



UNC
SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 44 | Number 3

Article 8

4-1-1966

Article Nine: Secured Transactions -- Perfection and Priorities

Richard M. Smith

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

Recommended Citation

Richard M. Smith, *Article Nine: Secured Transactions -- Perfection and Priorities*, 44 N.C. L. REV. 753 (1966).

Available at: <http://scholarship.law.unc.edu/nclr/vol44/iss3/8>

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

ARTICLE NINE: SECURED TRANSACTIONS— PERFECTION AND PRIORITIES

RICHARD M. SMITH*

SUMMARY OF CONTENTS

PERFECTION	754
I. Filing	756
II. Taking Possession of the Collateral	763
III. "Automatic" and "Temporary" Methods of Perfection	768
THE CONSEQUENCES OF "PERFECTION"—PRIORITIES	780
I. The Priority of the Lien Creditor	781
II. The Priorities of "Buyers," "Purchasers," and "Transferees"	783
III. Priorities Between Secured Parties	794
IV. Special Priority and Perfection Rules	802

At this time in North Carolina the well-informed attorney with considerable experience in dealing with various types of security interests could at best hazard an educated guess as to the relative priorities of a conditional sales contract and a trust receipt; of a chattel mortgage and lien on accounts receivable or factor's lien. There has been no unified or integrated statutory scheme and only scanty judicial opinion defining the relationship between the myriad statutes that have been enacted through the years in response to specific need. The purpose of Part 3 of Article 9, achieved through borrowing from the Federal Bankruptcy Act, prior statutes such as the Uniform Trust Receipts Act, and the common-law background, is to provide for this default in existing law while at the same time establishing a new set of rules of priority designed to take into account exceptions necessitated by the commercial settings of particular transactions. It is in Part 3 of Article 9 that the significance of the definitions contained in sections 9-105, 9-106 and 9-109 becomes most apparent. One cannot solve with assurance the problems of priority without knowing within which of the definitions the collateral fits. If this is kept in mind, the apparent complexity of the Uniform Commercial Code priority rules can be understood, if not completely appreciated. Also it should be understood that, basically,

* Assistant Professor of Law, University of North Carolina at Chapel Hill; Consultant to the North Carolina Legislative Council for Article 9.

Article 9 is complex only where the transactions to which the rules apply are complex. The simple transactions, with rare exception, are subject to simple priority rules that lead to results generally consistent with the existing law. However, this is not to say that the priority rules leave no unanswered questions, are without some ambiguities, and are always based upon the soundest possible policies. Such deficiencies are to be expected in any statute of this magnitude and Article 9 is no exception, although it probably has fewer deficiencies, at this time, than any other secured transactions statute in the past proposed or enacted. The purpose of this paper is to examine the various priority rules of Article 9 and to relate them, insofar as is thought useful, to the existing North Carolina law.

PERFECTION

"Perfection" is the word that, under Article 9, signifies the secured party's status of protection from intervention by the subsequently acquired rights of third parties.¹ However, it is a term of art; no emotional overtones should be attached to it and it has precisely the significance reasonable interpretation of Article 9 attributes to it. Holding a perfected security interest under Article 9 will be the rough equivalent of holding a properly recorded conditional sales contract or chattel mortgage under present North Carolina law, but such a simple comparison should not be relied upon too extensively. As will be seen, perfection is not an absolute concept; it does not confer absolute protection² and it is not the exclusive key to priorities of conflicting claims.³ Nevertheless, the time and method of perfection are the points at which initial inquiry must be made in dealing with most priority problems.

Subsection 9-303(1) provides that perfection is achieved when the security interest has "attached and when all of the applicable steps required for perfection have been taken."⁴ The reason for this

¹ "Perfection" has long had essentially the same usage under the Federal Bankruptcy Act §§ 60(a)(2), 67(d)(5), 30 Stat. 562, 564 (1898), as amended, 11 U.S.C. §§ 96(a)(2), 107(d)(5) (1964).

² Several types of subsequent purchasers of the collateral will take priority over the perfected security interest, see *infra* pp. 787-93, as will the holder of a possessory lien created by operation of law. G.S. § 25-9-310.

³ The time of "filing," as distinguished from the time of "perfection," determines priorities between two consensual security interests that are perfected by filing. G.S. § 25-9-312(5)(a). See *infra* pp. 795-97.

⁴ G.S. § 25-9-303(1). A security interest "attaches" when "there is agreement . . . that it attach and value is given and the debtor has rights in the collateral." G.S. § 25-9-204(1).

apparent inanity is that it is impossible, because of the several methods of perfection permitted under Article 9, to state with a higher level of abstraction a general rule regarding the time of perfection. At least three factors justify more than one method of perfection. Acts that will impart sufficient notice with reference to one type of collateral will impart no or insufficient notice of the secured party's interest in another type of collateral. It is in most cases proper and desirable to give the secured party and debtor some freedom in choosing the method by which notice is given. And some types of security interests are so transient that traditional methods of perfection—recording and possession in the secured party—are not commercially feasible while protection of the interest is commercially desirable. Article 9 sanctions three basic methods of perfection. Depending upon the type of collateral involved or upon certain characteristics of the security interest and the consideration therefor,⁵ the secured party may perfect by (1) filing a financing state-

⁵ The following table illustrates the basic distinctions and permissible methods of perfection. It is offered with the caveat that it does not tell all.

Type of Collateral	<i>Method of Perfection Permitted</i>		
	Filing	Possession	Automatic
1. Consumer Goods	yes	yes	yes, if purchase money security interest in collateral other than a motor vehicle or a fixture. § 9-302(1)(d).
2. Inventory	yes	yes, but would probably lose character as inventory.	no
3. Farm Products	yes	yes	no
4. Equipment	yes	yes	only if "farm" equipment not a fixture having purchase price of less than \$2500 and security interest is for purchase money. § 9-302(1)(c).
5. Instruments			} yes, for 21 days after attaching it for new value under written agreement. § 9-304(4). Also for 21 days when delivered over for specified purposes. § 9-304(5).
(a) non-negotiable	no	yes	
(b) negotiable	no	yes	
6. Documents			probably for 21 days when delivered for specified purposes. § 9-304(5).
(a) non-negotiable	no	yes	
(b) negotiable	yes	yes	same as for instruments above.
7. Chattel Paper	yes	yes	no

ment, (2) taking possession of the collateral, or (3) doing nothing other than creating a security interest that has attached.⁶

In some commercial transactions each of these methods of perfection will have been used at some stage in the process of acquisition of the security interest and transfer of possession to the collateral to the debtor. In such circumstances the necessity of subsection 9-303(2) is apparent. That subsection provides that if the security interest is once perfected and subsequently it becomes necessary or desirable to perfect by a different method, the security interest shall be deemed to have been continuously perfected provided that there was no time after initial perfection during which the security interest was unperfected. This dates the time of perfection, where such is important to priority, from the time of initial perfection rather than the time the last method of perfection was taken.

I. FILING

A. When Permitted

Public recordation or filing of evidence of the security interest has long been the legislative solution to the problem of giving adequate notice of security interests and other transfers to interested third parties. Article 9 continues this solution with some refinements and distinctions not heretofore apparent in North Carolina. Filing a financing statement in accordance with Part 4 of Article 9 is a permissible method of perfection of any security interest in "goods,"

8. Accounts	yes	no	} only if the transfer and others from the same debtor do not constitute a "significant part" of debtor's outstanding ac- counts. § 9-302(1)(e).
9. Contract Rights	yes	no	
10. General Intangibles	yes	no	no

⁶ This third "method" will often be referred to in this article as "automatic" perfection. This collective reference is not intended to imply that "automatic" perfection uniformly gives the same degree of protection or is permitted for the same reasons. When describing perfection of a security interest in instruments and negotiable documents under G.S. § 25-9-304(4), the adjective "temporary" should be added. The temporary perfection after turnover of instruments or documents for specific purposes under G.S. § 25-9-304(5), although for convenience discussed under the general heading of automatic perfection, cannot be properly described as "automatic."

other than motor vehicles which are required to be registered⁷ and security interests subjected by United States statute to national registration.⁸ Filing may also be used to perfect a security interest in chattel paper and negotiable documents.⁹ Perfection of a security interest or other transferee's interest in accounts, contract rights or general intangibles can be achieved exclusively by filing. The filing of a financing statement or security agreement covering "instruments" will not result in perfection.¹⁰

B. Mechanics of Filing

Article 9 adopts a "notice" filing system, a type that has been in effect in North Carolina under the Uniform Trust Receipts Act¹¹ and the Factor's Lien Act.¹² The objective of such a system is to apprise interested third parties of the fact of possible adverse interest, leaving to inquiry of the debtor the ascertainment of the extent and terms of existence of the interest. The objective can be adequately achieved through something less than the present requirement of recording the complete conditional sales contract or chattel mortgage agreement. Article 9 requires filing of a "financing statement," which need contain only (1) the names and addresses of the debtor and the secured party,¹³ (2) a description of the collateral,

⁷ G.S. § 25-9-302(3)(b). The security interest in a motor vehicle normally will be noted on the certificate of title. N.C. GEN. STAT. § 20-58 (1965). A security in a vehicle that is exempt from registration by N. C. GEN. STAT. § 20-51 (1965) must be perfected under the provisions of Article 9 applicable to the class of collateral.

⁸ G.S. § 25-9-302(3)(a). *E.g.*, Security interests in aircraft can be perfected only by filing with the Federal Aviation Agency. Federal Aviation Act, 72 Stat. 772 (1958), as amended, 49 U.S.C. § 1403 (1964). See G.S. § 25-9-302, comment 8.

⁹ G.S. § 25-9-304(1).

¹⁰ *Ibid.* This exception is justified on the ground that the commercial use of "instruments" as collateral does not contemplate possession being in the debtor for a long period of time; therefore, need for permitting perfection by filing is not apparent. G.S. § 25-9-304, comment 1. The reason why the same cannot be said for negotiable documents is not stated. However, the fact that the negotiable document is often the initial "form" in which the secured party finds goods in which he will claim a security interest after the document has been redeemed offers some basis for permitting a single early filing that will result in perfection before and after redemption of the document.

¹¹ N.C. GEN. STAT. §§ 45-46 to -66 (Supp. 1965).

¹² N.C. GEN. STAT. §§ 44-70 to -77 (Supp. 1965).

¹³ The address of the secured party must be one "from which information concerning the security interest can be obtained." "A mailing address" of the debtor will be sufficient. G.S. § 25-9-402(1).

by specific item or by type,¹⁴ and (3) the signatures of the debtor and the secured party.¹⁵ From this minimal public record the interested third party can acquire sufficient knowledge to enable him to make additional private inquiry, of or through the debtor,¹⁶ to ascertain the amount of the outstanding debt, the maturity date of the obligation, and the exact identity of the collateral covered.¹⁷ Nothing is gained by requiring that the entire agreement or agreements be made a part of the public record when the debtor has either knowledge of or access to the information. The third party is amply protected if he can determine, without risk of duplicity on the part of debtor, that a security interest does exist. If the debtor should refuse to give the desired information or sign a request for information, the third party is free to refuse to deal with the debtor.¹⁸

¹⁴ If the collateral is crops or fixtures (including goods which are to become fixtures), the real estate involved must be described and, in North Carolina, the name of the record owner or lessee of the real estate must be included. G.S. § 25-9-402(3).

¹⁵ The signature of the debtor is not required where collateral subject to a security interest is brought from another state or where the secured party is attempting to perfect as to proceeds of collateral subject to a perfected security interest. G.S. § 25-9-402(2). The number of reported controversies indicates a lack of awareness of the necessity of the secured party's signature on the financing statement. The two appellate courts dealing with situations where the secured party has failed to affix formally his signature have rescued the secured party on the grounds that the typed name and address of the secured party on the standard form is sufficient "authentication" of the financing statement where he misunderstood the instructions, *Benedict v. Lebowitz*, 346 F.2d 120 (2d Cir. 1965), or "that a period of indulgence should be granted in connection with cases arising under the Commercial Code." *Alloway v. Stuart*, 385 S.W.2d 41, 44 (Ky. Ct. App. 1964). The reliance by the court in the *Benedict* case upon the "substantial compliance" provision, UCC § 9-402(5), could give to the case broader implications for secured parties who neglect to sign the financing statement, as it could indicate a willingness on the part of the court to dispense with the requirement of secured party's "signature" where ability to acquire the basic information from the financing statement is not impaired. Nevertheless, omission of the secured party's signature is not recommended.

¹⁶ G.S. § 25-9-208 provides a method whereby the uncertain debtor can require the secured party to render a statement of amount due and, where the secured party's records permit, approve a list of the collateral claimed. This method of acquiring information is not available directly to a third party, but, if the third party is actually "interested," the debtor should not object to signing a request.

¹⁷ Even if the third party acquires correct information given in good faith by the secured party, he risks having his security interest subordinated to subsequent advances made by the original secured party where the first-to-file rule of priority is applicable. See 1 COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER UNIFORM COMMERCIAL CODE § 6.08[5] (1963) [hereinafter cited as COOGAN, HOGAN & VAGTS].

¹⁸ This rationale cannot be applied to the "lien creditor." But he has, by prior extension of unsecured credit, accepted the risk of subsequent total

However, "notice" filing and its concomitant short-form financing statement are most useful in those situations where the parties contemplate a continuing relationship, either through subsequent execution of additional security agreements or through the use of the after-acquired property and future advances clauses in an initial agreement. It would make little sense to require that parties to a single, nonrecurring type of security interest, such as a conditional sales contract, execute a written agreement and a financing statement, and the Code does not so require. The security agreement—the entire written contract between the parties—may be used as a financing statement,¹⁹ provided that it meets the requirements. In most cases this means only that the secured party must, in addition to normal execution, sign the security agreement to make it usable in the public record. The converse is not necessarily true. A financing statement cast in a form similar to that suggested by subsection 9-402(3) is not a written security agreement that can be used as a basis for enforcing the interest under section 9-203.²⁰

The financing statement may be filed at any time—before or after the security interest exists or attaches.²¹ Filing before the security interest attaches will not result in perfection of the interest,²² but it will confer priority over any subsequently filed security interest without regard to the time of perfection of either.²³ A filing remains effective for a period of five years unless the financing statement indicates a maturity date of the obligation—and such indication is not required—in which case the filing is effective until sixty days after the specified maturity date but not more than five years.²⁴ If the maturity date of the obligation is more than five years from the date of the filing or has been extended beyond the date stated in the original filing, the secured party, with or without the

encumbrance of the debtor's property. He is in no position to claim disadvantage as a result of being unable to ascertain, immediately prior to levy, the exact amount of the debt or the collateral covered.

¹⁹ G.S. § 25-9-401(1).

²⁰ *American Card Co. v. H.M.N. Co.*, 196 A.2d 150 (R.I. 1963).

²¹ G.S. § 25-9-402(1); *In re United Thrift Stores, Inc.*, 242 F. Supp. 714 (D.N.J. 1965). This will probably result in the North Carolina court's changing its approach to the validity of recording made before the debtor owns the collateral. *Compare* *National Bank v. Greensboro Motor Co.*, 264 N.C. 568, 142 S.E.2d 166 (1965), *with* *Chandler v. Cameron*, 229 N.C. 62, 47 S.E.2d 528 (1948).

²² G.S. § 25-9-303(1).

²³ G.S. § 25-9-312(5)(a).

²⁴ G.S. § 25-9-403(2).

cooperation of the debtor, may extend the effectiveness of the original filing for an additional five years or, if desired, less, by filing a "continuation" statement within six months preceding the original maturity date or expiration of the five-year period and before the original filing expires.²⁵ If the secured party neglects to keep the filing effective, perfection and priority will be lost.

An instrument is deemed to be filed under Article 9 when it is presented with a tender of fees or accepted by the filing officer.²⁶ Presently, in North Carolina, an instrument is not recorded so as to be notice to third parties until it is properly indexed.²⁷ Therefore, the risk of derelictions of the filing officer is now on the party offering the instrument for record.²⁸ Section 9-403(1) will shift the risk to inquiring third parties.²⁹

The North Carolina version of the Uniform Commercial Code contains an additional section³⁰ in Part 4 of Article 9. The added section makes a distinction between "filing" and "recording," permitting any county to serve notice on the Secretary of State designating itself as a "recording" county, and permitting the secured party to elect to "record" his security agreement rather than "file" it. Hopefully, the only effect of the rather formidable-looking addition will be to permit the continued use of reproduction machines owned by the county. A "filing" county will accept the instrument offered by the secured party retaining it for the public record; a "recording" county will make a copy of the instrument, use the copy for the public record, and return the original to the secured party.

C. Place of Filing³¹

The ideal place for filing or recording notice of security interests is the place that results in no inconvenience to the secured party or the subsequent inquiring third party, while affording certainty of

²⁵ G.S. § 25-9-403(3). The continuation statement must state its purpose, contain the file number of the original financing statement, and be signed by the secured party.

²⁶ G.S. § 25-9-403(1).

²⁷ *Johnson Cotton Co. v. Hobgood*, 243 N.C. 227, 90 S.E.2d 541 (1955) (dictum); *Story v. Slade*, 199 N.C. 596, 155 S.E. 256 (1930). *Contra*, N. C. GEN. STAT. § 45-58(c) (Supp. 1965) (Uniform Trust Receipts Act).

²⁸ *Ely v. Norman*, 175 N.C. 294, 95 S.E. 543 (1918).

²⁹ *Ex-Cello Corp. v. Oneida Nat'l Bank & Trust Co.*, 342 F.2d 294 (2d Cir. 1965) (dictum).

³⁰ G.S. § 25-9-408.

³¹ See generally 1 COOGAN, HOGAN & VAGTS, ch. 6B.

application to the secured party and certainty of location to the third party. With interests in real property, the choice is obvious and simple—the geographical recording unit within which the property is located. However, the mobility of personal property precludes the simple choice. The location of the property, the residence or place of business of the debtor, or some central location within the jurisdiction each has some rational basis as a place for filing and some disadvantages inconsistent with the objectives noted above. Rather than adopting a single rule for the entire spectrum of security interests and types of debtors, the alternative Code filing system adopted by North Carolina utilizes all of the four rational possibilities in appropriate situations.

If the security interest is subject to the filing requirements of Part 4³² and the collateral is consumer goods or farm-connected property—farm equipment, farm products, “accounts, contract rights or general intangibles arising from . . . the sale of farm products by the farmer”³³—the financing statement must be filed in the county where the debtor resides. If the debtor is not a resident of the state, the filing shall be in the county where the “goods” are located.³⁴ In addition, if the collateral is crops, a filing must be made in the county where the land upon which they are grown is located if that is not also the county in which the debtor resides.

If the collateral is goods that are or are to become fixtures, without regard to the fact that they might also be properly classified as consumer goods or equipment under section 9-109, the financing statement must be filed in the county where the land to which they

³² Nothing here said about “place” of filing is applicable to security interests excluded from filing under Part 4 by G.S. §§ 25-9-302(3)-(5), or security interests excluded entirely from the operation of Article 9 by G.S. § 25-9-104.

³³ G.S. § 25-9-401(1)(a). The term “farm products” is defined in G.S. § 25-9-109(3) as “crops or livestock or supplies used or produced in farming operations or . . . products of crops or livestock in their unmanufactured states . . . in the possession of a debtor engaged in . . . farming operations.”

³⁴ G.S. § 25-9-401(1)(a). Accounts, contract rights and general intangibles are not “goods.” G.S. § 25-9-105(1)(f). Thus, § 9-401 leaves uncertain the place of filing the security interest in “accounts, contract rights, or general intangibles arising from the sale of farm products” if the debtor is a nonresident. Accounts and contract rights have a “situs” at the office of the assignor where records concerning them are kept. G.S. § 25-9-103(1). It is only a guess that filing at the location of that office would be sufficient in this situation on the theory that this is where they are “kept.” If the farmer does not keep the records of the accounts, etc., in this state, the security interest probably would not be in any way subject to the law of this jurisdiction. G.S. § 25-9-103(1).

are or are to be affixed is located.³⁵ No other filing is necessary with respect to fixtures.³⁶

A security interest in any other type of collateral that may be perfected by filing—nonfarm connected equipment, accounts, contract rights and general intangibles, inventory, negotiable documents, chattel paper—is subject to a dual filing requirement. A financing statement must be filed centrally, in the office of the Secretary of State, and locally, in the county where the debtor maintains his sole place of business in this state.³⁷ If the debtor has a place of business in more than one county in the state, local filing is not required. If the debtor has no place of business in the state, but resides herein, the local filing shall be in the county where the debtor resides. In rare situations where the debtor neither resides in the state nor maintains a place of business here, filing only in the Secretary of State's office will be sufficient.

The rules of subsection 9-401(1) may appear complex, but as long as the type of collateral with which one is dealing is kept in mind, they should not be as difficult to apply nor as potentially problematical as the current rules of determining the recording place of conditional sales contracts and chattel mortgages.³⁸ Locating the debtor's residence³⁹ or the place of business of the debtor and determining whether, at the time of filing, the debtor had a place of business in more than one county,⁴⁰ will undoubtedly consume some of the court's time, but probably no amount of legislative definition

³⁵ G.S. § 25-9-401(1)(b). The Code terminology is "where a mortgage on the real estate concerned would be filed . . ." which, in North Carolina is the county where the land is located. N.C. GEN. STAT. § 47-20.1 (Supp. 1965).

³⁶ This is not to say that additional filing is not desirable in view of the ambiguity which surrounds the word "fixtures." See text accompanying notes 216-18 *infra*.

³⁷ G.S. § 25-9-401(1)(c).

³⁸ N.C. GEN. STAT. § 47-20.2 (Supp. 1965). The rules there set out require distinctions between individuals, partnerships, domestic corporations and foreign corporations, and a determination, for the second, of the principal place of business and, for the third and fourth groups, the principal office if incorporated or domesticated before July 1, 1957.

³⁹ "Residence" in this context has been defined by the court to be the person's actual place of abode, not necessarily his "domicile." See, *e.g.*, *Sheffield v. Walker*, 231 N.C. 556, 58 S.E.2d 356 (1950); *Industrial Discount Corp. v. Radecky*, 205 N.C. 163, 170 S.E. 640 (1933). There is no reason to depart from these decisions under the Code.

⁴⁰ In *In re Falkof*, 2 UCC REPORTING SERV. 731 (D. Mass. Jan. 9, 1963), the referee in bankruptcy held that the debtor did not have a second "place of business" where in his home he received mail and telephone calls and held conferences that related to the establishment of his dry cleaning business.

could decide, in advance, the cases likely to arise. It should be noted that the "place of business" of a corporation under this section is probably the place from which the corporation in fact conducts its business, which is not necessarily the county where its registered office is located.

Subsection 9-401(3) provides for continued validity of an original filing properly made, even though the facts determining place of filing—residence or place of business of the debtor or classification of the collateral—thereafter change. Thus, the burden of determining whether the facts have changed is on the third party.

II. TAKING POSSESSION OF THE COLLATERAL

Originating with pledge or pawn transaction, the secured party's taking of possession of the collateral under a security agreement has traditionally been deemed to give sufficient notoriety to the possible existence of an adverse interest in personal property to entitle the secured party to priority over subsequent lien creditors of or purchasers from the debtor.⁴¹ Article 9 will permit continued use of possession as a method of perfection,⁴² making explicit some heretofore implicit assumptions concerning the type of property subject to possession. "Possession" by the secured party gives notice to third parties only where the property is tangible or is represented by something tangible and can, in a meaningful way, be taken from the control of the debtor. Therefore, Article 9 limits the use of possession as a method of perfection to security interests in "goods, instruments, negotiable documents, or chattel paper."⁴³

It is probably not accurate to assume that the secured party may perfect a security interest in any type of "goods"⁴⁴ by taking possession. Those security interests that must be perfected by registration under a United States statute or by rotation on a certificate of title⁴⁵ may also be subject to a requirement in applicable statute that the interest be so registered or noted to be valid against third parties. The Federal Aviation Act provides unequivocally that the interest must be recorded under the act to be valid as to any third

⁴¹ See, *e.g.*, *Wachovia Bank & Trust Co. v. Wayne Fin. Co.*, 262 N.C. 711, 138 S.E.2d 481 (1964); *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960).

⁴² G.S. § 25-9-305.

⁴³ G.S. § 25-9-305.

⁴⁴ As defined in G.S. § 25-9-105(1)(f).

⁴⁵ G.S. § 25-9-302(3).

person who does not have "actual notice" of the unrecorded interest,⁴⁶ and possession by the secured party is not, standing alone, sufficient to charge third parties with notice.⁴⁷ Thus, security interests in aircraft are not automatically subject to perfection by taking possession of the collateral.

The same problem could arise in connection with motor vehicles and state statutes requiring perfection by notation on a certificate of title. If the certificate-of-title act provides for perfection only by way of compliance with its provisions, section 9-305, even though enacted later, should not be construed to permit perfection by taking of possession in contradiction to the policy of the certificate-of-title law.⁴⁸ However, the North Carolina court may not face the exact construction problem presented by section 9-305 and the Motor Vehicle Act because, without the aid of such subsequent enactment, it has stated in dictum that the recently amended notation of liens section⁴⁹ of the Motor Vehicle Act permits perfection of a chattel mortgage by taking possession of the vehicles.⁵⁰ If that dictum holds, the secured party will be justified in taking possession of automobiles, leaving the certificates of title in the hands of the debtor, and relying upon possession as a permissible method of perfection under section 9-305.

⁴⁶ 72 Stat. 772 (1958), as amended, 49 U.S.C. § 1403(c) (1964).

⁴⁷ *Marsden v. Southern Flight Serv., Inc.*, 227 F. Supp. 411 (M.D.N.C. 1961).

⁴⁸ G.S. § 25-9-302(3) is neutral on the question, providing only that the "filing provisions" do not apply if the interest is subject to the specified types of statutes.

⁴⁹ N.C. GEN. STAT. § 20-58 (1965).

⁵⁰ *Wachovia Bank & Trust Co. v. Wayne Fin. Co.*, 262 N.C. 711, 138 S.E.2d 481 (1964) (dictum). The court reached this broad conclusion in the face of the extraordinary preamble to the act, which provided, "Whereas, a certificate of title that can be relied upon as a ready means by which all legal interests in motor vehicles may be determined would be in the public interest," and the express language of the act, "Except as provided in G.S. 20-58.9, a security interest . . . is not valid against creditors of the owner or subsequent transferees or lien holders of the vehicle unless perfected as provided in this chapter." The facts as stated by the court make the opinion even more mystifying. N.C. GEN. STAT. § 20-58.9 (1965) exempts from the requirement of notation on the certificate of title security interests created by a manufacturer or dealer who holds the automobile for resale. Not being subject to N.C. GEN. STAT. § 20-58 (1965), such security interests implicitly should be subject to normal perfection rules, *i.e.*, recording under N.C. GEN. STAT. § 47-20 (Supp. 1965). The debtor was an automobile dealer. All of the mortgages were recorded, the ones to which the court ultimately gave priority being recorded first. Therefore, the court could have more reasonably applied N.C. GEN. STAT. § 20-58.9 (1965) and reached an identical result without ever mentioning possession.

Possession will be an equally effective method of perfection where the collateral is negotiable documents,⁵¹ *e.g.*, negotiable warehouse receipts or bills of lading and other documents which run to order or bearer and with which the goods are deemed integrated in the sense that the presentation of the piece of paper is the exclusive method of obtaining possession or control of the goods from the bailee. The method for taking "possession" of collateral that is in the possession of a bailee, who has not issued a negotiable document covering the collateral is, under the Code, the giving of notice to the bailee.⁵² When notice is received by the bailee, the secured party will have completed the acts necessary for perfection if the security interest has attached. This is in contrast to the common-law rule, which required, in addition to receipt of notice, the bailee's "attornment," or acknowledgment that he held the goods at the pleasure of the party giving notice, before that party would be deemed to be in possession of the goods.⁵³

The problems of perfection by possession as related to writings and intangibles that are or represent the obligations of third parties are primarily definitional. It is possible to perfect by taking possession of "instruments" and "chattel paper."⁵⁴ A security interest in "accounts," "contract rights," or "general intangibles"⁵⁵ cannot be perfected by taking "possession."⁵⁶ The terms instruments, chattel paper, accounts, and contract rights all describe types of obligations of third parties (obligors) which, in this context, the obligee or owner thereof desires to use as collateral for an advance made by the secured party. Chattel paper is a type of monetary obligation,

⁵¹ "Document" as used in Article 9 means "Document of Title," as defined in G.S. § 25-1-201(15). G.S. § 25-9-105(1)(e). The document of title must purport to be issued by a bailee and cover identified goods in the hands of the bailee. Domestically, the document is negotiable "if by its terms the goods are to be delivered to bearer or to the order of a named person." G.S. § 25-7-104(1)(a). An automobile certificate of title and like instruments are not "documents of title" because, if for no other reason, they are not issued by a bailee. See *Semple v. State Farm Mut. Auto. Ins. Co.*, 215 F. Supp. 645 (E.D. Pa. 1963).

⁵² G.S. § 25-9-305.

⁵³ *E.g.*, *United States v. Lucas*, 148 F. Supp. 768 (M.D.N.C. 1957).

⁵⁴ G.S. § 25-9-305.

⁵⁵ "General Intangibles" is the residual classification of collateral. Anything that does not properly fit within the other six basic classifications is a general intangible. G.S. § 25-9-106. "Examples are good will, literary rights . . . rights to performance . . . copyrights, trademarks and patents . . ." G.S. § 25-9-106, comment. See generally 2 COOGAN, HOGAN & VAGTS, ch. 21.

⁵⁶ This conclusion is derived by implication from the omission of these classes collateral from G.S. § 25-9-305.

payment of which is secured by a "security interest in or lease of specific goods" arising out of the transaction giving rise to the obligation.⁵⁷ A typical example is the conditional sales contract under which major consumer appliances are sold. However, any written security agreement that evidences or that is accompanied by written evidence of the obligation will be chattel paper, without regard to whether the accompanying instrument is negotiable or non-negotiable.

The second class of third-party obligations that may be perfected by taking possession is the instrument.⁵⁸ Beginning with the readily recognizable negotiable instrument and corporate security, the concept otherwise rapidly drops off into the obfuscated area between the non-negotiable instrument, which can be possessed for purposes of perfection, and the account,⁵⁹ which cannot be so possessed. Drawing the line between the non-negotiable instrument which is not a security and the account is, in the abstract, not difficult—any written evidence of an obligation will be an "instrument" if it is a type that is in the business community normally "transferred by delivery with any necessary endorsement or assignment," that is, any writing that is generally regarded by the business community as so embodying the obligation that rights to the obligation must be transferred through transfer of the instrument. The official comments further suggest that the obligation must be evidenced by an "indispensable instrument,"⁶⁰ which, if applicable, brings the Code definition around to a more familiar, if not more certain, concept. The concept of indispensable instrument has been relevant in determining whether the obligation can be attached by creditors,⁶¹ can be the subject of a common-law

⁵⁷ G.S. § 25-9-105(1) (b).

⁵⁸ "Instrument" is defined in G.S. § 25-9-105(g) as "a negotiable instrument, or a security (defined in Section 8-102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in the ordinary course of business transferred by delivery with any necessary endorsement."

⁵⁹ An "account" is "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper." G.S. § 25-9-106.

⁶⁰ G.S. § 25-9-106, comment.

⁶¹ *E.g.*, N.C. GEN. STAT. § 1-315(a) (5) (Supp. 1965), which subjects to levy "choses in action represented by instruments which are indispensable to the chose in action." The North Carolina court has apparently not construed the subsection.

gift,⁶² is covered by assignment of accounts receivable acts,⁶³ as well as whether it can be the collateral in a common-law pledge transaction.⁶⁴ In these contexts, and probably under the Code, the essential question is whether the instrument customarily controls the right to payment.⁶⁵ Examples of such instruments include "share certificates, bonds, interim certificates, savings bank books, . . . insurance policies,"⁶⁶ and non-negotiable warrants issued by the United States.⁶⁷ In addition, non-negotiable promissory notes or drafts would, under certain circumstances, have been considered "indispensable."⁶⁸

It is unlikely that the attitudes of the courts will change significantly as a result of the minor rewording of the concept as it appears in section 9-105. Of course, there will not be a problem with reference to stock certificates or bonds as they are expressly included in the definition of instruments. The insurance policy or the passbook for a savings account will continue to be governed by the common law or applicable statutes as security interests therein are excluded entirely from the operation of Article 9.⁶⁹ If the secured party has a security interest in an "indispensable instrument," one that controls the right to payment as a matter of law or by contract and that is generally transferred by delivery of the piece of paper, he can perfect by taking possession. If his security interest is in an open book account or a simple memorandum of a contract calling for payment in return for goods or services ren-

⁶² See generally 3 WILLISTON, CONTRACTS § 439 (3d ed. 1960).

⁶³ *E.g.*, N.C. GEN. STAT. § 44-77 (Supp. 1965), although not expressed in terms of indispensability, clearly reaches for the same concept in defining what is not an "account receivable" as an "other instrument, the . . . possession . . . of which customarily gives to the . . . holder . . . the right to payment thereon."

⁶⁴ RESTATEMENT, SECURITY § 1, comment *e* (1941).

⁶⁵ This question is not determined solely by the fact that the contract for payment is required by a Statute of Frauds to be in writing. *M. M. Landy, Inc. v. Nicholas*, 221 F.2d 923, 929 (5th Cir. 1955) (dictum).

⁶⁶ RESTATEMENT, SECURITY § 1, comment *e* (1941). See also 3 WILLISTON, CONTRACTS § 439 (3d ed. 1960).

⁶⁷ *M. M. Landy, Inc. v. Nicholas*, 221 F.2d 923, 929 (5th Cir. 1955) (dictum). The case also includes an excellent discussion of the entire problem.

⁶⁸ *E.g.*, *Jerome v. Eastern Fin. Corp.*, 317 Mass. 364, 58 N.E.2d 122 (1944), where, although the court phrased its decision in terms of estoppel, a non-negotiable draft issued by an insurance company in payment of a claim was held to control the right to payment.

⁶⁹ G.S. § 25-9-104(g), (k).

dered, even though the contract is required to be in writing, he probably has an interest in an "account" or "contract right" that can be perfected only by filing.

III. "AUTOMATIC" AND "TEMPORARY" METHODS OF PERFECTION

For various commercial reasons, Article 9 affords to security interests in certain types of collateral, under specific circumstances, the status of perfection from the time the security interest attaches, without requiring the secured party to file a financing statement or have possession of the collateral. This "method" of perfection is herein referred to as "automatic perfection."⁷⁰

A. Consumer Goods

Perhaps because of an assumed public realization of the likelihood that individuals who purchase major items for personal or family use are going to purchase on credit and, as a result, there will be a security interest in the goods, the concession of automatic perfection is afforded the purchase-money security interest⁷¹ in consumer goods.⁷² The secured party's interest will be perfected from the time of attachment. This provision, which will change existing North Carolina law,⁷³ probably will not significantly change existing practice for many secured parties because of the fact that many finance companies or vendors, at the present time, do not record the conditional sales contract or the chattel mortgage arising from the installment sale of consumer goods. When the Code becomes effective, these parties can continue their nonfiling and will enjoy substantially more protection against the debtor's subsequent lien creditors, including a trustee in bankruptcy,⁷⁴ and commercial purchasers.⁷⁵ However, while the secured party, in this situation, will have a "perfected" security interest, the interest will not be as

⁷⁰ The word "automatic" admittedly has limitations in this context. *Supra* note 6.

⁷¹ Defined in § 9-107. See Hanft, *Article Nine: Secured Transactions—Validity, Rights of the Parties; Default*, 44 N.C.L. REV. 716 (1966).

⁷² G.S. § 25-9-302(1)(d).

⁷³ The present recording statute, N.C. GEN. STAT. § 47-20 (Supp. 1965) does not recognize any similar exception for consumer goods, nor do the North Carolina cases.

⁷⁴ *In re White*, 2 UCC REPORTING SERV. 192 (E.D. Ky. June 8, 1964); *In re Kretzer*, 1 UCC REPORTING SERV. 369 (E.D. Pa. Nov. 3, 1955).

⁷⁵ *United Gas Improvement Co. v. McFalls*, 18 Pa.D. & C. 2d 713, 1 UCC REPORTING SERV. 508 (Pa. Ct. C.P. 1959).

completely protected as it would be if he filed a financing statement. Where the automatic perfection is claimed as the only basis for priority, a subsequent party who purchases the goods from the debtor for his personal or family use or for use in his farming operations will defeat the security interest. The same type of perfection, with the same limitations, is granted the purchase-money security interest in "farm equipment having a purchase price not in excess of twenty-five hundred dollars."⁷⁶

A security interest in goods that are or are to become fixtures or in motor vehicles required to be licensed, even though the goods are also consumer goods or farm equipment, cannot be perfected automatically. The security interest in fixtures must be filed under Part 4; the security interest in motor vehicles must be perfected in a manner permitted by the Motor Vehicles Act.⁷⁷

While there is no stated limit upon the time for which this automatic perfection for consumer goods or farm equipment will be effective, the possibility of unlimited perfection until the purchase price has been paid is complicated by the fact that the distinctions between consumer goods, farm equipment, and other types of goods are based upon the use to which the collateral is put and not upon physical characteristics. An item in the hands of a person using it for his personal use in his home will be consumer goods under the definitions of section 9-109. If that same person should, subsequent to the purchase, decide to use the item in his business, it would become equipment.⁷⁸ Clearly, the secured party holds a perfected security interest in the item as consumer goods. But, since the item is now equipment, which requires filing or possession for perfection of the security interest, does the secured party's perfection continue? This question of effect of changes in use generally was raised in 1954 during the hearings held by the New York Law Revision Commission.⁷⁹ There was at that time no satisfactory

⁷⁶ G.S. § 25-9-302(1)(c).

⁷⁷ G.S. § 25-9-302(1)(c), (d). See *supra* note 50. A literal reading of the subsection would indicate that "filing" of the security interest under this article would be required where the collateral is a motor vehicle and also consumer goods or farm equipment. Obviously, this would serve no purpose and the "filing" referred to in G.S. § 25-9-302(1)(c), (d) with respect to motor vehicles should be construed as "filing or other steps for perfection required by the Motor Vehicle Act."

⁷⁸ G.S. § 25-9-109(2).

⁷⁹ 2 N.Y. LAW REVISION COMMISSION, REPORT AND HEARINGS ON THE UNIFORM COMMERCIAL CODE 1104 (1954).

answer as Article 9 did not then purport to solve the general problems raised by change in use of collateral and the effect on prior perfection. Subsequently, in 1955, subsection (3) of section 9-401 was amended to read: "A filing which is made in the proper place in this State continues effective even though the debtor's residence or place of business or the location of the collateral or *its use, whichever controlled the original filing*, is thereafter changed."⁸⁰ Does this section apply as well to security interests that have not been perfected by filing, such as those covered by the consumer-goods and farm-equipment exceptions? The drafters of that subsection apparently thought so. A comment to the amendment stated ". . . an item bought for personal, family use would be consumer goods and *non-filing or filing* with respect thereto would continue to have the same effect even though the item was subsequently used as equipment."⁸¹ However, to reach this conclusion, *non-filing* must be equated with *filing* for this purpose, as section 9-401(3) refers only to security interests that have been perfected by filing. The language of Article 9 and the general use of the word "filing" do not appear to support this equation. The language creating the exceptions is "a financing statement must be filed to perfect all security interests except . . ."⁸² Grouped with the consumer-goods and farm-equipment exceptions are the perfection-by-possession and temporary-perfection-of-security-interest-in-instruments-and-documents exceptions. Both of the latter exceptions are intended to give "perfect[ion] otherwise than by filing"⁸³ in operation of the priority rules.⁸⁴ It is difficult to see why the automatic perfection for interests in consumer goods and farm equipment would not also be perfection otherwise than by filing for that purpose. If the automatic perfection is perfection otherwise than by filing for priorities, is it perfection by filing under subsection 9-402(3)?

Of course, such a technical construction could be ignored, if there are compelling reasons for giving the benefit of section 9-402(3) to a secured party who elects to perfect his interest in consumer goods or farm equipment without filing, or if the prob-

⁸⁰ The italicized words were added by the 1955 amendment.

⁸¹ AMERICAN LAW INSTITUTE, UNIFORM COMMERCIAL CODE, Supp. No. 1, at 78 (1955). (Italics added.) See also, *Panel Discussion on U.C.C.*, 19 BUS. LAWYER 20, 41 (1963).

⁸² G.S. § 25-9-302(1).

⁸³ G.S. § 25-9-312(6).

lem is totally without significance. An examination of the secured party's situation with relation to the third-party purchaser reveals no compelling equity in favor of the secured party. And, while cases of changes of use may be rare, to the dealer or other person who purchases from the debtor for other than personal or farm use,⁸⁵ the question of whether he can rely upon the use to which the goods are then being put *and* the state of the public filings has significant ramifications that are amplified by the facts that there is no limit on the value of the consumer goods in which a purchase-money security interest may be perfected automatically and the limit on farm equipment is a relatively high 2500 dollars.

Where public filing of a security interest in goods is required,⁸⁶ the risk of a change in use is no more difficult for the inquiring party to guard against than is a change in residence or place of business of the debtor. If the third party has knowledge with reference to the latter two factors, guarding against the possibility of change in use is simple—the third party need only search the records in the county of residence and the Secretary of State's office, or, where applicable, the location of the place of business, which he should do in any event if he wants to be certain of the state of title. On the other hand, where there has been no public filing, it is impractical, if not impossible, for the third party to find out with certainty whether there is an unfiled but "perfected" purchase-money security interest in the goods which he views, for example, as equipment, but which may at one time have been sold as consumer goods. True, if the goods are, at the time of purchase by the third party, being used as "consumer goods," he takes a risk of the unfiled interest in purchasing; but in that situation it is a risk that can be immediately comprehended from the state of the goods. When the goods are, at that time, equipment, the risk can be comprehended only by laborious inquiry of persons who sell that type of article. Indeed, every piece of equipment⁸⁷ that could

⁸⁴ G.S. § 25-9-312, comment 4; 1 COOGAN, HOGAN & VAGTS, § 7.05[3][e].

⁸⁵ The purchaser who buys for his own or farm use will, in any event, have priority over the unfiled security interest. G.S. § 25-9-307(2).

⁸⁶ Filing will be required for perfection of a security interest in any type of goods other than consumer goods or farm equipment. There is no automatic perfection of any type or duration for equipment other than farm equipment, inventory, or farm products—unless the secured party has perfected by possession, and in that event, no change in use problems could possibly arise.

⁸⁷ If the debtor converted his consumer goods or farm equipment into

conceivably be used as consumer goods or farm equipment would be suspect, even though there was never security interest in it, if the secured party is as a general matter, able to retain perfection after the change in use of consumer goods or farm equipment. Furthermore, as between the secured party and the third-party purchaser, each is theoretically equally able to guard against the chicanery of the debtor. Where the secured party can protect himself as simply as by filing and does not do so, the decision should go to the innocent third party.⁸⁸

Therefore, the secured party, as an additional risk to his taking advantage of the concession of automatic perfection, should bear the burden of loss of perfection if the use of the goods has changed so as to put the third party in an ambiguous position.⁸⁹

B. Accounts and Contract Rights

Filing is not required to perfect a security interest or other transfer of accounts or contract rights that arises by way of an assignment of less than a "significant part of the outstanding accounts or contract rights of the assignor."⁹⁰ Thus, there is an automatic perfection of such a security interest or transfer. This section, insofar as it is applicable, would merely continue the common-law rule, as interpreted in New York and other jurisdictions,⁹¹ that the first transferee of accounts or contract rights has priority over subsequent transferees or creditors without giving notice to the account debtor or filing.⁹² However, to be entitled to this auto-

inventory in his business, the same problem is presented to the purchaser, but such a problem would be resolved under G.S. § 25-9-307(1), which gives the buyer in the ordinary course of business clear title over "a security interest created by his seller."

⁸⁸ This discussion assumes an "innocent" purchaser. Under G.S. § 25-9-301 no purchaser who has knowledge of the existence of a security interest will have priority over that interest.

⁸⁹ As a result of loss of perfection, the secured party would also lose to the lien creditor. The lien creditor in many instances will not have the same equities in his favor as the purchaser, but the same can be said for any unperfected interest in a system as adopted by the Code where the lien creditor's priority does not depend upon the time he extended credit.

⁹⁰ G.S. § 25-9-302(1)(e).

⁹¹ *E.g.*, *Superior Brassiere Co. v. Zimetbaum*, 214 App. Div. 525, 212 N.Y. Supp. 473 (1925).

⁹² Of course, the entire area of assignments of accounts underwent considerable reshuffling after *Corn Exch. Nat'l Bank & Trust Co. v. Klauder*, 318 U.S. 434 (1943). See generally 3 COLLIER, *BANKRUPTCY* ¶ 60.48 (14th ed. 1964). The North Carolina solution is N.C. GEN. STAT. §§ 44-77 to -85 (Supp. 1965), enacted in 1945 and repealed as of the effective date of the

matic perfection, the secured party or transferee will presumably have the burden of proving that *total value* of the accounts of the debtor or transferor held by the secured party do not constitute a significant part of the total value of all outstanding accounts of the debtor or transferor. It will not be sufficient to show merely that the particular transfer, perfection of which is claimed, constituted less than a significant part of those outstanding accounts. When the secured party is in doubt whether the transfer does constitute a significant part, he can file a financing statement covering accounts of the debtor and achieve perfection in that method. Indeed, it will be preferable, in all commercial transactions, to follow this course, as the assignment of any percentage of the debtor's accounts on a regular basis could be called a significant part of the outstanding accounts even though the percentage did not exceed four or five per cent at any given time.

C. Instruments and Negotiable Documents

Article 9 permits perfection of a security interest in two other types of collateral, instruments and negotiable documents, for a limited period of time, twenty-one days, without requiring filing or taking of possession of the collateral.⁹³ The secured party may take advantage of this automatic perfection without having ever seen or handled the collateral. The only requirements are that (1) there be a written security agreement, and (2) the secured party give "new value." There is no restriction on the purposes for which the debtor retains possession. Thus, with the instruments and documents in which the debtor has rights, the secured party can get a twenty-one-day automatic perfection through the execution of the security agreement and the making of an advance pursuant thereto. The twenty-one-day period begins to run from the time of attachment, *i.e.*, from the time of the execution of the agreement or the

Code, G.S. § 25-10-102, which requires filing to protect the assignment. There is no stated exemption from filing in the present North Carolina Act, so G.S. § 25-9-302(1)(e) will probably, to the extent it is applicable, modify the North Carolina position.

⁹³ G.S. § 25-9-304(4), (5). The Uniform Trust Receipts Act, N.C. GEN. STAT. §§ 45-48, -53 (Supp. 1965), offers the only existing counterpart to the Code provisions. The type of transaction sanctioned by G.S. § 25-9-304(4) might look like the common-law "equitable pledge." See *Godwin v. Murchison Nat'l Bank*, 145 N.C. 320, 59 S.E. 154 (1907). Under the Code, it is not an equitable pledge nor anything else equitable; it is simply a temporary perfection.

time of the advance, whichever occurs last.⁹⁴ To illustrate the minimum contact between the secured party and the debtor required by this section, suppose that a debtor is in possession of some instruments or documents in which he has an interest and which he desires to use as collateral for a loan. All that would be required would be a telephone call to the bank, the execution and mailing by the debtor of a written agreement describing the collateral, and the bank's crediting of the debtor's account for the amount of the loan.⁹⁵ The bank would have a perfected security in the described collateral for twenty-one days without ever having looked at the debtor or the collateral.⁹⁶ At the end of the twenty-one-day period the perfection will lapse unless the bank, in the meantime, has taken steps to perfect the security interest otherwise, by filing as to negotiable documents or by taking possession of instruments.

There is also a probability that the secured party in certain circumstances can rely upon the temporary perfection, even though the debtor does not at that time execute a written agreement and the secured party does not then make an advance. If there is in existence a written agreement executed at some time in the past covering instruments or negotiable documents and containing an after-acquired property clause, no reason appears why that agreement should not satisfy the requirement of subsection 9-304(4). Furthermore, the Code provides in section 9-108 that where after-acquired property comes under an antecedent security agreement, the security interest "shall be deemed to be taken for new value . . . if the debtor acquires his rights in such collateral either in the

⁹⁴ G.S. § 25-9-304(4).

⁹⁵ However, where negotiable documents, particularly bills of lading, are involved, the transaction would rarely be cast in this form. The seller will have shipped goods under the bills of lading and will prevent the buyer-debtor from getting possession of the goods or documents by first requiring payment or acceptance of drafts, usually at the buyer's bank. Thus, the bank will have possession of the bills of lading, and if a loan is made, the bank will turn over the documents to the buyer after execution of a security agreement. The bank probably will then be in a position to rely upon temporary perfection under G.S. § 25-9-304(5), which it might be well advised to do for reasons discussed *infra* pp. 777-79.

⁹⁶ Before becoming too elated about the temporary perfection, secured parties should realize the inherent limitations of any perfection where the debtor is left in possession of negotiable documents or instruments. Article 9 does not in any way impair negotiability or rights of purchasers of negotiable instruments or documents. G.S. § 25-9-309. See text accompanying notes 164-75 *infra*.

ordinary course of business or . . . within a reasonable time after new value is given."⁹⁷ Although the section was primarily intended as an attempt to forestall the bankruptcy courts from determining that after-acquired property was given for an antecedent debt,⁹⁸ in specifying what is deemed "new value," it should have application wherever that term is used in Article 9, including subsection 9-304(4).⁹⁹ Thus, the secured party could have a perfected security interest in instruments or negotiable documents without knowing of their existence, if there is an after-acquired property clause and the debtor acquires the instruments or documents in the ordinary course of business within a reasonable time after the original advance is made.

Subsection 9-304(5) provides for another situation in which the secured party, having an interest in instruments or documents of title, will be entitled to a temporary perfection. The effect of subsection (5) is closely related to the operation of subsection (4) in the sense that many transactions will arise in which the secured party may claim the twenty-one-day perfection under either subsection. However, subsection (5) is broader in scope of collateral and types of interests covered and narrower in permissible limits of operation than subsection (4).

Subsection (5) permits the temporary retention of perfection of security interests in goods in the possession of a bailee who has not issued a negotiable document, as well as interests in instruments and negotiable documents. Compared to subsection (4), its operation is limited by two requirements: (1) the secured party must have had a perfected interest at the time of the turnover, which means, in the case of instruments, that the secured party must have had possession of them or, in the case of negotiable documents or goods, that the secured party had possession¹⁰⁰ or filed;¹⁰¹ and (2) the collateral must be released to the debtor only for

⁹⁷ G.S. § 25-9-108. The section and the comments unfortunately give no hint concerning the factors to be considered in determining what is a reasonable time after execution of the initial giving of new value.

⁹⁸ UCC § 9-108, comment 1.

⁹⁹ 1 COOGAN, HOGAN & VAGTS § 7.08[5].

¹⁰⁰ The secured party gets "possession" of goods in the hands of a bailee for perfection purposes when notice is given to the bailee. G.S. § 25-9-305.

¹⁰¹ Where a secured party has filed a financial statement which remains effective, his security interest in the goods or negotiable documents would be perfected by the filing and would remain perfected when the collateral is released to the debtor. Therefore, as a practical matter, the necessity for G.S. § 25-9-304(5) will be restricted to situations where the secured party

the specified purposes.¹⁰² The first requirement has the effect of preventing the secured party from, after the fact, contending that he should be entitled to up to forty-two days of perfection on the grounds that the debtor held possession of the collateral for twenty-one days under subsection 9-304(4) and for an additional twenty-one days for the specific purposes enumerated in subsection 9-304(5). In rare cases the secured party might ultimately realize out of one transaction forty-two days of the automatic and temporary perfection; but this would be only where, at the end of the twenty-one-day period specified in subsection 9-304(4), he took possession of the collateral, thus perfecting the security interest in that manner, and subsequently released the collateral to the debtor for one of the specified purposes under subsection 9-305(5).

A question arises whether the twenty-one-day period mentioned in subsections 9-304(4) and (5) is actually "perfection" or merely a "relation-back" or "grace period" within which the secured party may legitimately perfect his interest and have the perfection relate back to the time of attachment of the security interest. The question, although probably academic where the Bankruptcy Act is involved,¹⁰³ has some significance to the secured party who waits

has not filed, but was using his possession of the collateral as the basis for initial perfection.

¹⁰² The purposes for which goods or negotiable documents may be released to the debtor are "ultimate sale or exchange or . . . loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange." G.S. § 25-9-304(5) (a). Since all of the permitted acts with reference to the goods or documents must relate to ultimate sale or exchange, the section will have application primarily to goods that are to become inventory. And a secured party, who releases equipment or consumer goods for use as such, would get no benefit from this section.

Instruments can be delivered to the debtor under this section only for "ultimate sale or exchange or presentation, collection, renewal or registration of transfer." G.S. § 25-9-304(5) (b).

¹⁰³ At least it is academic as long as the period stated in the Code is no more than twenty-one days. Under § 60 of the Bankruptcy Act, if the twenty-one-day period is referred to as a period of perfection and the secured party fails to file or otherwise perfect within twenty-one days, the interest has not been "so far perfected that no subsequent lien . . . could become superior to the rights of the transferee," § 60(a) (2), because a lien creditor attaching the property during the gap between the expiration of the twenty-one days and the subsequent perfection would have priority. G.S. § 25-9-301; G.S. § 25-9-303, comment 2. If the twenty-one-day period is a relation-back period, the secured party, by failing to file or take possession within the twenty-one days, would not be in compliance with state law or the Bankruptcy Act. § 60(a) (7) (I). Thus, under either theory the transfer to the secured party would be deemed made at the time he finally perfected the interest by filing or taking possession, or if he did not later perfect, it would be deemed

until the twenty-second day following attachment of the security interest to perfect by filing. To illustrate, suppose that the secured party takes a security interest in negotiable documents under subsection 9-304(4) relying upon the temporary "perfection," but intending to file later. At some time between the time of attachment of his interest and the twenty-first day following, a creditor of the debtor acquires a lien on the documents. The secured party neglects to file his interest until the twenty-second day following attachment. Under a "relation-back" theory the lien creditor would prevail because the secured party lost his right to have the subsequent perfection deemed to have been made at the date of attachment.¹⁰⁴ Under a "perfection" theory, however, the secured party should prevail because the lien creditor's rights did not arise at a time when the interest was "unperfected,"¹⁰⁵ without regard to whether the interest may later have become unperfected. The most authoritative bankruptcy treatise apparently treats the twenty-one-day period as a relation-back period.¹⁰⁶ However, the express language of the sections and statements in the official comments indicate an intent that the twenty-one-day period be a period of perfection rather than a relation-back period. If for no other reason, the interest should be treated as being perfected for twenty-one days because subsections 9-304(4) and (5) state expressly that it shall be "perfected," and the consequences of perfection under the Code should be given the interest during that period whether or not it is subsequently perfected within the twenty-one days by filing or possession.¹⁰⁷

Where the secured party relies upon subsection 9-304(4) as the basis of his perfection of a security interest in instruments or negotiable documents, there is also a question, particularly with reference to documents, whether the perfection will continue for twenty-one days in all circumstances. Of course, the secured party

perfected immediately before bankruptcy, § 60(a)(2), and the transfer would be for an antecedent debt.

¹⁰⁴ This is the result indicated by G.S. § 25-9-301(2) (limited effect ten-day relation-back for purchase-money security interests) in the only situation where the official comments refer expressly to any type of relation-back period.

¹⁰⁵ See G.S. § 25-9-301; G.S. § 25-9-303, comment 2.

¹⁰⁶ 3 COLLIER, BANKRUPTCY ¶ 60.51A at 1050.4 (14th ed. 1964).

¹⁰⁷ G.S. § 25-9-301(2) and G.S. § 25-9-303, comment 2, inferentially support the conclusion as well. *But see* the second sentence of G.S. § 25-9-304, comment 4.

taking an interest in negotiable documents is primarily interested in having a security interest in the goods that are represented by the documents, and this is what he gets. When he takes his security interest under section 9-304(4), his interest in the document and the goods that it represents is unquestionably perfected for so long as the document is outstanding. However, a question is presented where, during the twenty-one-day period, the document is given up by the debtor in exchange for the goods. Does the secured party then have a perfected security interest in the "goods" for the unused portion of the twenty-one-day period? The answer is not clear. The official comments were apparently written under the assumption that the security interest remains perfected until the expiration of the period without regard to whether the document may have been converted into goods during the perfection period.¹⁰⁸ Whether such an assumption is justified by the actual wording of section 9-304 remains to be seen. In this context, subsection 9-304(4) provides only for perfection of a security interest in "negotiable documents." To reach the conclusion desired by the secured party, this will have to be interpreted to read: "negotiable documents or goods when the document is no more." Subsection 9-304(2) provides that where goods are in the possession of someone who has issued a negotiable document therefor, "a security interest in goods is perfected by perfecting a security interest in the document" If that subsection said no more, it might be inferred that a security interest in the negotiable document is the exact equivalent of a security interest in the goods. But prefatory words of subsection 9-304(2) seem pretty clearly to say that perfection of a security interest in the goods by perfecting the interest in documents lasts only "during the period that the goods are in the possession of the issuer" of the document. Thus, it would not be unreasonable for a court to conclude that the temporary perfection terminated at the time that the debtor took possession of the goods from the issuer of the document, or at most ten days thereafter.¹⁰⁹

If, in similar situations, the documents are released by the secured party under subsection 9-304(5) for the specified purposes, the secured party faces less uncertain statutory language and probably

¹⁰⁸ *E.g.*, G.S. § 25-9-303, comment 2.

¹⁰⁹ Possibly the secured party would be successful in contending that the goods were "proceeds" of the document within the meaning of G.S. § 25-9-306(1), and thereby gain the ten-day automatic perfection for the security interest in proceeds. See *infra*, pp. 808-10.

should be successful in contending that the security interest should remain perfected for the complete twenty-one-day period without regard to the time at which the document is surrendered in return for the goods. The express purposes for which the release of the documents is permitted under the subsection—loading, unloading, storing, shipping, manufacturing, etc.—contemplate that the debtor will, during the twenty-one-day period convert the document into goods. Otherwise, he would not be able to accomplish many of the purposes for which the release is made. Furthermore, the first sentence refers merely to a “security interest” being perfected for the twenty-one days, not, as does subsection (4), of a security interest in specific things, such as negotiable documents. And, since there is a security interest in both the goods and the documents, the secured party should have the benefit of perfection under subsection (5) for the full twenty-one days. Otherwise, the subsection would make little sense.

However, in these situations as in other places where a similar question may arise about the automatic perfection, the advice for the secured party is to file a financing statement, if he desires to be certain of the maximum allowable protection under the Code. In the documents situation, since the secured party will undoubtedly have a security interest in both the documents and the goods, he can file as soon after taking his interest as he thinks the documents will be exchanged by the debtor for the goods. The security interest will then be perfected permanently both as to the documents and as to any goods covered by the financing statement.

If the secured party releases instruments under either of the twenty-one-day perfection subsections, he will almost certainly take the risk that the instrument will be converted by collection into its proceeds during that period and his “perfection” cut short. Thus, if the debtor collects the instrument on the first day after possession has been released to him by the secured party, the security interest in the instrument will cease to exist because the instrument, in any meaningful sense, ceases to exist. With the “proceeds” in the hands of the debtor, the secured party’s term of “perfection” will probably shrink to a maximum of ten additional days under the provision applicable to proceeds specifically.¹¹⁰ Filing, in this circumstance, is of no practical assistance to the secured party, as it will

¹¹⁰ G.S. § 25-9-306(3).

not result in perfection of his security interest in original instruments¹¹¹ and would result in perfection of his interest in the proceeds only if the character of the proceeds was such that an interest therein could be perfected by filing.¹¹²

In summary, the temporary perfection permitted by subsections 9-304(4) and (5) may have such a low potential priority and be attended with so many risks that its use will be discouraged. In any event, reliance upon this type of "perfection" should be made only by one familiar with its limitations.

THE CONSEQUENCES OF "PERFECTION"— PRIORITIES

Subject to exceptions in the case of transactions covered by the Uniform Trust Receipts Act,¹¹³ at the present time it can be stated that generally in North Carolina the rights of all subsequent parties who claim to have an interest in personal property superior to that of the holder of a security interest, except the rights of a bona fide purchaser in the ordinary course of business, will be determined on the same basis—whether the secured party took the steps necessary for perfection before the intervention of the subsequent party's interest. Under Article 9 of the Code, such a general statement is subject to so many exceptions that it would be virtually meaningless. The Code treats separately (although not always with different results) the problems of priority between the security interest, and the purchaser in general,¹¹⁴ buyers in the ordinary course of busi-

¹¹¹ G.S. § 25-9-304(1).

¹¹² G.S. § 25-9-306(3) provides for two methods of perfection beyond ten days of a security interest in "proceeds": First, if there is a filed financing statement covering the original collateral that also covers proceeds, the interest in proceeds will be perfected. Second, the secured party may perfect by perfecting a security interest in "the proceeds." If the debtor received, in return for the surrender of the instrument, tangible personal property or an account the secured party could probably perfect his interest in the "proceeds" under G.S. § 25-9-306(3)(b) by filing, a permissible method of perfection for that type of collateral. But if the proceeds are themselves instruments or cash, it would seem that filing would not perfect an interest in "the proceeds" any more than it would if the instruments or cash were not proceeds. See text accompanying notes 224-27 *infra*.

¹¹³ N.C. GEN. STAT. §§ 45-46 to -66 (Supp. 1965), repealed, effective July 1, 1967, G.S. § 25-10-102.

¹¹⁴ G.S. § 25-9-301(1)(b), (c). Other special classes of purchasers are dealt with in G.S. §§ 25-9-308, -309, -307(2).

ness,¹¹⁵ lien creditors,¹¹⁶ other consensual security interests,¹¹⁷ and nonconsensual mechanic's or artisan's liens.¹¹⁸ Generally, the results that might be expected in these situations will prevail under the Code as well. However, there are enough significant differences between existing results and results under the Code to require close analysis of the Code provisions.

By way of general introduction, the priorities between the secured party and lien creditors and purchasers will be determined by the time of "perfection" of the interest, whereas priorities between consensual security interests will be determined by time of filing or time of perfection,¹¹⁹ or other special rules.¹²⁰ Thus, an attorney should never expect that, because he has created a security interest that will be secure against the lien creditor, he necessarily has an interest good against other types of interests.

I. THE PRIORITY OF THE LIEN CREDITOR

One significant change from prior law should be noted at the outset. North Carolina has been a pure "race" jurisdiction in the matter of priorities where public recordation of interest is required. Therefore, the knowledge that a person might acquire prior to the acquisition of his own interest in the property is of no significance in determining the priorities under the recording acts—the first interest recorded is prior to the later perfected interest.¹²¹ At least insofar as the ability of a lien creditor to acquire priority over an unperfected security interest is concerned, the Code will partially convert North Carolina into what has been referred to as a "notice" jurisdiction,¹²² and the lien creditor will not be able to acquire priority over the unperfected security interest if he has knowledge of its existence at the time he acquires his lien.¹²³

¹¹⁵ G.S. § 25-9-307(1).

¹¹⁶ G.S. § 25-9-301(1)(b).

¹¹⁷ G.S. § 25-9-312. Some other special rules on priority are contained in G.S. §§ 25-9-313 (fixtures), -314 (accessions), -315 (commingled and processed goods).

¹¹⁸ G.S. § 25-9-310.

¹¹⁹ G.S. § 25-9-312(3).

¹²⁰ *E.g.*, G.S. § 25-9-312(3), (4) (purchase-money security interest); G.S. § 25-9-312(2).

¹²¹ The cases are numerous. *E.g.*, *Smith v. Turnage-Winslow Co.*, 212 N.C. 310, 193 S.E. 685 (1937) (dictum); *North State Piano Co. v. Spruill & Bros.*, 150 N.C. 168, 63 S.E. 723 (1909).

¹²² CASNER & LEACH, *CASES AND TEXT ON PROPERTY* 783 (1950).

¹²³ G.S. § 25-9-301(1)(b). In some circumstances, knowledge of certain

The keys to ascertaining the priority of the lien creditor are the time of the acquisition of the lien and the time of perfection of the security interest. The lien of judgment on personal property arises at the time of the attachment or levy,¹²⁴ that is, at the time that the sheriff or levying officer takes actual or constructive possession of the property.¹²⁵ If the lien creditor under the Code acquires his lien "without knowledge of the security interest and before it is perfected," he will take priority over the security interest. More precisely, a person who becomes a lien creditor at a time when the security interest is unperfected will have priority. There is a possibility under Article 9, where more than one method of perfection may have been used in any given transaction, that the security interest will have been perfected by possession and subsequently, after possession has been relinquished, by late filing so that a gap would exist during which the security interest was not perfected. If the lien creditor's interest arises and attaches within that gap, the lien creditor should have priority even though the security interest was originally perfected "before" the lien creditor's rights attached.¹²⁶

A lien creditor is defined by section 9-301 to include not only the creditor for whose benefit the property has been levied upon, but the assignee for benefit of creditors, a receiver appointed by a court of equity, and the trustee in bankruptcy. The latter, of course, does not acquire his status by sufferance of state law and would in any event have the status of a lien creditor by virtue of the provisions of the Bankruptcy Act.¹²⁷ In the circumstances where the debtor is an insolvent and a representative has been appointed to wind up his affairs, the Code attempts to attribute to the representative of the estate, be he a receiver, assignee, or trustee in bankruptcy, the knowledge of all creditors for the purpose of denying

facts is also relevant to priorities of purchasers. G.S. §§ 25-9-301(1)(c), or -301(1)(d), or -307, -308 and -309. See text accompanying notes 131-79 *infra*. Where the contest is between two consensual security interests, the knowledge of the second party is relevant to priorities only in a very limited context. A defectively filed financing statement is effective against a person who has actual knowledge of its contents. G.S. § 25-9-401(2).

¹²⁴ G.S. § 25-9-301(3); N.C. GEN. STAT. § 1-313 (1953).

¹²⁵ *Starling v. Selma Cotton Mills*, 171 N.C. 222, 88 S.E. 242 (1916); *Bland v. Whitfield*, 46 N.C. 122, 125 (1853).

¹²⁶ G.S. § 25-9-303, comment 2.

¹²⁷ Bankruptcy Act § 70(c), 30 Stat. 565 (1898), as amended, 11 U.S.C. § 110(c) (1964).

priority.¹²⁸ The knowledge of all creditors of the existence of a security interest can and probably should be imputed to the representative of those creditors in an insolvency proceeding that is instituted and sanctioned under state law. However, it is questionable whether this provision of subsection 9-301(3) will be effective against the trustee in bankruptcy. The trustee's status as a lien creditor under subsection 70(c) and his consequent ability to set aside security interests that are unperfected at the date of bankruptcy do not depend upon the existence of an actual creditor who, if vested with a lien, could take priority over the security interests.¹²⁹ Therefore, in those circuits wherein the above theory of the trustee's powers is followed, the holder of the unperfected security interest probably cannot prevail over the trustee by showing that all creditors have knowledge of the security interest and would themselves be precluded from taking priority over the security interest.¹³⁰

II. THE PRIORITIES OF "BUYERS," "PURCHASERS," AND "TRANSFEREES"

This part of the paper is intended to examine the remaining classes of subsequent parties whose interest in the particular property is not a "security interest" but whose rights conflict with those of a person who holds a "security interest" in the property. In other words, it basically is concerned with the rights of the secured party vis-à-vis other persons who are not lien creditors or secured parties. Because of the broad definition of "purchase" under the Code¹³¹ and the intended absence of restriction on its use in sections 9-308 and 9-309, this section of the paper does overlap to some extent into the area of priorities between secured parties with reference to interests in chattel paper, instruments, and negotiable documents.¹³² However, for security interests in collateral other than chattel paper, instruments, and negotiable documents, the priorities

¹²⁸ G.S. § 25-9-301(3).

¹²⁹ *Hoffman v. Cream-O-Products*, 180 F.2d 649 (2d Cir. 1950); 3 COLLIER, BANKRUPTCY ¶ 70.53 (14th ed. 1964). See *In the matter of Rosenberg Iron & Metal Co.*, 343 F.2d 527 (7th Cir. 1965). *Contra*, *Pacific Fin. Corp. v. Edwards*, 304 F.2d 224 (9th Cir. 1962).

¹³⁰ *Hoffman v. Cream-O-Products*, *supra* note 129; 3 COLLIER, BANKRUPTCY ¶ 70.62A 9 (14th ed. 1964). However, the only reported decision decided under the Uniform Commercial Code is *contra*. *In the matter of Komfo Prods. Corp.*, 224 F. Supp. 229 (E.D. Pa. 1965).

¹³¹ G.S. § 25-1-201(32).

¹³² See text accompanying notes 174-75 *infra*.

between secured parties are covered in section 9-312 and the sections following; and the rights of the purchaser or buyer under preceding sections, specifically sections 9-301 and 9-307, are restricted, explicitly or implicitly, to those persons who are not secured parties. The paper is here primarily concerned with the latter.

To avoid confusion in reading Article 9 and determining the rights of the various types of transferees, it helps to keep in mind the fact that section 9-301 defines the priorities between certain classes of persons and the *unperfected* security interest. The other sections of Part 3, Article 9 that deal with the rights of these transferees¹³³ detail the priority of the eligible transferees over the *perfected* security interest, leaving to rather involved construction the conclusion that those persons will also have priority over the unperfected security interest.¹³⁴

A. Purchasers and Transferees Who Have Priority Over Unperfected Security Interests

Consistent with existing law, which gives to a bona fide purchaser of property an interest superior to that of a prior secured party who has failed to record or otherwise perfect his interest,¹³⁵ Article 9 provides that the transferee who is not a secured party¹³⁶ of goods, instruments, documents, or chattel paper will have priority over an unperfected security interest in the property "to the extent that he gives value and received delivery of the collateral without knowledge of the security interest"¹³⁷ Of course, if the transferee acquired knowledge of the security interest is perfected before he accepts complete delivery of the property *or* before

¹³³ Specifically, G.S. §§ 25-9-307, -308, -309.

¹³⁴ G.S. § 25-9-312(1); G.S. § 25-9-301(1)(a), comment 2.

¹³⁵ *E.g.*, N.C. GEN. STAT. § 47-20 (Supp. 1965).

¹³⁶ The wording of the section is "a person who is not a secured party and who is a transferee in bulk or other buyer not in the ordinary course of business . . ." G.S. § 25-9-301(1)(c). In conjunction with other sections, this round-about language means that any purchaser who buys absolute ownership in the property without knowledge of the unperfected security interest will prevail. If the purchaser can also qualify as a "buyer in the ordinary course of business," G.S. 25-1-201(9), he will be in an even better position. G.S. § 25-9-307(1). See text accompanying notes 147-54 *infra*. If the purchaser "buys" only a "security interest," G.S. § 25-1-201(37) in the property, his right to priority, if any, will be governed by § 9-312.

¹³⁷ G.S. § 25-9-301(1)(c). Here, as in the case of the lien creditor, the requirement that the transferee be without knowledge of the security interest will change North Carolina law. See notes 121-23 *supra*.

he has given full value, he will have priority over the security interest only to the extent that either of the required acts has been performed.¹³⁸ Determining the extent to which the transferee has accepted delivery will present few problems as it is an easily measurable physical fact. Neither should determining the extent to which value is given present any difficult problems in this context. Clearly, the extent-of-value provision is not intended to open the door to a measuring of the economic value of the consideration given against the economic value of what was received by the transferee.¹³⁹ The context assumes some type of sales transaction and, in such a situation, "value" is given "by accepting delivery pursuant to a preexisting contract for purchase."¹⁴⁰ Thus, since both delivery and value are required under subsection 9-301(1)(b), the extent of the transferee's rights is determined by the extent of delivery, if there is a contract for purchase. If delivery has been made and there is no obligation on the transferee, the transferee will have given no value.

The Code provisions relating to rights of purchasers generally of accounts, contract rights and general intangibles are less complex than those for the "tangible" types of collateral. There are no problems of ostensible ownership or negotiability to make desirable special exceptions in favor of special classes of purchasers of these types of collateral. Consequently, the purchaser of the accounts can find his priority under either section 9-312 or section 9-301. The latter section defines, as in the case of tangible classes of collateral, the rights of purchasers other than secured parties over unperfected security interests in the collateral. The transferee will have priority if he is "a person who is *not a secured party* and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected."¹⁴¹

However, with relation to accounts, contract rights, and chattel paper, the author can conceive of no commercially significant situa-

¹³⁸ G.S. § 25-9-301, comment 4.

¹³⁹ This is a function more appropriately reserved for legislation such as N.C. GEN. STAT. § 39-15 (1950) (fraudulent conveyances) and the Uniform Fraudulent Conveyances Act. Aside from that, "value" is a word of art, defined in G.S. § 25-1-201(44).

¹⁴⁰ G.S. § 25-1-201(44)(c). Value is given for rights if the rights are acquired (1) in return for binding commitment to extend credit, (2) in satisfaction of preexisting claim, (3) accepting delivery, etc., or (4) in return for consideration sufficient to support a simple contract.

¹⁴¹ G.S. § 25-9-301(1)(d). (Emphasis added.)

tion in which the transferee thereof would not, under Article 9, be a "secured party," thus casting in doubt whether subsections 9-301(c) and (d) in reality have much significance in relation to the transfers of interests in these types of collateral. It is the purpose of Article 9 to govern any "sale of accounts, contract rights, or chattel paper."¹⁴² To accomplish this purpose, "security interest" is defined to include "any interest of a buyer of accounts, chattel paper, or contract rights which is subject to Article 9."¹⁴³ Thus, it would seem that any commercial purchaser of accounts, contract rights, or chattel paper would be the holder of a "security interest" under Article 9. "Secured party" is defined as any person "in whose favor there is a security interest, including a person to whom accounts, contract rights or chattel paper have been sold."¹⁴⁴ Therefore, the transferee of these three classes of collateral, whether he takes by "sale" or as security, is probably going to be deemed a "secured party" under subsections 9-301(c) and (d). As a result, he would be excluded from these sections and his priority over the unperfected security interest would come, if at all, by virtue of section 9-312, or possibly, where chattel paper is the collateral, section 9-308. The transferee, who becomes such otherwise than by gift or some other transfer not by sale or for security, will have an interest generally subject to Article 9 and will have priority over the security interest unperfected at the time he gave value only if he (the transferee) files or otherwise perfects first. If the collateral is chattel paper, the transferee would perfect the transfer by taking possession of it; if it is accounts and contract rights, the transferee would have to perfect by filing¹⁴⁵ first.¹⁴⁶ However, nothing here

¹⁴² G.S. § 25-9-102(1)(b).

¹⁴³ G.S. § 25-1-201(37).

¹⁴⁴ G.S. § 25-9-105(1)(i).

¹⁴⁵ Or by bringing the transfer within the automatic perfection of G.S. § 25-9-302(1)(e).

¹⁴⁶ Thus, in the case of chattel paper, it would make no difference in the ultimate result whether the transfer claimed under G.S. § 25-9-301(1)(c) or G.S. § 25-9-312. Under the former section, read literally, the transferee would have priority to the extent he took delivery. Under G.S. § 25-9-312 the result would be the same. The transferee's interest was perfected at the time he took possession, G.S. § 25-9-305; the perfection was otherwise than by filing and the first-to-perfect rule, G.S. § 25-9-312(5)(b) would apply giving him priority. If the original security interest was "perfected," the transferee or purchaser might also prevail under the special rules of G.S. § 25-9-308.

Whether the result would be different where accounts or contract rights are involved depends upon the meaning of "transferee," a term not defined

said could affect the operations of subsections 9-301(c) and (d) on the other types of collateral respectively included therein.

*B. Purchasers Who Take Priority Over Perfected
Security Interests*

In certain circumstances under the Uniform Commercial Code, some types of purchasers of some types of collateral will take priority over a perfected as well as an unperfected security interest. The situations to which this priority is assigned are determined on the basis that either the status of the purchaser, the actions of the secured party, or the method of perfection dictates that the secured party should derive a limited protection from perfection. The underlying reasons for the individual instances are much better seen in direct relation to the exceptions created.

1. *The Buyer in the Ordinary Course of Business.*—A purchaser who can bring himself within the definition of “buyer in the ordinary course of business”¹⁴⁷ will take priority over the security interest in the property created by his vendor.¹⁴⁸ Thus, Article 9 makes positive law a result that the courts, over the years, have grappled for, often with diverse and diffuse results, using theories of waiver or estoppel and other theories equally inappropriate or inefficient.¹⁴⁹ Concern for delicate balancing of the “property rights” of the secured party and the equities inherent in the position of the lowly consumer prevented the judicial process from ever achieving a satisfactory, reliable rule upon which actions could be based in this area.

In three instances the North Carolina legislature has in past years, by design or by inadvertance, sanctioned rules intended to achieve essentially the same results as will be obtained when the Code becomes effective.¹⁵⁰ However, these past legislative attempts added not sense but more inconsistency to the general law on the

by the Code. If it means a person with a “perfected” interest, the result under either G.S. § 25-9-301 or G.S. § 25-9-312 would be the same. If it means simply a person to whom rights have been transferred, the result would be different.

¹⁴⁷ As defined in G.S. § 25-1-201(9).

¹⁴⁸ G.S. § 25-9-307(1).

¹⁴⁹ See *e.g.*, *Atlantic Discount Corp. v. Young*, 224 N.C. 89, 29 S.E.2d 29 (1944); *Southern Ry. Co. v. W. A. Simpkins Co.*, 178 N.C. 273, 100 S.E. 418 (1919).

¹⁵⁰ N.C. GEN. STAT. § 45-54 (Supp. 1965) (Uniform Trust Receipts Act), repealed effective July 1, 1967, G.S. § 25-10-102; N.C. GEN. STAT. § 44-73 (Supp. 1965) (Factor's Lien Act), repealed effective July 1, 1967, G.S. §

subject. After the final legislative solution antedating the adoption of Uniform Commercial Code was enacted in 1961, the consumer who purchased goods from a merchant could take free of a security interest created by the merchant if the security interest was cast in the form of the trust receipt.¹⁵¹ In an identical situation, substituting a chattel mortgage for the trust receipt, the consumer would lose; but if he purchased an automobile as opposed to a refrigerator, he would win in both situations.¹⁵² In place of such nonsensical distinctions is substituted the Code rule that the buyer in the ordinary course of business of any type of "goods" that may be subject to any type of security interest will take priority over the perfected or unperfected interest of the secured party. The buyer's knowledge of the existence of the security interest is relevant only where he not only knows¹⁵³ of the existence of the interest, but also knows that specific provisions of the security agreement prohibited sale by the debtor in the situation.¹⁵⁴ In the typical consumer-sales situation, knowledge will seldom, if ever, be a factor in determining priority unless the secured party stands at the door and presents to every customer a copy of the security agreement with the provisions prohibiting sale underlined in red. The average consumer may suspect that the retailer is being financed by a third party who has a security interest in the goods, but it is unlikely that the consumer knows even this fact; much less does he "know" of the specific provisions of the security agreement prohibiting sale. Thus, the consumer's expectations will be met under the Code by giving him a title free of the interest of the secured party. It should be noted that the priority of the buyer in the ordinary course of business is not limited to sales of consumer goods. It should apply to any situation in which the seller is regularly engaged in the business of selling the type of goods involved, except where the purchaser buys farm products from a farmer. However, as the level of sophistication of the buyer rises and the frequency of sales of the type of items decreases, there is greater likelihood that the buyer may have

25-10-102; N.C. GEN. STAT. § 20-58.9 (Supp. 1965) (purchaser of automobile from dealer).

¹⁵¹ N.C. GEN. STAT. § 45-54(b)(1) (Supp. 1965), repealed effective July 1, 1967, G.S. § 25-10-102.

¹⁵² N.C. GEN. STAT. § 20-58.9(3) (Supp. 1965).

¹⁵³ "A person knows or has knowledge of a fact when he has actual knowledge of it." G.S. § 25-1-201(25).

¹⁵⁴ G.S. § 25-9-307, comment 2; G.S. § 25-1-201(9).

knowledge of facts which will prevent him from taking priority over the security interest. Nevertheless, actual knowledge is still the requirement, not merely knowledge of facts sufficient to put a reasonable man on inquiry.

Casual examination of subsection 9-307(2) would lead one to the conclusion that the section is designed to protect the buyer of the goods only in the situation where the perfected security interest antedates the purchase, that is, it contemplates only a situation where there will be a security interest in the inventory at the time that the buyer purchases. Not so, said a Pennsylvania court in *Weisel v. McBride*,¹⁵⁵ where the purchaser of an automobile left the forms by which the certificate of title could be procured with the seller upon the seller's representation that he would procure the title for the buyer. Seller instead procured the certificate of title in his own name and on the basis of this certificate procured an advance from the plaintiff who took a security interest in the automobile from the seller. The court implicitly found this to be a "security interest created by his seller" and, therefore, held that the buyer had priority.

2. *Purchasers of Chattel Paper, Instruments and Negotiable Instruments.*—Chattel paper, instruments, and negotiable documents are subject to some special rules of priority where the rights of a purchaser or holder are in conflict with the rights of a prior secured party who has a perfected security interest therein.¹⁵⁶ The effect of these special rules is to modify what would otherwise be the anticipated results between secured parties under section 9-312.

As heretofore noted, the Code permits the perfection of a security interest in chattel paper by filing a financial statement or by the secured party's taking possession of the paper.¹⁵⁷ Where filing is the method of perfection chosen by the original secured party, perfection will be less than complete protection against the intervening rights of some third parties. The secured party, by permitting the debtor to remain in possession of the chattel paper and collect the debts represented by it, will effectively subordinate his perfected security interest to the rights of a purchaser of the paper who gives new value and takes possession of the paper in the ordinary course

¹⁵⁵ 191 Pa. Super. 411, 156 A.2d 613 (1959).

¹⁵⁶ G.S. § 25-9-308 (chattel paper and non-negotiable instruments); G.S. § 25-9-309 (negotiable instruments and documents and "securities").

¹⁵⁷ G.S. § 25-9-305.

of his business without knowledge of the prior security interest.¹⁵⁸ Knowledge again means actual knowledge of the purchaser with reference to the specific paper he is purchasing;¹⁵⁹ the constructive notice imputed by the filed financing statement will not be sufficient to deprive the purchaser of his priority. The ordinary course of business here relevant is the ordinary course of the transferee's business,¹⁶⁰ not, as in the case of buyers of goods,¹⁶¹ the ordinary course of business of the transferor.

A "purchaser" in this context is a person who takes "by sale, discount, . . . mortgage, pledge, lien, . . . gift or any other voluntary transaction creating an interest in property."¹⁶² Of course, the requirement of giving "new value" and taking possession in the ordinary course of business would exclude the lien creditor, a donee and other noncommercial transferees from the benefits of this section.

Chattel paper is subject to yet another exception. Since it is nearly always the end result of a sale from inventory, chattel paper is "proceeds" under subsection 9-306(1). The last sentence of section 9-308 provides that a purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over the security interest in the chattel paper that is claimed merely as a result of the fact that this chattel paper is proceeds. More significantly, such a purchaser will take priority even though he has knowledge that the paper that he purchases is subject to the competing perfected interest of the secured party. The obvious intended effect of this provision is to prevent the supplier or financier of a merchant from acquiring an automatic monopoly on the chattel paper of that merchant that results from the sale of the inventory in which the supplier or financier had a

¹⁵⁸ G.S. § 25-9-308. If this section were not included in Article 9, the transfers included in it would be governed by G.S. 25-9-312 as they would be contests between "secured parties." See text accompanying notes 142-46 *supra*. The first secured party perfected by filing and the second perfected by possession. The second rule of G.S. § 25-9-312(5) would give priority to the first secured party as he was the first to perfect. This, of course, assumes that the first secured party had a perfected interest, not merely a filed financing statement.

¹⁵⁹ G.S. § 25-9-308; G.S. § 25-1-201(25).

¹⁶⁰ G.S. § 25-9-308.

¹⁶¹ G.S. § 25-9-307(1).

¹⁶² G.S. § 25-1-201(32), (33). Purchase also includes taking by "negotiation" and "issue of re-issue," terms not applicable to any transfer of chattel paper.

security interest. In other words, the mere acquisition of inventory through the financing of one secured party will not prevent the merchant from retaining bargaining position in relation to chattel paper that is proceeds of the inventory. The merchant has the option at the completion of a sale from inventory that gives rise to chattel paper to retain the paper in which case it will remain subject to the security interest, or to sell the chattel paper to some third party. If the original inventory financier wishes to deny to the merchant this option by foreclosing the rights of the purchaser who has knowledge of the security interest, he can bargain with the merchant for a security interest in the chattel paper separately, including in the agreement an after-acquired property clause. When the secured party gives value for the chattel paper separately and the security interest attaches, the secured party can file and have protection against all purchasers except those claiming under the first sentence of section 9-308, or he can file and take possession of the paper and have complete protection.¹⁶³

As in the case of chattel paper, a purchaser of a non-negotiable instrument other than a security¹⁶⁴ "who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific . . . instrument is subject to a security interest,"¹⁶⁵ will have priority over the perfected security interest. However, filing is not a permissible method of perfection of a security interest in instruments.¹⁶⁶ Consequently, the only situation where this provision would be applicable would be where the debtor had possession of the non-negotiable instrument and the secured party claimed temporary perfection under subsections 9-304(4) or (5).¹⁶⁷ Although a non-negotiable instrument might be "proceeds"¹⁶⁸ of collateral in which a person had a perfected security interest, thereby giving him a ten-day perfection of the security interest in the proceeds¹⁶⁹—the instrument—the Code makes no express provision for the rights of a purchaser who claims adversely to the secured party's "perfected" interest in that situation. How-

¹⁶³ See generally, 1 COOGAN, HOGAN & VAGTS § 7.09(3)(b).

¹⁶⁴ The purchaser of a "security," whether or not it is negotiable, is protected, if at all, under G.S. § 25-9-309.

¹⁶⁵ G.S. § 25-9-308.

¹⁶⁶ G.S. § 25-9-304(1).

¹⁶⁷ G.S. § 25-9-308, comment 3.

¹⁶⁸ G.S. § 25-9-306(1).

¹⁶⁹ G.S. § 25-9-306(3).

ever, since the proceeds perfection in that situation, like the twenty-one-day perfection, in nonpossessory, there would be little reason to depart from the rule of section 9-308 permitting the unknowing purchaser who gives new value to have priority.¹⁷⁰

Probably because non-negotiable instruments alone are not a significant source of commercial financing and not often proceeds, the last sentence of section 9-308, which broadens the rights of purchasers of chattel paper where it is claimed as proceeds, is not applicable to non-negotiable instruments.

Any time a secured party is claiming a nonpossessory perfected security interest in a negotiable instrument, a negotiable document, or a security,¹⁷¹ his rights can be cut off by a transferee of the particular collateral who is in a position to cut off claims of ownership generally.¹⁷² Any other, more restrictive rule would have a broad adverse effect on the negotiability or transferability of these instruments and documents, a result that would in no way be justified solely on the ground of protection of the secured party's nonpossessory perfection.

The situations in which the subsequent purchaser will cut off the secured party's interest depend, of course, upon the formalities required for the purchaser to become a holder in due course of the negotiable instrument, one to whom a negotiable document has been duly negotiated, or a bona fide purchaser of a security.¹⁷³ Generally, taking the instrument, document, or security as security for or in payment of a new advance or an antecedent debt will not preclude one, otherwise qualified, from acquiring the ability to cut off the

¹⁷⁰ The secured party should then have a perfected security interest in the "proceeds" of the "proceeds." G.S. § 25-9-306.

¹⁷¹ This will normally be where these documents have been released to the debtor under G.S. § 25-9-304(4) or (5), although, conceivably, it could be where he claims the perfected security interest in proceeds. G.S. § 25-9-306.

¹⁷² G.S. § 25-9-309.

¹⁷³ To become a holder in due course of a negotiable instrument a purchaser must first become a "holder." G.S. § 25-3-302(1), which requires that order paper be indorsed to him or in blank and delivered; bearer paper need only to be delivered. G.S. § 25-1-201(20).

The negotiable document is "negotiated" in essentially the same manner as a negotiable instrument. G.S. § 25-7-501.

"A 'bona fide purchaser' is a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank." G.S. 25-8-302.

claims of ownership or adverse interest.¹⁷⁴ Therefore, the subsequent holder in due course or bona fide purchaser, even though he acquires only a security interest in the collateral, will take priority over the rights of the secured party having the temporarily perfected interest.¹⁷⁵

The fact that absence of notice of adverse claim is a prerequisite to a transferee's claim of priority under section 9-309¹⁷⁶ raises the question whether the secured party, when releasing the instruments or documents to the debtor, can in any way protect himself from parties who claim under section 9-309. It would seem that the secured party could stamp or otherwise clearly note on the face of the paper the fact that he claims a security interest in the paper and thereby preclude any subsequent purchaser from taking free of his interest.¹⁷⁷ If so, this could possibly create an anomalous situation. For example, assume the release of commercial paper. For twenty-one days after release of the instrument the secured party would have a perfected security interest,¹⁷⁸ and because of the notice of the secured party's claim written on the paper, no purchaser could become a holder in due course. After twenty-one days the secured party's security interest would become unperfected and, while no purchaser could become a holder in due course, a subsequent pledgee or other secured party perfecting his security interest by taking possession would prevail over the first secured party under subsection 9-312(5)(a).¹⁷⁹ If there is a firm answer to this problem, it escapes the author.

¹⁷⁴ G.S. § 25-3-303(b) (negotiable instrument) (by implication). Compare G.S. § 25-8-302 (bona fide purchaser of security), with G.S. § 25-1-201(32) ("purchase" defined), and G.S. § 25-1-201(44)(b) ("value" defined).

However, a negotiable document is not "duly negotiated" when it is taken in "settlement or payment of a money obligation." UCC § 7-501(4), comment 1.

¹⁷⁵ This situation brings G.S. § 25-9-309 into intended conflict with the rules of priority between secured parties, G.S. § 25-9-312. Whether or not the transferee is a "secured party," if he qualifies under this section, he will take priority over the first perfected security interest, G.S. § 25-9-312(1).

¹⁷⁶ To become a holder in due course, bona fide purchaser or one to whom a document has been duly negotiated, the purchaser must take without notice of any adverse claim. G.S. §§ 25-3-302(1)(c), -8-302, -7-501(4). The permissible filing of security interests in negotiable documents, G.S. § 25-9-304(1), does not constitute "notice" to the purchaser. G.S. § 25-9-309.

¹⁷⁷ See Mooney, *The Old and the New: Article 9*, 16 ARK. L. REV. 145, n.13 (1961).

¹⁷⁸ G.S. § 25-9-304(5).

¹⁷⁹ This is assuming that knowledge of a prior security interest will not

III. PRIORITIES BETWEEN SECURED PARTIES

Where two persons are owners of consensual security interests in identical goods, accounts, contract rights, or general intangibles, the determination of which has priority will basically be made by application of the rules of section 9-312. If the competing security interests are in chattel paper, instruments, or documents, the priorities will likewise be governed by section 9-312, except where one of the secured parties can bring himself and the situation within one of the previously discussed special rules of sections 9-308 or 9-309.

The basic rules under section 9-312 are set out in subsection (5) of that section and are generally referred to as (1) the "first-to-file" rule, (2) the "first-to-perfect" rule, and (3) the "first-to-attach" rule. They mean exactly what the references imply. If the first-to-file rule is applicable to a given situation, the party who first filed his financing statement will have priority, and so on. The key to determining which of the first two rules is applicable is the method of perfection of each of the security interests. The first rule is applicable only where both of the competing interests are perfected by filing; the second is applicable only where one or both of the interests are perfected otherwise than by filing. Since Article 9 permits perfection of various security interests by several methods other than filing and since more than one of these methods may have been used in a single transaction, the problem arises of deciding which of the methods used shall control the application of the priority rules. Subsection 9-312(6) provides the answer. The first method by which the security interest was perfected, if the security remains continuously perfected, shall determine which of the priority rules is applicable.

To illustrate, suppose that C Bank took a security interest in some goods covered by negotiable documents. The bank must originally perfect its security interest in the goods by perfecting an interest in the documents. The security interest in the document may be perfected in any of three ways: (1) by filing,¹⁸⁰

prevent the perfected security interest from taking priority over the unperfected one. Knowledge is expressly a factor in determining priorities of purchasers not secured parties and lien creditors. G.S. § 25-9-301. However, the lack of knowledge requirement is conspicuously absent from G.S. § 25-9-312(5) (b), which would govern the priorities between the two "secured parties."

¹⁸⁰ G.S. § 25-9-304(1).

(2) by taking possession after the security interest attaches,¹⁸¹ or (3) by claiming a temporary perfection and permitting the documents to remain in or releasing them to the debtor's possession.¹⁸² Assuming that the bank chose the first method and filed a financing statement covering the documents and goods before it made an advance, the bank's interest would, so long as it remained continuously perfected, be deemed to be perfected by filing. This would be so even though the bank subsequently took possession of the document or the goods.

If the bank chose to perfect by taking possession initially, but several days later filed a financing statement and released the documents and goods to the debtor, the bank's interest would be deemed perfected otherwise than by filing. The same would be true if the bank initially relied upon the twenty-one-day temporary perfection, and before the debtor converted the document into goods in his possession, the bank filed a financing statement; the bank would be deemed to have perfected otherwise than by filing. However, if at any time there was a period during which the security interest was not perfected—for example, if the bank failed to file until twenty-two days after the documents were released to the debtor—not only would the bank's time of perfection date from the twenty-second day, but the method of perfection taken on that day would control the operation of the priority rules thereafter.

Having identified the method of perfection of each security interest, the application of the priority rules is relatively simple.

*A. The First-To-File Rule*¹⁸³

Simply stated, the rule is: Where both competing security interests are or are deemed to be perfected by filing, the security interest related to the first filed financing statement shall have priority. The first secured party to procure the debtor's name on a financing statement and file the statement will have priority over any subsequently filed security interests. The relative times of attachment and perfection of the security interests, where this rule is applicable, are irrelevant. Therefore, at the time of filing of the first financing statement, the secured party need not make an advance, nor need there be a security agreement in existence at that time.

¹⁸¹ G.S. § 25-9-305.

¹⁸² G.S. § 25-9-304(4) or (5).

¹⁸³ G.S. § 25-9-312(5)(a).

To be extreme in example, suppose that on January 1, 1963, *A* files a financing statement adequately describing all of the equipment used in debtor's business. No security agreement is executed and *A* does not make any advance at that time. On January 1, 1965, *B* loans the debtor 100,000 dollars, taking a security interest in the debtor's equipment. The same day *B* files a financing statement covering the transaction. On June 1, 1965, *A* finally loans the debtor 50,000 dollars and a security agreement covering the equipment is executed. In a contest for the equipment between *A* and *B*, *A* would have priority. Both security interests having been perfected by filing, the first-to-file a financing statement prevails.

Standing alone, the first-to-file rule may appear to give to the first filer unwarranted ability to tie up the assets of a debtor. However, on the facts given above, there are methods by which *B* could have insured himself priority over the subsequent advance made by *A*.

First,¹⁸⁴ *B*, having notice of the first filing, could have required the debtor to procure a termination statement from *A*. When no secured obligation is outstanding against a filed financing statement, the secured party is obligated, upon written demand of the debtor, to provide a statement, which when filed will terminate the effectiveness of the original financing statement.¹⁸⁵ Thus, *B* could have procured termination of the original filing and its own filing would have been first.

Second, *B* could have originally perfected its security interest otherwise than by filing, in which case the first-to-file rule would not have applied. For example, *B* could have initially perfected by taking possession of the collateral and subsequently released it to the debtor after filing a financing statement. The first-to-perfect rule would then govern priorities.

¹⁸⁴ These observations are by no means original with the author. See generally 1 COOGAN, HOGAN & VAGTS § 7.05. Other possibilities, which require the acquiescence of the first secured party, are a subordination agreement, G.S. § 25-9-316, or an agreement procuring release of collateral. G.S. § 25-9-406.

¹⁸⁵ G.S. § 25-9-404(1). If the secured party fails to comply within ten days with a proper request for termination statement, he becomes obligated to pay to the debtor one hundred dollars plus any other damages the debtor suffers as a result of the failure to comply.

*B. The First-To-Perfect Rule*¹⁸⁶

If either or both of the competing security interests are or are deemed perfected otherwise than by filing, the first security interest perfected shall have priority. Therefore, any time one of the competing security interests was originally perfected otherwise than by filing—by the secured party's taking possession or by one of the automatic or temporary types of perfection—and has remained continuously perfected, priority will be awarded to the security interest that first achieved the "perfected" status. A security interest can become perfected only concurrently with or subsequent to the time of attachment, that is, the time at which (1) the secured party gives value, (2) there is an agreement that the interest shall attach, and (3) the debtor acquires rights in the collateral.¹⁸⁷

In the example given, assuming that *B* had initially perfected by taking possession of the collateral, *B* would be entitled to priority under the first-to-perfect rule. At the time *B* acquired his perfected security interest, *A* had not given value and there was no agreement that the security interest attach. *A*'s security interest did not become perfected until June 1, 1965.

*C. The First-To-Attach Rule*¹⁸⁸

In the unlikely event that neither of the competing security interests has been perfected, priority will be given in the order of attachment of the security interests.

D. The Future Advances Problem

Closely related to the operation of subsection 9-312(5) and other priority rules is subsection 9-204(5), which validates provisions in security agreements for obligatory or nonobligatory future advances—the "open-end mortgage" situation.¹⁸⁹ Comparison of subsection 9-204(5) with the priority rules raises one of the most discussed and least resolved problems arising under Article 9. Essentially, the problem is: Does the inclusion of a future advances provision in a security agreement confer upon the security interest a priority over

¹⁸⁶ G.S. § 25-9-312(5)(b).

¹⁸⁷ G.S. § 25-9-204(1).

¹⁸⁸ G.S. § 25-9-312(5)(c).

¹⁸⁹ G.S. § 25-9-204(5) provides: "Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment."

all subsequent interests in the property to the extent of advances made before or after the subsequent interest arises? For example, suppose that *A* loans the debtor one hundred dollars on January 1, 1966, taking a security interest in all of the debtor's personal property. The security agreement provides that the collateral shall also secure any advances *A* might make in the future. *A* files the security agreement on the same day. On June 1, 1966, any one of the following things happens: (1) *B* loans the debtor one hundred dollars, takes a security interest in debtor's property and files a financing statement; or (2) *C* loans the debtor one hundred dollars and takes a security interest in debtor's refrigerator, which interest *C* perfects by taking possession of the refrigerator; or (3) *D* purchases a freezer from the debtor, pays 200 dollars cash and takes possession of the freezer; or (4) *E*, a judgment creditor of debtor, directs levy and execution on a gas range belonging to debtor. On June 15, 1966, *A* loans debtor an additional 10,000 dollars. Which, if any, of the four subsequent parties have priority over *A*'s security interest and to what extent?

Two conclusions are clearly dictated by the language of Article 9. First, none of the subsequent parties will have priority over *A* with reference to any property necessary to satisfy the one-hundred-dollar debt outstanding at the time their interests arose. At that time, *A* had a fully perfected security interest for one hundred dollars, and the interest was both first filed and first perfected.¹⁰⁰ Second, *B* will not have priority over *A* for any amount. The first-to-file rule will confer on *A* a priority to the extent of any perfected interest he holds at the time the contest arises, without regard to the time of perfection.

However, the priority of *C*, *D*, or *E* with reference to any property necessary to satisfy *A*'s 10,000-dollar advance is in doubt. All three of these subsequent interests have one thing in common—with relation to *A*, their priority is determined by whether and to what extent *A* had a "perfected" security interest at the time their interests arose.¹⁰¹ When *A* made the one-hundred-dollar advance on January 1, 1966, coupled with a security agreement and filing, he acquired a "perfected" security interest to at least the extent of one hundred dollars. Did he also acquire a "perfected" security

¹⁰⁰ G.S. § 25-9-312(5) (a) and (b).

¹⁰¹ G.S. § 25-9-301; G.S. § 25-9-312(5) (b).

interest as to any other dollars he might in the future choose to extend to the debtor?¹⁹²

It would seem, in relation to the subsequent lien creditor, that the only reasonable conclusion that can be reached is that *A* has a perfected security interest only to the extent of the original one-hundred-dollar advance until such time as an additional advance is made. To conclude otherwise would permit the secured party, at nominal cost, indefinitely to tie up all of the debtor's property described by the security agreement. *A* should not be able to prevent attachment by a lien creditor of the debtor's interest in the property for so long as the one hundred dollars remains unpaid. Furthermore, section 9-311 expressly provides that the interest of the debtor is subject to levy and execution. While it could be argued that the signing of a security agreement with the nonobligatory future-advances provision destroys or suspends the "rights" of the debtor referred to in section 9-311, it would be ludicrous to hold that the debtor and one willing creditor, through such an agreement and a one or one-hundred-dollar advance, could effectively postpone the ability of all other general creditors to satisfy their claims as long as the advance remains unpaid, a result that would logically follow from the argument.

The subsequent purchaser of the debtor's property or the subsequent secured party who perfects otherwise than by filing are in somewhat the same position as the lien creditor with respect to technical analysis of Article 9. However, the considerations that might dictate a similar result are centered around the debtor rather than the third party. The purchaser and the secured party have an option that is often not available to the lien creditor at the critical time—they can refuse to deal with the debtor who has put himself in such a position. But, from the point of view of the debtor, it seems equally unwise to construe the nonobligatory future-advances provision as suspending all of his rights in the collateral in this fashion. Section 9-311 is also affirmative in its declaration that no provision in the security agreement can prevent voluntary transfer of the debtor's rights by sale or by creation of another

¹⁹² See generally 1 COOGAN, HOGAN & VAGTS §§ 4.05, 3.07(3) n.83. M. Coogan takes the position that two or more security interests are involved in this type situation. The first security interest is perfected to the extent of the original value given; the second and following are perfected only as additional value is given.

security interest. And, while it might not be unsound policy to declare that the future-advances provision will effectively destroy the debtor's rights in the collateral in a commercial situation, Article 9 is not applicable only to highly sophisticated commercial transactions. The unsuspecting debtor in the hypothetical situation would probably be surprised to learn that the security interest given to *A* has made his property singularly unattractive to any subsequent purchaser or lender because of the possibility that they would not have priority over *A* with reference to any advances that *A* might decide to make in the future. It is true that the original secured party could never actually acquire an interest in the property of greater value than the amounts that he at some time advances. But that does not seem to this writer to answer the general objection to comprehensively giving secured parties the ability to cast such a cloud of uncertainty over the debtor's interest in the property—an interest that they may never need to satisfy the obligation—and to giving them the potential ability to tie the debtor to their source of credit without making any long-term commitment themselves. Furthermore, the first-to-file rule of priority might be very difficult to live with in general application unless there are some ways other than purchase-money priority to avoid it in this type of situation.

Therefore, referring again to the hypothetical situation, treating *A*'s interests in the property as two security interests, the first perfected for one hundred dollars before the intervention of the subsequent interests and the second perfected for 10,000 dollars after the intervention of those interests, the first-to-perfect rule would give the "perfected" interests of *C* and *D* priority over *A* with reference to any property not necessary to satisfy the one-hundred-dollar obligation of the debtor.

But, while this theory may be a step in the right direction and may be the only such theory that can be applied consistently with the language and concepts of Article 9, it is conceded that it may be too long a step away from the legitimate interests of the initial secured party. When most commercial future-advance provisions are written, it is contemplated that the future advances will be made periodically in the normal course of business and such advances are so made. However, if the advancer is threatened with the possibility of there being a subsequent interest in the property that will have priority over his advances because it is perfected before the

interest arising from his advances is perfected, he must, to be certain that no such interest exists, check the collateral that the debtor has on hand before making each advance. Moreover, because there may also be a security interest originally perfected otherwise than by filing to take advantage of the first-to-perfect rule and subsequently perfected by filing, the advancer will be required to check the state of the public record before making each advance. This is probably too burdensome on the original secured party.

The solution that appears best to compromise the conflicting considerations and give adequate protection to all concerned parties is that of permitting the original secured party to have priority with reference to any advances made prior to the time he has actual knowledge of the subsequent interest.¹⁹³ This rule would properly put the burden of giving notice on the individual subsequent parties; if the subsequent parties desired to be assured of priority over subsequent advances made by the original secured party, they could easily give written notice to the prior secured parties whose names appear on the public record. The rule would retain the saleability of the debtor's interest in the property and relieve the advancer of laborious inquiry. However, this approach is beset with an internal problem—there is simply no direct authority for its application under the terms of Article 9. A court deciding a case similar to the hypothetical situation would seem to have only the alternative of accepting or rejecting the two-security-interest approach. If it is accepted, the case must be decided on the basis of relative times of perfection, a rule that does not take into account the knowledge of the secured party at the time subsequent advances were made. Therefore, if this entire future-advances problem is or becomes of practical importance—and fairness requires noting that the absence of reported cases indicates that it may not be a practical problem—the solution would lie in amendment of Article 9.^{193a}

¹⁹³ This is the rule adopted by many courts in dealing with the problem in relation to real estate mortgages. *E.g.*, *Oaks v. Weingartner*, 105 Cal. App. 2d 598, 234 P.2d 194 (1951). However, the diversity of judicial results indicates that the problem has never been one subject to easy solution. See OSBORNE, MORTGAGES §§ 117-20 (1951).

^{193a} The following amendment to UCC § 9-312 was at one time under consideration by the Permanent Editorial Board for the Code:

When a later secured party gives new value and perfects his security interest in equipment, consumer goods or farm products covered by an earlier perfected security interest, he has priority over the earlier security interest as to any advance subsequently made by the holder of

IV. SPECIAL PERFECTION AND PRIORITY RULES

Section 9-312 provides for two situations in which a special priority is given to security interests even though the particular interests would not have priority by application of the first-to-file or first-to-perfect rules.

A. The Purchase-Money Security Interest

The North Carolina court has, as have most others, given a superior protection to the purchase-money security interest.¹⁹⁵ The purchase-money security interest has generally been held to have priority over preexisting dower rights, judgment liens, and, most importantly for personal property,¹⁹⁶ the after-acquired property clause contained in a prior mortgage. The North Carolina court has held that the purchase-money security interest will prevail over a previously executed after-acquired property clause even though the purchase-money security interest is not recorded or otherwise perfected before the party claims under the prior security agreement.¹⁹⁷

Article 9 continues the basic policy of giving the purchase-money

the earlier security interest unless the subsequent advance or a commitment to make it was made before the holder of the earlier security interest knew of the new value given by the second secured party, or was made for the necessary protection, maintenance or preservation of the collateral or any part thereof.

Quoted from 1 COOGAN, HOGAN & VAGTS § 7.11[7].

For some unexplained reason this amendment was subsequently dropped from consideration. Unfortunately, no helpful inference concerning the intent of the Code provisions as they stand now can be drawn from the fact that this amendment was considered and rejected. If adopted, the amendment would have altered the first-to-file rule with respect to security interests in the types of collateral covered—equipment, consumer goods, and farm products. But it would have left unchanged the uncertainty concerning security interests in other types of collateral and the rights of other purchasers and lien creditors with reference to all types of collateral.

¹⁹⁴ G.S. § 25-1-201(44)(a). "Value" includes a "binding commitment to extend credit."

¹⁹⁵ For the definition of purchase money security interest see Hanft, *Article Nine: Secured Transactions—Validity, Rights of the Parties; Default*, 44 N.C.L. REV. 716, 731 (1966).

¹⁹⁶ Dower and the judgment lien are not problems of personal property purchase-money security interest priority. There is no inchoate dower interest in personal property in this state. The judgment lien, because it does not arise until levy, note 125 *supra*, will always be a subsequent, not a pre-existing interest.

¹⁹⁷ *Cox v. New Bern Lighting & Fuel Co.*, 151 N.C. 62, 65 S.E. 648 (1909).

security interest preferred treatment. However, the Code treatment differs from prior law in two important respects.

The first relates to filing and perfection problems. The Code will require generally that the purchase-money security interest, to retain priority over conflicting security interest, be perfected within ten days after the debtor takes possession of the collateral.¹⁹⁸ If the secured party does perfect within the ten-day period, his perfection relates back to the day the debtor took possession, and he will have priority over an after-acquired property clause or any security interest that arose during the ten-day period. Also, the relation back applies to a limited extent to protect the purchase-money security interest from other subsequent interests. If the secured party files within ten days, he will have priority over a lien creditor or bulk purchaser whose interest arose during the ten-day period.¹⁹⁹ However, any purchaser not a secured party, lien creditor, or bulk purchaser will have priority over the purchase-money security interest to the extent he gives value and takes delivery before the purchase-money security interest is perfected.²⁰⁰

The second change that the Code will make is of highest importance to those who finance any type of inventory. The purchase-money security interest in "inventory"²⁰¹ will *not* be entitled to priority over a preexisting after-acquired property clause, unless the purchase-money secured party (1) gives written notice to the holder of the previously filed conflicting security interest, describing the items of type of inventory in which he will claim purchase-money priority, and (2) perfects his own security interest *before* the debtor receives possession of the collateral.²⁰² Only if these conditions are complied with will the purchase-money security interest have priority.

From the standpoint of the inventory financier who makes regular advances against the incoming inventory of a debtor-seller,

¹⁹⁸ G.S. § 25-9-312(4); *National Cash Register Co. v. Firestone & Co.*, 191 N.E.2d 471 (Mass. 1963). Of course, if the purchase-money security is subject to § 9-312(3), discussed below, it must be perfected at the time the debtor is given possession of the property.

¹⁹⁹ G.S. § 25-9-301(2).

²⁰⁰ G.S. § 25-9-301, comment 5.

²⁰¹ "Inventory" is goods "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 business." G.S. § 25-9-109(2).

²⁰² G.S. § 25-9-312(3).

this section represents a decided advantage over the probable state of prior law. It severely curtails the ability of the debtor to undercut the original security interest by purchasing subject to purchase-money security interests while at the same time maintaining a sufficient air of respectability to his primary financier to encourage continuation of the advances. Under the Code, the primary financier can be reasonably certain that he will have a security interest prior to any purchase-money security interest unless he receives written notice that someone else will be claiming priority with respect to a particular shipment.²⁰³

B. The Agricultural Lien on Crops

Basically, the crop lien or mortgage is treated in the Code as is any other security interest in tangible personal property. With respect to the validity of the agreement between the parties, the procedures to be followed upon default, the methods of perfection, and for the most part the priorities, such a security interest is identical to a security interest in any other goods. However, there is one exception that affords preferred treatment to the security interest taken for new value given to enable the debtor to produce his crops. This security interest will have priority over a previously perfected security interest in the same crops to the extent that (1) the security interest is created "not more than three months before the crops become growing crops" and is perfected, and (2) the perfected security interest over which priority is claimed secured obligations due more than six months before the crops become growing crops.²⁰⁴ Since a Code-created security interest cannot attach to crops that become such by planting more than a year from the date of the security agreement,²⁰⁵ the competing interests most likely to be involved will be the real estate transactions excepted from the one-year rule by subsection 9-204(4)—the mortgage or lease on the real estate, which also includes a security interest in crops.²⁰⁶ As to amortization or rental payments due less than six

²⁰³ He can be only "reasonably certain" because there is some question whether G.S. § 25-9-312(3), as read literally, applies where the purchase-money secured party perfects otherwise than by filing. 1 COOGAN, HOGAN & VAGTS § 7.06, n.89.

²⁰⁴ G.S. § 25-9-312(2).

²⁰⁵ G.S. § 25-9-204(4)(a).

²⁰⁶ The current priority given landlord's lien, which arises by operation of law, N.C. GEN. STAT. § 42-15 (1950), is probably retained under the

months before the time of planting of the crop, the secured party under the first perfected agreement will have priority.

C. *The Security Interest in Fixtures*

Section 9-313 of Article 9 defines the rights of a secured party holding a security interest in a "fixture" in relation to the rights of owners of interests in the real estate to which the fixture is attached. Other than to exclude basic construction materials incorporated into the structure, such as "lumber, bricks, tiles, cement, glass, metal work," etc., the Code offers no definition of "fixture," leaving this determination to the other law of the jurisdiction.²⁰⁷ Briefly summarized, the rules for determining the rights and priorities of the holder of the security interest are as follows:

(1) A security interest that attaches to an item before that item is affixed to the real estate will have priority over all then-existing interests in the real estate whether or not the security interest is perfected. If the security interest is perfected, it will also have priority over any lien creditor, purchaser, or encumbrancer who acquires an interest in the real estate after perfection of the security interest.²⁰⁸

(2) A security interest that attaches to an item after that item is affixed to the real estate will be inferior to any interest then existing in the real estate unless the owner of the real estate interest consents in writing to the security interest or disclaims any interest in the goods as fixtures. If the security interest is perfected, it will have priority over any subsequent lien creditor, purchaser or encumbrancer who acquires an interest in the real estate.²⁰⁹

(3) Where, under the above rules, the secured party has priority over *all* of the interests in the real estate, he may, upon default, remove the collateral from the real estate subject to a duty to reimburse the owners of the real estate interests (other than the debtor) for the cost of repair of any physical injury to the real estate.²¹⁰

(4) A security interest in items that "are or are to become

Code, Hanft, *Article Nine: Secured Transactions—Validity, Rights of Parties; Default*, 44 N.C.L. REV. 716, 732 (1966), and therefore would not be affected by G. S. § 25-9-312(2).

²⁰⁷ G.S. § 25-9-313(1).

²⁰⁸ G.S. § 25-9-313(2), (4).

²⁰⁹ G.S. § 25-9-313(3), (4).

²¹⁰ G.S. § 25-9-313(5).

fixtures" can be perfected only by filing in the county where the land to which the items are affixed is located.²¹¹

These rules, in fundamental approach, are, with the exception of the place of filing, virtually identical to the present state of North Carolina law. The most often referred to North Carolina case, *Standard Motors Fin. Co. v. Weaver*,²¹² involved a situation where the only competing interests were a recorded conditional sales contract covering a sprinkler system and a purchaser at the foreclosure sale of a mortgage on the real estate to which the sprinkler system was attached. The court held that the conditional vendor had priority over the interests of the mortgagee of the real property, and, since the conditional sales contract was recorded (in the chattel-mortgage file), the interest of the conditional vendor would also have priority over the purchaser at the foreclosure sale. The court reasoned that the execution of the conditional sales contract by the vendee indicated an intention that the property remain personalty, and because it retained its character as such, the proper place of recording was the chattel-mortgage file in the county where the debtor resided.

The other important aspect of the secured party's rights—the right of removal of the item from the realty in the event of default—has also been dealt with in a manner favorable to the secured party. In *Brunswick-Balke-Collender Co. v. Carolina Bowling Alleys, Inc.*,²¹³ the court held that the removal by the conditional vendor of a large amount of bowling equipment affixed to the realty owned by the debtor's lessor would be permitted even though material injury to the realty would result from the removal where the injury was of a type that could be repaired by an expenditure of money.²¹⁴

Application of the basic Code rules to these situations, assuming a recording in the real-estate files in the *Standard Motors* case, would give results identical to those reached by the North Carolina courts.²¹⁵ But, however close to identical the results might be, the

²¹¹ G.S. § 25-9-401(1)(b). The financing statement must be filed and indexed in the same manner as a mortgage on real estate would be recorded. G.S. § 25-9-403(4).

²¹² 199 N.C. 178, 153 S.E. 861 (1930).

²¹³ 204 N.C. 609, 169 S.E. 186 (1933).

²¹⁴ *But see* Cox v. New Bern Lighting & Fuel Co., 151 N.C. 62, 67, 65 S.E. 648, 651 (1909) (dictum).

²¹⁵ The North Carolina rule on right of removal as stated by the court

fact that the results are reached on entirely different grounds possibly will preclude what would otherwise be an anticipated displacement of the North Carolina cases by section 9-313.

The Code rules have application only to those goods that under state law are or are to become fixtures.²¹⁶ As generally used heretofore in North Carolina, the word "fixture" refers to a real-property interest, not personal property.²¹⁷ It is quite possible that the court will continue to hold, on the authority of the *Standard Motors* case, that the execution of a security interest in items to be attached to realty indicated an intention that the items that are affixed should remain personal property. It would logically follow that the personal property is not a "fixture" under this state's law, and therefore, section 9-313 and, more importantly, subsection 9-401(1)(b) have no application to such a transaction.²¹⁸ If this conclusion is reached by the court, the vendor or mortgagee of goods that were attached to realty would not have a validly perfected security interest if he filed in the county where the land was located. Perfection could be achieved only by filing in the manner applicable generally to security interests in personal property. This would leave the purchaser of the real property in the previously existing position of having to search the chattel files in any county where his vendor may have resided or had a place of business before he can be certain of the state of title of items affixed to the property.

The semantic entanglement and the uncertainty surrounding the term "fixtures" can be avoided only by definitive action of the court or the legislature. The court might conclude that the reasoning in the *Standard Motors* case was dictated by a sound desire to insure

in the *Brunswick* case would presumably put upon the secured party, as a condition to removal, the burden of demonstrating that the damage caused to the real estate could be repaired by an expenditure of money. G.S. § 25-9-313(5), gives the secured party an absolute right of removal, thus presuming that all damage can be compensated for in money. The difference in approach would have little practical significance in most cases.

²¹⁶ G.S. § 25-9-313(1); G.S. 25-9-401(1)(b).

²¹⁷ *Brown v. North Carolina Joint Stock Land Bank*, 213 N.C. 594, 597, 197 S.E. 140, 142 (1938); *Basnight v. Small*, 163 N.C. 15, 18, 79 S.E. 269, 270 (1913). *But see* *Horne v. Smith*, 105 N.C. 322, 323, 11 S.E. 373, 374 (1890).

²¹⁸ Such was the reasoning of the court in *Cain v. Country Club Delicatessen, Inc.*, 25 Conn. Supp. 327, 203 A.2d 441 (1964). See also *In re West Hartford Club Car, Inc.*, 2 UCC REPORTING SERV. 738 (D. Conn. April 16, 1964).

a method, in absence of legislative action, whereby the conditional vendor or chattel mortgagee could protect his interest. Necessary to the protection at that time was the conclusion that the item remained personal property so that a valid recording could be made in the chattel-mortgage file. Such a conclusion is not, under the Code, an integral step toward the secured party's protection. The court could rely upon a more conventional test of physical attachment and integration of use, rather than the somewhat fictional intent attributed to the fact of encumbrance, to determine whether or not an item becomes a fixture under the Code. This would give the secured party the same degree of protection he now enjoys while at the same time giving more certainty to real-estate titles by requiring filing in the county where the land is located. Or the legislature could amend section 9-313 to define fixture in terms of physical attachment and integration of use. Of course, any definition of fixture is going to leave an area of uncertainty at the outer edges of the concept. But the secured party could protect against that uncertainty by filing as if the item were a fixture and as if it were a chattel.

But, until there has been an interpretation of the word "fixture" as used under the Code, either by the court or the legislature, the secured party who takes an interest in any personal property that is to be attached to or used in connection with real property will be well advised to file both in the county where the land is located and the county dictated under subsection 9-401(1)(a) by the debtor's situation.

D. The Security Interest in Proceeds

Like the common law of many jurisdictions²¹⁹ and statutes²²⁰ before it, Article 9 provides that a security interest in collateral will extend to identifiable proceeds arising from the sale of that collateral by the debtor.²²¹ This security interest will attach to the

²¹⁹ *E.g.*, *Watson v. Carolina Portland Cement Co.*, 93 Miss. 553, 46 So. 707 (1908); *Doughten v. Gray*, 10 N.J. Eq. (2 Stock.) 323 (1855). *But cf.* *Presley E. Brown Lumber Co. v. Textile Banking Co.*, 248 N.C. 308, 103 S.E.2d 334 (1958).

²²⁰ *E.g.*, N.C. GEN. STAT. § 45-54 (Supp. 1965) (Uniform Trust Receipts Act); N.C. GEN. STAT. § 44-73 (Supp. 1965) (Factor's Lien Act); N.C. GEN. STAT. § 44-83 (1950) (accounts receivable); all repealed effective July 1, 1967, G.S. § 25-10-102.

²²¹ G.S. § 25-9-306(2). "Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of.

identifiable proceeds as they come into the hands of the debtor without regard to whether the original security agreement specifically included proceeds. Also irrelevant is the question of whether the secured party authorized the sale by the debtor.

However, the mere existence of a security interest is of little value to the secured party in the critical situation—insolvency of the debtor—where a representative of the debtor's estate will take the collateral free of any unperfected security interest therein.²²² Therefore, the Code further provides that, if the security interest in the original collateral was perfected, the security interest in the proceeds is automatically perfected for ten days after the receipt thereof by the debtor.²²³ The ten-day perfection may be extended indefinitely by the secured party in one of two ways.

First, if the security interest in the original collateral was perfected by filing and the filed financing statement contained a claim to proceeds, perfection of the security interest in proceeds will continue beyond the ten-day period until termination of the filing. Presumably, in this situation, perfection may be had by "filing" even though the character of the proceeds would not permit an original perfection by filing.²²⁴

Second, if the secured party did not perfect the original security interest by filing or failed to claim proceeds in the original financing statement, he may continue the perfection by, during the ten-day period, perfecting a security interest in "the proceeds."²²⁵ Where this latter course is the only one open for continued perfection, the method whereby the secured party may perfect is not certain from the language of the Code or the comments. Where the proceeds are a class of collateral in which a security interest might originally be perfected by filing—goods, negotiable documents, chattel paper, accounts, contract rights, or general intangibles—the interest in proceeds may be perfected by filing a financing statement describing the original collateral and claiming the proceeds. In this instance, the secured party may file the financing

The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are 'cash proceeds.' All other proceeds are 'non-cash proceeds.'" G.S. § 25-9-306(1).

²²² G.S. § 25-9-301(1)(a), (3); Bankruptcy Act § 70(c), 30 Stat. 565 (1898), as amended, 11 U.S.C. § 110(c) (1964).

²²³ G.S. § 25-9-306(3).

²²⁴ G.S. § 25-9-306(3)(a).

²²⁵ G.S. § 25-9-306(3)(b).

statement without the cooperation of the debtor—the debtor's signature is not required on a financing statement filed for this purpose.²²⁶ If, however, "the proceeds" are a class of collateral in which a security interest cannot originally be perfected by filing, *e.g.*, instruments, the secured party probably can continue perfection only by taking possession of "the proceeds" within the ten-day period.²²⁷

When the security interest in proceeds remains perfected during the ten-day period, and thereafter, if the appropriate steps have been taken before or during the ten-day period, the perfection is ostensibly deemed to be continuous from the time of the perfection of the security interest in the original collateral.²²⁸ Where there are two security interests in the original collateral antedating the sale of the collateral, this provision probably will insure to the secured party holding the prior security interest in the original collateral priority with reference to the proceeds, at least where the original priority is based upon first filing or first perfection.²²⁹ Less certain is the priority in proceeds where the original priority is based upon the special purchase-money priority rules. For example, suppose that the original collateral was subject to a first filed after-acquired-property security interest and a filed purchase-money security interest entitled to priority under subsection 9-312(3) or (4). When this collateral is sold, does the purchase-money priority follow and attach to the proceeds? It is arguable that the close identification of proceeds with original collateral resulting from the continuous perfection theory indicates an intent that the perfected security interest in proceeds have the identical priority that would have been given to the security interest in the original collateral. Furthermore, particularly with reference to inventory, the purchase-money priority would be substantially undercut if that same priority did not attach to the proceeds of goods that by definition are to be sold and converted into proceeds.

²²⁶ G.S. § 25-9-402(2) (b).

²²⁷ See G.S. § 25-9-306, comment 2(b).

²²⁸ G.S. § 25-9-306(3)

²²⁹ The time of perfection of the security interest in proceeds would be the time of the perfection of the original security interest. Presumably, also the method of perfection of the security interest in proceeds for the purpose of applying the priority rules of § 9-312(5) would be deemed to be the method whereby the security interest in the original collateral was initially perfected, although this is by no means clear from § 9-306.

The continuous perfection theory also represents an attempt to take the time of transfer, for bankruptcy preference problems,²³⁰ back to the time of the original perfection.²³¹ If successful, this, of course, may remove the time of transfer from the critical four-month period preceding bankruptcy and may have the effect of making the transfer for a present consideration rather than for an antecedent debt. However, even if the courts should refuse to take the time of transfer of the proceeds back to the time of the original perfection, or if the original perfection took place within the four-month period, the secured party, at least where the original collateral is inventory, or where he authorized the sale, should not be presented with a preference problem. At the moment that the goods are exchanged for the proceeds by the debtor, the security interest in the proceeds attaches and becomes perfected. Thus, the secured party contemporaneously loses the right to enforce his security interest against the goods and gains a perfected security interest in the proceeds. A simultaneous exchange of one perfected, nonpreferential security interest for another valid and perfected security interest of equal or less value is generally not considered to be a preferential transfer in bankruptcy,²³² nor should such a transfer of proceeds be so considered in this context.

But, where the secured party retains a perfected security interest enforceable against the purchaser of the collateral and also claims a perfected security interest in the proceeds of the sale of that collateral,²³³ he is likely to fare less well in bankruptcy by his con-

²³⁰ Bankruptcy Act § 60(a), 30 Stat. 562 (1898), as amended, 11 U.S.C. § 101 (1964).

²³¹ G.S. § 25-9-306, comment 2(b).

²³² See generally, 3 COLLIER, BANKRUPTCY ¶ 60.21 (14th ed. 1964).

²³³ G.S. § 25-9-306, comment 3, indicates that the secured party may have a security interest in the proceeds and the original collateral, if the purchaser does not take free of the latter, "but of course may have only one satisfaction." However, except where the purchaser had knowledge of the security interest or the jurisdiction holds that record notice precludes reliance on misrepresentation, it is difficult to conceive a situation where the secured party would, as a practical matter, need and be able to enforce the security interest against both the identifiable proceeds and the original collateral. In other situations, there almost certainly would have been fraud or misrepresentation by the seller that would permit the purchaser to rescind the transaction. See 5 WILLISTON, CONTRACTS § 1525 (rev. ed. 1937), return the collateral, and, particularly if the seller is insolvent, impose a constructive trust on the consideration which he gave the "proceeds." RESTATEMENT, RESTITUTION §§ 160, 166 (1937). The secured party would by acquisition of the security interest be a third-party purchaser of the proceeds, but it would seem that he should be charged with notice of the un-

tention that, because the security interest in the proceeds is deemed perfected at the time of perfection of the security interest in the original collateral, the transfer is outside the four-month period or not for an antecedent debt and hence not a preference. If the original collateral was not of sufficient value at the time of the sale to satisfy the debtor's obligation, the secured party will be in a tenuous position in claiming that he should also be given a secured claim in the proceeds sufficient to satisfy the remainder of the obligation. This is not a substitution of collateral situation, and the transfer does give to the secured party a preferred claim by enhancing the value of his security above its value before the sale by the debtor. Furthermore, it is difficult for this author to see how the security interest in proceeds in this situation can be deemed perfected and the transfer made at a time when no proceeds existed, *i.e.*, at the time of perfection of the security interest in the original collateral. Other requisites being present, this would probably be a preference to the extent the secured party acquires interest of greater value than the original collateral at the time of the sale.

In addition to the security interest in identifiable proceeds, which arises as a matter of course in any situation, the Code purports to give the secured party additional protection in a limited context. It is provided that, in the event of the institution of insolvency proceedings by or against the debtor, the secured party shall also have a "perfected security interest" in all cash and bank accounts of the debtor, but limited to an "amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings . . . less the amount of cash proceeds paid over to the secured party during the ten day period."²³⁴

authorized sale and the probability that it resulted from misrepresentation of the seller so as to preclude him from being a bona fide purchaser and taking free of the constructive trust rights of the innocent purchaser. Referring to the secured party's interest as "perfected" would not seem to add anything to his rights against the purchaser with respect to the proceeds.²³⁴ G.S. § 25-9-306(4). The security interest is, however, subject to any right of setoff that the bank might have.

Beyond the scope of this paper is examination of the effectiveness of this subsection in bankruptcy proceedings, a problem that has engendered considerable detailed discussion. Those persons desiring to sustain the validity of the security interest in bankruptcy should see Henson, "*Proceeds*" Under the Uniform Commercial Code, 65 COLUM. L. REV. 232 (1965). The possible objections to enforcement of the interest are detailed in Kennedy, *Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 RUTGERS L. REV. 518 (1960).