THE SECURED PARTY AND HIS NEMESIS, THE TRUSTEE IN BANKRUPTCY: AFTER-ACQUIRED PROPERTY, UNIDENTIFIED PROCEEDS, AND SELECTED PREFERENCE PROBLEMS

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I. A Brief Historical Sketch

A TRUSTEE IN BANKRUPTCY, in addition to succeeding to the rights of the bankrupt,¹ has several avoiding powers. Some of these avoiding powers² are based on practices which, like vice, are of "so frightful mien that to be hated [need] but to be seen."³ Preferences may not be included among such practices. Indeed, the English view⁴ exhibits ambivalence towards preferences. At one time it regarded "preferences [as] the good fortune of the creditor."⁵ A later view was

"that the preferring of one creditor over others within a short time of bankruptcy and in contemplation thereof, was a "fraud on the bankruptcy law" which could be required to be righted or undone."⁶

In the United States the voidability of preferences has been statutory,⁷ and the Statute with which this paper is concerned is the Federal Bankruptcy Act. That Act provides that any preference as defined⁸ therein

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1 11 U.S.C.A. § 110(a) and (b) (1953).
2 11 U.S.C.A. § 107(d) (2) (d).
5 Id.
6 Id.
7 Id.
8 "A preference is a transfer, as defined in this act of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class." 11 U.S.C.A. § 96(a) (1) (1968).
"may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent." 9

Of course, fraud may be involved. If a payment is made or security given in payment of, or as security for, an antecedent debt three days before bankruptcy, and the party paid swears that payment was in fact made four months earlier, there is fraud. The party paid has perjured himself about an essential element of preference. This type of deceit was facilitated prior to 1938 in cases involving mortgages not recorded until just prior to bankruptcy although they had allegedly existed long before, and involving so-called equitable liens, secret liens which were not fully perfected until immediately before bankruptcy, but which related back to a time which precluded vulnerability under the Bankruptcy act. 10 The vice of recognizing secret liens was two-fold: One, such recognition facilitated fraud and two, potential creditors were deceived concerning the true state of a potential debtor's affairs. The second evil is so classified on the assumption that creditors lend money on the basis of ostensible ownership. This assumption has been subject to criticism and may, in fact, have no foundation. 11

A major revision to the Bankruptcy Act was made in 1938 by the Chandler Amendment. One consistent theme which runs through the legislative history of that amendment is that secret liens must be invalidated. 12 All secret liens? No, although a case could probably have been made for the desirability of providing that a transfer shall be deemed to take place when the


12 The invalidation was accomplished by defining artificially the time of transfer: "... [A] transfer shall be deemed to have been made when it becomes so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein and if such transfer is not so perfected prior to the filing of the petition in Bankruptcy or of the original petition under chapter X, XI, XII, or XIII of this Act, it shall be deemed to have been made immediately before bankruptcy" (emphasis supplied). B.A. as amended by Act of March 18, 1950, P. L. 461, 81st Cong.
transfer is publicized by filing or when the secured party takes possession of the collateral.\textsuperscript{13} Congress did not take this functional approach but instead decided to postpone the transfer under the provision cited in footnote 12.

Since unrecorded mortgages and equitable liens, the two types of secret liens aimed at by the 1938 Amendment, were subject to defeat by bona-fide purchasers under State law,\textsuperscript{14} the Bankruptcy Act by the Chandler Amendment achieved its goal of eliminating the types of secret liens which prior to 1938 had caused the most controversy. Questions remained unanswered. What of secret liens which were not vulnerable to bona-fide purchasers? \textsuperscript{15} What of publicized liens which were vulnerable? A question of great moment because of the then-burgeoning business of lending on the security of accounts receivable, under so-called "non-notification financing," was whether or not the security interest in such accounts was vulnerable under the Bankruptcy Act.

One who reads the legislative history of the Act would probably agree that publicized liens, certainly those publicized by filing under security statutes such as the Uniform Trusts Receipts Act, should be safe. The secret lien was the vice aimed at by the 1938 Amendment. Certainly no reason existed to strike down the various statutes which enabled lending on the security of inventory. The difficulty here is that the secured party must depend for the repayment of his debt on the sale of the inventory, and it is impossible to draft a statute providing for inventory security without providing that a buyer who buys in good faith without knowledge that the purchase is in violation of the rights of a secured party takes free of the security interest. Such a provision is found in § 9-307(1) of the Uniform Commercial Code,\textsuperscript{16} and a similar provision is found in § 9 of

\textsuperscript{13} Analysis of H.R. 12889, House Judiciary Committee Print, 74 Cong., 2d Sess., 188 (1936) "The purpose of the test [see note 12 supra] is to strike down secret transfers, and thus the transfer is to be deemed made when it becomes known and not when it was actually made."

\textsuperscript{14} The same Analysis, supra n. 13, states that the perfection test "... includes a failure to record and any other ground that could be asserted by a bona fide purchaser. ..." Analysis of H.R. 12889, 74th Cong., 2d Sess. (1936) 188.

\textsuperscript{15} They were safe despite Analysis, supra n. 13.

\textsuperscript{16} Unless otherwise indicated all references as to the U.C.C. are to the 1962 official text with comments. The Code was not adopted in any state until after the 1950 amendment to the Bankruptcy Act, which amendment elimi- (Continued on next page)
the Uniform Trusts Receipts Act. If one reads literally, it could be argued that a buyer in the ordinary course of trade is a bona-fide purchaser and therefore no security interest in inventory is deemed perfected under the Bankruptcy Act until "immediately before bankruptcy." Such an interpretation seems unreasonable and an analysis of the Bankruptcy Act in light of its purpose suggests that a buyer in the ordinary course of trade within the meaning of the Uniform Trusts Receipts Act is not a bona-fide purchaser within the meaning of the Bankruptcy Act. The Supreme Court never had an opportunity to analyze this question, although a lower Federal court decided that since a lien under the Uniform Trusts Receipts Act is subject under § 9 of the Act to buyers in the ordinary course of trade, perfection is postponed until "immediately before bankruptcy," when of course all of the elements of bankruptcy will almost certainly be present.

This opinion recalls the admonition of Walter Wheeler Cook given in 1942: 

"The tendency to assume that a word which appears in two or more legal rules and so in connection with more than one purpose has and should have precisely the same scope in all of them runs through all legal discussions. It has all the tenacity of original sin and must constantly be guarded against."

We have seen that a Federal District Court let down its guard. We will never know what the Supreme Court would have done. Some clue perhaps is provided by the case of Corn Ex-

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nated the bona fide purchaser test re personalty. It is cited to support the truth of the statement that inventory security must be salable free of the security interest, to certain types of bona fide purchasers.


19 We do know what the 4th Cir. Court of Appeals did. It reversed on the basis of the 1950 amendment to the B. A. Coin Machine Acceptance Corp. v. O'Donnell, supra n. 17. The 1950 amendment still in effect provides:

"(2) For the purposes of subdivisions (a) and (b) of this section [§ 60], a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide

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change National Bank and Trust Co. v. Klauder,\textsuperscript{20} where the Supreme Court held that since a bona-fide purchaser of accounts receivable who gave notice to the obligor on an assigned account had rights under State (Pennsylvania) law superior to those of the first assignee, the first assignment was deemed not perfected within the meaning of the Bankruptcy Act. The Supreme Court admitted that:

“notice to the debtors sufficient to satisfy the requirements of applicable State law might never have been communicated to the creditors, and that many States do not require notice to the debtor to foreclose possible superior rights of subsequent assignees.”\textsuperscript{21}

Nevertheless, the Court found “...nothing in Congressional policy which warrants taking this case out of the letter of the Act.”\textsuperscript{22} The Court reached its conclusion despite the fact that “the bank had taken an assignment of the accounts receivable for present consideration” and that “far from being a secret transaction, this had been arranged by a creditor’s committee which had previously taken supervision of the debtor’s business.”\textsuperscript{23} A curious result is produced by the decision in the Klauder\textsuperscript{24} case. In those jurisdictions where the first assignee is vulnerable to challenge by a bona-fide purchaser, the lien is subject to attack by the trustee in bankruptcy. We know that

purchase from the debtor could create rights in such property superior to the rights of the transferee. If any transfer of real property is not so perfected against a bona fide purchase or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.” 11 U.S.C. 96(a)(2), P.L. 461, 81st Cong. ch 70, 2d Sess.

It added (dictum) that even under the unamended Act, it would have reversed, reasoning as follows: “[I]t is hardly reasonable to suppose that Congress intended to strike down this healthy and ‘above the board’ business; and it is elementary that acts of Congress are to be given a reasonable interpretation and not one that leads to hardship and absurd results. Sorells v. United States, 287 U.S. 435, 446-448, 53 S. Ct. 210, 77 L. Ed. 413. . . .” Coin Machine Acceptance Corp. v. O’Donnell, supra n. 17, 776. The court quotes approvingly Moore and Tone, 57 Yale L. J. 683, 688: “Nor would the ‘plain meaning’ rule of interpretation preclude this view, for the distinction can readily be drawn between the traditional concept of the bona fide purchaser and that of the buyer in the ordinary course of trade.”

\textsuperscript{21} Id. at 441.
\textsuperscript{22} Id. at 438.
\textsuperscript{23} J. Moore and L. King, 3 Collier on Bankruptcy 943 (14th ed. 1969).
\textsuperscript{24} Supra n. 20.
the Bankruptcy Amendment of 1938 was aimed at certain secret liens. If we wish to include among the liens struck down the property interest held by an assignee of accounts receivable, we must attribute to Congress an intent to strike down secret liens in some States and not in others, based on fortuitous property rules25 completely unrelated to the basic policy of the 1938 Amendment. And despite the Court's talk of "policy" the Klauder opinion generated fear of a literal interpretation of § 60 of the Bankruptcy Act. These fears were exacerbated by the case of Vardaman Shoe Co.,26 where it was held that, if a bona-fide purchaser of accounts receivable could defeat a prior assignee by an act performed subsequent to his bona-fide purchase, then the transfer to the first assignee was subject to the second; and therefore the transfer was not perfected within the meaning of the Bankruptcy Act. (The subsequent acts referred to are found in the Restatement of Contracts.) 27 This seems a strange interpretation of the Act. As Judge Goodrich points out in the Rosen28 case, the first assignee with rights against a bona-fide purchaser "may lose them by subsequent events not connected with the original acquisition." 29 He points out that the favored position acquired by the subsequent assignee in

25 See Countryman, supra, n. 10 at 79, for a discussion of the various rules in the context of accounts receivable financing.
27 Restatement of Contracts § 173 (1932) provides:
"Where the obligee or an assignee makes two or more successive assignments of the same right, each of which would have been effective if it were the only assignment, the respective rights of the several assignees are determined by the following rules:

(a) A subsequent assignee acquires a right against the obligor to the exclusion of a prior assignee if the prior assignment is revocable or voidable by the assignor;

(b) Any assignee who purchases his assignment for value in good faith without notice of a prior assignment, and who obtains

(i) payment or satisfaction of the obligor's duty, or
(ii) judgment against the obligor, or
(iii) a new contract with the obligor by means of a novation, or
(iv) delivery of a tangible token or writing, surrender of which is required by the obligor's contract for its enforcement,

can retain any performance so received and can enforce any judgment or novation so acquired, and, if he has obtained a token or writing as stated in subclause (iv), can enforce against the obligor the assigned right;

(c) Except as stated in Clauses (a) and (b), a prior assignee is entitled to the exclusion of a subsequent assignee to the assigned right and its proceeds."

29 Id. at 1001.
the situations noted in the Restatement\textsuperscript{30} \ldots comes not from his status as bona-fide purchaser, but from his activities following his belated assignment." \textsuperscript{31} He points out that even if the New Jersey Courts had adopted the so-called Massachusetts rule, the second assignee does not acquire rights superior to the first assignee "by virtue of being a bona-fide purchaser." \textsuperscript{32} Judge Goodrich's view that the Bankruptcy Act's bona-fide purchaser test gives the trustee only such rights as are derived by a bona-fide purchaser's status as such, is consistent with the view that bona-fide purchaser as used in the Bankruptcy Act "is commonly, though not necessarily, used to designate a person who makes a bona-fide purchase and does nothing more." \textsuperscript{33}

The \textit{Klauder}\textsuperscript{34} case, the \textit{Vardaman}\textsuperscript{35} case and the \textit{Harvey}\textsuperscript{36} case, except for their instructional value in warning observers how the courts may approach the Bankruptcy Act, are now moot, since many States have solved the problem presented by passing validation or other statutes making it clear that the first assignee's rights are superior to those of the second assignee no matter what subsequent actions he has taken.\textsuperscript{37} In other States this had been true,\textsuperscript{38} so no amendment to the Bankruptcy Act was needed to solve the problem posed by the \textit{Klauder}\textsuperscript{39} case. However the \textit{Klauder} decision troubled the commercial community. If the Court would apply the language of the Act literally in the \textit{Klauder} situation, would it not do so also in the inventory, and therefore invalidate the Uniform Trusts Receipts Act, various factor's lien acts, and miscellaneous other devices providing for inventory security?\textsuperscript{40} In the

\begin{itemize}
\item \textsuperscript{30} Restatement of Contracts, supra n. 27.
\item \textsuperscript{31} Supra n. 28, at 1001.
\item \textsuperscript{32} Supra n. 28, at 1002.
\item \textsuperscript{33} McLaughlin, \textit{Defining a Preference in Bankruptcy}. 60 Harv. L. Rev. 233, 246-247 (1946). It is noteworthy that the author, unlike the \textit{Rosen Court}, supra n. 28 at 998, would not give the trustee the benefit of state laws providing that a second assignee who first gave notice would prevail over prior assignee. Id. at 246. This latter view seems preferable.
\item \textsuperscript{34} Supra n. 20.
\item \textsuperscript{35} Supra n. 26.
\item \textsuperscript{36} Supra n. 17.
\item \textsuperscript{37} See Countryman, supra n. 10, at 81.
\item \textsuperscript{38} Under the New York rule, id. at 79.
\item \textsuperscript{39} Supra n. 20. There was a third group of states (nine in number) which either followed the English rule applied in \textit{Klauder} or had no rule at all. Countryman, supra note 10, at 81-82. In these states safety for assignees awaited the 1950 Amendment to § 60(a) of the Bankruptcy Act.
\end{itemize}
writer's opinion the answer is no, but this opinion is not supported by Matter of Harvey Distributing Co., Inc.\textsuperscript{41} (reversed on appeal but still a cause for worry).\textsuperscript{42} That case involved the Harvey Corporation, which executed notes and trusts receipts in accordance with provisions of Chapter 147(b) of the Code of Virginia (Virginia's version of the Uniform Trusts Receipts Act). The notes were executed to Coin Machine Acceptance Corporations, the "Entruster."\textsuperscript{43} This security interest of the Entruster was duly filed with the secretary of the Commonwealth on March 28, 1948. Almost a year later, on March 4, 1949, an involuntary petition in bankruptcy was filed against Harvey, and on March 21, 1949, Harvey was adjudicated a bankrupt. The trustee attacked the lien obtained under the Trusts Receipts Act and relied upon the definition of transfer quoted above.\textsuperscript{44} Of course the Uniform Trusts Receipts Act provides that a buyer in the ordinary course of trade takes free of a filed trust receipt. The policy of the Act, as was noted earlier,\textsuperscript{45} is to protect the buyer whose purchase is essential if the Entruster is to receive repayment of his loan. The purpose of the bona-fide purchaser test in the Bankruptcy Act was entirely different, the striking down of secret liens. It seems perfectly clear that the "plain-meaning" rule has been ignored in too many instances by the Supreme Court and lower courts for anyone to seriously contend that the Federal District Court of the Eastern District of Virginia was bound to follow it.\textsuperscript{46} Certainly a determination by that

\textsuperscript{41} Supra n. 17.

\textsuperscript{42} This case was reversed on the basis of the retroactive 1950 amendment to the B. A. See Coin Machine Acceptance Corp. v. O'Donnell, supra n. 17. Although the reversing court said (dictum) that the case was wrongly decided on the basis of the Bankruptcy Act as amended in 1938, that dictum was not available to the commercial community prior to the 1950 amendment, and there is no assurance that it would have been followed by other courts. Certainly the Harvey Case was not calculated to give comfort to those who worried about the future of inventory financing.

\textsuperscript{43} "... person who ... takes a security interest in goods, documents or instruments under a trust receipt transaction. ..." U.T.R.A. § 1.

\textsuperscript{44} Supra n. 12.

\textsuperscript{45} See text accompanying n. 16 supra.

\textsuperscript{46} See McBoyle v. U.S., 283 U.S. 25 (1939); Coin Machine Acceptance Corp. v. McDonell, supra n. 17. For a more recent case see Bank of Marin v. England, 385 U.S. 99 (1966), where Justice Douglas wrote, "We do not read those statutory words with the ease of a computer." Id. 103. Mr. Justice Harlan, dissenting, could not escape the impact of what Congress had done. See also Gottlieb, The Logic of Choice (1969) 101 to 104 (1968). He writes:

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court that the Bankruptcy Act was not directed at this result would have been consistent with the legislative will. The reaction to this case was the amendment to the Bankruptcy Act which changed the bona-fide purchaser test to the bona-fide purchase test as far as real property is concerned and which substituted a lien creditor test for the bona-fide purchaser test with respect to personal property. The new provision protected the Uniform Trusts Receipts Act from the holding in the Harvey case, but at the price of bringing back the secret equitable lien. For although equitable liens may be defeated by a good faith purchase, they are generally not defeated by lien creditors, and Congress was forced to amend the Bankruptcy Act, adding § 60 (a) (6) which made voidable certain equitable liens, so-called "bad equitable liens." The Harvey case, though clearly overruled by the Statute, still has a cautionary effect. For in some of the current problems which will be discussed in this paper hyper-literalism could yield results contrary to the manifest will of both the state legislatures and the Congress of the United States. Some of the language of the Harvey case is instructive on this point. The Court admits:

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"A rule of guidance must be capable of guiding a choice before a decision is made. It must be possible for a judge to act on it. A rule of justification enables a judge to give such rule as a reason for his decision even though he did not rely on it in making his decision. Rules of guidance are also rules of justification, but it can be seen in the canons of interpretation that not all rules of justification are also rules of guidance." Id. at 103. In the context of the one plain meaning rule MacLachlan wrote: "The history of statutory construction from earliest times shows a dualism—the conflict between the letter and the spirit. For every decision and every canon of construction saying there is no room for construction when the statutory language is unambiguous and that it is for the legislature and not the court to review the wisdom of what the legislature has declared, there is another decision and another canon to the effect that what a statute really says is to be determined by considering the entire enactment in the light of its purpose and in view of the mischief to be remedied. The Chandler amendment sought to strike at secret liens, fictions of relation back and inequitable 'equitable liens.'" J. MacLachlan, Bankruptcy 301. (1956). See also Traynor, Trial 37, 39. (May 1969).

47 See Moore & Tone, supra n. 18.
49 Coin Machine Acceptance Corp. v. O'Donnell, supra n. 17.
50 A term used by Professor Gilmore to designate equitable liens made voidable by B.A. § 60(a) (6). See 2 G. Gilmore, Security Interests in Personal Property 1919 (1965).
51 Supra n. 17.
"At the time of the action of Congress the Uniform Trust Receipt Act was relatively new, and it is not unlikely that Coin Machine is correct in its contention that Congress did not contemplate situations arising under that Act which is in derogation of common law principles and a wide departure from such principles theretofor firmly embedded in the law of commerce." 52

However, the Court goes on to say:

"Not having become so perfected [protected against a buyer in the ordinary course of trade] under § 60 (a) of the Bankruptcy Act it [the security interest of Coin Machine] must be deemed to have been made immediately before the bankruptcy and therefore invalid. It is clear that if Congress had intended that such lien should be valid in bankruptcy, the italicized language of § 60 (a) would not have been used." 53

Congress, according to this analysis, by its use of the bona-fide purchaser test, exhibited an intent to strike down inventory financing and in the context of the Harvey decision exhibited an intent to make the Uniform Trusts Receipts Act a useless statute, since creditors who perfected their interest under the Act would be relegated to the status of general creditors. How the Court could have been so certain that that was the will of Congress is not apparent. An explanation can perhaps be found in the words of Professor Cook quoted above about the tenacity of the view that words used in different contexts have identical meaning regardless of their setting.

II. The Present Problem—The Bankruptcy Act and the U.C.C.

The question now to be considered is whether there is a conflict between the U.C.C.'s validation of the after-acquired property interest and the Bankruptcy Act as amended in 1950. The 1950 Amendment was designed:

52 Id. at 468.
53 Id.
54 Supra n. 18.
55 "In Sexton v. Kessler (1912) 225 U.S. 90, the Sup. Ct., under the language of the Bankruptcy Act prior to the 1938 amendment, recognized as valid a pledge of stocks and bonds consummated within the 4-month period, at a time when the pledgor was insolvent, because a promise to make a pledge had been made before the commencement of the 4-month period. The result was reached by the doctrine of 'relation back.'" H.R. Report No. 1293, August 22, 1949, 81st Cong. 2nd Sess. as published in U.S. Code, Cong. Serv- ice p. 1986 (1950). "Similarly, in Carey v. Donohue, 240 U.S. 430 (1916), the Supreme Court recognized as valid an unrecorded deed to real estate, on the ground that the applicable State statute did not make such a deed invalid as against judgment creditors. The Carey case, accordingly, became known as the 'pocket lien' case." Id.
"(A) To retain unimpaired the basic object of the 1938 Amendment, which eliminated the 'relation back' doctrine of Sexton v. Kessler, and the 'pocket lien' doctrine of Carey v. Donohue . . .;"\textsuperscript{55}

"(B) To eliminate the evil of allowing a trustee in bankruptcy to take the position of a potential and artificial bona fide purchaser, and to restore him to the position of a lien creditor in harmony with his functions under the Bankruptcy Act; and

"(C) In effectuation of said policy to provide that no transfer made in good faith, for a new present consideration, shall constitute a preference to the extent of such consideration actually advanced, if the provisions of applicable State law governing the perfection of such transfer are complied with, with an appropriately rigid time limitation (21 days) for such perfection if such limitation is not itself described by the applicable State law."\textsuperscript{56}

This problem is most often met when the collateral under consideration is inventory or accounts receivable. Inventory and accounts receivable financing obviously involves taking security interests in future property. Although a balance sheet may show inventory as being constant, perhaps a hundred thousand dollars in any given month of the year; or, more probably, fluctuating up and down depending on sales; the individual components of the inventory valued in the balance sheet are continually changing. The same is true of accounts receivable. Individual accounts are paid off; other accounts are substituted. A business analyst doing a funds flow study may ignore the individual components. The increase of accounts receivable is a use of funds; the decrease is a source of funds. The same is true of inventory and, indeed, any other item on the asset side of a balance sheet. Difficulty, however, arises in bankruptcy, because in actuality there are or may be a succession of transfers. Take a situation where a security interest is perfected in January, 1969, in accounts receivable or in inventory. On December 31, 1969, the debtor goes into bankruptcy. The balance sheet from month to month may show inventory and accounts receivable as fairly stable. But as trouble approaches, these accounts will in most instances decline, since receivables and inventory tend to vary directly with sales volume according to various formulae. Let us assume that the items are fairly constant from January until August and then there is a gradual decline up un-

til December 31, when a petition in Bankruptcy is filed. It is clear from a reading of the Uniform Commercial Code that the Code gives a security interest in the components of inventory received by the debtor after January 15 and up to December 31. The same is true of individual accounts which come into existence during this period. Section 9-204(3) declares: "Except as provided in subsection (4) a security agreement may provide that the collateral, whenever acquired, shall secure all obligations covered by the security agreement." The Code provides in § 9-108 when after-acquired collateral is not security for an antecedent debt. The intent of the Code draftsmen is clear. The security interest in after-acquired property should not be vulnerable. The history which we have recounted of the 1938 and the 1950 Amendments of the Bankruptcy Act demonstrates no hostility toward publicized security interests. If the policy of the Code is in favor of the validity of the security interest in after acquired property and there is nothing in the policy of the Bankruptcy Act which overrides the Code, it seems that the solution of the problem of reconciling these two Acts should be a simple one. Unhappily, it is not. The courts have wrestled with the problem, and the Supreme Court has denied certiorari.

The courts have acted favorably to the Code. Hostility remains. Some hostility can be explained on the basis of the language of the Code. Some runs deeper. Although reversed by the courts, the opinion of Referee Snedecor is still persuasive, and some of its language is worth considering at this point:

"[Under the Uniform Commercial Code] a merchant by a simple signed agreement, regardless of form, may create a general floating lien for present and future advances on

57 See Official Comments to § 9-108.

58 The problem of the vulnerability of some of those non possessory security interests which may be perfected without filing under § 9-302 will be discussed later (footnote 142 infra).


60 Supra n. 59.

inventory and accounts receivable including future acquisitions. With such an agreement in existence the secured party may leave the merchant in complete control of his business and funds and yet be protected against the claims of other creditors, except purchase money security interests, by filing with the Secretary of State and the County Clerk a financing statement. Such a statement "is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral." (UCC 9-402 (1).) There is no requirement that it contain any information concerning the limit of the credit to be extended, the amounts advanced or to be advanced or the terms of payment. All such information must be obtained from the secured party. The desired information may vary from day to day according to advances made. So that the information obtained one day may not serve as a criterion for credit a few days or weeks later. There seems to be no requirement that the secured party furnish the desired information in writing. Oral information would be of little value to an inquiring creditor who may have in contemplation the extension of credit to the debtor on a secured or unsecured basis."

Later in his opinion Referee Snedecor writes:

"The old-fashioned method of operating a business on the strength of equity capital and unsecured bank credit based upon the financial integrity of the debtor seems to be giving way to the modern trend of financing business operations in reliance upon a floating lien on current assets with little or no regard for equity capital. Added to this is the more recent development of leasing, instead of owning, plant and equipment. These methods leave the daily suppliers and employees in a perilous position."

Even the Official Comment expresses doubt regarding the desirability of Code policy:

The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors a cushion of free assets should be preserved. That inarticulate premise has much to recommend it. This Article decisively rejects it not on the ground that it was wrong in policy but on the ground that it has not been effective. In the past fifty years there has been
a multiplication of security devices designed to avoid the policy: field warehousing, trust receipts, factor's lien acts and so on. The cushion of free assets has not been preserved. In almost every state it is now possible for the borrower to give a lien on everything he has or will have. There have no doubt been sufficient economic reasons for the change. This Article, in expressly validating the floating charge, merely recognizes an existing state of things. The substantive rules of law set forth in the balance of the Article are designed to achieve the protection of the debtor and the equitable resolution of the conflicting claims of creditors which the old rules no longer give.\(^6\) (Emphasis added.)

It is not surprising that opponents of the Code seize upon every possible argument to invalidate the "floating lien" under the Bankruptcy Act. And even those who feel the policy of the U.C.C. can be reconciled with the Bankruptcy Act find difficulty in the language of the U.C.C.

Lawrence P. King, Editor in Chief—Revisions of Collier on Bankruptcy (the leading treatise on bankruptcy), writes:

"§ 9-303 [U.C.C.] says that there can be no perfection until the security interest attaches. In view of this clear statutory mandate, how can considerations of policy be relevant?"\(^6\)

The difficulty is suggested by the language of § 9-303(1) that "[a] security interest is perfected when it has attached and when all the applicable steps required for perfection have been taken." Ordinarily all but one step will have been taken when an interest in after-acquired accounts receivable or after-acquired inventory is granted. But the one step that the secured party may not have control over is attachment. Section 9-204(1) provides: "A security interest cannot attach until there is agreement . . . that it attach and value is given and the debtor has rights in the collateral." If, in our hypothetical case, we take the position that the debtor obtained rights in the collateral as each component of inventory was received from January until December, and as each account came into existence,\(^6\) it could be argued that there was not one perfection in January but a series of perfections,

\(^{62}\) U.C.C. § 9-204 Official Comment 3.


\(^{64}\) § 9-204(2)(d).
some of which took place within the dangerous four months before bankruptcy. Assume that in January the secured party extended $100,000 secured by inventory or accounts receivable, and that the pay-back schedule required that $10,000 per year be paid commencing in January, 1970. It is clear that, if a transfer within the meaning of the Bankruptcy Act, was made on or after August 31, it was both a transfer for an antecedent debt and a transfer within four months before bankruptcy. Assuming insolvency of the debtor at the time of the transfer and reasonable cause to believe that the debtor was insolvent, the transaction is vulnerable. The other elements of a preference would certainly be present and must be assumed by a planner setting up a security arrangement. A great deal of the concern about the vulnerability of the security interest in after-acquired property is felt by draftsmen—"office practitioners"—who set up the transactions. They must assume the worst in order to give an unqualified opinion that the security interest is good. They must assume that if the transfer is deemed to take place within four months of bankruptcy, then the other elements will be present and the security interest will be vulnerable. In order for them to feel safe they must get assurance that the transfer took place in January (or at least no later than August 30). Various theories have been put forward to support a January transfer. The so-called entity theory looks upon the inventory as a single unit and the accounts receivable as a single unit. Thus there is only one transfer, the transfer of the entity in January. No transfer takes place as the components of that inventory or account receivable entity change. The substitution-of-collateral theory relies on the doctrine that if collateral is replaced by other collateral, of an equal or a greater value, prior to the release of the old security, there is no preference. Section 9-108 is accepted by the Rosenberg v. Rutnick court as a definition of antecedent debt and thus saves a security interest. Probably the best approach is the "so far perfected test." According to this test, it matters not when there is perfection under the U.C.C. For the Bankruptcy Act does not require full perfection but "deems that a transfer is made when it becomes so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." (Emphasis supplied)

65 Supra n. 59.
66 B.A. 60(a) (2).
According to this test, even though under the Code, security interests were perfected in different components of inventory throughout the entire year from January until December, a transfer within the meaning of the Bankruptcy Act took place only once, in January. The other tests have received sufficient commentary to warrant excluding them from this article. However, there are three questions relating to the “so far perfected test” which will be discussed.

1. In January was the future inventory or the future accounts receivable “property” within the meaning of the Uniform Commercial Code?

2. Were these future assets “property” within the meaning of the Bankruptcy Act?

3. Assuming the answer is yes to both questions above, could any subsequent lien, that is, a lien obtained subsequent to the grant of a security interest in the after-acquired property, become superior to the rights of the transferee?

If the first two of the above three questions are answered in the affirmative, and the third in the negative, then the transfer is deemed to have taken place in January according to the language of the Bankruptcy Act §60(a)(2), and the after-acquired property interest is safe, provided that it successfully runs the hurdle of Bankruptcy Act §60(a)(6). If it is found that a security interest in future property is a “bad equitable lien” under Bankruptcy Act 60(a)(6), then the transfer of future property is not perfected within the meaning of B.A. 60(a)(2).

III. The Property Interest

Assume that in January, 1969, all of the requirements of §9-303(1) were met, with the possible exception of the attachment requirement that the debtor have rights in the collateral. This assumption suggests that in January legal machinery was set in motion, so that under state law no subsequent lien creditor on a simple contract could ever obtain rights superior to the transferee (secured party). Does it necessarily follow that a transfer was deemed made in January and that consequently no transfer took place within the four months preceding bankruptcy? Professor Gordon writes that in fixing the crucial time of transfer two questions must be asked: (1) “Has a transfer of any of the debtor’s property taken place?” and (2) “If and only
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if, such a transfer has taken place, has it been sufficiently perfected as against lien creditors or bona fide purchasers?" 67 His opinion that a transfer must be a transfer of property is supported by the language of the Bankruptcy Act. Section 60(a)(2) of the Act, in adopting the lien creditor test, speaks of a "transfer of property other than real property," and in adopting the bona fide purchase test, a "transfer of real property." Further, the definition of "transfer" in Bankruptcy Act § 1(30) talks in terms of a disposition of property or an "interest therein."

The Uniform Commercial Code also talks in terms of property. Section 9-204 provides that the debtor must have rights in the collateral before a security interest can attach. U.C.C. § 9-105 (c) defines collateral as "property subject to a security interest. . . ." Section 1-201(37) defines a security interest "as an interest in personal property or fixtures which secures payment or performance of an obligation. . . ." Assuming that, in our hypothetical case, the debtor obtained rights in Widget #1007 in December, how is it possible to say that a property interest existed in January, so that one can say that the only transfer that took place was the January transfer? If one looks at the inventory or accounts as an entity, the answer is clear. If, on the other hand, one looks at inventory in the aggregate, then no interest accrued in Widget #1007 until December. It is here that Gordon finds the Achilles' heel,68 and argues that no property transfer occurred in January with respect to Widget #1007. Before considering Professor Gordon's arguments, which are based on the federal component of the definition of property, let us first examine whether there was a security interest transferred in January under the Uniform Commercial Code.

One approach is to say that when the secured party in January acquired an interest in the future property called Widget #1007, he obtained a present right in a general intangible, the proceeds of which general intangible was Widget #1007. If this approach is correct, then under § 9-306 (3) the security in Widget #1007 is "a continuously perfected security interest," since "the interest in the original collateral was perfected." To determine whether future property is a species of property, we turn to § 9-204. Section 9-204 (3) provides that "a security agree-

68 Id. at 1188-1191.
ment may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.” This language, though perhaps ambiguous, suggests that the future property may presently secure obligations. This interpretation is buttressed by official comment two to § 9-204, which provides: “The security interest in after-acquired property is not merely an ‘equitable’ interest.” The implication is clear that an interest in after-acquired property is a present legal interest.69 Professor Gilmore, speaking in another context, supports this view. He states that “[u]nder Article 9 the future earnings or receivables of an enterprise can, and on the whole should be, considered as a presently existing aggregate or entity.” He adds, “What we have said about a debtor’s future receivables would seem to apply with equal force to a debtor’s future inventory.” He argues there is nothing in Article 9 inconsistent with the idea that “earnings under future contracts are presently existing ‘general intangibles.’” 70

One embarrassment in regarding future property as a presently existing general intangible is that the 1952 official draft of the Uniform Commercial Code contained no category for general intangibles.71 The Enlarged Editorial Board for Amendment of Text of the U.C.C. in 1954 proposed the addition of the classification “general intangible” to § 9-106 because:

“The term ‘general intangibles’ brings under this Article miscellaneous types of contractual rights and other personal property which are used or may become customarily used as commercial security. Examples are good will, literary rights and rights to performance. Other examples are copyrights, trademarks and patents to the extent that they are not regulated by statutes of the United States (See Section 9-104(a)). This Article solves the problems of filing of security interests in these types of intangibles (Sections 9-103 (2) and 9-401(1) (d)). It should be noted that this catchall definition does not apply to types of intangibles which are specifically excluded from the coverage of Article 9 (Section 9-104).” 72

69 For a general discussion of the civil law device, a “mortgage on an estate to come” and its common law acceptance, see Cohen and Gerber, The After-acquired Property Clause, 87 U. Pa. L. Rev. 635 (1939).
72 Supplement No. 1 to the 1952 Official Draft of Text and Comments of the Uniform Commercial Code, as amended by action of the American Law Institute and the National Conference of Commissioners on Uniform State Laws at their respective meetings in 1954, p. 64.
The recommended definition of general intangibles was accepted, but the embarrassment springs from two factors. One, if the Code drafters had intended that future property is a presently existing general intangible, why did they not so provide in the 1952 and earlier drafts? And, two, if the amendment proposed in 1954 was intended to include, in the category of general intangibles, future property, why did not the comments so state? Surely, the problem of the after-acquired property clause and the Bankruptcy Act was of sufficient importance that the problem should have been mentioned, if it in fact was dealt with. Its omission somewhat weakens the argument we have been supporting but hardly destroys it.

One argument in favor of including, in the definition of general intangible, future property is what may be called the validation argument. The U.C.C. drafters clearly intended (see § 9-108 and comments thereto) that after-acquired property should be invulnerable to attack in bankruptcy.\(^7\) Courts faced with an interpretation of the Code should, where two possible interpretations are possible, so interpret the Code as to effectuate its clear intent.\(^7\) Unhappily this argument, whatever its worth, cannot be applied to the definition of property in the Bankruptcy Act, to which we now turn.

**IV. Federal Property Definition**

According to Collier,\(^7\) "(A) s a general proposition it has been tersely stated that 'a transfer of property within the meaning of the bankruptcy law includes the giving or conveying of anything of value which has debt-paying or debt-securing power.'" This definition is found in *Pirie v. Chicago Title & Trust Co.*,\(^7\) a case concerned with the question whether money is property within the meaning of the Bankruptcy Act. The *Pirie* case made it clear that the definition of property is a broad

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\(^7\) Section 9-108 serves two functions. It provides a technical justification which the courts may or may not accept. Further it makes pellucid Code policy: "In any event, even if the definition adopted by § 9-108 is not accepted, the section clearly shows that the intent of the Uniform Commercial Code is that a transfer such as the one involved here should not be considered a preferential one, and the Code's provisions as to perfection and attachment of security interests should not be interpreted to produce a different result." *Rosenberg v. Rudnick*, *supra* n. 59, at 639. See also § 1-102(1).

\(^7\) Id.

\(^7\) *Collier on Bankruptcy, 14th Ed.,* para. 60.07, p. 791 (14th ed. 1969).

\(^7\) 182 U.S. 438 (1901).
one, broad enough, it is submitted, to cover after acquired property. Gordon writes:

"[T]rue, the Act does not define 'property,' and the author has found no federal case holding that a state-recognized lien in after-acquired property is not a 'transfer of any of the property of the debtor' within the meaning of Section 60. In fact, the earlier equitable lien cases seemed to have assumed that it is a transfer."

Gordon continues however that Local Loan Co. v. Hunt is authority for holding that future property is not presently property within the meaning of the Bankruptcy Act. His reliance on Local Loan Co. v. Hunt is misplaced. In that case respondent borrowed from petitioner the sum of $300 and executed an assignment of a portion of his wages thereafter to be earned. Under the law of Illinois, the assignment of future wages constituted an enforceable lien. This view of the Supreme Court of Illinois was a minority view, but the contention was made that even though the general view be otherwise, the Supreme Court is bound to follow the Illinois view, "since the question of the existence of a lien depends upon Illinois law." The Supreme Court disagreed with this contention. It pointed out that the Bankruptcy Act is paramount and that the purpose of that Act is to "relieve the honest debtor from the weight of oppressive indebtedness and to permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." The Court said:

"The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty, quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern." (Emphasis supplied.)

Pauperism is seen by the Court as an outcome of the Illinois rule. The Court concludes:

"Confining our determination to the case in hand and leaving prospective liens upon other forms of acquisitions to be dealt with as they may rise, we reject the Illinois de-

76 Gordon, supra, n. 62, at 1190.
77 292 U.S. 234 (1934).
78 Id. at 244.
79 Id.
80 Id. at 245.
The action by the Supreme Court clearly shows that under certain circumstances, the definition of property will be determined not only by what states denominate as property but also by a federal element. Exactly when that federal element will be injected is difficult to judge. However, Local Loan does not stand for the proposition that future inventory and future accounts receivable are not present property within the meaning of the federal Bankruptcy Act. A U.C.C. case closer to Local Loan would be made if the secured party were claiming an interest in inventory received by the debtor after the date of the petition. Here, the fresh start argument would have some meaning, although the court in the last quoted sentence expressly refused to decide whether it would extend the fresh-start argument beyond the question of future wages. Certainly, the arguments about pauperism and the argument that we are concerned more with liberty than property rights is ill suited for application to the inventory and accounts receivable situation. Even if we accept the worst, that future inventory and future accounts receivable are to be treated the same as future wages, the decision is clearly distinguishable. Wages earned in the four months preceding bankruptcy were not considered by the court. The language of the opinion suggests that the Illinois law would have been respected with regard to these wages. In the Code problem with the Bankruptcy Act, we are not concerned with inventory and accounts receivable generated after the petition in bankruptcy has been filed, but with those in which the debtor acquires rights during the four months prior to bankruptcy. There is nothing in Local Loan Co. v. Hunt which compels an interpretation of the Bankruptcy Act which would invalidate the floating lien.

The Local Loan case does stand for the proposition that there is a federal component to the definition of property, which component is derived from the overall purpose of the Bankruptcy Act. Professor Gilmore points out:

"Federal law is generally interstitial in its nature. This is the most familiar example of the 'interstitial' character of federal law."

81 Id.

of federal law is the Bankruptcy Act. In general Congress has chosen to do no more than provide a mechanism for the distribution of assets of insolvent estates, leaving to the background of state law the determination of the validity of property rights and other claims to the assets.”

According to Professor Corbin “the term ‘property’ is an abused term, seldom defined or subjected to careful analysis, and nearly always used to obtain some desired end with variable underlying assumptions that are not expressed.” It is submitted that if, on the basis of the policy of the Bankruptcy Act, the Supreme Court should decide that after-acquired property interests should be voidable in bankruptcy, a statement that future property is not property would adequately describe its result. Such a statement, however, would clearly enunciate a rule of justification, not a rule of guidance. Neither Local Loan nor any other case warrants the inference that the amorphous word “property” must be construed to strike down the U.C.C. interest in after-acquired property.

V. Termination of Vulnerability to Creditor Who Obtains Lien on a Simple Contract

For purposes of the Uniform Commercial Code a critical question, with respect to the after-acquired property clause, is the timing of the transfer. The timing of the transfer is a matter of federal law, but the federal formula incorporates as one of its elements non-bankruptcy (in most cases, state) rules of priority. The Code may not be able to affect the time of the transfer by its definition of antecedent debt (§ 9-108) nor by its definition of perfection, but it is clearly within the province of the state legislature to determine priorities between lien creditors and secured parties. If, under Code priority rules, no subsequent lien could become superior to the interest of the secured party, then a transfer is deemed made under B.A. 60(a) (2). Unlike the problem encountered in defining property supra, which has

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84 A. Corbin, Corbin on Contracts 791. (Student ed. 1952.)
86 Bankruptcy Act, § 60(a) (2) 11 U.S.C. § 96(a) (2).
87 “The term ‘state law’ is frequently used as more concrete than ‘applicable law’ and less awkward than ‘non-bankruptcy law.’” J. MacLachlan, Bankruptcy 297 (1956). The U.C.C. has been adopted in 49 states, the Virgin Islands, and the District of Columbia.
a federal element, this aspect of the after-acquired property problem is exclusively within the control of the legislative bodies adopting the Uniform Commercial Code.

The Code rules of priority are stated in § 9-312 and other sections to which § 9-312 refers. The only section referred to which deals with the conflict between lien creditors and security interests is § 9-301, which provides that: "(1) . . . an unperfected security interest is subordinate to the rights of . . . (b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected." (Emphasis supplied.) This subsection is an exception to U.C.C. § 9-201, which reads: "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 [lien] creditors." (Emphasis supplied.) Sections 9-301 and 9-201, supported by the official comments to § 9-201, mean that one must obtain a lien prior to perfection of a security interest in order to gain rights equal or superior to the secured party. For if one obtains a lien subsequent to perfection, or simultaneously therewith, the exception of § 9-301 does not apply, and absent this exception a security interest is "effective" against lien creditors under § 9-201. Can we be sanguine about this solution, or does complexity lurk beneath this simple facade? Would it have been better if the Code had provided explicit priority rules in situations covering the after-acquired property security interest? It might have provided, borrowing some language of § 9-108, the following:

"Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral [shall have priority over subsequent liens upon such collateral obtained by legal or equitable proceedings on a simple contract] if the debtor acquires his rights in such collateral either in the ordinary course of

88 "‘Creditor’ includes a . . . a lien creditor. . . ." U.C.C. § 1-201(12).

89 "In general the security agreement is effective between the parties; it is likewise effective against third parties. Exceptions to this general rule arise where there is a specific provision in any Article of this Act, for example, where Article 1 invalidates a disclaimer of the obligations of good faith, etc. (Section 1-102(3)), or this Article subordinates the security interest because it has not been perfected (Section 9-301) or for other reasons (see Section 9-312 on priorities) or defeats the security interest where certain types of claimants are involved (for example Section 9-307 on buyers of goods)." (Emphasis added) Comment to § 9-201.
his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

Such a provision would have forestalled various objections. For example, Professor King, in addressing himself to the instant problem, writes that its solution under the "so far perfected test" of B.A. 60 (a) (2) "rests on the assumption that the security interest attaches automatically and before the judgment lien does. In fact, both attach simultaneously, so the answer is not that clear." \(^\text{90}\) (Emphasis supplied.) He continues that "Both Professor Gilmore and Mr. Coogan see problems in the area of intangible financing on this very issue and they conclude that neither the Code nor the non-Code state law provides the priority answers." \(^\text{91}\) Professor Gilmore observes, "On general principles it seems that the levy, attachment, garnishment or what not has nothing to bite on until the moment when the fund comes into existence and at that moment the security interest automatically attaches and becomes perfected." \(^\text{92}\) He adds, however, a cautionary note: "But the law of judgment liens is a largely unexplored jungle and general principles may not guarantee a safe passage." \(^\text{93}\) Mr. Coogan also addresses himself to this problem. \(^\text{94}\) Mr. Coogan speaks to the situation where the judgment creditor's interest and the secured party's interest attach simultaneously when an account arises. He states that "[n]o priority rule in the Code or CPLR [the New York Civil Practice Law and Rules] specifically governs this situation." \(^\text{95}\)

We return now to our hypothetical case, where the security interest was perfected in January. In order to avoid the stigma of antecedent debt, a transfer should be deemed made simultaneously with the extension of credit, which was extended, let us say, on January 15. Under the test of § 60 (a) (2) the question is whether any subsequent lien obtainable on a simple contract could become superior to the rights of the transferee. The word "subsequent" refers to a lien obtained subsequent to January 15,


\(^\text{91}\) Id.


\(^\text{93}\) Id.

\(^\text{94}\) Coogan, Intangibles as Collateral under the Uniform Commercial Code, 77 Harv. L. Rev. 997, 1006 et seq. (1964).

\(^\text{95}\) Id. at 1016.
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when the original transaction was consummated. There are three possibilities: first a lien which is obtained subsequent to perfection, second a lien which is obtained simultaneously with perfection and third a lien obtained prior to perfection (this may be wholly a theoretical construct, since it is difficult to see how a creditor of the debtor could obtain a lien on the collateral prior to the time that the debtor obtained "rights in the collateral").

At this point, we must examine our temporal reference point, the time when the debtor gets rights in the collateral under § 9-204. This is not as clear as its enunciation might suggest. Ambiguity is injected by the difficulty of identifying collateral. Are we talking about the particular account or the particular component of inventory when we speak of the collateral? Or are we speaking about the property interest classified as a general intangible in the future inventory or the future accounts? Resolution of this problem obviously has a bearing on the priority rules, for the property interest in the general intangible—future property—will be acquired simultaneously with the extension of credit, and the only subsequent lien creditor who could attack the transaction would be one in the first of our three indicated possibilities (supra, preceding paragraph) namely, a lien creditor who obtained his lien after perfection. It would seem on the basis of common sense that such creditor clearly would lose out to the secured party. If a perfected security interest were subject under the Code to the rights of a general creditor who attached or garnished, who obtained a judgment and levied execution, etc., then Article 9 of the U.C.C. would not be worth the paper it is written on. However, even with regard to this problem, which is probably the simplest of the priority problems between the secured creditor and a lien creditor, two courts have had difficulty arriving at a result. Neither court found any explicit solution in the Code. Both arrived at their result (favoring the secured party) by negative inference and in each case the negative inference was based on a different premise. Before examining the two cases it might

96 A further difficulty is generated by the difficulty of timing, once collateral has been identified. See Hogan, Future Goods, Floating Liens and Foolish Creditors, 17 Stan. L. Rev. 822 (1965). With respect to inventory, it may be "identification" under § 2-501, passage of title, or the debtor obtaining possession. Id. Regarding accounts, the Code is explicit. No security interest attaches until the account comes into existence. § 9-204(1) and (2)(d).

97 Rosenberg v. Rudnick, supra n. 59; Grain Merchants of Indiana v. The Union Bank & Savings Co., supra n. 59.
be well to consider a provision that was found in earlier drafts of the Uniform Commercial Code, but has disappeared by the time the 1952 draft appeared.

Section 1-102.1 had provided: "Where a section is silent on a particular point, negative inference may be justified when the reason of the situation requires or justifies such inference." The deletion of this section from the Code, it is submitted, adds nothing to the way the Code will be interpreted. Obviously a negative inference may always be drawn where appropriate. The difficult question is, when is it appropriate? Layman Allen points out that one of the most commonly overlooked ambiguities in legal drafting is "whether the connection between two elements of a statement is intended to be or implication [if A, then B] or a co-implication [if and only if A, then B]." Since our choice, where this ambiguity is present, is between two distinct major premises, the rationale of a case must go beyond the mere statement that a negative inference was intended. Reason, policy and purpose must be consulted. To say that sometimes a listing in a statute or other legal document is exhaustive (exclusive) and that sometimes it is not (i.e., is inclusive) is but to state the obvious. To decide, on the basis of a conclusion that inclusiveness or exclusiveness was intended, is but to state a result, while the reason for the decision remains inarticulate and perhaps unconscious. We return now to the two cases previously mentioned.

In Grain Merchants the Court looked to the U.C.C. and not to the non-Code debt collection law to determine priorities. The court stated that "the Code does not explicitly resolve this problem" but that "we are persuaded by virtue of § 9-301 (1) (d) taken in conjunction with § 9-204 (3) that a secured creditor who has duly filed a financing statement covering after-acquired collateral is entitled to priority over a subsequent lien creditor"

99 "You always can imply a condition in a contract. But why do you imply it?" Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 466 (1897).
101 Supra n. 97.
seeking to levy on the same property." 103 The court added: "(A) s soon as an account receivable comes into existence and is sought to be attached by a lien creditor, it has already become subject to a perfected security interest—here that of the bank. The very occurrence which gives rise to the full perfection of the security interest prevents the subsequent lien creditor from obtaining a priority as to the property." 104 (emphasis supplied). The court here was talking about priority only as between the secured party and a lien creditor who obtains his lien subsequent to full protection in the individual account under the Code. 105 The Court did not address itself to the question of priorities between a lien creditor whose lien was obtained simultaneously with the bank’s obtaining rights in the collateral, which rights were obtained, according to the court, when the accounts receivable came into existence. 106

The opinion is to be lauded in that it looks to the Code to decide the priority question. Allowing non-Code law to be controlling would destroy uniformity, which is one of the central policies of the Code. 107 The Court is to be faulted, however, for relying on § 9-301 (1) (d) when 9-301 (1) (b) is the applicable section; and for suggesting that the Code rule is not explicitly stated, despite the fact that under § 9-201 a perfected security interest is effective against lien creditors. Section 9-201 does not speak in terms of priorities, but it is difficult to find a meaning for the word “effective” if a subsequent lien “obtainable by legal or equitable proceeding on a simple contract could become superior to the rights of [the secured party].” 108

In Rosenberg v. Rudnick, 109 the defendant, Rudnick, made a loan to Boyle Sundries Inc. in the amount of $110,000 on April 30, 1962. By a security agreement executed in connection with

103 Id. at 213.
104 Id.
105 In Grain Merchants, supra n. 102, the Permanent Editorial Board for the Uniform Commercial Code sought to link accounts receivable and inventory. The security interest in the inventory was perfected prior to Sept. 20, and hence was invulnerable to a preference attack. The Permanent Editorial Board’s contention, that the accounts billed after Sept. 20, 1966 were proceeds of inventory was not considered, since it had not been raised in the district court.
106 See § 9-303 (1), 9-204 (1), 9-204 (2) (d).
107 U.C.C. § 1-102 (2) (c).
108 B.A. § 60 (a) (2).
109 Supra n. 59.
the loan, Boyle gave to Rudnick "... a security interest in all the equipment, machinery, fixtures, inventory and accounts receivable of the debtor, together with all additions thereto and all property now or hereafter substituted therefor or otherwise acquired in the ordinary course of business." 110 On the issue of priorities between the holder of this security interest and lien creditors, the Court stated that perfection under state law (applicable non-bankruptcy law) need not be full perfection but only perfection "so far as is necessary to meet the test of § 60(a)(2)."

"While the Massachusetts law may not regard a security interest in after-acquired inventory as fully perfected until it attaches to items as they are acquired by the debtor, nevertheless § 9-204(3) recognizes that a lien in such inventory items can be validly created by a security agreement. Such a lien, after proper compliance with the filing provisions, is superior to all subsequently acquired contract creditor's liens or other claims of third parties except the rights of buyers in the ordinary course of business under § 9-307(1) and holders of perfected purchase money security interest under § 9-312(3). In this case the security interest was created by the execution of the security agreement on April 30, 1962 and the subsequent compliance with the filing provisions. As of that date the security interest met with the requirements of § 60(a)(2) and the transfer must be regarded as having taken place on that date." 110a

It should be noted that the temporal reference used by the court in talking about subsequent lien creditors is not the date of full perfection but the date when the security interest was created by the execution of the security agreement. 111 It is not clear why the Court, in reaching this decision, did not rely on U.C.C. § 9-201. The Court seems to be saying that since §§ 9-307(1) and 9-312(3) are the exclusive sections which allow defeat of a

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110 Id. at 636.

110a Id. at 638.

111 Under B.A. § 60(a)(7) a transfer is deemed made when the actual transfer is made if filing is accomplished within 21 days (or less if required by state law, i.e. 10 days re purchase money security interest, § 9-301(2)). Thus if a security interest is granted on January 15 and credit is simultaneously extended, the transfer is deemed made on January 15 even though the security interest is not made invulnerable against lien creditors for a period of up to 21 days. If the 21 days, or shorter applicable period, before a necessary filing (or other necessary overt act), is exceeded, then the "deemed made" provision of § 60(a)(2) is applicable, there is a transfer for an antecedent debt, and the security interest is vulnerable, if bankruptcy occurs within four months of the overt act.
perfected security interest, therefore, by implication, a lien creditor not included in either of these sections must be subordinate. The writer has earlier noted his objections to this type of reasoning.

It should also be noted that the Court did not address itself to the "linked" collateral solution of the priority problem. This solution is best studied in a concrete situation. Assume a security interest is perfected on January 15, 1969, in present and future accounts, and account No. 113 comes into existence on December 15, within four months of bankruptcy (petition is filed December 31). What are the relative rights of the secured party and a creditor who obtained his lien upon a simple contract on December 15, simultaneously with the accounts birth? If the perfected security interest in the account is dated from December 15, then the lien and the security interest arose simultaneously. If such a simultaneously-arising lien is superior to the rights of the secured party, then perfection is deemed postponed, under B.A. 60(a)(2), until after the birth of the account. In this context the question of the simultaneous perfection priority problem is important. Another approach may be taken, however. The account, No. 113, can be treated as proceeds of its antecedents. Its most remote antecedent is the general intangible, future accounts, which arose on January 15. Under § 9-306(3) a security interest in proceeds is "...a continuously perfected security interest if the interest in the original collateral was perfected...." Thus we may date the security interest in account No. 113 back to January 15. So dated, it would be superior to the lien obtained in December. So dated, we need not be concerned about simultaneous perfection, because under B.A. 60(a)(2) the federal formula only speaks of subsequent liens. It is possible to link collateral but not date the security interest back to its most remote antecedent. For example, the linking argued for in Grain Merchants extended back only to inventory.112 And linking may be rejected, so we turn now to the question of the priority of a secured party whose security was perfected simultaneously with a competing lien upon a simple contract.

Sections 9-201 and 9-301(1)(b) in the writer's opinion give priority to the secured party, but a reading of the literature con-

112 Supra n. 105.
continues to inject a nagging doubt. Prior to the adoption of the U.C.C., the solution to priority problems was less clear than it now appears. A search of the digests for a case where mortgages or other consensual security interests arose simultaneously with the interest of a lien creditor upon a simple contract has proven frustrating. In the United States, many jurisdictions follow the rule that “delivery of a writ of execution to the sheriff creates a lien on the judgment debtor’s chattels within the officer’s bailiwick... A growing number of states defer the creation of a lien until an actual levy...” In the latter states, in order for there to be a simultaneous perfection, the creditor competing with the secured party would have to levy on the goods simultaneously with the secured party’s acquisition of rights in the collateral. Such a feat is indeed deft, even for our hypothetical lien creditor, for although the Bankruptcy Act gives the trustee the benefit of state law under any conceivable set of facts, it is somewhat difficult to conceive of a fact situation in the “levy” states where the liens will arise simultaneously. It is less improbable to have simultaneously-arising liens in those states where the delivery of the writ of execution to the sheriff determines the time of the lien. Munson v. Commercial State Bank is such a case. The writ of execution was delivered to the sheriff on June 2, 1926, at 4:30 P.M. A chattel mortgage was filed for record on the same date at 4:30 P.M. Here there was the simultaneous arising of a lien and a mortgage and on a trial of right, it was held that the burden is upon the claimant, that is, the chattel mortgagee, to prove his right to the property. Since he failed to show a superior right, he failed. Under this case, a lien creditor did in fact get rights superior to the chattel mortgagee. Under the Uniform Commercial Code this could not happen. Regardless of whether one is in a “levy” state or a state where the issuance of the writ determines the time of the lien, or in some other state, the secured party would have rights superior to the lien creditor, since under U.C.C. § 9-201 his security interest is effective against lien creditors. This language is sufficiently clear to solve the concurrent lien problem;

114 S. _Riesenfeld, Creditors' Remedies and Debtors' Protection 100, 101 (1967).
115 246 Ill. App. 369 (1927).
116 See Riesenfeld, supra n. 114.
and if any doubt exists, resort to policy confirms this interpreta-
tion, since a different interpretation would imperil the after-
acquired property security interest, an interest which the Code
clearly seeks to preserve. We turn now to the theoretical con-
struct, possibility three (supra p. 117).

Some statutes bind the debtor's property from the time the
writ of execution is delivered to the sheriff. Suppose a security
interest is granted in future property on January 15, a writ of
execution is issued on June 1, and the debtor gets rights in the
property on June 9. The sheriff levies on June 9 after, or pos-
sibly simultaneously with the debtor's obtaining rights in the
property. Statutes provide that when possession is taken there
is a relation back to the time when the writ of execution was
delivered to the sheriff. Thus the lien under the execution writ
would date from June 1, while the lien under the after-acquired
property clause would date from June 9. Two approaches may
be taken in dealing with this problem. If one assumes that the
collateral levied upon constitutes proceeds of the general in-
tangible—future property—in which a security agreement was
perfected prior to June 1, then the secured party has priority
over the execution lien, since under § 9-306 (3) "[a] security in-
terest in proceeds is a continuously perfected security interest."
If the proceeds argument is rejected, it might be possible to argue
that the lien obtained upon a simple contract is superior. This
would be a disastrous result under B.A. 60 (a) (2), and an inter-
pretation that seems unreasonable, since there should be no re-
lation back to a time before the debtor obtained rights in the
collateral. One case so holds and is authority for the conclu-
sion that the interests would be concurrent. The court reasons:
"There is no proof showing that the property seized was the
property of the judgment debtor when the execution was origi-
nally issued or at any time until the actual levy was made. A
lien could not attach to a thing not in being." (emphasis sup-
plied). Under § 679 of the Civil Practice Act of New York, the
statute effective and applicable at the time of the case, goods
were bound by the execution "from the time of delivery thereof
to the proper officer to be executed." However, the relation back
to the time of such delivery occurred only when the judgment

\textsuperscript{117} In re Laskaris, 4 F. Supp. 652 (Dist. Ct. W. District of N.Y. 1933). See
also, regarding intangibles, Riesenfeld, supra n. 114, at 167.

\textsuperscript{117\textsuperscript{a}} Id. at 653.
debtor had property subject to execution at the time the writ of execution was delivered. If a judgment debtor does not acquire such property until the exact time that the debtor has rights in the collateral within the meaning of § 9-204, no lien obtained by the execution would be superior to the perfected security interest. This conclusion is based on the assumption that the interests attach simultaneously and that, under § 9-201 as discussed previously, a perfected security interest is superior to a lien on a simple contract which is perfected simultaneously. Of course, it would be possible for a court to decide that a judgment debtor had sufficient rights in the collateral to support an execution, but not sufficient rights in the collateral to have a perfected security interest within the meaning of the Uniform Commercial Code §§ 9-303 and 9-204. Although such perversity is theoretically possible, it is offensive to the policy of the Code and seems to be such a sufficiently remote contingency that it may be safely discounted.\textsuperscript{118}

VI. Increases in Collateral During the Four Month Period Preceding Bankruptcy

The above analysis suggests that, in the ordinary situation where the accounts receivable and the inventory decline during the four months preceding bankruptcy, there is safety. But what of the situation where there is an increase, whether in the ordinary course of business or out of the ordinary course of business? Let us take the last situation first. Assume in our continuing hypothetical case that there is a security interest entered into on January 15. Value is given on January 15, and the debtor obtains rights in all present and future accounts. Good practice dictates that filing should antedate the attachment and we may assume that filing took place on January 14, although under § 60 (a) (7) of the Bankruptcy Act, filing may be postponed for a period of not more than 21 days (perhaps less, depending on state law) without affecting the rule that the

\textsuperscript{118} § 10-103—General repealer, provides, with exceptions not relevant here, that "all acts and parts of act inconsistent with this Act are hereby repealed." Does this not argue for repeal of any non-Code statute which would give such a priority to a lien, obtained upon a simple contract, that the Code would be vulnerable in Bankruptcy. "This Act" within the meaning of § 10-103 surely includes § 9-108, and probably the basic policy of the Code in general. As for non-Code statutes passed subsequent to the Code —§ 1-104 provides a rule of construction against implicit repealer. Express priority rules defeating the Code interest are possible, but unlikely to be passed.
transfer is deemed to be made on January 15. Let us assume, now, that during the four months preceding bankruptcy—September, October, November and December—collateral increases. The accounts receivable may increase for any number of reasons including a slowing down of the debt payment,—i.e. average accounts may go from 60 days to 90 or 120 days. Or inventory may be increased, whether or not in the ordinary course of business. In the latter situation, where collateral is increased not in the ordinary course of business, the Code affords little protection. Section 9-108 of the Uniform Commercial Code reads:

"Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

According to Professor Gilmore:

"By necessary implication Section 9-108 says that after-acquired property interests of any other type are, as a matter of state law, antecedent debt transfers. We may assume that a transfer which, at the state law level, is stigmatized as being one for antecedent debt would also be one at the federal law level." 119

Although exactly what is meant by the phrase "ordinary course of business" may not be clear, certain situations suggest themselves as not falling within that term. One possibility is that a debtor, desiring to favor a particular secured party, would rapidly increase his inventory during the four month period prior to bankruptcy in order to give the secured party more of a return in bankruptcy. Of course, if the security agreement were set up, as many are, so that the amount of the loan has a conservative ratio to the amount of the security (loan is limited to 80% of the value of security), this temptation would not be present. However, in a situation where the debt exceeds the value of the security and the secured party is a favored creditor, the debtor might well use assets which should be available to

general creditors under the equality of distribution rule to purchase material covered by the security interest. Such an increase in collateral would be a benefit, condemned by both the policy of the Bankruptcy Act and the policy of the Code. The offense to the policy of the Bankruptcy Act is obvious. Feeding the lien in this manner is one of the most blatant types of preference, clearly calculated to destroy equality of distribution. It is likewise contrary to the policy of the Code, as implied by § 9-108. If the Code drafters had provided that property not protected by § 9-108 should be either (a) not subject to the security agreement, or (b) vulnerable to a lien creditor on a simple contract, there is no question that the Bankruptcy Court would recognize the Code's determination. However, under the Code, there is a valid security interest in such property and under the Code, if the above analysis is correct (the analysis of the priorities based on §§ 9-201 and 9-301), the offending security interest in the property in question is covered by the security interest under the after-acquired property clause and is also invulnerable to attack by a lien creditor on a simple contract. In Re Crosstown Motors¹²⁰ and In Re Harpeth Motors¹²¹ demonstrate that while the states may affect the outcome in bankruptcy by changing, not labels, but operative results under state law, which operative results are made part of a bankruptcy formula they may not directly affect a bankruptcy outcome. It seems unlikely that a court will ever uphold the security interest in the type of property we are discussing. However, had the Code adjusted its priority rules to fit its policy expressed in § 9-108, a decision reflecting such a policy choice would be easier to justify. As things stand, the court will have to decide, despite the rather plain language in § 9-201 and § 9-301 U.C.C., that the Code's policy dictates subordinating rights of secured parties in such property not only to the bankruptcy trustee but to all lien creditors on a simple contract.

VII. Increase in Ordinary Course of Business

A more serious question involves the fact situation where the increase in property during the four months preceding bankruptcy is a result of a transaction in the ordinary course of business or possibly under a contract of purchase made pursuant

to the security agreement within a reasonable time after new value is given. With respect to an increase in inventory in the ordinary course of business prior to bankruptcy, the so-far-perfected test of § 60(a)(2) of the Bankruptcy Act clearly supports the validity of a security interest. Section 9-108 likewise provides support for such interest. There is some doubt, however. In *Rosenburg v. Rudnick*, the plaintiff argued that the court should consider the inventory as a whole and:

"If it can be shown that there was an increase in the total value of the inventory, between certain dates within the four month period, this increase in value should be attributed to the goods acquired during that period and that a preference to the extent of the increased value of the inventory had been shown."  

The court rejected plaintiff's contention on the ground that no increase was in fact shown, leaving for further consideration the question of whether, had such an increase been shown even in the ordinary course of business, there would have been a preference to the extent of the increase. The *Grain Merchants* case has language even more chilling to those who have a security interest in collateral which increases during the four month period prior to bankruptcy. The Court points out that since the dominion rule of *Benedict v. Ratner* is no more, having been overturned by § 9-205, it is no longer appropriate to apply strict timing or value rules in relying on the substitution-of-collateral doctrine. This doctrine can support the after-acquired property interest in collateral "so long as at all relevant times the total pool of collateral, as here, exceeded the total debt." The Court finds noteworthy the two-pronged test suggested by the National Bankruptcy Conference, which provides that "... transfers of receivables, pursuant to security agreement within four months of bankruptcy will not constitute preferences

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123 Id. at 640.
124 Supra n. 102.
125 268 U.S. 353 (1925).
126 The Court's footnote 10 states, "The timing rule is that the new collateral must be transferred to the secured party either prior to or contemporaneously with the release of old collateral. The value rule is that if the new collateral is of no greater value than the collateral which is released, a voidable preference to the extent of the difference in value will result." 408 F.2d 209, 217 (1969).
127 Grain Merchants supra n. 102, 217.
if they arose in the ordinary course of the debtor's business." 128 The above test accords with § 9-108 of the Uniform Commercial Code, but there is a proposed two-point test, which provides that "there will be a preference to the extent that the aggregate value of the receivables subject to the security agreement on the date of filing the bankruptcy petition exceeds the aggregate value subject to the security agreement four months earlier." 129 The court concludes:

"Here the pool of accounts receivable was remarkably steady in aggregate value throughout the entire period of the security agreement . . . , justifying the applicability of the substitution of collateral principle to these facts. Hence, for this additional reason, we conclude that there was no forbidden preference." 130

It is difficult to read the above quoted language without coming to the conclusion that if collateral is exceeded by the total debt and there is an increase, even in the ordinary course of business, during the four months preceding bankruptcy, this Court would find a preference to the extent of the increase. Such conclusion violates the policy of the Code expressed in § 9-108 and does not seem to be mandated by any policies of the Bankruptcy Act. The language in B.A. 60 (a) (2) dictates a contrary result. Perhaps we should not be overly concerned with this dictum because the problem is not acute as a practical matter. A secured party in extending credit does not rely on an increase in collateral in ordinary course on the eve of bankruptcy, so this dictum is unlikely to affect lending practice. If in fact, collateral does increase (as is more than possible in seasonal businesses) there is a substantial chance of victory against the trustee, despite the dictum discussed above.

This paper is concerned with two basic problems as far as the after-acquired property clause is concerned. One is the so-far-perfected test of § 60 (a) (2) which has been discussed. The other is the problem of an attack under the equitable lien section of the Bankruptcy Act, § 60 (a) (6). Before the equitable lien section is discussed, some general comments on the cases to date seem in order. The cases have talked about the so "far-perfected" test. They have also relied on other tests. For example, both Grain Merchants and Rosenberg v. Rudnick

128 Id. at 217, 218.
129 Id. at 218.
130 Id.
accepted as an alternate rationale the entity theory, whereas the *DuBay v. Williams* case declined resort to the entity theory, in rejecting the trustee's argument. Probably the distinguishing feature of all the decisions is a disposition to do the will of the legislatures which enacted the Code so far as that will is consistent, not with the words of Congress, but with the policy exhibited by the Bankruptcy Act. Finding no clash between the wording of the Code and the policy of the Bankruptcy Act, the courts have upheld the Act, at least to the extent of not avoiding security interests in after-acquired property where the property did not expand in the four month period prior to bankruptcy. This, in the writer's opinion, is the most important area, and hopefully the Supreme Court eventually, and other lower Courts in the meantime, will protect the Code, at least in this area.

**VIII. The Equitable Lien Problem**

Section 60(a)(6) of the Bankruptcy Act provides that if a lien is a "bad equitable lien" then such transfer is not perfected within the meaning of paragraph 2.\(^{132}\) Professor MacLachlan, the author of the equitable lien section, has written:

"Where a delivery, a recording, or the like, is required by applicable law for the full validity of such a transfer against third persons other than a buyer in the ordinary course of trade, claiming through or under the transferor, and where such overt act has not been taken, such a transfer is regarded as not perfected, whether or not it gives rise to an 'equitable lien.'"\(^{133}\) (Emphasis supplied.)

Professor Gilmore has said: "A perfectly possible construction of § 60(a)(6) is that any interest which could have been perfected against purchasers, but was not, is an invalid equitable lien."\(^{134}\) Professor Gilmore further states:

"If it is true that any interest in after-acquired property is, as a rule of federal law, a section 60(a)(6) equitable lien, then the Article 9 after-acquired property interest is quite clearly a bad equitable lien which does not escape condemnation under the second sentence."\(^{135}\)


\(^{132}\) Par. 2 of § 60(a) B.A.


\(^{135}\) *Id.* at § 45.7, 1321.
If we read together the language of the author of the Bankruptcy Act provision, Professor MacLachlan, and the language of Professor Gilmore, one of the principal draftsmen of Article 9 and perhaps the country's leading authority on that Article, we arrive at a rather unhappy conclusion. Professor MacLachlan says that if the lien is "bad" it need not be an equitable lien to be vulnerable under § 60 (a) (6). Professor Gilmore says that if it is an equitable lien, it is necessarily bad. Putting the two comments together it is difficult to see how the interest in the after-acquired property can escape § 60 (a) (6) B.A., even if it successfully runs the gauntlet of § 60 (a) (2) B.A. under the "so-far-perfected test," "entity test" or other tests which we have discussed. What is an equitable lien? According to Mr. Earl, "[T]he words 'equitable lien' are intensely undefined." 136 We are told in an article by Cohen & Gerber137 that the civil law recognized a "mortgage on an estate to come" and that Justice Storey, one of the greatest students of the civil law, was the first on the bench to "establish the precedent in Anglo-American law that future property may be presently charged." 138 This article quotes Storey as stating that "[a]lthough it was true that future property could not be presently charged at common law, nevertheless equity would enforce the agreement." 139 A reading of the Article as a whole suggests that, where recognized, a present interest in after-acquired property was indeed an equitable interest. Does this background stigmatize an interest in after-acquired property as an equitable lien? Probably not. The common law is subject to change by statute, and the Uniform Commercial Code has denominated a present interest in future property a legal interest.140 Thus, prior characterization as an equitable lien seems to be irrelevant. Nor is any reason evident why a federal court should find in the term "equitable lien" used in § 60 (a) (6) of the Bankruptcy Act a direction from Congress to establish an independent federal test which would invalidate the "floating lien."

In an article written in 1951 Professor Countryman lists four criteria which may be used in determining what is an equitable lien.

138 Id. at 636.
139 Id. at 637.
140 § 9-204 Official Comment 2.
In applying these tests to a non-possessory lien which can be perfected without filing under § 9-302, it is certainly arguable that the lien is equitable (for it is a secret lien), and there is a possibility that this equitable lien is a "bad equitable lien." The characterization is not as clear respecting filed, and therefore non-secret interests in future property. However, an attorney defending against an attack under § 60(a)(6) of the Bankruptcy Act would be ill-advised to limit his defense to the contention that his security interest is not an equitable lien, given Profes-

141 Countryman, The Secured Transactions Article of the Uniform Commercial Code and Section 60 of the Bankruptcy Act 16 Law and Contemp. Prob. 76, 96 (1951). He asks whether it is confined to "those 'judge-made' liens which cannot be classified as common law possessory liens? Does it include consensual liens which a statute, like the Code . . . gives some but not full protection against third persons even though not accompanied by possession or filing. Does it extend to liens created by statute the enforcement of which often comes within 'the equity jurisdiction'? Or, in view of the draftsman's concern with 'secret liens,' should the term be construed to apply to all 'security interest based neither on possession nor on public record.'" (Footnotes omitted.)

142 A good example of the workings of § 60(a)(6) B.A. can be shown if we assume that a security interest, perfected without filing or the taking of possession under § 9-302, is an equitable lien. § 9-302 provides that "A financing statement must be filed to perfect all security interests except . . . " The exceptions include, naturally enough, collateral in the possession of the secured party but also include non-possessory interests. § 9-302(c) and (d) permit perfection of a security interest, without filing, in certain farm equipment and in consumer goods, if the interest is a purchase money security interest. The perfection afforded to such purchase money security interests is not as good as perfection by filing, for the purchase money man, unless he files, is subject to certain buyers, under § 9-307(2) which provides:

"(2) In the case of consumer goods and in the case of farm equipment having an original purchase price not in excess of $2500 (other than fixtures, see Section 9-313), a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods."

The assumption that the security interests made vulnerable by § 9-306(2) are equitable liens is reasonable. They are secret, non-possessory interests. Are they vulnerable to "third persons other than a buyer in the ordinary course of trade." B.A. 60(a)(6). I think the answer is clearly yes at least in the case of consumer goods bought for the buyer's own personal, family or household purposes. [Gilmore (2 Gilmore, Security Interests in Personal Property 1332 fn 10) raises the question under 60(a)(6) B.A. of the vulnerability of security interests subject to defeat under § 9-307(2) and makes no distinction between consumer goods and farm equipment.] On the above assumptions the security interest is a "bad equitable lien" because: under the second sentence of 60(a)(2), applicable law, the Code, requires an overt act, filing, as a condition of the security interest's full validity against third persons other than buyers in the ordinary course of trade; by hypothesis such overt action has not been taken; and also by hypothesis, the purchase money secured party acquires only an equitable lien. Therefore, the transfer of the security interest is not perfected within the meaning of paragraph (2) of section 60(a) of the B.A.
sor MacLachlan's comments supra and the amorphous definitions of equitable liens. Professor Gilmore says § 60 (a) (6) B.A. defeats you if your security interest is not characterized as a legal interest. We will now analyze § 60 (a) (6) B.A. on the assumption that a security interest in future property is equitable. Because of the language difficulties involved, it seems worthwhile to set forth § 60 (a) (6) of the Bankruptcy Act in full:

"The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section. If a transfer is for security and if (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like overt action as a condition to its full validity against third persons other than a buyer in the ordinary course of trade claiming through or under the transferor and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, then such transfer is not perfected within the meaning of paragraph (2). Notwithstanding the first sentence of paragraph (2), it shall not suffice to perfect a transfer which creates an equitable lien such as is described in the first sentence of paragraph (6), that it is made for a valuable consideration and that both parties intend to perfect it and that they take action sufficient to effect a transfer as against liens by legal or equitable proceedings on a simple contract: Provided, however, that where the debtor's own interest is only equitable, he can perfect a transfer thereof by any means appropriate fully to transfer an interest of that character: And provided further, that nothing in paragraph (6) shall be construed to be contrary to the provisions of paragraph (7)."

In analyzing B.A. § 60 (a) (6), §§ 9-307, 9-312 (3), & (4) are relevant. Section 9-307 of the Uniform Commercial Code declares:

"A buyer in the ordinary course of business . . . [with the exception of certain purchasers of farm products] takes free of a security interest created by a seller even though the security interest is perfected and even though the buyer knows of its existence."

This provision presents no difficulty, for § 60 (a) (6) B.A. requires only full validity against third persons other than a buyer in the ordinary course of trade. A buyer in the ordinary course of business under the Uniform Commercial Code is a type of buyer in the ordinary course of trade within the meaning of the

143 B.A. 60 (a) (6).
144 § 1-201(9).
Bankruptcy Act, and so little trouble is given on this score.\textsuperscript{145} However, under the Code a purchase money security interest in inventory collateral (U.C.C. § 9-312(3)) and a purchase money security interest in collateral other than inventory (§ 9-312(4)) has priority over the holder of a security interest in after-acquired property, if certain conditions are met. It is this § 9-312 vulnerability that troubles Professor Gilmore. He writes that even if the Article 9 requirements for validity and perfection have been complied with and the "overt action" has been taken, there is still trouble in the language of clause (A) (B.A. 60 (a) (6) (A))

"which seems to mean that when the overt action has been taken the result must be that the lien (if it is to be saved) will have 'full validity against third persons other than a buyer in the ordinary course of trade.' The Article 9 after-acquired property interest, even if perfected, does not have that degree of 'validity': it runs the risk of subordination to subsequent purchase money interests . . . ." \textsuperscript{146}

Gilmore speculates that, had the draftsmen of the Code been given the benefit of hindsight, they might have drafted the clause to say: "[A]s a condition to its full validity against third persons other than a buyer in the ordinary course of trade or the holder of a purchase money security interest . . . ." \textsuperscript{147} But he writes that the "draftsmen had never heard of a statute which expressly validated the after-acquired property interest but subordinated it to a subsequent purchase-money interest; there was no such statute." \textsuperscript{148} And he uses this as an illustration of what he means when he says that § 60 (a) (6) and Article 9 of the Uniform Commercial Code "belong to different universes of discourse." \textsuperscript{149}

Assuming the existence of different universes of discourse, is there any way to interpret the language of § 60 (a) (6) so that the equitable interest in future property is not a "bad equitable lien"? The first sentence of § 60 (a) (6) talks about the recognition of equitable liens where available means of perfecting legal liens have not been employed. Such recognition is declared to be "contrary to the policy of this section." If, as we are assuming

\textsuperscript{145} Id. Official Comment 9.
\textsuperscript{146} 2 G. Gilmore, Security Interests in Personal Property § 45.7, 1321 (1965).
\textsuperscript{147} Id. at 1322.
\textsuperscript{148} Id. at 1321, 1322.
\textsuperscript{149} Id. at 1322.
arguendo, an interest in future property is an equitable interest, the policy of the Act is not subverted, since there is no way of perfecting a legal interest in such future property. Turning to the second sentence of § 60(a) (2), the Bankruptcy Act requires an overt act, if applicable law requires such an act. Applicable law (the U.C.C.) requires filing or possession to protect some security interests against buyers not in the ordinary course of trade (i.e. holders of non-purchase money security interests). However, since we are assuming filing with respect to a security interest in future property, and since applicable law (the Code) does not require—indeed it does not even authorize—an overt act other than filing for full validity of security interests in "future property" against purchase money security interests complying with § 9-312 (3) and (4) of the Uniform Commercial Code, it is no violation of the requirements of the second sentence for the secured party to fail to do an act which is impossible.150 The writer is assuming that the debtor's reducing future property to present property is not considered an applicable overt act. Section 60(a) (6) (A) of the Bankruptcy Act talks about “a signed and delivered writing,” a “delivery of possession” (to the secured party), a filing or recording or other like overt action, and it would seem to be a bizarre interpretation of the Act to say that future property must be reduced to present property to avoid attack under § 60(a) (6).151 The fairest reading of § 60(a) (6), in the context of our problem, is that if there is no applicable law under which full validity against purchase money security interest can be obtained, then no overt action need be taken, and the equitable lien is a valid equitable lien.152

Assuming the worst, assuming that the Supreme Court should decide that a security interest in after-acquired property is a bad equitable lien, is there anything a draftsman can do to avoid falling under the condemnation of such a holding? In describing collateral, draftsmen provide for a security interest in present and after-acquired collateral. Suppose the draftsmen

150 Porter v. Searle, 228 F.2d 748 (10th Cir. 1955).
151 A requirement that a debtor increase his inventory by buying all inventory presently, calls for sheer madness. Ejsus generis suggests that the language "like overt act" requires no such absurdity.
152 Basically the major premise of 60(a) (6) has three conjunctive elements in its antecedent. The consequent is invalidity. Deny any one of the three antecedent elements and you deny the antecedent, on the affirmance of which the consequent depends.
provided for an interest in present and after-acquired collateral, but limited the description so as to exclude collateral obtained by the debtor subject to a purchase money security interest unless and until the purchase money secured party had failed to perform those actions necessary to give such purchase money secured party priority under § 9-312 (3) and (4). Such a provision would give us a security interest in after-acquired property which is not subject to a purchase money security interest. For the scope of the security claimed would not include property subject to be defeated by a purchase money interest. If § 60 (a) (6) should become a serious threat, such a provision may indeed become necessary. But does not the suggestion for the express inclusion of such a provision suggest another argument for avoiding Bankruptcy Act § 60 (a) (6) vulnerability? Even if a security interest has no express exclusion with respect to purchase money security interests, would it not be reasonable to attribute to the draftsmen of the security agreement an intent not to include, within the description of the collateral, property in which they could have no rights under the U.C.C., when such inclusion might invalidate the entire security agreement under the Bankruptcy Act? Such a construction of after-acquired property clauses seems eminently reasonable, and coupled with the analysis we have made of § 60 (a) (6) suggests that, even should courts decide that the interest in future property is equitable in nature, such equitable interests would not be vulnerable under § 60 (a) (6).

IX. Bankruptcy Act § 60(a)(7) and the Uniform Commercial Code

Under § 9-402 of the Uniform Commercial Code, “(A) financing statement may be filed before a security agreement is made or a security interest otherwise attaches.” It is good practice to do this because, with respect to non-purchase money security interests, the failure to file prior to attachment means that between the time of attachment and the time of filing, assuming filing is necessary to perfect the security interest, the interest is subject to the rights of a person who becomes a lien creditor without knowledge of the security interest. With respect to purchase money interests, “(I)f the secured party files . . . before or within ten days after the collateral comes

153 § 9-301 (1) (b).
into the possession of the debtor, he takes priority over the rights of a transferee in bulk or a lien creditor which arise between the time the security interest attaches and the time of filing." 154 If filing takes place on the eleventh day, then the purchase money security interest has been vulnerable to lien creditors for the period between attachment and filing. Since vulnerability to lien creditors under § 9-301 postpones the time when the transfer will be deemed to take place under § 60 (a) (2) B.A., there is a possibility of harsh application of the Bankruptcy Act when there is a minor delay. To alleviate this harshness, 155 § 60 (a) (7) (I) B.A. provides that if the recording, delivery or other act which is required by applicable law, in our case state law, is accomplished within 21 days or such shorter period as applicable law requires, then such "... transfer shall be deemed to be made or suffered at the time of the transfer." 156 This provision only makes sense when read together with § 60 (a) (2). Section 60 (a) (2) provides that the operative transfer (for purposes of § 60 (a) and (b)) is not the actual transfer but the transfer deemed to be made according to a certain formula. Section 60 (a) (7) provides that when certain conditions are met this operative transfer shall be deemed to be the actual transfer, thus neutralizing § 60 (a) (2). In other words, § 60 (a) (2) deems that the transfer under § 60 (a) does not take place until filing, in the case of a security interest which may only be perfected by filing, and § 60 (a) (7) deems a transfer back again to the time of the original grant of a security interest. Section 60 (a) (7) of the Bankruptcy Act yields peculiar results when it is framed against § 9-304 of the Code.

Section 9-304 (4) of the Code provides, "(A) security interest in instruments or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement." Professor Gilmore suggests that § 60 (a) (7) B.A. is talking about a sort of grace period which does not include the automatic perfection under § 9-304 (4). 157 If a statute provided that if there is recording or some other overt act within x number of days of a grant of security, then

154 § 9-301 (2).
156 B.A. 60 (a) (7) (I).
the lien is good from the time of the actual transfer (actual grant), that would be the type of statute contemplated by § 60 (a) (7) B.A. Under such a statute the 21 or less days (x days) would begin to run from the first day that the lien or security interest or whatever would be vulnerable to lien creditors but for the subsequent overt act. Since under the Code, § 9-304 (4), the perfection for a period of 21 days is complete perfection and there is no vulnerability to lien creditors during those days regardless of a future act, Professor Gilmore suggests that it could be argued (on a high level of technicality) that the 21-day period begins to run on the 22nd day, thus giving the secured party 42 days to perform the required overt act. He rejects such a technical argument on the basis that it is not justified on any policy ground.\footnote{Id.} It is arguably not justified on the language of the Bankruptcy Act either. There are three times made relevant by § 60 (a) (7). For purposes of convenience they shall be referred to as T1, T2, T3.\footnote{T1 = time of actual transfer. T2 = time by which, under applicable law, recording, delivery, or some other act is required in order that no lien obtainable by legal or equitable proceeding upon a single contract could become superior to the rights of the transferee. T3 = time within which under B.A. required recording or delivery or other act must be accomplished in order that the transfer shall be deemed to be made or suffered at the time of transfer. If T2 = 21 or less days after the transfer, then T2 = T3. If T2 = 21 plus days, then T3 = 21 days. Thus if T2 = 30 days, T3 = 21 days; if T2 = 21 days, T3 = 21 days; if T2 = 10 days, T3 = 10 days.} The 21 (or less)-day period is measured from T1, the time of actual transfer, and no transfer takes place at the termination of the 21-day period provided for in § 9-304 (4). Hence it is not consistent with the language of the Bankruptcy Act to count 21 days beginning there.

A more serious problem is presented by § 9-304 (5). Occasionally a secured party must release security for various purposes. The Act recognizes the validity of such releases by providing in UCC 9-304 (5) that:

“A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, a negotiable docu-
ment or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange; or

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.”

Official comment 4 to § 9-304 states that the period of 21 days in §§ 4 and 5 was chosen “to conform to the provisions of § 60 of the Federal Bankruptcy Act.” The selection of the 21-day period to conform to the Bankruptcy Act raises merely a curiosity as far as § 9-304 (4) is concerned. With respect to § 9-304 (5) however, it presents a serious problem. We have seen that the Bankruptcy Act provides certain protection in § 60 (a) (7) against a possible harsh and literal reading of § 60 (a) (2). Assume a situation where a security interest in negotiable documents is perfected by the secured party taking possession of the documents. Assume that the security interest attached on January 10, but that possession was not taken until January 30. Since possession is essential to perfect the security interest in the document (absent filing), the transfer under § 60 (a) (2) would be deemed made on January 30. However, under § 60 (a) (7) of the Bankruptcy Act the transfer, notwithstanding § 60 (a) (2), would be deemed to be made or suffered at the time of the actual transfer, January 10. Assume in March that the secured party surrenders up the possession of the documents for a period of, let us say, 29 days. The security would remain perfected for a period of 21 days and would be unperfected in the gap between the loss of perfection and the return of possession at the termination of 29 days. When possession is regained by the secured party, there is again invulnerability to a lien creditor, and, presumably, a transfer under § 60 (a) (2). In this situation, § 60 (a) (7) would be of no help to the secured party, and if the 29th day were within four months of bankruptcy, a preference problem would be presented. Assume now that the Code were amended to provide for a

160 It is assumed in this hypothetical case that there is no § 9-304 (4) protection. The security interest did not arise for new value.
period of 30 days in § 9-304(5). Under such an amendment a
security agreement would remain perfected for the entire 29
days. There would be no transfer deemed made when possession
was returned to the secured party and, therefore, no possibility
of a transfer for an antecedent debt within the meaning of
§ 60 (a) (1) B.A. Since the perfection in the negotiable docu-
ments continued for 30 days without possession, and since posses-
sion was regained prior to the expiration of the 30-day protected
period, there was no time when the documents were vulnerable
under § 9-301 to a lien creditor, and therefore no bankruptcy
preference problem. Why the drafters of Official Comment 4 to
the Uniform Commercial Code felt impelled to pick a 21-day
period on the basis of the Bankruptcy Act is uncertain. How-
ever, the 21-day period is now the law under the Code and the
comment does no harm so far as § 9-304 (4) and (5) is concerned.
It does, however, lend support to the argument that when collat-
eral is moved to another state, perfection must be accomplished
within 21 days,161 rather than within the four months provided
for by the Uniform Commercial Code.162

Under § 9-103 (3), “If the security interest was already per-
fected under the law of the jurisdiction where the property was
when the security interest attached and before being brought
into the state, the security interest continues perfected in this
state for four months and also thereafter if within the four month
period it is perfected in this state.” Here, again, we have no
transfer. The security interest was perfected in the first state.
It continued perfected in the second state for four months. This
continuation was further continued if, within that four month
period, perfection was accomplished by filing or otherwise.
There never was an actual transfer and there never was deemed
a transfer under § 60(a)(2) of the Bankruptcy Act. How
§ 60 (a) (7) B.A. can impose a requirement in this context is
difficult to fathom. But the Comments to § 9-301 (4)163 appar-
tently have fathomed it and, sooner or later, somebody will make
an attack based upon a failure to perfect within the 21-day
period. The attack is probably doomed to failure for the reasons
advanced in the discussion of § 9-304 (5). The 21 day period of

161 Countryman, The Secured Transactions Article of the Uniform Commer-
cial Code and § 60 of the Bankruptcy Act, 16 Law & Contemp. Prob. 76, 96
(1951). Professor Countryman sees a problem here.
162 § 9-103(3).
163 § 9-304, Official Comment 4.
§ 60 (a) (7) is dated from "Ti"¹⁶⁴ but there is no transfer, actual or deemed, when the property is brought into another jurisdiction.¹⁶⁵

X. Proceeds

The Uniform Commercial Code provides in § 9-306 (2) that "... a security interest ... continues in any identifiable proceeds¹⁶⁶ including collections received by the debtor." Except for the difficulty of identifying proceeds which have been commingled, the law is clear and simple to apply. However, under § 9-306 (4) difficulties abound. Section 9-306 (4) reads:

"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

(a) in identifiable non-cash proceeds;
(b) in identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;
(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and
(d) 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 (d) is

(i) subject to any right of set-off and
(ii) 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 less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period."

A threshold question to be asked about § 9-306 (4) is whether or not its listing of proceeds, in which a security interest

¹⁶⁴ See 159 supra.
¹⁶⁵ But see MacLachlan on Bankruptcy 308 (1956).
¹⁶⁶ § 9-306 (1) "Proceeds includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are 'cash proceeds.' All other proceeds are 'non-cash proceeds.'"
continues in the event of insolvency proceedings, is exclusive or inclusive. The sense of the Code makes it clear that the answer is exclusive and support for that is ample. Thus, when insolvency proceedings are instituted, and such proceedings obviously include the filing of a petition in bankruptcy, the security interest is limited to certain identifiable proceeds, those listed in § 9-306 (4) (a), (b) and (c), and to what we will hereafter refer to as "formula proceeds," those referred to in § 9-306 (4) (d). The formula gives the secured party some advantage. He need not trace the proceeds. Tracing "... depends upon difficult and confusing doctrines ... (e.g., first-in, first-out; non-trust-funds used first; etc.)." However, the secured party's relief from the difficulties of tracing has been purchased at a heavy price. Take a situation where a debtor has deposited proceeds of collateral in a bank account which contains other proceeds and deposits which are not proceeds. Assume that in the 30 days prior to bankruptcy or other insolvency proceedings, he has deposited one thousand dollars a day, and that under the law of tracing, he can identify the thirty thousand dollars. Prior to the initiation of the insolvency proceedings the secured party under § 9-306 (2) had a security interest in $30,000. At the moment of initiation of insolvency proceedings, under the "formula," the security interest goes down to $10,000. What is the rationale for this reduction in the amount of collateral in which the secured party has an interest? The answer is that the Code in this provision seeks to encourage "policing." We have seen that the Code has overturned the doctrine of Benedict v. Ratner. Its policing rules were unnecessarily strict, at least as interpreted by some Courts. "[F]or example it has been thought necessary for the debtor to make daily remittances to the lender of all collections received, even though the amount remitted is immediately returned to the debtor in order to keep the loan at an agreed level." Such strict rules of policing, generated by the doctrine of fraud in law, have been abolished by § 9-205, but the drafters of the Code agree that it is good business practice

108 U.C.C. 1-201 (22); B.A. 1 (13), 11 U.S.C. 61 (13).
170 268 U.S. 353 (1925), § 9-205.
171 § 9-205 Official Comment 1.
for secured parties not only to protect themselves, but also to protect other creditors, by policing collateral. The basis of this is not difficult to understand. The most tightly drawn security agreement is a worthless scrap of paper if the collateral has been dissipated. Hence the Code seeks to avoid dissipation. Professor Gilmore tells us:

"If self-interest does not do the job, § 9-306(4) (d) supplies the incentive. If a secured party, relying on the abolition of the Benedict rule, allows his debtor to make unrestricted use of proceeds and collections, paragraph 4(d) puts beyond his reach, if insolvency proceedings occur, everything except the last 10 days' receipts. To protect himself the secured party will have to require periodic accounting; if he does not pick up the proceeds at 10 day intervals, he will lose them irrevocably in the one contingency where he will ever need them—the institution of insolvency proceedings.”

One objection may be made to the above argument. Business practice may not always dictate the necessity of policing. In any individual case, a secured party may, on the basis of long association with the debtor or otherwise, have sufficient trust and confidence in him that he feels, on the basis of sound business judgment, that policing is not required. The Code's underlying purposes and policies include permitting “continued expansion of commercial practices through custom, usage and agreement of parties.” To the extent that good business practices may be identified, there is no vice in legislation. The difficulty is that good business practices are not generally reducible to pat formulae.

May a secured party circumvent the policing rule by requiring a debtor to deposit proceeds in a separate bank account? The answer is clearly yes under the California version of § 9-306 where § 9-306(4) (a) grants, in the event of insolvency proceedings, a perfected security interest not only in identifiable non-cash proceeds, but also in “a separate bank account containing only proceeds.” The permanent Editorial board for the Uniform Commercial Code rejected the California Amendment.

173 § 1-102(2) (b).
It reasoned that "... California has only made explicit what is otherwise the necessary construction of the statute." A reading of § 9-306(4) (a) (b) and (c) of the unamended Code does not make it clear that California's Amendment is unnecessary. Without it the sense of the California Amendment does not appear to be a necessary construction of the Code. "In the event of insolvency proceedings" a perfected security interest in proceeds is granted by the Code only in certain types of cash proceeds. The cash proceeds referred in § 9-306(4) (b) and (4) (c) do not include cash proceeds deposited in a bank account. It seems relatively clear that the money deposited in a separate account does not fall within the definition of identifiable non-cash proceeds. Non-cash proceeds suggests a used car turned in on the purchase of a new car. It does not suggest money or checks, trade acceptances, or the like which are deposited in a separate bank account by the debtor. In fact, money, checks, and the like in § 9-306(4) (b) and (c) are explicitly included as a form of cash proceeds, and it is impossible to reconcile this inclusion with the inclusion of money, checks, and the like within the meaning of non-cash proceeds used in § 9-306 (4) (a). Apart from linguistic analysis, there is a question whether the California Amendment comports with the policy of the Code, which is to force the secured party to police collateral. There is no requirement in the California Amendment that the secured party exercise any control over the money deposited in a separate bank account. Under the California law the security interest in such an account would continue even though the debtor had full right to withdraw, and did in fact withdraw funds. The position of the Permanent Editorial Board doubtless will carry weight with the courts; and it probably is desirable, not only in California, but in other states, for the secured party to insist that proceeds, deposited in a bank, be deposited in a separate account. Nevertheless, there are difficulties involved in accepting the Permanent Editorial Board's rationale for the rejection of the California Amendment.

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176 Id.
177 The 1962 official text.
178 This is supported by the California Report, supra, n. 113, which states, (pp. 571, 572) that unless the term "identifiable noncash proceeds" (in the unamended Code) includes a separate bank account in which the debtor is required to deposit proceeds and in which he deposits only proceeds, then the right of the secured party to such a bank account would be limited to "formula proceeds" under 9-306(4) (d). But see Gilmore, supra n. 172, at 1338.
The discussion thus far might suggest that § 9-306(4) (d) was a victory for the general creditors’ lobby and that the California Amendment was a victory for the secured party which partially ameliorated the adverse effects of § 9-306 (4) (d). Such an assumption would be subject to question, however, for the “formula proceeds” provision of § 9-306 (4) (d) has come under heavy attack as a violation of the policy of the Bankruptcy Act. Professor Marsh, in his review of Professor Gilmore’s treatise, seriously questions the invulnerability in bankruptcy of the security interests in “formula proceeds.” His attacks are based on three sections of the Bankruptcy Act, any of which may be lethal. The first section considered is § 67 (c). This was amended in 1966, after the publication of Marsh’s article. However, the amendment does not take the sting out of § 67 (c) if the security interest in formula proceeds is a “statutory lien.” Under the amendment § 67 (c) of the Bankruptcy Act now provides: “(1) [T]he following liens shall be invalid against the trustee: (A) every statutory lien which first becomes effective upon the insolvency of the debtor. . . .” Since the formula proceeds arise “in the event of insolvency proceedings” (§ 9-306(4)), the present § 67 (c) of the Bankruptcy Act would be damning if the security interest in formula proceeds under § 9-306(4) (d) were a statutory lien. The term “statutory lien” is defined in the Bankruptcy Act as “. . . a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is fully effective by statute.” (Emphasis supplied.) Since the security interest in “formula proceeds” arises from a consensual transaction, and is dependent upon an agreement to give security, it is expressly excluded by the Bankruptcy Act’s definition of a statutory lien. This is not to say that the legislative history to the 1966 Amendment to the Bankruptcy Act is

180 Sections 60, 67 & 70(c) Bankruptcy Act.
181 B.A. § 1(29). At the time of the Marsh book review, supra n. 179, it was not a defined term.
182 But see 4A Collier on Bankruptcy 710 (14th ed. 1969), where the opinion is offered that it is a statutory lien because “the security agreement itself would not cover the cash and bank accounts of the debtor” and because “it is an additional lien on additional collateral granted by the U.C.C. under the prescribed circumstances.”
irrelevant. A House Report\textsuperscript{184} characterizes liens which become effective only in the event of insolvency as spurious liens, which are in reality disguised priorities. Consensual liens, which by definition escape invalidation under § 67 (c) B.A., are vulnerable under § 64 B.A., if they are characterized as priorities. Birth of a lien at the moment insolvency proceedings are instituted is one of the indicia of a priority.\textsuperscript{185} Can one not reason by analogy from § 67 (c) that if statutory liens are really disguised priorities if they become effective upon the insolvency of the debtor, consensual liens are likewise disguised priorities if they first become effective in the event of insolvency proceedings? The vulnerability of formula proceeds under § 64 of the Act will be discussed \textit{infra}. At present, we will consider a second attack leveled by Professor Marsh.

Professor Marsh claims that unless formula proceeds "represent identifiable proceeds," the security interest is vulnerable under § 70 (c) of the Bankruptcy Act. He states: "[T]he only argument which a person claiming a section 9-306 (4) (d) lien could use against an attack by a trustee in bankruptcy under section 70 (c) would be that his lien under state law attached \textit{simultaneously} with the trustee's lien rights under federal law."\textsuperscript{186} (Emphasis in original.) Professor Marsh suggests that a trustee in bankruptcy under § 70 (c) would have rights superior to a simultaneously-perfected security interest. The \textit{Lewis} case\textsuperscript{187} holds that the trustee in bankruptcy gets his rights under § 70 (c) at the moment of bankruptcy. Justice Douglas pointed out that:

\"... one consistent theory underlies the several versions of section 70 sub. c ... (T)he rights of creditors ... to which the trustee succeeds are to be ascertained as of 'the date of bankruptcy' not at an anterior point of time.\"\textsuperscript{188}

Despite certain language in \textit{Collier on Bankruptcy},\textsuperscript{189} it is irrelevant (since the Supreme Court in \textit{Lewis} rejected the doctrine

\textsuperscript{185} \textit{In re Harpeth Motors, Inc.}, 135 F. Supp. 863 (M.D. Tenn. 1955).
\textsuperscript{186} Marsh, supra n. 113, at 908.
\textsuperscript{188} Id. at 607.
\textsuperscript{189} The opinion is offered in \textit{Collier} (n. 182 supra at 710) that § 70 (c) B.A. may be used against the security interests in unidentifiable proceeds. We are told, quite correctly, that "if an attaching creditor had levied upon the
of *Constance v. Harvey*) that a lien creditor who obtained his lien the day before bankruptcy could obtain rights superior to those of the secured party. When we turn to simultaneous perfection, we have a problem which was discussed earlier in a different context, and the conclusion we reached there applies here. That conclusion was that under § 9-201 and § 9-301 (1) (b) of the Uniform Commercial Code a perfected security interest is effective against a lien creditor whose lien is obtained simultaneously with the security interest. It appears that attacks under § 67 (c) and 70 (c) of the Bankruptcy Act may be safely discounted. The real danger, it appears to the writer, flows from B.A. § 60 and § 64. Professor Marsh states:

"[A] previously nonexistent lien which springs up under state law at the moment of bankruptcy to secure an antecedent debt would seem to raise a serious question—as to whether it is a voidable preference under section 60 of the Bankruptcy Act."

Professor Gilmore defends "formula proceeds" against the attack that it is a vulnerable state-created priority and against the attack that it is a voidable preference. Concerning priorities he writes:

"... (I)n ninety-nine cases out of a hundred (the estimate is conservative), what will be in the debtor's account on the date of insolvency, in any case where a secured party has a § 9-306 (4) (d) claim, will have come from deposits of proceeds to a much greater extent than the carefully limited amount of the claim."

He insists that attacks on § 9-306 (4) (d) are based on a "superficial reading" of that section, and he goes on to assert that:

"in the great run of cases, whatever is left in the debtor's bank account on bankruptcy day will represent deposits of proceeds of collateral made during the several weeks preceding bankruptcy. On pre-Code theories of tracing, the secured party in many cases might be able to establish his claim to the entire balance. Paragraph 4(d) restricts his

(Continued from preceding page)

bank accounts of the debtor prior to bankruptcy, there is no doubt that he would take priority over a secured creditor if insolvency proceedings commenced thereafter." (Emphasis supplied.) The treatise writer adds: "At the date of bankruptcy, the trustee is such an attaching creditor." He is not, and the assertion that he is conflicts with the *Lewis* case (*supra* n. 187). The trustee is not on who levies prior to bankruptcy.

190 215 F.2d 571 (2d Cir. 1954).
191 Marsh, *supra* n. 122, at 908.
192 *Supra* n. 172, at 1339.
claim to whatever may have been received during the 10
days, less the required deductions.”

He argues that a rule which re-enacts “the substance if not the
form of the Benedict rule” should not be invalidated. His
arguments against the attack on § 9-306 (4) (d) based on § 60
B.A. are in a similar vein. He admits:

“It would surely not be hard to construct a § 60 argument
against a ‘security interest’ which, on the filing of a bank-
ruptcy petition, attached, for the first time to the bankrupt’s
unencumbered ‘general assets.’”

Then he argues that § 9-306 (4) (b) of the Code, unlike § 10 (b)
of the UTRA “does not give a claim to ‘general assets,’ but only
to money in the bank account. Factually, the possibility that the
bank account will be made up of anything but the deposits and
collections of proceeds is small indeed.”

Professor Gilmore’s arguments (not all of which are listed
supra) are very persuasive, and perhaps should lead to an
amendment to the Bankruptcy Act, validating section 9-306 (4)
(d) of the Uniform Commercial Code. His argument that, in
the great run of cases, trustees in bankruptcy will be helped
and general creditors will get a greater dividend under the Code
provision than under pre-Code laws of tracing, which the Bank-
ruptcy Act recognized, is persuasive. The difficulty with this
approach is that the trustee in bankruptcy may not be interested
that, in general, trustees will be benefited by this section. He
will argue that under the criteria, admittedly vague, for deter-
mining what is a priority, this is a state-created priority; and he
will argue further that there is a preference, assuming he can
show that the transferee, secured party, had reasonable cause
to believe that the debtor was insolvent.

What is a priority? In re Harpeth Motors, Inc. held that
§ 10 (b) of the Uniform Trust Receipts Act did not create a
priority. However, there was language in the Harpeth case
which is disturbing to those defending § 9-306 (4) (d) of the Uni-
form Commercial Code. The Court writes that section 10 of the
Uniform Trust Receipts Act does not make “. . . the insolvency

193 Id. at 1340.
194 Id.
195 Id. at 1344.
196 Id.
197 Supra n. 185.
of the trustee a condition precedent to the rights conferred” by that section. The rights, it is said, were intended to be preserved “even in the absence of a proceeding looking to the general distribution of the assets of the trustee.” The rights granted by section 9-306(4) (d) arise only “in the event of insolvency proceedings." Thus, even the Harpeth case, to which one might look for support of the Code, has language which is troublesome. In re Crosstown Motors, Inc. held that § 10 of the Uniform Trust Receipts Act “... does not create a lien on the general assets of the Bankrupt, but is a state-created priority invalid under § 64 of the Bankruptcy Act 11 U.S.C.A. 104 ...” The reasoning of the Court leaves something to be desired. The court relied heavily on the fact that the Uniform Trust Receipts Act used the word “priority” in describing the interest protected. The Code drafters originally used the word “priority” in § 9-306 (4) (d), but avoided the verbal trap by changing the language after the Harpeth case was decided. Section 9-306(4) makes it clear that the § 9-306 (4) (d) interest is a perfected security interest. The change in terminology deprives the trustee in bankruptcy of one argument, but can hardly be dispositive on the question of priority. In re Harpeth Motors, Inc. teaches that the test does not depend upon labels but upon an examination of the nature of the interest created.

One basis of argument that the Uniform Commercial Code interest created by § 9-306 (4) (d) is not a priority, and one way to distinguish the Uniform Trust Receipts Act, is that the Uniform Trust Receipts Act gave a claim on the general assets of the bankrupt, whereas the Uniform Commercial Code's interest is more circumscribed. Other tests are suggested. Professor Honnold, under the heading “Lien v. Priority: the search for an objective test” asks two questions:

“... [One] is it not necessary to ascertain the concrete situations in which state law would preclude a levy by creditors against the assets in question? Cf. Bankruptcy Act Section

198 Id. at 868.
199 Id.
200 272 F.2d 224 (7th Cir. 1959), cert. den. 363 U.S. 811 (1960).
201 Id. at 225.
202 Gilmore, supra n. 172, at 1343, 1344.
203 Supra n. 185.
204 Gilmore, supra n. 172, at 1344.
SELECTED PREFERENCE PROBLEMS

60 (a) (2). [Two] Would it not also be helpful to consider the extent to which state law has impact apart from stating rules of priority for the distribution of assets in an insolvency proceedings?

The interest created by § 9-306 (4) (d) of the Code seems to be in trouble under both questions. Up to the time of bankruptcy the proceeds commingled with other money in a bank account would be subject to lien creditors, and the § 9-306 (4) (d) rule under state law has no impact at all, apart from stating rules of priority for the distribution of certain assets in insolvency proceedings.

It would seem that the interests of the secured party in "formula proceeds" under § 9-306 (4) (d) of the U.C.C. is indeed precarious. However, hope need not be abandoned. There are technical reasons supporting the secured party against a preference attack, and the priority test under § 64 is sufficiently vague that a court may go either way. Given judicial latitude, Gilmore's policy and fairness arguments take on added significance.

XI. Technical Defense Against a Preference Charge

Section 9-306 (4) (d) poses a preference problem because the transfer, made simultaneously with the filing of a bankruptcy petition, will invariably be for an antecedent debt. That there is a transfer is, of course, unmistakable. Prior to the petition there was no interest held by the secured party in the bank account of the debtor. At the instant the petition is filed, § 9-306(4) (d) grants to the secured party an interest he did not have before. However, to constitute a preference a transfer must occur "within four months before the filing . . . . of the petition . . . initiating a proceeding under this Act." (emphasis supplied). Section 9-306 (4) makes it clear that the transfer takes place "in the event of insolvency proceedings." Insolvency proceedings clearly include Bankruptcy proceedings. Thus the reasonable construction of § 9-306 (4) is that the transfer takes place at the very instant the petition is filed, not before filing. Thus, one of the essential elements of a bankruptcy preference is missing, and the trustee, if he is to prevail, must look to some other sec-

206 Infra, next paragraph.
207 B.A. 60(a).
208 U.C.C. 1-201(22).
tion of the Bankruptcy Act. Section 64 is the obvious section and the outcome there is, as indicated, uncertain.

XII. Prior Identifiable Proceeds

Thus far we have been assuming, with respect to §9-306(4)(d), that the bank account, whether it contained proceeds or not, did not contain proceeds identifiable prior to the "event of insolvency proceedings." The attacks of the trustee are easily repulsed if the bank account contained funds identifiable as proceeds. Here §9-306(4)(d) would either cut down the secured party's interest previously safe under §9-306(2), or grant a security interest, according to formula, equal to the identifiable proceeds. The second alternative, a happy one for the secured party, would occur if collections were made every ten days.

There would be no preference problem (assuming the security interest in the identifiable proceeds was invulnerable), since there would be no transfer of the property of the debtor. There would be no problem under §67(c) B.A., because the lien does not first become effective upon the insolvency of the debtor.209 Section 70(c) B.A. would pose no problem, since the security interest would antedate bankruptcy and there would be continuous perfection.210 As for the §64 B.A. attack, in addition to the defenses listed above, there would be the additional defense that the security interest did not arise at the institution of insolvency proceedings, and that the secured party was safe from lien creditors prior to the insolvency proceedings.

XIII. Conclusion

In writings and speeches too numerous to mention, the Code has been subjected to attack, and often the cudgel has been, quite naturally, the Bankruptcy Act. Underlying the technical bases of attacks, there lies hostility to the Code's allowance of perfection of security interests in a wide range of collateral in a manner that is relatively easy, even for the amateur. Some of these attacks have been reviewed in this article. The Code opponents fear that the great power granted by the Code will result in actions that are unwise. Financing institutions may over-

209 §9-303(2).
210 Id.
reach in demanding security, and debtors may unwisely ex- 
hau their capacity to attract capital. Indeed these evils may 
be attendant on the Code's liberality. But the legislature is not 
the only force that has the power of deterring folly. The in-
visible hand of Adam Smith, the workings of the market place, 
is effective to ferret it out. Indeed it is a better mechanism 
than legislative action. For if the Code had restricted the areas 
in which security could be perfected, it undoubtedly would 
have condemned wise action along with the unwise. Broad 
legislation cannot be effectively refined to make distinctions in 
all areas where delicate business judgment can adequately do 
the job. It is the best part of wisdom to broadly validate security 
interests, with appropriate restrictions for publication, possession, 
etc. and leave it to individual decision to work out the best de-
vices unfettered by legislative restrictions. The following is a 
slightly altered quote from Davis v. Turner:

“If a short and easy mode could be found of cutting up 
[folly] . . . by the roots, the discovery would be invaluable, 
but such an enterprise is beyond the limits of human wis-
dom.” 211

Lacking such wisdom, the legislature, in invalidating broad-
ly, will inevitably impair legitimate and wise financing in its at-
tempt to limit security devices to prevent possible abuses. The 
drafters of the Code avoided this trap without trenching on the 
general policies and purposes of the Bankruptcy Act. Their 
works should bear fruit unimpaired by that Act.

211 4 Grottan 422 (1848).