Priority Rules of Article Nine

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SPECIAL PROJECT

THE PRIORITY RULES OF
ARTICLE NINE

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I

Introduction

Priorities. The very word sends chills down the sane lawyer's spine. But if fear and loathing of Article Nine's priority scheme served as a deterrent to undertaking this enterprise, they served as an incentive as well. The complexity of the priority rules is matched only by their importance, for as long as secured financing flourishes, priority disputes over personal property are inevitable. It is the purpose of this project to set forth and explore the body of law that resolves those disputes: the priority rules of Article Nine.

The yeoman service rendered by Professors White and Summers made this task much easier. Because their *Handbook of the Law Under the Uniform Commercial Code* examines the state of Code law through 1971, this survey concentrates on developments since that time. Most important among those developments was the extensive revision of Article Nine in 1972. Thus, although prior authority is drawn on when helpful, this discussion focuses on the Code as amended and on post-1971 case law.

A. Code Policy and the Priority Rules

The draftsmen of Article Nine, working in the wilderness of pre-Code law, strove to identify policies upon which to build a sensible system of priority rules. Central among the draftsmen's concerns was the need to objectify and simplify legal structures in order to promote certainty and efficiency in commercial financing. In turn, this goal worked hand-in-hand with the Code's underlying policies of uniformity and modernization. But the priority rules represent a complex interplay of many, sometimes subtle, policy considerations. The following discussion isolates the

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2 Throughout this survey, references to the Code sections, unless otherwise indicated, are to the Code as amended in 1972. Sixteen states have adopted the 1972 amendments. 3 U.L.A. 1977 Pamphlet 2-3 (Adoptions of Revised Article 9).


4 The Comment to U.C.C. § 9-101 states in part: "The aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty."

5 See U.C.C. § 1-102(2)(a), (c).
most important of these policies and presents specific examples of their operation within the Code.\(^6\)

1. **Commercial Certainty**

Commercial financers must be able to ascertain readily their rights with respect to borrowers, buyers, and other creditors. The Code endeavors to address this need with comprehensive provisions. The Code's fundamental priority rule is the race-to-file principle of section 9-312. This rule provides a simple test for determining priority. Public filing will reveal to others security interests already taken in the debtor's property, and under a pure-race rule creditors may rely on the files to establish their priority definitively.\(^7\)

Significantly changing pre-Code law, section 9-312 makes knowledge and notice irrelevant to priority. A creditor with knowledge of an unperfected security interest may nonetheless take priority by filing first. This result is justifiable—it is easy to file, and secret security interests impede commercial transactions. Eliminating knowledge as a factor provides more objective standards for determining priorities and encourages creditors to file. Commercial certainty correspondingly flourishes.

Article Nine's explicit and extensive definitions and comprehensive conflict-resolving rules guard against judicial tinkering.\(^8\) Although extra-Code law remains applicable under section 1-103,\(^9\) the thoroughness of the priority rules militates against its application. Moreover, the Code abolishes a meddlesome multitude of pre-Code consensual security devices and court-imposed remedies such as equitable liens.\(^10\) In short, Article Nine provides sure and simple rules that should answer most of the secured party's legal questions before he heads for the courthouse.

2. **Efficiency**

In general, the certainty and notice supplied by the pure-race priority scheme facilitate efficiency in the business world.

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\(^6\) Specific provisions of Article Nine must be analyzed with reference to the underlying policies of the priority rules. See U.C.C. § 1-102(1).

\(^7\) The secured creditor can also achieve priority by taking and retaining possession of the collateral. See U.C.C. § 9-305.

\(^8\) Detailed definitions are provided in U.C.C. §§ 1-201, 9-105 to -109.

\(^9\) Whenever possible, the Code's provisions should be applied without resort to non-Code law. Cf. U.C.C. § 1-104, Comment ("This Act [is] carefully integrated and intended as a uniform codification of permanent character covering an entire 'field' of law . . . ").

\(^10\) The Code has abolished equitable liens only in part, and they continue to pose difficulties. See notes 286-309 and accompanying text infra.
Businessmen can find out exactly where they stand, and therefore can plan effectively. Occasionally, however, efficiency requires a sacrifice of other values underlying Article Nine. For example, section 9-302(1)(d) automatically perfects purchase money security interests in consumer goods. With this rule, the Code favors sellers and other financers of consumer goods, who would otherwise be required to file innumerable financing statements in collateral frequently of little value. In this exceptional case the Code endorses the secret security interest, all to encourage efficiency in secured financing and to avoid economic waste.

3. Protecting Reliance Interests

To avoid adverse reliance, Article Nine usually conditions priority upon the creditor's provision of notice. Creditors supply this notice by filing financing statements or by taking possession of the collateral. The priority rules impose sanctions to encourage this practice: sections 9-301 and 9-312 reward those who file or take possession and penalize those who do not. Roughly speaking, when one relies on the absence of notice of a prior interest, he obtains priority by filing first or by buying without knowledge of a prior security interest in the collateral.¹¹

Filing usually suffices to give a creditor priority. However, the drafters recognized that Article Nine's filing rules would not supply adequate notice in all situations. The Code therefore provides or encourages certain special filing procedures, as in the case of fixtures¹² and motor vehicles.¹³ In keeping with the notice value, the Code in some circumstances makes knowledge of another's interest a bar to defeating that interest, as in sections 9-307(2), 9-301(1)(c), and 9-308, which govern priority disputes involving buyers and transferees. In sum, although notice may not explain all priority outcomes, it is at the heart of priority policy.

4. Encouragement of Commercial Growth

"Good business practice should be good business law."¹⁴ In keeping with this maxim, the priority rules encourage socially useful commercial practices. Because the security of purchasers—

¹¹See, e.g., U.C.C. § 9-307(1), (2) (buyers in ordinary course of business and buyers of consumer goods), U.C.C. § 9-308 ( transferees of chattel paper in inventory sales), U.C.C. § 9-309 (transferees of negotiable paper).

¹²U.C.C. §§ 9-313(1), 9-402(5).

¹³U.C.C. § 9-302(1)(d), (3)(b).

consumers, bulk buyers, holders in due course, or transferees of chattel paper—is crucial to the free flow of goods through the economy, these parties receive broad protection.\(^5\) Allowing the seller's secured creditor recourse to collateral purchased by a consumer would, aside from raising serious questions of fairness, weaken the underpinnings of our economic system by discouraging marketplace transactions. Accordingly, the Code shelters buyers out of inventory with one of its most important consumer-protection provisions—section 9-307(1). Sections 9-306 through 9-309 allow various purchasers to take collateral free of the interests of secured creditors. Indeed the drafters found the buyer-protection interest so important that in certain cases they chose to protect even buyers with knowledge of preexisting security interests.\(^6\)

On the whole, the simple pure-race rule of section 9-312 keeps the stream of commerce flowing smoothly and facilitates commercial growth. But the drafters were also aware of problems inherent in the first-to-file rule. Leery of the adverse effect that monopolization of credit might have on our growth-oriented economy, they wisely arranged for debtor access to alternate sources of funds. The purchase money priority provisions carry out this purpose, as do Code-endorsed subordination agreements and the termination procedures of section 9-404. Moreover, the Code allows debtors to obtain detailed information on existing credit arrangements, permitting them to deal frankly and fruitfully with other would-be lenders.\(^7\) In short, the Code allows businessmen to structure their transactions with complete information and substantial freedom from restrictive rules.

5. Fairness

Article Nine's simplified and objective rules for settling priority disputes are remarkably attuned to achieving not just certainty, but equity as well. To the extent that availability of information is important to equity, the infusion of notice into the priority rules

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\(^{15}\) See U.C.C. §§ 9-301(1)(c), 9-307, 9-308, 9-309.

\(^{16}\) See U.C.C. § 9-307(1) & Comment 2. One interesting example of priority rule favoritism involves not buyers, however, but construction mortgagees. Section 9-313(6) protects the optional advances made by these creditors against previously filed purchase money security interests in fixtures, even if the construction mortgagee has knowledge of the fixture interest. This priority rule appeared for the first time in 1972, perhaps in response to a depressed construction industry. See generally U.C.C. § 9-313, Comment 4(e); notes 450-61 and accompanying text infra.

\(^{17}\) See U.C.C. § 9-401 & Comment 1; U.C.C. § 9-407.
goes far toward achieving fair results. Section 9-401(2) mitigates the rigor of a hard-and-fast first-to-file rule by protecting the good faith creditor who files improperly, if his competitor has obtained knowledge of the contents of his financing statement. Thus, even in the hard race between diligent creditors, the Code inserts a rule to avoid rigidity. The priority rules show a further concern with equity in distinguishing between those who buy in good or bad faith, and by generally endorsing equitable doctrines such as estoppel.

In keeping with notions of equity, the priority rules vigorously favor the diligent; the most diligent creditor will almost always win. At times, this emphasis on diligence may trod fairness underfoot. The most obvious case involves the secured creditor who perfects with knowledge of a preexisting unperfected security interest, yet takes priority over it. This result may seem harsh, but removing the element of subjective knowledge goes a long way toward achieving efficiency, simplicity, and certainty in secured financing.

The interaction of these policies has produced the subtly sophisticated fabric of rules embodied in Article Nine. Policy issues will arise repeatedly in this survey of the priority rules. Judges and lawyers must be ever sensitive to these policies, for they provide not only fertile sources of argument, but the very bedrock on which Article Nine is built.

B. The General Validity of Security Agreements—Section 9-201

By establishing the general validity of security agreements, section 9-201 provides the proper point of departure for any examination of the priority rules:

Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. . . .

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19 See U.C.C. § 1-103.
20 See U.C.C. §§ 9-301, 9-312. Purchase money secured creditors whose interests automatically perfect under § 9-302(1)(d) obtain extra protection against consumers by taking the otherwise needless step of filing. See U.C.C. § 9-307(2) & Comment 3.
22 U.C.C. § 9-201.
In effect, this section provides that upon the debtor's default, the holder of an Article Nine security interest has rights in the claimed collateral superior to anyone, anywhere, anyhow—"[e]xcept as otherwise provided by this Act." The importance of that phrase cannot be overestimated, for the "exception" of section 9-201 encompasses all of Article Nine's priority rules.

Courts usually refer to section 9-201 only in passing before beginning their analysis of priorities. In General Motors Acceptance Corp. v. Allstate Insurance Co., however, the court gave section 9-201 an unprecedented reading. In that case, GMAC held a perfected purchase money security interest in the debtor's car. The debtor was involved in an automobile accident with a driver insured by Allstate. As part of the insurance settlement, the debtor's virtually demolished car was transferred by bill of sale to Allstate. When the debtor defaulted on his contract with GMAC, GMAC demanded the entire accelerated balance due from Allstate. Relying on section 9-201's declaration that "a security agreement 'is effective according to its terms . . . against purchasers of the collateral,'" the court held that Allstate, as purchaser of the automobile, owed GMAC the balance of the purchase price. Although uncomfortable with its decision, the court felt "bound to follow the statutes." In "following" section 9-201, however, the court gave the section an unjustifiable interpretation. The secured creditor's remedy upon default against a subsequent "purchaser" of the collateral is repossession. Upon default, GMAC could have repossessed the wreck. By "purchasing" the automobile, Allstate did not assume contractual liability for the debt. In holding to the contrary, the court defeated the parties' expectations. The purchaser of collateral subject to a security interest should not have to fear liability for the balance of the debtor's obligation. In extending a loan secured by collateral, the secured creditor contemplates a dual remedy upon default against both the debtor and the collateral. His expected remedy does not include the right to collect

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23 See WHITE & SUMMERS, supra note 1, § 25-2, at 901.
24 See U.C.C. § 9-201, Comment.
26 Id. at 850, 355 N.Y.S.2d at 79. Although Allstate took title, it permitted the debtor to retain possession so that he could realize the salvage value of the wreck.
27 Id. (emphasis deleted).
28 Id. at 851, 355 N.Y.S.2d at 80.
directly from third parties. Providing such a remedy sorely distorts
the language of the Code and contradicts sound commercial
practice.

II

PRIORITIES AMONG SECURED CREDITORS—SECTION 9-312

First in time, first in right. That rule once rode roughshod
through commercial law.\textsuperscript{30} Too gross a generalization; it left in-
equity and confusion in its train. But time has tamed that unman-
ageable maxim. No longer does it summon up more questions than
answers, or provide a tool for ad hoc jurisprudence. Though it
runs as a theme through Article Nine, the rule has been tempered
in light of its testing. The result is section 9-312.\textsuperscript{31}

Section 9-312 settles disputes—disputes arising when multiple
parties hold competing security interests in the same collateral.\textsuperscript{32}

\textsuperscript{30} See White & Summers, supra note 1, § 25-4, at 905-06.

\textsuperscript{31} Consider one commentator’s observations on pre-Code secured transactions law:
“[T]he trouble has come from the ever-increasing complexity of the commercial facts of
the credit economy. Certainly in the last forty years, these facts have, like the proverbial
hare, outrun the tortoise-like capability of courts to deal with them.” Oldfather, Floor Plan

For a recent example of a court’s application of the first-in-time rule without an un-
derstanding of Code refinements, see Valley Bank & Trust Co. v. Gerber, 526 P.2d 1121,
15 U.C.C. Rep. 1035 (Utah 1974). In that case, involving a dispute between two purchase
money secured parties over home furnishings, the court essentially ignored the Article
Nine rules on purchase money security interests. Instead, it summarily based its holding on
this statement: “The general rule is that as between security interests in the same property,
the one prior in time ordinarily takes preference over a later one.” 526 P.2d at 1125, 15
U.C.C. Rep. at 1040 (footnote omitted). Such conclusory reasoning invites the same confu-
sion that characterized pre-Code priority conflicts. Indeed, the Valley Bank court granted
priority to the first security interest to attach. Because both security interests were per-
fected, that test was patently inapplicable. See U.C.C. § 9-312(4), (5)(b). The court also
failed to address such important issues as priority between conflicting purchase money
security interests (see notes 223-28 and accompanying text \textit{infra}), and the effect of auto-
matic perfection of purchase money security interests in consumer goods (see U.C.C. §
9-302(1)(d)). Amazingly, since both security interests were purchase money security inter-
ests in consumer goods, they perfected automatically. U.C.C. § 9-302(1)(d). Hence, the
dates of attachment were the dates of perfection, and the dates of attachment determined
the priorities. Although it reached a correct result, the court was clearly oblivious to this
unusual path through the Code.

\textsuperscript{32} U.C.C. § 1-201(37) defines a “security interest” as
an interest in personal property or fixtures which secures payment or perfor-
mance of an obligation. The retention or reservation of title by a seller of goods
notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in
effect to a reservation of a “security interest”. The term also includes any interest
of a buyer of accounts or chattel paper which is subject to Article 9. . . .
For the most part, its rules are strikingly straightforward. Yet important issues remain unresolved.

A. Basics and the Basic Rule

1. Competing Security Interests—The Scope of Section 9-312

Section 9-312 sets priorities among competing security interests; it does not apply when only one secured creditor asserts an interest in the debtor’s property.\(^3\) If, for example, a buyer challenges a secured creditor claiming through the seller, he should not look for help in section 9-312.

An important and illustrative “competing security interest” issue involves priority disputes between the typical secured party, such as a bank, and a contractor's surety.\(^4\) Is the surety a secured party, and therefore subject to Article Nine’s priority rules? Well, yes and no.

Surety contracts normally provide for assignment of the contractor's accounts to the surety upon default by the contractor, and completion of performance by the surety. Although this conditional right to accounts looks like a security interest, the Code apparently exempts it from the rules of Article Nine.\(^5\) Courts have found that acquiring a security interest is “as easy as rolling off a log.” He is quick to add, however, that “the security interest, once taken and perfected, is then circumscribed by [a] network of limitations . . . , most of all, by the elaborate structure of the priority rules.” \(^1\) GILMORE, supra note 3, § 11.7, at 364.


\(^4\) See generally 2 GILMORE, supra note 3, ch. 36; WHITE & SUMMERS, supra note 1, § 22-5, at 769-71; Cushman, The Surety's Right of Equitable Priority to Contract Balances in Relation to the Uniform Commercial Code, 39 TEMP. L.Q. 239 (1966); Withers, Surety vs. Lender: Priority of Claims to Contract Funds, 10 WASHBURN L.J. 556 (1971); Note, Equitable Subrogation—Too Hardy a Plant To Be Uprooted by Article 9 of the UCC?, 32 U. PITT. L. REV. 580 (1971).

\(^5\) U.C.C. § 9-104(f) makes Article Nine inapplicable to “a transfer of a right to payment under a contract to an assignee who is also to do the performance under the contract . . . .” Gilmore argues that § 9-104(f) was not intended to apply to sureties, but only to delegates of the contractor's duties. Hence, he concludes that § 9-312(5) probably does cover priority disputes between sureties and secured parties, but recommends use of such “escapes” as subrogation theory and special proceeds rules to protect the surety against the danger that, through failing to file, he would lose to the secured creditor under
consistently held that the surety's right to accounts springs from the equitable doctrine of subrogation,\textsuperscript{36} which properly augments Article Nine via section 1-103.\textsuperscript{37} Hence, whether or not it has filed or perfected, the surety will take priority as to the contractor's accounts and contract rights over a properly perfected secured creditor.\textsuperscript{38}

But the courts have danced a different step where the surety obtains rights in the debtor's equipment contingent upon default. This is a security interest, and section 9-312 controls.\textsuperscript{39}

Be not deceived by this brief analysis. Professor Gilmore cautions that "[d]espite more than sixty years of judicial analysis, the bank-surety priority problem may today be further than ever from a generally accepted solution."\textsuperscript{40}

\begin{footnotesize}
\begin{enumerate}
\item See 2 Gilmore, supra note 3, § 36.7, at 973-78. It is also noteworthy that, insofar as the surety's rights arise by operation of law through the subrogation doctrine, its "security interest" is nonconsensual and therefore free of Article Nine restrictions by virtue of § 9-102. See White & Summers, supra note 1, § 22-5, at 770.
\item See cases cited in note 38 infra.
\item U.C.C. § 1-103 provides:

\begin{quote}
Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.
\end{quote}

\item 2 Gilmore, supra note 3, § 36.1, at 949. Gilmore's conclusion strikes us as somewhat inaccurate. The surety-versus-secured-party conflict has caused far more confusion among commentators than courts.
\end{enumerate}
\end{footnotesize}
2. Priorities and Filing—A Pragmatic Introduction

The priority rules work hand-in-hand with the filing system, and an understanding of each is necessary to appreciate the other. With respect to filing, section 9-312 gives rise to two basic, practical rules for anyone thinking of acquiring a security interest.41 These rules should be emphasized at the outset:

(1) File.
(2) Check for previous filings.42

To the uninitiated, these rules may appear inverted. Not so. Filing does not create a security interest; a filing, with nothing more, obligates no one to do anything.43 The moral: file fast—at least as soon as a security agreement is in sight.44 First in time may well mean first in right.45

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41 Indeed, these rules are not limited to those seeking to acquire a security interest. Potential buyers and sellers as well must often proceed with caution. See, e.g., Rivan Die Mold Corp. v. Stewart-Warner Corp., 26 Ill. App. 3d 637, 325 N.E.2d 357, 17 U.C.C. Rep. 570 (1975) (A contracted to pay B's invoices directly to C; A exposed to double liability because of failure to check files and discover D's security interest in B's accounts).

42 An important corollary to this rule is: "Check the debtor"; that is, make sure the debtor is in possession of the collateral. If he is not, chances are another creditor has perfected by taking possession—if the collateral exists at all.

43 "[T]he document placed on file is not the relevant security agreement... but merely a statement or notice that the parties intend to engage in a security transaction or in a series of such transactions." 2 GILMORE, supra note 3, § 34.3, at 903. Although financing statements have occasionally been held to constitute security agreements, courts generally disfavor this construction. See, e.g., Barth Bros. v. Billings, 68 Wis. 2d 80, 87-90, 227 N.W.2d 673, 677-78, 17 U.C.C. Rep. 237, 242-44 (1975) (to qualify as security agreement, financing statement must expressly indicate debtor's intention to create security interest). The careful practitioner will avoid this potential pitfall by including a clause in the financing statement stating that the parties do not intend the financing statement to serve as a security agreement.

44 The Code specifically allows the filing of a financing statement before the execution of a security agreement (U.C.C. § 9-402(1)), although some parties may experience a "fear of filing." For example, in James Talcott, Inc. v. Franklin Nat'l Bank, 292 Minn. 277, 194 N.W.2d 775, 10 U.C.C. Rep. 11 (1972), a lessor lost purchase money priority because it failed to file as to a lease later held to give rise to a security interest. Perhaps the lessor feared that filing would provide evidence that its lease was intended as a security agreement. See U.C.C. § 9-201(37). But see U.C.C. § 9-408 (filing by itself not evidence that lease intended as security). But how would this matter? In any case, if the lessor had filed, it would have received priority. As a nonfiling secured party, however, it got nothing. It is difficult to imagine a situation in which an early filing could harm the filer, aside perhaps from potentially adverse tax consequences and the cost and inconvenience that recording a financing statement entails. See U.C.C. § 9-403(5).

45 In Transport Equip. Co. v. Guaranty State Bank, 518 F.2d 377, 17 U.C.C. Rep. 1 (10th Cir. 1975), A, a secured party, filed as to C's "body kits" at 1:57 p.m. on March 22. B, another secured party, began to load the body kits onto its trucks sometime after 3:24 p.m. the same day, so as to perfect by taking possession. Although the case, in our opinion, was
But before entering into a security agreement, check the files. In most cases, a previously filed financing statement covering intended collateral guarantees subordinate status to a later-filing secured creditor. Rush into filing, but not into contracting. This will maximize the chances of gaining what all secured parties seek: priority.

3. The First-to-Perfect-or-File Rule—Section 9-312(5)(a)

To appreciate practicalities, the practitioner must know the law. Let us start with the general rule:

In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsection (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

Section 9-312(5)(a) defines "first in time." The basic rule is simple: Among secured creditors, the first to perfect or file wins. The most common application of this rule allows a perfected security interest to take priority over an unperfected security interest. Between

wrongly decided (see notes 98-108 and accompanying text infra), it nonetheless illustrates the dangers of delayed perfection.

46 U.C.C. § 9-312(5)(a). Professors White and Summers correctly emphasize the importance of this section. "Subsection (5) is the million dollar residuary clause, and it governs more priority disputes than all of the other subsections combined." WHITE & SUMMERS, supra note 1, § 25-3, at 905. Accord, Balint, Section 9-312: Priorities Among Conflicting Security Interests in the Same Collateral, 1975 ARIZ. ST. L.J. 311, 312. Actually, a majority of post-1971 cases involve the purchase money priority rules of subsections 9-312(3) and (4). But as § 9-312(5) makes clear, secured parties who fail to qualify for purchase money priority tumble into § 9-312(5)(a), where they are generally defeated. For one of numerous applications of this rule, see National Bank v. Dugger, 335 So. 2d 859, 19 U.C.C. Rep. 1396 (Fla. Dist. Ct. App. 1976) (because priorities unaffected by lis pendens, first filer prevails).

47 Section 9-301(1)(a) emphasizes this conclusion. Comment 2 to § 9-301 explains: "The interests given priority under Section 9-312 and the other sections therein cited take such priority in general even over a perfected security interest. A fortiori they take priority over an unperfected security interest, and paragraph (1)(a) of this section so states."
perfected secured parties, the first to perfect or file wins, even if his security interest is second to attach; and the first to file takes priority, even if his security interest is the second to be perfected.

Knowledge of a prior security interest is irrelevant to priority. Section 9-312(5)(a) is a pure race statute. The drafters' security interests. Since an unperfected security interest is nonetheless a security interest, and since a perfected secured party will always file or perfect before his unperfected competitor, § 9-312 always favors perfected over unperfected security interests. Hence, § 9-301(1)(a) is a merely a cross-reference, rather than a substantive provision.


The court in Thompson v. United States, 408 F.2d 1075, 1083 n.13, 6 U.C.C. Rep. 20, 28 n.13 (8th Cir. 1969), commented that "generally, notice of a pre-existing, unperfected lien is immaterial under the Code." The court's use of "generally" apparently refers to § 9-401(2) (see notes 84-88 and accompanying text infra) and certain provisions of § 9-301. The 1972 amendments removed the knowledge requirement from § 9-301(1)(b), on the ground that it was inconsistent with the "race" nature of the priority rules. See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, FINAL REPORT 78 (1971) [hereinafter cited as FINAL REPORT].

Gilmore toys with the notion of distinguishing knowledge at the time of attachment from knowledge at the time of perfection as a possible interpretation of § 9-312(5). See 2 GILMORE, supra note 3, § 34.2, at 900-01. See also Comment, Knowledge and Priorities under Article Nine: A Proposed Rule Change in the "Race of Diligent Creditors," 47 U. COLO. L. REV. 467, 469-70 n.12 (1976). Yet even Gilmore concedes that "the apparent meaning of § 9-312(5) is that there is no good faith limitation and that knowledge at any time is irrelevant." 2 GILMORE, supra note 3, § 34.2, at 901. See In re Smith, 326 F. Supp. 1311, 1314, 9 U.C.C. Rep. 549, 553 (D. Minn. 1971) (rejecting Gilmore's distinction).

A "pure race" rule grants priority to the first party to file or perfect. A "race-notice" rule grants priority to the first party to file or perfect, unless he has notice of another party's security interest. The pure race rule is simpler and more predictable, reduces litigation, and if litigation arises, obviates the need for evidence concerning state of mind. On
choice of "pure racing" is in keeping with the Code's goal of simplifying, clarifying, and modernizing commercial law.\textsuperscript{52} Results under a pure race rule and race-notice rule seldom differ, because the first to file almost always lacks knowledge of a previous security interest. Hence, the predictability that section 9-312(5)(a) ensures more than offsets the few inequities it produces. This principle is perhaps best appreciated in the context of all of Article Nine:

The fundamental purpose of Art. 9 of the code is to make the process of perfecting a security interest easy, simple, and certain. It was intended to be a complete reversal of prior chattel security law and to rid the unaware of the traps of requirement of specific types of acknowledgments, technical affidavits of consideration, selection of specific proper forms, and other pitfalls that were not uncommon. The code very simply and briefly provides for a notice-filing procedure with a minimum of information required to be publicized in a filed financing statement. All that is required is a minimal description, and it may be by type or kind. The statement need not necessarily contain detail as to collateral, nor any statement of quantity, size, description or specifications, or serial numbers. No preciseness is required with respect to whether the collateral exists at the time of filing or is to be acquired thereafter, and no statement of charges, payment schedule, or maturity date need be included in the statement. \textit{The first to file shall prevail. Although there are a few exceptions, they are very clearly and definitely stated.}\textsuperscript{53}

In short, the general rule is simple and straightforward. Yet courts still manage to misapply it.\textsuperscript{54}

\textsuperscript{52} See \textsc{U.C.C.} \textsection{} 1-102(2)(a).

\textsuperscript{53} James Talcott, Inc. v. Franklin Nat'l Bank, 292 Minn. 277, 295, 194 N.W.2d 775, 786, 10 \textsc{U.C.C.} Rep. 11, 28 (1972) (emphasis added).

\textsuperscript{54} For example, in \textsc{Leasing Serv. Corp. v. American Nat'l Bank & Trust Co.}, 19 \textsc{U.C.C.} Rep. 252 (D.N.J. 1976), the court, in ruling on a motion for summary judgment, found that although \textit{A} filed first as to all of \textit{C}'s after-acquired collateral, priority could not be determined until the court examined \textit{B}'s later-filed financing statement. \textit{Id.} at 264. Although the court held that \textit{A} had priority as to property acquired by \textit{C} prior to \textit{B}'s filing, it reasoned that if \textit{B}'s financing statement also included an after-acquired property clause, \textit{A}'s and \textit{B}'s security interests in property acquired by \textit{C} after \textit{B}'s filing would perfect simultaneously. The court characterized this as a "thorny issue." \textit{Id.} But the court's "thorny issue" turns out to be a paper tiger. If both parties perfect by filing, the first to file takes priority regardless
The 1972 amendments to the Code altered the language of section 9-312.\textsuperscript{55} Formerly two rules did the work of section 9-312(5)(a):

In all cases not governed by other rules stated in this section . . . priority between conflicting security interests in the same collateral shall be determined as follows:

(a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) and whether it attached before or after filing;

(b) in the order of perfection unless both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) and, in the case of a filed security interest, whether it attached before or after filing . . . .\textsuperscript{56}

The new, unified rule works one change in priorities. Consider this sequence of events: $A$ files; $B$ perfects in a manner other than filing; $A$ perfects. Under former law, section 9-312(5)(b) controlled because one security interest was not perfected by filing. Therefore $B$, the first to perfect, took priority. But under the new first-to-perfect-or-file rule, $A$, the first to file, wins. Hence, the amendment expands the already sweeping rights of the first filer.\textsuperscript{57}

At least four policy reasons support the change:

(1) Certainty. Under the former rule the first filer could not be sure of his status during the period between filing and perfection. Yet the very purpose of the filing system is to eliminate the need for subsequent checking once a creditor records a financing statement.\textsuperscript{58}

\textsuperscript{55} Article Nine received the lion's share of the 1972 amendments; the alteration of \$ 9-312, however, was primarily cosmetic. \textsc{White} \& \textsc{Summers}, \textit{supra} note 1, \$ 25-4, at 913.

\textsuperscript{56} \textsc{U.C.C.} \textsuperscript{5} \% 9-312(5)(a)-(b) (1962 version).

\textsuperscript{57} Commenting on former \$ 9-312, Professors White and Summers observed: "Because the draftsmen chose to permit perfection by possession and by other non-filing acts, they could not simply give priority to the first to file. However, they went as far as possible in that direction and 9-312(5)(a) is the result . . . ." \textsc{White} \& \textsc{Summers}, \textit{supra} note 1, \$ 25-4, at 907. The remark is something of an exaggeration, since the new version of \$ 9-312, as demonstrated, goes even further than its predecessor in protecting the first filer. In fairness to Professors White and Summers, it must be pointed out that they were among the first to discuss this effect of the 1972 amendment. \textit{See} \textsc{White} \& \textsc{Summers}, \textit{supra} note 1, \$ 25-4, at 912. \textit{See also} Bernstein \& Fleisher, \textit{The Revisions of Article 9 of the Uniform Commercial Code—An Overview}, 54 Chi. B. Rec. 318, 329 n.11 (1973).

\textsuperscript{58} "The justification for the rule lies in the necessity of protecting the filing system—that is, of allowing the secured party who has first filed to make subsequent advances
(2) **Consistency.** If \( B \) had perfected by filing, he would not take priority over \( A \). Why should the result differ merely because \( B \) employs a different method of perfection? Under former section 9-312(5), the force of the first-to-file rule was diminished because an alert subsequent creditor could sometimes circumvent it.

(3) **Notice.** The present rule does not prejudice \( B \). Because a financing statement has been recorded, he can protect himself fully by checking the files.\(^5\) As a matter of policy, it is difficult to distinguish this situation from that in which \( A \) has already filed and perfected. In both cases, \( B \) has at least constructive notice of \( A \)'s interest, or expected interest, in the property. Upon discovering the financing statement, he should look further into the debtor's arrangements, intentions, and desires.

(4) **Policing.** The present rule reduces the possibility of collusion between the debtor and \( B \).\(^6\) Moreover, by increasing the incentive of creditors to examine the files, it reduces the chances of the debtor obtaining value from two innocent creditors, neither of whom intend to obtain a subordinate security interest.

4. **Competing Unperfected Security Interests—Section 9-312(5)(b)**

Section 9-312(5)(b) fills a tiny gap left by the general rule. With laudable terseness, it provides for priority among unperfected security interests:

So long as conflicting security interests are unperfected, the first to attach has priority.\(^6\)

As the Comment explains, this subsection gets little business:

Subsection (5)(b) adds the thought that so long as neither of the interests is perfected, the one which first attached (i.e., under the advance first made) has priority. The last mentioned rule may be thought to be of merely theoretical interest, since it is hard to imagine a situation where the case would come into litigation without either [party] having perfected his interest.\(^6\)

The Comment's prediction is borne out by the case law. Only one reported post-1971 case even flirts with the notion of applying

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\(^5\) See Coogan, *supra* note 33, at 508.


\(^6\) U.C.C. § 9-312(5)(b).

\(^6\) U.C.C. § 9-312, Comment 5.
The subsection's extended vacation results largely from the fact that a secured creditor may perfect his security interest by taking possession of the collateral in foreclosure. Of course, the taking of possession by one secured party is what generally leads to court fights over priorities.

B. Exceptions to the First-to-Perfect-or-File Rule

Exceptions—and supposed exceptions—riddle the first-to-perfect-or-file rule. Some emerge from section 9-312. Others hide in the crannies of Article Nine.

1. Security Interests in Crops—Section 9-312(2)

As impotent as section 9-312(5)(b) is section 9-312(2):

A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops

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63 In Engelsma v. Superior Prods. Mfg. Co., 298 Minn. 77, 212 N.W.2d 884, 13 U.C.C. Rep. 944 (1973) (per curiam), the trial court held for A, whose security agreement covered property sold to C, over B, whose security agreement covered property brought onto C's premises. The lower court found that neither party had perfected, and that A's security interest had attached first, i.e., upon sale rather than upon delivery of the collateral. Id. at 80-81, 212 N.W.2d at 886, 13 U.C.C. Rep. at 946-47 (appellate court's summary of trial court's opinion). The Minnesota Supreme Court affirmed, relying on pre-Code law. Unable to resist a reference to Article Nine, however, the court went on to point out that even if the Code applied, priority belonged to A. The court found that A had perfected its security interest through repossession, and was entitled to priority under the first-to-perfect rule. Id. at 80, 212 N.W.2d at 886, 13 U.C.C. Rep. at 947. But the court conceded that under its own or the lower court's theory, A was entitled to priority. Id. at 80-81, 212 N.W.2d at 886, 13 U.C.C. Rep. at 947. Hence, the only reported use since 1971 of the first-to-attach rule came in the form of "alternative dictum."

64 In re Char, 4 SEC. TRANS GUIDE (CCH) ¶ 52,373 (S.D.N.Y., Bankr. Ct. 1974) (summary of opinion); James Talcott, Inc. v. Franklin Nat'l Bank, 292 Minn. 277, 194 N.W.2d 775, 10 U.C.C. Rep. 11 (1972); Barry v. Bank of New Hampshire, 113 N.H. 158, 304 A.2d 879, 12 U.C.C. Rep. 732 (1973). See U.C.C. § 9-305. Note that possession of the collateral by the secured party may serve as a perfecting act (U.C.C. § 9-305), an "attaching act" (U.C.C. § 9-203), or both. But to substitute for a security agreement, possession must be "pursuant to agreement." U.C.C. § 9-305(1). Therefore, repossession without agreement will not result in attachment. No agreement is necessary for possessory perfection, but one court has suggested, somewhat obscurely, that perfection will not result if the secured party repossesses "wrongfully." Engelsma v. Superior Prods. Mfg. Co., 298 Minn. 77, 80 n.2, 212 N.W.2d 884, 886 n.2, 13 U.C.C. Rep. 944, 947 n.2 (1973).

65 Gilmore suggests that § 9-312(5)(b) might control where one or both parties file improperly. 2 GILMORE, supra note 3, § 34.1, at 895 n.3 (citing Plaza Corp. v. Alban Tractor Co., 219 Md. 570, 151 A.2d 170 (1959), a pre-Code example). As a practical matter, in such cases one party will normally repossess. For a case in which § 9-312(5)(b) was held to control, see Johnson v. Dempsey, 117 Ga. App. 722, 161 S.E.2d 889, 5 U.C.C. Rep. 394 (1968) (unperfected security interest that attached first given priority; repossession not discussed).
become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.\(^6\)

The subsection smacks of purchase money theory.\(^6\) But the qualification that such a "purchase money" security interest in crops dislodges a prior interest only if the prior interest secures debts more than six months overdue saps the section of vitality.\(^6\) Again, at least since 1971, no reported case applies this subsection.\(^6\)

2. **Lapse of Perfection—Section 9-403(2)**

Consider again the last sentence of section 9-312(5)(a):

Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.\(^7\)

A financing statement has but a five-year lifespan. Under section 9-403(2), the effectiveness of a filed financing statement lapses on the expiration of the five-year period unless a continuation statement is filed prior to lapse. Assume \(A\) files in 1970; \(B\) files as to the same property in 1972; and the debtor goes broke in 1976. If \(A\) has not filed a continuation statement or maintained continuous perfection in some other manner, \(B\) gets the collateral.\(^7\) For \(A\), there

\(^6\) U.C.C. § 9-312(2).

\(^7\) Coates, *Financing the Farmer*, PRAC. LAW., Nov. 1974, at 45, 55. It has been suggested that security interests in crops that satisfy the requirements of § 9-107 may qualify for purchase money priority under § 9-312(4). 2 Gilmore, *supra* note 3, § 32.5, at 869 n.4. However, § 9-312(2) appears to be exclusive. *Id.*


\(^9\) A handful of cases have held § 9-312(2) inapplicable. *E.g.*, *In re Bounds*, 4 Sec. TRANS. GUIDE (CCH) ¶ 52,748 (W.D. Okla., Bankr. Ct. 1976) (summary of opinion) (because prior claims not due more than six months before crops began growing, priorities not affected by § 9-312(2)).

\(^10\) U.C.C. § 9-312(5)(a) (emphasis added).

\(^11\) U.C.C. § 9-403, Comment 3, specifically provides for this result:

[1] If \(A\) and \(B\) both make non-purchase money advances against the same collateral, and both perfect security interests by filing, \(A\) who files first is entitled to priority under Section 9-312(5). But if no continuation statement is filed, \(A\)’s filing may lapse first. So long as \(B\)’s interest remains perfected thereafter, he is entitled to priority over \(A\)’s unperfected interest.
has been a period "when there is neither filing nor perfection." Although A was first to perfect or file, B prevails.\(^7\)

Perfection may also lapse if collateral is moved into another state. Under section 9-103(3)(e), a security interest in property brought into the second state expires four months after arrival. Thus a first-filed financing statement may provide priority for only four short months.\(^7\) If the four-month period passes without continuation in the second state, a second-perfected party takes priority even if he has knowledge of the first filing, or if the property is later returned to the state where the first filing occurred.\(^7\) Lapse of perfection of a security interest in proceeds resulting from failure to comply with the continuation provisions of section 9-306(3) may also pave the way to priority for a later-filing creditor.

3. Subordination by Agreement—Section 9-316

Secured creditors may alter Code priorities by agreement. Section 9-316 provides:

Gilmore, calling \(\S\) 9-403(2) "cryptically ambiguous," argues that the Comment is wrong. He equates the Comment's rule with a "game of roulette," and argues that priorities should be fixed at the time the second security interest is perfected. Gilmore quotes language from the 1952 Code supporting his position and states that, according to his recollection, its deletion in the 1956 version resulted from "a curious typographical error." 1 GILMORE, \textit{supra} note 3, \S\ 21.6, at 588-90.

Gilmore's position seems strained, although in fairness it should be pointed out that Gilmore made these comments before the 1972 amendments added language to \(\S\) 9-312(5) specifically referring to lapse. See 1 GILMORE, \textit{supra} note 3, \S\ 21.6, at 592. But even as a statement of policy, Gilmore's argument appears deficient. Loss of priority is an appropriate penalty for one who fails to comply with the Code's filing provisions. Courts have universally construed the Code in accordance with the Comment. See cases cited in note 72 infra.


\(^7\) See \textit{In re Welker}, 2 U.C.C. Rep. 169 (W.D. Pa., Bankr. Ct. 1964) (lack of knowledge of debtor's departure irrelevant to lapse resulting from failure to refile in second state; perfection lapsed after five months); U.C.C. \(\S\) 9-103, Comment 7.

Nothing in this Article prevents subordination by agreement by any person entitled to priority.\textsuperscript{75}

Subordination agreements may be oral\textsuperscript{76} although naturally this exacerbates problems of proof. Moreover, subordination agreements may arise out of a course of dealing.\textsuperscript{77} In certain circumstances, a secured creditor who is not a party to the subordination agreement may obtain its benefit by invoking estoppel or third party beneficiary theory.\textsuperscript{78} On the other hand, a creditor cannot lose priority under an agreement to which he is not a party.\textsuperscript{79} Like all contracts, subordination agreements must be carefully drafted. False assumptions and lack of caution may result in an unexpected reversal of priorities.\textsuperscript{80} Moreover, section 9-316 subordination agreements are subject to traditional contract defenses.\textsuperscript{81}

Subordination agreements may produce interesting results. For example, in General Electric Credit Corp. v. Pennsylvania Bank & Trust Co.\textsuperscript{82} the court held that although a second creditor's security interest had become unperfected through lapse, his subordination agreement still entitled him to priority. Suppose, in such a case, both parties were competing with a trustee in bankruptcy. Possible result: trustee takes priority over the perfected security interest.\textsuperscript{83}

\begin{footnotes}
\item[75] U.C.C. § 9-316.
\item[79] U.C.C. § 9-316, Comment.
\item[83] See In re Smith, 326 F. Supp. 1311, 9 U.C.C. Rep. 549 (D. Minn. 1971) (court assumed trustee's subrogation to priority of unperfected secured creditor under Bankruptcy Act). Section 70e of the Bankruptcy Act, 11 U.S.C. § 110e (1970), arguably allows the trustee to step into the shoes of the unperfected creditor. Professors White and Summers disagree with this interpretation of § 70e, at least where the trustee seeks to be subrogated to the rights of one perfected creditor over another perfected creditor under § 9-312(5). See White & Summers, supra note 1, § 24-8, at 891-92. They reason in part that the bankruptcy trustee should not be subrogated to the rights of a creditor whom the trustee can-
\end{footnotes}
4. Knowledge of Improper Filing—Section 9-401(2)

Section 9-401(2) provides an important exception to the first-to-perfect-or-file rule. That section provides:

A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this Article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.\(^8^4\)

This rule mitigates the rigor of section 9-312 as a pure-race statute.\(^8^5\) The key to section 9-401(2) is "knowledge of the contents," a slippery phrase that has given courts some difficulty.

Recent cases indicate a movement toward equating knowledge that a security interest exists with "knowledge of the contents of [the] financing statement."\(^8^6\) Although some suggest that such a view would swallow the pure-race rule of section 9-312(5),\(^8^7\) one requirement of section 9-401 militates against this possibility. To swing section 9-401 into operation, a prior filing is necessary. Hence, notice of a previous, but unfiled, security interest has no effect on section 9-312 priorities. The fact that most unperfected security interests result from failure to file rather than improper filing limits the effect of section 9-401(2).\(^8^8\)

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\(^{84}\) U.C.C. § 9-401(2).

\(^{85}\) Of course, where a financing statement is improperly filed, and the competing secured party lacks knowledge of its contents, the later filer wins under § 9-312(5). "First to file" in such a case means "first to file properly." Mountain Credit v. Michiana Lumber & Supply, Inc., 31 Colo. App. 112, 114, 498 P.2d 967, 968-69 (1972) (first-to-file rule template proper filings).


\(^{87}\) See Comment, supra note 50, at 481.

\(^{88}\) For a discussion of developments under § 9-401(2) and some suggested changes, see Comment, supra note 50, at 472-87.
ARTICLE NINE PRIORITY RULES

5. Good Faith and Supplementary Law—Sections 1-103 and 1-203

The Comment to section 1-203 states: "This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties." This good faith principle applies to secured transactions. Although the principle has rarely been invoked in priority disputes, it has altered section 9-312 results where a debtor's violation of a competing security agreement resulted in priority for a party closely related to the debtor. However, the good faith requirement does not alter the pure-race rule of section 9-312.

Like good faith, principles of supplementary law, such as estoppel and waiver, may prevent blind adherence to section 9-312. In section 9-312 cases, however, courts have been slow to embrace these theories in light of the section's clear language and the Code's avowed purpose of furthering certainty in commercial transactions. Litigants have also challenged section 9-312 results.

89 U.C.C. § 1-203, Comment. Section 1-203 provides:
Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

90 Central Soya Co. v. Bundrick, 137 Ga. App. 63, 66, 222 S.E.2d 852, 855, 19 U.C.C. Rep. 300, 303 (1975) (principles of estoppel and good faith underlie entire Code, including Article Nine). "Fraud is fraud, no matter how cunningly contrived, and a good faith limitation can always be—in appropriate cases should always be—read into a statute." 2 GILMORE, supra note 3, § 34.5, at 915.


95 The Code's supplementary law provision is § 1-103, set out in note 37 supra. For an example of its application in the priority context, see French Lumber Co. v. Commercial Realty & Fin. Co., 346 Mass. 716, 195 N.E.2d 507 (1964) (A defaults on obligations to first filer and second filer; B, who pays off debt to first filer, and files third, later takes priority over second filer because subrogation doctrine supplements Code under § 1-103). See also In re Johnson, 4 Sec. TRANS. GUIDE (CCH) ¶ 52,294 (D. Neb., Bankr. Ct. 1973) (summary of opinion) (although Article Nine governs transaction, bankruptcy court may liberally apply equitable remedies, including those found in Article Two's unconscionability provision, § 2-302).

96 For cases in which estoppel is discussed but rejected on the facts, see Hillman's
as simply inequitable, but courts have unwaveringly rebuffed such attempts to avoid clear Code commands.97

6. **Prohibiting “Relation Back”—Section 9-305**

A, without obtaining a security agreement, files as to C’s St. Bernard. C remains in possession. B obtains a security agreement covering C’s St. Bernard and files. A then takes possession of C’s St. Bernard, thus perfecting his security interest. These are the essential—though much simplified—facts of *Transport Equipment Co. v. Guaranty State Bank,*98 in which the Tenth Circuit, relying on section 9-305, granted priority to B, the second filer. Although the court’s analysis is murky, it ultimately rests on “the non-retroactivity rule of [section] 9-305.”99

The court’s reasoning goes like this: A had not perfected until he took possession. Therefore he “perfected by possession,” and is defeated by the third sentence of section 9-305:

A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this Article.100

But “Alps on Alps arise”101 from the court’s simple syllogism.

First, did A in fact “perfect by possession”? Assume that instead of A taking possession, A and C executed a security agreement. At this point A’s security interest would have attached,102 and would have become perfected.103 In a sense, the security in-

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99 Id. at 382, 17 U.C.C. Rep. at 8.

100 U.C.C. § 9-305.

101 A. POPE, AN ESSAY ON CRITICISM line 232, at 15 (London 1711).

102 See U.C.C. § 9-201.

103 See U.C.C. § 9-303.
terest would be perfected by attachment, but only because attachment is a prerequisite of perfection. The key step on the road to perfection is filing (or another perfecting act), for it is filing (or another perfecting act) that differentiates the perfected security interest from the run-of-the-mill attached security interest. In short, the word "by" in section 9-305 is a word of requirement, not of time. It does not matter when the security interest was perfected. What matters is how. In Transport Equipment, possession was a necessary act of attachment, but not a necessary act of perfection, since a financing statement was already on file. Section 9-305 contemplates and deals with perfection by possession, not attachment by possession.104

But even assuming that A's security interest was perfected by possession and that perfection therefore dates from the "time possession is taken," this does not necessarily mean that section 9-312(5) does not apply. After all, the first-to-perfect-or-file rule covers exactly those situations in which the first filer's perfection follows perfection by another.105 Hence, the Transport Equipment court must have relied on those loaded words of section 9-305, "without relation back."106 The court apparently concluded that section 9-305 prohibits relation back of attachment time to filing time. This reading of the "relation back" language is incorrect. As Comment 3 to section 9-305 makes clear, the Code's draftsmen intended this passage to prevent relation back of a security interest perfected by possession to the time the original security agreement was executed, not relation back of possession to the time of filing.107 In Transport Equipment, however, the security interest was not perfected by possession, and no security agreement was ever executed.

The Transport Equipment decision not only reflects shoddy statutory interpretation; it also undercuts the basic policy of notice filing. B had access to the files. He therefore had, or should have


105 See note 49 and accompanying text supra.

106 It is significant that the court, in rejecting the first filer's arguments, italicized the words "relation back": "This section further provides that there can be no relation back of the perfection date when perfection is obtained through possession." 518 F.2d at 382, 17 U.C.C. Rep. at 7 (emphasis in original).

107 U.C.C. § 9-305, Comment 3, states: "The third sentence of the section rejects the 'equitable pledge' theory of relation back, under which the taking possession [sic] was deemed to relate back to the date of the original security agreement."
had, notice of A's prior claim. A must be able to rely on his filing. That is the essence of Article Nine.  

7. *Imperfections in the Debtor's Title*

Assume A enters into a security agreement with C, covering all of C's after-acquired accounts. A files properly. B then enters into a security agreement with D covering all of D's accounts. B later files. D transfers his accounts to C, and both conveniently go bankrupt. Who gets the accounts, A or B?  

A literal reading of section 9-312(5) suggests that A should win. After all, these are "conflicting security interests in the same collateral." A filed first, and that's that.

But the explorer must hike the jungles of Article Nine in search of an exception. First, he encounters section 9-306(2), which assures him that B's security interest continues in the collateral if the sale was unauthorized. Unfortunately, section 9-306(2) leaves unanswered the priority question. What does it matter if the creditor still has a security interest? That only gets him into section 9-312(5), not past it. Section 9-201 looks more promising:

> **Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.**

If A's security agreement is good "against creditors," why should it not operate against B? It does—"[e]xcept as otherwise provided by this Act." This proviso opens a door through which section 9-312 is ready to burst. The Comment makes clear that it can: "Exceptions to this general rule arise where . . . this Article subordinates the

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108 See U.C.C. § 9-312, Comment 5, set out in part in note 58 supra.

109 For a case involving similar facts, see First Security Bank v. Zions First Nat'l Bank, 537 P.2d 1024, 17 U.C.C. Rep. 858 (Utah 1975), in which the court summarily concluded that calculators and calculator parts were not subject to the security interest of the transferee's creditor, even though the security interest covered all after-acquired inventory. The opinion is short on facts. Most importantly, it fails to disclose clearly the transferee's intended use of the calculators. The court's statement, however, that the transferee "was engaged in the marketing of the products," (id. at 1026, 17 U.C.C. Rep. at 860) suggests that the calculators were inventory in the transferee's hands. If they were, the security interest of the transferee's creditor at least arguably attached to them (but only arguably because of the shelter principle argument discussed below, see notes 113-14 and accompanying text infra). The opinion, however, does not discuss this point.

110 It would be highly unusual for an accounts financer to authorize the transfer of all the debtor's accounts. The cautious lender will make the extent of any authorization clear in the security agreement.

111 U.C.C. § 9-201.
security interest because it has not been perfected (Section 9-301) or for other reasons (see Section 9-312 on priorities). . . .”¹¹²

Alas, Article Nine has confounded the searcher. But before him lie Articles One and Two. Section 2-403 embodies the “shelter principle”: a purchaser acquires all the rights that his transferee has power to give.¹¹³ The term “purchaser” includes one who acquires an interest in property through the creation of a security interest.¹¹⁴ Therefore the shelter principle argument goes like this: Because C, the buyer, took subject to B’s security interest, the interest he transferred to A, his creditor, was limited by B’s prior rights.

But section 2-403 does not control. First, it applies only to purchasers of goods. Our hypothetical accounts receivable clearly fall outside that category.¹¹⁵ Second, if section 2-403 applies at all, it applies only by negative implication. The section states that a purchaser acquires all title held by his transferee. This does not preclude the possibility that he acquires more.¹¹⁶ Third, Article Two deals with sales of goods, Article Nine with secured transactions. A’s “purchase” looks more like one of the latter. Indeed, section 2-403 itself suggests that our explorer should avoid Article Two.¹¹⁷

Of course, Article One runs through Article Nine, and its “supplementary law” provision, section 1-103, may inject the shelter principle into our hypothetical conflict.¹¹⁸ But again, that section begins with a disclaimer:

Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions.¹¹⁹

The clear language of section 9-312 appears to be preemptive.¹²⁰

¹¹² U.C.C. § 9-201, Comment.
¹¹³ See generally White & Summers, supra note 1, § 25-1, at 900-01.
¹¹⁵ U.C.C. § 9-105(1)(h).
¹¹⁶ See Oldfather, supra note 31, at 583-84.
¹¹⁷ U.C.C. § 2-403(4) provides:

The rights of other purchasers of goods and of lien creditors are governed by the [Article] on Secured Transactions (Article 9) . . .

See generally U.C.C. § 2-402(3)(a).
¹¹⁸ White & Summers, supra note 1, § 25-1, at 900-01.
¹¹⁹ U.C.C. § 1-103 (emphasis added).
¹²⁰ Cf. First Nat’l Bank v. Lone Star Life Ins. Co., 524 S.W.2d 525, 530 (Tex. Civ. App. 1975) (rejecting bank’s argument that lender’s security interest in certificate of deposit was subject to bank’s right of set-off because debtor could only transfer those rights that he held).
But the fearless forge on. A direct assault on section 9-312 is needed, and the commentators have supplied one. The attack focuses on the word “priority.” The word has been interpreted to mean priority between security interests created by a single debtor.\(^1\) This interpretation avoids the intuitively undesirable outcome suggested by the hypothetical. Proponents of this view\(^2\) also observe that the eight examples set out in the Comments to section 9-312 all portray conflicts involving but a single debtor.\(^3\) Most importantly, this interpretation provides a commercially sensible and just result. \(A\) certainly would not, or at least should not, advance funds expecting to acquire a superior interest in property encumbered prior to transfer. He can contractually insist that such property not be acquired by \(C\) or that \(C\) obtain the previous creditor’s authorization, at least when buying from an insolvent or near-insolvent seller. But \(B\), who carefully checked for prior filings, can hardly plan for or prevent this development. Checking the files does not protect him, as it should in a notice filing system. The transfer saps his security interest of its strength. Clearly this will discourage secured lending.

Yet the language of section 9-312(5) seems clear and controlling. Moreover, if section 9-312 is restricted to single-debtor priority disputes, the word “priority” must take on different meanings in different sections of Article Nine.\(^4\) The absence of a dual-debtor hypothetical in the Comments’ eight examples is hardly surprising, and certainly an inaccurate gauge of the drafters’ intentions, since most priority disputes in fact arise where competing security interests are created by the same debtor. Most importantly, the statute does not qualify the word “priority,” a term not restricted in common usage to single-debtor priority disputes.\(^5\) Although the courts have not specifically addressed this issue, they

\(^{121}\) See Oldfather, supra note 31, at 583; Skilton, Security Interests in After-Acquired Property Under the Uniform Commercial Code, 1974 Wis. L. Rev. 926, 948.

\(^{122}\) See Oldfather, supra note 31, at 583.

\(^{123}\) See U.C.C. § 9-312, Comments 5-8.

\(^{124}\) “If this [interpretation of § 9-312(5)] means that the word ‘priority’ has a broader meaning in some contexts than it does in others, my reply is that it has to. My suggestion is that some statutory clarification would seem to be called for.” Oldfather, supra note 31, at 583-84 (emphasis in original) (footnote omitted).

\(^{125}\) Black’s Law Dictionary 1357 (rev. 4th ed. 1968) provides the following definition of “priority”: Precedence; going before. A legal preference or precedence. When two persons have similar rights in respect of the same subject-matter, but one is entitled to exercise his right to the exclusion of the other, he is said to have priority. “Priority” is not defined in the Code.

For an analysis of other problems arising when multiple debtors create security interests in the same collateral, see Skilton, Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters), 1974 Wis. L. Rev. 1, 76-88. Skilton concludes that the shelter provided by § 9-307 to the buyer in ordinary course extends to the secured party who finances the buyer's purchase. He apparently bases this conclusion on authority suggesting that § 9-307 completely cuts off the prior security interest upon transfer. See Crystal State Bank v. Columbia Heights State Bank, 295 Minn. 181, 185, 203 N.W.2d 389, 391-92, 11 U.C.C. Rep. 922, 925-26 (1973) (seller's security interest "released" upon sale to buyer in ordinary course, giving buyer's creditor priority over seller's inventory financer). The language of § 9-307 and case law interpreting it, however, make clear that the section is only a priority rule, and that the inventory financer's security interest persists notwithstanding unauthorized sale. See U.C.C. § 9-306(2). The following imaginary conversation suggests the policy considerations relevant to resolving this priorities problem:

\textit{Edgar: Where a sale is made to a buyer in ordinary course, surely the law should favor his creditor over the seller's inventory financer even if the inventory lender was the first to file. A contrary rule will discourage consumer lending or at least increase the cost of borrowing. Section 9-307 is designed to help buyers, particularly consumers. Your recommended rule penalizes the consumer. Moreover, it is certainly unusual—indeed, unfair—for the buyer's creditor to bear a loss caused by the defalcations of a seller with whom the buyer's financer has had no dealings. Let's place the risk on the seller's financer. After all, he is in the best position to monitor and control the seller's activities.

\textit{Betsy:} Just a minute. The Code is not as simple-minded as you think. Certainly the inventory financer will generally be the first to file. But the Code adequately protects the consumer lender with its purchase money priority provisions. Under § 9-302, the consumer lender need not even file to perfect his security interest.

\textit{Edgar:} Although the purchase money priority rules might help sometimes, they lack the clout necessary to protect consumer lenders consistently. If both creditors hold purchase money security interests, the first to perfect or file prevails (see notes 223-28 and accompanying text infra), and that will normally be the inventory financer. Conflicts between purchase money security interests are likely to recur in this context since the security interests are created by different debtors. Besides, inventory financers will generally be in a better position to bear the loss. The inability to repossess a car will certainly fall more heavily on Tiny's Credit Union than on GMAC. Furthermore, GMAC may well have a security interest continuing in the proceeds arising from the sale. Let's not give it the kitchen sink too.

\textit{Betsy:} Edgar, you're stirring up a tempest in a teapot. This priority conflict will arise so infrequently, it's hardly worth discussing. Do you realize what has to happen for this question to arise? First, both the inventory financer and the consumer lender will have to hold purchase money security interests. Under § 9-302, the consumer lender need not even file to perfect his security interest.

\textit{Edgar:} Although the purchase money priority rules might help sometimes, they lack the clout necessary to protect consumer lenders consistently. If both creditors hold purchase money security interests, the first to perfect or file prevails (see notes 223-28 and accompanying text infra), and that will normally be the inventory financer. Conflicts between purchase money security interests are likely to recur in this context since the security interests are created by different debtors. Besides, inventory financers will generally be in a better position to bear the loss. The inability to repossess a car will certainly fall more heavily on Tiny's Credit Union than on GMAC. Furthermore, GMAC may well have a security interest continuing in the proceeds arising from the sale. Let's not give it the kitchen sink too.

\textit{Betsy:} Edgar, you're stirring up a tempest in a teapot. This priority conflict will arise so infrequently, it's hardly worth discussing. Do you realize what has to happen for this question to arise? First, both the inventory financer and the consumer lender will have to hold purchase money security interests. Second, the seller and buyer will have to default simultaneously. If only the buyer defaults, the inventory financer has no recourse against the item sold, because the obligation owed him by the seller is not in default. Third, the inventory financer will have to go after the collateral, which in the case of many consumer goods probably won't be worth his bother. This conflict will arise so infrequently that consumer
8. Future Advances—An Attempted Exception

Future advances have produced almost nothing but headaches for courts construing section 9-312. On Day One, A makes an advance to C, takes a security interest in C's bicycle, and files a financing statement. On Day Two, B makes an advance to C, takes a security interest in the same bicycle, and files. On Day Three, A makes another advance to C, executing a second security agreement that again covers the bicycle. No new financing statement is filed. A's second advance—an advance based on the initial financing statement—is a future advance. If A defaults on his obligations, who gets the bike? Does it matter whether A's original security agreement or financing statement allows or requires future advances? Does it matter whether C pays off the initial debt before A makes his second advance?

The struggle to answer these questions begins with Coin-O-Matic Service Co. v. Rhode Island Hospital Trust Co. In that case, a lower Rhode Island court held that the original lender's second loan did not "relate back" to the initial financing statement because the original security agreement did not specifically provide for the later advances. The leading case disputing Coin-O-Matic is In re Rivet, in which the Eastern District of Michigan gave priority to a future advance lender over an intervening creditor, even though the original security agreement did not provide for future advances. Although most courts have adopted the Rivet view,

lenders won't give it a thought. And if now and then one becomes paranoid, he can always check the files and refuse to extend credit, or try to obtain a subordination agreement. So let's keep life simple. The Code says the first to perfect or file should win. Judicial variation of clear Code rules only increases commercial uncertainty, which is exactly what the Code was designed to prevent.

Future advance arrangements are generally more advantageous than one-shot lending for both creditor and debtor. By reducing his initial outlay, the lender reduces the chances of a catastrophic loss. He can monitor both the debtor's success and the collateral itself over a period of time, and gauge his advances accordingly. Moreover, the lender may not have sufficient funds on hand to make one large loan. As for the debtor, future advance financing allows him to postpone interest payments until he is actually in need of funds.

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Coin-O-Matic has attracted a modest following.133

Fans of Coin-O-Matic argue that the Rivet rule unduly restricts the debtor's ability to obtain additional funds. No creditor, they urge, will make an advance where a prior creditor can "take away" his priority by making a future advance covered by a previously filed financing statement.134 They argue that the Rivet rule effec-

The better view holds that, where originally a security agreement is executed, an indebtedness created, and a financing statement describing the collateral filed, followed at a later date by another advance made pursuant to a subsequent security agreement covering the same collateral, the lender has a perfected security interest in the collateral not only for the original debt but also for the later advance. 292 Minn. at 291-92, 194 N.W.2d at 784, 10 U.C.C. Rep. at 25-26.


In Merriman the court refused to give the future advance lender priority, but only because the debtor continuously owed him money. 4 U.C.C. Rep. at 236. More recent cases have also retreated from giving future-advance security interests the sweeping priority advocated by the Review Committee. See Kimbell Foods, Inc. v. Republic Nat'l Bank, 401 F. Supp. 316, 325 (N.D. Tex. 1975) (requiring reperfection of each new security interest if parties intend to deal on single loan basis); In re HGS Technical Assocs., Inc., 4 SEC. TRANS. GUIDE (CCH) ¶ 52,435, at 67,563 (E.D. Tenn., Bankr. Ct. 1974) (summary of opinion) (future advance lender granted priority, but emphasis placed on parties' contemplation of subsequent loans). Furthermore, In re H.G. Hagler, 10 U.C.C. Rep. 1285, 1288-89 (E.D. Tenn., Bankr. Ct. 1972), swallows Coin-O-Matic lock, stock, and barrel. Hence, characterizations of Coin-O-Matic as "a minority of one," WHITE & SUMMERS, supra note 1, § 25-4, at 908, and "an aberration with all other reported cases reaching the 'correct' result," Balint, supra note 46, at 313 n.16, are exaggerations.

Safe Deposit Bank & Trust Co. v. Berman, 393 F.2d 401 (1st Cir. 1968), although apparently inapposite, points up the uncertainty in this area. That case involved the existence of a valid security agreement authorizing additional advances so as to comply with what is now § 9-204(3), not the "relation back" of an acknowledged security agreement to a previously filed financing statement. Safe Deposit Bank, however, affirmatively cites the lower court decision in In re Rivet, 4 INSTAL. CREDIT GUIDE (CCH) ¶ 97,858 (E.D. Mich., Bankr. Ct. 1967), rev'd, 299 F. Supp. 374, 6 U.C.C. Rep. 460 (E.D. Mich. 1969), in which the referee adopted the reasoning of Coin-O-Matic. 393 F.2d at 403.

Rivet and Safe Deposit Bank underscore the confusion surrounding the phrase "future advances." Although generally used to describe advances intended to be covered by an earlier financing statement (as in Rivet and Coin-O-Matic), the phrase is also used to describe advances based on an earlier security agreement, where no new agreement is executed (as in Safe Deposit Bank). In the latter situation, under § 9-204(3) (and the interpretative language of Comment 5 to that section), the security agreement must specifically provide for later advances. This difference in usage accounts for the difference in result between Rivet and Safe Deposit Bank, and may also explain why the court in Coin-O-Matic reached an incorrect result.

134 One writer has summarized this argument as follows:

A subsequent creditor will be most reluctant to lend funds on an agreement that takes security in a previously encumbered asset. As long as the original creditor has even one dollar remaining in the asset, it is possible for him to loan up to the full loan value of the collateral and preempt any creditor who takes a junior security in the same collateral.

Note, Priorities of "Future Advances" Under Previously Perfected Security Interests and Article 9 of
tively ties the debtor to one creditor, who can then gouge his helpless customer by collecting hefty interest rates. In addition, they argue that giving priority to the future advance lender reduces the "loan value" of an asset. Although the debtor may have substantial equity in an asset, no one will take it as security. In short, the debtor is at the mercy of his initial creditor.135

This just isn't so in the real world, say Coin-O-Matic critics. "[I]t is a rare banker who will lend against the same collateral which secures a prior loan; in our experience the commercial practice is for the second lender to pay off the first and so take a first priority as to all of the collateral."136 Critics also argue that the Coin-O-Matic result undermines the notice-filing philosophy of Article Nine. Consider this passage from a leading future advances case:

The whole purpose of notice filing would be nullified if a financing statement had to be filed whenever a new transaction took place between a secured party and a debtor. Once a financing statement is on file describing property by type, the entire world is warned, not only that the secured party may already have a security interest in the property of that type . . . , but that it may later acquire a perfected security interest in property of the same type acquired by the debtor in the future.137

Moreover, other provisions of Article Nine mitigate whatever harshness future advance priority may produce. The Code allows a debtor to terminate a financing statement when no future commitment or existing obligation is covered by the collateral,138 and limits the time during which a financing statement is effective.139

the U.C.C., 58 MARQ. L. REV. 759, 766 (1975). This argument's bark is worse than its bite. The second lender need only pay off the remaining one-dollar debt, obtain a termination statement, and walk away with priority.

135 For a commentary supporting Coin-O-Matic, which sets out these arguments at greater length and with surer enthusiasm, see Note, supra note 134.

136 WHITE & SUMMERS, supra note 1, § 25-4, at 908.

137 James Talcott, Inc. v. Franklin Nat'l Bank, 292 Minn. 277, 290, 194 N.W.2d 775, 783, 10 U.C.C. Rep. 11, 24 (1972).


139 See U.C.C. § 9-304(2). Gilmore has stated:

Article 9, unlike the earlier notice filing statutes, does provide a mechanism whereby a debtor can have a financing statement removed from the files when there are no outstanding obligations and no commitment by the secured party to make future advances. Apart from agreements which commit the lender in advance, the debtor is not, therefore, chained in perpetuity to the first filer: if he wants to switch to a new source of financing, he can do so, on condition of paying the first man off.

2 GILMORE, supra note 3, § 34.4, at 908 (footnotes omitted).
The purchase money priority rules may also provide an alternate source of funds in certain circumstances.140

The U.C.C. Review Committee was appalled by Coin-O-Matic: "The Committee considered drafting a provision emphasizing its disagreement with the Coin-o-Matic [sic] line of cases, but concluded that the existing Code is clear enough, and should not be disturbed just to overrule some lower court cases."141 The Committee reasoned that section 9-402(1), which expressly allows the filing of a financing statement before the execution of a security agreement, protects security interests covering future advances.142 Comment 5 to section 9-204(3),143 cited in Coin-O-Matic, refers to the operation of security agreements—not financing statements.144 Therefore, section 9-204(3) does not bar relation back of future advances to the date of filing.145

One of the Code's 1972 amendments was section 9-312(7):

If future advances are made while a security interest is perfected by filing or the taking of possession, the security interest has the same priority for purposes of subsection (5) with respect to the future advances as it does with respect to the first advance... 146

Although this passage was designed for the limited purpose of establishing priorities between the future advancer and an intervening pledgee,147 it seems to solve most future advance priority problems. Perhaps the drafters drew better than they knew.

The one future advances question left unsettled by section 9-312(7) arises when the initial advance is fully satisfied before

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140 See text accompanying note 160 infra.
141 Final Report, supra note 50, at 227.
142 See id. at 226. Filing is intended to give notice of existing or future security interests in specific collateral. It is not intended to relate to a specific security agreement. In re Wilson, [1969-1973 Transfer Binder] SEC. TRANS. GUIDE (CCH) ¶ 52,215 (E.D. Tenn., Bankr. Ct. 1973) (summary of opinion) (single financing statement may support multiple security agreements); Coogan, supra note 33, at 509.
143 Until 1972, and at the time Coin-O-Matic was decided, the relevant language of the present Comment 5 was located in Comment 8.
144 See note 133 supra.
145 U.C.C. § 9-204, Comment 5 states: "Under subsection (3) collateral may secure future as well as present advances when the security agreement so provides." (Emphasis added.) But the same Comment redundantly emphasizes that § 9-204(3) has nothing to do with filing. In fairness to the Coin-O-Matic court, it should be noted that this language was not added to the Comment until 1972. Comment 5 thus provides a classic example of how the Comments can be manipulated to create an ex post facto "legislative history." Such Comments should carry limited weight in deciphering legislative intent.
146 U.C.C. § 9-312(7).
147 See Final Report, supra note 50, at 227.
future advances are made. In re Hagler, decided by Bankruptcy Judge Clive W. Bare, involves precisely this issue. A has a security interest in C's furniture, which has been perfected by filing. The security agreement expressly provides for extensions or renewals of the original debt. B makes a loan to C, taking a security interest in C's furniture. While filing, B discovers A's financing statement. Understandably disturbed, B sends A a check for the remainder of the debt. However, neither B nor C requests that A terminate his financing statement. A makes subsequent advances to C, relying on this earlier financing statement. Naturally, C goes broke. The issue is who gets the furniture, and who gets stuck.

Judge Bare gave priority to B, relying on section 9-404, a non-Code Tennessee statute, Coin-O-Matic, and his perception of the equities. He concluded (1) that A had a duty to file a termination statement, and (2) that under the Code A was not entitled to priority despite C's failure to terminate the financing statement, emphasizing that A and C did not initially contemplate future advances.

Under strictly a Code analysis (and Judge Bare speaks mostly of the U.C.C.), the case is wrongly decided. Section 9-404 requires that the secured party provide a termination statement "on written demand by the debtor." Here, the debtor made no such request. Absent termination, section 9-402(1) controls, and the filing remains fully effective notwithstanding delayed attachment. The Review Committee specifically addressed this problem. In discussing Coin-O-Matic, it stated:

The Committee disapproves this line of cases, and believes that an appropriate financing statement may perfect security interests securing advances made under agreements not contemplated at the time of the filing of the financing statement, even if the advances then contemplated have been fully paid in the interim.

Even the equities did not cut as sharply in favor of the intervening lender as Judge Bare suggested. The future advance lender, backed by clear Code provisions, relied on his previously filed

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148 Because a security interest must secure an obligation, when the debt has been entirely paid off the security interest ceases to exist. See U.C.C. § 1-201(37), set out in part in note 32 supra. Hence, § 9-312(7) will not apply.
150 Id. at 1288.
151 Id. at 1289.
152 Final Report, supra note 50, at 226 (emphasis added).
financing statement in making his second advance. Moreover, the second secured party could have easily obtained a termination statement and avoided litigation altogether. Granting him priority rewards his lack of diligence. As the *Rivet* court pointed out:

Because of the priority given to the first person to file a financing statement under the first-to-file rule of section 9312(5)(a), a second lender must always proceed cautiously before he does any financing of the debtor if there is already a financing statement on file covering the collateral in which he is interested. If there is such a prior filing, the second lender should do one of the following things:

(a) Insist that the record be cleared by the filing of a termination statement as to the financing statement which is on file. If there is, in fact, no outstanding indebtedness between the first lender and debtor, the debtor can demand such a termination statement (§ 9404). The second lender should not simply rely on the fact that he is satisfied that there is no actual loan outstanding between the first lender and debtor for so long as the first financing statement remains on file any subsequent advance made by the first lender to debtor would be fatal to second lender's rights under the first-to-file priority rule (§ 9312(5)(a)).

The future of future advances seems bright. The Code and the Commissioners stand firmly behind them, regardless of whether the debtor and lender contemplate additional advances when their dealings begin. But if the past is any guide to the future, courts may well seek to avoid the occasionally harsh consequences that unbending rules produce. If so, the practitioner must emphasize not only the statutory scheme establishing the priority of future advances, but the policies supporting it as well.

C. Purchase Money Security Interests—Special Priorities

Section 9-312 bestows special privileges on the purchase money security interest, a phrase defined in section 9-107:

A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

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153 See 10 U.C.C. Rep. at 1286.

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.\(^{155}\)

Section 9-312 gives purchase money security interests priority over prior perfected security interests if certain requirements are met.\(^{156}\) Where a purchase money secured party fails to leap through the statutory hoops, he will lose to a prior perfected party claiming under an after-acquired property clause.\(^{157}\) Although the statutory requirements lack complexity and the cost of noncompliance is high, cases abound in which a purchase money secured party loses priority by failing to take the simple steps prescribed in subsections 9-312(3) and (4).\(^{158}\)

The prejudice in favor of purchase money priority results partially from longstanding pre-Code recognition. Conditional sales agreements, in which the purchase money secured party could assure himself of priority by retaining title, were an integral part of pre-Code financing.\(^{159}\) More importantly, the special status of purchase money security interests continues to provide an alternate source of funds when a perfected creditor holding a security interest in the debtor's after-acquired property refuses to extend further credit. In this way, the purchase money exception facilitates commerce and reduces the potential unfairness created by

\(^{155}\) U.C.C. § 9-107.


\(^{159}\) U.C.C. § 9-312, Comment 3. For a detailed discussion of pre-Code financing, see Coogan, supra note 3, at 840-44.
monopolization of credit.\textsuperscript{160} Unlike the common law,\textsuperscript{161} the Code broadly validates security interests in after-acquired property.\textsuperscript{162} Special priorities for purchase money security interests balance this development by limiting opportunities for abuse and providing alternate avenues for the debtor in need of additional financing.

1. \textit{Lenders and Purchase Money Security Interests—Section 9-107}

As section 9-107 makes clear, both sellers and lenders may acquire purchase money security interests. Subsection (b), pertaining to lenders, raises some difficult issues bearing on the determination of priorities.

First, this subsection requires that a lender's advance "enable" the debtor to acquire rights in collateral.\textsuperscript{163} Gilmore argues that after-the-fact advances may satisfy this requirement—that is, if a bank makes advances against purchased goods to a buyer who uses the advances to pay off the debt incurred through the purchase, the bank has \textit{enabled} the debtor to acquire rights in the collateral:

If the loan transaction appears to be closely allied to the purchase transaction, that should suffice. The evident intent of paragraph (b) is to free the purchase-money concept from artificial limitations; rigid adherence to particular formalities and sequences should not be required.\textsuperscript{164}

Just such an argument was made—and rejected—in \textit{North Platte State Bank v. Production Credit Association}.\textsuperscript{165} Buyer purchased cows on open account. Two months after taking possession, he

\begin{footnotesize}
\begin{enumerate}
\item The purchase money preference also protects sellers and lenders who might otherwise fear having their priority "taken away" by a future advance lender. See text accompanying notes 134 & 140 \textit{supra}.
\item See U.C.C. § 9-204(1). Comment 1 to § 9-204 explains:

Subsection (1) makes clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. That is to say: the security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party—such as the taking of a supplemental agreement covering the new collateral—is required.

\item \textit{Cf. In re Waltman, 4 SEC. TRANS. GUIDE (CCH) ¶ 52,766} (S.D. Ala., Bankr. Ct. 1975) (security interests covering after-acquired property as well as collateral that advance enabled debtor to buy held not purchase money security interests).
\item 2 \textit{Gilmore, supra} note 3, § 29.2, at 782. \textit{See White & Summers, supra} note 1, § 25-5, at 915.
\item 189 Neb. 44, 200 N.W.2d 1, 10 U.C.C. Rep. 1336 (1972) (alternate holding).
\end{enumerate}
\end{footnotesize}
obtained a loan from a bank and used it to pay off the seller. The court held that the loan did not "enable" the debtor to obtain "rights in or the use of collateral." Because the buyer had title and possession, he already held all the rights he could possibly have in the collateral. The bank's advance only enabled him to pay a debt. Arguably, the North Platte result unduly emphasizes location of title, the importance of which is substantially diluted by the Code.

Under section 9-107, value advanced for the acquisition of collateral must be "in fact so used." The commentators emphasize that lenders should draw checks payable to the seller to insure compliance with this requirement. Even this stratagem, however, may not guarantee purchase money status, because the debtor may negotiate the check to the seller-payee without acquiring rights in the intended collateral.

2. Finding the Proper Purchase Money Rule—Section 9-109

Purchase money priority conflicts always raise a preliminary question: Which subsection of section 9-312 applies? The answer hinges on whether the collateral is inventory. If it is, subsection (3) swings into operation. If it is not, subsection (4) controls.

Section 9-109 defines the various types of collateral. Al-

166 Id. at 51-52, 200 N.W.2d at 6, 10 U.C.C. Rep. at 1344. For a case interpreting "rights in or the use of collateral," see Ingram v. Ozark Prod. Credit Ass'n, 468 F.2d 564, 11 U.C.C. Rep. 605 (5th Cir. 1972) ("rights in or use of collateral" not acquired as to offspring of leased sows).

167 189 Neb. at 52, 200 N.W.2d at 6, 10 U.C.C. Rep. at 1344.

168 U.C.C. § 9-202 provides:

Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor. See U.C.C. § 1-201(37), set out in part in note 32 supra.

169 2 Gilmore, supra note 3, § 29.2, at 781-82; White & Summers, supra note 1, § 25-5, at 915.

170 E.g., Welcome Credit Union v. Capitol Bank & Trust Co., 14 U.C.C. Rep. 804 (Mass., Boston Mun. Ct. 1974) (D, who obtains check payable to seller from Bank 1 secured by Car 1, negotiates check to seller, receiving cash and $1,000 credit; D receives second check from Bank 2 secured by Car 2, which D buys with second check and $1,000 credit; held: Bank 1 does not have purchase money security interest in Car 2).

171 U.C.C. § 9-109 provides:

Goods are

(1) "consumer goods" if they are used or bought for use primarily for personal, family or household purposes;

(2) "equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;
though distinguishing collateral is usually not difficult, problems may arise. The status of collateral may change through transfer. For example, cattle in a farmer's barn are farm products. In a slaughterhouse they constitute inventory. Hence, if the farmer sells his cattle to the slaughterhouse on credit, and wishes to acquire purchase money priority, he must meet the requirements of section 9-312(3). As a practical matter, if it is unclear whether collateral is inventory, caution counsels taking the few extra steps necessary to comply with these requirements. It won't hurt, and it may help immensely.

3. Purchase Money Security Interests in Inventory—Section 9-312(3)

What steps must be taken when the purchase money security interest covers inventory? Section 9-312(3) lays them out:

A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory; and
(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the begin-

(3) “farm products” if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory;

(4) “inventory” if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.


ning of the 21 day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of Section 9-304); and
(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and
(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.\textsuperscript{174}

If his security interest is in inventory, the purchase money secured party must perfect before his debtor receives possession of the collateral.\textsuperscript{175} This maximizes the probability that other parties, particularly buyers not in the ordinary course of business, will discover the prior interest.\textsuperscript{176}

The key, however, to purchase money priority under section 9-312(3) is notice, although notification need only be given to previously perfected secured parties who perfected by filing.\textsuperscript{177} Prior to 1972, section 9-312(3) did not specifically require notice in writing, and at least one court held that oral notification was sufficient.\textsuperscript{178} The statute now explicitly requires written notice.\textsuperscript{179} Like a financing statement, notification is effective for five years—another result of the 1972 amendments.\textsuperscript{180}

At least two significant notice issues remain, however, both of which were addressed in the pre-amendment case of Fedders Financial Corp. v. Chiarelli Brothers.\textsuperscript{181} In Fedders, a financing company claiming priority through a purchase money security interest in the

\textsuperscript{174} U.C.C. § 9-312(3).
\textsuperscript{175} For discussion of the difficult question of when a "debtor receives possession," see notes 229-65 and accompanying text infra.
\textsuperscript{176} See U.C.C. § 9-307.
\textsuperscript{177} "Revised subsection 9-312(3) thus clarifies, among other things, (a) that a secured party need not notify another secured party who is known to the holder of the purchase money security interest, but who has not filed a financing statement . . . ." Bernstein & Fleisher, supra note 57, at 322 (emphasis in original).
\textsuperscript{178} See GAC Credit Corp. v. Small Bus. Admin., 323 F. Supp. 795, 798 (W.D. Mo. 1971) (notification by telephone satisfied 1962 version of § 9-312(3)).
\textsuperscript{179} U.C.C. § 9-312(3)(b).
\textsuperscript{180} U.C.C. § 9-312(3)(c). The burden of proof regarding compliance with the notice provisions of § 9-312(3) apparently rests on the purchase money secured party. See Douglas-Guardian Warehouse Corp. v. Esslair Endsley Co., 10 U.C.C. Rep. 176, 191 (W.D. Mich. 1971), in which the court concluded: "There is no evidence nor claim before the court that the Bank complied with the notice provisions of § 9312(3). Therefore, the priority provision of [§ 9-312(3)] is of no benefit to the Bank."
debtor's air conditioner inventory had provided the following notification to a prior perfected bank:

Fedders Financial Corporation has, or expects to acquire, purchase money security interest in certain inventory of [Chiarelli], and the proceeds therefrom, which inventory consists of: air conditioners, dehumidifiers, convectors, unit heaters, heating equipment, ranges, refrigerators, washers, ironers, dryers, dishwashers, sewing machines and other domestic and commercial appliances or the like and accessories and replacement parts for any such merchandise, and the proceeds thereof.\(^{182}\)

The court correctly concluded that section 9-110\(^{183}\) required only a reasonable identification of the goods, and that the notification's explicit reference to "air conditioners" satisfied this requirement.\(^{184}\) As the Comment to section 9-110 points out:

The test of sufficiency of a description laid down by this section is that the description do the job assigned to it—that it make possible the identification of the thing described. Under this rule courts should refuse to follow the holdings, often found in the older chattel mortgage cases, that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called "serial number" test.\(^{185}\)

The purpose of description coincides with that of notification: to warn the secured party not to lend against certain collateral, at least until he has taken appropriate precautions.\(^{186}\) "Overdescription" is harmless. It merely puts the prior lender on greater guard than "serial number" notification. The lender is not prohibited from making additional advances against later-acquired inventory; he need only assure himself that it has not been newly encum-

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\(^{182}\) Id. at 230, 289 A.2d at 172, 10 U.C.C. Rep. at 884.

\(^{183}\) U.C.C. § 9-110 provides:

For the purposes of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.


\(^{185}\) U.C.C. § 9-110, Comment.

\(^{186}\) U.C.C. § 9-312, Comment 3, states:

A fraudulent debtor may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party. The notification requirement protects the inventory financer in such a situation: if he has received notification, he will presumably not make an advance; if he has not received notification (or if the other interest does not qualify as a purchase money interest), any advance he may make will have priority.
bered. Of course, debtors should be careful lest such sweeping notices scare off their original inventory financers.

The reasonable-notice rule complements the other requirements of section 9-312(3). Exact description of collateral may not be possible until the debtor comes into possession. But if the secured creditor is to obtain purchase money priority, perfection, which generally requires filing, must occur before possession, and notification must precede filing. Hence, the reasonable-notice rule allows creation of a purchase money security interest where specific description prior to possession is impossible or impracticable. Moreover, the reasonableness test avoids defeat on technicalities, such as incorrect recording of serial numbers. It eliminates the need for frequent notification—a potential nuisance for both prior and purchase money creditors. Finally, it recognizes the purchase money creditor's desire for flexibility and his impatience with needless technicality.

Fedders also raised and resolved a second issue: whether the purchase money secured party must provide notice before acquiring each of several purchase money security interests. In Fedders, air conditioners financed by the financing company were periodically shipped to the debtor, Chiarelli. Although notice was given on December 22, 1966, several air conditioners were not sent until sixteen months later, at which time the purchase money lender's security interest in those air conditioners attached. The court flatly rejected the argument that the Code required notice prior to each delivery:

The Code contains no provision which would require a separate notification each time goods are shipped to a dealer. It is apparent, however, from comment 3 to § 9-312 that the reason for notification of other creditors is to allow them to avoid a fraudulent debtor who "may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party". Once appellant was in-

187 U.C.C. § 9-312(3)(a).
188 U.C.C. § 9-312(3)(b)(i).
formed of the relationship between appellee [the financing company] and Chiarelli, it certainly could have ascertained the nature and status of that relationship from appellee and protected itself against a fraudulent debtor. Furthermore, appellant has not made any allegation that it gave new value to Chiarelli after December 22, 1966.190

The court's reasoning is sound.191 The single-notice rule eliminates administrative problems for the purchase money secured party, while putting the original lender on guard as to the status of subsequent advances. Written notice minimizes the chances of forgotten notice. The five-year lifespan of notification, an innovation of the 1972 amendments, also supports the court's conclusion. Since a single notice concerning a single transaction remains effective for five years, it is difficult to see why the same notification should lose effect before that period has elapsed merely because it covers a series of transactions.192

Although the Fedders court points out that the prior perfected party made no advances against the after-acquired property, this factor should be irrelevant. The purpose of the notice requirement is to give fair warning to the prior perfected lender. If he nonetheless chooses to make additional advances, that is his business—and perhaps his loss.

4. Purchase Money Security Interests in Noninventory—
Section 9-312(4)

Section 9-312(4) gives special treatment to noninventory purchase money security interests:

A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.193

It is important to note the differences in the Code's treatment of inventory and noninventory purchase money security interests.

191 Gilmore, commenting on former § 9-312, agrees with the Fedders court. 2 GILMORE, supra note 3, § 29.3, at 788-89.
192 At least one commentator finds the five-year notice rule dispositive of this issue. See Balint, supra note 46, at 316. The Review Committee apparently agrees. See FINAL REPORT, supra note 50, at 113. Even if this view is correct, the issue remains important in jurisdictions where the 1972 amendments are not in force.
193 U.C.C. § 9-312(4).
The first distinction emerges from the opening words of the two applicable provisions. While section 9-312(3) protects the "perfected purchase money security interest," section 9-312(4) omits the word "perfected." Of course, section 9-312(4) goes on to require perfection within ten days after the debtor comes into possession of the collateral. But the omission and the lapse provision,194 coupled with a literal reading of section 9-312, suggest one extraordinary outcome.

Consider these facts: A lends C $10,000. C's later-acquired lawn mowers secure the debt, which is to be paid back over the next ten years. A promptly and properly files.

One year later B sells a lawn mower to C for $7,000 and takes a purchase money security interest. The debt is to be paid over the next nine years. B executes a security agreement and files a financing statement before C receives possession. Deciding to play it safe, B also supplies A with sufficient notice to satisfy section 9-312(3). At the end of five years, A files a continuation statement, maintaining uninterrupted perfection. B, however, forgets about the five-year limit, and fails to refile. In the eighth year, C defaults. Incredibly, who gets the lawn mower depends upon what type of collateral the lawn mower turns out to be.195

Assume C is a lawn mower dealer. The mower in his hands is inventory, and section 9-312(3) applies. In the seventh year B does not have a "perfected security interest in inventory." Therefore, even though he complied with section 9-312(3)'s notice and perfection requirements, B loses to A.

But what if C is a professional lawn cutter? The mower becomes equipment, and section 9-312(4) applies. That subsection does not require that B's purchase money security interest be perfected. B meets the requirements of section 9-312(4) and takes priority, much to the chagrin of his perplexed, perfected competitor.196

No doubt the omission of "perfected" in section 9-312(4) resulted from a slip of the drafter's pen. The Comment ignores the

194 See notes 70-74 and accompanying text supra.
195 Section 9-109, set out in note 171 supra, provides the statutory categories for classifying goods as inventory, equipment, consumer goods, or farm products.
196 A hybrid hypothetical can also be constructed: Assume that C holds the world's greatest collection of lawn mowers. He doesn't sell them. He doesn't use them. He only looks at them. His lawn mowers are consumer goods, and § 9-312(4) controls. But in this case B's security interest perfected automatically (U.C.C. § 9-302(1)(d)), and remains perfected despite B's failure to refile. Hence, B takes priority without reliance on the strange omission in § 9-312(4).
distinction, and policy frowns on the result. Of course, only a bizarre pattern of facts will give rise to this equally bizarre outcome. But aside from the exceptions provided by sections 9-401 and 9-316, this is perhaps the only case in which the Code subordinates a perfected security interest to an unperfected challenger.

A second basis for distinction between subsections (3) and (4) is the latter's omission of a notice requirement. Comment 3 explains: "Since an arrangement for periodic advances against incoming property is unusual outside the inventory field, no notification requirement is included in subsection (4)."

Third, section 9-312(4) provides a ten-day grace period following the debtor's receipt of possession during which the purchase money secured party may perfect and take priority. The grace period represents a compromise among conflicting considerations. The possibility that another creditor may rely on the debtor's possessory rights in making future advances or in executing a security agreement favors prompt perfection, perhaps before possession. Furthermore, buyers not in the ordinary course of business may rely on the absence of a filed financing statement. But debtors seldom sell noninventory—not, at least, within ten days after taking possession. This fact of commercial life limits the need to protect unsuspecting buyers. Pre-possession perfection requirement might needlessly disrupt sales by forcing sellers to delay delivery. Moreover, creditors leery of a competing purchase money security interest can guard against disaster simply by waiting until ten days after delivery to make advances against collateral in the debtor's possession.

The fourth and most important distinction between subsec-

197 As the discussion suggests, lapse of perfection will bring about this strange result under § 9-312(4). Section 9-312(3), although requiring perfection, also fails to deal with lapse. Consider these facts: In 1970, A obtains a security interest in C's after-acquired property and properly perfects. In 1971, B sells and delivers inventory to C, and obtains a timely perfected purchase money security interest. A files a continuation statement in 1975; B does not file a continuation statement in 1976, and his perfection lapses. In 1977, C defaults. B takes possession of the inventory, thus re-perfecting his security interest. Admittedly, these facts are outrageously bizarre, but it is arguable that B takes priority because, unlike § 9-312(5), § 9-312(3) does not expressly require continuous perfection.

198 For the bankruptcy implications of this unusual outcome, see note 83 supra, and notes 329-30 and accompanying text infra.

199 U.C.C. § 9-312, Comment 3.


202 See Coogan, supra note 3, at 863 n.93.
tions (3) and (4) is their varying treatment of proceeds. While section 9-312(4) extends purchase money priority to proceeds arising from a sale of the collateral, section 9-312(3) limits its application to "identifiable cash proceeds received on or before the delivery of the inventory to a buyer." In short, section 9-312(4) extends purchase money protection to accounts, while section 9-312(3) does not. This distinction is rooted in business practice. Most accounts are generated through the sale of inventory. Granting purchase money priority to inventory proceeds would therefore discourage accounts lending, a method of financing much more common and workable than lending against inventory. 203 "Hence, the principal value of a purchase money security interest in inventory will be in those situations where the supplier will be able to reclaim unsold inventory in the event of debtor's default." 204 Noninventory, such as equipment or consumer goods, seldom produces accounts. Because the general rule extends priority to proceeds of collateral, 205 and account financers infrequently rely on accounts arising from the sale of noninventory, 206 section 9-312(4) extends purchase money priority to proceeds arising from noninventory. 207

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203 See Balint, supra note 46, at 317 n. 41:
Accounts receivable financing has been replacing inventory financing. A purchase money priority in inventory would be difficult to trace into accounts if the affected inventory were only part of the goods sold. In addition, accounts financing is intricate and not easily or safely terminated on the receipt of the purchase money lender's notice.

Consider also these comments sent to the authors by the president of a middle-sized midwestern bank:

The reason why banks prefer to loan on receivables is probably two-fold. One is the liquidity of the loan. In case the balloon goes up we can sit back and let the receivables come in and pay off the note. . . . Taking over inventory is time-consuming—and a problem in public relations with possible suits from other creditors who are usually local customers of the bank. Also, as you know, to move inventory we have to turn the key in the door of the business and this creates problems and hardships for the employees. All of our credits—which rely principally on the inventory—are loans made where the inventory is fully marketable, i.e., new automobiles, oil, paper.

Letter from Gus A. Zuehlke to Dan Coenen (Nov. 10, 1976) (emphasis in original). See White & Summers, supra note 1, § 25-4, at 909; Coogan, supra note 33, at 517.

204 Balint, supra note 46, at 318.


206 See U.C.C. § 9-312, Comment 3.

207 The 1972 amendment of § 9-306 works at least one change in proceeds priorities for the holder of a purchase money security interest. Suppose A lends money to C, a farmer, to buy cattle. A perfects by filing within 10 days, but does not check the box on the form financing statement referring to proceeds. B, a prior filer with a security interest in C's after-acquired cattle, takes possession of the cattle upon C's default. The cattle are
D. Purchase Money Security Interests—Special Problems

Subsections 9-312(3) and (4) have produced some of the most heated issues in Article Nine litigation. The most important are explored below.

1. Equity and the After-Acquired Property Clause

The place is Florida. The year, 1972. A majority of the state district court has just awarded a first-filing bank a defaulting debtor’s farm equipment over a purchase money seller who failed to perfect his security interest within section 9-312(4)’s ten-day grace period. The speaker is Judge Rawls. “The law is an ass,” he exclaims. 208 Accusing his colleagues in the majority of “unduly emphasizing the formalistic language of the Uniform Commercial Code,” he argues that the bank’s after-acquired property interest is limited to the buyer’s equity in the collateral. 209 Nonplussed, he asks: “How did the bank acquire as security for its debt property that the debtor did not even own?” 210

Two years later, in International Harvester Credit Corp. v. American National Bank, 211 the Florida Supreme Court answered Judge Rawls by agreeing that a security interest in after-acquired property is indeed limited to the buyer’s equity. 212

In an opinion fraught with generalizations, the higher court cited “contractual constitutional requirements,” “avoidance of unjust enrichment,” “logical and traditional equitable reasons,” and “a windfall not favored by the code” to support its conclusion. 213 A reader of the opinion can only conclude with Judge Rawls that at times the law is indeed an ass. 214

auctioned, producing cash proceeds. Under the pre-1972 Code, the Wisconsin Supreme Court awarded priority to B, reasoning that A’s perfection lapsed 10 days after the cattle were sold. Barth Bros. v. Billings, 68 Wis. 2d 80, 92-93, 227 N.W.2d 673, 679-80, 17 U.C.C. Rep. 237, 246 (1975) (alternate holding). Under the new Code, however, perfection continues if “a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds.” U.C.C. § 9-306(3)(b). Hence, A’s purchase money security interest in C’s cattle would continue as a perfected security interest in the proceeds arising from sale. Moreover, new § 9-312(4) grants purchase money priority in collateral or its proceeds. Hence, A wins under the new Code.

209 269 So. 2d at 731-32, 11 U.C.C. Rep. at 690.
210 Id. at 732, 11 U.C.C. Rep. at 690.
211 296 So. 2d 32, 14 U.C.C. Rep. 19 (Fla. 1974).
212 Id. at 34-35, 14 U.C.C. Rep. at 23-24.
213 Id.
214 “It is not acceptable in these times for courts, any courts, to thwart the expressed
Running through the court's opinion is a patent aversion to Article Nine's rejection of title theory. But the court carried things much too far. The Code nowhere suggests that for purposes of after-acquired property clauses, property equals equity. Comment 2 to section 9-204 states: "This Article validates a security interest in the debtor's existing and future assets."

The majority opinion in International Harvester has received a rash of criticism, including a stinging dissent. The case stands alone in restricting security interests in after-acquired property, and numerous other courts have held to the contrary, at least by implication. As one practical commentator has stated: "Warning to secured sellers: Don't count on the Florida decision to attract a following. Be sure to comply timewise and otherwise with section 9-312(3) or section 9-312(4), as the case may be, to obtain special priority, in case there are prior filers as to the type of collateral."

2. Competing Purchase Money Security Interests

A wants to buy a $2,000 tractor. B lends him $1,000. The next day A buys the tractor from C, making a down payment of the $1,000 he received from B, and agreeing to pay C the remaining $1,000 over the next two years. The day before A obtains possession, B files. C files twelve minutes later. A goes bankrupt, and the tractor is sold for $1,000. It is clear that both B and C have priority over any previously perfected security interest in A's after-acquired property. But between B and C, who—if either—has priority?
White and Summers tersely conclude that section 9-312(5) controls, and that B therefore prevails.

If Bank lends the downpayment, seller lends the rest and each file within ten days, both (and therefore neither) are "entitled to the special priority" in subsection (4). Although one might argue that such creditors should share pro rata and neither receive priority, we believe that the proper rule is to go to the subsection (5) residuary clause and award priority to the winner there.\(^2\)

At least one court agrees.\(^2\)

Although the Code's language seems to require this approach,\(^2\) sound policy favors pro rata distribution between competing purchase money creditors.\(^2\) A pro rata rule would eliminate the need for a race to the courthouse between two secured parties who gave credit at about the same time. It would reduce the uncertainty of purchase money creditors, and encourage cooperation between them. It would reduce the debtor's opportu-

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\(^2\) See Framingham U.A.W. Credit Union v. Dick Russell Pontiac, Inc., 41 Mass. App. Dec. 146, 7 U.C.C. Rep. 252 (1969). Although Framingham clearly held that § 9-312(5) settles priority disputes between competing purchase money security interests, the court reached an incorrect result on the facts. The collateral in this case was an automobile. Since Massachusetts does not require filing to perfect security interests in automobiles (contra, U.C.C. § 9-302(1)(d)), and since security interests in consumer goods perfect automatically (id.), the security interests of both the lender and the seller became perfected when the debtor received rights in the collateral. (The purchase money lender executed a security agreement before the buyer and the seller entered into their conditional sales contract.) Hence, the security interests were perfected simultaneously, and the collateral should have been prorated between both purchase money creditors. Professors White and Summers agree with the Framingham result, arguing that the lender's security interest did not attach until the buyer acquired title. WHITE & SUMMERS, supra note 1, § 25-5, at 920 n.40. But location of title is irrelevant to the acquisition of a security interest. U.C.C. § 9-202. The Code requires only that the debtor have rights in the collateral. U.C.C. § 9-203(1)(c). At the same time that the debtor in Framingham acquired rights to which the seller's security interest attached, the bank's security interest attached as well.

\(^2\) See U.C.C. § 9-312(5), set out in text accompanying note 46 supra.

\(^2\) Significantly, the Code fails to provide for pro rata distribution of collateral when competing secured parties have equal priority, although the commentators agree that pro rata distribution is the answer to the equal priority problem. See 2 GILMORE, supra note 3, § 34.5, at 913. See also 22 BAYLOR L. REV. 456, 460-61 (1970) (U.C.C. § 9-314(2) deemed relevant by analogy). Moreover, the term "pro rata" requires definition. Surely equity favors proration based on the balance due each creditor, rather than on the extent of each initial contribution. See id. at 461-62.
nities to engage in fraud. Indeed, it would advance the underlying purpose of the purchase money priority rules: to furnish the moneyless debtor with property to put up as collateral in borrowing additional funds. Under a strict application of section 9-312(5), if C discovered B’s prior filing, he would, no doubt, refuse to sell. A would then find himself right where he started, with no tractor and nowhere to get funds. At worst, the skeptic retorts, this result will eliminate dual-creditor purchase money financing. But dual financing between lender and seller is a useful and common commercial practice. For creditors, it spreads the risk of loss. For debtors, it may provide the only available method of financing.

3. Purchase Money Priority—Debtors and Possession

Under subsections 9-312(3) and (4), effective perfection of a purchase money security interest hinges on when the “debtor receives possession.” These three words have sparked the hottest controversy under section 9-312 in recent years. For purposes of the section, when does a “debtor” receive “possession”? The word “debtor” is defined in section 9-105(1)(d):

“Debtor” means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral . . . .

The Code does not define “possession,” perhaps because its meaning varies in different contexts. As normally used in the Code and at common law, however, the term implies physical control of property. The degree of control necessary for possession

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228 Consider the observation made by the court in Framingham:

This result is in accord with common sense in that the plaintiff credit union could not possibly obtain an interest in the collateral supposedly securing its loan unless and until defendant, the owner, was willing to put an interest in the collateral in [the buyer's] hands under the conditional sale. This presumably it would not be willing to do without retaining an interest in the collateral superior to all other interests therein. Obviously, it would not part with the collateral, if by so doing it was vesting in another party a security interest superior to its own.


229 U.C.C. § 9-105(1)(d).

230 “Possession” may have different meanings in different sections of the Code. For example, a seller may have physical control of property, but if his possession precedes relinquishment of the property to the debtor, it is doubtful whether his security interest is perfected through possession. See U.C.C. § 9-305. The key to § 9-305 is the demonstration of “ostensible ownership which indicates the perfected security interest to other potential creditors.” In re Automated Bookbinding Servs., Inc., 471 F.2d 546, 554, 11 U.C.C. Rep. 897, 908 (4th Cir. 1972).

231 “[A] person who is in possession of a chattel is one who . . . has physical control of
depends on the nature of the collateral.  
The "debtor receives possession" question first arose in *Brodie Hotel Supply, Inc. v. United States.* A sold restaurant equipment to B, A's lessee, who shortly thereafter went bankrupt. A recovered the property, but left it in the restaurant. C, with A's permission, reopened the restaurant. For five months A and C negotiated a purchase price for the restaurant equipment. Meanwhile, D lent money to C, took a security interest in the restaurant equipment, and promptly filed a financing statement. A and C then agreed upon a purchase price for the equipment, and executed a sale and security agreement. A filed within ten days of execution. The court.
granted purchase money priority to A, reasoning that there was no "obligation secured" by the collateral until execution of the sales contract and security agreement.\textsuperscript{235} Therefore, C was not a "debtor" until the security agreement came into being. A had ten days after execution of the security agreement, rather than ten days after C's taking of possession, to perfect and take priority.

\textit{In re Automated Bookbinding Services, Inc.}\textsuperscript{236} involved similar facts, but produced a different result. A contracted to sell bookbinders to B, and executed a security agreement. The contract required A to install and test the machines. A filed within ten days of installation, but more than ten days after delivery of the machine parts.

Both the district court and the court of appeals focused on the "possession" issue.

The district court granted A purchase money priority over C, who held a security interest in B's equipment, ruling that B did not obtain possession until A tendered delivery. Tender of delivery, the court reasoned, could not take place until installation was completed.\textsuperscript{237}

The court of appeals reversed, giving three reasons. First, it rejected the tender of delivery rationale as a sales concept inapplicable to secured creditors.\textsuperscript{238} Second, the court argued that adopting the tender theory would allow secured creditors to avoid filing altogether:

Secured parties are required, in most cases, to file a financing statement in order to perfect their security interest. To define "possession" as requiring completion of tender of delivery terms would permit a secured creditor to delay performance of a tender of delivery term, and thereby avoid the filing requirement indefinitely.\textsuperscript{239}

\textsuperscript{235} 431 F.2d at 1319, 8 U.C.C. Rep. at 116. Under the court's reasoning it appears that both a sales contract and a security agreement must be executed before the buyer becomes a "debtor" within the meaning of § 9-105(1)(d), since the buyer's "obligation" does not come into existence until the sales contract is made, and that obligation will not be "secured" until execution of the security agreement. As a practical matter, parties usually incorporate both agreements into one document, commonly referred to as a conditional sales agreement.


\textsuperscript{237} 936 F. Supp. at 1134-35, 10 U.C.C. Rep. at 218.

\textsuperscript{238} 471 F.2d at 553, 11 U.C.C. Rep. at 907.

\textsuperscript{239} Id.
Finally, the court reasoned that the lower court's interpretation would undermine the Code's purpose of providing "a precise guide for commercial transactions under which businessmen may predict with confidence the results of their dealings." The court feared that a second creditor, upon finding the debtor in possession of property without a financing statement on file, might lend against the machinery in ignorance of the seller's competing interest.

Despite the looming presence of the same policy problems in *Brodie*, the court distinguished that case as one in which the debtor was in possession before the goods were sold and the security agreement was executed. Hence, the *Bookbinding* court did not discuss the "debtor" issue.

But the next important case, *James Talcott, Inc. v. Associates Capital Co.*, does. In that case, *A* delivered equipment to *B* on February 17. On February 25, *A* and *B* executed a lease-option agreement. On March 3, *A* filed. The court refused to give *A* purchase money priority. Although the court addressed the debtor issue, it sidestepped a direct confrontation with the underlying weakness of the *Brodie* analysis by holding that *B* was a "debtor" in "possession" more than ten days before *A* filed. Forced to distinguish *Brodie*, the court pointed to the February 25 lease-option agreement, which specifically stated that *B*'s lease began on February 17. Hence, the court reasoned, *B* was a "debtor" as of that date.

This distinction points up the fragility of *Brodie*. The court's reasoning in *Talcott* compels the conclusion that, in order to obtain purchase money priority, *A* would merely have had to write into the

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240 Id. at 552, 11 U.C.C. Rep. at 905.
241 Id. at 553 n.14, 11 U.C.C. Rep. at 907 n.14.
242 Arguably the buyer in *Bookbinding*—as in *Brodie*—was not a "debtor" when it obtained possession. Clearly the seller's installation of the machinery was a condition precedent to the buyer's obligation to pay, since the seller's invoice specifically required payment after installation. See also U.C.C. § 2-507. The interesting issue this raises is whether under these circumstances the buyer "owes payment or other performance"—a requirement of becoming a debtor under § 9-105(1)(d). Until the seller installed the machinery the buyer had no present duty to pay. See Restatement of Contracts § 250(a) (1932). It is unclear whether a buyer whose obligation has not yet matured "owes payment or other performance" under § 9-105(1)(d) (emphasis added). A more fitting characterization may be that the buyer in such a case only might owe payment. This issue is not addressed in *Bookbinding*.
244 Id. at 883, 14 U.C.C. Rep. at 207.
lease that B’s obligation arose not on February 17, but on February 25. Form conquers substance, and the result turns on a mere technicality. Hence, the manner in which the court distinguished Brodie does nothing to reduce uncertainty for subsequent lenders—a purpose which the Talcott court espoused in reaching its conclusion.245

In re Ultra Precision Industries, Inc.246 blends the facts of Bookbinding and Brodie. As in Bookbinding, the seller shipped complicated equipment requiring installation to a buyer who demanded a reasonable testing period. In addition, the sale was conditioned on the buyer arranging for outside financing, apparently to guarantee that the buyer would have sufficient funds to pay off his debts to the seller as they became due. After the acquisition of credit and the completion of testing, the buyer and seller executed a security agreement. Seller’s assignee filed within ten days of execution, but more than a month after the buyer received possession of the parts.

The court, addressing only the “debtor” issue, granted the seller purchase money priority. It distinguished Bookbinding just as Bookbinding distinguished Brodie, arguing that in the present case the debtor had possession of the goods prior to sale and execution of the security agreement.247 Again, the distinction is unsatisfying because it makes the date on which a document is signed the sole controlling factor in determining priorities.248

The problems raised by the Brodie-Ultra Precision line of cases are serious. A creditor can frustrate the purpose of section 9-312’s time limits merely by postponing execution of a security agreement. The third-party lender has no way of discovering the potentially preemptive “inchoate” security interest of the purchase money creditor.249 Accordingly, the Brodie rule invites collusion or fraud where a debtor is desperate for funds.250 It encourages the

245 Id. at 882-83, 14 U.C.C. Rep. at 206.
246 503 F.2d 414, 15 U.C.C. Rep. 281 (9th Cir. 1974).
247 Id. at 418, 15 U.C.C. Rep. at 285.
248 In granting purchase money priority, the Ultra Precision court emphasized the absence of adverse reliance on the buyer’s possession of the collateral. Id. at 418, 15 U.C.C. Rep. at 286. However, in light of the Ultra Precision court’s heavy reliance on Brodie, and in light of the terms (i.e., “good faith,” “estoppel”) in which the court couched its concern, it is highly doubtful that additional advances by the nonpurchase money secured party, absent bad faith on the part of the purchase money secured creditor, would have affected in any way the result reached in the case.
250 The Brodie decision, like that in Ultra Precision Industries, makes the commence-
very evil that Article Nine's perfection and priority provisions were
designed to eradicate: secret security interests.

Litigators and commentators, uncomfortable with Brodie's re-
sults, have urged a different interpretation of the word "debtor" in
section 9-312. Some have argued that the "obligation secured" re-
ferred to in section 9-105(1)(d) does not mean the obligation owed
to the purchase money secured party. Priority disputes arise be-
cause another "obligation secured" exists, albeit owed to another
creditor. It has been argued that although a security agreement has
not been executed with the purchase money creditor, the person
receiving purchase money credit is nonetheless a "debtor" because
of his relationship with the prior lender. This argument was
specifically rejected in Ultra Precision: "To us, the word 'debtor'
in § 9312(4) means the debtor of the seller or holder of the 'pur-
chase money security interest in the collateral' (the thing sold)."

Others have argued that for purposes of section 9-312,
"debtor" simply does not mean "debtor"—not, at least, in the sec-
section 9-105(1)(d) sense. Rather, they say, the drafters slipped in the
word "debtor" simply as a matter of convenience, and it should be
read to include the debtor-to-be. The emphasis, it is suggested,
should be on possession. It has been pointed out that the word
"debtor" is used loosely in other sections of Article Nine.

251 Id. at 1028-29.
tion Credit Ass'n, 189 Neb. 44, 53, 200 N.W.2d 1, 6, 10 U.C.C. Rep. 1336, 1344-45 (1972).
253 Note, supra note 249, at 853.
254 Thus, the term "debtor," although specifically defined in section 9-105(1)(d) of
the Code, is used outside that definition as necessary to identify the parties. For
example, if the section 9-105(1)(d) definition were read into section 9-402(1)
where a financing statement, signed by the "debtor" and "secured party," must be
filed prior to execution of the security agreement, a blatant inconsistency is re-
vealed: since there is no security agreement, there can be no "debtor" or "secured
party." Under such circumstances it is more reasonable to assume the term "debt-
or" is being used as a procedural convenience to identify the parties more easily.
over, section 9-105 requires observance of its definitional provisions "unless the context otherwise requires." A broad reading of this language, coupled with the overriding notice-filing philosophy of Article Nine, suggests the plausibility of this position. But proper interpretation of the Code requires adherence to definitional provisions. Courts may therefore hesitate to embrace this argument, and none has done so to date.

Still other attacks have been launched against Brodie. Critics have argued that purchase money creditors can easily file before transfer of possession, regardless of whether a security agreement is eventually executed. Section 9-312, however, requires perfection—not just filing—before the grace period ends. Hence, execution of a security agreement, as well as filing, is necessary to meet the statutory requirements. Where no security agreement is foreseen at the time possession is transferred, changing the meaning of "debtor" will eliminate purchase money protection for certain deserving sellers and lenders. Moreover, requiring execution of a security agreement before transfer of possession (or within ten days thereafter) seems needlessly demanding, especially in cases where the purchase price is undetermined, and a sale might never occur. It will be impossible to create a security interest where no obligation exists, as in the case where a buyer takes goods on a trial basis.

These problems indicate a need for amendment. First, the "debtor" concept should be banished from section 9-312. Second, subsections (3) and (4) should be rewritten to require perfection or filing within the statutory time limits. These two changes will accomplish the goals unsuccessfully sought by the present purchase money provisions.

Filing will put others on notice of the purchase money security interest without requiring of the purchase money creditor the inordinately impractical or downright impossible. It is filing—not execution of a security agreement—that protects existing and po-

**Footnotes:**

255 In light of Article Nine's near-banishment of secret security interests and the Code's proclaimed purpose of modernizing commercial law (U.C.C. § 1-102(2)), a strong argument can be made that the "context" of § 9-312(3) and (4) requires rejection of the definition of "debtor" in § 9-105(1)(d).


258 A security interest must secure an obligation. See U.C.C. § 1-201(37), set out in part in note 32 supra; note 235 supra.
tential creditors. The Code recognizes this in the nonpurchase money context by specifically allowing filing before attachment, and by basing priority on the date of filing.

Eliminating the "debtor" issue will refocus the statute on possession, rather than on the easily manipulated time at which the sale is consummated and the security agreement executed. Together these reforms will protect third-party creditors by insuring notice and limiting the opportunities for fraud. Additionally, they will give the purchase money creditor adequate flexibility. The proposed amendment will neither allow secret security interests nor handcuff purchase money financiers. In short, it will advance the aims of Article Nine.

Of course, problems will persist. Consider the facts of Fan-Gil Corp. v. American Hospital Supply Corp. A doctor works for a hospital for many years, during which time he keeps his own equipment at the hospital. The hospital fails to pay the doctor's wages. The doctor decides to quit, and the hospital agrees to buy his equipment. Under the proposed amendment, the doctor cannot obtain a purchase money security interest because he failed to file before transfer of possession. The distinction between Fan-Gil and the Brodie-Ultra Precision line of cases is that, at the time the doctor transferred possession, he had no intention of ever selling his equipment to the hospital. An exception could surely be carved

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259 U.C.C. § 9-402(1).
260 U.C.C. § 9-312(5)(a).
261 A revised § 9-312(4) might read:

A purchase money security interest in collateral other than inventory takes priority over a conflicting security interest in the same collateral or its proceeds if the person holding the purchase money security interest files or perfects by the time the person acquiring rights in the collateral receives possession or within ten days thereafter.

263 The actual Fan-Gil decision addresses neither the debtor nor the possession issue. Instead the court concluded that the purchase money lender takes priority because his security interest was perfected within 10 days after attachment. See id. at 112, 211 N.W.2d at 564, 13 U.C.C. Rep. at 737. This reasoning sorely misconstrues the statute, unless the court's unarticulated premise is that until the security agreement attached there was no "obligation secured" and correspondingly no "debtor." For an analysis of the case in this light, see 20 WAYNE L. REV. 1407 (1974).
264 In Ultra Precision the sellers envisioned an eventual sale. Because the terms of sale were apparently agreed upon, it would have been easy for the seller to perfect its security interest prior to transfer of possession. The security agreement, like the sale contract in Bookbinding, could have been made conditional upon proper installation and successful inspection.
out to cover this relatively rare situation.\textsuperscript{265}

Arguments suggesting Brodie's failings are strong on policy, but weak on Code language. To date, courts have deferred to the latter. Be it the courts' fault or the Code's, the Brodie line of cases fails to provide sensible and certain rules for sellers and lenders. The problem, it appears, can only be solved through amendment.

III

THE ARTICLE NINE SECURED PARTY VERSUS NON-ARTICLE-NINE INTERESTS

A. Lien Creditors—Section 9-301

Section 9-301 sets forth the rights of an unperfected secured creditor against other creditors with claims to the collateral. Recent cases indicate that courts apply section 9-301 mechanically, but often have difficulty determining whether a creditor is secured and/or perfected.\textsuperscript{266} Although a secured creditor's claim is superior to that of an unsecured creditor without a lien,\textsuperscript{267} the secured creditor runs the risk of being subordinated to other creditors if he fails to perfect his interest.\textsuperscript{268} The interest of an unperfected, secured creditor is not void; it is merely inferior.\textsuperscript{269}

Section 9-301(1)(a) subordinates unperfected security interests to interests entitled to priority under section 9-312. Thus, a perfected security interest takes priority over an unperfected interest even if the unperfected interest was created earlier and was known to the perfected creditor when he attached and perfected his interest.\textsuperscript{270}

A lien creditor who levies against the collateral before the perfection of a competing security interest, will obtain priority over the secured creditor under section 9-301(1)(b).\textsuperscript{271} Thus, a se-

\textsuperscript{265} The Fan-Gil problem is more likely to arise when possession is initially transferred pursuant to a genuine lease, with the parties later agreeing to a sale.


\textsuperscript{267} See U.C.C. § 9-201.

\textsuperscript{268} See U.C.C. §§ 9-301(1), 9-312.

\textsuperscript{269} 2 W. Hawkland, supra note 114, ¶ 2.2901, at 656.


\textsuperscript{271} See, e.g., General Lithographing Co. v. Sight & Sound Projectors, Inc., 128 Ga.
cured creditor who delays in perfecting his interest may be cut off by a lien creditor. But if the secured creditor is a purchase money secured creditor, he has ten days after the debtor receives the collateral within which to perfect his interest.272

Massachusetts Mutual Life Insurance Co. v. Central Penn National Bank273 illustrates the analysis of priorities under section 9-301. In that case, creditors of Miller attempted to collect their debts out of commissions that Massachusetts Mutual owed to Miller on an agency contract. The creditors included Central Penn National Bank (Central Penn), Industrial Valley Bank (IVB), Mercantile Financial Corp. (Mercantile), Franklin National Bank (Franklin National), Marine Midland Grace Trust Co. (Marine Midland), and Isadore and Dorothy Mokrin (Izzy and Dot).274 In June 1963, Central Penn perfected a security interest in Miller’s commissions. IVB took a security interest in Miller’s commissions in May 1964, but did not perfect. Mercantile entered a judgment by confession against Miller, and served a writ of execution on Massachusetts Mutual in January 1966. In February 1966, Franklin National sued Miller on a note, and obtained a temporary restraining order barring Massachusetts Mutual from assigning or transferring any amounts due to Miller under the agency contract. Marine Midland entered a judgment by confession against Miller in June 1966, but did not execute it. Izzy and Dot entered a similar judgment against Miller, and served a writ of execution on Massachusetts Mutual in March 1967. Massachusetts Mutual filed an interpleader action to resolve these conflicting claims to the commissions it owed to Miller.

The court held that Central Penn was entitled to first priority

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272 U.C.C. § 9-301(2) provides:

If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

This is an exception to the first-in-time rule. 2 W. HAWKLAND, supra note 114, ¶ 2.2902, at 658.


274 When asked if “Izzy and Dot” was an acceptable reference to the Mokrins, Izzy said “I don’t care.” Telephone conversation with Isadore Mokrin, April 7, 1977.
because "a perfected security interest takes priority over an unper-
fected security interest and 'cannot be defeated in insolvency pro-
ceedings or in general by creditors.'"\textsuperscript{275} Mercantile, Franklin Na-
tional, and Izzy and Dot came next in priority as lien creditors
under the 1962 version of section 9-301(1)(b).\textsuperscript{276} That section pro-
vides that "an unperfected security interest is subordinate to the
rights of . . . a person who becomes a lien creditor without knowl-
dge of the security interest and before it is perfected."\textsuperscript{277} Mercan-
tile and Izzy and Dot secured their status as lien creditors by ley-
ing against the property in compliance with section 9-301(3).\textsuperscript{278}
Franklin National, on the other hand, obtained a temporary re-
straining order precluding any payments by Massachusetts Mutual
to Miller until a certain amount was accumulated for the benefit
of Franklin National or for any creditors with priority over Frank-
lin National.\textsuperscript{279} This procedure was challenged as inadequate to
give Franklin National the status of a lien creditor for purposes of
section 9-301(1)(b). The court rejected this argument, however,
implicitly characterizing Franklin National's interest as falling
under section 9-301's saving clause for "lien[s] . . . , lev[ies] or the
like."\textsuperscript{280} "Section 9-301 reserves lien creditor status for those cred-
itors who acquire a lien by invoking the judicial process. Despite
the conditional nature of Franklin's lien, it suffices to qualify that
claimant as a 'lien creditor' as of [the date the restraining order was
obtained]."\textsuperscript{281}

The unperfected secured creditor, IVB, challenged the su-
periority of the lien creditors on the ground that they knew of
IVB's prior interest when they secured their judgments. IVB ar-
gued that the lien creditors bore the burden of proving their
ignorance of its security interest. The court dismissed this
argument,\textsuperscript{282} referring to the 1972 amendments' elimination of the
knowledge requirement as support for its conclusion that the bur-

\textsuperscript{277} U.C.C. § 9-301(1)(b) (1962 version). The 1972 version of this section eliminates the
lack-of-knowledge requirement.
\textsuperscript{278} U.C.C. § 9-301(3) provides in part:
\begin{quote}
A "lien creditor" means a creditor who has acquired a lien on the property
involved by attachment, levy or the like . . . .
\end{quote}
\textsuperscript{279} 372 F. Supp. at 1043, 14 U.C.C. Rep. at 217.
\textsuperscript{280} U.C.C. § 9-301(3) (emphasis added).
\textsuperscript{281} 372 F. Supp. at 1043, 14 U.C.C. Rep. at 217.
den of proof was on IVB.\textsuperscript{283} Having failed to meet that burden, IVB was subordinated to all the lien creditors.

In the race for priority, Marine Midland brought up the rear. Although it had a judgment against Miller, it failed to resort to the simple enforcement procedure required to attach a judgment creditor's interest in particular collateral.\textsuperscript{284} Thus, Marine Midland qualified neither as a secured creditor nor as a lien creditor, and was consequently subordinated to all competitors. The court pointed out that "not all 'judgment creditors' are 'lien creditors.' A lien arises only after the judgment is enforced through the judicial process—by 'writ of execution, attachment, levy or the like.'"\textsuperscript{285}

B. Equitable Interests

Conflicts between Article Nine creditors and holders of judicially imposed equitable interests pose awkward priority problems. Such disputes often fall beyond the scope of Article Nine's priority rules.\textsuperscript{286} In searching for neutral principles of decision, however, courts have attempted to squeeze these disputes into the Code's priority rules.\textsuperscript{287} The following discussion deals with the proper resolution of priority conflicts between Code creditors and the beneficiaries of two types of equitable interests—the "equitable lien or mortgage" and the "constructive trust."\textsuperscript{288}

Unfortunately, these interests have often been lumped together and referred to generically as "equitable liens."\textsuperscript{289} Different policies, however, underlie each interest; therefore the priority rules applicable to each should vary. The phrase "equitable lien or mortgage," as used herein, refers to the court-imposed lien arising

\textsuperscript{283} Id. at 1043-44 n.7, 14 U.C.C. Rep. at 218 n.7.

\textsuperscript{284} See U.C.C. § 9-301(3), set out in part in note 278 supra.


\textsuperscript{286} When an Article Nine secured creditor is involved, and Code rules arguably apply, § 1-103 makes it clear that equitable interests, which are not displaced by particular Code provisions, should be governed by equitable principles. See U.C.C. §§ 1-103, 9-102(1). In general, Article Nine does not apply to liens or similar interests in personal property that arise by operation of law, with the exception of those liens covered by § 9-310. See U.C.C. § 9-104(b),(c); WHITE & SUMMERS, supra note 1, § 22-2, at 757-58.


\textsuperscript{288} Analysis has been confused by the many uses of the term "equitable lien." See GILMORE, supra note 3, § 7.2, at 198-200.

\textsuperscript{289} See id.; 4 J. POMEROY, EQUITY JURISPRUDENCE §§ 1233-1234, at 691-95 (5th ed. 1941).
when parties who intend to create a security interest fail to comply with the formalities required by Article Nine. The "constructive trust" arises when a transferee has acquired property fraudulently, and the court imposes a trust on the property for the benefit of the defrauded transferor.

1. Equitable Liens

The drafters of Article Nine sought to eliminate equitable liens because they undermined the basic Code policies of furthering certainty in commercial transactions and abolishing secret security agreements. The Comment to section 9-203 manifests the drafters' hostility to equitable liens. Nevertheless, the equitable lien has managed to survive the Code. In Chattanooga Brick & Tile, Inc. v. Agnew, the Tennessee Court of Appeals subordinated a competing interest to an equitable lien based on a subcontractor's oral promise to satisfy a debt out of retainages. The court was misguided. Enforcement of secret oral agreements against other

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290 Every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property a security for debt or other obligation, or whereby the party promises to convey or assign or transfer the property as security, creates an equitable lien upon the property so indicated, which is enforceable against the property in the hands of the original contractor, his heirs, assignees, and purchasers or encumbrancers with notice. Under like circumstances, a merely verbal agreement may create a similar lien upon personal property.

4 J. Pomeroy, supra note 289, § 1235, at 696 (footnote omitted). See also U.C.C. § 9-203, Comment 5.

291 See generally 4 J. Pomeroy, supra note 289, § 1044, at 93-94; Restatement of Restitution § 160 (1937).

292 See U.C.C. § 9-203, Comment 5, set out in note 293 infra. The bankruptcy rule on equitable liens provides a useful model for determining the appropriate treatment of equitable liens in other contexts. Section 60a(6) of the Bankruptcy Act, 11 U.S.C. § 96(a)(6) (1970), sets forth the rule: "The recognition of equitable liens where available means of perfecting legal liens have not been employed is declared to be contrary to the policy of this section."

293 U.C.C. § 9-203, Comment 5, states: Unless the secured party is in possession of the collateral, his security interest, absent a writing which satisfies [section 9-203(1)(a)] is not enforceable even against the debtor, and cannot be made so on any theory of equitable mortgage or the like. More harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing.

294 See 1 Gilmore, supra note 3, § 11.5, at 345, in which the author notes that the Code's attempt to eliminate all equitable mortgages had "overshot the mark." For an example of judicial affirmation of equitable liens when a writing is involved, see Warren Tool Co. v. Stephenson, 11 Mich. App. 274, 161 N.W.2d 133, 5 U.C.C. Rep. 1017 (1968).

creditors subverts section 9-203, the Code's priority rules, and fundamental Article Nine policy.

2. Constructive Trusts

Not all equitable interests that may exist in a secured party's collateral are as disfavored as the equitable lien arising out of an unwritten agreement; the constructive trust requires a different analysis. The constructive trust imposed on property or proceeds in favor of a defrauded transferor has nothing to do with secured transactions or trust law. The parties to a constructive trust certainly do not intend to create a trust relationship. The defrauded constructive beneficiary has no opportunity to enter into a security agreement with the debtor-trustee, and no way to perfect his interest.

The special circumstances that result in raising a constructive trust are beyond the realm of the Code, and Code priority rules should not provide more than a policy guide in resolving disputes between the constructive beneficiary and the Article Nine secured creditor. The recent Texas case of Meadows v. Bierschwale illustrates the weakness of using Code priority rules.

In that case, Bierschwale sold an apartment complex to Oakes in exchange for third-party notes payable to Oakes. Before Bierschwale realized that the notes were worthless, Oakes sold the complex to Goldman, a bona fide purchaser. In an action by Bierschwale against Oakes, the trial court found that Oakes had

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296 See, e.g., U.C.C. § 9-312 (priority determined by date of perfection or attachment).
297 Gilmore suggests that courts should continue to enforce certain equitable interests that result from dealings among nonprofessionals. 1 GILMORE, supra note 3, § 11.1, at 336-37. See note 300 infra.
298 4 J. POMEROY, supra note 289, § 1044, at 94.
299 Section 2-702(3), which gives sellers the right to reclaim goods if the buyer misrepresents his solvency, can be viewed as endorsing the constructive trust remedy in limited circumstances. The seller reclaiming under this provision may find himself in a priority dispute with a secured creditor or a trustee in bankruptcy. Part of the considerable literature on this subject is set out in note 314 infra.
300 Gilmore recognizes these limitations:
Article 9, for all its comprehensiveness, is a statute drafted to regulate certain well-known or institutionalized types of financing transactions . . . . [A] transaction which sets out to be one of those types should conform to the Article 9 rules or fall by the wayside. But beyond the area of institutionalized transaction, there stretches a no-man's land, in which strange creatures do strange things. For these strange things there are no rules; it makes no sense to measure them against the rules which professionals have developed for professional transactions.

1 GILMORE, supra note 3, § 11.1, at 336-37.
301 516 S.W.2d 125, 16 U.C.C. Rep. 515 (Tex. 1974).
fraudulently misrepresented the value of the notes, and therefore declared a constructive trust in the proceeds of Oakes' sale in favor of Bierschwale. This resulted in a priority dispute between Bierschwale and Smith, Oakes' secured creditor. Finding that improper filing prevented perfection of Smith's security interest, the Texas Supreme Court characterized the constructive beneficiary as a section 9-301(3) lien creditor, and invoked section 9-301(1)(b) to give Bierschwale priority.

Although the result is justifiable, the court's reasoning is unacceptable. It is unlikely that the Code's drafters intended section 9-301 to apply to constructive trusts. In our opinion, viewing a constructive trust as an "attachment, levy or the like" strains that language to the breaking point. Attachment and levy are methods of cashing in on court-imposed remedies; the constructive trust, on the other hand, is itself a remedy, rather than a mechanism for enforcement. In addition to this difference in the nature of their interests, equating beneficiaries of constructive trusts with section 9-301 lien creditors leads to undesirable priority results. Since a constructive trust arises at the time of the fraud, under section 9-301(1)(b) the beneficiary would take priority over any security interest attaching or perfecting after the fraudulent transfer.

When notice is unavailable and competing secured creditors

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302 Id. at 133, 16 U.C.C. Rep. at 519.
303 Bierschwale is a lien creditor by virtue of his equitable right to a constructive trust on the Goldman proceeds. Section 9.301(c) [U.C.C. § 9-301(3)]. The constructive trust arises when legal title passes, in the instant case when the apartment complex was transferred to Oakes. . . . When the property subject to a constructive trust is transferred, a constructive trust fastens on the proceeds. . . . Bierschwale's right arose prior to and without knowledge of Smith's right. Therefore, Bierschwale's claim to the proceeds . . . takes precedence over the claim of Smith.

304 Other cases have refused to broaden § 9-301(3)'s definition of lien creditor. In Gamble v. Hinds, 10 Cal. App. 3d 1021, 89 Cal. Rptr. 341, 8 U.C.C. Rep. 3 (1970), the court refused to read "lien creditor" expansively, noting that if the legislature had intended such a reading it should have been more specific. Id. at 1026, 89 Cal. Rptr. at 344, 8 U.C.C. Rep. at 9. A federal district court has held that a judgment creditor was not a "lien creditor" until he sought to enforce his judgment. Massachusetts Mut. Life Ins. Co. v. Central Penn Bank, 372 F. Supp. 1027, 1044, 14 U.C.C. Rep. 212, 218 (E.D. Pa. 1974), aff'd mem., 510 F.2d 969, id. at 970 (3d Cir. 1975).

305 See 4 J. POMEROY, supra note 289, § 1044, at 96.
306 See U.C.C. § 9-301(1)(b).
are innocent third parties, giving the beneficiary priority seems extreme. A judicial lien itself gives those who would subsequently extend credit notice of the lienor's interest. But no notice is given when a constructive trust is involved. Until the beneficiary discovers the fraud, even he will be unaware that the trust has arisen. If the secured creditor perfects his interest after the fraud but before the declaration of the constructive trust, and he has no knowledge of any foul play, there is no satisfying reason to subordinate him.  

Both the perfected secured creditor and the beneficiary are innocent parties. One is favored by the policy of protecting victims of fraud, while the other represents the diligent creditor who took all steps necessary to perfect his interest and had no notice of any prior claims against the debtor. Between these equally innocent parties, the question is not really one of priorities, but one of allocating risks. The law generally places the risk of loss on the party better able to avoid the loss or protect himself against it. In most cases, this will be the beneficiary. As the victim of the fraud, he had the closest dealings with the defrauder. He was therefore in the best position to take precautions. As a party to the fraudulent transaction, he may have had an opportunity to avoid the fraud, an opportunity the secured creditor certainly never had. The secured party holding a valid, perfected interest has done all he could. This may or may not be true of the beneficiary.

Beyond this allocation of risk, equitable concerns provide little assistance. Code rules, although not controlling, provide further principles for the risk-allocation analysis. Code policy favoring commercial certainty lines up on the side of protecting perfected secured parties. Disfavoring such a party would cast doubt on just how perfect the perfected security interest is. This could only discourage secured lending. Article Nine represents a willingness to implement certainty-centered pure-race rules at the expense of the beneficiary.

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207 See 4 J. Pomeroy, supra note 289, § 1058b, at 97. Pomeroy notes that the policy of the constructive trust doctrine is to make the beneficiary whole at the expense of the constructive trustee, not innocent third parties, such as bona fide purchasers. Third parties without notice therefore generally take free of the trust. Moreover, the beneficiary still has a cause of action against the defrauding trustee for damages. Id.

208 Similarly, in other situations, the Code imposes the loss on the party in greatest proximity to the wrongdoer. See, e.g., note 648 and accompanying text infra. If the contending parties were equally innocent, courts of equity generally imposed the loss on the party who suffered it. See, e.g., Holly v. Missionary Soc'y, 180 U.S. 284, 295 (1900) ("equity will not transfer a loss that has already fallen upon one innocent party to another party equally innocent").
fairness value underlying race-notice systems, and equity generally protects innocent third-party transferees. Courts should refuse to undermine these policies absent clearly superior considerations favoring the beneficiary.

The beneficiary's position in relation to unperfected secured creditors without notice is more problematic. Although the proximity-to-the-fraud argument remains, a secured creditor who fails to perfect before he receives notice of the fraud has not finished the race of the diligent creditor. The force of the commercial certainty argument is accordingly diminished. Beyond this, the Code, by subordinating unperfected security interests to general creditors who obtain judicial liens, promotes filing and notice in general. The same systemic argument supports subordinating the unperfected security interest to the constructive trust.

C. The Trustee in Bankruptcy

The objectives of Article Nine's priority rules provide a contrast with those of the Bankruptcy Act. Rather than rewarding the diligent, the Bankruptcy Act's basic goal is equal treatment of the bankrupt's creditors. The interface between state debtor-creditor law and federal bankruptcy law is thus bound to generate conflicts. Those conflicts are minimized, however, by the Bankruptcy Act's heavy reliance on state law. This not only reduces conflicts between state and federal law, but also implies that the Code will frequently govern or influence creditor priorities in bankruptcy court.

A caveat is in order. The interplay between Article Nine's priority rules and the Bankruptcy Act will not be explored here with the same thoroughness as the priority issues arising under Article Nine. The wealth of recent scholarly work, the pendency of bankruptcy reform, and the scarcity of recent reported decisions all militate against a detailed examination of conflicts between Article Nine secured parties and bankruptcy trustees.

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309 See notes 52-53 and accompanying text supra.
312 For a comprehensive examination of the effect of the proposed bankruptcy acts on trustee vs. secured party priorities, see Note, The Proposed Bankruptcy Acts—Chapter IV, Part 6: Reshaping the Trustee's Sword, 61 CORNELL L. REV. 257 (1976).
313 In lieu of an extensive analysis, we have attempted to provide in the footnotes to this section an exhaustive compilation of the important scholarly work from the past decade dealing with the treatment of secured parties in bankruptcy courts. See generally 3 W.
To prevent the preferential treatment of creditors, the Bankruptcy Act gives the trustee in bankruptcy broad powers to avoid priorities granted to certain creditors under state law.\(^{314}\) The most potent weapon in the trustee's arsenal is section 70c of the Bankruptcy Act,\(^{315}\) the so-called "strong-arm clause." This provision gives the trustee the status of a hypothetical lien creditor as defined by state law—i.e., Code section 9-301(3).\(^{316}\) This enables the trustee to invalidate any security interest that remains unperfected when the bankruptcy petition is filed.\(^{317}\) To the extent that the trustee is an ideal lien creditor under the Act,\(^{318}\) section 70c comes into clear conflict with the 1962 version of Code section 9-301(1)(b).\(^{319}\) The latter provision can be read as depriving the trustee of priority if all actual creditors had knowledge of the unperfected security interest.

\(^{314}\) See Bankruptcy Act §§ 60, 67a, 67c, 67d, 70c, 70e, 11 U.S.C. §§ 96, 107(a), 107(c), 107(d), 110(c), 110(e) (1970).


\(^{316}\) For discussion of § 70c, see 3 W. COLLIER, BANKRUPTCY MANUAL § 13.001 (1974); 2 GILMORE, supra note 3, §§ 45.3.2; WHITE & SUMMERS, supra note 1, § 24-3; Hiller, Secured Transactions in Bankruptcy Administration, 41 PA. B.A.Q. 147, 157 (1970) (bankruptcy trustee versus unperfected security interest); Note, supra note 312, at 283-84 (trustee's power under present law and under proposed amendment); 50 B.U.L. REV. 483 (1970) (bankruptcy trustee as lien creditor versus automatically perfected purchase money security interest). See generally Henson, Some Thoughts on Lien Creditors Under Article 9, 1974 U. ILL. L.F. 237 (1974) (concluding that Article Nine has strengthened strong-arm clause).


\(^{318}\) See Bankruptcy Act § 70c, 11 U.S.C. § 110(c) (1970); Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603 (1961); Pacific Fin. Corp. v. Edwards, 304 F.2d 224 (9th Cir. 1962) (for trustee to take position of creditor with lien at date of bankruptcy under earlier version of § 70c, creditor of this type must actually have existed).

\(^{319}\) Except as otherwise provided in subsection (2), an unperfected security interest...
Several cases have suggested this result. But others have held that creditors' actual knowledge is irrelevant to the trustee's priority. In *In re Callahan Motors, Inc.*, for example, the court held that, despite knowledge by all creditors, section 70c left the trustee with a "federally created status as a lien creditor without notice." Section 70e places the trustee in the shoes of an unsecured creditor with a provable claim. Along with section 67a, section 70e subrogates the trustee to the claims of certain lien creditors, and thus may enable the trustee to subordinate Article Nine interests. With respect to this 70e-67a attack, it remains unclear

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.

U.C.C. § 9-301(1)(b) (1962 version) (emphasis added).


*Id.*

*Id.*, § 107(a).

*See* 2 GILMORE, *supra* note 3, § 45.3.1, at 1290-92; WHITE & SUMMERS, *supra* note 1, § 24-8, at 888-92; Gamble, Secured Transactions: The Perfected Security Interest Versus Competing Claims, 5 CUM.-SAM. L. REV. 1, 16-17 (1974) (discussing "gap creditor" and trustee's subrogation rights under §§ 70e & 67a). Section 67a invalidates liens obtained during the four months preceding the filing of a bankruptcy petition if the debtor was insolvent when the lien was obtained.
whether the trustee may defeat a subordinate security interest in toto, or only to the extent of the lienor's interest. Furthermore, where other means are unavailing, the trustee may argue that the language of section 70e allows him to subrogate himself to the priority status of an actual secured creditor. If he were subrogated to the rights of a secured creditor, the trustee could claim priority over more junior secured creditors. Although the language of section 70e favors this conclusion, it has not been widely adopted.

It has, however, given rise to sharp disagreement among the commentators.

Sections 70e and 67d permit the trustee to attack fraudulent conveyances, including fraudulently acquired security interests. Under these sections the trustee is subrogated to the rights of actual creditors who are the victims of a fraudulent transfer of security.

A secured creditor may also lose to the trustee part or all of his interest in the collateral under Bankruptcy Act section 60. Under that section, the trustee may attack either direct payments or the granting of a security interest to a creditor prior to bankruptcy. Specifically, section 60 allows the trustee to avoid a

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328 The controversy has arisen out of Moore v. Bay, 284 U.S. 4 (1931), in which Justice Holmes upheld the security interest's total defeat. See White & Summers, supra note 1, § 24-8, at 890.

329 At least two cases suggest that the trustee may claim through a secured party. See Abramson v. Boedecker, 379 F.2d 741, 748-49 (5th Cir.) (subrogation allowed under § 70e to claims of secured party under pre-Code law), cert. denied, 389 U.S. 1006 (1967); In re Smith, 326 F. Supp. 1311, 9 U.C.C. Rep. 549 (D. Minn. 1971) (dictum).

330 The leading writer on bankruptcy law favors subrogating the trustee to the rights of a secured creditor. See 4A Collier on Bankruptcy ¶ 70.90(1), at 1034 (14th ed. 1976). Contra, White & Summers, supra note 1, § 24-8, at 891-92. See generally Kennedy, supra note 83, at 1428-34 (extensively analyzing trustee subrogation rights under § 70e); 20 S.C.L. Rev. 311 (1968). For specific examples of how the trustee might profit from this broad interpretation, see note 83 supra.


332 Id. § 107(d).

333 See 3 W. Collier, Bankruptcy Manual §§ 13.002-003 (1974); 1 Coogan, Hogan, & Vagts, supra note 33, § 9.03[3], at 984-91; White & Summers, supra note 1, § 24-9, at 892-97; Miller & Goldstein, supra note 313, at 642-45; Note, supra note 312, at 278-83 (avoiding fraudulent conveyances under present and proposed acts). See also Broude, Toward a New Fraudulent Conveyance: The Trustee in Bankruptcy and the Usurious Lender, 63 Nw. U.L. Rev. 331 (1968); Miller, Fraudulent Conveyances—Some Reflections on Section 70a(4) of the Bankruptcy Act, 48 B.U.L. Rev. 222 (1968).


336 On voidable preferences in general, see 3 W. Collier, Bankruptcy Manual § 13.001(2) (1974); White & Summers, supra note 1, § 24-4, at 871-76.
bankrupt’s “transfer” for or on account of an antecedent debt to a creditor within four months of bankruptcy, if the creditor had reasonable cause to believe the debtor was insolvent, and if the creditor thereby received a greater percentage of his debt than other creditors of the same class.\textsuperscript{337} Of the several questions raised by the application of section 60 to Article Nine security interests, three are particularly worth noting.

First, the perfection of a security interest is a “transfer” under the Bankruptcy Act.\textsuperscript{338} Therefore, when a delayed perfection occurs within the four months preceding bankruptcy, the transfer will be on account of an antecedent debt, unless there is a grace period within which to perfect. Perfection within a grace period is deemed to have occurred at the time the debt arose, and thus prevents the debt from being antecedent.\textsuperscript{339} Where state law provides no grace period during which a secured party may perfect and defeat an intervening lien creditor, section 60 gives the secured creditor twenty-one days during which to perfect.\textsuperscript{340} In our view, the Code states no general grace period, and therefore the twenty-one-day rule should apply to perfection of Code security interests.\textsuperscript{341} Under section 9-301(2), however, a purchase money security interest will be deemed perfected as of the date of attachment if a financing statement is filed within ten days after the debtor comes into possession of the property.\textsuperscript{342} As a result, purchase money secured creditors may be subject to a greater risk of defeat by the trustee under section 60 than non-purchase money secured parties. The better view supports a twenty-one-day grace period for all Code security interests.\textsuperscript{343} The proposed bankruptcy


\textsuperscript{339} Id. § 60a(7)(1), 11 U.S.C. § 96(a)(7)(1) (“transfer shall be deemed to be made or suffered at the time of the transfer”).

\textsuperscript{340} Id.

\textsuperscript{341} See U.C.C. § 9-301, Comment 5.

\textsuperscript{342} U.C.C. § 9-301(2).

\textsuperscript{343} Compare Henson, supra note 316, at 246 (recommending 21-day rule under § 67a(7) for purchase money and non-purchase money security interests), with King, supra note 337, at 207-08 (suggesting Code should be read as setting 0-day grace period under § 67a(7)).
acts would solve this problem by amendment.\textsuperscript{344}

Second, trustees have tried to use section 60 to avoid security interests that validly attach to goods acquired by the debtor after the security agreement was filed. Debate over the status of these so-called “floating liens” has raged, with the benefit of extensive commentary and few cases.\textsuperscript{345} Although never expressly relied

\textit{See also} Comment, \textit{supra} note 320, at 950-52 (suggesting 0-day grace period represents “strained reading” of Code).

At least three arguments can be made for a 21-day, rather than a 10-day, grace period. First, § 60a(7) was designed to deal with statutes that provided for grace periods following creation of a security interest. \textit{See, e.g.}, Uniform Sales Act § 5. The grace period under Code § 9-301(3), however, begins running when the debtor obtains possession of the collateral. Usually transfer of possession will not occur at the same time as attachment of the security interest. Second, although transfer of possession is a “transfer” under Bankruptcy Act § 1(30), we would argue that both transfers referred to in § 60a(7)(I) (i.e., the transfer that relates back and the transfer to which it relates back) must be transfers \textit{from the debtor}. Section 60, after all, deals with the trustee’s ability to recapture property transferred by the bankrupt prior to bankruptcy. Finally, if the 21-day grace period applies to run-of-the-mill secured parties, as we believe it clearly does, it would be highly anomalous if the purchase money secured party, Article Nine’s favorite child, received less favorable treatment.

In the only published case addressing this issue, \textit{In re Anderson}, 4 SEC. TRANS. GUIDE ¶ 52,353 (N.D. Ala., Bankr. Ct. 1974) (summary of opinion), the court applied the 10-day grace period, holding that absent contrary proof, the court was required to presume that delivery occurred when the security agreement was executed. The case appears to be wrongly decided, not only because the court applied the grace period of Code § 9-301(3), but also because it presumed that delivery and attachment were simultaneous. Numerous cases recognize that the burden of proving all the elements of a voidable preference is on the trustee. \textit{See, e.g.}, Wilkie v. Brooks, 515 F.2d 741, 744 (6th Cir. 1975); Gentry v. Bodan, 347 F. Supp. 367, 371 (W.D. La. 1972).

\textsuperscript{344} \textit{See} Note, \textit{supra} note 312, at 263-66.

upon, Code section 9-108, which attempts to protect floating liens from trustee attack, has won the day.\footnote{346} The cases have, with few aberrations, upheld floating liens.\footnote{347} Furthermore, both proposed bankruptcy acts would resolve the conflict by upholding floating liens against trustee attack.\footnote{348}

Third, Code section 9-306(4) limits the commingled proceeds claimable by a secured creditor if his debtor goes into bankruptcy.\footnote{349} Although the section's shift in proceeds interests is not itself a preference,\footnote{350} trustees have invoked section 60 to challenge secured creditors who, prior to bankruptcy, collect other-


\footnote{346} U.C.C. § 9-108 provides:

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.


\footnote{348} I Coogan, Hogan, & Vagts, supra note 33, § 9A.03[4], at 1027–28; Kronman, Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act, 124 U. Pa. L. Rev. 110 (1975); Skilton, supra note 121, at 999–1009 (proposed bankruptcy act and voidable preferences); Note, supra note 345, 9 Ga. L. Rev. at 697–701 (setting forth and criticizing proposed act's treatment of floating liens); Comment, Voidable Preferences: An Analysis of the Proposed Revisions of Section 60 of the Bankruptcy Act, 1974 Wis. L. Rev. 481.

wise-attached "proceeds" excluded by section 9-306(4)(d). One court has upheld this attack, reasoning that "the state law which creates the security interest also limits its application to commingled proceeds in the event of insolvency."\textsuperscript{351}

In addition to these avenues of attack, the trustee has "the benefits of all defenses available to the bankrupt as against third persons."\textsuperscript{352} Hence, the trustee may challenge a claimant's security interest as ineffective or unperfected through lack of compliance with Code formalities,\textsuperscript{353} or on traditional grounds of rescission, such as fraud and unconscionability.\textsuperscript{354} Similarly, the trustee may invoke these doctrines to attack the existence or amount of the underlying debt, thus avoiding security interest and priority issues entirely.\textsuperscript{355}

D. Mechanic's and Artisan's Liens—Section 9-310

Priority under Article Nine generally depends on compliance with formalities designed to provide potential creditors with notice of outstanding interests. Yet the otherwise preeminent perfected secured creditor, with or without notice, may find himself subordinated by the simple possessory lien of a mechanic who supplies goods or services with respect to collateral.\textsuperscript{356} In most jurisdictions,

\textsuperscript{350} See, e.g., WHITE & SUMMERS, supra note 1, § 24-6, at 887; Comment, supra note 320, at 954-55. Cf. First Nat'l Bank v. Julian, 383 F.2d 329, 334 (8th Cir. 1967) (substitution, exchange, or renewal of securities does not constitute preference if debtor's estate not diminished).

\textsuperscript{351} Fitzpatrick v. Philco Finance Corp., 491 F.2d 1288, 1291 (7th Cir. 1974) (noting inequitable treatment of secured creditors).

\textsuperscript{352} Bankruptcy Act § 70c, 11 U.S.C. § 110(c) (1970).

\textsuperscript{353} See In re Parkwood, Inc., [1970-73 Transfer Binder] BANKR. L. REP. (CCH) ¶ 64,183 (D.C. Cir. 1971) (summary of decision) (as hypothetical lien creditor, trustee could challenge security agreement, although debtor estopped from mounting similar challenge). Compare In re McClain, 447 F.2d 241 (10th Cir. 1971) (trustee, as ideal lien creditor under Bankruptcy Act, could introduce parol evidence to attack security interest; applicable state law parol evidence rule only bound parties to security agreement), cert. denied sub nom. Utica Square Nat'l Bank v. Woodson, 405 U.S. 918 (1972), with In re Financial Computer Sys., Inc., [1970-73 Transfer Binder] BANKR. L. REP. (CCH) ¶ 64,722 (9th Cir. 1973) (trustee barred from introducing parol evidence proving lease a security interest).


\textsuperscript{355} See, e.g., In re Worthley, 1 Bankr. Ct. Dec. 1694 (N.D. Me. 1975) (usury defense asserted by trustee).

the secured creditor is powerless to guard against this lien unless he retains possession of the collateral. Certain liens created by statute and case law receive this "super-priority" under section 9-310:

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.357

1. The General Operation of Section 9-310

Section 9-310 generally operates simply. Assume S perfects a security interest in D's tractor. D takes the tractor for repairs to R, a tractor mechanic. After completing the repairs, R makes a reasonable charge of $250. D fails to pay the bill and does not pick up the tractor. D also defaults in his payments to S. If the state recognizes a common-law mechanic's lien,358 R takes priority over S to the extent of R's lien, even if pre-Code case law subordinated the mechanic.359 If the mechanic's lien is statutory, R will take priority over S unless the statute expressly provides otherwise.

2. Common-Law and Statutory Mechanic's Liens

Section 9-310 provides that non-Code statutes subordinating the mechanic survive and control under the Code.360 In states that recognize the common-law lien but in which the lien statute expressly subordinates the mechanic, the mechanic who furnishes services or materials with respect to collateral should retain possession of the goods and base his claim on his common-law lien.361 By using this stratagem, the mechanic can defeat the secured creditor whose interest vis-à-vis the statutory lien is unassailable.362

Although several states refused to recognize common-law liens

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357 U.C.C. § 9-310.
358 Throughout this discussion, the phrases "common-law mechanic's lien" and "statutory mechanic's lien" refer to the special possessory liens granted to those individuals, including mechanics and artisans, who furnish services and materials with respect to collateral.
359 U.C.C. § 9-310, Comment 2.
after their enactment of mechanic's lien statutes, courts in some jurisdictions have found that the liens co-exist.\textsuperscript{363} For example, in \textit{General Motors Acceptance Corp. v. Colwell Diesel Service \& Garage, Inc.},\textsuperscript{364} the Maine Supreme Judicial Court employed an equitable rationale in recognizing the common-law mechanic's lien despite enactment of a mechanic's lien statute. The debtor in \textit{Colwell Diesel} bought a truck and gave a purchase money security interest to the dealer, who perfected the interest and assigned it to GMAC. The debtor took the truck to Colwell for repairs. When the debtor failed to pay the repair bills, Colwell asserted a possessory mechanic's lien, served notice, and attempted to enforce the statutory lien. GMAC then replevied the truck. Declaring that prosecution of the statutory lien remedy was not a waiver of the common-law lien,\textsuperscript{365} the court ruled that Colwell held a valid possessory mechanic's lien on the truck.\textsuperscript{366} The court stated that "principles of natural justice and commercial necessity" support the right to a common-law mechanic's lien.\textsuperscript{367} "It is clear equity that a party, who has enhanced the value of the property, by incorporating therein his labor or materials, shall have security on the improved property."\textsuperscript{368}

As \textit{Colwell Diesel} demonstrates, even where the statutory lien

\textsuperscript{363} \textit{See}, e.g., \textit{Ford Motor Credit Co. v. Howell Bros. Truck \& Auto Repair, Inc.}, 57 Ala. App. 46, 49, 325 So. 2d 562, 565, 18 U.C.C. Rep. 798, 800-01 (1975) (court finds neither statutory nor common-law lien applicable on facts); \textit{General Motors Acceptance Corp. v. Colwell Diesel Serv. \& Garage, Inc.}, 302 A.2d 595, 599, 12 U.C.C. Rep. 226, 232-33 (Me. 1973) (common-law repairman's lien held to survive enactment of statutory mechanic's lien); \textit{Ferrante Equip. Co. v. Foley Mach. Co.}, 49 N.J. 432, 436, 231 A.2d 208, 211 (1967) (common-law artisan's lien survived enactment of statutory lien). \textit{Contra}, \textit{Bond v. Dudley}, 244 Ark. 568, 571, 426 S.W.2d 780, 781 (1968) (common-law lien superseded by statutory lien). In \textit{Nickell v. Lambrecht}, 29 Mich. App. 191, 185 N.W.2d 155 (1970), although the state had a 50-year-old artisan's and garagekeeper's lien statute, a Michigan Court of Appeals found that the common-law artisan's lien persisted. The court said: "[W]e think it a sounder course to follow the lead of the courts of other jurisdictions, which, in general, have decided this question in favor of the continued viability of the common law lien, than ourselves to embark on a futile search for legislative intention." \textit{Id.} at 197-98, 185 N.W.2d at 158. \textit{Nickell} involved a priority contest between the unpaid seller of an automobile and the mechanic who had repaired it. Because the seller, who held title to the car under a conditional sales contract, did not authorize the repairs, the mechanic failed to qualify under the garageman's lien statute. Relying heavily on considerations of equity, however, the court revived the common-law lien to give the mechanic the same status that he would have had under the garageman's lien statute and \textsection{} 9-310. \textit{Id.} at 201, 185 N.W.2d at 160.


\textsuperscript{365} \textit{Id.} at 597, 12 U.C.C. Rep. at 229-30.

\textsuperscript{366} \textit{Id.} at 601, 12 U.C.C. Rep. at 234-35.

\textsuperscript{367} \textit{Id.} at 596-97, 12 U.C.C. Rep. at 228-29.

would subordinate the mechanic to the secured creditor, courts may freely grant priority to "deserving" mechanics. In addition to fostering uncertainty, this creates an unusual situation. On the one hand, section 9-310 expressly grants priority to possessory mechanic's lienors over secured creditors. On the other, it expressly allows states in their mechanic's lien statutes to subordinate the mechanic's interest. Yet even if state legislatures choose to subordinate the mechanic, courts may apply section 9-310 to the mechanic's advantage by recognizing and enforcing common-law liens. The policy underlying mechanics' "super-priority" can be summarized as follows: To the extent repairs increase the value of collateral, they directly increase the "interest" the secured creditor holds; hence, giving the secured creditor the benefit of improvements made by the mechanic constitutes unjust enrichment.369

When state legislatures reject the general rule of section 9-310, they reject as well this creditor-benefit rationale. Yet courts have invoked this same rationale in recognizing the common-law lien.370 To avoid such judicial meddling, legislatures must eradicate by statute all rules of law that grant special priority to the mechanic-lienor. Then, and only then, will the legislative decision to override section 9-310 be carried into effect.

3. The Scope of Section 9-310—What Liens Does It Protect?

Section 9-310 was designed to give priority to "liens securing claims arising from work intended to enhance or preserve the value of the collateral."371 The possessory mechanic's lien, either common-law or statutory, is the interest most often protected under section 9-310.372 In addition to mechanic's liens, storage liens have been held to take priority over security interests under

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369 See 2 Gilmore, supra note 3, § 33.3, at 878; Note, Nonconsensual Liens Under Article 9, 76 YALE L.J. 1649, 1651 (1967).
370 See note 368 and accompanying text supra.
371 U.C.C. § 9-310, Comment 1.
372 Rules vary slightly from jurisdiction to jurisdiction, but the following is a typical formulation of the mechanic's lien:

A person who makes, alters, repairs or performs work or services of any nature and description upon, or in any way enhances the value of an article of personal property, at the request or with the consent of the owner, has a lien on such article, while lawfully in possession thereof, for his reasonable charges for the work done and materials furnished, and may retain possession thereof until such charges are paid.

ARTICLE NINE PRIORITY RULES

These liens have been protected on the theory that the services of storing and protecting the collateral may be as valuable to the secured creditor as repairs made by a mechanic. Despite this argument, however, several states have enacted statutes subordinating storage liens while retaining section 9-310’s “super-priority” for mechanic’s liens. Custom in some jurisdictions may support this distinction, but the positions of those who repair and of those who store collateral are difficult to distinguish. Both services benefit the secured creditor. Both would be severely hampered if an examination of the public records were necessary before beginning performance. The policy considerations are the same in both cases; accordingly, the priority rules should not differ.

Mechanic’s liens and storage liens fit easily into section 9-310’s definition of the interests protected by “super-priority.” Comment 1 to section 9-310 seems to limit the applicability of the section, however, by stating that its purpose is “[t]o provide that liens securing claims arising from work intended to enhance or preserve the value of the collateral take priority over an earlier security interest even though perfected.” The apparent conflict between the Comment and the section creates an ambiguity that courts must confront. For example, although long-term storage will generally “enhance or preserve the value of the collateral,” a lien arising from short-term warehousing pending transport of the goods may not fall within the language of the Comment.


See note 369 and accompanying text supra.

See, e.g., Ferrante Equip. Co. v. Foley Mach. Co., 49 N.J. 432, 437, 231 A.2d 208, 210 (1967) (New Jersey’s garageman’s lien statute subordinates storer to secured creditor, while common-law mechanic’s lien entitles to priority under U.C.C. § 9-310); Murray, supra note 362, at 685-86 (Virginia law subordinates garageman’s lien for storage charges, but grants priority to mechanic’s lien for up to $75 in charges).

U.C.C. § 9-310, Comment 1 (emphasis added).

The formulation in the section itself is far less focused. Section 9-310 extends protection to liens arising when one “fur nishes services or materials with respect to goods” (emphasis added).

Relying on the Comment, a secured creditor in In re Big Boy Mobile Homes, Inc., 10 U.C.C. Rep. 1307 (E.D. Tenn., Bankr. Ct. 1972), argued that the holder of a storage lien did not do work to “enhance or preserve the value of the collateral” and therefore did not deserve § 9-310 priority. The court held, however, that “the towing and storing of [a] vehicle after it had broken down on the highway ‘preserved’ its value.” Id. at 1310. Hence, the storage lienor was given priority over the secured creditor.

See U.C.C. § 7-209.
The innkeeper's lien presents a similar problem. In Nicholson's Mobile Home Sales, Inc. v. Schramm, for example, Schramm, a mobile home park owner, rented four lots to the debtor. The debtor installed trailers on the lots, each subject to a purchase money security interest. When the debtor defaulted on his rent payments, Schramm asserted a possessory innkeeper's lien over the trailers. The secured creditor sought to repossess the trailers. The appellate court held that for purposes of section 9-310 "the providing of rental or storage space does come under the category of services."

The court in Nicholson did not limit the applicability of section 9-310 priority to the special lien of mobile home park owners. Arguably, by renting lots, often complete with water, electricity, and sewage connections, the mobile home park owner "preserves" the collateral. The same cannot be said of the ordinary innkeeper. The charges generally secured by an innkeeper's lien are charges for room and board of the person who brought the collateral onto the innkeeper's property. The holder of a security interest does not benefit from these materials and services. Furthermore, such charges are not for services performed "with respect to" the collateral. In giving section 9-310 priority to the special innkeeper's lien in Nicholson, however, the court left room for expansion of this priority. Relying on that case, another court might grant priority to a more typical holder of a common-law or statutory innkeeper's lien. Section 9-310 is an extraordinary priority rule, however, and should not be extended beyond protecting those who furnish services or materials "with respect to goods subject to a security interest." The "innkeeper" in Nicholson met this description. In most cases the innkeeper will not.

381 Indiana law extends innkeeper's liens to mobile home park owners: "The owner, operator, or caretaker of any mobile home park shall have an innkeeper's lien or hotel keeper's lien upon the property of his guest in the same manner, for the same purposes, and subject to the same restrictions as innkeeper's lien or hotel keeper's lien." IND. CODE § 13-1-7-33 (1971).
383 The Indiana innkeeper's lien statute which was extended to mobile home park owners provides: "The owner or keeper of any hotel . . . shall have a lien upon any . . . article of value brought into such hotel . . . by such person or persons for any and all proper charges due from such person or persons for food, lodging, entertainment, or other accommodation . . . ." IND. CODE § 32-8-27-2 (1971). For a general discussion of innkeeper's liens, see Note, Evolving Concepts of the Innkeeper's Lien, 61 CORNELL L. REV. 587 (1976).
384 See text accompanying note 356 supra.
385 U.C.C. § 9-310.
4. Possession of the Collateral

For section 9-310 to apply, the lienor must be in possession of the collateral. Carried over from the common law, this requirement conflicts with mechanic's lien statutes that allow the mechanic to file his lien and release the collateral to the debtor. The mechanic who surrenders possession of the collateral under a nonpossessory lien statute also surrenders his ability to take priority over a secured creditor under section 9-310. Thus, although both section 9-310 and the state nonpossessory lien statutes are broadly intended to benefit the mechanic, their combination may lead to the mechanic-lienor's defeat. Until each state with a nonpossessory lien statute amends it to conform to section 9-310, secured creditors may be enriched by the material and labor of others in contravention of the policies of both laws.

5. Title and Consent

Prior to the Code's enactment, some jurisdictions assigned priority to secured creditors or mechanic's lienors on the basis of title. When the debtor held title, the mechanic's lien was superior to the security interest. If the secured party held title, however, the mechanic could not assert a lien on the collateral because the debtor did not own the collateral and the secured party had not authorized the repairs. State statutes imposing mechanic's liens only if the titleholder consented to the repairs were

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386 As long as the mechanic intends to retain possession and does not voluntarily surrender the collateral, he is in technical possession. See, e.g., Ford Motor Credit Co. v. Howell Bros. Truck & Auto Repair, Inc., 57 Ala. App. 46, 48, 325 So. 2d 562, 564, 18 U.C.C. Rep. 798, 800 (1975) (where repairman surrendered vehicle and later regained possession by attachment, surrender held waiver of common-law mechanic's lien); Finch v. Miller, 271 Or. 271, 274, 531 P.2d 892, 893 (1975) (where possession involuntarily lost, lien persists). Thus, the mechanic retains "possession," if another party replevis the collateral, or takes it from him without his authorization. See, e.g., General Motors Acceptance Corp. v. Colwell Diesel Serv. & Garage, Inc., 302 A.2d 595, 12 U.C.C. Rep. 226 (Me. 1973) (requirement of constant possession fulfilled where replevin caused loss of possession).


388 The mechanic, aware that his lien persists despite lack of possession, may release the collateral. But preservation of the lien does not ensure its priority. Section 9-310 negatively implies that nonpossessory liens will always lose to perfected security interests "unless the statute expressly provides otherwise."

389 See, e.g., Forest Gate Ford, Inc. v. Fryar, 62 Tenn. App. 572, 577, 465 S.W.2d 882, 884 (1970) (repairman must retain possession of repaired vehicle in order to maintain priority of his statutory lien over previously perfected security interest).


391 Id.

not directly altered by the Code's enactment. Section 9-310 is only a priority provision; it does not govern the creation of liens. Under the general policy of Article Nine, however, location of title is immaterial.393 Looking beyond the title and consent requirements, both pre- and post-Code courts have granted priority to mechanic's liensors who performed work at the behest of non-owner debtors.394 The secured creditor's consent to repairs may be implied from the debtor's duty to keep the collateral in good repair.395 Mechanic's liensors receive special priority over secured creditors because mechanics "perform useful services to the general public,"396 and because "the secured creditor as well as the debtor benefits from such work."397 Court enforcement of title and consent provisions "would practically deprive [section 9-310] of any meaningful effect . . . ."398 As a general matter, the Code should be liberally construed.399 Therefore, effective application of section 9-310 requires that the location-of-title and consent requirements be ignored.400

6. Good Faith Under Section 9-310

Professor Gilmore has argued that the special priority given the mechanic's lienor should be denied or limited if his charges are excessive.401 Gilmore states:

393 See U.C.C. § 9-202, set out at note 168 supra.
394 See cases cited at note 398 infra. For examples of pre-Code cases finding location of title nondeterminative, see New Britain Real Estate & Title Co. v. Collington, 102 Conn. 652, 656, 129 A. 780, 781 (1925); Hammond v. Danielson, 126 Mass. 294, 296 (1879); De Van Motor Co. v. Bailey, 177 Miss. 441, 449, 171 So. 342, 344 (1936).
395 2 W. HAWKLAND, supra note 114, ¶ 2.320202, at 712.
396 Id.
397 See cases cited at note 398 infra.
398 General Motors Acceptance Corp. v. Colwell Diesel Serv. & Garage, Inc., 302 A.2d 595, 599-600, 12 U.C.C. Rep. 226, 233 (Me. 1973) (enforcement of requirement that debtor have title in order for mechanic to take priority over secured creditor would render § 9-310 substantially ineffective); Nickell v. Lambrecht, 29 Mich. App. 191, 200, 185 N.W.2d 155, 160 (1970) (requiring conditional vendor's consent to mechanic's repairs would contravene Code's policy of de-emphasizing title); Manufacturers Acceptance Corp. v. Gibson, 220 Tenn. 654, 422 S.W.2d 435 (1967) (conditional vendor's perfected security interest subordinate to repairman's lien even though repairs made without vendor's knowledge). But see Municipal Equip. Co. v. Butch & Son Deep Rock, 185 N.W.2d 756 (Iowa 1971) (Iowa's garageman's lien statute required car repairman to get consent of prior lienholders of record to establish priority); Parker v. West, 161 Mont. 170, 505 P.2d 94 (1973) (to obtain priority over perfected security interest notice must be provided within 10 days under agister lien statute).
399 U.C.C. § 1-102(1).
401 2 GILMORE, supra note 3, § 33.5, at 888-89.
ARTICLE NINE PRIORITY RULES

To be entitled to priority under § 9-310 the lienor must have furnished services or materials "in the ordinary course of his business." This limitation should be read as tantamount to a requirement of good faith. . . . A general provision of the Code specifies that: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." Section 9-310 is designed to protect the honest lienor and not the crook. However, the "ordinary course of business" limitation goes beyond cases of actual fraud, which the courts could be trusted to handle no matter what the statute said. Is it, for example, within the "ordinary course of business" of a garageman to run up a bill of $400 on a car which, after the repairs, is worth $200? A court could well use the "ordinary course of business" formula to deny, or reduce to a reasonable amount, the priority of unduly rapacious lienors.\(^4\)

Here Gilmore argues that section 1-203 imposes a good faith standard on the performance of contracts and duties under the Code. The Code's general requirement of good faith requires "honesty in fact in the conduct or transaction concerned."\(^4\) Applying this subjective standard, however, does not solve the problem of the overcharging mechanic. In egregious cases, mechanics may engage in fraud, but most cases of simple overcharging will not involve subjective bad faith. In addition, section 1-203 applies only to the performance or enforcement of a contract or duty. The mechanic who overcharges for his services or overstates the amount of necessary repairs may well act in bad faith at the time the contract is made, without doing so in its subsequent performance or enforcement.\(^4\)

\(^4\) See Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 VA. L. REV. 195, 220-21 (1968). Professor Summers argues that the Code proscribes bad faith during the formation of contracts through § 1-103, non-Code law and specific sections of Article Two. His description of potential abuses in the area of sales applies equally to the furnishing of services by mechanics:

Forms of bad faith at the negotiation and contract formation stage include negotiating without serious intent to contract, abusing the privilege to break off negotiations, entering into a contract without having the intent to perform, entering a deal recklessly disregarding prospective inability to perform, failing to disclose
Gilmore is not satisfied with applying the normal good faith test. Instead he argues that the good faith requirement imposed by section 9-310 prohibits more than actual fraud. Without specifically stating that Article Two's definition of good faith should control in section 9-310 cases, Gilmore, in arguing for an objective standard, necessarily implies that he would extend the merchant-good-faith standard to mechanic's lienors. Section 2-103(1)(b) provides:

In this Article unless the context otherwise requires

... (b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

If applicable, this rule would reach commercially unreasonable overcharges. By its own terms, however, the standard applies only to Article Two.

Gilmore reads the "good faith" requirement into section 9-310 through its "ordinary course of business" clause. This interpretation plays fast and loose with terms that have a special meaning under the Code. "Ordinary course of business" imposes a wide range of qualifications for buyers under section 1-201(9), including a requirement that the buyer act in good faith. A mechanic, however, is not a buyer, and section 9-310 does not include the exact phrase "ordinary course of business." The section begins: "When a person in the ordinary course of his business furnishes services or materials ... ." The phrase "his business" provides a subjective standard, and does not carry an additional good faith requirement. Thus, the very language of section 9-310, as well as

Id. at 220 (emphasis added).

See text accompanying note 402 supra.

U.C.C. § 2-103(1)(b).

For a more thorough discussion of the applicability of the merchant-good-faith standard to Article Nine priority disputes, see notes 621-32 and accompanying text infra.

U.C.C. § 1-201(9) provides:

"Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind ...

U.C.C. § 9-310 (emphasis added).

For a discussion of the language "ordinary course of his business," see notes 686-91 and accompanying text infra. Since the phrase "ordinary course of his business" refers to the general practices of a particular person (see id.), that language would not even subordinate
the language of section 2-103(1)(b), precludes the infusion of Article Two's good faith standard into section 9-310.

Professor Summers has suggested an alternative method of imposing a more stringent good faith standard than that of section 1-203. He concludes that in the area of sales, "extra-Code law on good faith—via section 1-103, which states that 'general principles' are to supplement the Code's specific provisions—will prove a more fertile source of Code requirements of good faith than will the Code sections which use these very words." These extra-Code standards can be read just as easily into Article Nine. The law outside the Code imposes sanctions on a wide variety of transgressions ranging from fraud to unclean hands. Integration of these provisions into the standard that a mechanic must satisfy before obtaining section 9-310 priority would go beyond the requirement of simple honesty.

The application of Code standards to the creation and enforcement of mechanic's liens by way of a priority rule is questionable at best. Non-Code law governs mechanic's liens, and non-Code law should determine the extent of the lien and the reasonableness of the mechanic's charges. Indeed some states expressly provide by statute that mechanic's liens exist only to the extent of the reasonable value of the services and materials supplied. In these states the Article Nine secured creditor has full opportunity to challenge the mechanic's lien before the Code's priority rules swing into operation. Moreover, the secured party may be able to challenge a mechanic's lien under non-Code law on the grounds of fraud, misrepresentation, or unclean hands. A mechanic's lien granted by state law should receive priority under section 9-310 to the full extent that state law recognizes the lien. The priorities of section 9-310 should not be altered by implied

the fraudulent mechanic who engaged in fraud regularly. Of course, such rascals should be subordinated; the proper vehicle for doing so, however, is state law applied via § 1-103.

411 See Summers, supra note 404, at 220.
412 Id. at 197 (footnotes omitted).
413 Professor Summers analyzes the non-Code law on good faith as serving primarily as an "excluder" of unacceptable conduct, rather than as a positive standard of behavior. Id. at 202.
414 U.C.C. § 9-104(c). This section provides that Article Nine "does not apply . . . to a lien given by statute or other rule of law for services or materials except as provided in Section 9-310 on priority of such liens . . . ."
416 We do not now stop to consider the restrictions on asserting jus tertii. Problems and solutions will no doubt vary from state to state.
prerequisites of good faith and reasonableness except to the extent that these requirements are imposed by non-Code law.\textsuperscript{417}

IV

SPECIAL PROPERTY AND SPECIAL PRIORITY RULES

A. Fixtures—Section 9-313

Fixtures fall within a no man's land between personalty and realty.\textsuperscript{418} They are the only realty-type interest to which the Code applies.\textsuperscript{419} Under the Code, definition of the term "fixture" is left entirely to non-Code property law.\textsuperscript{420} Hence, the meaning of "fixture"—and the scope of the Code's fixture provisions—varies from state to state. For purposes of Article Nine's priority rules, however, a chattel related to realty falls into one of three categories:

(1) those which retain their chattel character entirely and are not part of the real estate; (2) ordinary building materials which have become an integral part of the real estate and cannot retain their chattel character for purposes of finance; and (3) an intermediate class which has become real estate for certain purposes, but as to which chattel financing may be preserved.\textsuperscript{421}

The Code denominates this last category "fixtures," and assigns section 9-313 the task of resolving priority disputes involving such property.

1. Defining "Fixture"—A Lesson in Commercial Confusion

A fixture creditor will be subordinated to competing realty interests under section 9-313(4) if he does not correctly identify his

\textsuperscript{417} One author respectfully concurs in part and dissents in part with the foregoing analysis. Although this author agrees that the phrase "ordinary course of his business" has nothing to do with good faith, that the merchant standard is inapplicable, and that punishing overcharging mechanic's lienors should generally be left to non-Code law, he also feels that the Code's drafters evinced a sufficient interest in mechanic's liens and intended to give § 1-203 a sufficiently broad application to impose a requirement of subjective good faith on those who seek the benefits of § 9-310.

\textsuperscript{418} See U.C.C. § 9-313, Comment 1; \textit{White & Summers, supra} note 1, § 25-8, at 924-25.

\textsuperscript{419} U.C.C. § 9-104(j) states that "[t]his Article does not apply . . . except to the extent that provision is made for fixtures in Section 9-313, to the creation or transfer of an interest in or lien on real estate . . . ."

\textsuperscript{420} See U.C.C. § 9-313(1)(a) & Comment 2; 2 \textit{R. Anderson, Anderson on the Uniform Commercial Code} § 9-313:2, at 591 (2d ed. 1970) [hereinafter cited as \textit{Anderson}].

\textsuperscript{421} U.C.C. § 9-313, Comment 3.
collateral as a fixture and perfect his interest by filing in the local real estate records. Unfortunately for creditors, identification of fixtures is easier to require than accomplish. State fixture law is so confused that some states found it necessary to alter section 9-313 before enacting the Code.

State law definitions of the term "fixture" are notoriously vague; however, they usually embody three general requirements: the chattel's permanent annexation to the land, its adaptation to the use of the realty, and the intention of the parties to make a permanent addition to the land. Clearly these are shifting sands on which to build. "Permanent annexation," for example, is subject to a variety of interpretations. Moreover, as the removal remedy


To the definition of "fixtures," the Code adds its own small refinement: "goods are 'fixtures' when they become so related to particular real estate that an interest in them arises under real estate law." U.C.C. § 9-313(1)(a).


Prior to its enactment of the Code, Massachusetts defined a fixture as "a nonremovable part of the realty." Coogan, Security Interests in Fixtures Under the Uniform Commercial Code, 75 HARV. L. REV. 1319, 1346 (1962) (emphasis added). That definition did not allow for the part-chattel, part-realty good that the Code calls a fixture. In contrast, the Supreme Court of Washington held that a giant scrap shear enclosed by a building and craneway—a contraption that "cost approximately half a million dollars and was capable of exerting a pressure of 880 tons, [and] was installed on pilings and a reinforced concrete base which was three feet thick"—was personality rather than a fixture because its removal was physi-
adopted in section 9-313(8) suggests, a fixture's annexation to the realty may be far less than permanent.\textsuperscript{426} The concept of "adaptation" is usually merged with that of annexation, and is equally elastic.\textsuperscript{427} Finally, although courts generally view intent as the controlling factor,\textsuperscript{428} parties seldom express their intentions in this regard. And even where the parties clearly manifest their intent, a court may simply ignore it.\textsuperscript{429} In light of this confusion, the secured creditor with a potential fixture as collateral should observe Peskind's law—"file everywhere it could possibly benefit you to do so."\textsuperscript{430}

2. Fixture Financing—The Interface of Article Nine and State Real Property Law

Because fixtures are on the borderline between realty and personality, a security interest in fixtures can be created under the Code or under local real estate law.\textsuperscript{431} The creditor seeking to encumber fixtures may: (1) perfect a fixture interest under Article...
Nine;\footnote{See U.C.C. § 9-313(1)(b).} (2) acquire an interest under local law in the real estate to which the fixture is attached;\footnote{U.C.C. § 9-313(3) states: "This Article does not prevent creation of an encumbrance upon fixtures pursuant to real estate law."} or, (3) if he is eligible to take a mechanic's lien on real property, wait for a default in payment and slap such a lien on the property to which the fixture is attached.\footnote{2 GILMORE, supra note 3, § 30.3, at 811. The New York statutory formulation of a mechanic's lien on real property provides: A contractor, subcontractor, laborer, materialman, landscape gardener, nurseryman or person or corporation selling fruit or ornamental trees . . . who performs labor or furnishes materials for the improvement of real property with the consent or at the request of the owner thereof, or of his agent, contractor or subcontractor, shall have a lien for the principal and interest, of the value, or the agreed price, of such labor or materials upon the real property improved or to be improved and upon such improvement, from the time of filing a notice of such lien . . . . N.Y. LIEN LAW § 3 (McKinney 1966).} If the creditor follows the first path, his claim to the collateral will be governed by the priority rules of subsections 9-313(4) and (5). If the creditor takes the second route and his competitor holds an Article Nine fixture security interest, the same provisions apply. But when the conflicting claimants—be they mortgagees and/or mechanics—both assert interests in the fixture by reason of real estate encumbrances, Article Nine defers to state real estate law to iron out priority problems.\footnote{See 2 GILMORE, supra note 3, § 30.3, at 811.}

The applicability of these different laws provides potential fixture creditors with flexibility. The mortgagee or materialman can create an interest in both fixtures and realty at once. The interplay of these laws may, however, trap the unwary creditor. Because the applicable priority rules depend upon the type of interest the creditor takes, the creditor should not select a particular method of securing his advances without first determining what alternatives are available and evaluating the implications of each course of action.

3. Section 9-313 Before and After—The 1972 Amendments and Fixture Priorities

Section 9-313 determines the priorities between secured fixture creditors and real estate owners or encumbrancers holding an interest in the real estate to which the fixture is attached. The section's priority rules are designed to uphold parties' reasonable expectations and to encourage reliance on real estate recording
systems. Under section 9-313(2) of the 1962 version of the Code, the secured fixture creditor whose security interest attaches to the property before it becomes a fixture usually takes priority over all real estate encumbrancers. If the security interest attaches to the property after it becomes a fixture, the Article Nine fixture interest will take priority over only "subsequent" encumbrancers of the realty. Exceptions to these rules protect certain subsequent real estate claimants who extend credit against the fixture without knowledge of the outstanding security interest prior to its perfection. In effect, section 9-313 subordinates holders of security interests in fixtures who provide insufficient warning to intervening encumbrancers of the real estate.

The confusion generated by the 1962 version of section 9-313 prompted the Review Committee for Article Nine to revise and clarify the fixture provisions in the Code's 1972 amendments.

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436 See generally U.C.C. § 9-313, Comment 1.
438 U.C.C. § 9-313(3) (1962 version) provides:
   A security interest which attaches to goods after they become fixtures is valid against all persons subsequently acquiring interests in the real estate...but is invalid against any person with an interest in the real estate at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as fixtures.
439 U.C.C. § 9-313(4) (1962 version) provides:
   The security interests described in subsections (2) and (3) do not take priority over
   (a) a subsequent purchaser for value of any interest in the real estate; or
   (b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or
   (c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances
   if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section.
441 Final Report, supra note 50, at 126; Bernstein & Fleisher, supra note 57, at 318-19.
Thus far, only a few states have adopted the amended section. Consequently, the statute has not received sufficient judicial interpretation to indicate the extent of the Review Committee's success in identifying and correcting the section's deficiencies, but on its face the 1972 amendment goes a long way toward fixing the fixture section.

One difficulty under the 1962 version of section 9-313 is the meaning of the term "subsequent." The old version of section 9-313(4) provides that fixture security interests are subordinate to the interests of (1) a "subsequent purchaser for value";\(^4\) \(^4\) (2) a creditor with a "subsequently obtained" judgment lien;\(^4\) \(^4\) and (3) a prior recorded real estate encumbrancer "to the extent that he makes subsequent advances."\(^4\) \(^4\) Unfortunately, the section does not indicate whether "subsequent" means after the security interest has attached or after the good has been affixed to the realty.\(^4\) \(^4\) The 1972 version resolves this problem. Priorities are determined by reference to the easily ascertained date of the fixture filing.\(^4\) \(^4\) Prospective creditors may now rely on the real estate records to reveal any prior, and therefore superior, interests in fixtures.

The 1962 version of section 9-313 also fails to follow the format of other Article Nine priority rules in making little reference to perfected, as opposed to unperfected, security interests.\(^4\) \(^4\) The


\(^{446}\) For example, U.C.C. § 9-313(4)(b) (1972 version) states:

A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where

\[\ldots\]

(b) The security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record . . . .

A fixture security interest is perfected when a financing statement complying with § 9-402(5) is filed in the real estate records. U.C.C. § 9-313(1)(b).

A mortgage effectively perfects a fixture interest from the date it is filed if it complies with § 9-402(6).

\(^{447}\) U.C.C. § 9-313(2) (1962 version) refers to "[a] security interest which attaches to
amended version of section 9-313, however, establishes special priority for perfected fixture security interests and sets forth precise rules governing the priority of unperfected security interests in fixtures.

4. Fixture Security Interests and Construction Mortgages

Construction mortgages present a special priorities problem. Under the 1962 version of section 9-313(4), "a creditor with a prior encumbrance of record on the real estate [will take priority] to the extent that he makes subsequent advances if . . . the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected." The phrase "or contracted for" provides an opening for the construction mortgagee to claim priority over a perfected purchase money security interest in a fixture.

The construction mortgagee's interest begins when the encumbered property is still vacant land and continues, as he makes subsequent advances, during the entire course of construction. Thus the construction mortgagee seems to qualify as a prior "encumbrancer" under section 9-313(4), at least where he initially commits himself to making periodic future advances. Construction financers feared, however, that courts, by reading the statute narrowly, would subordinate their interests to creditors with fixture goods before they become fixtures," and § 9-313(3) (1962 version) refers to "[a] security interest which attaches to goods after they become fixtures." Only subsection (4) grants priority to certain interests that arise before perfection. In contrast, the priority rules governing chattels clearly distinguish between perfected and unperfected security interests. See, e.g., U.C.C. §§ 9-301, 9-312.

Under U.C.C. § 9-313(5) a security interest in fixtures, whether perfected or unperfected, is effective against owners or encumbrancers of realty where

(a) the encumbrancer or owner has consented in writing to the security interest or has disclaimer an interest in the goods as fixtures; or

(b) the debtor has a right to remove the goods as against the encumbrancer or owner.

These conditions are consistent with the notice and reliance concepts of Article Nine. A written disclaimer or a right of removal ensures in most cases that the real estate owner or encumbrancer was aware of and consented to the superiority of the fixture creditor's interest.

The 1972 Amendments to the Code define a "construction mortgage" as a mortgage "to the extent that it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates." U.C.C. § 9-313(1)(c).

See 2 GILMORE, supra note 3, § 30.6, at 829-32.
collateral. Indeed, it has been argued that interpreting the old version of section 9-313 to grant priority to construction mortgagees would "reverse the scheme of priorities which [section] 9-313 and Article 9 as a whole seem to accept." The Review Committee recognized this ambiguity, and in the 1972 amendments added a new subsection specifically dealing with construction mortgages. New section 9-313(6) provides that "a security interest in fixtures is subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction." The construction mortgagee takes priority whether his advances are optional or contractually required. The mortgagee who refines a construction mortgage also takes priority over a perfected security interest under the new rule.

The new section on construction mortgages eliminates the confusion that existed under the 1962 version of section 9-313. Moreover, the construction mortgagee's treatment does not wholly violate the interests protected by the rest of Article Nine. Both the construction mortgagee and the fixture creditor extend new credit. The priority given to construction mortgagees primarily reflects the drafters' preference of real estate interests over personal property interests. Vacant land is insufficient collateral for the construction mortgagee's advances. The construction mortgagee must rely instead on the structure being built to secure his loan. A creditor considering a purchase money security interest in fixtures can discover the existence of a construction mortgage in the real estate records. Because the priority of a construction mortgagee "applies only during the construction period leading to the completion of

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454 2 Gilmore, supra note 3, § 30.6, at 832. See id. at 830-32. Article Nine, in the purchase money provisions of § 9-312 and the fixture provisions of § 9-313, gives "an apparently absolute priority to the purchase-money or fixture interest." Id. at 830. The 1962 Code's fixture priority rules do not distinguish between purchase money and non-purchase money security interests.
456 The Article Nine Review Committee thought that construction mortgagees deserved preferential treatment and that such a rule would not compromise Article Nine's priority scheme. Final Report, supra note 50, at 203.
457 U.C.C. § 9-313(6).
458 U.C.C. § 9-313, Comment 4(e). This conclusion is based on the language of § 9-313(1)(c), set out at note 450 supra.
460 See Final Report, supra note 50, at 203 (general comment on the approach of the Review Committee); White & Summers, supra note 1, § 25-11, at 937.
the improvement,"⁴⁶¹ construction activity itself will alert the potential fixture creditor that another's advances may be secured under a prior recorded mortgage. Even optional advances are generally predictable. Moreover the potential fixture creditor can easily discover whether such advances are permitted under the original agreement. In sum, fixture creditors should not be able to disrupt the priority of a construction mortgagee if the mortgage was recorded in time to give fair notice to the potential Article Nine secured creditor.

5. Fixtures Attached to Realty Not Owned by the Debtor

When fixtures subject to a security interest are attached to land owned by someone other than the debtor, special problems develop. Two important questions are: (1) What happens when a fixture interest is filed in the real estate records against a debtor who has no recorded interest in the real estate? and (2) What effect does a landlord-tenant agreement have on fixture interests?⁴⁶² The 1962 version of section 9-313 ignores these problems. Under that provision, if the fixture interest is filed under the debtor's name and the debtor has no recorded interest in the realty, the real estate encumbrancer is practically helpless—a search of the real estate records will not reveal the fixture creditor's interest.⁴⁶³ If not alerted by the debtor's physical possession of the realty, the real estate creditor will remain unaware of the perfected fixture interest when evaluating the property as collateral for a loan. In a fight for priority, the fixture creditor will triumph. The 1972 amendments to section 9-313 attempt to resolve these problems by providing notice to creditors who will be subordinated to prior interests.

Amended section 9-313(4)(a) limits the general priority of a purchase money fixture creditor over real estate interests.⁴⁶⁴ The

⁴⁶¹ U.C.C. § 9-313, Comment 4(e). The priority given to construction mortgagees does not extend to the financing of additions to the building long after completion of the improvement. This is true even though the construction mortgagee provides such financing under an open-end clause of the construction mortgage. Id.

⁴⁶² WHITE & SUMMERS, supra note 1, § 25-10, at 933-34.

⁴⁶³ ANDERSON, supra note 420, § 9-313:17(a), at 1263-64 (Cum. Supp. 1970-74). If the debtor has no recorded interest in the real estate, the filing would fulfill all the requirements of the 1962 versions of §§ 9-401 and 9-313, but would not form a link in the property's chain of title. Thus the real estate encumbrancer would be unable to discover it no matter how diligent he was.

⁴⁶⁴ A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where
fixture creditor may only take priority if the real estate interest arises before the goods become fixtures and the debtor has possession of, or a recorded interest in, the real estate. The language and purpose of the provision are clear. The requirement that the debtor have an apparent interest in the land is designed to warn the potential real estate creditor that prior obligations may exist under the name of someone other than the landowner. The real estate encumbrancer should check for prior interests before he relies on the fixture in extending credit. Thus, new section 9-313(4) is fully consistent with the Code's emphasis on notice and reliance.

Prior to the 1972 amendments to section 9-313, the impact of an agreement between a landlord and a tenant with respect to the removal of fixtures was uncertain. The new section 9-313(5)(b) fills in this gap. Under this provision, the tenant's fixture creditor, whether or not his interest is perfected, takes priority over the owner or encumbrancer of real estate where "the debtor [i.e., the tenant] has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates, the priority of the security interest continues for a reasonable time." Although this provision does not establish priorities on the basis of notice, it may not entirely undermine Article Nine's policy of preventing adverse reliance and protecting those who rely without notice:

Mortgagees are big boys; they can be expected to understand leases and to know that certain tenants commonly install fixtures and retain a right to remove them. If they wish to guard against that possibility, they can lend a little less money or can insist that landlords to whom they lend use leases which deny the tenant the right of removal.

Under the amended section, creditors can at least be certain of the law. Accordingly, they can take steps to ensure that their interests are protected.

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(a) the security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, the security interest is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate . . . .

U.C.C. § 9-313(4)(a).

465 See U.C.C. § 9-313, Comment 5.
466 U.C.C. § 9-313(5)(b).
467 WHITE & SUMMERS, supra note 1, § 25-10, at 933.
B. Accessions—Section 9-314

Personal property law's analogue to fixtures is "accessions," a term defined in section 9-314(1) as "goods . . . installed in or affixed to other goods." Closely patterned after the pre-1972 fixture section, section 9-314 governs priority disputes involving security interests in accessions. Subsection (1) broadly protects the security interest in accessions obtained prior to their installation or affixation. Subsection (2) protects accession security interests acquired after installation or affixation except against parties who have previously obtained interests in the whole. Exceptions to both rules are found in subsection (3), which subordinates accession security interests to specific parties who subsequently obtain interests in the whole (namely, subsequent purchasers, subsequent lien creditors, and previously perfected secured creditors making subsequent advances) without knowledge of the accession security interest, and prior to its perfection. Litigation involving section

468 Section 9-314 is virtually a carbon copy of former § 9-313, with the substitution of a few key words to apply its rules to accessions rather than fixtures. Gilmore remarks that the Code's draftsmen treated accessions and fixtures as "identical twins." 2 GILMORE, supra note 3, § 31.3, at 845. It is interesting to note that although the Code's fixture provision was totally rewritten in 1972, § 9-314 avoided the editing pencil completely.

469 (1) A security interest in goods which attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section "accessions") over the claims of all persons to the whole except as stated in subsection (3) and subject to Section 9-315(1).

U.C.C. § 9-314(1).

470 (2) A security interest which attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole except as stated in subsection (3) but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as part of the whole.

U.C.C. § 9-314(2).

Two points about this section—one practical and one esoteric—deserve special mention. First, the creditor making advances against accessions should make sure that his security agreement is executed (and therefore that the security interest is attached) before the collateral is installed or affixed. This will assure him of the more generous treatment provided by subsection (1). Second, the section's characterization of the security interest as "invalid" suggests a strong case for trustee subrogation to prior interests under § 70e of the Bankruptcy Act in certain unusual cases. See notes 329-30 and accompanying text supra.

471 (3) The security interests described in subsections (1) and (2) do not take priority over

(a) a subsequent purchaser for value of any interest in the whole; or
(b) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or
(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances.
9-314 is uncommon, and Code commentators have given accessions short shrift. The reported cases, however, do point up some definite problems with section 9-314, and show that courts fail to understand fully the statute's scope and meaning.

1. Defining "Accession"

The threshold question in every section 9-314 case is whether the goods involved qualify as accessions. Properly noting the limitation imposed by section 9-315, one commentator has defined section 9-314 accessions as "what occurs when goods are affixed to other goods, without destroying their respective identities." Un-

if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. U.C.C. § 9-314(3).

Our research uncovered only seven reported cases dealing with § 9-314.

Characteristically, the most thorough treatment has been provided by Professor Gilmore. See 2 GILMORE, supra note 3, §§ 31.1, .3, at 837-41, 844-45. Uncharacteristically, Professors White and Summers do not even mention accessions in their one-volume treatise on the Code.

Because the statute is virtually identical to the 1962 fixtures provision discussed in the previous section, these problems need not be reexplored. Most important among them, however, is the meaning of "subsequent" in subsection 9-314(3). See notes 442-45 and accompanying text supra.

See, e.g., In re Verrango Limestone Co., 1 U.C.C. Rep. 591, 601-02 (W.D. Pa., Bankr. Ct.), aff'd, 1 U.C.C. Rep. 602 (W.D. Pa. 1960). In discussing § 9-314, the Verrango court made two serious errors. Its first mistake was discussing the section at all. Since the goods involved were allegedly attached to reality rather than personality, the case was totally controlled by the Code's fixture provisions. However, in addition to analyzing the case under § 9-313, the court launched into an unwarranted application of § 9-314. Moreover, the court's muddled § 9-314 analysis was itself laced with error. In quoting only isolated parts of § 9-314, the court demonstrated ignorance of the fact that even if the disputed goods were accessions, the bankruptcy trustee (claiming under § 70c of the Bankruptcy Act as a subsequent lien creditor) would lose priority, since the secured party perfected prior to bankruptcy. Rather, the court rested its decision in favor of the secured creditor on conclusory passages from the Comments which, rather than illustrating its specific applications, summarized the general rule. Although the court decided the case under the 1953 Code (12A PA. CONS. STAT. ANN. § 9-314 (Appendix—U.C.C. 1953), at 582-83 (Purdon 1970)), the new section would change neither the case's result nor the analysis set forth above. For another decision that mishandles § 9-314, see In re Williams, 12 U.C.C. Rep. 990 (E.D. Wis., Bankr. Ct. 1973), discussed at length in note 479 infra.

See U.C.C. § 9-314, Comment 3. Section 9-315 governs priority disputes over goods that "become part of a product or mass." Comment 3 to § 9-315 states that "components ... assembled into a machine" are within the scope of the section, but makes clear that such goods also qualify as accessions. See note 499 infra.

Lee, Perfection and Priorities Under the Uniform Commercial Code, 17 Wyo. L.J. 1, 45 (1972) (footnote omitted). For a closer look at the interplay of §§ 9-314 and 9-315, see notes 499-508 and accompanying text infra.
like the fixtures provision,\textsuperscript{478} section 9-314 does not leave the definition of accessions entirely to non-Code law. But perhaps due to the generality of subsection 9-314(1)'s definition, courts have looked to pre-Code and non-Code law in deciding what qualifies as an accession.\textsuperscript{479} This approach creates several problems. First, the section on its face defines accessions broadly. It does not mention integration, nondetachability, or other catchwords traditionally associated with accessions;\textsuperscript{480} instead, it requires only installation or

\begin{itemize}
\item \textsuperscript{478}U.C.C. § 9-313.
\item \textsuperscript{479}For examples of items held to be accessions under pre-Code law, see Annot., 43 A.L.R.2d 813, 820 (1955). In \textit{In re Williams}, 12 U.C.C. Rep. 990 (E.D. Wis., Bankr. Ct. 1973) (dictum), the bankruptcy court held that § 9-314 codified, rather than modified, the common-law definition of accessions. It therefore applied the "integral part" test, and found that an air compressor affixed to a truck "with eight to ten bolts" was not an accession. Id. at 991-92. The court cited removability without injury and the secured party's treatment of the compressor as distinct property (evidenced by execution of a separate security agreement) as relevant to its conclusion. Id. at 992.
\item \textit{Williams} illustrates the confusion surrounding § 9-314. The Bank of Menasha obtained and perfected a security interest in Williams' truck. Later it financed the compressor, executing a security agreement covering it. The bank, however, did not file as to the compressor. Williams' trustee in bankruptcy therefore challenged the security interest in the compressor, apparently relying on his lien creditor status and § 9-301. The court responded by analyzing at some length whether the compressor was an accession. After concluding that the machinery was not an accession, the court added:
\begin{quote}
However, the bank did not perfect its lien on the compressor by filing notice with the Secretary of State. The Wisconsin Supreme Court has held that failure to file with both the Register of Deeds and the Secretary of State renders the lien void against a lien creditor. . . . A trustee in bankruptcy has the status of a lien creditor so the lien on the compressor is therefore null and void against the trustee.
\end{quote}
\textit{Id.} (citation omitted).
\end{itemize}

The court's accession analysis is mysterious, since § 9-314 appears irrelevant to the conflict posed in the case. Section 9-314 does not resolve all priority disputes involving accessions; it only settles priority disputes between creditors secured by the accession and parties holding interests in the whole. Here, however, the trustee's claim was based on his hypothetical judgment lien in the compressor arising under § 70c of the Bankruptcy Act. See notes 315-17 and accompanying text supra. Because the dispute involved conflicting interests in the accession itself, the standard priority provisions of Article Nine—here, § 9-301(1)(b)—should have controlled. The opinion could be read as viewing the trustee's interest as a judgment lien on both the truck and the compressor—a perfectly defensible position under Bankruptcy Act § 70c. If this construction of the Bankruptcy Act is correct, the trustee would have been a "creditor with a lien on the whole" (U.C.C. § 9-314(3)(b)), and § 9-314 would apply if the compressor were an accession. But whether or not the compressor qualified as an accession under § 9-314, the trustee was entitled to priority. If it were an accession, § 9-314(3) would give the trustee priority since the bank did not perfect its security interest before the trustee assumed the status of a hypothetical lien creditor. If it were not an accession, the conflict would be resolved outside § 9-314, and § 9-301(1)(b) would give priority to the trustee. In short, the court's entire analysis of the accession issue is dictum.

\textsuperscript{480}See Annot., 43 A.L.R.2d 813, 814 (1955).
affixation. Second, reliance on restrictive common-law tests not only dilutes the statute’s importance, but may result in trespassing on territory intended to be covered by section 9-315.  

Section 9-314’s definition of accessions applies only to section 9-314, and is irrelevant to determining whether a good should be categorized as an accession for other purposes. This point is driven home in classic fashion by Mills-Morris Automotive v. Baskin, a distressingly unclear opinion. Mills-Morris installed wrecker apparatus on Milligan’s truck, took an Article Nine security interest in the wrecking equipment, and properly filed a financing statement. Milligan sold the truck to Baskin and defaulted on his obligation. Mills-Morris sued Baskin in replevin for the installed equipment. After ruling that the wrecking apparatus was not an “accession to or an integral part of the truck,” the court nonetheless applied section 9-314 to give Mills-Morris priority. One plausible explanation is that the court was utterly confused; once it found that no accession was involved, it should have applied the Code provisions dealing with buyers of separate goods. A more generous explanation is that the court possessed sufficient mental dexterity to conclude that the same word may have different meanings in different contexts. According to this view, the court did not mean to say the wrecking apparatus was not an accession under section 9-314. Rather, the court concluded that the equipment was not so integral a part of the truck as to require recording of the security interests under the state’s motor vehicle registration statute. Therefore, the reasoning goes, the wrecking equipment was enough of an accession to qualify under section 9-314, but not enough of an accession to require special filing under Tennessee’s motor vehicle registration statute as a condition of perfection. Hence, Mills-Morris’ interest covered a section 9-314 accession, was 

481 Gilmore has this to say of §§ 9-314 and 9-315: “[T]hin partitions do their bounds divide and it may not always be easy to see where one leaves off and the other takes up.” 2 GILMORE, supra note 3, § 31.1, at 837.
483 The court does not make explicit that Mills-Morris’ security interest was in the equipment rather than in the truck itself. The court’s application of § 9-314 strongly suggests, however, that the security interest covered only the wrecker machinery.
484 The court again fails to make clear whether Mills-Morris sued for the equipment or the truck. However, if it is safe to assume that its security interest extended only to the equipment (see note 483 supra), it is reasonable to conclude that the replevin action concerned only the equipment.
485 224 Tenn. at 699-700, 462 S.W.2d at 487, 8 U.C.C. Rep. at 733.
487 See notes 488-91 and accompanying text infra.
perfected before sale, and therefore was not defeated by section 9-314(3).

2. Motor Vehicle Registration and Section 9-314

A second issue, also important in Mills-Morris, concerns the extent to which non-Code statutes affect section 9-314. Since accession questions normally arise where the “whole” is a motor vehicle, the most important of these potential intruders are motor vehicle registration statutes. Section 9-314 is completely silent on this point, but one court has specifically denied priority to a party secured by an accession installed in a mobile home due to noncompliance with a state certificate-of-title statute. Problems of this sort will vary among jurisdictions, but a few generalizations can be made. First, basic Code policy favors expansive notice. Courts are certain to be influenced by this philosophy, especially where, as with motor vehicles, subsequent lenders and buyers tend to rely exclusively on the certificate of title. Potential creditors and buyers may not even consider examining the Article Nine files for independent security interests in affixed or installed property. Second, it is clear that the practitioner must familiarize himself with his own state’s law. Much will hinge on statutory language, and some statutes may even expressly resolve this problem. Third, the practical practitioner should file liberally, at least where the law is unclear and the stakes are high.

3. Mechanic’s Liens and Section 9-314

The final point to make about priorities and accessions borders on the obvious, although it has apparently confused some lawyers. Section 9-314 deals only with Article Nine security in-

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488 See 2 Gilmore, supra note 3, § 31.1, at 837.
489 See U.C.C. § 9-302(1)(d), (3)(b), which specifically allows states to implement special registration and filing provisions under certificate-of-title statutes.
terests. Since accessions often arise when machine parts are re-
placed, some parties holding mechanic's or artisan's liens have
looked for help in section 9-314. These creditors belong in section
9-310, and courts have correctly shooed them away when they
have knocked on the door of section 9-314.

C. Processed and Commingled Goods—Section 9-315

When a mixing of goods resulted in the loss of their separate
identities, the common law characterized the result as "confu-

This is one of the subjects dealt with in section 9-315, and
no word could more aptly summarize that provision. The first of
its two subsections reads in full:

If a security interest in goods was perfected and subsequently
the goods or a part thereof have become part of a product or
mass, the security interest continues in the product or mass if
(a) the goods are so manufactured, processed, assembled or
commingled that their identity is lost in the product or mass;
or
(b) a financing statement covering the original goods also cov-
ers the product into which the goods have been manufactured,
processed or assembled.
In a case to which paragraph (b) applies, no separate security
interest in that part of the original goods which has been man-
ufactured, processed or assembled into the product may be
claimed under section 9-314.

Notice first that section 9-315(1) is not a true priority rule.
Instead, like section 9-201, it merely ensures that security interests
survive certain vicissitudes of commercial life. Unlike section 9-201,
the subsection also transforms a security interest in certain goods
(i.e., constituent or ingredient parts) into a security interest in other
goods (i.e., resulting products or masses). Because many goods
provided by many sellers may go into the production of finished
goods, and because many creditors may already hold security in-

492 Section 9-310 is set out in text accompanying note 357 supra.
App. 46, 49, 325 So. 2d 562, 565 (1975) (§ 9-314 does not protect truck repairman who
failed to acquire security interest); Municipal Equip. Co. v. Butch & Son Deep Rock, 185
N.W.2d 756, 759, 8 U.C.C. Rep. 1368, 1372 (Iowa 1971) (§ 9-314 inapplicable because no
security interest attached to accessions).
495 Treat v. Barber, 7 Conn. 274, 280 (1828).
496 U.C.C. § 9-315(1).
terests in the producer's inventories, priority problems are inevit-able. In short, subsection (1) merely causes priority disputes. It is subsection (2)'s job to resolve them. The miraculous change facilitated by section 9-315(1) occurs only if a security interest in a good was perfected prior to its incorporation into the product or mass, and in addition, if the conditions of either paragraph (a) or (b) are satisfied. Paragraph (a) allows transformation if the "identity [of the good] is lost" through manufacturing, processing, assembling or commingling. Paragraph (b) by omission disclaims applicability to "commingling" and "masses," and shifts the security interest only if the financing statement covering the unincorporated goods covers the product they go into as well.

1. The Overlap of Sections 9-314 and 9-315

The final sentence of section 9-315(1) makes it clear that the goods covered by paragraph (b) include at least some accessions, and resolves the problem that arises when particular goods match the descriptions embodied in both sections 9-314 and 9-315(1). In effect, section 9-315 gives the creditor holding a security interest in such goods a choice. He can file as to the goods and the product, in which case his security interest will shift to the product upon production. Alternatively, he can restrict his security interest to the goods themselves, in which case the security interest will not shift to the product, and priority will be determined under section 9-314.

Unfortunately, the Code does not clarify exactly which "goods-in-contact" qualify for the option presented by the final sentence of section 9-315(1). It can be argued that the broad

497 Of course, the security interest may terminate entirely prior to incorporation. See Associated Poultry, Inc. v. Wake Farmers Coop., Inc., 17 N.C. App. 722, 195 S.E.2d 325 (1973) (§ 9-315 ignored by court where security interest apparently terminated through authorized sale before goods commingled by buyer).

498 As a practical matter, most financers of raw materials or ingredients, knowing that these goods will go into making other products, will take a security interest in the debtor's finished products.

499 U.C.C. § 9-315, Comment 3 states:

This section applies not only to cases where flour, sugar and eggs are commingled into cake mix or cake, but also to cases where components are assembled into a machine. In the latter case a secured party is put to an election at the time of filing, by the last sentence of subsection (1), whether to claim under this section or to claim a security interest in one component under Section 9-314.

500 See 2 Gilmore, supra note 3, § 31.4, at 848-49.
language of section 9-315 ("goods . . . manufactured, processed or assembled [into a product]") subsumes all accessions ("goods . . . installed in or affixed to other goods"). We reject this argument for two reasons. First, had the drafters intended this result, they could have expressly provided for it by incorporating the specific language of section 9-314(1) into section 9-315(1)(b). Second, the Comment suggests that the election rule was specifically designed to cover "components . . . assembled into a machine."\textsuperscript{501} Although we are unprepared to say that machine components are the only goods to which the election rule applies,\textsuperscript{502} the Comment persuades us that election is not allowed for all accession security interests.

As a practical matter, the secured creditor should generally elect the shift-to-the-product security route. If he chooses the goods-only security interest, his remedy will be limited to removal, and he will be liable for resulting property damage.\textsuperscript{503} Under section 9-315(1)(b), he will obtain rights to an allocable portion of the proceeds arising from sale of the whole.\textsuperscript{504} Besides being simpler and more efficient, this process avoids the possible pitfall of incurring liability for property damage—a liability that may exceed the value of the repossessed collateral.

2. Separability, Lost Identity, and a Schematic View of In-Contact Goods

Probably the single most serious problem presented by section 9-315(1) involves fleshing out the notion of "lost identity." Three sound reasons suggest that the determination should hinge on whether the goods are severable or separable from the product or mass. First, this approach is in keeping with the different results and remedies afforded by section 9-314 (allowing security interests in goods to continue despite affixation to other goods, and providing a remedy of removal) and section 9-315 (facilitating transformation of security interest in part into security interest in whole, and allocating the whole pro rata among secured creditors). Second, the policy of the section, which is to afford continued protec-
tion to diligent creditors and a practical remedy to secured creditors whose collateral is amalgamated into a mass or product, may recommend looking to separability even when the collateral continues to be technically identifiable. Finally, we fear that a definition focusing on factors other than separability will bring ruination to the carefully constructed diagram we have set out below.

The fundamental assumption of this model is that the Code envisions three mutually exclusive and jointly exhaustive categories of goods. Goods are classifiable by how easily they can be severed or separated from other goods, and in accordance with this variable are placed by the Code into one of three classes: (1) separate chattels, (2) accessions, and (3) goods that lose their identity in becoming part of a product. All goods (except fixtures) fall into one of these classes. Moreover, they fall on the continuum of separability at one, and only one, point. The continuum would be complicated by fungibles and ingredients—goods that are clearly covered by section 9-315, but not dealt with by section 9-314. Hence, they are excluded. We offer our model without further explication.

We challenge the reader to come up with an example of nonfixture goods (excluding ingredients and fungibles) that does not fall on this continuum or that can be plotted at more than one point.

Assume, for example, that A manufactures black jelly beans and that B manufactures white jelly beans. Both sell them to C and take perfected security interests. C then mixes them, bags them, and defaults on his obligations. When the beans are mixed, each group remains clearly identifiable. Separating them, however, would be highly impractical. Prorating the whole is infinitely more sensible than forcing each creditor to reclaim his own jelly beans from C.

The diagram, representing our view of the interplay of sections 9-314 and 9-315, is based on (1) the foregoing analysis, (2) our sanguine (and perhaps presumptuous) conclusion that the drafters intended in sections 9-314 and 9-315 to deal with "in-contact goods" comprehensively and coherently, (3) the broad definition of accessions suggested by the Comments, and (4) the admonition of the Comment to section 9-314 that "accessions" and "lost-identity" goods are mutually exclusive categories. Comment 3 to § 9-314 states: "This section does not apply to goods which, for example, are so commingled in a manufacturing process that their original identity is lost. That type of situation is covered in Section 9-315."

Intermingled fungibles and ingredients form their own continuum based on separability, at some point becoming "lost identity" goods rather than separate goods.

<table>
<thead>
<tr>
<th>separate goods</th>
<th>goods that lose identity</th>
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<tbody>
<tr>
<td>HIGH SEPARABILITY</td>
<td>LOW SEPARABILITY</td>
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It is important to realize that this diagram merely provides a framework for
### 3. Priorities as to Processed or Commingled Goods—Section 9-315(2)

Now that the interplay of sections 9-314 and 9-315 is clear, we shall analyze the latter section’s priority provision, section 9-315(2). The rule states:

> When under subsection (1) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

The section controls priority “[w]hen under subsection (1) more than one security interest attaches to the product or mass.” Apparently this means that both competing security interests must have arisen “magically” under section 9-315. Hence, subsection (2) has no bearing on the more common conflict between a section 9-315 security interest and the security interest covering the debtor’s finished product. If two section 9-315 security interests do con-

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**HIGH SEPARABILITY**

<table>
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<tr>
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<tbody>
<tr>
<td>goods that become part of a product or mass</td>
<td>goods installed or affixed to other goods (accessions)</td>
<td>goods that lose identity</td>
</tr>
</tbody>
</table>

**LOW SEPARABILITY**

<table>
<thead>
<tr>
<th>U.C.C. § 9-315(1)(b)</th>
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<tbody>
<tr>
<td>goods that are manufactured, processed, or assembled into a product</td>
</tr>
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</table>
flict, they "rank equally," and the amount each secured creditor recovers is controlled by section 9-315’s formula:

\[
\frac{\text{cost of goods to which his security interest attached} \times \text{total proceeds}}{\text{cost of the total product or mass}}
\]

Unfortunately this apparently simple formula is rife with serious problems.

The first problem arises because the formula is cost-based. Assume A sells C $100 worth of tin on credit, and perfects a security interest in it. B sells C $100 worth of copper, takes a $50 downpayment, and likewise perfects. C melts the metals into bronze, the market crumbles, C defaults, and the bronze is sold for $100. A’s and B’s security interests both continued in the bronze under section 9-315(1)(a). Hence, subsection (2) controls. Applying the formula, A gets $50 (i.e., his debt is one-half paid), and B gets $50 (i.e., his debt is paid in full). The result seems sorely inequitable. Moreover, section 9-315(2) fails to follow the rule of bankruptcy distribution, its closest analogue, which bases pro rata distribution on the amount still owed each creditor. Finally, and most importantly, no sensible justification supports this unusual scheme.

Defining the formula’s denominator presents a second problem. If, as Professor Gilmore suggests, the "cost of the total product or mass" includes labor and overhead costs in addition to the cost of materials, in many cases the secured creditors together will receive only part of the total proceeds resulting from sale of the mutually encumbered collateral. Unlike Professor Gilmore, we feel that this anomalous outcome justifies limiting "the cost of the total product or mass" to the cost of its constituent parts. The phrase, at least in context, is not unambiguous. Moreover, as cost accountants insist, actual cost is incalculable. But inasmuch as the line must be drawn, policy should guide the pen. Defining "the cost of the total product or mass" as the sum of the costs of its parts or ingredients avoids not only anomalous results, but also complex problems of proof.

A final problem results from section 9-315’s failure to give special treatment to purchase money security interests. Concerned with the specter that purchase money secured parties may have to share the loaf with secured parties claiming under an after-acquired property clause covering the goods to be processed or

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510 2 Gilmore, supra note 3, § 31.5, at 852.
511 Id. at 852-53.
commingled, Gilmore recommends that in cases involving section 9-315(2) courts should allow the after-acquired property interest to attach only to the debtor's equity in the collateral. Gilmore's position borders on the outrageous. It is wholly without statutory foundation and invites a potentially disastrous emasculation of the Code-endorsed after-acquired property clause. Gilmore bases the argument on his fear of a result that "seems unfair." Exactly the same unfairness argument and property-equals-equity analysis recently convinced the Florida Supreme Court to repeal judicially the priority scheme envisioned by sections 9-204(1) and 9-312(4). The drafters of the Code, it seems, should be more protective of the fruits of their labor.

V

SECURED CREDITORS AND TRANSFEREES OF COLLATERAL
Sections 9-306 to 9-309

The typical commercial setting in which sections 9-307, 9-308, and 9-309 operate looks like this:

A lender has extended credit to a seller in return for a security interest in collateral. The seller has sold part or all of the collateral to a purchaser, perhaps giving rise to another security interest. At this point all is well: the lender has a security interest in the proceeds of the sale, the seller has been paid, and the purchaser has the collateral to use as he pleases. If the purchaser bought on credit, other lenders and new security interests may come into the picture. In any event, as long as everyone continues to meet his obligations, the stream of commerce flows smoothly and the priority rules remain in the background.

Inevitably, however, someone defaults on an obligation secured by the collateral. Once this trigger is pulled, all interested parties scramble to get a grip on the collateral before the hammer falls. The resulting battle is the cue for the priority rules to step in and resolve the conflict.

A. Was the Sale Authorized?

Section 9-306(2) goes far toward protecting the secured creditor against surprise sales by his debtor:

\[^{512}\text{id. at 855-56.}\]
\[^{513}\text{id. at 856.}\]
Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.515

Thus, the purchaser and the secured party fight the first round over whether the secured party authorized a sale of the collateral. If the purchaser shows that the secured party authorized the sale, the fight is over: the purchaser takes the collateral free of the security interest.516 In attempting to meet this burden, the purchaser is not limited to the four corners of the security agreement; he can show that the sale was authorized through a course of dealing or usage of trade.517

_Tanbro Fabrics Corp. v. Deering Milliken, Inc._518 illustrates such an authorization. In that case, the debtor-seller converted raw textiles into finished goods. The lender had a security interest in all of the debtor's finished and unfinished inventory. In accordance with industry practice, the debtor occasionally sold some of his excess unfinished stock in the market. The debtor normally applied the proceeds of these sales to its outstanding debt with the secured party. In light of this industry custom and the parties' own course of dealing, the New York Court of Appeals found an implied authority to sell; after all, the court reasoned, if the debtor were ever to liquidate his debt to the secured party, such sales would have to be authorized.519

In essence, section 9-306(2) provides that when a secured party cloaks his debtor with apparent authority to sell collateral, he should be estopped from denying later that the debtor had no such authority.520 If the secured party's conduct does not go far enough,


515 U.C.C. § 9-306(2). This provision creates an exception to the general rule of Article Nine that "a security agreement is effective according to its terms . . . against purchasers of the collateral and against creditors." U.C.C. § 9-201.
517 See Planters Prod. Credit Ass'n v. Bowles, 256 Ark. 1063, 511 S.W.2d 645, 14 U.C.C. Rep. 1435 (1974) (credit association authorized sale where member-debtors, in accordance with association policy, sold collateral and applied proceeds toward debts at will).
519 Id. at 637, 350 N.E.2d at 593, 385 N.Y.S.2d at 262, 19 U.C.C. Rep. at 389-90.
no authorization will be found. For example, a bank's failure to file a purchase money security interest in an automobile is insufficient to give the debtor apparent authority to sell the car, where the applicable statute does not require filing to perfect the security interest.\(^5\) And even where the secured party explicitly authorizes the sale, if he does so upon a condition, the sale will not be deemed authorized unless the condition is met.\(^5\)

Comment 3 to section 9-306(2) in the 1962 Code suggests that authorization might be inferred from the secured party's claim in the security agreement to all proceeds resulting from the sale of the collateral.\(^5\) Although Comment 3 under the 1972 amendments retreats from this position,\(^5\) at least one court has recognized that an authorization to sell might be inferred from a claim to proceeds.\(^5\) Clearly, such a claim should be considered in the overall commercial setting as one fact tending to show authorization.\(^5\)

If the sale was authorized, the lender's security interest is severed at the moment of sale, and the buyer acquires full rights in the collateral. In addition, any secured party claiming through the buyer takes free of the original security interest.\(^5\) The purchaser

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\(^5\) See, for example, South Omaha Prod. Credit Ass'n v. Tyson's Inc., 189 Neb. 702, 204 N.W.2d 806, 12 U.C.C. Rep. 352 (1973), where the secured creditor agreed to a sale of the collateral on the condition that the proceeds first be applied in full satisfaction of its claim. Because some of the proceeds went to another creditor before the secured party's claim was fully satisfied, the court found no authorization for the sale.

\(^5\) U.C.C. § 9-306(2) (1962 version), Comment 3, states: "A claim to proceeds in a filed financing statement might be considered as impliedly authorizing sale or other disposition of the collateral, depending upon the circumstances of the parties, the nature of the collateral, the course of dealing of the parties and the usage of trade (see Section 1-205)."

\(^5\) U.C.C. § 9-306(2), Comment 3, now states: "The right to proceeds, either under the rules of this section or under specific mention thereof in a security agreement or financing statement does not in itself constitute an authorization of sale."


\(^5\) Indeed, the 1972 Comment, set out in note 524 supra, suggests this by negative implication.

prevails without resorting to the "otherwise" ammunition in the first clause of section 9-306(2). This point bears repeating: It is only when the purchaser is unable to show that the sale was authorized that he need resort to the "[e]xcept where this Article otherwise provides" language of section 9-306(2). Some courts have missed this point entirely and have launched into unnecessary analyses under section 9-307. It is only when sales are unauthorized that courts must turn to the buyer-versus-secured-party priority rules.

B. The Buyer Versus the Unperfected Security Interest

Section 9-301(1)(c) grants buyers not in the ordinary course of business priority over unperfected security interests to the extent they give value and take possession of the collateral without knowledge of the security interest before the interest is perfected. A comparison of sections 9-301(1)(c) and 9-307(1) points up the important characteristics of the former section and provides a good introduction to the latter.

Like section 9-307(1), section 9-301(1)(c) protects "buyers." However, it does not limit its protection to buyers of goods. Rather it covers transfers of "goods, instruments, documents, and chattel paper." Section 9-301(1)(c), as amended in 1972, also protects ordinary-course buyers of farm products, a group specifically excluded from section 9-307.

\footnotesize

531 U.C.C. § 9-301(1)(c) provides:
Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

... (c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected

...\n
532 For a discussion of the term "buyer," see notes 546-61 and accompanying text infra. Elsewhere we argue that § 9-301(1)(c) also protects holders of commercial paper—a group of purchasers not traditionally referred to as "buyers." See note 716 infra.
533 Section 9-307(1) is set out in text accompanying note 542 infra.
534 U.C.C. § 9-301(1)(c).
535 The 1962 version of § 9-301(1)(c) made no reference to buyers of farm products in
The buyer under section 9-301(1)(c) takes priority only to the extent that he gives value without knowledge of the security interest and before it is perfected. The requirement that a buyer give value raises an ambiguity. Under section 1-201(44)(b), the giving of "value" includes a transfer in satisfaction of a pre-existing debt. Under section 1-201(9), however, a transfer in satisfaction of a pre-existing debt does not constitute "buying." In our opinion, section 9-301(1)(c) covers only those who engage in "buying."\textsuperscript{536} The section's "to the extent that he gives value" language should thus be read not as broadening the class of protected purchasers, but as merely delineating the extent to which a "buyer" may claim the protection of section 9-301(1)(c).

Perhaps the most mysterious feature of section 9-301(1)(c) is its requirement that the buyer take possession of the collateral without knowledge of the security interest. This rule applies even if the buyer has already committed himself by paying for yet-undelivered goods or paper. The Code's drafters apparently intended to force the buyer in such cases to resort to his right of rejection; since the seller has breached his warranty of title,\textsuperscript{537} the buyer can sue for restitution. The requirement that he take without knowledge, however, seems overly severe and difficult to justify. Priority conflicts arise when and because the seller has defaulted. Under these circumstances it is unlikely that the seller will be able to satisfy the buyer's restitutionary claim. Nevertheless, the buyer has emptied his pocket into the seller's drawer and now seeks the law's assistance in recovering his money. The purpose of section 9-301(1)(c) is to protect buyers not in the ordinary course against those who fail to give such buyers notice of their interests. It therefore seems inconsistent and arbitrary to subordinate the buyer who, after giving value but before taking delivery, discovers the security interest of the creditor—at least in those cases where the creditor could have filed and thus put the buyer on notice.\textsuperscript{538}

\textsuperscript{536}See notes 558-59 and accompanying text \textit{infra}.
\textsuperscript{537}See \textit{U.C.C.} § 2-312(1)(b), (2).
\textsuperscript{538}The drafters no doubt also wanted to protect the creditor who, without knowledge that the buyer had given value, obtained a security interest relying on the seller's possession of collateral, and thereafter promptly perfected. In attempting to protect such creditors, however, § 9-301(1)(c) paints with too broad a brush; it has the further effect of
The knowledge referred to in section 9-301(1)(c) means actual knowledge of a competing security interest. Knowledge of the underlying debt does not constitute knowledge that the debt is secured. But if the buyer knows of a competing security interest, it makes no difference whether he knows who holds it; knowledge that a security interest exists is sufficient by itself to subordinate the buyer.

C. Protecting Buyers in Ordinary Course—Section 9-307(1)

If the purchaser cannot obtain an early victory under section 9-306(2) or 9-301(1)(c), he must prepare for a more arduous struggle under section 9-307.

Section 9-307(1) provides:

A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

We find seven conditions in sections 9-307(1) and 1-201(9) that a purchaser must satisfy to avoid subordination to a secured creditor claiming under section 9-201:

1. He must be a buyer of goods
2. who took by non-bulk sale

protecting prior secured creditors who, by failing to file, denied buyers the chance to protect themselves. A compromise is in order. If a buyer of the collateral obtains knowledge (or the security interest is perfected) after payment but before delivery, only those creditors who rely on the seller’s possession of the collateral in taking their security interest and who file within 10 days after the interest attaches should be protected. We recommend that § 9-301(1)(c) be amended to achieve this result.

See U.C.C. § 1-201(25); In re Dennis Mitchell Indus., Inc., 419 F.2d 349, 353 n.11, 6 U.C.C. Rep. 573, 579 n.11 (3d Cir. 1969).


U.C.C. § 9-307(1).

U.C.C. § 1-201(9) defines “buyer in ordinary course of business”: “Buyer in ordinary course of business” means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker . . . “Buying” may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

U.C.C. § 9-201 is set out in the text accompanying note 22 supra.
(3) giving new value
(4) from one in the business of selling goods of that kind (i.e., out of inventory)
(5) in good faith and without knowledge that the sale violated others' ownership rights or security interests
(6) and who did not buy farm products.
(7) Finally, the security interest that the buyer is competing against must have been "created by his seller."$445

We shall examine each of these requirements in turn.

1. Requirement 1: Is the Purchaser a "Buyer" for Purposes of Section 9-307(1)?

To qualify as a buyer in ordinary course of business (BIOC), one must first qualify as a "buyer."$446 Unfortunately, "buyer" is not functionally defined in Article Nine.$447 Although it is usually clear

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$445 Professors White and Summers identify six conditions that the buyer must satisfy to qualify for the protection of § 9-307(1):

(I) He must be a buyer in the ordinary course
(2) who does not buy in bulk and does not take his interest as security for or in total or partial satisfaction of a pre-existing debt (that is, he must give some form of "new" value)
(3) who buys from one in the business of selling goods of that kind (that is, cars from a car dealer, i.e. inventory);
(4) who buys in good faith and without knowledge that his purchase is in violation of others' ownership rights or security interests, and
(5) does not buy farm products from a person engaged in farming operations, and
(6) the competing security interest must be one "created by his seller".

WHITE & SUMMERS, supra note 1, § 25-13, at 940.

Although this analytic structure is extremely helpful and provides the basis for our own organization, we find the first condition conclusory, and therefore potentially confusing. Accordingly we have modified the list in an effort to provide a more precise framework for analysis.

$446 Section 9-307(1) was intended to protect the class of persons who normally buy from a seller's inventory. WHITE & SUMMERS, supra note 1, § 25-13, at 940. Although it is clear that a consumer or business buying for use or resale can be a BIOC (2 Gilmore, supra note 3, § 26.6, at 697), in the early days of Article Nine it was unclear whether a party buying from another party on the same level in the chain of distribution (as in dealer-dealer or manufacturer-manufacturer transactions) could qualify as a BIOC. Id. Today the question is settled: the buyer's business is immaterial. As long as he otherwise qualifies, even a fellow merchant may be a BIOC. See Weidinger Chevrolet, Inc. v. Universal C.I.T. Credit Corp., 501 F.2d 459, 15 U.C.C. Rep. 197 (6th Cir.), cert. denied, 419 U.S. 1033 (1974); Sherrock v. Commercial Credit Corp., 290 A.2d 648, 10 U.C.C. Rep. 523 (Del. 1972); Bank of Utica v. Castle Ford, Inc., 36 App. Div. 2d 6, 317 N.Y.S.2d 542, 8 U.C.C. Rep. 910 (4th Dep't 1971); Associates Discount Corp. v. Rattan Chevrolet, Inc., 462 S.W.2d 546, 8 U.C.C. Rep. 117 (Tex. 1970). The only class of purchasers specifically excluded from the protection of § 9-307(1) are pawnbrokers. See U.C.C. § 1-201(9).

$447 Section 2-103(1)(a) defines "buyer" for purposes of Article Two as "a person who
whether a party qualifies as a buyer, at least one court has had to address this issue. In *Troy Lumber Co. v. Williams*, a purchaser gave a dealer a $600 deposit on a new mobile home. Before the purchase was consummated, one of the dealer’s officers absconded with all of the company’s cash. The purchaser, seeking to recover his $600 deposit, attached the mobile home to satisfy his claim. He thus came into conflict with the manufacturer of the mobile home, which held a perfected security interest in the dealer’s inventory. The court held that the purchaser could not invoke section 9-307(1) to sever the manufacturer’s security interest; because he had rescinded his contract with the dealer and demanded return of his down payment, the purchaser was not a buyer within the meaning of that section. To qualify as a BIOC, the court reasoned, a purchaser must seek to vindicate his rights in a manner consistent with his status as a BIOC—that is, he must complete the process of buying. Had the purchaser sought full performance under his contract with the dealer, he would have behaved like a “buyer” and would therefore have qualified as a BIOC. Since the purchaser had insisted on rescinding rather than going forward with the transaction, he could not use section 9-307(1) to cut off the manufacturer’s interest.

Although the court in *Troy Lumber* reached a correct result, it left much unsaid. In one sense, *Troy Lumber*’s buyer-turned-attacher was a “buyer.” However, the policies underlying section 9-307 militate against awarding him “buyer” status. The two basic purposes of section 9-307(1) are to facilitate the free exchange of goods in the market place, and to protect legitimate reliance interests of owners who acquire goods in common commercial transactions. In this case, however, neither of these policies applied because the “buyer” rescinded his contract. The buyer, like any other lienor, was merely trying to collect an obligation owed him by the dealer. To do this, he could have attached any property of the dealer. His decision to attach a mobile home as to which he had buys or contracts to buy.” This circularity, however, hardly amounts to an operational definition. See *White & Summers, supra* note 1, § 25-13, at 942 n.90.


549 Id. at 637-38, 185 S.E.2d at 582, 9 U.C.C. Rep. at 1145-46.

550 Having contracted to buy, he at least satisfied Article Two’s definition of “buyer.” See U.C.C. § 2-103(1)(a). He could thus resort to “buyers’ ” remedies, including the remedy of rescission which in fact he exercised. The Article Two definition, however, is inapplicable to Article Nine. See note 557 and accompanying text infra.
specifically rejected an ownership interest should not affect the result. Moreover, we find rescission cases indistinguishable from cases in which tendered goods are rejected. In both settings, the policies of section 9-307 require forsaking the would-be "buyer."

Another case—this one involving section 9-301(1)(c)—also poses an interesting "buyer" question. In Ray v. City Bank & Trust Co. the purchaser of an oil drilling rig failed to qualify as a BIOC because the transfer was in satisfaction of a pre-existing debt. This, however, did not end the court's inquiry. Due to a misleading omission in the financing statement, the security interest in the rig had not been properly perfected. In resolving the conflict between the buyer and the seller's unperfected secured creditor, the court reasoned that priorities involving unperfected security interests are governed by section 9-301, which subordinates unperfected security interests to buyers not in the ordinary course. Finding no further complications, the court granted priority to the purchaser of the rig.

But wait a minute. Section 9-301(1)(c) makes unperfected security interests subordinate to "buyers not in ordinary course." If the purchaser fails to qualify as a BIOC, he cannot automatically claim that he is a "buyer not in ordinary course." Under section 9-301(1)(c), as under section 9-307(1), he must first show that he is a "buyer." This, however, is no easy task. Article Nine provides no definition of "buyer," and the Article Two definition in section 2-103(1)(a) does not apply to Article Nine. The only place left to turn to is Article One. Although Article One does not define "buyer," it does discuss, if not define, "buying":

"Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or

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551 At least one court has specifically found § 9-307 inapplicable where the buyer rejected goods. See Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 208 N.W.2d 97, 12 U.C.C. Rep. 849 (1973) (buyer not in ordinary course of business because no sale occurred).


553 Id. at 639.

554 Id. at 641.

555 U.C.C. § 9-301(1)(c) (emphasis added).

556 "Purchaser" is defined in U.C.C. § 1-201(32)-(33):

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person who takes by purchase.

557 See U.C.C. § 2-103(1)(a), set out in part in note 547 supra.
documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.\textsuperscript{558}

Largely because no other formulation exists, we recommend compliance with this language as the minimum requirement for establishing "buyer" status under Article Nine.\textsuperscript{559}

Under this test, the court's decision in \textit{Ray} is incorrect. "Buying" specifically excludes a "transfer . . . in . . . satisfaction of a money debt."\textsuperscript{560} Therefore, the purchaser who took the rig in satisfaction of such a debt did not engage in "buying" and hence did not qualify as a "buyer." Because section 9-301(1)(c) was inapplicable, the security interest, even though unperfected, should have prevailed against the purchaser under the golden rule of section 9-201.\textsuperscript{561}

\textbf{2. Requirement 2: Did the Transaction Amount to a Sale?}

Section 1-201(9) uses the word "sale" in defining buyer in the ordinary course of business. If secured parties seize on this language in arguing that a section 9-307 claimant is not a BIOC,\textsuperscript{562} the factfinder will have to address the question of whether a "sale" has occurred.\textsuperscript{563} Section 2-106 defines "sale" as "the passing of title from the seller to the buyer for a price (Section 2-401)."\textsuperscript{564} If title

\textsuperscript{558} U.C.C. § 1-201(9).
\textsuperscript{559} Although the Code discusses "buying" in § 1-201(9), which defines "buyer in ordinary course of business," we feel that the term "buying" was intended to have an independent significance. Note first that the term "buying" is physically set apart from the definition of "buyer in ordinary course of business." Second, the definition of the latter phrase does not even include the term "buying." Finally the concepts embodied in the discussion of "buying" could have easily been written into the definition of "buyer in ordinary course of business." Their inclusion in the broader term "buying" suggests that the drafters intended these concepts to have a broader application. It is thus our view that at the very least a "buyer" is one who engages in "buying."

\textsuperscript{560} U.C.C. § 1-201(9).

\textsuperscript{561} Even the most deserving buyer may not qualify as a BIOC. Section 9-201 confers this special status only on buyers of "goods," a term defined for Article Nine purposes in § 9-105(1)(h) as essentially "things which are movable." Others have discussed what is meant by "goods" (see 1 \textit{Gilmore}, supra note 3, § 12.2, at 368-71; \textit{White & Summers}, supra note 1, § 2-2, at 45), and we do not pause to consider this issue.


\textsuperscript{564} U.C.C. § 2-106. Section 9-105(3) makes this definition of "sale" applicable to Article Nine.
has passed under section 2-401, the buyer will not be defeated by the security interest simply because he has not taken actual possession.\textsuperscript{565} However, if the buyer rejects the goods or does not accept them in accordance with the provisions of Article Two, the transaction between the seller and the buyer has no binding effect, and the secured party will win.\textsuperscript{566}

Whether a "sale" has occurred may become an important question when the buyer has returned goods to the seller. In foreclosing on the seller's inventory while the goods are in the seller's possession, a secured party will argue that his security interest continues in the goods despite the seller's momentary loss of possession.\textsuperscript{567} In such cases, the outcome depends on whether the antecedent dealings between buyer and seller constituted a completed sale.

Two cases aptly illustrate these concepts. In \textit{Chrysler Corp. v. Adamatic, Inc.}\textsuperscript{568} and \textit{International Harvester Credit Corp. v. Associates Financial Services Co.},\textsuperscript{569} the seller's secured creditor foreclosed while the seller had possession of goods claimed by the buyer. In both cases the buyer sought to free the goods from the perfected security interest of the inventory financer by claiming that he was a BIOC.

\textit{Adamatic} involved contracts for the manufacture of several machines. The seller-manufacturer completed the first machine and delivered it to the buyer. While the second and third machines were still being manufactured, the buyer returned the first machine for repairs. A creditor of the seller, seeking at this point to foreclose on the seller's inventory, asserted a perfected security interest in all three machines.

In \textit{International Harvester}, the dealer, having contracted to sell tractor-trucks and matching trailers to the buyer, agreed to store the trucks until the trailers were also ready for delivery. Before delivery could be made, the dealer's secured creditor foreclosed on the dealer's inventory. Arguing that the transaction between the dealer and the buyer had never been consummated, the creditor claimed a security interest in the undelivered trucks.

\textit{Adamatic} and \textit{International Harvester} thus collectively represent transactions at three different stages of completion:

\textsuperscript{566} See id.
\textsuperscript{567} See, e.g., id. at 231, 208 N.W.2d at 102, 12 U.C.C. Rep. at 857-58.
\textsuperscript{568} 59 Wis. 2d 219, 208 N.W.2d 97, 12 U.C.C. Rep. 849 (1973).
(1) First machine in *Adamatic*—delivery completed, goods returned for repair.

(2) Trucks in *International Harvester*—"sale" completed except for delivery.

(3) Second and third machines in *Adamatic*—goods still in the process of manufacture.

In both cases, the courts held that although the Code failed to cover explicitly situations where buying involved nonreceipt of goods, it was reasonable to assume that section 1-201(9) requires a "sale." Thus, with respect to the first machine in *Adamatic*, the court held that the return of the machine for repairs did not undo the sale completed earlier. There was neither evidence that the buyer was rejecting or refusing to accept the machine, nor anything to indicate that the buyer was rescinding the contract.

With respect to the trucks, the court in *International Harvester* held that the transaction had progressed far enough to constitute a "sale" under section 2-106. Unless otherwise agreed, title under the Code passes when the seller finally commits himself. Since title passed under section 2-401, a sale took place under section 2-106. The buyer's failure to take immediate possession did not vitiate the sale, because the seller had finally committed himself.

Finally, with respect to the second and third machines in *Adamatic*, the court found that title had not passed under section 2-401 before the secured party foreclosed. Hence a section 2-106 sale had not taken place. The seller's security interest was not

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571 59 Wis. 2d at 233, 208 N.W.2d at 103, 12 U.C.C. Rep. at 859.

572 Id. at 292-33, 208 N.W.2d at 103, 12 U.C.C. Rep. at 858-59.


574 See U.C.C. § 2-401(2)-(3). Comment 4 explains:

The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated subsection (3) turns on the seller's final commitment, i.e. the delivery of documents or the making of the contract.

U.C.C. § 2-401, Comment 4.

Since the parties in *International Harvester* made no plans for shipment, § 2-401(3) fixed the point of final commitment at the time the contract was signed.


576 59 Wis. 2d at 233-39, 208 N.W.2d at 106-07, 12 U.C.C. Rep. at 863-64.
severed because the transaction had not progressed far enough to make the buyer a BIOC.577

In sum, Adamatic and International Harvester illustrate the importance to the buyer of a completed sale. Only if the buyer has participated in this sacred act will Article Nine bless him with the protection of section 9-307(1).578

3. Requirement 3: Did the Purchaser Give "New Value" and Take More than Mere Security?

Section 9-307 applies when sellers and buyers exchange goods for tangible value in discrete transactions. Such marketplace transactions enjoy considerable buoyancy in the Code's stream of commerce, unlike transactions involving intangibles such as debt. For a transfer to qualify as a protected marketplace transaction, "new value" must be given. This requirement is embedded in the last sentence of section 1-201(9):

"Buying" may be for cash or by exchange of other property . . .
but does not include a transfer . . . as security for or in total or partial satisfaction of a money debt.579

This language contains more than a mere "new value" requirement. It also requires that the "seller" transfer more than just security. In most cases, an exchange of one good for another, without more, qualifies as "buying" under section 1-201(9).580 But

577 Id. Note that the buyer in Adamatic successfully repleived all three machines following the secured creditor's threat to foreclose. Id. at 228, 208 N.W.2d at 101, 12 U.C.C. Rep. at 856. The court held, however, that the replevin action was not a part of the process by which title might pass; i.e., a buyer could not replevy the undelivered goods and then claim that a delivery had completed the transaction. Id. at 239-40, 208 N.W.2d at 107, 12 U.C.C. Rep. at 864-65. The court recognized that this result was unfair, because the buyer had already made substantial payments on the undelivered goods. Id. at 241-42, 208 N.W.2d at 107, 12 U.C.C. Rep. at 864. As the court pointed out, however, a financing buyer can protect himself against the perfected security interests of other creditors by taking a security interest directly in the goods to be manufactured and obtaining an agreement in which the seller's other creditors partially subordinate their security interests in the seller's inventory. Id. at 242, 208 N.W.2d at 108, 12 U.C.C. Rep. at 865. The other secured creditors, eager to see the seller take on more business, should be willing to enter into such an agreement, especially if they realize that the financing buyer will not otherwise make the purchase.

578 Under some circumstances buyers may be protected even though a sale has not been finalized. See, e.g., Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 269-70, 288 N.Y.S.2d 525, 533-34, 5 U.C.C. Rep. 226, 235 (Sup. Ct. 1968) (Article Two applies to effect sale even though technically title failed to pass).

579 U.C.C. § 1-201(9).

if $L$ and $D$ exchange goods, and $L$ takes $D$'s property merely as security for the debt arising from $D$'s receipt of the property from $L$, $L$ will not qualify as a BIOC; all $L$ has received is "security for . . . a money debt."\textsuperscript{581} Similarly, one who makes a cash advance and takes property with the understanding that it will be returned upon repayment of the debt cannot claim the protection of section 9-307.\textsuperscript{582} Courts have carefully scrutinized such attempts to place security transactions in the posture of a "sale," and have not hesitated to deny section 9-307 protection when too many elements of debt security appear in the transaction.\textsuperscript{583}

But the heart of the "buying" language is its new value requirement. Under section 1-201(9), no "buying" occurs when a seller-debtor transfers his inventory directly to a buyer-creditor in satisfaction of a preexisting debt. But has "buying" occurred when the buyer takes the seller's inventory, agreeing in return to assume the seller's debt to a third party? The Eighth Circuit faced this question in \textit{Weidinger Chevrolet, Inc. v. Universal C.I.T. Credit Corp.}\textsuperscript{584} The case involved two inventory lenders ($L_1$ and $L_2$) and two car dealers ($D_1$ and $D_2$). $L_1$ extended credit to $D_1$ in return for promissory notes and a security interest (which $L_1$ later perfected) in all cars that $D_1$ purchased for inventory. In another business venture, $D_1$ accepted credit from $L_2$ and gave $L_2$ a security interest in the cars already subject to $L_1$'s security interest. $D_1$ subsequently assigned cars to $D_2$, which agreed to issue its own notes to $L_1$ in place of $D_1$'s notes to $L_1$. Although the cars remained on $D_1$'s lot, $D_2$ set the minimum selling price. $D_1$ then sold the cars to regular customers for whatever price he could get and pocketed any excess over $D_2$'s minimum selling price.\textsuperscript{585} $D_1$ defaulted on his obligation to $L_2$, and $L_2$ sought satisfaction out of $D_1$'s inventory.

In court, $L_2$ and $D_2$ locked horns over $D_2$'s status as a BIOC. $L_2$ contended that the transfer of cars from $D_1$ to $D_2$ was in "satis-


\textsuperscript{585} This arrangement was not unusual because the sole owner of $D_2$ was also a $\frac{1}{2}$ owner of $L_1$. In fact, it was not uncommon for $D_1$ to send directly to $L_1$ what $D_1$ originally owed on the car (before the assignment to $D_2$) and settle with $D_2$ later. \textit{Id.} at 464 n.9, 15 U.C.C. Rep. at 205 n.9.
faction of a money debt." The Eighth Circuit agreed, but went on to rule that the "satisfaction of a money debt" exclusion in section 1-201(9) operates to deny BIOC status only when the debt satisfied is owed directly to the buyer. The court held that when a sale eliminates the seller's debt to a third party, the buyer who assumes the seller's obligation as part of the consideration for the sale may qualify as a BIOC.\(^{586}\)

The Eighth Circuit's interpretation of "buying" is questionable. Section 1-201(9) merely states that "buying" does not include a transfer in satisfaction of a debt. It does not distinguish between debts owed to the buyer and debts owed to a third party. Yet the Weidinger court obliquely distinguished the two, implying that it would have denied the buyer BIOC status if the seller had owed the debt to him.\(^{587}\)

Although the finding that D2 was a BIOC was unnecessary to the holding of the case,\(^{588}\) the court's reasoning and the result it reached contravene one of the basic policies of Article Nine. Article Nine favors creditors who secure their obligations by perfecting security interests in collateral held by their debtors.\(^{589}\) Any situation in which the debtor is given essentially unfettered discretion to favor an unsecured creditor over a perfected secured creditor in derogation of a security agreement surely contravenes this policy. Yet the approach taken in Weidinger has precisely this effect.

Under the Weidinger rationale, a party could change virtually any transfer in satisfaction of a debt into "buying" in ordinary course by interposing a straw man between the debtor-seller and the creditor. Consider the following hypothetical. D1, a car dealer, owes X $1,000. This debt is unsecured. L, an inventory lender, has an ironclad perfected security interest in all of D1's inventory. D1 is experiencing liquidity problems and would like to use the cars on his lot to satisfy his $1,000 debt to X. With L lurking in the background, D1 cannot give X a car in satisfaction of the debt because

\(^{586}\) Id. at 463-64 n.8, 15 U.C.C. Rep. at 204 n.8. The court found that D2 and L1 were separate corporations despite their overlapping ownership, and refused to hold that the transfer of the cars to D2 was really a transfer to L1. Id. at 463, 15 U.C.C. Rep. at 204. For another case involving the third-party-debt issue, see First Nat'l Bank, Martinsville v. Crone, 301 N.E.2d 378, 13 U.C.C. Rep. 542 (Ind. Ct. App. 1973) (buyer granted BIOC status even though he paid off seller's debt to third party on items purchased by seller from third party).

\(^{587}\) See 501 F.2d at 463-64 n.8, 15 U.C.C. Rep. at 204 n.8.

\(^{588}\) Section 2-326 disposed of the controversy and eliminated any need to refer to § 1-201(9). See id. at 464-65, 15 U.C.C. Rep. at 205-06.

\(^{589}\) See note 20 and accompanying text supra.
X could not qualify as a BIOC.\textsuperscript{590} Thus, \textit{D1} approaches \textit{D2} (another car dealer) and, without mentioning his desire to favor \textit{X} over \textit{L}, obtains the following agreement: \textit{D1} will transfer to \textit{D2} $1,000 worth of cars in return for \textit{D2}'s assumption of \textit{D1}'s debt to \textit{X}. So far, so good; \textit{D1} has followed the Eighth Circuit's holding like a recipe. The net result, however, is that \textit{D1} satisfies his debt to \textit{X} using collateral subject to \textit{L}'s security interest. \textit{D2} qualifies as a BIOC under the \textit{Weidinger} rationale, \textit{X} collects from \textit{D2}, and \textit{L} has lost $1,000 worth of collateral.\textsuperscript{591} \textit{X}, the unsecured creditor hitherto left out in the rain, now collects his money under the umbrella of section 9-307, while \textit{L} looks on helplessly at the diminishing pool of inventory that secures his debt. Even a security interest in proceeds under section 9-306(3) is useless to \textit{L} because there are no "proceeds" to which his security interest can attach. The only thing that might be called "proceeds" is \textit{D2}'s assumption of \textit{D1}'s debt, and it would be too novel to suggest that an inventory lender has a security interest in that.\textsuperscript{592} \textit{D1} has defeated the underlying policy of Article Nine by favoring an unsecured creditor over a perfected secured creditor.

One might argue that a good faith obstacle must be overcome before courts would uphold this transaction. A good faith requirement does apply to \textit{D2}, who seeks the status of a BIOC, and perhaps also to \textit{X}.\textsuperscript{593} But as long as \textit{D1} avoids collusion with \textit{X}, or \textit{D2}, they will both meet the good faith requirement with little difficulty. The most serious charge to which \textit{X} or \textit{D2} is vulnerable is knowledge of \textit{L}'s security interest. With respect to \textit{D2}, such knowledge will not affect his status as a BIOC,\textsuperscript{594} and with respect to \textit{X}, it is too much to require that he vindicate \textit{L}'s rights by refusing the novation. The only party who will have clearly acted in bad faith is the party from whom \textit{L} can expect the least: \textit{D1}.\textsuperscript{595}

\textsuperscript{590} See U.C.C. § 1-201(9), set out in note 543 supra.
\textsuperscript{591} Arguably, \textit{D1} has not "satisfied" his obligation at all. After all, \textit{X} has not been paid: he only has a new debtor. But the practical result is the same. Substituting a solvent debtor (\textit{D2}) for a debtor about to default (\textit{D1}) gives \textit{X} exactly what the "new value" requirement of § 1-201(9) was designed to deny him: preferential treatment over otherwise equal or superior creditors.
\textsuperscript{592} For the definition of "proceeds," see U.C.C. § 9-306(1).
\textsuperscript{593} See U.C.C. § 1-203.
\textsuperscript{594} See U.C.C. § 9-307(1).
\textsuperscript{595} The result reached in \textit{Weidinger} can be supported by two arguments. First, although our analysis focuses on how the secured inventory lender may be effectively subordinated, the \textit{Weidinger} court seemed more concerned about protecting the innocent purchaser. After all, it is his property that will be taken away. Although we sympathize with
4. Requirement 4: Was the Purchase Out of Seller’s Inventory?

Since section 9-307(1) protects only those who buy out of inventory, a buyer cannot become a BIOC if the goods he buys were “equipment” or “consumer goods” in the seller’s hands. But even if an item is classifiable as “inventory” under section 9-109, this does not automatically make the buyer a BIOC. The crucial test—a question of fact—is whether the seller is “in the business of selling goods of that kind.” Factors relevant to this determination include (1) whether the seller holds himself out to the public as regularly selling the item; (2) whether the seller uses business cards with an appropriate trade name; (3) whether the buyer uses the seller’s trade name to obtain financing for the sale; (4) whether checks are regularly made out to the order of the seller’s trade name; and (5) whether a manufacturer does warranty work for the seller’s customers. These factors have been mentioned only in passing. Others have generated more controversy and case law.

innocent purchasers, we must point out that § 9-307(1) does not protect all purchasers; it protects only those who buy goods out of inventory in commonplace commercial transactions. Purchasing a car from a car dealer is certainly commonplace, but it is highly unusual to pay for the car by assuming the seller’s indebtedness. We suspect that those who engage in such transactions are not the type of buyers § 9-307(1) was designed to protect. Moreover, the specific mention of antecedent debts in § 1-201(9) gives these buyers sufficient warning that they purchase at their peril. Second, one can argue that such transactions may actually work to the secured creditor’s benefit by mitigating the seller’s cash-flow problems and thus reducing the chances of default. Although this argument may please academicians, it will little humor the perfected secured creditor whose debtor has just filed for bankruptcy.

596 WHITE & SUMMERS, supra note 1, § 25-13, at 940.
a. Does Selling the Item Have to be Seller's Primary Business? A glance at section 1-201(9) should make it clear that the seller does not have to be a "merchant" under section 2-104 before his buyer may qualify as a BIOC. In Hempstead Bank v. Andy's Car Rental System, Inc.,\(^{601}\) however, the New York Appellate Division held that an automobile rental agency engaged primarily in the business of leasing cars, but which occasionally sold them as well, was not "in the business of selling" automobiles.\(^{602}\) The opinion fails to reveal whether the court reached this conclusion on the facts or whether it found as a matter of law that the rental agency was not "in the business of selling" because selling cars was not its predominant business.

In Tanbro Fabrics Corp. v. Deering Milliken, Inc.,\(^{603}\) however, the New York Court of Appeals held that predominance of sales was not essential to a buyer's attaining BIOC status.\(^{604}\) In Tanbro, the seller's predominant business was converting unfinished textiles into finished goods. Nevertheless, the court held that a sale of unfinished goods was made "in ordinary course" because converters throughout the industry customarily made such sales.\(^{605}\) Thus the requirement of section 1-201(9) that the BIOC "buy from a person in the business of selling goods of that kind" is satisfied if the "sale [is] of the variety reasonably to be expected in the regular course of an on-going business."\(^{606}\)

As long as a sale is "in the ordinary course," it does not matter that it was only incidental to the seller's primary business, or that such sales were infrequently made.\(^{607}\) In Tanbro, excess unfinished goods were held in accordance with industry practice as inventory for resale. This distinguishes the case from Hempstead Bank, where the cars were not true "inventory" but capital assets of a leasing firm.\(^{608}\)

In sum, the crucial inquiry appears to have shifted away from whether the seller was literally "in the business," towards whether the sale was ordinary or predictable in the industry. If the sale can

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\(^{602}\) Id. at 39, 312 N.Y.S.2d at 321, 7 U.C.C. Rep. at 937.


\(^{604}\) Id. at 637, 385 N.Y.S.2d at 262, 350 N.E.2d at 592-93, 19 U.C.C. Rep. at 389.

\(^{605}\) Id.

\(^{606}\) Id. at 637, 385 N.Y.S.2d at 262-63, 350 N.E.2d at 593, 19 U.C.C. Rep. at 390.

\(^{607}\) Id. at 637, 385 N.Y.S.2d at 262, 350 N.E.2d at 592, 19 U.C.C. Rep. at 389.

\(^{608}\) Id. at 637-38, 385 N.Y.S.2d at 263, 350 N.E.2d at 593, 19 U.C.C. Rep. at 390.
be reasonably anticipated as a matter of industry custom, it will trigger the protection of section 9-307(1). Thus, even if leasing cars were a company's primary business, the company might be "sufficiently" involved in selling cars to bring this activity within the sweep of section 9-307(1). Moreover, even where the seller makes only one sale of a particular item, he will still have engaged in "the business of selling goods of that kind" if the item comes within a class of goods regularly sold by the seller.

b. A Shift in the Use of Collateral. The use of the collateral changes if the seller buys an item originally classifiable as "equipment," "consumer goods," or "farm products" in his hands, and later transfers the item to his inventory. For example, assume the seller gives a security interest in "equipment" to a creditor who properly perfects. Unfortunately for the creditor, the seller also regularly sells this item in the ordinary course of his business. Sooner or later the seller places this item in his inventory and sells it to an innocent buyer. Professor Gilmore suggests that the buyer in this case should defeat the secured party, in spite of the secured party's argument that the item was not in fact "inventory." We agree. Gilmore's analysis comports with the policy of section 9-307, since it protects buyers who have relied on ownership rights obtained through normal channels of commerce.

c. What Type of Interest Was Sold? Where sales within an industry typically involve the transfer of all rights to an item, a sale of a one-half interest has been held not "in the ordinary course." Thus, in Whitmire v. Keylon, a sale was deemed "out of the ordinary" because the buyer bought only a one-half interest in a boat while the seller reserved the other half for himself. Although it was customary to sell the entire interest in a boat to two buyers who each

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took a one-half interest, it was extraordinary to sell only a partial interest in the item, the seller retaining the rest.\footnote{Id. at 1207.}

Predominance of sales, a shift in the use of collateral, and the type of interest sold are only some of the factors relevant in determining whether a seller is "in the business of selling goods of that kind." It is most important to remember that, at least in close cases, courts will scrutinize the equities and policies of the statute in resolving this issue.\footnote{See, e.g., Michigan Nat'l Bank v. Grandberry, 11 U.C.C. Rep. 193 (Tenn. Ct. App. 1972) (seller of mobile home satisfied "selling goods of that kind" requirement, despite no indication of any other sales; court cited buyer's fifth grade education, appearance of trailers as being held for sale, sales tour of five trailers, and § 9-307 policy of protecting innocent buyers).}

5. Requirement 5: Did the Buyer Act in Good Faith?

If a buyer is to gain the protection of section 9-307(I), he must act in "good faith and without knowledge that the sale to him is in violation of the ownership rights" of others.\footnote{U.C.C. § 1-201(9).} Knowledge of the security interest, however, will not automatically taint the buyer with bad faith. He may still believe that the sale to him was authorized.\footnote{Under § 9-306(2), set out in text accompanying note 515 \textit{supra}, a security interest in the seller's goods ends upon authorized sale.} As long as the buyer takes the collateral unaware that the sale was unauthorized, he may take it free of the security interest.\footnote{WHITE & SUMERS, \textit{supra} note 1, § 25-13, at 941-42. U.C.C. § 9-307, Comment 2, states: Reading [sections 1-201(9) and 9-307(1)] together, it results that the buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement not waived by the words or conduct of the secured party. \textit{See also} Whitmire v. Keylon, 12 U.C.C. Rep. 1203, 1209 (Tenn. Ct. App. 1973) (knowledge that seller had obligation to pay interest on collateral not sufficient to put buyer on notice that sale of collateral violated secured party's ownership rights).} Although courts have been slow to conclude that a buyer acted in bad faith,\footnote{See, e.g., Balon v. Cadillac Auto. Co., 113 N.H. 108, 112-13, 303 A.2d 194, 196-97, 12 U.C.C. Rep. 397, 401-02 (1973) (buyer qualified as good faith purchaser of car despite purchase from friend who obtained it through shady dealings).} they have not hesitated to protect secured parties where bad faith was clearly involved.\footnote{See, e.g., Sierra Financial Corp. v. Brooks-Farrer Co., 15 Cal. App. 3d 698, 702-03, 93 Cal. Rptr. 422, 424-25, 8 U.C.C. Rep. 1125, 1128-29 (1971) (sale made in bad faith where buyer knew of security interest and purchased inventory at far below fair market value with agreement that seller could repurchase goods at market price); South Omaha Prod. Credit Ass'n v. Tyson's, Inc., 189 Neb. 702, 704-05, 204 N.W.2d 806, 808-09, 12}
Section 1-201(19) sets out the basic good faith requirement of the Code. The more exacting good faith standard applicable to merchants is provided in section 2-103(1)(b). When commercial traffic involves BIOC's who are also merchants, the resulting clash between these two good faith standards has produced inconsistent rulings. One case has held that the standard under section 1-201(19) applies regardless of the nature of the buyer. Other cases have held that where the purchaser is a merchant, the applicable standard is that of section 2-103(1)(b). Even these latter cases, however, have split on precisely what section 2-103(1)(b) requires of the merchant-buyer.

The Delaware Supreme Court's majority and dissenting opinions in Sherrock v. Commercial Credit Corp. illustrate the divergence of thought on this issue. D2, a car dealer, purchased two new cars from D1, another car dealer. D2 paid for the cars, but, by agreement, delivery was delayed for several days. During this interval, L, who held a security interest in all of D1's inventory, discovered that D1 had been selling his inventory without accounting for the proceeds. L promptly foreclosed on all of D1's inven-
tory, including the two cars that D2 had purchased. D2, claiming BIOC status, brought an action for conversion.

The crucial question was whether D2 purchased the automobiles in "good faith." The trial court concluded that the Code's drafters intended the standard to vary with the buyer. Thus, if the buyer wore the hat of a "consumer," "honesty in fact" would be the applicable standard. But if the buyer sought to wear the hat of a "merchant," he would also have to observe "reasonable commercial standards." On appeal, the majority of the Delaware Supreme Court was "unable to approve that rationale." The court relied on Article Nine's lack of a definitional reference to Article Two, the express reference to section 1-201(9) in section 9-307, the Comment's "Definitional Cross Reference" to section 1-201(9), and the express limitation of the Article Two standard to Article Two.

The dissent emphasized Code policy, rather than Code language, in reaching the opposite conclusion:

It is said by the majority that this transaction must be governed in its entirety by Article 9 and specifically by [section] 9-307(1). I think, however, this cannot be, because that section speaks of a buyer in the ordinary course of business which means, it seems to me, that he must be a purchaser not familiar with the usages of automobile dealers dealing with each other. Since [D2] is not such a buyer, but is in fact a fellow car dealer knowing of the customary usages in the trade where one dealer purchases from another, it must be considered in that light. It is, therefore, a merchant buyer, the standard of conduct for which is prescribed in [section] 2-103(1)(b) which provides that good faith in the case of a merchant means honesty in fact and "the observance of reasonable commercial standards of fair dealing in the trade." The language of section 9-307(1) clearly indicates an intention to oil the wheels of trade by protecting all honestly acquired owner-

627 U.C.C. § 1-201(19).
629 290 A.2d at 650, 10 U.C.C. Rep. at 526.
630 The court cited § 9-105(4), which refers to Article One but omits any reference to Article Two. Id. at 650, 10 U.C.C. Rep. at 523.
631 Id. at 651, 10 U.C.C. Rep. at 527.
632 Id. at 652, 10 U.C.C. Rep. at 528.
ship interests. Much can be said for imposing an objective standard of reasonableness on merchant-buyers familiar with particular goods and commercial practices. The Code’s drafters and state legislatures, however, have rejected the reasonableness requirement. Whether reform is necessary should be for them, not the courts, to determine.

6. Requirement 6: Did the Buyer Buy Farm Products?

If the buyer deals with one “engaged in farming operations” and buys goods classified as “farm products” in the seller’s hands, any pre-existing perfected security interest in the collateral will take priority. Regardless of whether the buyer otherwise qualifies as a BIOC, section 9-307(1) will not sever the security interest when he buys “farm products from a person engaged in farming operations.” The only axe the buyer has with which to cut off the security interest in the collateral is section 9-306(2). If the buyer cannot show that his purchase was authorized by the secured party, he will have to surrender the collateral.

Although a sale of farm products to a BIOC does not sever all security interests, farm products that pass from one engaged in farming operations to a farmers’ cooperative, for example, may become “inventory” in the process. In such a case, the goods are no longer “farm products,” and section 9-307 gives secondary buyers—i.e., those who buy from the cooperative—full protection.

For the Code’s definition of farm products, see note 171 supra.

Since the Code defines farm products with respect to “the debtor” (U.C.C. § 9-109(3), set out in note 171 supra), § 9-307 apparently requires that the goods qualify as “farm products” in the seller’s hands. For cases in which courts assume that the goods must be farm products in the seller’s hands, see United States v. Hext, 444 F.2d 804, 813-14, 9 U.C.C. Rep. 321, 335-36 (5th Cir. 1971); United States v. Busing, 7 U.C.C. Rep. 1120, 1123 (E.D. Ill. 1970).


See notes 515-30 and accompanying text supra.


2 GILMORE, supra note 3, § 26.6, at 694; WHITE & SUMMERS, supra note 1, § 25-13, at 940. Gilmore correctly concludes that the definition of “farm products” (see note 171 supra) makes the requirement that the seller be engaged in farming operations redundant.


See also United States v. Hext, 444 F.2d 804, 9 U.C.C. Rep. 321 (5th Cir. 1971). In Hext, a ginning company ginned a farmer’s cotton. Because it was customary to buy cotton directly from the ginning company without participation by the farmer, the court held that the purchase was not made from one engaged in farming operations, even though the farmer was the sole owner of the ginning company.
7. Requirement 7: Was the Security Interest "Created by his Seller"?

Even if a buyer establishes that he bought in the ordinary course of business, he will still lose if his seller did not create the security interest asserted against the buyer. The "created by his seller" limitation of section 9-307(1) applies to priority disputes arising from multiple sales. Consider a typical fact pattern: D1, a dealer, has given a security interest covering all of his inventory to L. If B1, a fully qualified consumer-BIOC, buys from D1, he will take the item free of L's security interest because D1 created this interest. Suppose, however, that B1 obtains independent financing from F and gives F a security interest in the item purchased from D1. Next, B1 (in violation of his security agreement with F) sells the item to D2, another dealer. Finally, D2 sells the item to B2, another fully qualified consumer-BIOC. A priority dispute ensues between F and B2, and B2 seeks victory on the strength of his BIOC status. B2, however, will not take free of F's security interest (as B1 did of L's security interest) because D2 (B2's seller) did not create this interest—B1 did. But B2 has one (low) trump card left to play. He can allege a D2-B1 agency relationship with B1 as principal and D2 as agent. If B2 can prove such a relationship, he will satisfy the "created by his seller" requirement because B1, as the principal, would qualify as his seller. But now B2 has taken himself out of section 9-307(1) again! B1 is not a person "in the business of selling goods of that kind" and hence B2 would not be a BIOC.


642 Security Pac. Nat'l Bank v. Goodman, 24 Cal. App. 3d 131, 100 Cal. Rptr. 763, 10 U.C.C. Rep. 529 (1972). If D1, whose inventory secures obligations owed to L, sells directly to D2, who then sells to B2, a wrinkle appears; D2 now qualifies as a BIOC. (In the original hypothetical, D2 was not a BIOC because B1 was not a person "in the business of selling goods of that kind." U.C.C. § 1-201(9).) A literal reading of § 9-307(1) would not change the result. D2 (B2's seller) did not create the security interest which B2 seeks to avoid, and that's the end of it; L wins. However, § 2-403(1) of the Code provides that "[a] purchaser of goods acquires all title which his transferor had." Since D2 qualifies as a BIOC, he has full title to the item free of L's security interest. When he sells to B2, he transfers full title, and § 2-403(1) will shelter B2 from the reach of the competing security interest. But hold on! Where is the authority in the Code for the proposition that an Article Two provision governs the disposition of an Article Nine priority conflict? Professors White and Summers have suggested that § 2-403 should not be used to resolve Article
Yet all is not lost. If $B_2$ successfully applies agency principles to show that $B_1$ really was his seller, victory remains possible under section 9-307(2).\textsuperscript{643} The sale is now between two "amateurs," and if $F$'s interest is an unfiled purchase money security interest,\textsuperscript{644} $B_2$ will emerge victorious.\textsuperscript{645}

In light of the policy underlying section 9-307, the "created by his seller" requirement is difficult to justify. If a goal of section 9-307(1) is to protect innocent buyers from secured creditors whose debtors pollute the stream of commerce, there is no valid distinction between $B_1$ and $B_2$. Each has purchased out of a dealer’s inventory without knowledge of adverse claims to the item.\textsuperscript{646} But while section 9-307(1) hands $B_1$ a gleaming scalpel with which to cut off the meddlesome security interest, it offers $B_2$ nothing. $B_2$ can sue $D_2$ for breach of warranty of title,\textsuperscript{647} but he gets no protection under section 9-307(1).

Perhaps this result can be justified. The "created by his seller" requirement may reflect the Code’s policy of placing the ultimate loss, as between two innocent parties, on the party who dealt most

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\textsuperscript{643} Nine priority disputes. \textit{White & Summers, supra} note 1, § 25-15, at 946. \textit{But see Skilton, supra} note 126, at 78-87.

Exclusive use of Article Nine to resolve such a dispute creates an anomalous result. The underlying goal of § 9-307(1) is to protect innocent buyers who purchase out of inventory. \textit{See text} accompanying note 646 infra. Yet we have just seen that a refusal to apply § 2-403(1) renders the secured party victorious over $B_2$ and vanquished by $D_2$. Hence the "created by his seller" language causes § 9-307(1) to protect a fellow dealer but not an innocent buyer. It is hard to believe that the drafters so intended to frustrate the purpose of § 9-307(1). On the other hand, reading a shelter principle into Article Nine would render the "created by his seller" requirement effectively useless in most cases and would do little to avoid unfair results in those cases to which it still applied. For example, in the hypothetical set out in the text, $B_2$ would still not be protected even though he bought from a dealer. If $B_1$ is not a BIOC, $D_2$, having bought from a consumer ($B_1$) rather than out of inventory, could not qualify as a BIOC. Accordingly, his buyer ($B_2$) could not be sheltered with protected BIOC status under § 2-403 even though he bought out of inventory. For a discussion of another serious shelter principle problem, see note 126 supra.

\textsuperscript{644} See notes 649-64 and accompanying text infra.

\textsuperscript{645} Filing is generally not required to perfect a purchase money security interest in "consumer goods." \textit{See U.C.C.} § 9-302(1)(d). In our hypothetical, $B_1$ is a consumer. Thus, $F$’s retention of the purchase money security interest in $B_1$’s purchase without bothering to file is in keeping with common practice. If, however, the item purchased is a motor vehicle or fixture, $F$ must file to perfect (id.), and § 9-307(2) will be useless to $B_2$ if $F$ properly perfected.

\textsuperscript{646} See note 652 and accompanying text infra.

\textsuperscript{647} \textit{See White & Summers, supra} note 1, § 25-13, at 942-43. Where the "equities" clearly favor the BIOC, courts have managed to avoid the application of this restriction. \textit{See, e.g., United States v. Hext, 444 F.2d 804, 9 U.C.C. Rep. 321 (5th Cir. 1971).
closely with the "bad guy." After the sale from B1 to D2, the two innocent parties are B2 and F. B2 will sue D2, who will sue B1, continuing up the line until the "bad guy" is forced to pay. If B1 absconds or is judgment-proof, D2, who dealt most closely with B1 in the "fraud," will bear the ultimate loss.

D. Protecting the Buyer in Amateur Sales—Section 9-307(2)

Like section 9-307(1), section 9-307(2) allows the buyer to sever a perfected security interest in goods when certain conditions have been met:

In the case of consumer goods, 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 unless prior to the purchase the secured party has filed a financing statement covering such goods.

Unlike section 9-307(1), however, the scope of this provision is so narrow that it is of little importance. Section 9-307(2) resolves priority conflicts arising from a sale of used goods by one consumer to another when the security interest in the collateral is a purchase money security interest perfected without filing.

Section 9-307(2) protects the buyer only if four conditions are satisfied:

(1) In the seller's hands the goods are either consumer goods or farm equipment . . .
(2) The buyer must have no knowledge of the security interest
(3) The buyer must buy for value and for his own family or

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648 The warranty provisions of Article Two on Sales and of Articles Three and Four on Commercial Paper and Banking Transactions are based on this notion. Proximity to the "bad guy" improves one's opportunity to examine and judge the "bad guy's" commercial responsibility. See WHITE & SUMMERS, supra note 1, § 15-1, at 495.

649 U.C.C. § 9-307(2).

650 Section 9-302(1)(d) provides:
(1) A financing statement must be filed to perfect all security interests except the following:

(d) a purchase money security interest in consumer goods; but filing is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-313 . . . .

651 For a discussion of the term "buyer," see notes 546-61 and accompanying text supra.
For several reasons, section 9-307(2) is seldom applied in practice. First, this provision and section 9-307(1) protect mutually exclusive classes of buyers. Under section 9-307(1), the goods must be "inventory" in the seller's hands. In contrast, under section 9-307(2) the goods must be "consumer goods" in the seller's hands. Second, if a financing statement has been filed naming the sold goods as collateral, the fourth condition has not been met and section 9-307(2) does not apply. Finally, unlike section 9-307(1), section 9-307(2) is inapplicable to transactions in which the buyer is a dealer or a trustee in bankruptcy, because the goods will not be used for personal or household purposes. In short, section 9-307(2) applies only to the less commercially significant sales "by amateurs to amateurs."

Since section 9-307(2) reaches only amateur transactions, it poses few interpretive problems. Consider the following hypothetical, based in part on Balon v. Cadillac Automobile Co. The parties are: S, the owner of an automobile dealership; B, a customer of S; and D, a dealer-seller and secured party. S wishes to buy one of D's automobiles for B. Posing as a consumer, S enters into an installment contract with D for the purchase of the automobile. D retains a purchase money security interest in the car but does not file, believing that under section 9-302(1)(d) he has an interest in "consumer goods" that perfects automatically upon sale.

S sells the car to B for cash and absconds with the money. When the payments fail to appear, D traces his security interest to the car in B's hands. B resists and seeks to invoke the protection of section 9-307.
In analyzing these events, we must first classify the car in S's hands. Because S is an automobile dealer and B treated him as such, there is a temptation to say that the car in S's hands was "inventory." If this is the case, D's purchase money security interest was never perfected, and B will win under either section 9-307(1) or section 9-301(1)(c). Section 9-307(2) would be wholly inapplicable since the goods were not consumer goods in the hands of the seller. To avoid this result, one must find, as did the Balon court, that S purchased as a consumer, and that the car was therefore a "consumer good" in his hands. This puts section 9-307(2) back on the blackboard with condition (1) satisfied, gives D the section 9-302(1)(d) perfected purchase money security interest he thought he had, and places the burden on B to show that the other three conditions of section 9-307(2) have been met.

Condition (2) of section 9-307(2) requires that the buyer lack knowledge of D's security interest at the time of sale. The facts of the hypothetical raise serious doubts as to B's good faith, as D would undoubtedly argue. But it is possible that B acted in good faith, and if he can convince the court of his ignorance, he will clear this second hurdle.

To satisfy the third requirement, B will have to show that he purchased the car for "his own personal, family or household purposes." Since B is a typical consumer, this condition will be easily met. But it is the final requirement—the one exclusively in D's control—that seals B's victory. If D had filed a financing statement, all would be lost for B. But D neglected to file, and B jaunts contentedly across the finish line unsullied by D's security interest.

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658 See U.C.C. § 9-302(1)(d), set out in note 650 supra. This section allows perfection without filing only if the security interest is in "consumer goods."

659 See notes 542-45 and accompanying text supra.

660 See notes 531-41 and accompanying text supra.


663 See, e.g., id. at 112-13, 303 A.2d at 197, 12 U.C.C. Rep. at 401-02.

E. Protecting the Buyer of Chattel Paper—Section 9-308

"Goods" are not the only assets that may secure a debt. Resourceful businessmen also finance their enterprises by creating security interests in intangible assets. Section 9-308 settles priority disputes involving two types of intangibles: chattel paper and instruments. Section 9-105(1)(b) defines "chattel paper" as

a writing or writings which evidence both a monetary obligation and a security interest in . . . specific goods . . . . When a transaction is evidenced . . . by such a security agreement . . . the group of writings taken together constitutes chattel paper.

The most common example of chattel paper is an installment contract attached to a security agreement.

Section 9-308 supplies the following rules:

A purchaser of chattel paper or an instrument who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in the chattel paper or instrument

(a) which is perfected under Section 9-304 (permissive filing and temporary perfection) or under Section 9-306 (perfection as to proceeds) if he acts without knowledge that the specific paper or instrument is subject to a security interest; or

(b) which is claimed merely as proceeds of inventory subject to a security interest (Section 9-306) even though he knows that the specific paper or instrument is subject to the security interest.

Section 9-308 thus governs the chattel paper counterpart to the section 9-307 inventory "goods" purchase. The adversaries in this arena are the holder of a security interest in the chattel paper and the subsequent purchaser of the paper. The opening clause of section 9-308 enumerates three of the four requirements a purchaser must satisfy to take the chattel paper free of the creditor's security interest. The purchaser must: (1) give new value, (2) take possession of the chattel paper, and (3) purchase it in the "ordinary course of his business."
The fourth requirement depends on the nature of the security interest held by the creditor. If the creditor holds a security interest in the debtor's inventory and claims that the security interest shifted to the chattel paper upon sale of the inventory, he has a "mere" proceeds claim to the chattel paper. Under section 9-308(b), there is no fourth requirement for the purchaser of this paper; he will win even if he knew of the creditor's security interest in the chattel paper. If, however, the creditor has given value directly against the chattel paper (as where the creditor has taken a security interest in the debtor's accounts receivable), the purchaser must satisfy a fourth requirement: he must take without knowledge of the creditor's security interest in the chattel paper.

Commercial Credit Corp. v. National Credit Corp. presented a tailor-made situation for the application of section 9-308. The parties involved were Mathews, the dealer (D); Edgerson, the buyer of inventory goods (B); Commercial, the retail financer and purchaser of chattel paper (F); and National, D's inventory lender (L). D sold a car to B. In return for the automobile, B signed an installment contract and gave D a security interest in the car. As proceeds of the sale, the chattel paper (i.e., the installment contract and security agreement) was unassignable under the terms of the trust agreement executed by L and D. D breached his contractual duty to L

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670 The shift is accomplished by operation of § 9-306(2). 2 Gilmore, supra note 3, § 27.3, at 730.
Clause (b) of the section deals with the case where the security interest in the chattel paper is claimed merely as proceeds—i.e., on behalf of an inventory financer who has not by some new transaction with the debtor acquired a specific interest in the chattel paper. In that case a purchaser, even though he knows of the inventory financer's proceeds interest, takes priority provided he gives new value and takes possession of the paper in the ordinary course of his business.
672 Whether the creditor financed the inventory whose sale gave rise to the chattel paper is irrelevant. U.C.C. § 9-308, Comment 3.
673 2 Gilmore, supra note 3, § 27.3, at 729-30.
674 U.C.C. § 9-308(a) & Comment 3.
676 The trust agreement provided: "Trustee shall deliver to Entruster from the proceeds of said sale, the amount of said minimum sale price. Until such delivery, Trustee shall hold the entire proceeds in trust for Entruster; separate from the funds and property of Trustee. . . ." Id. at 544, 473 S.W.2d at 878, 10 U.C.C. Rep. at 235. The court did not focus on the effect of this language, and waivered on whether the case was controlled by § 9-306(2) or § 9-308. If L had authorized the assignment of the chattel paper, its security interest in the paper would have been cut off by § 9-306(2). F alone would then have had rights in the paper, and § 9-308 would have been inapplicable. Despite the trust agreement's explicit language, the court at one point seemed to follow this route: "[A]fter
by transferring the chattel paper to $F$ in return for the discounted cash value of the paper. Justifiably outraged, $L$ brought an action against $F$ to recover the chattel paper and the corresponding right to receive future installment payments from $B$, claiming the chattel paper as proceeds of the sale of his inventory collateral. $F$, in turn, claimed the chattel paper as a protected purchaser.

1. The Inventory Lender's Section 9-308(b) Strategy

Assume the inventory lender ($L$) finds himself in this situation. He must argue that the chattel paper purchaser ($F$) failed to meet one or more of section 9-308's four requirements.

Under section 9-308(b), $L$ will first attempt to show that his claim to the chattel paper is more than a "mere" claim to proceeds. If he fails, priority will be determined by section 9-308(b), which makes the chattel paper assignee's knowledge of competing security interests irrelevant. What does it take to make $L$'s interest more than a "mere" interest in proceeds? Would it be enough if $L$ perfected his interest in proceeds by specifically including proceeds in his inventory financing statement? Apparently not. Some separate transaction is required through which $L$ acquires a specific interest directly in the chattel paper. Absent a separate transaction, there is nothing to indicate that $L$ relied substantially on the chattel paper (as $F$ did) in extending credit. Thus, fairness

[D] sold [B]'s contract to [F], [L]'s security interest would not have followed the chattel paper into the hands of [F], but would have continued in the proceeds [D] received from [F] in the sale of the chattel paper (contract). Ark. Stat. Ann. § 85-9-306." Id. at 549, 473 S.W.2d at 880, 10 U.C.C. Rep. at 299. However, the court then went on to discuss a commentator's example involving § 9-308 that it viewed as "in point." Id. at 549-50, 473 S.W.2d at 880-81, 10 U.C.C. Rep. at 299. The court thus appears not to have been tuned in to the "authorized/unauthorized" distinction.


678 Rex Financial Corp. v. Great W. Bank & Trust, 23 Ariz. App. 286, 289, 532 P.2d 558, 561, 16 U.C.C. Rep. 1155, 1158-59 (1975). Such a transaction might go like this: $L$ advances credit on $D$'s inventory; the inventory is sold; chattel paper comes to $D$ as proceeds from the sale; $D$ pays off the inventory advance, and $L$ gives $D$ a new loan secured by the chattel paper.

679 Id. White and Summers suggest that the inventory lender who merely claims "proceeds" in his financing statement should be allowed to testify as to the extent to which he relied on the chattel paper in extending credit. According to this view, if $L$ can convince the court that he "placed substantial reliance on the chattel paper," he should be allowed to meet $F$ on the more favorable turf of subsection (a) rather than subsection (b). WHITE & SUMMERS, supra note 1, § 25-17, at 951.
favors $F$; for him the "chattel paper is his main course," but for $L$ it is "merely the frosting on the cake."$^{680}$ $F$ has given new value and has taken possession of the chattel paper in the ordinary course of his business. His claim is thus superior to $L$'s "mere" proceeds claim. That $F$ may have known of $L$'s security interest in inventory and proceeds is irrelevant; $F$ will prevail even if he knew that $D$ was under a specific duty to turn the chattel paper over to $L$ as proceeds of the sale.$^{681}$

2. The Inventory Lender's Section 9-308(a) Strategy

Assume now that $L$ has more than a "mere" proceeds interest in the chattel paper. $L$'s strategy changes. He will now try to show that $F$ purchased the chattel paper with knowledge that $L$ was lending directly against it. Section 9-308(a) makes such knowledge fatal to $F$'s claim.

If $L$ had had the opportunity or the foresight to monitor $D$ closely, he would have taken possession of the chattel paper at the time of sale. $F$ then could not have taken possession of the chattel paper and, without possession, would have lost the protection of section 9-308.$^{682}$ If $L$ did not wish to take possession of the chattel paper, he still could have protected himself by indicating his security interest on the face of the chattel paper. If $L$ had done so, $F$ could not possibly have taken the paper without notice of $L$'s interest.$^{683}$

3. The Inventory Lender's Other Strategies

Under section 9-308 $L$ can always try to show that $F$ either failed to give new value for the chattel paper or failed to take possession of it in the ordinary course of his business.$^{684}$ Beyond the examples given in section 9-108—making an advance, incurring an obligation, or releasing a perfected security interest—what constitutes "new value" is not always clear.$^{685}$ Thus, $L$ may have

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$^{682}$ U.C.C., § 9-308 (opening clause).

$^{683}$ 2 GILMORE, supra note 3, § 25.5, at 669; WHITE & SUMMERS, supra note 1, § 25-17, at 950.

$^{684}$ The purchaser of chattel paper must always satisfy these two conditions to prevail under § 9-308. See note 669 and accompanying text supra.

$^{685}$ U.C.C. § 9-108 is set out in note 346 supra.
some latitude within which to disqualify $F$.

Finally, $L$ may try to show that $F$ did not take possession of the chattel paper in the ordinary course of his business. Whether $F$ took possession is easy enough to determine, but proving that $F$ did not take in the ordinary course of his business is much more difficult. The "ordinary course of business" requirement of section 9-307 is totally different from the "ordinary course of his business" requirement of section 9-308. Under section 9-307, the standard is objective; under section 9-308, it is subjective. Thus, "ordinary course of his business" means the chattel paper purchaser's normal operating procedures, not the practice normally followed in the industry. It is not enough for $L$ to show that no reasonable finance company purchases chattel paper in this manner; $L$ must show that $F$'s purchase was totally out of character. $L$'s problem, unfortunately, is that $F$, not $L$, can better determine whether the purchase was "ordinary."

A subjective test, however, works to $L$'s advantage in one respect. Because section 9-308 speaks of "his business," its terms do not cover amateurs. A purchaser may only invoke the protection of section 9-308 if he is a "professional" in the lending business. Thus, unlike the large field of BIOCs who can defeat $L$ under section 9-307, the class of $L$'s potential adversaries under section 9-308 is relatively small.

**F. The Twilight Zone Between Sections 9-307 and 9-308**

The intersection of sections 9-307 and 9-308 has produced a troublesome problem for which the Code provides no clear solution.

The facts of *Commercial Credit Corp. v. National Credit Corp.*, used as the hypothetical in the previous section, illustrate this issue. In the hypothetical, $B$ buys inventory goods from $D$. We tacitly cloaked $B$ with BIOC status, and in *Commercial Credit, B* appears in that capacity. $B$'s purchase from $D$ in the ordinary course severs $L$'s

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686 U.C.C. § 9-308 (emphasis added).
687 2 GILMORE, supra note 3, § 25.5, at 667; WHITE & SUMMERS, supra note 1, § 25-17, at 949.
689 See notes 609-10 and accompanying text supra.
691 2 GILMORE, supra note 3, § 25.5, at 667.
security interest in the inventory. The only security interest \( L \) has after the sale is a proceeds interest in the chattel paper transferred to \( F \).\(^{693}\) After section 9-308(b) comes to the rescue, \( F \) rides off into the sunset with the chattel paper safe in his saddlebag.\(^{694}\)

But what if \( B \) fails to qualify as a BIOC? If the sale to him is unauthorized under section 9-306(2), \( L \)'s security interest in the inventory collateral survives the sale, and \( F \)'s chattel paper becomes just that, a piece of paper. Section 9-308 resolves the conflict between \( L \) and \( F \) when both are tearing at the chattel paper, but does not govern the conflict between an unsevered security interest in inventory collateral and the chattel paper assignee's security interest in the buyer's goods.\(^{695}\) Section 9-312, which determines priorities among conflicting security interests, should settle this dispute. The assignee (\( F \)) will probably be protected by section 9-312's purchase money priority provisions.\(^{696}\) But one commentator, relying on the policy of section 9-308,\(^{697}\) believes that the chattel paper assignee should be protected whether or not he qualifies for purchase money priority.\(^{698}\) Otherwise, he reasons, priority will turn entirely on whether the buyer (\( B \)) qualifies as a buyer in ordinary course.\(^{699}\) The central function of section 9-308 is to allocate risks between \( D \)'s inventory lender and \( D \)'s chattel paper assignee. The status of \( B \), he argues, should not disturb that allocation:

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\text{[U]nless we say that [F] should check with every buyer directly before [he] takes the chattel paper, there is nothing that [F] did or failed to do that should make [his] position of priority dependent on the kind of buyer [B] was. The question posed by section 9-308 is what is, or should be, the ordinary course of business for a retail financer like [F].}
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\text{Did [L] bear the risk of its dealer-debtor misconduct, in case his dealer-debtor sold to a buyer in ordinary course, as far as [L's] rights against [F] are concerned? Yes, says section 9-308. It's not too much to say that [L's] risk versus [F] should likewise}
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\(^{693}\) Id. at 549, 473 S.W.2d at 880, 10 U.C.C. Rep. at 299.

\(^{694}\) Id.

\(^{695}\) Skilton, supra note 126, at 79.

\(^{696}\) U.C.C. § 9-107, Comment 1, states that “a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper.”

\(^{697}\) U.C.C. § 1-102(1) provides that “[t]his Act shall be liberally construed and applied to promote its underlying purposes and policies.”

\(^{698}\) See Skilton, supra note 126, at 79-80.

\(^{699}\) Id.
extend to the case where [B] is, unknown to [F] not a buyer in ordinary course, since [L] already bears the burden of knowing his dealer and keeping an eye on him.\footnote{700}

We reject this argument. It is one thing to grant to a good faith buyer of chattel paper priority as to the paper itself, but quite another to grant priority to an assignee of a security interest who has neither made an effort to determine the good faith of the collateral's holder, nor looked into the circumstances in which the collateral was acquired. Such precautions are required of other assignees of security interests, and we see little reason to distinguish chattel paper purchasers. Moreover, chattel paper assignees will almost always be protected by the purchase money priority rules. But in the rare cases in which section 9-312 fails to protect the chattel paper assignee, we see no reason to saddle an innocent inventory financer with the loss.\footnote{701}

G. Protecting the Holder in Due Course—Section 9-309

Section 9-309 helps resolve priority battles fought by the titans of the Code: the perfected secured creditor versus the holder in due course, the holder of a negotiable document of title, or the bona fide purchaser of a security. The section provides:

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (Section 3-302) or a holder to whom a negotiable document of title has been duly negotiated (Section 7-501) or a bona fide purchaser of a security (Section 8-301) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.\footnote{702}

\textit{Citizens Valley Bank v. Pacific Materials Co.}\footnote{703} illustrates the operation of this section. In that case the plaintiff bank had filed a financing statement covering all of D & P Construction Co.'s proceeds and accounts receivable. Rogers, one of D & P's account debtors, settled his account by issuing a promissory note to D & P as payee. D & P negotiated this note to defendant Pacific, and Rogers later paid Pacific. At trial the bank claimed a perfected

\footnote{700 Id. at 85.}
\footnote{701 For more general discussion of priorities among security interests created by different debtors, see notes 109-26 and accompanying text supra.}
\footnote{702 U.C.C. § 9-309.}
\footnote{703 263 Or. 557, 503 P.2d 491, 11 U.C.C. Rep. 1009 (1972).}
security interest in the proceeds. Pacific argued that its status as a holder in due course (HDC) entitled it to priority. Relying on the requirement that an HDC take an instrument "without notice . . . of any . . . claim to it on the part of any person," the bank argued that its filing of a financing statement gave Pacific constructive notice of its interest in the note, thus disqualifying Pacific as an HDC. As the court pointed out, however, section 9-309 explicitly provides that filing "does not constitute notice of the security interest." Pacific therefore qualified as an HDC and took the note free of the bank's security interest.

Beyond the simple rule that filing by itself does not constitute notice of a security interest, there is disagreement about the degree of knowledge necessary for disqualification under the requirement that a holder take without knowledge of conflicting claims. At one extreme, a concurring judge in Howick v. Bank of Salt Lake found that no real "claim" to an instrument subject to a security interest arises unless and until the debtor defaults on the obligation secured by the instrument. Under this view, even actual knowledge of the security interest in the instrument will not prevent a

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704 U.C.C. § 3-302(1)(c).
705 263 Or. at 558, 503 P.2d at 492, 11 U.C.C. Rep. at 1010.
707 If the facts in Citizens Valley were slightly different, the parties' claims could be analyzed under § 9-308 without regard to HDC status. Although we have discussed this section only in the context of a chattel paper purchase (see notes 665-91 and accompanying text supra), it applies equally to purchases of negotiable instruments. Assume that Pacific was a professional lender that gave new value for the note and took it "in the ordinary course of [its] business." See U.C.C. § 9-308; notes 686-91 and accompanying text supra. Under § 9-308(a), Pacific would then take priority in the note over the bank's security interest because it "ac[ed] without knowledge that the . . . instrument [was] subject to a security interest." The bank's filing of its security interest would not have provided notice to Pacific. See U.C.C. § 9-309. If we change the facts further so that the note constituted proceeds of inventory rather than accounts receivable, Pacific would prevail under § 9-308(b), even if it had notice of the bank's security interest, because the bank's claim would have been a mere claim to proceeds. See notes 677-81 and accompanying text supra. Under the pre-1972 Code a holder of a negotiable instrument did not enjoy this protection, because § 9-308 applied only to chattel paper and non-negotiable instruments. U.C.C. § 9-308 (1962 version). In jurisdictions that have adopted the 1972 amendments, the importance of § 9-308 to the professional lender cannot be overstated: he may prevail against competing perfected secured creditors without qualifying as an HDC. 3 U.L.A. 1977 Pamphlet, U.C.C. § 9-308 note (Official Reasons for 1972 Change). See text accompanying notes 713-14 infra.
709 Id. at 68, 498 P.2d at 354, 11 U.C.C. Rep. at 126.
holder from taking the instrument in due course. In contrast, Standard Acceptance Co. v. United States suggests that a security interest specifically extending to "proceeds" constitutes a "claim" to any instrument received as proceeds. Thus, a holder disqualifies himself as an HDC by taking the instrument with notice of such a security interest. A fortiori, notice of the security interest in the instrument itself will preclude the holder from holding in due course.

Article Nine supports the test formulated in Standard Acceptance. Section 9-309 expressly provides that filing is insufficient to give notice of a conflicting security interest to an HDC. We do not believe that the drafters would have specifically addressed this question if they did not fear that courts would view such notice as fatal to the would-be HDC. The rule would be unnecessary, however, under the Howick position that even actual notice of a conflicting interest is insufficient to deprive the holder of HDC status. The drafters apparently gave thought to this matter, and we conclude that they consciously decided to limit the exception regarding notice of claims to cases involving constructive, rather than actual, notice.

Stronger evidence of the drafters' intent that knowledge of the security interest should defeat HDC status appears in the commentary to section 9-308 accompanying the 1972 amendments to Article Nine. One purpose of the amendment to section 9-308 was to extend its protection to purchasers of negotiable instruments, who were previously limited to whatever protection was available under section 9-309. Elaborating on this theme, the comment states: "The holder of a negotiable instrument had protection only if he achieved the holder in due course status referred to in section 9-309, which status would not be achieved if the holder had knowledge of a conflicting proceeds claim." This language directly

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710 Id.
711 342 F. Supp. 45, 11 U.C.C. Rep. 37 (N.D. Ill. 1972). In Standard Acceptance the debtor sold collateral subject to a security interest that specifically included "proceeds," and received payment in the form of a check. The debtor negotiated the check to the Internal Revenue Service to discharge a federal tax obligation. Although the court dismissed for lack of subject matter jurisdiction, it went on to provide this gratuitous analysis: When the collateral was sold, the security interest shifted to the check as "proceeds" under § 9-306(3)(a). Because the IRS had actual knowledge of the security interest, it could not claim protection as an HDC.
712 Id. at 48 n*, 11 U.C.C. Rep. at 40 n*.
714 Id.
supports the *Standard Acceptance* view. \(^{715}\) This, coupled with the implication of the actual language of section 9-309, leads us to reject the *Howick* concurrence and accept *Standard Acceptance* as the correct interpretation. \(^{716}\)

H. *Goods Returned to Inventory—Section 9-306(5)*

Rather than requiring the buyer to obtain outside financing, a seller may agree to sell on an installment plan, reserving a security interest in the goods until they are paid for. The seller will then convert the buyer's future installment payments into ready cash by discounting the receivables. If the buyer defaults, the seller or the transferee of the receivables will repossess the goods to satisfy his claim. Once repossessed, the goods may again become subject to the security interest of the seller's inventory lender. \(^{717}\) If the goods are then sold to a second buyer, even more claims will arise. Section 9-306(5) establishes priority rules for sales involving both a

\(^{715}\) Furthermore, *Standard Acceptance* will not impair the free flow of negotiability, because § 3-105(2)(a) makes it difficult to convey notice that the instrument is itself collateral without destroying the instrument's negotiability. A negotiable instrument must "contain an unconditional promise or order to pay." U.C.C. § 3-104(1)(b). The promise is unconditional even though the instrument itself "stated that it arises out of a separate agreement." U.C.C. § 3-105(1)(c). But the promise is conditional if the instrument "states that it is subject to or governed by any other agreement." U.C.C. § 3-105(2)(a). Section 3-105(1)(e) does not affect this problem, since this provision merely ensures that an instrument is not rendered conditional if it states that it is secured; in this case the instrument itself is security. Thus, any debtor or secured creditor seeking to impart notice of a security interest by placing explicit language in the instrument will face this dilemma: the more general the language is made to ensure negotiability under § 3-105(1)(c), the greater the risk that it will be found insufficient to notify subsequent holders that the instrument is subject to a security interest; the more specific the language is made to notify subsequent holders, however, the greater the chance that negotiability will be destroyed under § 3-105(2)(a). The net result is that knowledge of a security interest will play a significant role only in isolated instances where the holder has acquired peculiar knowledge of the commercial circumstances surrounding his receipt of the instrument. Because the holder in such cases will presumably take the instrument with a heightened awareness of the significance of his action, we see no reason to cloak him with HDC status.

\(^{716}\) The *Standard Acceptance* view causes an interesting result under § 9-301(1)(c) when a dispute arises between a non-HDC and an unperfected secured creditor. If the holder lost his HDC status because he had knowledge of the security interest in the instrument, he not only loses the protection of § 9-309 but that of § 9-301(1)(c) as well. To prevail under § 9-301(1)(c), the holder must take the instrument "without knowledge of the security interest." U.C.C. § 9-301(1)(c). However, if the holder does not qualify as an HDC because he violated one or more of the requirements under § 3-302, he loses only the protection of § 9-309; as long as he can show that he gave value and took the instrument without knowledge that it was subject to a security interest, he will defeat the unperfected secured creditor. Thus, § 9-301(1)(c) distinguishes between non-HDCs, and favors those who lost their HDC status for reasons unrelated to the Article Nine security interest.

\(^{717}\) See U.C.C. § 9-306(5)(a).
transfer of receivables and a later return or repossession of the goods:

If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:
(a) If the goods were collateral at the time of the sale, for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.
(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under Section 9-308.
(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).
(d) A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.\textsuperscript{718}

Upon the repossession or return of goods, section 9-306(5) does four things: (1) it reinstates the inventory lender's security interest; (2) it shifts the transferee's security interest from the chattel paper or account to the returned goods; (3) it fits all the security interests in the goods into one of four categories: a subsection (a) claim, a subsection (b) claim, a subsection (c) claim, or a subsection (d) claim; and (4) it draws on other Article Nine provisions to resolve priority disputes involving these claims.

Courts have had problems applying section 9-306(5). Some have failed to realize that a repossession has taken place;\textsuperscript{719} others

\textsuperscript{718} U.C.C. § 9-306(5).
have incorrectly classified the competing interests;\(^{720}\) and still others have overlooked security interests upon which a party could have prevailed.\(^{721}\) Despite this sloppy analysis, however, most courts have somehow arrived at correct results. Before describing their struggles with section 9-306(5), our analysis turns to the classification of claims under that section.

1. *The Inventory Lender's Claim—Section 9-306(5)(a)*

Subsection (a) merely codifies the inventory lender's and seller's expectations: the lender extended credit and retained a security interest, believing that proceeds of the inventory's sale would retire the seller's indebtedness. But if the goods are returned to the seller because of the buyer's rescission or default, the basis for any expectancy in proceeds evaporates. Thus, the lender's security interest reattaches to the returned goods with the same effect it had prior to the sale.\(^ {722}\) If the security interest was originally perfected by possession, the lender must again take possession of the returned goods or must file to preserve his perfected status; if he initially perfected by filing, he need only make sure that his financing statement has not lapsed.

Before a subsection (a) claim can arise, the security interest must have covered the goods at the time of sale and must have secured a debt still outstanding when the goods are returned to the seller.\(^ {723}\) If the goods were not collateral at the time of sale, or if the indebtedness secured by the goods has since been paid off, a security interest in the returned goods cannot reattach under subsection (a). If the returned or repossessed goods go back into the seller's inventory, the inventory lender will often be able to assert a subsection (d) claim based on a security interest covering the seller's after-acquired property.\(^ {724}\) To do so successfully, however,


\(^ {722}\) Although the opening clause of section 9-306(5) requires a transfer of receivables, Gilmore has suggested that the security interest should reattach even if no receivables have been transferred. He explains the requirement as stemming from the drafters' preoccupation with priority disputes between the inventory lender and the receivables transferee. 2 GILMORE, supra note 3, § 27.5, at 737.

\(^ {723}\) Id.

\(^ {724}\) See U.C.C. § 9-204(1). Inventory financiers often maintain ongoing relationships with dealers, and take security interests in all of the dealer's after-acquired inventory. Regardless of § 9-306(5)(a), this security interest in the debtor's inventory will reattach to
the inventory lender must establish that the seller has "rights in the collateral."\textsuperscript{725}

2. \textit{The Chattel Paper Transferee's Claim—Section 9-306(5)(b)}

As a matter of commercial practice, the seller and his chattel paper transferee usually agree that if the goods giving rise to the chattel paper are returned, they will replace the useless chattel paper as the transferee's security.\textsuperscript{726} But even without an agreement, section 9-306(5)(b) automatically works this shift in interests.

To resolve conflicts arising between an inventory lender claiming under subsection (a) and a chattel paper transferee claiming under subsection (b), section 9-306(5) looks to the priority rules of section 9-308.\textsuperscript{727} The result is that the party who would have received priority in the chattel paper takes priority in the returned goods, regardless of whether either party has taken steps to perfect his interest in the goods.\textsuperscript{728} It is only when the transferee takes on a subsection (a) claim that perfection is irrelevant. Indeed, the subsection (b) security interest must be perfected to take priority over goods when the buyer rejects them and the goods are returned to inventory. Although it is clear that this reading of the statute reduces substantially the importance of the priority rules of subsections (b) and (c), we find nothing in the statute that destroys security interests arising outside § 9-306(5).

\textsuperscript{725} If the dealer lacked authority to repossess the collateral, or if he was merely the agent of the receivables transferee, the transferee can argue that the dealer, in repossessing, obtained "no rights in the collateral." According to this reasoning the dealer would be unable to create other security interests in the returned goods (see U.C.C. § 9-203(1)(c)), and creditors claiming the repossessed collateral would be subordinated to the receivables transferee. See \textit{Mother Lode Bank v. General Motors Acceptance Corp.}, 46 Cal. App. 3d 807, 120 Cal. Rptr. 429, 16 U.C.C. Rep. 1131 (1975). In \textit{Mother Lode} the court held that the financing company with a security interest in the dealer's inventory was not entitled to repossessed trucks in the dealer's possession as against the retail financier. The retail financier had repossessed the trucks and had returned them to the dealer for the dealer's repurchase, as required by their recourse agreement. The court held that the dealer had no rights in the collateral to which the inventory financier's interest could attach, because the dealer had failed to repurchase the trucks from the retail financier. \textit{Id.} at 813-14, 120 Cal. Rptr. at 432-33, 16 U.C.C. Rep. at 1137-38.

\textsuperscript{726} See \textit{W. HAWKLAND}, supra note 114, ¶ 2.32020702, at 731.

\textsuperscript{727} Section 9-306(5)(b) states that the transferee's claim is superior to the subsection (a) claim "to the extent that the transferee of the chattel paper is entitled to priority under Section 9-308." By negative implication, the subsection (a) claim is superior to the extent that the transferee is not entitled to priority under § 9-308. No case specifically endorses this negative implication, and a court might conclude that if the chattel paper transferee does not take priority under § 9-308, then § 9-306(5)(b) does not apply. That would transport the conflict between the subsection (a) and subsection (b) claims out of § 9-306(5) and into § 9-312. At that point perfection in the returned goods would not only become relevant, but probably determinative.
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any other claim. Clearly the chattel paper transferee must perfect his interest in the returned goods if he is to obtain maximum protection. Even though the security interest in the chattel paper shifts to the returned goods, perfection of the interest in the chattel paper does not automatically carry over to the goods. If the interest in the chattel paper was perfected by possession, the transferee must either take possession of the returned goods or file. If the transferee filed as to the chattel paper, his perfected status with respect to the goods depends on what the financing statement covers; if the financing statement covers only the paper, and not the returned goods, the security interest in the goods must be perfected. If the financing statement does cover the returned goods, the transferee's perfected status simply continues in the goods. Because the chattel paper assignee will frequently have no way of knowing when goods are returned to the seller, he should always include the goods in his financing statement covering the chattel paper. In addition, unless the transferee repossesses the goods himself, he always runs the risk that his perfected status will lapse.

3. The Account Transferee's Claim—Section 9-306(5)(c)

With one exception, the foregoing analysis of chattel paper transfers also applies to transfers of accounts. The exception, however, is important. Unlike the chattel paper transferee's security interest, the account transferee's interest in the returned goods is always inferior to the inventory lender's subsection (a) claim. Although the Comment to section 9-306 suggests that priority disputes between unperfected subsection (a) claimants and transferees of accounts or chattel paper should be decided under section 9-312, we find nothing in section 9-306 to support this position.

731 U.C.C. § 9-306, Comment 4; 2 Gilmore, supra note 3, § 27.5, at 737.
732 2 Gilmore, supra note 3, § 27.5, at 738.
733 Id.
734 Id. Professor Gilmore has suggested that, to mitigate the transferee's problems, the returned goods should be deemed "proceeds" of the chattel paper. Then, under section 9-306(3), the transferee would have 10 days after the debtor's "receipt of the proceeds" to perfect his interest in the goods. Id. at 737. We concur. Gilmore's analysis conforms to the parties' expectation that the goods will provide substitute security for the "destroyed" chattel paper.
735 U.C.C. § 9-306(5)(c). Of course, the accounts assignee may protect himself by obtaining a subordination agreement. See U.C.C. § 9-316.
Section 9-306(5)(c) subordinates the subsection (c) claim to "a security interest asserted under paragraph (a)." Because the priority rule of subsection (c) does not distinguish between unperfected and perfected security interests, we reject the Comment's mysterious suggestion. Hence, as under subsection (b), perfection is irrelevant to priority disputes resolved under subsection (c).

4. Claims of the Seller’s Purchasers and Creditors—
Section 9-306(5)(d)

Whenever the conflict over returned goods involves a subsection (d) claimant, section 9-306(5) does not explicitly set priorities. It merely provides that the interest of the receivables transferee must be perfected to have any effect in priority battles against subsection (d) claimants. If the subsection (d) claimant is a “creditor” of the seller, the parties must resort to sections 9-301 or 9-312; if the subsection (d) claimant is a “purchaser” of the returned goods, the parties must resort to sections 9-301(1)(c) or 9-307.737 The receivables transferee does not have to perfect his interest in the returned goods for protection against the subsection (a) inventory lender,738 since the latter is not a subsection (d) “creditor” or “purchaser.”739

5. The Operation of Section 9-306(5)—A Case in Point

Commercial Credit Corp. v. National Credit Corp.740 illustrates the operation of section 9-306(5). National, an inventory lender, financed automobiles for Mathews, a dealer, retaining a security

736 See note 734 supra.
738 See note 728 and accompanying text supra.
739 2 GILMORE, supra note 3, § 27.5, at 739; O. SPIRACH, SECURED TRANSACTIONS 109 (1963); Skilton, supra note 126, at 83 n.199. Section 9-306(5)(b) invokes the machinery of § 9-308 to resolve the conflict between the subsection (a) lender and the chattel paper transferee. Bringing all subsection (a) claimants within the class of subsection (d) “creditors” would short circuit that scheme entirely.
interest in all of Mathews' inventory. Mathews sold a car out of inventory to Morgan on the installment plan, and transferred Morgan's chattel paper to Commercial, a retail financer. Upon Morgan's default, Commercial repossessed the car. In the ensuing priority conflict, Commercial claimed the car on the strength of its chattel paper, while National relied on its security interest in the dealer's inventory.

Without referring to section 9-306(5), the court analyzed the case as if the only security interests involved were those arising from the chattel paper. The real question, however, was not who had the right to receive payments from the buyer; the buyer had defaulted. Rather, the issue was who was entitled to the repossessed car. Under section 9-306(5)(b), Commercial held a security interest directly in the repossessed car against the dealer. Under section 9-306(5)(a), National's security interest in the car reattached at the time of repossession. Thus section 9-306(5) should have determined who had priority as to the car. Subsection (b) provides that these two interests in the automobile should be ranked according to the priority scheme provided in section 9-308 for competing interests in chattel paper. Because Commercial had priority over National in the paper, Commercial was entitled to the car.

The court drew attention to National's lack of a perfected security interest in the car resulting from the lapse of its financing statement. What effect this factor had on the court's decision is unclear, but under the priority rule of section 9-306(5)(b) perfection is irrelevant. Even if National's perfected status had never lapsed, Commercial still would have prevailed because—and only because—Commercial would have taken priority as to the chattel

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741 Id. at 708, 473 S.W.2d at 885, 10 U.C.C. Rep. at 291-92. In analogous cases other courts have also failed to realize that a repossession had occurred, and that the conflict directly concerned the repossessed goods. In Bank of Beulah v. Chase, 231 N.W.2d 738, 17 U.C.C. Rep. 259 (N.D. 1975), for example, the court concluded on similar facts that "the conflicting security interests are not in the [repossessed] motor vehicle itself, but rather in the [chattel paper] which carried the right to repossession of the motor vehicle." Id. at 744, 17 U.C.C. Rep. at 265. Such a view is technically incorrect: § 9-306(5) gives certain claimants security interests directly in returned goods, and only in certain situations will the priorities in the chattel paper determine the priorities in the repossessed goods. For example, if the chattel paper transferee competes with a § 9-306(5)(d) "creditor" or "purchaser," priority in the chattel paper is irrelevant; if the chattel paper transferee is to prevail, he must assert his security interest in the repossessed goods.

742 U.C.C. § 9-306(5)(b).


744 See 251 Ark. at 704, 707-08, 473 S.W.2d at 883, 884-85, 10 U.C.C. Rep. at 289, 291-92.
paper. Only if National had qualified as a subsection (d) "creditor" would Commercial have had to perfect its interest in the reposessed car. But because Commercial, rather than Mathews, repossessed the car, it was never returned to Mathews' inventory. Hence, National's security interest in Mathews' inventory never reattached to the repossessed car.

6. The Effect of Section 9-306(5) on Security Interests Arising Outside that Section

Courts have consistently misapplied section 9-306(5). But the drafters must share the blame. Section 9-306(5)'s overly simplistic rules open a Pandora's box of questions. The most significant unanswered question is the effect section 9-306(5) has on security interests created outside that section, but held by section 9-306(5) claimants.

a. The Survival of the Chattel Paper Assignee's Purchase Money Security Interest. Prior to the buyer's return of the goods to the seller, the chattel paper transferee has two security interests: a security interest in the chattel paper itself against the seller, and a purchase money security interest in the goods against the buyer. When the buyer returns the goods, what is the effect of section 9-306(5) on the transferee's purchase money security interest? Does section 9-306(5), by shifting the chattel paper interest to the returned goods, preclude the transferee from tracing his purchase money security interest through the buyer to those goods if he cannot collect from either the seller or the buyer? We think not. Nothing in the language of section 9-306(5) limits the chattel paper transferee to his interest therein, and it would be erroneous to read language granting security interests as simultaneously destroying others. Nevertheless, the seller's other creditors might present the following argument: The two interests existing in favor of the chattel paper transferee after the goods have been returned exist against two different debtors. The purchase money security interest applies against the buyer, the chattel paper interest against the seller. Section 9-312 will rank in priority only those claims existing against a common debtor, i.e., the seller. Because section

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745 U.C.C. § 9-306(5)(d). Following the court's reasoning, Commercial in fact perfected when it took possession of the car upon Morgan's default. See 251 Ark. at 706, 473 S.W.2d at 884, 10 U.C.C. Rep. at 290.

746 See U.C.C. § 9-107. Comment 1 to § 9-107 explains that "a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper."
9-306(5)(b) explicitly makes the chattel paper transferee a creditor of the seller, the transferee may assert only his interest under section 9-306(5)(b).

We reject this argument. It is not settled that section 9-312 resolves only priority disputes involving a single debtor. Assuming that the return to the seller was unauthorized, the chattel paper transferee should be allowed to assert his purchase money security interest in the returned or repossessed goods as if section 9-306(5) were nonexistent. If the retail financer had obtained his purchase money security interest by advancing money directly to the buyer, rather than by accepting transfer of the chattel paper from the seller, he could unquestionably assert his purchase money interest against the seller's other creditors. Section 9-107, which defines purchase money security interest, does not distinguish between a security interest obtained by lending to a buyer, and a security interest obtained by accepting a transfer of chattel paper. Thus we see no reason for treating the purchase money security interest of the chattel paper transferee any differently simply because section 9-306(5)(b) gives him an additional interest in the goods.

Providing the chattel paper transferee with a remedy on either his section 9-306(5)(b) interest or his purchase money security interest subjects the return and repossession cases to a double-barreled analysis. Such an analysis will not apply, however, if the buyer's secured party “authorized” the buyer's return or the seller's repossession. If the buyer returns the goods in an attempt to rescind the sale, or if he defaults on his payments, the chattel paper transferee will find it difficult to claim that he did not authorize the return of the goods to the seller. The buyer, in our opinion, is always “authorized” to pursue whatever remedies he has, and is always “authorized” to surrender the goods when he defaults. In many cases, therefore, the chattel paper transferee will be deemed to have authorized the return or repossession and will consequently forfeit his purchase money security interest. But

747 See notes 121-26 and accompanying text supra.
748 See U.C.C. § 9-306(2).
749 See U.C.C. § 9-107, Comment 1.
750 See U.C.C. § 9-306(2); notes 515-30 and accompanying text supra. This analysis assumes that a return or repossession constitutes a “disposition” of collateral. See U.C.C. § 9-306(2).
751 Of course, repossession by the seller may not be authorized, in which case the purchase money security interest would persist.
if the chattel paper transferee can show that the return was not authorized, his purchase money interest may be his ticket to victory. This is exactly what happened in *International Harvester Credit Corp. v. Commercial Credit Equipment Corp.*

International Harvester (International) and Commercial Credit (Commercial) had each filed a financing statement covering all of the dealer's inventory, International having filed first. Dealer sold a skidder out of inventory to Miller in return for an installment note and a purchase money security interest in the skidder. Dealer then transferred the chattel paper to Commercial, which filed within ten days after Miller took possession of the skidder. Somehow the skidder came into the possession of Lewis, who traded it in when he purchased a new skidder from Dealer. Dealer received the new skidder from International in exchange for a note secured by the traded skidder. Shortly after the Dealer's sale to Lewis, Miller stopped making payments to Commercial. Commercial then looked to the traded skidder for satisfaction of Miller's obligation. Using the analysis proposed above, Commercial could have asserted either its section 9-306(5)(b) interest or its purchase money security interest in the traded skidder.

Under section 9-107, Commercial's security interest in the skidder qualified as a purchase money security interest. Miller's disposition of the skidder—allowing Lewis to gain possession—was unauthorized; under section 9-306(2), Commercial's purchase money interest continued in the skidder after its return to the dealer. Thus the court invoked section 9-312 to subordinate International's perfected security interest, obtained after the old skidder was traded in, to Commercial's purchase money security interest.

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753 To acquire special protection under § 9-312(4), a creditor with a purchase money security interest in goods other than inventory must perfect within 10 days after the debtor takes possession. See notes 200-02 and accompanying text supra.
754 In a later case, *International Harvester Credit Corp. v. Associates Financial Servs. Co.*, 133 Ga. App. 488, 211 S.E.2d 430, 16 U.C.C. Rep. 396 (1974), the Georgia court cryptically stated in a footnote that *Commercial Credit* should have been decided under § 9-306(5). *Id.* at 492 n.1, 211 S.E.2d at 433 n.1, 16 U.C.C. Rep. at 400 n.1. The court provided no reason for this dictum, however, and we believe the *Commercial Credit* court's reliance on § 9-312(4) was proper. See notes 747-49 and accompanying text supra.
755 125 Ga. App. at 479, 188 S.E.2d at 112, 10 U.C.C. Rep. at 198; U.C.C. § 9-107(a) & Comment I.
756 See 125 Ga. App. at 477-78, 188 S.E.2d at 111-12, 10 U.C.C. Rep. at 197.
757 *Id.* at 479, 188 S.E.2d at 113, 10 U.C.C. Rep. at 198-99.
The purchase money security alternative worked for Commercial in this case because Miller's transfer of the skidder to Lewis was unauthorized. If Miller himself had rescinded the sale and returned the skidder, or if Dealer had repossessed when Miller defaulted, the skidder's return to Dealer might well have been "authorized." In this event, section 9-306(2) would have severed Commercial's purchase money security interest. Commercial could then have asserted only its section 9-306(5)(b) security interest.

b. Survival of the Inventory Financer's Security Interest in the Dealer's After-Acquired Property. Assume that Commercial failed to file its purchase money security interest within section 9-312(4)'s ten-day grace period. Or, better yet, assume that the court will not allow Commercial to trace its security to goods in the dealer's hands. Can Commercial still claim priority? Section 9-306(5)(b) grants Commercial a security interest in the traded skidder against the dealer. This interest is doubly perfected. Not only had Commercial filed a financing statement covering all of Dealer's inventory, it had filed a financing statement signed by Miller when the original sale was made.

The pivotal question thus becomes whether International is a claimant under subsection (a). If International is such a claimant, Commercial prevails under subsection (b); having taken the chattel paper for value in the ordinary course of its business, Commercial would take precedence as to the chattel paper over International, whose claim to the paper is, at best, a mere claim to proceeds from the Miller sale.758 But International is not a subsection (a) claimant. International comes under subsection (a) only if the skidder was collateral at the time of its sale, and the indebtedness secured by the skidder was still unpaid when the skidder was returned. Although the skidder was "collateral at the time of the sale,"759 the indebtedness it secured was apparently discharged. International took the returned skidder as security for a new indebtedness —credit extended by International to the dealer on the new skidder sold to Lewis. Thus, International qualifies as a perfected subsection (d) creditor; International's financing statement covers the returned skidder as after-acquired property in the hands of the dealer.

By operation of section 9-306(5)(b), Commercial holds a perfected security interest in the skidder against the dealer. By itself,

758 See U.C.C. § 9-308(b).
however, section 9-306(5) does not resolve conflicts between a perfected subsection (b) claimant and a subsection (d) creditor; resort must be made to section 9-312(5). A simple application of that section gives priority to International, for International was the first to file.

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