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# Current Developments Under UCC—Article 9

By ROY L. STEINHEIMER, JR.

## Scope of Article 9

As you will recall, Article 9 states that it applies to all secured transactions involving "personal property" which includes much more than just goods. The term "personal property" also includes accounts, contract rights, general intangibles, chattel paper, instruments and documents. We must comply with Article 9 when creating security interests in any of these items. Several interesting cases have come along to emphasize the pitfalls which may snare those who are not sensitive to the broad spectrum of transactions covered by Article 9.

One type of problem which can arise is illustrated by *Jacobs v. Northeastern Corp.*, 416 Pa. 417, 206 A. 2d 49 (1965) and *U.S. v. Fleetwood*, 165 F. Supp. 723 (D.C. Pa. 1958). Section 400.9-102 of the Code provides that Article 9 applies to "security interests created by contract" including "any transaction (regardless of its form) which is intended to create a security interest in . . . contract rights." With this in mind, consider the position of a surety which furnishes a performance or a payment bond covering the contractor on a construction project. If the contractor becomes insolvent and fails to complete performance or to pay the claims of laborers and materialmen, the surety must put up the money under its bond. Having done so, the surety would like to lay claim to any "drag" monies which may still be owing on the construction project to the

insolvent contractor. But the representative of the insolvent contractor will object to this as preferential treatment of the surety over other creditors of the insolvent contractor. One way around this objection would be for the surety to claim that the contractor had assigned to the surety his rights to payment under the construction contract to the extent necessary to cover any advances made by the surety. But is such an assignment of contract rights one intended for security so that we have an Article 9 secured transaction? The court in *U.S. v. Fleetwood* so held and since the surety had not filed a financing statement to perfect his security interest in the contract rights, the trustee in bankruptcy prevailed. One might conjecture as to why no reference was made in this case to Section 400.9-302(1)(e) which provides for automatic perfection of a security interest in "an assignment of . . . contract rights which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding . . . contract rights of the assignor." Perhaps the safety valve provided by this section could have been appropriately used by the surety in this case. Another approach which the surety could use is to rely on subrogation doctrines claiming the right to be subrogated to the insolvent contractor's claim to the payments still due under the construction contract. Article 9 applies only to security interests "created by contract" and rights of subroga-

## ABOUT THE AUTHOR



Mr. Steinheimer has been a Professor at the University of Michigan Law School since 1950. He received a J.D. degree from the University of Michigan in 1940 and practiced law in New York City until 1950. Professor Steinheimer has written articles on the Uniform Commercial Code in legal periodicals and has served as a lecturer on the Code in various states. This article is based on his lecture at the Missouri Bar Annual Meeting in Kansas City on September 7, 1967.

tion are created by law to avoid injustice and are not consensual in nature. Under this analysis it would seem that we do not have a secured transaction which is subject to Article 9. This is the substance of the holding by the majority of the court in *Jacobs v. Northeastern Corp.* These cases certainly demonstrate the careful attention which must be given to the pervasive coverage of Article 9.

*In re Ljosheim*, 4 UCC Rep. Serv. 46 (D.C. Cal. 1967) further emphasizes the need for care in matters relating to assignment of contract rights. Here an attorney had taken an assignment of his client's claim to an income tax refund as security for attorney's fees. When the client became bankrupt, it was held that the trustee in bankruptcy took priority over the attorney's claim to the income tax refund because this transaction involved an assignment of contract rights

which should have been perfected by filing a financing statement. Some might be inclined to question whether a claim to an income tax refund is a "contract right" (Sections 400.9-106 and 400.1-201 (11)). Some might wonder whether the safety valve provided by Section 400.9-302(1)(e) could have saved the assignment from the clutches of the trustee in bankruptcy.

Further with regard to the scope of Article 9, it has been held that assignment of a tort claim is not a secured transaction subject to Article 9. *Arkwright Mut. Ins. Co. v. Bargain City U.S.A.*, 251 F. Supp. 221 (D.C. Pa. 1967) aff'd 373 F.2d 701 (3rd Cir. 1967). A liquor permit is a "general intangible" (Section 400.9-106) which can be the subject of a security interest under Article 9. *Paramount Fin. Co. v. U.S.*, 379 F.2d 543 (6th Cir. 1967). The coin collection of a numismatist is "goods" (Section 400.9-105(1)(f)) which can be the subject of a security interest under Article 9. *In re Midas Coin Co.*, 264 F. Supp. 193 (D.C. Mo. 1967).

The Code treatment of consignment arrangements deserves some comment since it represents a potential trap for the unwary as indicated by several recent cases. Section 400.9-102 says that Article 9 applies to "any transaction (regardless of its form) which is intended to create a security interest in personal property" and, more specifically, to "security interests created by contract including . . . consignment intended as security." Section 400.1-201(37) says that "[u]nless a . . . consignment is intended as security, reservation of title thereunder is not a 'security interest.'" Much of the purpose in attempting to draw fine lines of distinction between consignments which are intended for security and those which are not is frustrated, however, by the further provision in Section 400.1-201(37) that "a consignment is in any event subject to the provisions on consignment sales" in Section 400.2-326. When we look at this section, we find that goods delivered on consignment are "deemed to be on sale or return" and that goods held on sale or return are subject to the

claims of consignee's creditors. But the consigned goods can be protected from this awful fate if the consignor does one of the three things suggested in Section 400.2-326(3). The first alternative—complying with any applicable sign-posting law—is available only in those few states which have enacted such laws as the consignor learned to his sorrow in *In re Downtown Drugstores*, 3 UCC Rep. Serv. 27 (D.C. Pa. 1965). The second alternative should be regarded primarily as an escape hatch to be used only as a last resort. It will not apparently be easy under this alternative to establish that the consignee is “generally known to his creditors to be substantially engaged in selling the goods of others” as is indicated by *General Electric Co. v. Pettin-gill Supply Co.*, 347 Mass. 631, 199 N.E.2d 326 (1964). This leaves us with the third alternative—comply with the filing provisions of Article 9. So when all is said and done, the only sensible course in most situations is to treat the consign-ment arrangement as a secured transac-tion and comply with Article 9.

As to leases, again the provisions of Section 400.9-102 are our starting point. From these provisions we see that a lease will be subject to Article 9 only if it is “intended to create a security interest.” This leaves us with the age-old problem of the distinction between “pure” leases and leases which are really security agreements. But the Code does try to give us a little guidance on this problem. Section 400.1-201(37) provides that “[w]hether a lease is intended as security is to be determined by the facts of each case.” This generalization is of little help. But there is more. It is further provided that “the inclusion of an option to purchase does not of itself make the lease one intended for security.” It does not follow from this provision that a lease is a “pure” lease simply because refer-ence to an option to purchase is omitted. The solution to the problem is not this simple as is indicated by *In re Transcon-tinental Industries*, 3 UCC Rep. Serv. 235 (D.C. Ga. 1965). In this case United States Leasing Corporation argued that its leases were “pure” leases because

they did not contain options to purchase. The referee, however, pointed out that the Code makes the distinction between “pure” leases and leases intended as security depend on all of the facts of each case. Since United States Leasing Cor-poration was essentially engaged in fi-nancing the acquisition of goods by lessees who were permitted to keep the goods at the end of the lease term de-spite the fact that there was no option to purchase, the referee found that the leases were intended as security. Section 400.1-201(37) further provides that “an agreement that upon compliance with the terms of the lease the lessee shall be-come or has the option to become the owner of the property for no additional consideration or for a nominal consid-eration does make the lease one intended for security.” This raises the problem of what is a “nominal consideration.” Just any kind of balloon payment at the end of the lease term won't solve the prob-lem. The payment should be related to the actual value of the goods at the end of the lease term. *In re Washington Proc-essing Co.*, 3 UCC Rep. Serv. 475 (D.C. Cal. 1966) and *In re Wheatland Electric Products Co.*, 237 F. Supp. 820 (D.C. Pa. 1964).

### **Removal From the State Of Goods Subject to a Perfected Security Interest**

Section 400.9-103(3) deals with prob-lems of perfection when goods are moved from one state to another. For example, assume a security interest in goods is perfected in Missouri and then the goods are moved to Kansas. This section says that the Missouri perfection continues effective for four months after removal of the goods to Kansas. At the end of the four-month period, the security in-terest becomes unperfected unless appro-priate action is taken in Kansas within the four-month period to continue the perfection. Now suppose nothing is done in Kansas to continue perfection beyond the four-month period. If a bona fide purchaser purchases the goods from the debtor in Kansas six months after re-moval, he obviously should prevail over

the security interest of the secured party on which the perfection had lapsed at the time of purchase (Section 400.9-301(1)(c)). But suppose the bona fide purchaser purchases within the four-month period while the Missouri perfection is still effective in Kansas. Normally a perfected security interest will prevail over a bona fide purchaser and our bona fide purchaser will lose (Section 400.9-301(1)(c)) unless the fact that the secured party has allowed his perfection to lapse subsequent to the purchase affects the result. The courts have held that the rights of the parties are fixed and determined as of the time of purchase and are not affected by subsequent events. So our bona fide purchaser loses in this situation. Thus substantial rights depend on the accident of whether the purchase takes place before or after expiration of the four-month period. *First Nat. Bank of Bay Shore v. Stamper*, 93 N.J. Super. 150, 225 A.2d 162 (Super. Ct. N.J. 1966); *Al Maroone Ford v. Mannheim Auto Auction*, 205 Pa. Super. 154, 208 A.2d 290 (Super. Ct. Pa. 1965). Compare the provisions of Section 400.9-312(4) where failure of the secured party to file within the ten-day period deprives him of purchase money priority status even as to interests which intervened before the ten-day period had expired.

The four-month limitation on perfection after goods are removed from the state does not apply if perfection is accomplished by notation of the security interest on a certificate of title as in the case of motor vehicles (Section 400.9-103(4)). Apparently the perfection by notation continues effective after removal to another state so long as the certificate of title bearing the notation remains in force and effect. *In re White*, 266 F. Supp. 863 (D.C. N.Y. 1967).

### The Security Agreement

Except for pledge transactions, a written security agreement is necessary to create a security interest (Section 400.9-203). In several cases where the secured party was caught short, it has been argued that the financing statement fulfills

the requirement of a written security agreement. This argument has been consistently rejected. *Mid-Eastern Electronics v. First Nat. Bank*, 380 F.2d 355 (4th Cir. 1967); *American Card Co. v. H.M.H. Co.*, 97 R.I. 59, 196 A.2d 150 (1963). As the Code stands these cases seem to be correct. Section 400.9-105(1)(h) defines "security agreement" as "an agreement [defined in Section 400.1-201(3)] which creates or provides for a security interest." The contents of a financing statement don't meet the demands of this definition (Section 400.9-402). Nor will notation of a lien on the certificate of title for a vehicle (*In re Nipper*, 3 UCC Rep. Serv. 1178 (D.C. Ore. 1966)) or the retention of the certificate of title by the secured party (*McDonald v. Peoples Automobile Loan & Fin.*, 115 Ga. App. 483, 154 S.E.2d 886 (Ct. App. Ga. 1967)) be an acceptable substitute for a written security agreement.

As to adequacy of description of the collateral in the security agreement, the Code seems to be accomplishing its intended result of eliminating high technicality. *In re Goodfriend*, 2 UCC Rep. Serv. 160 (D.C. Pa. 1964). But care must be exercised to be sure you have described each type of collateral which is involved in the transaction. In *U.S. v. Antenna Systems, Inc.*, 251 F. Supp. 1013, (D.C. N.H. 1966) the collateral was described as "all furniture, fixtures and equipment" of the debtor. The court held that this description did not include engineering blueprints and technical data developed by debtor's engineers because such items were "general intangibles" rather than "goods."

The Code seems to have given new life to the waiver of defense clause when inserted in an installment sale security agreement covering equipment. Section 400.9-206 contemplates that such a clause shall be given full force and effect in equipment financing and in *Beam v. John Deere Co.*, 240 Ark. 98, 398 S.W.2d 218 (1966) the court so held.

A pair of cases (*In re Dorset Steel Equipment Co.* and *In re Elkins-Dell Mfg. Co.*, 253 F.Supp. 864 (D.C. Pa. 1965)) have raised the issue of uncon-

scionability of a security agreement. As might be expected when this issue is raised, the courts are apparently going to be guided by the provisions of Section 400.2-302 dealing with unconscionability of sale contracts.

*In re United Thrift Stores*, 363 F.2d 11 (3rd Cir. 1966) confirms the fact that Section 400.9-205 has destroyed the questionable but pertinacious doctrine of *Benedict v. Ratner*, 268 U.S. 353 (1925).

### The Financing Statement

Problems usually arise in this area because of carelessness in the preparation of the financing statement by your clients. The Code recognizes that mechanical mistakes will inevitably be made in the preparation of financing statements. Section 400.9-402(5) provides that a "financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." I am happy to report that the courts have embraced this philosophy wholeheartedly. To many of you this will be a refreshing change. Now let's take a look at some of the errors which have triggered litigation.

First, the requirement of signature of the secured party on the financing statement (Section 400.9-402(1)). I would note in passing that some might properly question whether the Code should have required the signature of the secured party on the financing statement. It seems to serve little useful purpose. It is interesting, however, that the courts have not attempted to solve problems arising out of the secured party's signature by calling them "minor errors." Instead the courts have turned to the definition of "signed" (Section 400.1-201 (39)) which makes "any symbol executed or adopted by a party" operate as his signature. Under this definition the courts have been willing to find that if the secured party's name appears anywhere in the financing statement it will operate as his signature. *Plemens v. Diddle-Glaser, Inc.*, 244 Md. 556, 224 A.2d 464 (Ct. App. Md. 1966); *In re Hor-*

*vath*, 1 UCC Rep. Serv. 624 (D.C. Conn. 1963); *Benedict v. Lebowitz*, 346 F.2d 120 (2nd Cir. 1965). This approach is commendable and is in keeping with the spirit of the Code which abhors pointless technicality.

Another requirement of Section 400.9-402(1) is that the secured party's address must appear in the financing statement. This requirement also seems to serve little useful purpose for nowhere in Article 9 is a third party given the right to demand information directly from the secured party. Only the debtor can demand information from the secured party and he should know where to find the secured party without resort to the address in the financing statement. Can it be said that omission of secured party's address is a "minor error"? The New Mexico Supreme Court, in what seems to me to be a questionable opinion, has said "no." *Strevell-Paterson Finance Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967).

When it comes to the requirement of debtor's signature on the financing statement, we have a different problem. Obviously debtor's signature on a financing statement is essential and the courts should not be charitable in tolerating errors. *In re Causer's Town and Country Supermarket*, 2 UCC Rep. Serv. 541 (D.C. Ohio 1965) properly held that omission of the debtor's signature on the financing statement was fatal to perfection.

The requirement in Section 400.9-402 (1) that the financing statement must state the name of the debtor can raise some interesting problems. What is to be done if the debtor's name is not correctly phrased or spelled in the financing statement? Is this "minor error" which should be excused? Improper spelling of the debtor's name can lead to improper indexing of the financing statement which in turn can lead to a person being misled when a search of the records is made. If a third party has actually been misled in his search of the records, it would seem that the errors in debtor's name are not "minor errors" for they have actually been seriously misleading

and they should not be excused under Section 400.9-402(5). But suppose that the third party raising the issue of the errors in debtor's name has not made a search of the records so that the error did not actually mislead him. Isn't such a party opportunistically relying on sheer technicality to frustrate the transaction and to gain an advantage? If so, shouldn't a court hold that the errors were "minor" and "not seriously misleading"? There is some indication that the courts may approach the problem in this fashion. *In re Excel Stores, Inc.*, 341 F.2d 961 (2nd Cir. 1965); *Matter of Vaughan*, 4 UCC Rep. Serv. 61 (D.C. Mich. 1967); *In re Bengtson*, 3 UCC Rep. Serv. 283 (D.C. Conn. 1965).

### Perfection of the Security Interest

Filing of a financing statement is undoubtedly the commonest method used to perfect a security interest. Several matters should be mentioned regarding this method of perfection. Remember that the Code adopts the notice filing concept. The security agreement itself never is required to be filed. All that is required to be filed is a financing statement which is a simple notice that the secured party and the debtor intend to deal with one another with respect to the collateral described in the financing statement. The exact nature of their dealings in this collateral is immaterial. In a sense the filing gives the secured party a monopoly on the described collateral while the financing statement is effective. Anyone else who tries to procure an interest in this collateral while the filing is effective does so at his peril because he has been forewarned that the secured party has already "staked a claim" to the collateral. To illustrate, let us suppose that a secured party files a financing statement covering equipment of the debtor. Debtor signs a security agreement granting a security interest in the equipment and a loan is made. This loan is paid off but no termination statement is filed. A few months later debtor borrows some more money from secured party pursuant to a new security agreement which again grants a security in-

terest in the same equipment. No additional filing is made. Before this loan is paid off, debtor becomes bankrupt. The security interest created by the second security agreement is perfected against the trustee in bankruptcy because the single filing as to equipment protects the secured party in all financing transactions with the debtor involving this equipment for a period of five years or until a termination statement is filed. See *In re McCroskey*, 4 UCC Rep. Serv. 237 (D.C. Ohio 1966). Now let's take this kind of a case which raises the question of the effect of future advances under the notice filing concept. Lender # 1 files a financing statement covering equipment worth \$10,000 and advances \$1,000 pursuant to a security agreement with a provision for future advances. Lender # 2 subsequently files a financing statement covering the same equipment and advances \$6,000. Later Lender # 1 advances an additional \$5,000. Because of the notice filing concept, Lender # 1 should have priority for his full exposure of \$6,000 before Lender # 2 gets anything. Lender # 1 had locked up the collateral for his benefit by his filing. Precise amounts advanced by him and the timing of such advances are immaterial. The notice filing warned Lender # 2 that he was dealing with the collateral at his peril and that his rights would be junior to whatever rights Lender # 1 might have under the first-to-file rule (Section 400.9-312(5)(a)). The court in *Coin-o-Matic Service Co. v. Rhode Island Hospital Trust Co.*, 3 UCC Rep. Serv. 1112 (Sup. Ct. R.I. 1966) failed to appreciate the significance of this concept and reached what, to my mind, is an unfortunate result. One would hope this case will not be followed elsewhere.

The Code has some rather explicit provisions regarding what constitutes the filing of a financing statement. And these provisions can become important. Suppose for example, you tender a financing statement to the filing officer and he refuses to accept it because it is his "curbstone" opinion that the financing statement is not properly drawn. Section



400.9-403(1) provides that "[p]resentation for filing of a financing statement and tender of the filing fee . . . constitutes filing" under Article 9. So if the chips are down and it becomes important to you, it should be possible to establish the fact of filing even though the filing officer has refused to accept the financing statement. Compare *In re Smith*, 205 F. Supp. 27 (D.C. Pa. 1962) which seems to have been wrongly decided in light of this Code provision. Suppose the filing officer accepts your financing statement but fails to index it. Have you filed? The answer seems to be obvious from the provision in Section 400.9-403(1) that "acceptance of the [financing] statement constitutes filing." The contrary holding in *In re Herron*, 1 UCC Rep. Serv. 526 (D.C. Pa. 1962) is unfortunate.

Great care must be exercised in the perfection of security interests in goods which may become fixtures. Not the least of our difficulties lies in recognizing whether we have a fixture involved in the transaction—a problem on which the Code offers us no real assistance (Section 400.9-313(1)). Take the case of goods which are classified as business equipment (as opposed to farm equipment). If the equipment does not become a fixture, a filing with the secretary of state will be necessary (Section 400.9-401(1)(c)). But if the equipment becomes a fixture only a local filing is necessary (Section 400.9-401(1)(b)). Or assume we have a purchase money security interest in consumer goods. If the consumer goods do not become fixtures, no filing is necessary for we can rely on automatic perfection (Section 400.9-302(1)(d)). But if they become fixtures, a local filing will be necessary (Section 400.9-401(1)(b)). When there is doubt as to whether fixture financing is involved, it seems sensible to cover yourself both ways as to perfection or else you may be caught short. See *In re Park Corrugated Box Corp.*, 249 F. Supp. 56 (D.C. N.J. 1966); *In re Collier*, 3 UCC Rep. Serv. 1076 (D.C. Tenn. 1966); *In re Keystone Baking Co.*, 1 UCC Rep. Serv. 606 (D.C. Pa. 1958).

## Priorities of Security Interests

*Trustee in bankruptcy.* In discussing the priorities of security interests in the bankruptcy context, I want to look at the trustee's powers under Sections 70 and 60 of the Bankruptcy Act.

Let's look first at the trustee's powers under Section 70(c) which contains the so-called "strong arm" clause. This gives the trustee the powers of a hypothetically perfect lien creditor as of the date of bankruptcy as to property of the bankrupt. Assume that we have an unperfected security interest in collateral of the debtor at the time of bankruptcy. On the date of bankruptcy the trustee has the powers of a lien creditor as to this collateral and, as such, he will prevail over the unperfected security interest (Section 400.9-301(1)(b)). See *In re Hall*, 248 F. Supp. 124 (D.C. 1965). But if the security interest is perfected (including automatic perfection) before the date of bankruptcy, the perfected security interest will have priority over the trustee as a subsequent lien creditor (Section 400.9-301(1)(b)). See *In re Lucacos*, 1 UCC Rep. Serv. 553 (D.C. Pa. 1957).

Under Section 70(e) the trustee is empowered to exercise for the benefit of the bankrupt estate the actual rights of any general creditors having provable claims. Prior to the Code this power of the trustee created serious problems in a number of states where it was held that an unreasonable delay in recording of a chattel mortgage, for example, rendered the mortgage lien void as to a general creditor who intervened between the time the mortgage was executed and the time it was recorded. Where such doctrine prevailed, the trustee could step into the shoes of the interim general creditor under Section 70(e) and strike down the mortgage lien for the benefit of the bankrupt estate. This should no longer be possible under the Code as is indicated by the well reasoned opinion in *In re Weeks*, 2 UCC Rep. Serv. 870 (D.C. Mich. 1964); aff'd 2 UCC Rep. Serv. 877 (D.C. Mich. 1965).

Under Section 60 the trustee is empowered to void preferential transfers

as defined in that section. For our purposes the critical elements of a preferential transfer are that it must be a transfer of the bankrupt's property which is made within four months of bankruptcy for an antecedent debt. The granting of a security interest by the debtor is a transfer under Section 60. Such a transfer is deemed to have been made under Section 60 when the security interest is perfected against lien creditors. If the perfection occurs within four months of bankruptcy for an antecedent debt, we have the makings of a voidable preference. For example, assume that on 2/1/67 a secured party lends money to debtor pursuant to a security agreement granting a security interest in collateral. However, secured party does not file a financing statement until 8/1/67. Debtor becomes bankrupt on 8/15/67. In this example the security interest attached (Section 400.9-204) on 2/1/67 but it was not perfected (Section 400.9-303) until 8/1/67. So under Section 60 we have a transfer (perfection) within four months of bankruptcy for an antecedent debt (since value was given back on 2/1/67) and we are on the road to a voidable preference. This example illustrates the so-called "pocket lien" practice at which Section 60 was directed. Observe that by employing this technique the secured party has attached a security interest to the bankrupt's property but has kept this fact a secret from other creditors until he filed shortly before bankruptcy in a last minute effort to protect himself at the expense of other creditors. Such practice is clearly condemned by Section 60 and the "Johnny come lately" perfection of the security interest should be voidable. See *In re Jeavons*, 2 UCC Rep. Serv. 644 (D.C. Ohio 1965).

Now we come to the problem on which so much erudition has been expended and so much ink spilled—the voidable preference problem in the context of the floating lien under the Code. Assume that on 2/1/67 secured party lends \$50,000 to debtor under the terms of security agreement which grants a security interest in all of debtor's inventory which is now owned or here-

after acquired. Assume also that secured party has filed a financing statement covering this transaction at the outset. When the transaction is initiated on 2/1/67 secured party has a perfected security interest in debtor's existing inventory. Now let's assume that on the first day of each succeeding month from March to August the debtor acquires additional inventory and then debtor becomes bankrupt on 8/15/67. Can a preferential transfer be established as to the after-acquired inventory which came into the debtor's hands within four months of bankruptcy? To lay the basis for a case of preferential transfer the writers have argued that the security interest in after-acquired inventory cannot attach (Section 400.9-204) until it is acquired by the debtor and perfection cannot take place under the filing until such attachment occurs (Section 400.9-303). So, the writers say, we have a series of transfers of the debtor/bankrupt's property occurring each month as the secured party's security interest attached and became perfected as to the after-acquired property. So far so good. The writers then conclude that the transfers of security interests in after-acquired inventory which occurred within four months of bankruptcy must be for an antecedent debt since the secured party advanced the \$50,000 to the debtor way back in February. Here I must part company with them. To my mind the need for true floating lien financing is an economic fact of life. Its legitimate use should be protected from a crippling application of Section 60. In other words Section 60 should be applied to the floating lien transaction only if the Bankruptcy Act clearly makes such application inevitable and inescapable. I find nothing in the Bankruptcy Act which leads inexorably to the application of Section 60 to floating lien financing. Consider the legislative history of Section 60. It was directed essentially at the unfairness typified by the pocket lien transaction. But the floating lien transaction is not pocket lien stuff. From the start of the floating lien transaction there is full and fair

disclosure of what is happening through the filing of a financing statement. So it seems fair to say that Section 60 was not directed at legitimate transactions of this type. And there seems to be nothing in the language of Section 60 which requires its application to the floating lien transaction. The term "antecedent debt" is not defined in the Bankruptcy Act thus leaving it open to our courts to construe this term in a manner which is consonant with the policy of the Bankruptcy Act and with the needs of the business community for floating lien financing. A construction of this term along the lines suggested by Section 400.9-108 seems appropriate and permissible to serve these ends without violating the policy of the Bankruptcy Act. Fortunately the two cases which have considered the problem to date indicate that our courts are sympathetic to the need for floating lien financing and feel it can be accommodated under Section 60 of the Bankruptcy Act. *In re Portland Newspaper Publishing Co.*, 4 UCC Rep. Serv. 533 (D.C. Ore. 1967) reversing 3 UCC Rep. Serv. 194 (D.C. Ore. 1966); *Rosenberg v. Rudnick*, 262 F. Supp. 635 (D.C. Mass. 1967). For those who are still leery of the problem, it can be avoided by some careful structuring and policing of the floating lien transaction. For example, if the monies received from the sale of inventory by the debtor are earmarked as proceeds of the inventory and these monies are then used to purchase additional inventory, the after-acquired inventory becomes proceeds of the proceeds of the original inventory (Section 400.9-306(1)) and the perfection of the original inventory continues into the after-acquired inventory as proceeds without interruption (Section 400.9-306(3)(a)) thus avoiding the Section 60 preference problem. See *Howarth v. Universal C.I.T. Corp.*, 203 F. Supp. 279 (D.C. Pa. 1962).

*Bona fide purchasers.* The Code provides that a perfected security interest takes priority over a bona fide purchaser (Section 400.9-301(1)(c)). *Prime Business Co. v. Drinkwater*, 350 Mass. 642,

216 NE 2d 105 (1966). This rule applies where the secured party is relying on automatic perfection of a purchase money security interest in farm equipment or consumer goods (Section 400.9-302(1)(c) and (d)) unless the good faith purchaser is a consumer or a farmer (Section 400.9-307(2)). *National Shawmut Bank of Boston v. Vera*, 223 NE 2d 515 (Sup. Ct. Mass. 1967) involves an interesting situation in which a lien creditor who had levied on consumer goods subject to an automatically perfected purchase money security interest put the goods up for sale and then purchased them at the execution sale. When the secured party found out what was going on, it sued the lien creditor for conversion claiming priority under Section 400.9-301(1)(b). Lien creditor countered with the argument that he was now in the position of a consumer who had purchased the goods in good faith and was protected by Section 400.9-307(2). The court properly held that the lien creditor could not bootstrap himself into a position of priority in this way.

*Buyers in ordinary course of business.* Except for farm products, the buyer in ordinary course of business takes free of a perfected security interest (Section 400.9-307(1)). *Sterling Acceptance Co. v. Grimes*, 194 Pa. Super. 503, 168 A. 2d 600 (1961). Most of the problems in this area to date seem to center around the question of when a buyer can qualify as a "buyer in ordinary course of business" (Section 400.1-201(9)). Can a dealer who buys in ordinary course from another dealer qualify? Can he qualify even though he knows of the existence of the security interest in the inventory when he buys? The court answers both of these questions in the affirmative in *Main Investment Co. v. Gisolfi*, 203 Pa. Super. 244, 119 A.2d 535 (1964). But a dealer who not only knows of the security interest but also knows that sale of the goods to him is forbidden under the terms of the security agreement cannot qualify as a buyer in ordinary course of business. *O. M. Scott Credit Corp. v. Apex, Inc.*, 97 R.I. 442,

198 A.2d 673 (1964). Nor can one who does not give new value qualify. *Evans Products Co. v. Jorgensen*, 421 P. 2d 978 (Sup. Ct. Ore. 1966).

Under Section 400.9-307(1), the buyer of farm products in ordinary course of business is not protected against a perfected security interest in the farm products. But *Clovis Natl. Bank v. Thomas*, 77 N.M. 554, 425 P. 2d 726 (1967) indicates that a court which does not like this rule can easily side-step it unless the secured party has carefully structured and policed the secured transaction.

*First-to-file or first-to-perfect.* When both security interests are perfected by filing, the first-to-file takes priority (Section 400.9-312(5)(a)). This rule operates even though the secured party who filed first had knowledge of the competing security interest when he filed. *In re Gunderson*, 4 UCC Rep. Serv. 358 (D.C. Ill. 1967). In *French Lumber Co. v. Commercial Realty & Finance Co.*, 346 Mass. 716, 195 N.E. 2d 507 (1964), a secured party who refinanced an obligation and could easily have had the benefit of the first-to-file rule had he taken an assignment of the rights of the original secured party was saved by the court through doctrines of subrogation.

*Lonoke Production Credit Assn. v. Bohannon*, 238 Ark. 206, 379 S.E. 2d 17 (1964), is a good illustration of the operation of the first-to-perfect rule where one security interest is perfected automatically and another is perfected by filing (Section 400.9-312(5)(b)).

*Fixtures.* An unperfected security interest which attaches to goods before they are affixed to the realty as fixtures takes priority over prior-real estate interests (Section 400.9-313). *In re Royers Bakery, Inc.*, 1 UCC Rep. Serv. 570 (D.C. Pa. 1963). Unfortunately the court seems to have overlooked the applicability of this rule to the situation in *U.S. v. Baptist Golden Age Home*, 266 F. Supp. 892 (D.C. Ark. 1964).

*Accessions.* The priority rules as to accessions are similar to those for fixtures (Section 400.9-314). If the security interest attaches to goods before they are affixed as accessions to the whole, the

security interest, though unperfected, takes priority over existing interests in the whole. The problem of priority of interests in accessions to aircraft was discussed in *International Atlas, Inc. v. Twentieth Century Aircraft Company*, 251 Cal. App. 2d 495, 59 Cal. Rptr. 495 (Ct. App. Cal. 1967). The court unfortunately suggests in this case that the priority provisions of the Code relating to accessions are not applicable because the federal law relating to security interests in aircraft has preempted the field (cf. Section 9-104(a)).

*Proceeds.* Before we can handle priority problems relating to proceeds we must be able to identify items which are proceeds under the definition of Section 400.9-306(1). There can be borderline situations where the question is not an easy one. For example, in *Universal C.I.T. Credit Corp. v. Prudential Investment Corp.*, 222 A. 2d 571 (Sup. Ct. R.I. 1966) the court, in a close case influenced no doubt by the peculiar facts involved, decided that insurance money paid on an insurance policy covering casualty to the collateral was not proceeds under the Code definition. In *Hoffman v. Snack*, 2 UCC Rep. Serv. 862 (Com. Pl. Pa. 1964), it was held that debtor's claim for damages against a third party for tortious destruction of the collateral was not proceeds.

Assuming we have proceeds involved, it is important that the secured party assure himself of a continuously perfected security interest flowing from the original collateral into the proceeds. This normally can be accomplished by filing a financing statement which claims proceeds (Sections 400.9-402 and 400.9-306(3)(a)). *In re Platt*, 257 F. Supp. 478 (D.C. Pa. 1966) indicates the difficulties which can be encountered when one fails to claim proceeds in the financing statement.

If a perfected security interest is properly maintained in proceeds, the general rule of thumb is that the secured party should have the same priorities in the proceeds as he would have had in the original collateral. *Girard Trust Corn Exchange Bank v. Warren Lepke Ford*,

*Inc.*, 1 UCC Rep. Serv. 531 (Com. Pl. Pa. 1958) well illustrates the wonders which can be worked prioritywise through a perfected security interest in proceeds. See also, *Rodi Boat Co. v. Provident Tradesman's Bank & Trust Co.*, 339 F. 2d 259 (3rd Cir. 1964) where the court, without reference to the proceeds provisions of the Code, reaches an appropriate result through the application of common law proceeds principles and the constructive trust device.

The special priority rule governing chattel paper which is proceeds of the sale of inventory subject to a perfected security interest (Section 400.9-308) was applied in *Associates Discount Corp. v. Old Freeport Bank*, 421 Pa. 609, 220 A. 2d 621 (1966).

### Default Procedures

While the Code permits self-help repossession of collateral after default (Section 400.9-503), a little care and caution is indicated in the exercise of this right. In *Beggs v. Universal C.I.T. Credit Corp.*, 409 S.W. 2d 719 (Sup. Ct. Mo. 1966) the secured party was stuck with \$7,500 in punitive damages because it had repossessed the wrong truck.

Several cases have raised the question of what constitutes effective notice of resale after repossession. *Baber v. William Ford Co.*, 239 Ark. 1054, 396 S.W. 2d 302 (1965); *Mallicoat v. Volunteer Finance & Loan Corp.*, 4 UCC Rep.

Serv. 49 (Ct. App. Tenn. 1967). These cases indicate to me the desirability of including in the security agreement provisions which describe the techniques of giving notice of resale so that this type of litigation can be avoided.

*First Nat. Bank of Glendale v. Sheriff*, 34 Wis. 2d 535, 149 N.W. 2d 548 (1967) raised an interesting question with which you could be faced. A judgment creditor caused the sheriff to levy on goods which were subject to a perfected security interest. The secured party sought to replevy the goods from the sheriff despite the fact that the debtor was not in default under the terms of the security agreement. The court refused to permit replevin because without default under the security agreement, the secured party was not entitled to possession of the goods. As the court points out, Section 400.9-311 recognizes that there can be an involuntary transfer of collateral by judicial process and the goods would have to be sold at the execution sale subject to the perfected security interest of the secured party which should be ample protection to him. Doesn't this case indicate the usefulness of the common provision found in security agreements that attachment, levy, etc., on the goods shall constitute an act of default? Had there been default in this case, secured party would have been entitled to possession and the replevin action should have been successful. ■

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