were deposited during the ten day period. It may be allowed to use these proceeds in support of either its tracing based or mouse based claim, but not in support of both claims.

An alternative approach might credit any recovery from the bank account (transferee) against any recovery from the transferee (bank account). This may
III. ROLES, PRIORITY, AND RELIEF: RESTITUTION AND ARTICLE NINE

It is generally, but not universally, accepted that Article Nine provides an asymmetric constellation of entitlements to commingled funds.\(^7\)\(^3\) In the event of insolvency proceedings, section 9-306(4)(d) defines the secured party’s recovery from cash or deposit accounts of the debtor in which proceeds have been commingled with other funds. Both the LIBR and related restitutionary tracing doctrine define the entitlement to funds of the debtor containing commingled proceeds when there is no insolvency proceeding.

The question of what entitlement applies to funds which are no longer of the debtor because the debtor transferred them to a third party is independent of whether these definitions are correct. Logic might suggest that once bankruptcy intervenes, section 9-306(4)(d) cuts off secured claims to the transferred funds. The mouse displaces a secured party’s right to trace into a commingled account by means of extra-Code tracing rules. Following funds out of the account and into a transferee’s hands would require commingled fund tracing. Therefore, there can be no right to recover from the transferee. Article Nine may support this reasoning. It provides that in the event of bankruptcy, the secured claim is only in what is expressly recoverable under the mouse, and the mouse does not provide for the recovery of proceeds transferred out of the debtor’s commingled deposit account.\(^7\)\(^4\) On the other hand, section 9-306(4)(d) may be neutral with respect to cash proceeds transferred prior to bankruptcy, neither aiding nor hindering the secured party. The secured party would then be free to employ restitution to identify the transferred funds. It might also

\(^7\)\(^3\)See supra note 8 and accompanying text.
be argued that the mouse defines or limits the claim to the transferred funds, but does not cut it off.\footnote{A transferee of commingled cash proceeds subject to a security interest is a "debtor" even though the transferee is not liable for the obligation secured. See supra note 37. Therefore, the mouse might define a secured party's entitlement in the case of a bankrupt transferee's commingled cash and deposit accounts. However, the Code's drafting history indicates that § 9-306(4)(d) was envisioned as applicable only to "original debtors" liable for the secured obligation. See infra notes 92-113 and accompanying text.}

Uncertainty concerning secured claims to commingled funds is not limited to the entitlements. Issues of priority, relief, and restitution's general role in Article Nine also are opaquely perceived or resolved.

A. The Courts and Commingling

Case law generally supports the traditional view of Article Nine's asymmetric entitlements to commingled funds not transferred by the debtor: extra-Code tracing is available except in bankruptcy, where it is preempted by section 9-306(4)(d).\footnote{See, e.g. Fitzpatrick v. Philco Fin. Corp., 491 F.2d 1288 (7th Cir. 1974); First Nat'l Bank of Amarillo v. Martin, 40 U.C.C. Rep. Serv. (Callaghan) 1521 (S.D. Tex. 1985), rev'd, In re Martin, 25 Bankr. 25 (Bankr. N.D. Tex. 1982).} However, there are divergent views concerning the entitlement applicable when a security interest is asserted against transferred funds in a third party's hands. One view is reflected in First National Bank of Amarillo v. Martin.\footnote{40 U.C.C. Rep. Serv. (Callaghan) 1521 (S.D. Tex. 1985), rev'd, In re Martin, 25 Bankr. 25 (Bankr. N.D. Tex. 1982). The facts are set forth in the opinion of the bankruptcy judge.} The debtor's sale of goods over a leased department store counter was financed by a bank ("Secured Party") with a security interest in the debtor's inventory. Sales by the debtor were processed through the store's registers. The store made monthly accountings, deducted a percentage rental, and paid the
remaining balance to the debtor. The debtor customarily deposited the store's checks in her business checking account with Secured Party. Her revenue was seasonal, with the greatest sales occurring around Christmas.\textsuperscript{78}

As bankruptcy approached, the debtor cashed the check covering most of her 1980 Christmas sales at another bank ("Bank Two"), and placed the monies in a safe deposit box at that bank. There was no commingling of proceeds with nonproceeds in the box. A little over sixty percent of the cash was then deposited in a joint checking account that the debtor shared with her husband at a third bank ("Bank Three").\textsuperscript{79} There was commingling in this account. After some of the funds in this account were dissipated, the debtor and her husband executed an agreement

\textsuperscript{78}In re Martin, 25 Bankr. at 26.

\textsuperscript{79}Id. at 26-27. The action in the various bank accounts may be reconstructed as follows. All dates are in 1981. The bankruptcy petition was filed on March 4. For a discussion of how to calculate the LIBR, see supra text accompanying notes 57-69.

\begin{center}
\textit{Joint Account at Bank Three}
\end{center}

\begin{tabular}{lll}
\text{Date} & \text{Deposit/Withdrawal} & \text{Balance} \\
2/13 & +5,082 (from safe deposit box) & $4,957.36 \\
2/18 & +6,860 (from safe deposit box) & 11,817.36 \\
& (lowest intermediate balance between 2/18 and 2/23) & 10,684.10 \\
2/? & +29.46 (from ?) & 10,713.56* \\
2/23 & -5,356.78 (to Bank Four) & 5,356.78 \\
& (lowest intermediate balance between 2/23 and 4/17) & 4,200 \\
4/17 & -4,200 (to husband's account at Bank Three) & ? (probably 0)
\end{tabular}

*The bankruptcy court's opinion does not explain this increase in the account balance. The district court reasoned that it can be accounted for by including nonproceeds deposits on February 23 and subtracting the checks that were outstanding on that day. Whatever its source, the account must have been increased by this amount if it was partitioned into equal halves of $5,356.78 on February 23.

\begin{center}
\textit{Debtor's Account at Bank Four}
\end{center}

\begin{tabular}{lll}
\text{Date} & \text{Deposit/Withdrawal} & \text{Balance} \\
2/23 & +5,356.78 & $5,356.78 \\
& (lowest intermediate balance between 2/23 and 3/4)\dagger & $5,268.79
\end{tabular}

\dagger The debtor deposited $378.78 from the second department store check on an unspecified date after February 20. $100 from an undetermined source was deposited on March 12 after bankruptcy.

\begin{center}
\textit{Husband's Account at Bank Three}
\end{center}

\begin{tabular}{lll}
\text{Date} & \text{Deposit/Withdrawal} & \text{Balance} \\
4/17 & +4,200 & ? \\
& (lowest intermediate balance after 4/17 was never less than $4,200). &
\end{tabular}
partitioning the remainder of the account in half. The debtor placed her half in a new account opened in her name at a fourth bank ("Bank Four"). Part of the husband's half that remained in Bank Three was dissipated before he placed the balance in an account in his name at Bank Three. A second proceeds check covering the balance of the 1980 Christmas sales was cashed by the debtor at Bank Two. Some of these funds were paid to the debtor's attorney, with the balance deposited in the debtor's account at Bank Four. The debtor admitted that she intended to remove all the monies, or at least the husband's half of the joint account, from bankruptcy administration.

On appeal, the district court correctly read section 9-306(4) to permit the recovery of proceeds deposited in a bank account by means of two routes: (1) Where the account is shown to be a separate deposit account containing only proceeds; and (2) by application of the mouse. The first route was foreclosed to Secured Party because of commingling in the joint account at Bank Three. The bankruptcy court's decision, allowing Secured Party to employ the LIBR to trace through this account to show that the debtor's and her husband's accounts were separate and contained only proceeds, was inconsistent with the mouse's preemption of extra-Code tracing methods in bankruptcy. None of the accounts were separate in the sense of being specifically created and used only for the deposit of proceeds. However, the district court deemed the LIBR an appropriate

80 See supra note 79.
81 See supra note 79.
83 First Nat'l Bank of Amarillo, 40 U.C.C. Rep. Serv. (Callaghan) at 1525. This account apparently contained at least $29.46 of nonproceeds. See supra note 79.
84 First Nat'l Bank of Amarillo, 40 U.C.C. Rep. Serv. (Callaghan) at 1525. The district court reasoned that the Bank Four account was commingled because it contained some of the nonproceeds deposited in the joint account at Bank Three. See supra note 79.
means for identifying transferred funds in the presence of intentional wrongful conduct.\textsuperscript{85}

\textit{Martin} apparently assumes that section 9-306(4)(d) is neutral with respect to claims against third parties that may proceed by means of restitutionary tracing. An alternate view that the mouse limits the amount recoverable from a transferee is reflected in \textit{In re Datair Systems Corp.}\textsuperscript{86}

\textit{Datair} involved the Chapter Eleven reorganization of a parent corporation, Datair Systems ("Systems"). A wholly-owned subsidiary, Datair Financial ("Financial"), was the subject of a separate and completed Chapter Seven liquidation. Systems' assets served as collateral under a security agreement with the Small Business Administration ("SBA"). A bank held a security interest in Financial's assets, which it relied upon to reach certain of Systems' computer software and accounts receivable.\textsuperscript{87} There was evidence of cash transfers from Financial to Systems, and payments to both corporations were deposited in a bank account in Systems' name. Funds from this account were used to pay employees and creditors of both corporations depending upon "who hollered the loudest."\textsuperscript{88} The bank claimed that it was entitled to a constructive trust on the software and receivables with priority over the SBA.\textsuperscript{89}

The court recognized that the bank was asserting the following linkage: Assets of Financial (collateral) to funds deposited in the commingled Systems' account (cash proceeds) to the software and

\begin{footnotes}
\item[85] First Nat'l Bank of Amarillo, 40 U.C.C. Rep. Serv. (Callaghan) at 1526-27.
\item[87] The bank also had a separate perfected security interest in Systems' assets over which the SBA apparently had priority as the first to file. \textit{Id.} at 242-43. See U.C.C. § 9-312(5)(a). \textit{Datair} is concerned with the administration of assets in Systems' estate. It did not involve a substantive consolidation or a joint administration. \textit{See generally} 5 \textit{COLLIER}, \textit{supra} note 22, at \texttt{I} 1100.06-.07.
\item[88] Datair, 42 Bankr. at 243.
\item[89] \textit{Id.} at 244.
\end{footnotes}
receivables (noncash proceeds). Its treatment of the proceeds issues raised by the bank’s claim was more hesitant. The court ultimately focused on section 9-306(4)(d) and held that the bank should recover to the extent that it could demonstrate through documentary evidence that it had an interest under the mouse’s ten day formula.

### B. Lessons from the Mouse’s Ancestors

*Martin* and *Datair* comport with the traditional view that section 9-306(4)(d) controls a secured party’s entitlement to commingled funds in the bankruptcy estate of the debtor who created the security interest. However, they differ concerning the mouse’s role in the case of cash proceeds transferred prior to bankruptcy.

Section 9-306(4)(d)’s drafting history confirms that the traditional view is the correct one and indicates that the section was not intended to affect secured claims to funds transferred prior to bankruptcy. It also provides insight into the remedial and priority scheme envisioned for these claims.

In examining this drafting history, it is important to recognize that transferees of commingled cash proceeds often will be “good faith purchasers” entitled to protection from claims arising prior to the transfer. For example, a transferee of a check drawn on a commingled account, or of cash withdrawn from the account, can obtain this protected

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90 Initially, the court seemed to find controlling U.C.C. § 9-306(4) (claims to cash proceeds in insolvency proceedings), but it subsequently turned to U.C.C. § 9-306(2) (secured party’s general right to “identify” proceeds). Relevant state law permitted identification of commingled proceeds by means of the LIBR, but the bank’s entitlement under this rule apparently was zero. *See Datair*, 42 Bankr. at 244-45.

91 *In re Datair Systems Corp.*, 42 Bankr. at 244. *Datair* does not reason that Systems was a “debtor.” *See supra* note 75.

92 “Good faith purchaser” is used here in a general sense to refer to a transferee who is protected against property claims because it took in good faith, gave value, lacked notice of the claim, or for other reasons. The technically correct name for the good faith purchaser and the specific requirements for protection vary according to the type of personalty and the applicable case or statute law. *See infra* notes 117-22 and accompanying text. Because this article is concerned with the rights of secured parties, due attention must be given to Article Nine’s priority scheme, which protects some transferees against secured claims. *See infra* notes 140-53 and accompanying text.
status. Thus, the issue of how the mouse affects a security interest in transferred funds is most likely to arise in cases like *Martin* and *Datair* where the transfer was colorably out of the ordinary course, and the proceeds could be traced into the hands of a non good faith purchaser.

The Uniform Trust Receipts Act ("UTRA") and early commercial code drafts are the first links in the mouse's lengthy evolutionary chain.

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93 See infra note 145 and accompanying text.

94 Claims to transferred proceeds will not necessarily be initiated in insolvency proceedings. The secured party might sue the transferee in a court of general jurisdiction, in which case the mouse may be irrelevant, at least until the debtor enters bankruptcy. See U.C.C. 9-306(4)(d).

95 See generally Braucher, *Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 799 (1958). Section 10(b) of the Uniform Trust Receipts Act gave a secured party the right to the value of proceeds, whether identifiable or not, received by the debtor within ten days of bankruptcy. See UNIF. TRUST RECEIPTS ACT § 10(b), 9C U.L.A. 261 (1957) [hereinafter UTRA]. This right extended to the general assets of the debtor and was not limited to a bank account containing cash proceeds. See, e.g., Universal C.I.T. Credit Corp. v. Thursbay Chevrolet Co., 136 So.2d 15, 19 (Fla. Dist. Ct. App. 1962). See generally 2 G. GILMORE, supra note 4, at 1341-44. The UTRA also afforded a financer an independent right to recover identifiable proceeds. UTRA § 10(c), 9C U.L.A. at 261. See also id. § 10(a), 9C U.L.A. at 261. Sections 10(b) and 10(c) were intended to simplify the secured party's proof in insolvency proceedings and preserve common law tracing rights, possibly including commingled fund tracing conventions. See UTRA Commissioners' Prefatory Note, 9C U.L.A. at 225. Commingled fund tracing was approved in the common law of trust receipts. See In re Mulligan, 116 F. 715 (D. Mass. 1902); Frederick, *The Trust Receipt as Security II*, 22 COLUM. L. REV. 546, 555-57 (1922). But see Henning, *Article Nine's Treatment of Commingled Cash Proceeds in Non-Insolvency Cases*, 35 ARK. L. REV. 192, 211-12 (1981). The UTRA's right to trace followed proceeds into the hands of a transferee of the debtor, but was cut off by good faith purchasers such as a holder in due course of commercial paper. UTRA § 9, 9C U.L.A. at 255. See, e.g., General Motors Acceptance Corp. v. Associates Discount Corp., 38 N.Y.S.2d 972 (Syracuse Munic. Ct. 1942), rev'd on other grounds, 267 A.D. 1032, 48 N.Y.S.2d 242 (1944). It also could be lost if the secured party failed to demand an accounting by the debtor within ten days of obtaining knowledge of the existence of the proceeds. UTRA § 10(c), 9C U.L.A. at 261. See generally Skilton, *Cars For Sale: Some Comments on the Wholesale Financing of Automobiles*, 1957 WIS. L. REV. 352, 404-08.

UTRA influence on the mouse's U.C.C. ancestors is not surprising, given that Karl Llewellyn served as draftsman for the UTRA and, as Chief Reporter, was extensively involved with all sections of the early Code drafts. See W. TWNING, KARL LLEWELLYN AND THE REALIST MOVEMENT 105, 281, 300-01 (1973). These drafts provided for, *inter alia*, a formula-based right to the value of untransferred cash proceeds received by the debtor shortly prior to bankruptcy, and a right to reclaim cash proceeds transferred to third parties. See A.L.I & NAT'L CONF. OF COMM'R S ON UNIFORM STATE LAWS, COMMERCIAL CODE (GROUP NO. 3), TENTATIVE DRAFT NO. 1, art. VII §§ 17, 18, 19 (Apr. 21,
They provided financers with a formula-based right to the value of untransferred cash proceeds received by the debtor prior to bankruptcy, and an independent right to transferred cash proceeds in third party hands. Subsequently, the formula-based right was made exclusive in insolvency proceedings with respect to untransferred cash proceeds.

Statutory language and commentary relating to the exclusive formula-based right clouded a secured party's right to recover transferred cash proceeds. For example, a Code revision issued in October of 1949 ("October 1949 Revision") may evidence an intent to abrogate the right to transferred cash proceeds in the event of bankruptcy.

1948) [hereinafter TENTATIVE DRAFT 1]; A.L.I. & NAT'L CONF. OF COMM'R'S ON UNIFORM STATE LAWS, COMMERCIAL CODE TENTATIVE DRAFT NO. 2, art. VII § 313(1), (4) (Aug. 6, 1948) [hereinafter TENTATIVE DRAFT 2]. Transferred proceeds were impressed with a trust benefiting the secured party, but good faith purchasers were protected from financers' claims. The right to recover transferred proceeds also could be lost if the secured party acquiesced in the debtor's possession of the proceeds for a specified period of time. See TENTATIVE DRAFT 1, supra, at §§ 14, 17(1), 19; TENTATIVE DRAFT 2, supra, at § 313(2), (5). A legitimate creditor did not hold an ordinary course payment from the debtor as trustee for the secured party. See TENTATIVE DRAFT 1, supra, at 26-27, 29-30 (General Comments on Sections 17 through 22); A.L.I. & NAT'L CONF. OF COMM'R'S ON UNIFORM STATE LAWS, COMMERCIAL CODE NOTES AND COMMENTS TO TENTATIVE DRAFT NO. 2, art. VII at 20-21 (Aug. 6, 1948).

See supra note 95.

See A.L.I. & NAT'L CONF. OF COMM'R'S ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE, MAY 1949 DRAFT § 7-322 (1949) [hereinafter MAY 1949 DRAFT]. Secured parties were provided with a continuing lien on cash proceeds received by the debtor. The lien would not be good against persons who received proceeds for value in the ordinary course. See id. § 7-322(2)(b). In insolvency proceedings, a financer was given "in lieu of tracing cash proceeds, a lien on the cash of the borrower equal to the amount of cash proceeds received within one week prior to bankruptcy and no other right to cash proceeds." Id. § 7-322(2)(c). The formula right was intended to clarify the UTRA rule by specifying that the right was in lieu of tracing and not in addition thereto. Id. at § 7-322 comment 2.

See supra note 97.

See A.L.I. & NAT'L CONF. OF COMM'R'S ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE, OCTOBER 1949 REVISIONS OF SECTION 1-105; BANK COLLECTIONS PART OF ARTICLE 3; SECTION 6-303; AND ARTICLES ON SECURED TRANSACTIONS AND BULK TRANSFERS §§ 8-306, 8-308 (1949) [hereinafter OCTOBER 1949 REVISION]. The October 1949 Revision also considered a secured party's priority in transferred proceeds. Previously, the proceeds sections of Code drafts had contained their own priority rules for transferred proceeds. See MAY 1949 DRAFT, supra note 97, at § 7-322. The October 1949 Revision stripped the proceeds specific priority rules from the
1949 Revision states that a security interest continues on proceeds received by the debtor, subject to the formula-based recovery provided by the following mouse ancestor:

In insolvency proceedings a lender has, in lieu of any right to trace cash proceeds not subjected to his control, a right to the cash and checking accounts of the debtor equal to the amount of cash proceeds received by the debtor within one week prior to the institution of such proceedings. He has no other right to or lien on cash proceeds not subjected to his control before insolvency proceedings are instituted.100

Accompanying commentary speaks to transferred funds:

[T]he fact that the interest in proceeds is a perfected security interest does not prevent the proceeds from being disposed of free of the security interest. Thus, [under the October 1949 Revision] . . . the lender’s right to cash is limited to cash which he subjects to his control. The debtor’s use of cash proceeds to pay his unsecured debts is authorized so that the unsecured creditor does not hold as “trustee” for the secured lender. . . . [The October 1949 Revision] also . . . makes clear that the priority given is in lieu of tracing not in addition thereto.101

The October 1949 Revision seemingly makes the formula recovery right in the event of insolvency proceedings exclusive with respect to both transferred and untransferred cash proceeds, including funds in the possession of non good faith purchasers. The secured party’s failure to obtain control of the proceeds and the likelihood that many transferees will be good faith purchasers with priority over the secured party arguably served as rationales for cutting off all claims against transferees regardless of their bona fides.102 Nevertheless, there is good reason to question

Code’s proceeds provisions which, henceforth, would be read in conjunction with general priority rules applicable to both proceeds and original collateral. See OCTOBER 1949 REVISION, supra, §§ 8-306, 8-308. This reflected a substantial change in policy. Id. This development is significant for this article because it relates to the priority determinative content of U.C.C. § 9-306. See infra notes 140-53.

100OCTOBER 1949 REVISION, supra note 99, at § 8-306(2).
101Id. § 8-306 comments 1, 2.
102This resembles an argument made for requiring possession to perfect security interests in negotiable collateral in order to protect good faith purchasers. See generally O. SPIVACK, SECURED TRANSACTIONS 80-82 (3d ed. 1963).
whether the Code's drafters ever intended to protect non good faith purchasers against secured claims to commingled cash proceeds under any circumstances. Such protection was inconsistent with other provisions in the October 1949 Revision in which bona fides was a prerequisite to the protection of transferees.103

It is uncertain whether the drafters intentionally abrogated and then restored the right to recover cash proceeds from non good faith purchasers in the event of bankruptcy or merely recognized that they had inadvertently jeopardized the right, although the latter seems more likely. In any event, the right is recognized in the Official 1952 draft of the Code ("1952 Draft").104 The 1952 Draft's mouse ancestor also stated that a secured party had neither a right to nor a lien on cash proceeds not subjected to its control before bankruptcy.105 However, accompanying commentary makes clear that it did not affect the right to identify cash proceeds transferred to non good faith purchasers even if the debtor is bankrupt:

103See October 1949 Revision, supra note 99, at § 8-308. See also id. §§ 2-405, 3-302, 3-305.

104The process of removing this implication through the adoption of commentary apparently began in 1950. See A.L.I. & Nat'l Conf. of Comm’rs on Uniform State Laws, Uniform Commercial Code, Proposed Final Draft § 9-306 (Text & Comments ed. Spring 1950); Id. comment 2. That this is what was intended became clear with the 1952 Draft. See A.L.I. & Nat'l Conf. of Comm’rs on Uniform State Laws, Uniform Commercial Code, Official Draft § 9-306 (Text & Comments ed. 1952) [hereinafter 1952 Draft]. The 1952 Draft provided a general right to identify proceeds:

(1) When collateral is sold, exchanged, collected or otherwise disposed of by the debtor the security interest continues on any identifiable proceeds received by the debtor except as otherwise provided in subsection (2) . . . .

Id. § 9-306(1). This right was subject to the following mouse ancestor:

In insolvency proceedings a secured party with a perfected security interest has a right to the cash and bank accounts of the debtor equal to the amount of cash proceeds received by the debtor within ten days before the institution of such proceedings less the amount of such proceeds received by the debtor and paid over to the secured party during the ten day period, but no other right to or lien on cash proceeds not subjected to his control before insolvency proceedings are instituted . . . .

Id. § 9-306(2). Commentary stated that this mouse ancestor applied "whether or not the funds in the insolvent's possession are identifiable as cash proceeds of the collateral," is "exclusive," and that because of it the secured party "does not have the option to claim a greater sum if he is able to identify the greater sum as cash proceeds of the collateral." Id. § 9-306 comment 2(a). Identical language was enacted in Pennsylvania where it was stated that the mouse ancestor dealt only with cash proceeds turned over to a receiver, and did not prevent the recovery of noncash proceeds acquired with cash proceeds generated prior to the insolvency proceeding. See Girard Trust Corn Exchange Bank v. Warren Lepley Ford, Inc. (No. 3), 25 Pa. D. & C. 2d 395 (1958).

105See supra note 104.
A secured party who leaves proceeds in his debtor’s possession acts at his own risk. If the proceeds are transferred by the debtor in ordinary course of business, the secured party will in most cases not be able to recapture the proceeds from such a transferee. [Priority rules in other Article Nine sections are discussed.] Where cash proceeds are covered into the debtor’s checking account and paid out in the operation of the debtor’s business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party.\footnote{106}

This comment’s reference to the law of fraudulent conveyances indicates that the 1952 Draft did not in any way limit a financer’s recovery of transferred cash proceeds even if the debtor is bankrupt. Fraudulent conveyance law protects creditors against debtor misbehavior intended to hinder, delay, or defraud, and is specifically concerned with conveyances by persons who are or thereby will be rendered insolvent.\footnote{107} Hence, the comment contemplates secured party recovery of proceeds transferred prior to bankruptcy.

The nonitalicized portion of the 1952 Draft’s Comment Two (c) was eliminated with the issuance of the 1957 Official Uniform Commercial Code Text (“1957 Text”).\footnote{108} The italicized portion became the sole

\footnote{106}1952 DRAFT, supra note 104, § 9-306 comment 2(c) (emphasis added).
\footnote{107}See UNIF. FRAUDULENT CONVEYANCE ACT §§ 4, 7, 7A U.L.A. 509 (1985) [hereinafter UFCA]. Provided that the transfer is made with fraudulent intent, the creditor can have the conveyance avoided, or can disregard the conveyance and levy on the property in the transferee’s hands. See generally T. CRANDALL, R. HAGEDORN & F. SMITH, DEBTOR-CREDITOR LAW MANUAL ¶ 6.07(2)(b) (1985) [hereinafter DEBTOR-CREDITOR LAW]; 1 G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 62 (rev. ed. 1940); Jackson, Avoiding Powers in Bankruptcy, 36 STAN. L. REV. 725, 777-86 (1984).
\footnote{108}See A.L.I. & NAT’L CONF. OF COMM’RS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE, 1957 OFFICIAL TEXT WITH COMMENTS § 9-306 comment 2(c) (1958) [hereinafter 1957 TEXT]. The 1957 Text provided a general rule that “[e]xcept where this Article otherwise provides, a security interest . . . continues in any identifiable proceeds including collections received by the debtor.” Id. § 9-306(2). Its mouse ancestor provided that:

In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest . . . in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph . . . is . . . limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings . . . .

Id. § 9-306(4)(d)(ii).
content of Comment Two (c) to the 1957 Text's section 9-306. The 1957 Text did not affect a secured party's right to recover transferred cash proceeds. Work on the mouse was substantially complete with the promulgation of the 1957 Text. The 1957 version of section 9-306 was in effect until that section was officially amended to its current form in 1972. The 1972 amendments did not affect the right to identify funds

The secured party's recovery was subject to any right of set-off and reduced by cash proceeds paid over during the ten day period. Id. § 9-306(4)(d)(i), (ii). Comments indicated that this language provided a security interest in the debtor's cash and bank accounts without the need to trace and changed existing law, i.e., the UTRA. See id. § 9-306 comment 2(c); supra note 95 and accompanying text. Comment two (b) dealt with the problem of voidable preferences in bankruptcy and the perfection of security interests in proceeds. See id. § 9-306 comment 2(b). The 1957 Text's § 9-306 represents a general rewrite to enhance clarity. See A.L.I. & Nat'l Conf. of Comm'rs on Uniform State Laws, Uniform Commercial Code, 1956 Recommendations of the Editorial Board for the Uniform Commercial Code [hereinafter 1956 Recommendations] § 9-306 (reason for change) (1957). The mouse ancestor was rewritten:

to permit the retention of the security interest in identifiable cash proceeds, and
to give a security interest in all unidentified cash and bank accounts received by the debtor but limited to the net amount of cash proceeds received and retained by the debtor within ten days prior to insolvency proceedings.


109See 1957 Text, supra note 108, § 9-306 comment 2(c).
110See supra notes 108-09 and accompanying text.
111See 1962 Text, supra note 108, at § 9-306. Comments 2(a) and 2(c) to § 9-306 of this text also were identical to those contained in the 1957 Text. See id. § 9-306 comments 2(a), (c). The 1962 Text remained the official text until 1972. See A.L.I. & Nat'l Conf. of Comm'rs on Uniform State Laws, 1972 Official Text and Comments of Article 9 Secured Transactions and Conforming Amendments to Related Sections with Supplementary Text Showing Additions and Deletions and Statement of Reasons for Changes Made § 9-306 (1972) [hereinafter 1972 Amendments]. The statutory language in this version of § 9-306 is identical to that contained in the 1978 Official Text, see supra note 10 and accompanying text. See also A.L.I. & Nat'L Conf. of Comm'rs on Uniform State Laws, Article 2A. Leases (With Conforming Amendments to Articles 1 and 9) Proposed Final Draft 187-88 (1987) (adopted without alteration to the 1978 Official Text).
transferred prior to bankruptcy.\textsuperscript{112} The language of the Comment Two (c) appearing with the 1957 Text is identical to that of Comment Two (c) in the current Code ("Comment Two (c)").\textsuperscript{113}

C. Priority and Relief According to Comment Two (c)

The recovery right described in Comment Two (c) belongs to a secured party and the property recovered is designated as proceeds. Hence, its authors were speaking of recovering property subject to a security interest, not unsecured claims.\textsuperscript{114} Juxtaposition of the law of fraudulent conveyances with the law of secured claims initially may seem puzzling. Fraudulent conveyance doctrine ordinarily is invoked by general creditors lacking security interests in debtors' assets. A secured creditor would seem to be less concerned with fraudulent transfers of collateral because third parties generally take subject to security interests.\textsuperscript{115} Actually, this juxtaposition reveals much about Comment

\textsuperscript{112}The official reason for these amendments indicates that "[t]he revised subsection (4) is a clarification based on the California revision. It makes clear that the claim to cash allowed in insolvency is exclusive of any other claim based on tracing." 1972 AMENDMENTS, supra note 111, at 214. The California language was adopted because it clarified drafting imperfections in the 1962 Text unrelated to transferred cash proceeds. See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, FINAL REPORT 221 (1971); Skilton, supra note 1, at 67-70, 75-77. See generally Funk, The Proposed Revision of Article 9 of the Uniform Commercial Code, 26 BUS. LAW. 1465, 1481-82 (1971); Hawkland, The Proposed Amendments to Article 9 of the UCC Part II: Proceeds, 77 COM. L.J. 12, 19-20 (1972); Henson, Some "Proceeds" and Priority Problems Under Revised Article 9, 12 WM. & MARY L. REV. 750, 756 (1971).

\textsuperscript{113}See U.C.C. § 9-306 comment 2(c) (1977). Comment 2(a) indicates that § 9-306(4)(d) applies to a bankrupt debtor's cash and deposit accounts. See id. § 9-306 comment 2(a). Comment 2(b) addresses the bankruptcy preference problem and perfection of secured claims to proceeds. See id. § 9-306 comment 2(b).

\textsuperscript{114}Article Nine defines collateral as "property subject to a security interest," which includes proceeds. 1952 DRAFT, supra note 104, at §§ 9-105(1)(c), 9-306(1); 1957 TEXT, supra note 108, at §§ 9-105(1)(c), 9-306(1); U.C.C. §§ 9-105(c), 9-306(1) (1977).

\textsuperscript{115}See, e.g., Gaskin v. Smith, 375 Ill. 59, 30 N.E.2d 624 (1940); Lett v. West, 195 Okl. 472, 158 P.2d 1010 (1945). But see Shiveley's Adm's v. Jones, 45 Ky. 274 (1845). Secured creditors may have the right to have set aside fraudulent transfers of noncollateral. However, the presence of security can limit this right (e.g., the creditor may have to demonstrate that the collateral was insufficient). See Glenn, Creditors' Rights—A Review of Recent Developments, 32 VA. L. REV. 235,
Two (c)'s vision of secured rights to commingled funds.\textsuperscript{116}

Fraudulent conveyance law was cited for several reasons. One reason was to identify the class of transferees not subject to security interests in cash proceeds. Fraudulent conveyance doctrine shares a concern expressed in Comment Two (c) and elsewhere in the Code—protection of good faith purchasers.\textsuperscript{117} Comment Two (c) is specifically concerned with checks and money.\textsuperscript{118} The Code provides negotiability rules protecting holders in due course of checks.\textsuperscript{119} The law of fraudulent conveyances contains doctrine protecting good faith purchasers of instruments.\textsuperscript{120} The

\textsuperscript{116}Comment 2(c)'s authors confidently asserted that "no doubt" cash proceeds can be recovered in an appropriate case. See 1952 DRAFT, supra note 104, § 9-306 comment 2(c). In fact, it may have required a leap of faith to conclude that a security interest in cash proceeds survived commingling. See 2 G. Gilmore, supra note 4, at 735-36, 1338. However, there was precedent for the use of commingled fund tracing in the context of pre-Code trust receipt financing. See supra note 95. More recently, many courts have upheld the use of tracing techniques to identify proceeds commingled in a bank account. See generally Skilton, supra note 1, at 144-52. A somewhat cryptic reference to the law of fraudulent conveyances may seem a poor substitute for more detailed explication. However, it is consistent with Article Nine's general policy of leaving the details of judicial remedies to extra-Code law. See 1952 DRAFT, supra note 104, at § 9-501(1); 1957 TEXT, supra note 108, at § 9-501(1); U.C.C. § 9-501(1) (1977). Brevity also was appropriate given the drafter's charge of straightening up the muddle of pre-Code personal property security law, a task considered more demanding than cleaning the Augean stables. Everett, Securing Security, 16 LAW & CONTEMP. PROBS. 49 (1951). Commingled funds were far from the only proceeds related issue faced by the draftsmen. See generally Kripke, Inventory Financing of Hard Goods, 1956 U. ILL. L.F. 580, 594-99.

\textsuperscript{117}Grant Gilmore, who was an Associate Reporter and Reporter for Article Nine, described the protection accorded to good faith purchasers as a "triumph." Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 YALE L.J. 1057 (1954). See 1 G. Gilmore, supra note 4, at x-xii. The protection of good faith purchasers facilitates the movement of property to comparatively high valuing users. See Carlson, Rationality, Accident and Priority Under Article 9 of the Uniform Commercial Code, 71 MINN. L. REV. 207, 216-17 (1986).

\textsuperscript{118}1952 DRAFT, supra note 104, at § 9-306(3); 1957 TEXT, supra note 108, at § 9-306(1).


\textsuperscript{120}See 1 GLENN, supra note 107, at §§ 235-37.
two bodies of law are approximately congruent, undoubtedly because of commercial paper's historic role as a money substitute.\textsuperscript{121} Likewise, it may be possible to recover a fraudulent conveyance of money, but not from a good faith purchaser.\textsuperscript{122}

Comment Two (c)'s reference to the law of fraudulent conveyances also provides guidance for the recovery of commingled funds. The commentary likely was written in contemplation of a secured party's rights to reduce its claim to judgment and to foreclose its security interest by any available judicial procedure.\textsuperscript{123} A wide range of judicial remedies

\textsuperscript{121}For example, under both, creditors give value if they receive instruments in payment of antecedent claims. See 1952 DRAFT, supra note 104, at § 3-303(b); 1957 TEXT, supra note 108, at § 3-303(b); U.C.C. § 3-303(b) (1977); 1 GLENN, supra note 107, at §§ 289-289a. Both bodies are suspicious of persons who acquire instruments in bulk transactions. See 1952 DRAFT, supra, at § 3-302(3)(c); 1957 TEXT at § 3-302(3)(c); U.C.C. § 3-302(3)(c); 1 GLENN, supra, at § 309. Money's negotiable status is ancient, which is why the Code reflects, but need not provide, this attribute. See 1952 DRAFT, supra, at §§ 1-201(24), 2-105(1), 3-103(1) comment 1, 9-102(1)(a), 9-306(3); U.C.C. §§ 1-201(24), 2-105(1), 3-103(1), 9-102(1)(a), 9-306(1). See generally Weinberg, Commercial Paper in Economic Theory and Legal History, 70 KY. L.J. 567 (1981-82).


\textsuperscript{123}See 1952 DRAFT, supra note 104, at § 9-501(1)(a). This draft's foreclosure right expressly applied to goods, but apparently could be invoked for other types of collateral. See id. § 9-501(3). Subsequent versions of the Code placed no limits on the types of collateral subject to foreclosure by judicial procedure and stated that the secured party's remedies were cumulative. Later versions also specified that the lien of any levy made upon collateral by virtue of an execution based upon a secured party's judgment relates back to the date of perfection of the security interest. See 1956 RECOMMENDATIONS, supra note 108, at § 9-501(1), (5); U.C.C. § 9-501(1), (5) (1977). This rule should be applied to judicial liens that arise from attachments or garnishments. 2 G. GILMORE, supra note 4, at 1209 n.6. In general, a judicial lien obtained by a prejudgment attachment or garnishment is provisional. It becomes final when a judgment is obtained. Interests obtained by third parties during the provisional period are subject to the judgment creditor's rights. See generally DEBTOR-CREDITOR LAW, supra note 107, at ¶ 6.04(1)(f), (2)(e).

It is unlikely that Comment Two (c) contemplated the right to repossess by self-help or by action. 1952 DRAFT, supra, at § 9-503; 1957 TEXT, supra note 108, at § 9-503; U.C.C. § 9-503. Successful self-help repossession of transferred funds is improbable. The transferee almost certainly would be unwilling to turn them over voluntarily, and stealthy, yet legal, means to identify and possess funds in a bank account or safe deposit box are lacking. In employing self-help, the secured party is not permitted to breach the peace. See id. Obtaining funds from the transferee's account by means of a forged check or breaking into a safe deposit box are unlikely to meet this requirement and, in any event, seem unwise. See DEBTOR-CREDITOR LAW, supra, at ¶ 7.05(6)(c)(ii). Actions to gain possession
were provided by extra-Code law including attachment, garnishment, and creditor’s bills in equity.124 Comment Two (c) employed the law of fraudulent conveyances as a shorthand for this array of remedies, and particularly for relief obtainable without a judgment. Summary relief against fraudulent conveyances was possible by the time of Comment Two (c)’s adoption. Nonjudgment creditors had a right to equitable relief both under the Uniform Fraudulent Conveyances Act and nonuniform fraudulent transfer statutes.125 Prejudgment remedies of attachment or prior to foreclosure, such as replevin, are generally limited to recovering chattels. Replevin may be appropriate for the recovery of money only in situations in which bills or coins are specifically identifiable by virtue of being physically labeled or segregated. See id. at § 6.04(3)(b).

After default, a secured creditor is also entitled to notify an account debtor to make payment to the secured creditor and to take control of any proceeds to which it is entitled under § 9-306. See 1952 DRAFT, supra, at § 9-502(1); U.C.C. § 9-502(1). The account debtor is the person who owes a money claim to the debtor such as the obligor on an account receivable. See 1952 DRAFT, supra, at § 9-105(1)(a); U.C.C. § 9-105(1)(a). A bank in which the debtor maintains a deposit account might conceivably fall under this definition. See generally U.C.C. § 4-401; supra note 18. However, this remedy was considered primarily as a vehicle for recovering on noncash proceeds generated by a debtor’s sale of inventory (e.g., accounts or chattel paper), not cash proceeds. See generally 2 G. GILMORE, supra, at 1231-32. Furthermore, by 1956 deposit accounts were excluded as original collateral from the scope of Article Nine. See 1956 RECOMMENDATIONS, supra, at § 9-104(k).

124For example, a secured party should be permitted to employ prejudgment garnishment against a bank account containing cash proceeds if it has grounds under the garnishment statute and can trace into the account. Ex parte Alabama Mobile Homes, Inc. (Re ITT Diversified Credit Corp v. Alabama Mobile Homes, Inc.), 468 So.2d 156 (Ala. 1985). See generally A.L.I. & NAT’L CONF. OF COMM’RS ON UNIFORM STATE LAWS, 1958 SUPPLEMENT TO THE 1957 OFFICIAL TEXT WITH COMMENTS OF THE UNIFORM COMMERCIAL CODE § 9-501(1) (1958); 9 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 9-501:05 (1986). Details of the specific remedies available are a function of the jurisdiction in which relief is sought and the facts of the case. The law is not uniform. See DEBTOR-CREDITOR LAW, supra note 107, at ch. 6. Concerning the application of these remedies to cash proceeds (cash, checks, and bank accounts), see id. at ¶¶ 6.04(1)(e), (2)(d); S. RIESENFELD, CASES AND MATERIALS ON CREDITORS’ REMEDIES AND DEBTORS’ PROTECTION 163, 166-67 (4th ed. 1987).

125At one time, a judgment generally was necessary to obtain relief against a fraudulent conveyance. But this requirement was eliminated by the UFCA and other statutory and common law developments. See S. RIESENFELD, supra note 124, at 274-75; 1 G. GLENN, supra note 106, at §§ 76, 79, 84-85. The UFCA (like the U.C.C., a product of the National Conference of Commissioners on Uniform State Laws) was approved in 1918 and had been enacted in 19 jurisdictions by the promulgation of the 1952 Draft. See UFCA, supra note 107, at 427. These included important commercial states such as Massachusetts, New York, and Pennsylvania. Id.
garnishment also were available in many states.\textsuperscript{126} Rules of joinder permitted plaintiffs' claims to set aside fraudulent conveyances without first obtaining a judgment establishing a money claim.\textsuperscript{127} All these developments were intended to avoid delay, which was essential for a secured party pursuing transferred cash proceeds.\textsuperscript{128}

Relief suggested by Comment Two (c) also includes restitutionary relief by way of equitable liens or constructive trusts. The Comment's predecessors stated that non good faith purchasers held cash proceeds as trustees.\textsuperscript{129} Case law provided that a fraudulent transferee becomes a trustee for creditors of the transferor,\textsuperscript{130} a view reflected in the Restatement of Restitution.\textsuperscript{131} On Comment Two (c)’s authority, restitution has been successfully employed to recover cash proceeds commingled in a bank account.\textsuperscript{132}

\section*{D. Restitution and Article Nine}

This article has considered two instances in which restitution plays an important role within the framework of Article Nine. The LIBR and related tracing principles are employed to identify commingled funds subject to a security interest,\textsuperscript{133} and restitution provides judicial remedies for enforcing secured claims.\textsuperscript{134} It was reasonable to conclude in each case

\textsuperscript{126}See DEBTOR-CREDITOR LAW, supra note 107, at ¶¶ 6.04(1)(d), (2)(c); 1 G. GLENN, supra note 107, at § 80.

\textsuperscript{127}This was provided for in the original Federal Rules of Civil Procedure, which changed prior law and became effective in 1938. FED. R. CIV. P. 18(b). See S. RIESENFELD, supra note 124, at 275; 1 G. GLENN, supra note 107, at § 78, 131.

\textsuperscript{128}See generally 1 G. GLENN, supra note 107, § 83, 142.

\textsuperscript{129}See supra notes 95-101 and accompanying text.

\textsuperscript{130}See, e.g., Doherty v. Holiday, 137 Ind. 282, 32 N.E. 315 (1892).

\textsuperscript{131}Restatement of Restitution, supra note 7, at § 168(2) comment c.

\textsuperscript{132}See supra note 43 and accompanying text. Two factors generally should weigh in favor of a secured creditor’s judicial recovery of commingled cash proceeds. First, the recovery is sought against assets subject to a security interest, not general assets. Second, the creditor’s secured status probably is precarious. Enforcing a security interest in cash proceeds usually is likely to be attractive only if other collateral is insufficient to secure the debt, or is unreachable because of a priority rule. See, e.g., U.C.C. § 9-307(1). The security interest is further jeopardized because cash proceeds are negotiable. See infra notes 140-53 and accompanying text.

\textsuperscript{133}See supra note 43 and accompanying text.

\textsuperscript{134}See supra notes 128-29 and accompanying text.
that restitution provides supplemental principles of law not displaced by Article Nine. Article Nine requires a secured party to identify proceeds—except in cases subject to the malformed mouse—but does not specify how this task is accomplished, opening the door to restitutory tracing. Article Nine specifies that extra-Code judicial remedies are available to secured creditors. Article Nine also sets parameters for the application of restitutory remedies. A wrongful act generally is requisite to restitutionary relief. In the context of secured financing, this requirement should be assimilated to the Article Nine principle that a security interest continues on transferred collateral unless the secured party authorized its disposition. In each of these three instances, Article Nine was consulted first because it provides the validating framework for personal property security. Restitution was supplemental.

This approach also is appropriate when a secured party seeks restitutionary relief against cash proceeds or their product in a transferee's possession. Comment Two (c) provides little guidance concerning the priority of transferees, which may have caused Dataair to erroneously suggest that section 9-306(4)(d) controls priority. Section 9-306 does have priority determinative content, but it does not resolve these cases. To understand the priority structure of Article Nine and its

137 Id. § 9-501(1).
138 See supra notes 44-47 and accompanying text.
139 See supra notes 45-47 and accompanying text.
140 See supra notes 86-91 and accompanying text.
141 U.C.C. § 9-306 provides that a security interest continues in transferred collateral (including identifiable proceeds) unless the secured party authorized the transfer. See id. § 9-105(1)(c). This language effectively creates a priority rule. See id. § 9-306(2) comment 3; Hedrick Savings Bank v. Myers, 229 N.W.2d 252 (Iowa 1975). Section 9-306 also contains a priority rule applicable to returned or reposessed goods and subordinates a secured party's recovery under § 9-306(4)(d) to rightful bank set-offs. See U.C.C. § 9-306(4)(d)(5). However, the section generally is concerned with nonpriority matters, and is devoid of Article Nine's usual priority rule phraseology such as "is subordinate to," "has priority in," or "takes subject to." See, e.g., id. §§ 9-301(1); 9-312(3). This reflects a decision to place in other Code sections general priority rules for both proceeds and original collateral. See supra note 99. But see, e.g., id. § 9-308(b) (chattel paper claimed merely as proceeds of inventory).
The priority-determinative content of U.C.C. § 9-306 was at issue under the 1962 Official Text's § 9-312, which lists Article Nine priority rules, and refers to
relationship to restitution, consider an example in which secured party ("SP") seeks recovery of commingled but identifiable cash proceeds transferred by the debtor to A, which A deposited in a checking account used to purchase inventory. B, a creditor of A, also claims the account and inventory.

The first step is to determine whether SP's rights are superior or subordinate to A's. Under Article Nine, security interests are valid against third parties unless the Code provides to the contrary. The Code's priority rules are not limited to those fully explicated in Article Nine. Other Code articles provide priority rules, as does undisplaced extra-Code law. Thus, the priority of a secured party claiming cash proceeds might be governed by Article Three rules protecting holders in due course or extra-Code restitutionary rules protecting good faith transferees of money. The importance of negotiability for cash and cash

1See U.C.C. § 9-201 (1977) ("Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors"); Id. § 1-101 ("This Act shall be known and may be cited as the Uniform Commercial Code.").

2See supra note 142 and accompanying text.

3Transferees of checks may be protected by U.C.C. Articles Three and Four. See U.C.C. §§ 3-302, 3-305, 4-209. Holder in due course standing does not directly control when a check is drawn on an account containing proceeds. It provides protection against claims to the instrument, not to the contents of the account against which the check is drawn. Id. § 3-305. However, holder in due course status should be very persuasive in demonstrating that a check transferee cuts off claims to the commingled funds. A transferee's holder in due course standing is controlling if the debtor receives a check representing proceeds, for example, a payment from a purchaser of inventory collateral—which it subsequently negotiates to the transferee. See id. § 3-202(1). See generally Skilton,
equivalents dictates the general congruency of these Code and non-Code rules, but the Code’s fully explicated priority rules are primary and extra-Code law is supplementary. Ultimately, A’s priority will turn on a fact-sensitive inquiry into whether the transfer from the debtor to A was tainted by bad faith, A’s knowledge of fraud by the debtor, and so forth. Martin and Datair each present examples of facts likely to subordinate a transferee to a secured claim.

The example in the text involves a secured party employing restitution to vindicate a security interest. Department of Natural Resources v. Benjamin, 41 Colo. App. 520, 587 P.2d 1207 (1978) illustrates how Article Nine and restitutary priority rules may reach consistent results when restitutary rights are asserted against a secured party. A merchant wrongfully purchased inventory with proceeds from the sale of Colorado game and fishing licenses. The state instituted prejudgment attachment proceedings against the store’s inventory, claiming that it was subject to a constructive trust. A bank claiming a perfected security interest in the inventory intervened. The court looked to Article Nine’s priority rules, which favored the bank because the security interest was perfected before the state obtained a lien pursuant to the attachment. (The court erroneously cited section 9-312(5) as outcome-determinative; the correct priority rule would have been § 9-301(1)(b). See Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974)). The court also determined that restitutary doctrine permitted the bank as a bona fide purchaser for value without notice of a prior claim to cut off the state’s restitutary rights. But see Oesterle, supra note 2, at 192-94. On a more general level, reasoning under Article Nine in this sort of case might proceed as follows. A debtor who owns property subject only to an outstanding restitutary claim has sufficient rights for a security interest to attach. See U.C.C. § 9-203(1)(c); Id. § 1-103. See generally R. Hillman, J. McDonnell, & S. Nickles, supra note 37, at ch. 18. The debtor’s rights may be characterized by extra-Code restitutary doctrine as a legal title. See infra notes 191-95 and accompanying text. A person armed with a restitutary claim, but lacking a lien obtained by judicial proceedings, is not a lien creditor. See U.C.C. § 9-301(3). Rather, it is general creditor and its rights are subordinate to an unperfected security interest until a judicial lien is obtained. See U.C.C. §§ 9-201, 9-301. See also Restatement (Second) of Restitution, supra note 37, at § 43 comments a, d. In some instances a secured party may also be protected by Article Nine purchaser-protective priority rules. See infra note 153 and accompanying text.

See supra notes 77-91 and accompanying text. Negotiability generally may require that a transferee of cash or cash equivalents have priority even if the security interest is perfected by filing, the transferee knew that the deposit account from which payment was made contained proceeds, and the value given by the transferee consisted of an antecedent debt. See U.C.C. §§ 1-201(44), 9-308, 9-309. Cf. id. § 9-307(1). That the transfer was in the ordinary course of the transferor’s business may support a transferee’s priority. See id. § 9-306 comment 2(c). See generally McDonnell, Freedom from Claims and Defenses: A Study in Judicial
As a result of the rights asserted by B, a second step is necessary to complete the analysis. The starting premise is that B's rights are derivative of A's.\(^{148}\) B is subject to SP's secured claim if A was subject to the claim. However, it is possible for B to obtain better rights than A because of the operation of a priority rule. Priority protection for B will be dependent upon the nature of its claim.\(^{149}\) Recalling that A used funds from the checking account to purchase inventory, suppose that B's claim to the inventory is based upon an after-acquired property clause in a security agreement with A.\(^{150}\) The dispute is between SP, who claims the inventory as proceeds of the cash proceeds contained in A's checking account, and B, who claims the inventory under the after-acquired property clause.\(^{151}\) The priority provisions for contests between two secured parties contemplate the typical case, not present here, in which both interests are claimed through a common debtor.\(^{152}\) However, under

\(^{148}\) See, e.g., U.C.C. §§ 2-403(1); 3-201(1).

\(^{149}\) For example, extra-Code rules may pertain to banks that acquire funds by exercising set-off rights. See id. § 9-104(i). See generally Rauer, Conflicts Between Set-Offs and Article Nine Security Interests, 39 Stan. L. Rev. 235 (1986). A lien creditor garnishing a bank account should be subject to a perfected security interest to the extent that the account contains identifiable proceeds. See supra note 146.

\(^{150}\) See U.C.C. §§ 9-102(1), 9-109(4), 9-204(1).

\(^{151}\) B might claim the checking account as original collateral pursuant to a security agreement with A. This security interest is not within Article Nine's scope, but SP's proceeds claim to the account is. See U.C.C. § 9-104(l). The article has no priority rule governing this case. See Zubrow, supra note 60, at 899.

\(^{152}\) See generally Skilton, Security Interests in After-Acquired Property Under the Uniform Commercial Code, 1974 Wis. L. Rev. 925, 948. A case might arise in which the usual priority rules for competing secured claimants do apply. Suppose that A finances the debtor's T.V. inventory, and B finances the debtor's V.C.R. inventory. Each creditor has an enforceable security interest in their respective original collateral and all proceeds, and A filed first. Debtor sells all the T.V.s and V.C.R.s and commingles all the proceeds in a deposit account. The size of A's security interest against the deposit account should be determined by applying the LIBR, while ignoring B's security interest, and vice versa. See Zubrow, supra note 60, at 969-72. A probably has priority because it filed before B, see U.C.C. § 9-312(5)(a),(6) (1977), although the conclusion must be hedged because the two creditors arguably share pro rata if purchase money security interests are involved. See id. §§ 9-107, 9-312(3). Cf. id. § 9-315. But see John Deere Co. v. Production Credit Ass'n, 686 S.W.2d 904 (Tenn. App. 1984) (refusing to prorate). The restitutionary rule for commingled money of several persons may support this result although, as indicated supra at notes 132-36 and
Article Nine it is proper to label B a purchaser and apply priority rules that protect purchasers to determine B's priority against SP.\textsuperscript{153}

\section*{IV. ENTITLEMENTS AND CREDIT COST}

Section 9-306(4)(d) and restitutionary tracing, including the LIBR, each provide an entitlement to commingled funds containing proceeds and nonproceeds. Which of these entitlements is preferable given the opportunity to choose de novo and amend Article Nine to implement the choice?\textsuperscript{154} This part of the article assumes that the superior entitlement reduces aggregate credit costs to a greater extent.\textsuperscript{155} Justification for having any entitlement at all is considered first. Sources of credit cost relevant to an entitlement are then analyzed. One source of credit cost is the risk that the entitlement may be avoided in bankruptcy. Another cost is the risk of conversion by commingling. Lastly, these costs are considered in determining whether the mouse or restitutionary tracing more closely approaches optimality.

\subsection*{A. Why Any Entitlement?}

A security interest is a specialized property right created by agreement and regulated by Article Nine. What the security interest is

\begin{itemize}
  \item accompanying text, its role is supplemental. See \textit{Restatement of Restitution}, supra note 7, at § 213. The usual priority rules for contests between secured parties contemplate security interests in the same collateral, which occurred upon commingling of the proceeds in the deposit account. See U.C.C. §§ 9-105(1)(c), 9-306(2).
  \item\textsuperscript{153} The U.C.C. defines "purchaser" as a person who takes through a voluntary transaction creating an interest in property. See U.C.C. § 1-201(32), (33). Whether a secured party has priority \textit{qua} purchaser presents issues of law and fact, which are beyond the scope of this article. Guidance is obtainable from other sources. See Mattson v. Commercial Credit Business Loans, 301 Or. 407, 723 P.2d 996 (1986). See generally McDonnell, \textit{The Floating Lienor as Good Faith Purchaser}, 50 S. Cal. L. Rev. 429 (1977).
  \item\textsuperscript{154} The inquiry is limited to changing state law, and does not consider amending the Bankruptcy Code to provide a federal statutory entitlement.
  \item\textsuperscript{155} Minimizing credit costs provides an important theoretical justification for validating consensual secured credit. See generally White, \textit{Efficiency Justifications for Personal Property Security}, 37 Vand. L. Rev. 473 (1984).
\end{itemize}
enforceable in or has priority to is not specified in Article Nine. Article Nine requires that the collateral be described in the security agreement so that it can be distinguished at reasonable cost from noncollateral. Making this distinction is impossible after funds subject to a security interest are commingled with other funds. Therefore, the law must either provide some entitlement or terminate the creditor's secured status with respect to the funds. Whether the law should provide an entitlement is part of the broader question of whether the law should afford favorable treatment to secured as opposed to unsecured creditors.

The reduction of aggregate credit costs is an important justification for the legal validation of consensual nonpossessory security interests with priority over many third parties. It is theorized that subordinate creditors either are not harmed by or are compensated for the secured party's priority in the event of bankruptcy. For example, relational financing theory views security as a contractual mechanism for providing a secured party with leverage to influence the debtor in order to maximize the debtor's and secured creditor's joint returns from the financed enterprise. A legally enforceable floating lien and strong rights upon default enable the creditor to reduce the risk of debtor misconduct interfering with this goal. Debtors agree to security in return for financial services provided by the creditor. They also agree to security because leverage provided by the floating lien is more cost-effective than other means for protecting the secured party's interests. Unsecured creditors benefit from these services and are relieved of certain expenses which they would incur in the absence of a relational secured financer.

An entitlement to cash proceeds arising upon commingling functionally is part of a floating lien, and shares some of the same

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156 See, e.g., U.C.C. §§ 9-203(1)(a), 9-312 (1977) (the Article Nine statute of frauds and the rules governing priorities among conflicting security interests in the same collateral, respectively).


158 See generally Schwartz, The Continuing Puzzle of Secured Debt, 37 VAND. L. REV. 1051 (1984); White, supra note 155. Cost reduction and the facilitation of security arrangements allowing the debtor to have access to collateral are important Article Nine policies. See U.C.C. §§ 9-101 comment; 9-205.

159 See generally Jackson & Kronman, Secured Financing and Priorities Among Creditors, 88 YALE L.J. 1143 (1979).


161 See id. at 925.
Cash proceeds are collateral consisting of cash flow generated by the debtor’s disposition of original collateral such as inventory and accounts. A secured party is likely to perceive commingling of cash proceeds as a risk because it renders the proceeds physically indistinguishable from noncollateral. Commingling makes it more difficult for the secured party to monitor or take possession of cash proceeds, and makes it easier for the debtor to extinguish the security interest in the proceeds by unauthorized transfer. Lending against cash flow is less risky under a legal regime that provides an entitlement to commingled cash proceeds as compared to a regime that does not. An entitlement increases the secured party’s probability of recovery in the event of commingling and provides a substitute for reducing the commingling risk by monitoring the debtor. The entitlement’s definition determines just how close a substitute it is. Section 9-306(4)(d) and identification by restitutionary tracing are but two examples of how Article Nine facilitates financing against cash flow. Other examples include: (1) the right to perfect a security interest in cash proceeds by filing, even though filing is inappropriate for money, checks, or bank accounts as original collateral; and (2) the purchase money priority in inventory, which carries through only to cash proceeds.

Valuable insight into secured credit and a rationale for entitlements to commingled cash proceeds is also provided by monitoring theory. The floating lien’s priority is an essential incentive for relational financers. Without it, other persons with interests in the financed firm would harvest the benefits derived from the secured financer’s inputs. See id. at 961. See generally I G. GILMORE, supra note 4, at 359-60.

Goods that perform similar functions are substitutes. A “close” substitute does a better job of performing the function than a “weak” substitute. See generally THE PENGUIN DICTIONARY OF ECONOMICS 391 (1972).

The importance of monitoring is not merely theoretic. Professor Kripke has written that “[t]he greatest risk is that as the debtor’s financial position weakens, collections will be diverted to other business needs or even to personal needs. [Accounts receivable] . . . financing necessitates that the lender maintain an internal crew of field auditors to review the borrower’s books periodically . . . [O]nly a security interest . . . puts the lender in a position to monitor effectively.” Kripke, Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact, 133 U. PA. L. REV. 929, 951 (1985). He argues that a higher interest rate cannot compensate for these risks. Id. at 950.
accounts, inventory, and other commercial assets can serve as specific focal points for monitoring debtor misconduct. A security interest with priority in certain assets provides an incentive for efficient monitors to extend credit secured by these assets and to charge an interest rate that is lower than it would be in the absence of security.\textsuperscript{169} Filing provides notice of the priority to other creditors who cannot free ride on the monitor's efforts because they lack priority in the focal point assets. The monitor's notice filing reduces wasteful duplicative monitoring efforts by other creditors.\textsuperscript{170}

An entitlement to commingled cash proceeds can be viewed as part of the incentive to monitor. It provides both a carrot and a stick. Perfect monitoring, which prevents all commingling of cash proceeds by the debtor, often will be too costly to be efficient. Accordingly, some cash proceeds may be lost despite optimal monitoring.\textsuperscript{171} The entitlement assures a secured party who undertakes monitoring that all secured status will not necessarily be lost in the event that monitoring fails. This is the carrot that helps motivate the creditor to lend at a favorable rate. The stick is the situation that occurs when the creditor proves to be unsecured because the creditor's recovery under the entitlement is zero. An entitlement to commingled cash proceeds represents a legislative effort to strike a balance between encouraging secured credit without creating a hazard that secured parties with priority will provide insufficient monitoring.\textsuperscript{172} However the balance is struck, a public filing covering proceeds as well as original collateral provides notice of the entitlement to other creditors who can adjust their conduct accordingly.\textsuperscript{173}

\textsuperscript{169}But see supra note 168.

\textsuperscript{170}Banks and other asset-based lenders may be more efficient monitors because they enjoy economies of scale and have invested in special expertise. See Levmore, supra note 168, at 56-57.

\textsuperscript{171}See infra notes 213-19 and accompanying text.

\textsuperscript{172}An entitlement might be viewed as a form of insurance. Many business risks are uninsurable or only partially insurable because insurance would create a disincentive to avoid loss, \textit{i.e.}, a moral hazard. See R. Posner, Economic Analysis of Law 150, 376-77 (3d ed. 1986).

\textsuperscript{173}See generally Levmore, supra note 168, at 57-59. Security interests in proceeds are assumed by Article Nine because they are so fundamental to the secured party’s security and are almost universally claimed. See U.C.C. §§ 9-203(3), 9-402(3). The dimensions of the entitlement are defined by the law, not the security agreement. Therefore, third parties have notice of its existence and general scope, but may lack information needed to define its value at any given time. See infra notes 230-38 and accompanying text.
B. The Risk of Avoidance by the Trustee

If some entitlement to commingled cash proceeds is justified, then how should the entitlement be defined? The definitions provided by section 9-306(4)(d) and restitutionary tracing are creatures of state law. It makes little sense to consider them as alternatives if one is significantly more vulnerable to challenge by federal bankruptcy trustees.

1. The Mouse

Section 9-306(4)(d) has been held to create a voidable preference in bankruptcy.\textsuperscript{174} Broad consideration of the mouse's preference and other bankruptcy problems is not undertaken here because the literature dealing with these problems is already extensive.\textsuperscript{175} However, a few points concerning the mouse bear mentioning either because they have not been recognized, or have been given insufficient attention.

First, there is no way to physically demonstrate that any unit of value in a commingled bank account has an attached security interest. Therefore, any recovery from commingled funds must depend upon an entitlement.\textsuperscript{176} Nothing in the Bankruptcy Code mandates that funds become property of the debtor's estate just because they cannot be physically segregated as collateral subject to a security interest. To the contrary, courts have honored tracing-based unsecured claims to commingled funds in bankruptcy.\textsuperscript{177} Courts also seem willing to entertain properly substantiated secured claims in bankruptcy under section 9-306(4)(d).\textsuperscript{178}

Second, neither the mouse nor identification by restitutionary tracing is systematically biased in favor of or against secured creditors.\textsuperscript{179} Under

\textsuperscript{174}Arizona Wholesale Supply Co. v. Itule (In re Gibson Products), 543 F.2d 652, 654 (9th Cir. 1976).

\textsuperscript{175}See, e.g., R. Henson, supra note 8, at § 6-7; White & Summers, supra note 8, at § 24-6; Skilton, supra note 1, at 80-91.

\textsuperscript{176}See supra text accompanying note 157.

\textsuperscript{177}See infra notes 191-97 and accompanying text.


\textsuperscript{179}Professor Gilmore assumed that the mouse generally provides less to secured creditors in bankruptcy than they would receive from a solvent debtor. See 2 G. Gilmore, supra note 4, at 1337-40.
Article Nine's asymmetric scheme of entitlements, a secured creditor's recovery in bankruptcy under section 9-306(4)(d) almost always will be different from what would be recovered absent bankruptcy procedures where the secured party may identify proceeds by restitutionary tracing. Differing recoveries is one consequence of asymmetry, and is independent of the particular entitlements employed. It would occur, for example, even if the mouse required actual commingling of proceeds with nonproceeds during its ten day period.

The likelihood of different recoveries is not an indication of whether secured creditors are better or worse off under section 9-306(4)(d) than under restitutionary tracing. Consider the following example:

<table>
<thead>
<tr>
<th>Day</th>
<th>Deposit/Withdrawal</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>+ $1000 of proceeds</td>
<td>$1000</td>
</tr>
<tr>
<td>3</td>
<td>- 900</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>+ 1000 of nonproceeds</td>
<td>1,100</td>
</tr>
<tr>
<td>7</td>
<td>Debtor files for bankruptcy</td>
<td>1,100</td>
</tr>
</tbody>
</table>

The secured party recovers more under the mouse (one thousand dollars) than under the LIBR (one hundred dollars). However, if all facts remain the same except that the filing occurs on the eleventh day, the secured party would do better under the LIBR (one hundred dollars) than under the mouse (zero). The amount recovered under the entitlements is a function of the timing and size of receipts, deposits, and withdrawals; the date of bankruptcy; and whether receipts or deposits consist of proceeds or nonproceeds. Meaningful generalizations about these variables seem unlikely. In addition there is no empirical evidence concerning the occurrence of the variables. Therefore, there is no factual basis for concluding that either entitlement is systematically biased.

See supra notes 41-72 and accompanying text.

There is no empirical study concerning systematic bias of U.C.C. § 9-306(4)(d) or restitutionary tracing. Bankruptcy reports considering secured claims to commingled funds are unlikely to provide sufficient data for reliable findings because they typically focus on claims under U.C.C. § 9-306(4)(d), and do not consider tracing except to indicate that it is preempted by the mouse in bankruptcy. See, e.g., In re Jameson's Foods, 37 U.C.C. Rep. Serv. (Callaghan) 1381 (Bankr. D.S.C. 1983). Secured creditors often come up empty-handed under the mouse because of a lack of evidence that proceeds were received by the debtor during the ten day period. See, e.g., In re Cooper, 2 Bankr. 188, 196 (Bankr. S.D. Tex. 1980).
The Bankruptcy Code may be interpreted to condemn section 9-306(4)(d) because it sometimes awards a larger recovery than restitutionary tracing. However, neither the possibility nor the actuality of a larger recovery should offend bankruptcy policy unless the bankruptcy entitlement systematically awards more than the nonbankruptcy entitlement—which is not the case—or the entitlements can be manipulated by secured parties to this end—which seems unlikely.

2. Restitutionary Tracing

Section 9-306(4)(d) and its ancestors precluded the development of bankruptcy doctrine concerning the identification of security interests in commingled funds by means of restitutionary tracing principles. Suppose that 9-306(4)(d) were repealed and Article Nine amended to permit the use of restitution for this purpose. Could the secured claim withstand the trustee? An answer may lie in the possibility that bankruptcy law permits an unsecured creditor to employ restitution to recover funds from a bankruptcy estate. If this is possible, then a secured

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183 See supra text accompanying note 179. In the example, in which bankruptcy is on the seventh day, the mouse permits the secured party to recover $1,000 from a $1,100 account consisting of over 90 percent nonproceeds. See U.C.C. § 9-306(1); see supra notes 25-28 and accompanying text. Arguably, this results in a transfer to the creditor on account of an antecedent debt during the Bankruptcy Code's 90 day preference period to the extent that the secured party can recover more under the mouse ($1,000) than under the LIBR ($100), or $900. See 11 U.S.C. § 547(b), (e) (1982 & Supp. IV 1986); D. Baird & T. Jackson, Cases, Problems, and Materials on Security Interests in Personal Property 552 (2d ed. 1987).

184 See infra notes 235-39 and accompanying text.


186 For example, repeal of U.C.C. § 9-306(4) should permit a secured party to "identify" proceeds in bankruptcy pursuant to § 9-306(2) and extra-Code restitutionary doctrine. See supra text accompanying notes 42-44. See generally Gillombardo, supra note 185, at 30-31. A problem with this approach is that it leaves the secured party's tracing right to nonuniform extra-Code law. It might be desirable to define the term "identifiable" by codifying restitutionary tracing principles.
claim employing restitutionary tracing should be entitled to the usual bankruptcy recognition of security interests and would be subject to the usual trustee avoidance techniques.

Section 541 of the Bankruptcy Code provides that property in which the debtor holds only legal title at the commencement of bankruptcy, and not an equitable interest, is property of the bankruptcy estate only to the extent of the debtor's legal title. Legislative history indicates a congressional intent to exclude from the estate property held by the debtor, which is subject to a constructive trust. Cases applying section 541 conclude that the estate stands in the debtor's shoes. It may be required to relinquish possession of an asset to the beneficial owner if it holds only the legal portion of a bifurcated title. The state law relevant to unjust enrichment and restitution controls whether there is an equitable lien or a constructive trust on assets in the estate's possession. For example, a recent opinion of the Tenth Circuit held that state law imposed a fiduciary relationship on the debtor, which bound him to properly bill the plaintiff. Negligent overbilling subjected funds in

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

See id. at § 541(a)(1).
194 In re Mahan & Rowsey, 817 F.2d 682, 684 (10th Cir. 1987).
commingled bank accounts to a constructive trust and excluded them from the debtor's estate to an extent defined by the LIBR.195

While nonproperty of the estate may be defined by restitutionary tracing, the claimant must overcome many hurdles. The claimant must show that the funds are impressed with equitable rights, and that the funds existed in identifiable form among assets in the debtor's possession at the time of bankruptcy.196 A contractual requirement to hold funds in trust may not create a trust if the true relationship between the debtor and creditor is merely contractual, and not one of trustee and beneficiary. The debtor's rights to commingle and use funds infer a mere debtor-creditor relationship.197 Proof of these rights also jeopardizes the claimant's recovery because restitutionary rights are concealed, giving the debtor ostensible ownership of the funds.198 A claimant must distinguish its commingled funds from those of the debtor and other creditors, but the cases often fail to indicate what form of tracing comports with federal bankruptcy standards.199 Courts express concern over the difficulty and administrative expense of tracing when multiple claimants are involved.200 A bankruptcy trustee can employ a hypothetical lien creditor or other federal avoidance powers to defeat an otherwise sufficient tracing-based claim that assets are not property of the estate.201

195Id. at 683-84. Other cases support Mahan's broad holding that commingled funds may be identified as not being the property of the estate by means of tracing. See, e.g., Elliott v. Bumb, 356 F.2d 749 (9th Cir. 1966), cert. denied, 385 U.S. 829 (1966); Yonkers Bd. of Educ. v. Richmond Children's Center, Inc., 58 Bankr. 980 (S.D.N.Y. 1986); In re Martin Fein & Co., 43 Bankr. 623 (S.D.N.Y. 1984). See also 124 CONG. REC. 32,417 (1978) (courts should permit the use of reasonable assumptions under which taxing authorities can identify withheld taxes).

196In re Morales Travel Agency, 667 F.2d 1069, 1071 (1st Cir. 1981).

197Id. See also In re Auto-Train Corp., 53 Bankr. 990, 997 n.21 (Bankr. D.D.C. 1985).

198667 F.2d at 1073-74.

199See, e.g., In re Kennedy & Cohen, Inc., 612 F.2d 963, 966 (5th Cir. 1980) (per curiam); Elliott v. Bumb, 356 F.2d 749, 754 (9th Cir. 1966), cert. denied, 385 U.S. 829 (1966). This may be because some claimants make no effort to trace. See In re Esgro, Inc., 645 F.2d 794, 797 (9th Cir. 1981); In re Hurricane Elkhorne Coal Corp. II, 19 Bankr. 609, 613 (Bankr. W.D.Ky. 1982). Federal distributional policies may cause a court to scrutinize the state law grounds allegedly supporting a constructive trust. See In re North American Coin & Currency, 767 F.2d 1573, 1575 (9th Cir. 1986).

200See, e.g., In re First Fidelity Financial Services, 36 Bankr. 508, 514 (Bankr. S.D. Fla. 1983).

A secured creditor employing restitutionary tracing to identify a perfected security interest in commingled cash proceeds should be able to overcome many of these obstacles if due regard is given to restitution's supplemental role within Article Nine's framework.\textsuperscript{202} This is suggested in dictum, which states that caution must be exercised in imposing trusts in favor of unsecured creditors because "it would be a simple matter for one creditor, at the expenses of others, to circumvent the rules pertaining to the creation of bona fide security interests."\textsuperscript{203} A perfected secured claim does not share the ostensible ownership concerns related to restitutionary claims because a notice filing is present.\textsuperscript{204} A secured party's recovery from commingled funds identified by restitutionary tracing should not conflict with federal distributional policies because secured claims generally are recognized by the Bankruptcy Code.\textsuperscript{205} Article Nine's priority rules would determine the secured party's priority over the trustee and other claimants.\textsuperscript{206} Nonetheless, a secured creditor could face difficulties even if all these arguments are accepted. For example, a bankruptcy court might hold that state law does not permit secured creditors to identify proceeds by means of the LIBR.\textsuperscript{207}

In summary, neither section 9-306(4)(d) nor restitutionary tracing are per se invalid in bankruptcy. However, secured claims employing either state law entitlement face obstacles arising from the interaction with federal bankruptcy law. A more precise comparison of their respective avoidance risks is not possible. The risks will be assumed to be approximately equal for purposes of the remaining discussion in this part.

C. The Risk of Conversion by Commingling

Nonpossessory security necessarily involves a risk that the debtor will deal with collateral in an unauthorized manner that increases the riskiness.

\textsuperscript{202}See supra notes 133-39 and accompanying text.

\textsuperscript{203}In re Morales Travel Agency, 667 F.2d 1069, 1072 (1st Cir. 1981). See also id. at 1071 n.4 ("[T]he trust language may be viewed as an effort to create a security interest . . . . Since [the creditor] . . . has not asserted any claim to a security interest, we need not consider whether [one was created].").

\textsuperscript{204}See U.C.C. § 9-306(3)(b), (c) (1977).

\textsuperscript{205}See supra note 187.

\textsuperscript{206}See generally supra note 85; notes 140-55 and accompanying text.

\textsuperscript{207}Many jurisdictions have not ruled directly on the availability of restitutionary principles to identify commingled cash proceeds. See supra note 43. The probability of future negative holdings with respect to this issue is smaller than that of affirmative rulings, but is not zero.
of the secured loan.\textsuperscript{208} A debtor has an incentive to engage in this conduct because it enables the debtor to obtain a high-risk loan at a low-risk cost.\textsuperscript{209} Conversion by commingling results in collateral becoming physically indistinguishable from noncollateral.\textsuperscript{210} This conversion increases the riskiness of the secured loan by interfering with the secured party’s ability to monitor or take possession of the collateral. Commingling also may facilitate unauthorized transfers of collateral by reducing the risk that the transferee can be defeated by the secured party.\textsuperscript{211} Commingling cash proceeds is relatively inexpensive.\textsuperscript{212} It merely requires that the proceeds be deposited in a bank account containing nonproceeds, or vice versa.

A secured party may monitor the debtor’s behavior or take other steps to reduce the risk of commingling. The amount of risk reduction obtained depends upon circumstances such as the debtor’s credit history, the agreed interest rate, and the presence of other collateral, which is more difficult to convert.\textsuperscript{213} These factors affect the value of the commingling risk perceived by the secured party. The amount of protection purchased is also dependent upon cost.\textsuperscript{214} The ease of commingling cash proceeds suggests that the cost of protecting against this misbehavior is high.

Substantial risk protection results if the creditor intercepts all proceeds before they reach the debtor. Account debtors are required to make payments directly to a secured creditor under notification

\textsuperscript{208}So does possessory security, but the risk is much smaller. For example, a pledger might stealthily remove pledged securities from the pledgee’s possession.

\textsuperscript{209}See Jackson & Kronman, supra note 159, at 1149. The common statement that business reasons determine the extent to which secured parties protect themselves against debtor misconduct is accurate, and results from Article Nine’s allocation of most conversion risks (e.g., failure to physically maintain or insure collateral) to the secured party, and decision not to mandate monitoring of collateral. See, e.g., U.C.C. § 9-205 comment 5 (1977); Business Frauds, Their Perpetrations, Detection and Redress, 20 BUS. LAW. 83, 96 (1964).

\textsuperscript{210}See supra notes 30-31 and accompanying text.

\textsuperscript{211}See supra notes 145-47 and accompanying text.

\textsuperscript{212}Any collateral can be commingled if the debtor is willing to allocate sufficient resources to the effort. Commingling an automobile is relatively costly because it requires the removal of identification numbers and the disassembly of the vehicle into constituent parts or subassemblies. The marketability of encumbered goods may be enhanced by making them physically indistinguishable from unencumbered goods. See generally Weinberg, Sales Law, Economics, and the Negotiability of Goods, 9 J. LEG. STUD. 569, 571-74 (1980).

\textsuperscript{213}See supra note 212.

\textsuperscript{214}See Scott, supra note 160, at 924.
financing.\textsuperscript{215} However, notification financing is not universally elected because it adds administrative costs. In addition, a creditor may have to compensate the debtor for loss of goodwill resulting from the creditor’s intrusion into debtor-account debtor relationships.\textsuperscript{216} Another strategy is for the secured party to contractually bind the debtor to immediately report the receipt of cash proceeds, which must then be deposited in a special account accessible only by the secured party.\textsuperscript{217} The debtor also is subject to unscheduled audits. Audits make commingling more costly by increasing the risk that it will be detected and punished. However, a window for the opportunistic debtor remains open during the period between the debtor’s receipt of cash proceeds and the probable time of the secured creditor’s discovery of a conversion. The incremental cost of reducing this opening by more frequent audits may exceed the reduction

\textsuperscript{215}See generally Reisman, \textit{What Commercial Lawyers Should Know About Commercial Finance and Factoring}, 79 \textit{COM. L.J.} 146, 150-51 (1974). Initially, account debtors may be given no notice of a financing relationship. The secured party retains the option to notification finance, but receivables come directly to the debtor absent some occurrence that decreases the creditor’s comfort level, such as the debtor’s default in payments. See U.C.C. § 9-502(1); infra note 218 and accompanying text. See generally Colton, \textit{Legal Implications of Actions Taken by Lenders Against Troubled Borrowers}, 1981 \textit{J. COM. BANK LENDING}, 35, 40.

Notification financing does not eliminate the commingling risk. Some account debtors may continue to make direct payments to the debtor after notification, which suggests a need to monitor account debtors as well. Cf. U.C.C. § 9-318.

\textsuperscript{216}Notification financing is not the only means by which to substantially reduce the debtor’s access to cash proceeds, although it may be the least costly. An alternative is to have all the debtor’s mail delivered by the post office to the secured party. This requires a mechanism for the return to the debtor of mail unrelated to the financing relationship. Another alternative is for the secured party to employ a monitor to intercept cash proceeds upon arrival at the debtor’s premises and immediately deposit them into a special account accessible only to the secured party. This arrangement, which leaves the secured party exposed to the risk that the debtor may bribe the monitor, is reminiscent of inventory field warehousing. See generally Skilton, \textit{Field Warehousing as a Financing Device: The Warehouseman Goes to the Storer—Part 1}, 1961 \textit{WIS. L. REV.}, 221. In general, monitoring collateral is expensive. Monitors can command high salaries because they have special skills and are expected to remain loyal in the face of temptation. See generally Miller, \textit{Taking a Look at the Commercial Finance Contract}, 65 \textit{A.B.A. J.} 628 (1979).

\textsuperscript{217}A lender may require a “collateral reserve” or “blocked” account for the deposit of all of the debtor’s collections from the sale of inventory or the liquidation of accounts receivable. The debtor is not permitted to make withdrawals from the account without the creditor’s permission. The debtor may or may not have access to the collections prior to deposit, depending on the conversion risk perceived by the secured party. See generally 1 \textit{BENDER’S UNIFORM COMMERCIAL CODE SERVICE} §§ 4.02[5][d]; 4.08 (1988).
in conversion risk purchased. A secured party rationally may dispense with audits entirely or make them infrequent, relying instead on the debtor's contractual covenants to report proceeds and use a special account. Given a small enough conversion risk, the secured party may require the debtor to periodically report and pay proceeds without the use of a special account. This may amount to nothing more than monitoring the timeliness of scheduled loan repayments.

The quantity of risk reduction purchased by the secured creditor may vary during the financing relationship according to changes in the creditor's perception of the commingling risk. The risk is aggravated when a debtor is under financial stress and is motivated to take risks beyond those contemplated at the inception of the financing relationship. In this context, a secured creditor might invoke a previously unused audit right or demand strict compliance with reporting or special account covenants.

D. The Mouse, Restitution, and Optimality

If the reduction of aggregate credit costs is an important goal of personal property security law, does section 9-306(4)(d) or restitutionary tracing more closely approach optimality? The former entitlement saves administrative costs when compared to the latter. Under the mouse, it is necessary to decide only whether there were receipts during the ten day period, whether they consisted of proceeds, and whether the account was commingled. Under restitutionary tracing, the period of account activity defining the secured party's entitlement commences with the debtor's first wrongful act of commingling that is not followed by a lowest intermediate balance of zero. Wrongful acts may occur repeatedly and at any time before an event such as bankruptcy prevents further commingling. For example, consider a debtor with an active general account who occasionally converts proceeds for several months and then

[^218]: Changing market conditions or loss experience may cause a secured party to adjust the amount of risk reduction purchased. See Biborosch, *Floor Plan Financing*, 77 BANKING L.J. 725, 725-26, 737 (1960).


[^221]: See *supra* text accompanying notes 23-38.

[^222]: See *supra* text accompanying notes 41-44.
begins wholesale commingling a few weeks before bankruptcy. The amount of proceeds and nonproceeds in the account fluctuate as funds are deposited and withdrawn. Disputes will arise concerning whether a particular deposit consisted of proceeds, and whether the deposit was wrongful. Another issue is the size of the lowest intermediate balance.\footnote{It may be uncertain whether the debtor's conduct was authorized by the secured party. See supra notes 45-46. Section 9-306(4) and identification by restitutionary tracing present other administrative complications. For example, under the former it may be necessary to deduct payments to the secured party on account of cash proceeds received by the debtor during the mouse's ten day period. See supra note 22. Under restitutionary tracing, it may be necessary to decide whether the debtor's funds were deposited with an intent to make restitution. See supra note 61 and accompanying text.}

The relationship between the two entitlements and monitoring also may impact the aggregate cost of secured financing. Each entitlement provides a free substitute for the costly monitoring, which may affect a secured creditor's conduct.\footnote{See supra notes 164-65 and accompanying text. The entitlement is free in the sense that it is automatically obtained by operation of law, but only after resources have been expended in entering into a secured financing relationship.} A secured creditor will monitor less if the entitlement is a close substitute for monitoring and more if the entitlement is a weak substitute. Is there a significant difference between the quality of the monitoring substitutes provided by section 9-306(4)(d) and restitutionary tracing?\footnote{See supra notes 57-59 and accompanying text.}

Section 9-306(4)(d) cuts off a secured party's claim to untransferred commingled cash proceeds received prior to ten days before bankruptcy.\footnote{See U.C.C. § 9-306(4)(d) (1977). See supra text accompanying notes 92-114.} Therefore, assuming commingling, a secured party has ten days to obtain payment on account of the proceeds or begin a bankruptcy proceeding.\footnote{See U.C.C. § 9-306(4)(d)(ii).} Under restitution's LIBR, cash proceeds float on top of nonproceeds and remain undiminished until all the nonproceeds are withdrawn from the account.\footnote{See supra notes 57-59 and accompanying text.} Proceeds might stay afloat for more than ten days and remain identifiable to a security interest. It may follow that a secured creditor will start monitoring sooner and monitor more frequently under the mouse than under the LIBR, making the mouse a weaker substitute for monitoring. Nonetheless, any difference in the quality of the two substitutes is not so obvious.

Initially, a secured financer may broadly focus monitoring on the debtor's operational decisions and general business welfare rather than tightly focusing on cash proceeds.\footnote{See Scott, supra note 160, at 950-51.} The focus may shift towards tighter
monitoring if the financer suspects that the debtor is in financial straits or is behaving opportunistically. Cash proceeds cannot be tightly monitored, however, without determining whether each of the debtor’s cash receipts consists of proceeds or nonproceeds. The debtor’s possession and disposition of cash proceeds cannot be monitored without either segregating them before they are commingled, or by tracing. Therefore, a secured party wishing to monitor more tightly may take steps to capture proceeds before they are commingled, or may monitor cash flow, but is unlikely to monitor the flow of cash proceeds through the debtor’s enterprise. A secured party is unlikely to calculate the value of the entitlements because of the probable rapid obsolescence of the information and because of the desire for more security than the entitlements are likely to provide. Therefore, both section 9-306(4)(d) and restitutionary tracing are weak substitutes for monitoring and in this respect there is little basis for concluding that one is superior to the other.

An analysis of the optimality of Article Nine’s entitlements to commingled funds is incomplete if it is limited to section 9-306(4)(d) and restitutionary entitlements. These are the two components of an asymmetric entitlement scheme dependent upon the institution of insolvency proceedings. It has been suggested that this asymmetry may create an incentive for an unsecured creditor to force the debtor into bankruptcy if the creditor believes that the debtor’s secured creditor will get less under the mouse than through restitutionary tracing. A secured creditor would have the same incentive if it believed that the mouse would benefit its interests. A bankruptcy initiated because of such

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229 The financer would be required to monitor receipts even if it had the option of insisting upon notification financing. See supra text accompanying note 215. This option could not be implemented instantaneously, and might be appropriate only for account debtors with substantial or extended dealings with the debtor.

230 A secured creditor is not likely to make its monitoring dependent upon tracing. See infra notes 235-39 and accompanying text.

231 See Kripke, supra note 168, at 950, 968.

232 Several pieces of rapidly changing data may be required. See supra notes 181-82 and accompanying text.

incentives may not be in the collective best interests of all the debtor’s creditors.\textsuperscript{234}

This concern presupposes that the entitlements are biased or can be successfully manipulated. There is no bias.\textsuperscript{235} Manipulation assumes that a class of creditors enjoy a comparative advantage in knowing the timing and contents of the debtor’s deposits and withdrawals. This information is costly to obtain, quickly becomes obsolete, and is not essential to a concerned secured creditor’s two most likely courses of action: monitoring cash flow and segregating receipts to prevent commingling.\textsuperscript{236} A bank-creditor might enjoy some advantage in obtaining and utilizing this information if it is also the depository institution holding the commingled account.\textsuperscript{237} However, such a bank is likely to have a right to set off the secured debt against the account, which is independent of any rights it may have in cash proceeds \textit{qua} secured party.\textsuperscript{238} If this right exists, the bank can make a set-off, and may be indifferent to any advantage that the mouse offers over identification by restitutionary tracing.\textsuperscript{239}

V. CONCLUSION: TIME FOR THE “MURD’RING PATTLE”?

Section 9-306(4)(d) defines a secured party’s entitlement to commingled funds in a bankrupt debtor’s estate. Restitutionary tracing, including the LIBR, identifies the entitlement to cash proceeds in the debtor’s possession absent bankruptcy, and the entitlement to transferred funds in the debtor’s estate. See generally id. at 33.

\textsuperscript{234}See generally id. at 33.

\textsuperscript{235}See supra text accompanying notes 180-82.

\textsuperscript{236}See supra text accompanying notes 224-27.

\textsuperscript{237}See supra text accompanying notes 149, at 248-50.

\textsuperscript{238}The right to a set-off is excluded from the scope of Article Nine. See U.C.C. §§ 9-104(i), 9-306(4)(d)(1). A security interest covering the proceeds in an account may have priority over the set-off. See, e.g., Citizen’s Nat’l Bank v. Mid-States Dev. Co., 380 N.E.2d 1243 (Ind. App. 1978). A bank may not be permitted to set off against a bank account if it failed to file a financing statement against the original collateral from which the funds in the account were derived. See Craig v. Gudim, 488 P.2d 316 (Wyo. 1971). Banks’ set-off rights are preserved in bankruptcy, subject to certain limitations. See 11 U.S.C. § 553 (1982 & Supp. IV 1986). For example, deposits subjected to a set-off must not have been accepted for that purpose. See 11 U.S.C. §§ 506, 553(a)(3)(C) (1982 & Supp. IV 1986). See generally 4 COLLIER, supra note 22, at ¶ 553.14-.17.

\textsuperscript{239}The bank’s set-off rights are not limited by U.C.C. § 9-306(4)(d)’s ten day rule. See U.C.C. § 9-306(4)(d)(i), (ii). The existence of a right to set-off is determined by rules external to Article Nine. See Clark, \textit{Bank Exercise of Set-Off: Avoiding the Pitfalls}, 98 BANKING L.J. 221-22 (1981).
cash proceeds. In its general suppletive role under Article Nine, restitution is also a source of judicial remedies in cases of unauthorized commingling. An entitlement to commingled cash proceeds can lower the aggregate cost of secured credit. The mouse involves lower administrative costs than restitutionary tracing. In addition, there is no disadvantage associated with the mouse in terms of its avoidability in bankruptcy or as a substitute for monitoring. Neither entitlement is biased in favor of secured or unsecured creditors, and perverse incentives caused by Article Nine's asymmetric entitlement scheme seem unlikely.

Criticisms of section 9-306(4)(d) and Article Nine's entitlement scheme ultimately may reflect a concern that they are just too complex. A simpler approach might employ the same entitlement in all cases. For example, a secured party's entitlement could always turn on its ability to identify proceeds by means of restitutionary tracing.\(^{240}\) This approach avoids the need for a special bankruptcy entitlement. However, any gain in simplicity may be illusory because of the LIBR's complexity.\(^{241}\)

Complete symmetry also is obtainable by modifying section 9-306(4)(d) to define the secured party's entitlement in all cases without regard to whether the commingled cash proceeds are subject to bankruptcy administration or were transferred by the debtor. For example, the secured party might be absolutely barred from recovering on account of cash proceeds ten days after they are received by the debtor unless they are never commingled.\(^{242}\) The wisdom of such a rule in the case of transferred cash proceeds is debatable, however, because its only effect is to prevent recovery from non good faith purchasers.\(^{243}\)

Improved symmetry might be obtained if a modified mouse applied both in and out of bankruptcy in cases of untransferred cash proceeds, leaving transferred cash proceeds to identification by restitutionary tracing.\(^{244}\) The modified mouse would require a day-counting formula that is clear and reaches desirable results. Current section 9-306(4)(d) limits the secured creditor to the amount of any cash proceeds received by the debtor within ten days before the institution of insolvency

\(^{240}\)See Gillombardo, supra note 185, at 30-31. Not all states have held that identification by restitutionary tracing is available under Article Nine. See supra note 207.

\(^{241}\)See supra notes 221-23 and accompanying text.

\(^{242}\)The secured party would have ten days from receipt to formally assert its claim to cash proceeds that are commingled after receipt. See supra note 75.

\(^{243}\)See supra notes 92-94, 98-105 and accompanying text.

\(^{244}\)Cf. E. Farnsworth & J. Honnold, supra note 40, at 933.
proceedings. The formula works because bankruptcy commences with a filing, which generally freezes the actions of creditors. It is possible to conceive the outline of a modified mouse employing a day-counting formula similar to current section 9-306(4)(d)'s, but which operates in noninsolvency settings. However, fleshing out the details and enacting the product may not be worth the effort. The entitlement would be at least as complex as the mouse. In addition, it would be infrequently invoked, except when bankruptcy interferes with the secured party's self-help.

One could easily improve upon section 9-306(4)(d)'s complexity. For example, a secured party might be entitled to a statutory percentage of all

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247 Under a modified mouse applicable in and out of insolvency proceedings, a secured creditor might receive the amount of cash proceeds received within ten days before "any person becomes a lien creditor." Cf. U.C.C. § 9-301(1)(b), (3). Non-U.C.C. law would control the grounds for legal process, whether and when a lien is obtained, and so forth. These rules are not uniform, and may not be conducive to a bright line entitlement. See DEBTOR-CREDITOR LAW, supra note 107, at ¶¶ 6.04-.05. Aside from these possible objections, the entitlement might work if the lien is obtained by an unsecured creditor. The unsecured creditor would recover all the funds in the commingled account (up to to the amount of its judgment) minus the secured party's entitlement. The secured party would have no entitlement to proceeds received after the ten days, absent a second lien. The first lien presumably would be a default permitting the secured party to collect cash proceeds directly from account debtors or take other steps to avoid future commingling. See supra text accompanying notes 218-19.

Although workable, this entitlement might be insignificant in cases of competing secured claims. Suppose that SP1's perfected security interest extends to a commingled bank account because it covers inventory and proceeds. So does SP2's, which is subordinate to SP1 as the second filed under Article Nine's priority rules. See U.C.C. § 9-312(5). SP2 obtains a lien against the account on June 1, which "anchors" the end of SP1's ten day entitlement. See supra notes 123-24 and accompanying text. But what if SP1 then obtains a lien on June 6? This creates intersecting entitlements. SP1's priority should give it first claim to the amount of proceeds during the period of intersection. However, neither secured party is likely to go to the trouble of obtaining a lien under these circumstances. A more likely scenario is a declaration of the debtor's default followed by immediate efforts to collect cash proceeds from account debtors or other steps to monitor and avoid further commingling. See supra text accompanying notes 215-19. Such tactics will generally be faster and more effective than judicial relief because of a lack of information concerning the commingled account's contents and because summary relief is not instantaneous, if it is available at all. See supra text accompanying notes 125-26.

248 See supra note 247.
249 Id.
of the bankruptcy estate's commingled cash and bank accounts. Any percentage rule would be easier to administer than the mouse. However, one may doubt the palatability of an entitlement lacking some justifying assumption (e.g., proceeds float on nonproceeds; most of the debtor's receipts during its final days are proceeds; and so on). Caution also must be exercised, lest one adopt an entitlement that too greatly discourages monitoring by secured parties. In the end, it may be best to leave the malformed mouse alone.

250 There are other possibilities. For example, the financer might be required to share commingled proceeds pro rata with other perfected secured creditors. Cf U.C.C. § 9-315 (1977). This approach would cost the financer its priority over other perfected security interests in cases involving commingled cash proceeds, but would preserve its priority over unperfected security interests and unsecured creditors. See U.C.C. § 9-301(1)(b).

251 See supra text accompanying notes 6-7, 43.

252 See supra text accompanying notes 165, 168-73.