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Introduction

Perhaps no section of the Uniform Commercial Code[1] has engendered less literature than section 9-306(5),[2] the Code's answer to priorities among secured creditors when goods are returned or repossessed. Even the most thorough analysis of section 9-306 largely ignores subsection (5), as though the subsection forecloses all possible problems in application. This article will demonstrate that some gaps in the provision exist, creating problems which are not merely theoretical.

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* Assistant Professor of Law, University of North Dakota School of Law; J.D., Memphis State University School of Law (1975); LL.M. Yale University Law School (1976). Much of the research for this article was conducted, and the original manuscript prepared, while the author was enrolled in the LL.M. program at Yale.

1. All references to the Uniform Commercial Code (Code) will be to the 1962 version, unless otherwise provided.

2. UNIFORM COMMERCIAL CODE § 9-306(5) provides:

> (5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:
>
> (a) If the goods were collateral at the time of sale for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.
>
> (b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under Section 9-308.
>
> (c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).
>
> (d) A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.

THE BASICS OF SECTION 9-306(5)

Section 9-306(5) deals generally with perfection of and priorities to proceeds. Subsection (5) specifically addresses problems of establishing priorities in proceeds which have been created by a sale that for one reason or another is subsequently undone. Sales affected by the subsection are limited to those of *goods* that create "an account or chattel paper which is transferred by the seller."[3] Section 9-306(5)(a) applies where a financer with a perfected interest in the goods as inventory[4] remains unpaid after the sale and return of the goods to his debtor, the seller. At the time of repossession by the seller, or the secured party, the lender's interest reattaches to the goods. If the financer's original perfection was accomplished through a filing which is still effective, no more need be done to protect its interest; if the original perfection was accomplished in any other manner, or if the filing has expired or has been otherwise

3. UNIFORM COMMERCIAL CODE § 9-306(5). A sale which generated cash revenues would not bring § 9-306(5) into play, even if the goods were subsequently returned or repossessed and the inventory financer had not been paid by the proceeds of the original sale. The policy of the section should by analogy be implemented in these circumstances, to give back to the inventory financer his original security interest and thus fulfill his reasonable expectation that the obligation will be repaid. *See* 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 27.5, at 736 (1965) [hereinafter cited as GILMORE]. Such transactions were omitted from the provisions of the subsection, apparently because the Code's drafters were primarily concerned with the conflict between the inventory financer and the transferee. *Id.* at 737.

A sale which is financed by a third party purchase money enabler would not be within § 9-306(5), since a subsequent transfer of the paper or account would not be made by the seller. Since the subsection only applies to *sales* of goods, rental goods returned or taken on default would also not be covered by the subsection, assuming that the lease is a true lease under UNIFORM COMMERCIAL CODE § 1-201(37), and not one intended to create a security interest. Priorities of proceeds in rental returns are not covered even though conflicts between an inventory financer of the lessor and an account or chattel paper transferee may arise similar to those in sales covered by the subsection, and the Code definitions of both account and chattel paper include obligations which arise out of leases. *See* UNIFORM COMMERCIAL CODE §§ 9-105(1)(b), 9-106.

Finally, if the paper or account generated in the sales transaction is not transferred, but is retained by the seller and merely promised as the source of payment to an unsecured creditor, the subsection does not apply. *See* 2 GILMORE, *supra*, at 736.

4. On its face the subsection is not limited to an inventory situation, but the problems which occur often involve inventory financing. 2 GILMORE, *supra* note 3, at 736. A sale of equipment which is not inventory, such as a sale of a typewriter in the hands of a tractor retailer, which results in chattel paper or an account could bring about the application of the subsection if the typewriter were originally collateral and the chattel paper or account were transferred. Similarly, sales by a consumer could fall within the subsection, if the consumer-seller were fairly sophisticated.

extinguished,[5] the inventory financer must either file again as to the goods or take possession of them.[6] It might seem at this point that an unpaid transferee of the account or chattel paper is left with nothing, since the return of the goods has destroyed the "obligation which forms the basis of the original chattel paper,"[7] if not the basis of the original account.[8] Section 9-306(5)(b), however, subordinates the interest of the inventory financer to that of the unpaid chattel paper financer if the latter (1) gave new value at the time of its acquisition, (2) took possession in the ordinary course of its business, and (3) was without knowledge that the specific paper was subject to another security interest, or, if it knew of another security interest, it did not know the other interest derived only from a claim to proceeds of inventory.[9] By operation of law, subsection (5)(b) also

5. The filing may be extinguished by lapse under UNIFORM COMMERCIAL CODE § 9-403, or by release of the collateral under UNIFORM COMMERCIAL CODE § 9-406.

6. UNIFORM COMMERCIAL CODE § 306(5)(a).

7. Levie, *Security Interests in Chattel Paper*, 78 YALE L.J. 935, 939 (1969) [hereinafter cited as Levie].

8. Professor Gilmore asserts that accounts financers do not generally look to the goods for satisfaction of their debts, as do chattel paper financers. 2 GILMORE, *supra* note 3, at 740.

9. UNIFORM COMMERCIAL CODE § 9-306(5)(b) (incorporating UNIFORM COMMERCIAL CODE § 9-308). Section 9-308 states:

> A purchaser of chattel paper or a non-negotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under Section 9-304 (permissive filing and temporary perfection). A purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory subject to a security interest (Section 9-306), even though he knows that the specific paper is subject to the security interest.

This section, rewritten in 1972 for "clarity," creates certain problems. Under the 1962 version, the conflict between holders of two or more different security interests in the same chattel paper was resolved in favor of the purchaser who took possession of the paper, over the financer who filed, or temporarily perfected, under § 9-304. The second sentence of the 1962 version designated for priority the purchaser who took possession of the paper even though he knew of an interest in favor of the inventory financer, if the interest was claimed merely as proceeds. Thus, there was some question as to whether a security interest in favor of the inventory lender in "inventory and chattel paper" was a claim that the chattel paper was something greater than merely proceeds. *See* Weiss, *Original Collateral and Proceeds: A Code Puzzle*, 42 N.Y.U.L. REV. 785, 788 (1967) [hereinafter cited as Weiss].

The 1972 version of the section provides:

> A purchaser of chattel paper or an instrument who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in the chattel paper or instrument
>
> (a) which is perfected under Section 9-304 (permissive filing and temporary

creates a security interest in the goods in favor of the unpaid chattel paper transferee as against the transferor-seller.

Section 9-306(5)(c) creates a security interest in the returned goods against the transferor in favor of the unpaid transferee of an account. But the account transferee's security interest is given a lower priority than the interest of the inventory financer, whose interest reattached with the return or repossession of the goods. Section 9-306(5)(d), the final subsection, requires that the transferee perfect the security interest created under subsection (5)(b) or (5)(c) in order to be protected against creditors of the transferor or purchasers of the returned goods.

The Model Problem

A prototypical sale and return situation, along with some additional suppositions, may provide an understanding of the section's application. Seller sells gizmos, a highly sought consumer good. Bank *A* finances Seller's inventory, securing advances made by taking a security interest in the inventory and proceeds from it. Bank *A*'s interest is perfected by filing. Bank *B* specializes in purchasing chattel paper generated by the sale of gizmos; it sometimes perfects its interest by filing,[10] but more often takes possession of the paper to perfect. When Bank *B* files, it claims proceeds; the security agreement always claims proceeds. Bank *C* deals exclusively in accounts financing; as collateral, its filings list accounts generated from the sale of gizmos and all proceeds of the accounts.

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

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

Uniform Commercial Code § 9-308 (1972 version). The revision seems to strengthen the case of the inventory lender who can impart knowledge to the chattel paper financer of his claimed interest, since its reference to § 9-306 indicates a position that a claim to "chattel paper" made by the inventory financer could be made other than as a claim to proceeds. Thus, whereas under the 1962 Code, *any* claim to chattel paper made by the inventory financer could arguably be made only as a claim merely to proceeds, under the 1972 version of § 9-308, a claim made to chattel paper specifically as well as to proceeds generally, could elevate the inventory lender's interest. *See* note 15 *infra*.

10. Under Uniform Commercial Code § 9-304(1) "[a] security interest in chattel paper or negotiable documents may be perfected by filing."

Buyer-1 purchases a gizmo and pays Seller $500 in cash; the buyer signs a security agreement, financing statement, and negotiable instrument—chattel paper[11]— to secure the balance owing. At the time of this sale, the gizmo was covered by a filing financing statement in favor of Bank *A*. Assuming he is a buyer in ordinary course of business,[12] Buyer-1 takes free of this interest by virtue of section 9-307(1), since the interest was created by his seller. Bank *A* has a security interest in the proceeds of the sale, the $500 cash, and the chattel paper.[13] The retailer, Seller, may for purely commercially reasonable business motives[14] sell the chattel paper at a discount rate to Bank *B* rather than remit these proceeds to Bank *A*. Assuming that it meets the requirements of section 9-308, Bank *B* will have priority over Bank *A*'s interest in the paper as proceeds.[15]

Buyer-1 subsequently defaults on his obligation to Seller, to whom he has continued to make payments despite Seller's transfer to Bank *B* of the chattel paper representing the obligation.[16] Seller

11. UNIFORM COMMERCIAL CODE § 9-105(1)(b) provides that when a transaction is evidenced both by a security agreement or lease signifying an interest in specific goods and by a single instrument or series of instruments, "the group of writings taken together constitutes chattel paper."

12. A buyer in ordinary course is defined by UNIFORM COMMERCIAL CODE § 1-201(9) as "a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind." UNIFORM COMMERCIAL CODE § 9-307(1) provides: "A buyer in ordinary course of business . . . takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." Of course, if the sale were authorized, the buyer would take free of Bank *A*'s interest under UNIFORM COMMERCIAL CODE § 9-306(2).

13. UNIFORM COMMERCIAL CODE § 9-306(2).

14. Business motives, such as liquidity and competitive interest rates, may engender chattel paper or accounts transactions. *See generally* Skilton, *Buyer in Ordinary Course of Business under Article 9 of the Uniform Commercial Code (and Related Matters)*, 1974 WIS. L. REV. 1 [hereinafter cited as Skilton].

15. The problem of the revision of § 9-308 in the 1972 Code version is again demonstrated. If Bank *A* listed as original collateral the inventory and chattel paper of the retailer, its claim would theoretically not be one merely to proceeds, and Bank *B*'s knowledge of this will keep it from gaining priority over Bank *A*. Under the 1962 version of the Code, Comment 2 of § 9-308 suggested that Bank *A* would be subordinate unless "by some new transaction with the debtor [it] acquired a specific interest in the chattel paper." This was believed to be a new value requirement, and not merely an original claim or new filing requirement. *See* Weiss, *supra* note 9, at 813. Thus, an interest in chattel paper claimed by the inventory financer *in the original filing* under the 1962 Code version would be a claim merely to proceeds, and, even if Bank *B* knew this, it would prevail. Under the 1972 version, however, if Bank *B* discovers such an original filing, § 9-308(a) suggests that Bank *A* would prevail. This might foolishly encourage Bank *B* not to search the record for previous filings.

16. This assumes that notification of the assignment has not been given by Bank *B* to Buyer-1. *See* UNIFORM COMMERCIAL CODE § 9-318(3).

repossesses the gizmo and section 9-306(5)'s scheme is effected: under subsection (5)(a), Bank *A*'s interest in the goods reattaches upon repossession by Seller. Its interest, however, is subordinated to that of Bank *B* under subsection (5)(b).

Once the gizmo returns to the retailer, he will try to resell it. Buyer-2 enters the picture, paying cash for the gizmo at a reduced price since it is no longer new. Bank *A*'s interest will be cut off by section 9-307(1), if Buyer-2 is a buyer in ordinary course of business, since Bank *A*'s interest was created by Seller and subsection (5)(a) merely caused it to reattach. A question arises, however, whether the security interest asserted by Bank *B* was also created by the Seller, through his transfer of the chattel paper,[17] or was created by Buyer-1 because it was he that initially gave the security interest in the gizmo by signing the conditional sales agreement that constitutes the chattel paper. It can be argued that the interest in the goods was created by operation of law, under section 9-306(5)(b), and not by Seller or Buyer-1. But the definition of chattel paper clearly establishes that the interest extends not only to the paper, but to the goods themselves;[18] and it is clear that "[a] purchaser of chattel paper produced by the sale of goods can acquire a security interest in the goods themselves."[19] Yet, if the interest asserted by Bank *B* is considered to be created by Buyer-1, and not by Seller, section 9-307(1) will not apply to protect Buyer-2 against the interest asserted by Bank *B*. Moreoever, if Bank *B* has filed as to the goods after their return to the retailer, section 9-306(5)(d) apparently protects Bank *B*'s interest in the goods, and Buyer-2 would take subject to its interest.

It is submitted, however, that even if the interest asserted by Bank *B* is deemed to have been created by Buyer-1, and even if Bank *B* has filed as to the goods, Buyer-2 should take free of Bank *B*'s security interest through the application of section 2-403(2) of the Code.[20] Since Buyer-2 in this hypothetical situation is a buyer

17. *See* UNIFORM COMMERCIAL CODE §§ 1-201(37), 9-102(1)(b).

18. *See* UNIFORM COMMERCIAL CODE § 9-105(b).

19. *Project, California Chattel Security and Article Nine of the Uniform Commercial Code*, 8 U.C.L.A.L. REV. 806, 922 (1961) [hereinafter cited as *Project*].

20. UNIFORM COMMERCIAL CODE § 2-403(2) provides: "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." The drafters of the Code indicated an intent to protect the buyer in ordinary course by suggesting that he is fully protected under either § 2-403(2) or § 9-307(1), "whichever is technically applicable." UNIFORM COMMERCIAL

in ordinary course, and the interest of Bank *B* was created by someone other than Seller, section 2-403 is technically applicable.

If Buyer-2 were assumed not to be a buyer in ordinary course of business,[21] section 2-403 would not apply. If Bank *B* has filed as to the returned goods, Buyer-2 will take subject to Bank *B*'s security interest in the gizmo. This result is reasonable, since Buyer-2 in some manner has failed to buy in ordinary course;[22] the result is dictated by section 9-306(5)(d)—although Buyer-2 is not a buyer in ordinary course, he is clearly a purchaser.[23]

If, in the hypothetical situation, Bank *B* has not *filed* or otherwise perfected its interest *in the gizmo,* and Buyer-2 is not a buyer in ordinary course, Buyer-2 takes free of Bank *B*'s interest, despite Bank *B*'s perfection of its interest in the chattel paper.[24] This result is commercially reasonable; Bank *B* was given an opportunity to perfect its interest in the goods, failed to do so, and thus, it is unprotected as against purchasers.

Returning to the original hypothetical model, which assumed that Bank *B* has filed or otherwise perfected its interest in the gizmo, and that Buyer-2 is a buyer in ordinary course, a better, less convoluted approach to the facts is available and is consistent with section 9-306(5). Bank *B*'s interest may be deemed created by Seller, and not Buyer-1.[25] The transfer of the chattel paper by Seller to Bank *B*

CODE § 9-306, Comment 4. It has been sugggested that since both sections require that the buyer be in ordinary course, § 2-403 should apply whenever the interest was created by someone other than the buyer's seller, which would make § 9-307(1) (1972 version) technically inapplicable. Skilton, *supra* note 14, at 8. For further elaboration of this point see the discussion of Osborn v. First Nat'l Bank, 472 P.2d 440 (Okla. 1970) at notes 36-42 and accompanying text *infra.*

Despite arguments that article 9 interests are to be governed exclusively by that article, it can be asserted that the language of § 2-403(2) could be applicable in some circumstances. This view is sensible here, since an analysis under § 2-403(2) does not require an adoption of a purchase money argument. *See* notes 36-42 & 61-65 and accompanying text *infra.*

21. Buyer-2 would not be a buyer in ordinary course of business if he did not meet the requirements found in UNIFORM COMMERCIAL CODE § 1-201(9).

22. *See* note 12 *supra.*

23. UNIFORM COMMERCIAL CODE §§ 1-201(32), (33).

24. Although not explicitly stated in the Code in this manner, this result obtains from a cross-reference in subsection (d) to subsections (a) and (b) of § 9-306(5). The interest asserted under subsections (a) and (b) is in the goods, not the paper or account, and subsection (d) requires perfection of the interest in the goods for the protection against creditors of the transferor or purchasers from him.

25. According to UNIFORM COMMERCIAL CODE § 9-102, Comment 2 (1972 version), "[c]ommercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred, and a sale of such

creates a security interest in Bank *B*. *In that transaction,* Bank *B* is the secured party,[26] and Seller is the debtor.[27] By transferring the chattel paper to Bank *B*, the Seller created the security interest in Bank *B*, even though Buyer-1 had originally created a security interest in Seller. When the gizmo is repossessed by Seller, the security interest in the chattel paper existing in favor of Bank *B* shifts from the paper to the gizmo, by operation of law, under section 9-306(5)(b). Buyer-2, a buyer in ordinary course who purchases the repossessed goods, takes free of the interest of Bank *B*, the unpaid chattel transferee; section 9-307(1) applies since the interest was created by Seller and not Buyer-1.[28] Moreover, Buyer-2 takes free of Bank *B*'s interest regardless of whether Bank *B* has filed as to the goods once they have returned to Seller, since section 9-306(5)(d) offers Bank *B* protection against purchasers and creditors but not buyers in ordinary course.[29] Under this approach, protection is afforded Buyer-2 through the application of section 9-307(1), without resort to section 2-403(2).

Assuming that the original sale creates an account rather than chattel paper, Seller may transfer the account to Bank *C*. In these circumstances, Bank *A*'s interest in the gizmo, upon its repossession by Seller, is granted priority over Bank *C*'s interest under section 9-306(5)(c). If Buyer-2 is a buyer in ordinary course, he will take free of both the interests of Bank *A* and Bank *C* under section 9-307(1) or section 2-403(2). If, however, Buyer-2 is not a buyer in ordinary course, but merely a purchaser, Buyer-2 will take free of Bank *A*'s interest as he would have in the earlier constructed chattel paper transaction, since the sale was presumably "authorized by the secured party [bank *A*] in the security agreement or otherwise."[30] If Bank *C* fails to perfect as to the goods, as required by section 9-306(5)(d), Buyer-2 will take free of its interest, too. If Bank *C* does perfect as to the goods, Buyer-2 takes subject to its interest. In

property is therefore covered by subsection (1)(b) whether intended for security or not, unless excluded by Section 9-104." Section 9-102(1)(b) provides that article 9 applies to any sale of accounts or chattel paper. *See* UNIFORM COMMERCIAL CODE §§ 9-105(1)(b), (d), (m), 1-201(37).

26. UNIFORM COMMERCIAL CODE § 9-105(m).

27. UNIFORM COMMERCIAL CODE § 9-105(d).

28. *See* Skilton, *supra* note 14, at 8.

29. If Buyer-2 were not a buyer in ordinary course, but merely a purchaser of the gizmo, Bank *B*, having filed, would prevail; if Bank *B* had not filed, Buyer-2 would, notwithstanding his status as purchaser, take free of Bank *B*'s interest. *Id.* at 9.

30. UNIFORM COMMERCIAL CODE § 9-306(2).

contrast to the chattel paper model, where the priorities remain the same, here the accounts financer, Bank *C*, is subordinated to the inventory financer, Bank *A*, while the goods remain in the possession of the retailer; but by filing as to the goods, Bank *C* is able to assume priority over Bank *A* when Buyer-2 is a purchaser not in ordinary course. For Buyer-2, it makes no difference whether he purchases subject to Bank *B*'s interest, or the interest of Bank *C*; it may, however, make a substantial difference to Bank *A*.[31]

Having outlined the basic model with which section 9-306(5) deals, and added suppositions which embellish the skeletal design, a critical analysis of recent decisions involving section 9-306(5) factual situations can be attempted and potential problems under the Code section can be raised.

Cases Under Section 9-306(5)

The first decision to squarely address section 9-306(5) was *Osborn v. National Bank.*[32] Although the case reaches a sensible result, a portion of the court's reasoning may invite misconstruction of subsection (5). More importantly, a slight change of the facts demonstrates that the Code's language should be more specific.

In *Osborn*, an automobile[33] was sold to Buyer-1 and chattel paper generated from the sale was transferred to a bank, which took the paper with recourse. Buyer-1 defaulted on his obligation and the car

31. Whereas Buyer-2 is similarly affected regardless of whether the transaction is an accounts transfer or a chattel paper transfer, there is an effective difference in Bank *A*'s status in the two situations. Bank *A* was theoretically forewarned that Bank *B*'s interest would be prior to its own; but since Bank *C* would not ordinarily look to the goods, its filing as to them places Bank *A* in an unenviable position, assuming the retailer fails to remit funds to Bank *A*. Bank *A* has an interest in the proceeds of the sale to Buyer-2, which Bank *C* may also claim as proceeds. Bank *C* also would have an interest in the goods themselves. 2 Gilmore, *supra* note 3, at 740.

32. 472 P.2d 440 (Okla. 1970). Returns problems were not unknown prior to the adoption of the Code, but detailed discussion of the pre-Code law is beyond the scope of this article. There were few pre-Code cases decided in the area. *See, e.g.*, Bloch v. Mill Factors Corp., 119 F.2d 536 (2d Cir. 1941) (trustee prevailed in a confrontation between a trustee in bankruptcy and an accounts financer). For an examination of pre-Code law concerning returns see Skilton, *Cars for Sale: Some Comments on the Wholesale Financing of Automobiles*, 1957 Wis. L. Rev. 352, 412-18. *See also* Goodwin, *Priorities in Secured Transactions—Article 9, Uniform Commercial Code*, 20 Bus. Law. 877, 886 (1965) (asserting that the returns problem has been solved by the Code).

33. Oklahoma law makes no distinction between automobiles and other chattels. 472 P.2d at 441.

was repossessed by Seller; it was subsequently sold to Buyer-2,[34] a used car dealer. Buyer-2 sold to Buyer-3, another dealer, who sold to Buyer-4, the defendant Osborn. The bank claimed to have a prior security interest in the car; the court found otherwise. Applying section 9-306(5)(d), without considering whether Buyer-2 was a buyer in ordinary course or discussing the applicability of section 9-307 and section 2-403, the court concluded that the bank had not perfected its interest in the car when it was repossessed. Buyer-4 took free of the bank's interest.

There is little doubt that this was the appropriate result; however, the court's reasoning is questionable. In answer to the bank's assertion that Seller had acted without the bank's consent in repossessing the automobile from Buyer-1, the court applied an estoppel principle. Because of the recourse nature of the transaction the court determined that the bank was looking primarily to the retailer for satisfaction of the obligation and not the car. It therefore held the bank was estopped from asserting its interest in the automobile. Although the application of an estoppel did no harm in *Obsorn,* it is an open invitation to misconstruction and misapplication of subsection (5).[35] Since most assignments are made with recourse, an estoppel could be invoked almost anytime.

If the bank in *Osborn* had perfected its interest in the car when it was first repossessed by Seller, it is not certain whether Buyer-4 would necessarily have prevailed, even if Buyer-4 was a buyer in ordinary course. The question of whether Buyer-2 was a buyer in ordinary course would have become substantially more important under these facts, since only if Buyer-2 was a buyer in ordinary course could he cut off the bank's interest under section 9-307(1) or section 2-403(2). The court in *Osborn* recognized this, but since the bank had not perfected as to the car, the court could apply the

34. It was questionable whether Buyer-2 was a buyer in ordinary course since the transfer may have been made for an antecedent debt. The court considered this issue unimportant. *Id.* at 442.

35. Suppose, for example, that the bank in *Osborn* had attempted to repossess the car from Buyer-1 when default first occurred, or in some other manner had objectively manifested that it was looking to the car for satisfaction of its obligation. If it generally allowed the retailer to handle its repossessions, could it not be argued that estoppel was nonetheless applicable? Applying the court's reasoning, the bank's right as a secured party to repossess would also be invalidated under these factual circumstances. *See* UNIFORM COMMERCIAL CODE §§ 9-503, 9-105(m), 9-306(5). *But see* 4 R. ANDERSON, UNIFORM COMMERCIAL CODE §§ 9-306:20 to 9-306:23, at 314-16 (1971) [hereinafter cited as ANDERSON].

language in section 9-306(5)(d) concerning a purchaser.[36] However, if a reperfection by the bank had occurred, neither section 9-307 nor section 2-403(2) would be available to protect Buyer-2 against the bank's interest if Buyer-2 were not a buyer in ordinary course. Moreover, since Buyer-4 purchased the automobile from a retailer who had no connection with the bank's security interest, section 9-307(1) would not cut off the bank's interest since Buyer-4's seller did not create it. In these circumstances, a court would probably want to protect Buyer-4's interest. This may be accomplished by applying section 2-403(2) and asserting that although Buyer-2 did not cut off the bank's interest, Buyer-4 did. It would, however, necessitate a determination that the bank had entrusted the vehicle to Buyer-3, who was a retailer.[37] As a buyer in ordinary course, Buyer-4 would take free of the entruster's claim to the car. This analysis and application of section 2-403(2) is not universally accepted by Code scholars. Professors White and Summers argue that the Code's draftsmen intended that priority disputes between secured creditors and subsequent purchasers be governed exclusively by article nine of the Code.[38] They assert that the entrustment doctrine under section 2-403(2) should apply only when goods are returned for servicing.[39] Despite their argument, there is support for permitting Buyer-4 to prevail under a section 2-403(2) approach.[40] Indeed, a comment to section 9-306 states that the buyer in ordinary course is fully protected under either section 2-403(2) or section 9-307(1), depending on which is "technically applicable."[41] If the White and Summers view were accepted, it would render meaningless the comment

36. *See* 472 P.2d at 442.

37. Admittedly, under this analysis, application of an estoppel principle would be necessary but because of the changed facts, estoppel might be less often invoked and therefore less often abused. The estoppel would arise out of the acquiescence language of § 2-403(3).

38. *See* J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 944-46 (1972) [hereinafter cited as WHITE & SUMMERS]. It is interesting to note that for support of their argument, the authors call attention to the opening sentence of § 9-306(2), wherein exceptions are limited to those found within article 9; to comment 2 of § 2-403; and to an ambiguous statement in § 2-403(4) concerning rights of "other purchasers," which they concede could mean buyers not in ordinary course.

39. *Id.* at 946.

40. *Cf.* cases cited in *id.* at 945 n.98.

41. UNIFORM COMMERCIAL CODE § 9-306, Comment 4 states:

> If the dealer thereafter sells the chattel to a buyer in ordinary course of business in any of the foregoing cases, the buyer is fully protected under Section 2-403(2) as well as under Section 9-307(1), whichever is technically applicable.

language. In order to achieve a commercially reasonable result—allowing the buyer in ordinary course to be protected—a court should find section 2-403(2) applicable in a factual situation similar to that in *Osborn* where the bank has reperfected.[42]

A subsequent decision, rendered by the Oklahoma Court of Appeals, *National Savings & Finance Corp. v. First National Bank & Trust Co.*,[43] demonstrates how a court is likely to become confused when applying section 9-306(5). A retailer sold an automobile to Buyer-1 and transferred the chattel paper generated by the sale to Bank *A*, plaintiff National Savings. The car was repossessed by Seller and subsequently sold to Buyer-2; Buyer-2's paper was transferred to Bank *B*, defendant First National. Seller did not use the proceeds received from Bank *B* to pay Bank *A*. When Buyer-2 defaulted, the retailer again repossessed the car and sold it to Buyer-3, who dealt directly with Bank *B*. Bank *B* used the proceeds of the sale to extinguish the obligation of Buyer-2. Bank *A* attempted to replevy the car from Buyer-3 based on the note generated from the first sale to Buyer-1.

The court of appeals held that Bank *B*'s interest had priority and in effect, that Bank *A*'s interest had been cut off by the subsequent security interest of Bank *B*. A factual determination was made that there was an assignment of Buyer-1's paper. According to the court, there was not, as Bank *A* argued, an original transaction between Bank *A* and Buyer-1. The court concluded that Bank *A* failed to protect itself under sections 9-306 and 9-307 when it did not take possession of the car or refile as to it.

While the court reached a satisfactory result, it did so by a misapplication of the Code. It based its analysis on sections 9-306(2) and (5), emphasizing the last clause of subsection (5)(a); in fact, subsec-

42. Significantly, the *Osborn* court stopped at Buyer-2's status and did not even discuss whether Buyer-4 was a buyer in ordinary course. This seems to imply that if Buyer-2 were not a buyer in ordinary course, no one thereafter could be. This is not necessarily true. *See* E. PETERS, COMMERCIAL TRANSACTIONS 888 (1971). *See also* 2 GILMORE, *supra* note 3, § 26.6, at 696.

43. 44 Okla. Bar Ass'n J. 1975 (1973). Pursuant to OKLA. SUP. CT. R. 1.187, the Oklahoma Supreme Court ordered that the case not be considered as precedent or authority or be published in the official reporter. Under the rule, if the question decided is novel or unusual and request for publication is made by the presiding judge of the appellate court, the opinion can be published and may have persuasive although not precedential value. It is submitted that if the reasoning of the court were more cogent, *National Savings* could have been sufficiently novel to have been published.

tion (5)(a) had no relevance to the first sale: section 9-306(5)(a) deals only with a situation where the goods are encumbered by the seller at the time they are sold—that is, where the seller has a preexisting obligation secured by the goods.[44] Following its factual determination that there was an assignment of Buyer-1's paper to Bank *A* and not an original transaction between the two parties, the court relied on *Osborn* for its conclusion that Bank *A* had failed to protect its interest from being cut off by the subsequent transaction with Bank *B*. The Code permits the same conclusion to be reached through a more logical approach. When the car was repossessed from Buyer-1, Bank *A*, the unpaid chattel paper transferee, had a security interest in the goods against Seller.[45] Since Bank *A* did not perfect its interest, Buyer-2 bought the car free of the interest,[46] whether he was a buyer in ordinary course or merely a purchaser. At the time of the second repossession by Seller, Bank *A*, as unpaid transferee of the original sale to Buyer-1, and Bank *B*, as purchaser of the chattel paper generated from the sale to Buyer-2, both had interests in the automobile.[47]

It can be argued that Bank *A*'s interest in the automobile at the time of the second repossession can be likened to a subsection (5)(a) interest: subsection (5)(b), which created Bank *A*'s interest in the goods by operation of law, made the goods "collateral at the time of the sale, for an indebtedness of the seller which is still unpaid."[48] Under this analysis, Bank *B*'s interest in the goods should have priority over the interest of Bank *A* since Bank *A*'s subsection (5)(a) interest has been unperfected;[49] Bank *B*, under section 9-308, has

44. Typically, a § 9-306(5)(a) situation involves floor planned inventory; it could also occur in a less systematic scheme where the seller has given a security interest in specific chattels because he is in financial difficulty. The individual sale of equipment or consumer goods already being used as collateral may also fall within the scope of the subsection. In *National Savings*, however, there was no indication that the car was collateral at the time of the original sale. *But see* notes 48-55 and accompanying text *infra*, analyzing Bank *A*'s interest as a § 9-306(5)(a) interest.

45. UNIFORM COMMERCIAL CODE § 9-306(5)(b).

46. UNIFORM COMMERCIAL CODE § 9-306(5)(d).

47. This analysis is based on a literal reading of § 9-306(5)(b). It might be argued otherwise that the subsection operated to cut off Bank *A*'s interest permanently.

48. UNIFORM COMMERCIAL CODE § 9-306(5)(a). Under UNIFORM COMMERCIAL CODE § 9-105(1)(d), Seller is clearly a debtor; but it is questionable whether his indebtedness here is one contemplated by § 9-306(5)(a).

49. Bank *A*'s interest, which arose by operation of law upon the first repossession, was not perfected for protection against § 9-306(5)(d) purchasers. When it shifted to a § 9-

specific priority.[50]

At the third sale, both the rights of Bank *A* and Bank *B* were cut off[51] and Buyer-3 took free of encumbrance. Thus, Buyer-3 may independently give a valid security interest to a new lender. However, the independent lender in *National Savings* was Bank *B* itself. Since Bank *B* received new proceeds from the sale involving Buyer-3, the case becomes a returns and proceeds problem, rather than one simply of returns. Under these facts, whether or not Bank *A* had a perfected interest in the proceeds will not affect the outcome. The proceeds of Bank *A*'s chattel paper are the returned goods.[52] When the goods are resold, the new chattel paper reasonably would also constitute proceeds. Even if Bank *A* had filed as to the chattel paper it received from the sale to Buyer-1, claiming proceeds in its filing, and had taken possession of the paper, Bank *A*'s interest in the proceeds would be cut off by section 9-308: since Bank *A*'s claim is one to mere proceeds,[53] or alternatively since Bank *B* took its interest without knowledge of Bank *A*'s claimed interest in the specific paper, Bank *A*'s interest—perfected or not[54]—is subordinate to Bank *B*'s interest. Thus, Bank *B* prevails under reasoning consistent with the Code.

Sound policy reasons stand behind such a conclusion. The interest of Bank *B* in the proceeds of the sale to Buyer-3 has been fully perfected by its possession of the paper. Since Bank *B* advanced new value to Buyer-2 (and, presumably to Buyer-3), it should acquire protection.[55]

306(5)(a) interest, it remained unperfected. Had Bank *A* perfected its interest at the time of the second repossession, it would have been deemed continuously perfected, and Bank *A* would prevail. One commentator has asserted that if the interest in the chattel paper is unperfected under § 9-306(5)(b), the interest in the goods is also unperfected. 2 GILMORE, *supra* note 3, at 737. It does not follow, however, that if the interest in the paper is perfected, the interest in the goods is also perfected beyond the ten day period during which the goods may be proceeds of the paper. *See* note 54 *infra*.

50. For the statutory language see note 9 *supra*. Without this specific Code priority given to Bank *B*, Bank *A* would prevail; both the interests of Bank *A* and Bank *B* are unperfected and Bank *A*'s interest attached first. *But see* Weiss, *supra* note 9, at 788, for a discussion of parity of interests based on simultaneous attachment. *See also* notes 56-60 and accompanying text *infra*.

51. *See* UNIFORM COMMERCIAL CODE §§ 9-306(5)(d), 9-307(1).

52. 2 GILMORE, *supra* note 3, at 737.

53. Bank *A*'s claim is not strictly to proceeds of inventory, but rather to proceeds of proceeds of inventory.

54. If unperfected, Bank *A*'s claim to proceeds would have expired within ten days after conversion from car to paper. UNIFORM COMMERCIAL CODE § 9-306(3).

55. Protection should be afforded under UNIFORM COMMERCIAL CODE § 9-308 and the gen-

A court unwilling to accept an analysis which analogizes Bank *A*'s interest to a subsection (5)(a) interest may reach a different conclusion as to which party prevails. If it is asserted that neither Bank *A* nor Bank *B* has perfected its interest after the goods have been returned by filing as to the goods when they were repossessed for the second time, both financers will claim an interest in the goods which is good as against Seller. Bank *A* can assert that its interest attached at the first repossession, its interest was "tolled" by the second sale, and, upon the second repossession, it reattached prior to the attachment of Bank *B*'s interest. In effect, Bank *A* must argue that its interest *continued attached* and relates back to the first attachment.[56] If the court incorrectly accepted this premise, it would accord priority to Bank *A* over Bank *B*—since neither party perfected, the time of attachment would become critical.[57]

A court would more likely be disposed toward a more equitable solution; ignoring the "continuous attachment" argument of Bank *A*, it would determine that both banks' interests, neither of which was perfected, simultaneously attached at the second repossession and conclude that priority should be shared. Although the parity conclusion has been suggested by one authority,[58] it has been reasonably urged that the first to file as to the collateral—in this case, the first to possess or file as to the chattel paper—should be granted priority.[59] In order to determine which financer should be granted priority, however, the court would either have to accept the subsection (5)(a) analysis discussed above, or accord Bank *B* protection based on a realistic policy appraisal that it deserves to win.[60]

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eral Code policy of protecting injectors of new money into a commercial transaction. *See generally* Skilton, *supra* note 14.

56. *See* Weiss, *supra* note 9, at 785-93. *But see* Kripke, *Suggestions for Clarifying Article 9: Intangibles, Proceeds, and Priorities*, 41 N.Y.U.L. REV. 687, 705-14 (1966) [hereinafter cited as Kripke].

57. *See* UNIFORM COMMERCIAL CODE § 9-312(5)(c); UNIFORM COMMERCIAL CODE § 9-312 (5)(b) (1972 version).

58. *See* Weiss, *supra* note 9, at 788. A conclusion of parity of the interests would offer a compromise to a difficult situation.

59. *See* Henson, *Countersuggestions Regarding Article 9: A Reply to Professor Kripke*, 42 N.Y.U.L. REV. 74, 76-77 (1967).

60. *See* Felsenfeld, *Knowledge as a Factor in Determining Priorities Under the Uniform Commercial Code*, 42 N.Y.U.L. REV. 246, 267 (1967). Support for protecting Bank *B* over Bank *A* is rooted in the Uniform Trust Receipts Act, a source of part of the Code, with its underlying policy "to accord the protection that the act explicitly gave a retail purchaser to that purchaser's obligation to his financer." Felsenfeld, *supra* at 267. Simply, the policy

At least one commentator has argued that the priorities problem raised by *National Savings* cannot be resolved by section 9-306(5) or section 9-308.[61] Levie suggests that when a sale occurs, paper is transferred to Bank *A*, and the sale is later rescinded or undone, if there is a subsequent sale and transfer of new paper to Bank *B*, neither Code section is determinative. He reasons that the problem *should* have been covered by section 9-308 but was not, inasmuch as that section is limited to competing interests in the same chattel paper, and here, both financers claim rights in different chattel paper. Levie does not circumvent the difficulty by construing the chattel paper generated from the second sale as indirect proceeds of the first paper transferred to Bank *A*. In his view, section 9-306(5) is also inapplicable since that section merely grants a priority to the extent section 9-308 is effective. Levie concludes that the perfection section, 9-312,[62] applies and would grant priority to Bank *A* since it perfected its interest first. By deeming Bank *B*, the second financer, as a holder of a purchase money security interest who prevails under section 9-312,[63] Levie avoids granting priority to Bank *A*.

It is conceded that section 9-306(5) does not specifically cover the priority problem raised by a *National Savings* factual situation, since the conflict is between two subsection (5)(b) claimants. A court should avert the commercially unreasonable result of permitting Bank *A* to prevail by applying a transformation analysis, suggested earlier, which construes Bank *A*'s interest as a subsection (5)(a) interest; a less satisfactory solution, but one which arrives at the proper result, would be to recognize the technical alternative offered by Levie, a purchase money priority under section 9-312(4).

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behind the priority given the purchaser's financer is a continuation of the protection given the buyer. Under these facts, Buyer-3 takes free of Bank *A*'s interest in the automobile; Bank *B*, Buyer-3's financer who claims through Buyer-3, is also accorded protection.

61. *See* Levie, *supra* note 7, at 959-60.

62. UNIFORM COMMERCIAL CODE § 9-312(5)(c) states that priority between conflicting security interests which are unperfected is determined by the order of attachment.

63. UNIFORM COMMERCIAL CODE § 9-312(4). Levie proposes two "technical solutions" for avoiding the grant of priority to Bank *A*. *See* Levie, *supra* note 7, at 960. The first, based on § 9-307(1), continues to place the burden of perfecting its interest on the second financer, and thus it is of no aid to Bank *B*. The second, more satisfactory alternative accords the second financer a purchase money priority under § 9-312(4), allowing Bank *B* to prevail over Bank *A*. It may be argued, however, that the categorization of Bank *B*'s interest in *National Savings* as a purchase money security interest is not helpful in light of its failure to perfect. Since the asserted interests of Bank *A* and *B* are both unperfected, the question of which interest attaches first may again be raised. *See* note 62 *supra*.

An approach based on section 9-306(5)(d) will also provide a satisfactory resolution of priorities. The transferor of chattel paper is clearly a debtor under the Code,[64] and although the Code definition of creditor[65] does not specifically include a transferee of chattel paper, it can be assumed that such a transferee becomes a creditor of the transferor. Since the first chattel paper transferee, Bank *A*, has not perfected its interest in the returned goods, it loses under subsection (5)(d) to the second transferee, Bank *B*, a creditor of the transferor. Bank *B* thus prevails without resort to a purchase money security fiction.

Another case involving a potential section 9-306(5) factual situation was *International Harvester Credit Corp. v. Commercial Credit Equipment Corp.*[66] Buyer-1 purchased equipment from Seller, and chattel paper was transferred to Bank *A*, defendant Commercial Credit. The sales agreement contained a clause instructing Buyer-1 to pay Bank *A* directly. A third party, Buyer-2, came into possession of the equipment and traded it in to the original retailer, in partial exchange for a new unit. Buyer-2's paper was transferred to Bank *B*, plaintiff International Harvester, which also took an interest in the traded-in equipment. Shortly thereafter, Seller filed a petition in bankruptcy. Bank *B* repossessed the traded-in equipment and Bank *A* instituted suit against Bank *B*. Both financers apparently had perfected security interests in the retailer's inventory; Bank *B* had been the first to file.

The court ignored section 9-306(5) and ruled in favor of Bank *A* based on its purchase money security interest in the collateral.[67] Notwithstanding its indirect reasoning, the court arrived at a desirable result.[68] A better analysis, however, would involve sections 9-306 and 9-307. Buyer-1, if he were a buyer in ordinary course, takes free of both banks' inventory security interests under section 9-307(1). Bank *A*, the transferee for value of the chattel paper from the sale to Buyer-1, had an interest in the chattel paper superior to that of Bank *B*, since Bank *B* could merely claim the paper as proceeds of the sale to Buyer-1. When the equipment was returned

64. *See* UNIFORM COMMERCIAL CODE § 9-105(1)(d).
65. *See* UNIFORM COMMERCIAL CODE § 1-201(12).
66. 125 Ga. App. 477, 188 S.E.2d 110 (1972).
67. *Id.* at 479, 188 S.E.2d at 112.
68. *See* Kock, *Commercial Law*, 24 MERCER L. REV. 41, 65-66 (1973). The analysis of *Commercial Credit* which follows is similar to that offered by Professor Kock in his article.

to Seller, both banks' inventory interests reattached. Although Bank *B*'s original inventory interest was perfected first and had priority over Bank *A*'s inventory interest under the continuous perfection provision, Bank *A* may rely on its prior section 9-306(5)(b) chattel paper interest, rather than its inventory interest. Thus, Bank *A*'s interest acquires priority. Since the equipment was not resold, Bank *A* is entitled to it; the new money financer, here Bank *A*, correctly prevails. It could be argued that Bank *B* had in fact advanced the "newest" value, since it had financed Buyer-2's acquisition of the new equipment, partially by taking an additional interest in the returned goods. Presumably, it also had the security of the new equipment, although it is not clear from the court's opinion whether it had filed as to the goods held by Buyer-2. Arguably, the interest in the traded-in equipment given by Seller should not alter the result. Seller can encumber only *his* interest in the goods and the interest created by Buyer-1 for the benefit of Bank *A* continues.[69]

Yet, this answer is not satisfactory when applied to the facts of *Commercial Credit*. Bank *A*'s interest was technically not created by Buyer-1, but by operation of law, or by Seller's assignment. Although Bank *A*'s priority is still supported, a question arises whether Bank *B* was a creditor of the Seller against whom Bank *A* had to perfect in order to be protected under subsection (5)(d); it may be asserted that even if Bank *B* does not attain creditor status under subsection (5)(d),[70] Bank *B*'s refiling specifically as to the returned goods arguably serves to elevate it to the position of a creditor, particularly since it gave new value. A literal reading of subsection (5)(d) suggests that Bank *B* does in fact become an intervening creditor. Indeed, if Bank *B* were some other bank it would be viewed as a creditor of Seller. In these circumstances, however, policy considerations dictate a converse result; to accord Bank *B* priority would be to sanction the requirement of filings and refilings each time new value was advanced against used inventory. The consequence would be to effectively vitiate the first to file rule.[71] The path to the desired result is simply not clear under section 9-306.

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69. *Id.* at 66.

70. *See* 2 GILMORE, *supra* note 3, at 739.

71. The first to file is granted priority over subsequent filers under UNIFORM COMMERCIAL CODE § 9-312(5)(a). But if Bank *B* can, by refiling as a § 9-306(5)(d) creditor, usurp Bank *A*'s § 9-306(5)(b) priority, then the initial filing becomes meaningless.

There are three potential solutions to the problem, but each requires something more than the language presently contained in section 9-306 offers. First, a rule could be established that if the interest of the chattel paper transferee is perfected as to the *good* itself (as opposed to the paper) prior to the good's return, it is perfected for the purposes of subsection (5)(d). This rule leads to a question of notice and a problem of who the debtor[72] is; for that reason the solution is unsatisfactory. If the purchaser is listed as the debtor, which would be the case in a filing as to the goods, no notice is afforded Seller's creditors. Second, a rule could be established that an inventory financer or creditor such as Bank *B* could not elevate its position by merely giving new value and refiling. This would mean that once an inventory creditor was classified, he would remain in the position he originally found himself as to all subsequent transactions concerning *inventory* security. This rule seems preferable, but would have to include an exception in cases where there is a purchase money interest in inventory which has notice safeguards built in.[73] A third solution would be to accord Bank *B* priority unless Bank *A* files as to the goods after repossession. This appears to be the original thrust of section 9-306(5)(d).[74] Whichever of the three approaches is chosen, it should be explicitly incorporated into section 9-306 so that a court does not have to avoid the problem by deciding on the basis of a purchase money security interest fiction as in *Commercial Credit*.[75]

Two cases, *International Harvester Credit Corp. v. Associates Financial Services Co.*,[76] and *Chrysler Credit Corp. v. Sharp*,[77] present the issue of whether or not section 9-306 can apply if goods never leave the possession of Seller. In *Associates Financial Ser-*

72. *See* text accompanying note 82 *infra*.

73. *See* UNIFORM COMMERCIAL CODE § 9-312(3).

74. The situation is analogous to that raised by Professor Gilmore, in which the inventory financer asserts a § 9-306(5)(a) interest so that even an unperfected chattel interest would seem to take priority; however, here the interest of a § 9-306(5)(d) creditor would take priority over both the inventory lender and chattel paper holder. Circuity problems similar to those raised by Gilmore are discussed at note 89 *infra*. *See* 2 GILMORE, *supra* note 3, at 739.

75. It could be asserted, as Professor Kock impliedly does, that Bank *B* takes subject to Bank *A*'s interest even if Bank *B* advances new value, presumably because of its knowledge of Bank *A*'s claimed interest in the repossessed goods. This argument presumes too much; it infers knowledge where the Code requires it to be actually demonstrated.

76. 133 Ga. App. 488, 211 S.E.2d 430 (1974).

77. 56 Misc. 2d 261, 288 N.Y.S.2d 525 (1968).

vices, Bank *A*, defendant International Harvester, held a perfected security interest in a retailer's inventory. The buyer's acquisition of two trucks was financed by Bank *B*, plaintiff Associates Financial Services, with Bank *A*'s full knowledge and approval. Seller never delivered the trucks to the buyer, but assigned the paper generated to Bank *B*. The retailer never remitted these funds to Bank *A*; when Bank *A* learned that Seller had received payment, it demanded the money and received a subsequently dishonored check. Bank *A* took the trucks and disposed of them. Bank *B* filed suit against Bank *A* for the value of the trucks. The trial court held for Bank *B* and the judgment was affirmed on appeal. The court determined that the buyer bought in ordinary course and that Bank *B* took the chattel paper in accordance with section 9-308. Applying the rule of section 9-306(5), the court concluded that upon the trucks' return to Seller, the unpaid chattel paper transferee, Bank *B*, would prevail over the inventory financer, Bank *A*. Bank *A*, however, advanced the argument that no "sale" had taken place since the trucks had never left Seller's lot; therefore, it reasoned, section 9-306(5) could not be applied. The court answered the assertion with section 2-401(3).[78] By applying this section to determine that title passed at the time of contracting, the court concluded that a sale had occurred under section 2-106.[79] The court's reasoning that title passed, however, begs the question of whether there was a return.

Sharp predates *Osborn* by two years but it is not generally viewed as a returns case since, like *Associates Financial Services,* the goods at issue remained with the Seller. In *Sharp,* Bank *A* provided inventory financing for Seller, who sold an automobile to the buyer. The buyer's chattel paper was transferred to Bank *B*, Chrysler Credit, which took in accordance with section 9-308. Bank *A*, prior to the delivery of the car to the buyer, seized it and the rest of Seller's inventory, and sold them. Bank *B* sued for the proceeds of the sale. Finding in favor of Bank *B*, the court held that since Bank *B* furnished new value, which was paid to Seller on assignment, and purchased the chattel paper in due course, it was entitled to the returned or repossessed goods under sections 9-306(5)(b), (c), and

78. UNIFORM COMMERCIAL CODE § 2-401(3) provides that "where delivery is to be made without moving the goods . . . if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting."

79. UNIFORM COMMERCIAL CODE § 2-106(1) states: "A 'sale' consists in the passing of title from the seller to the buyer for a price . . . ."

(d) and 9-308.[80] The court virtually ignored the fundamental problem of whether there can be a return when the goods never left the retailer's possession. It assumed the applicability of section 9-306(5) and held that a buyer

> who knowingly signs a retail installment payment obligation and trades in an old car in addition must, certainly as to a retail financer furnishing new value . . . be deemed a buyer in the ordinary course of business, *without regard to the technicalities of when title is to pass pursuant to collateral oral agreements or as to time of delivery and without the necessity of determining whether such delay brings about technically, a bailment, a non-delivery, a repossession or whatever.*[81]

Significantly, the court applied the returns section despite the absence of the technical requirements of repossession. It apparently reasoned that since the goods were in Seller's possession it was immaterial how they got there. The court's reasoning is not entirely indefensible. Without the use of section 9-306(5), Bank *B* might not prevail under these facts; Bank *B* in effect would hold worthless paper whereas Bank *A* would have a perfected prior security interest. Thus, it is submitted that although section 9-306(5) *does not technically* apply in these circumstances, a court is justified in using it as an analogue. If there has been a transfer of chattel paper to a transferee who takes in accordance with section 9-308, and a sale sufficiently in ordinary course to justify termination of Bank *A*'s inventory interest, section 9-306(5) should apply. The fact that possession has never left Seller—that there has been no repossession—is immaterial.

An interesting sidebar of the *Sharp* case is whether or not the interest of Bank *B* was perfected in the sense necessary for its protection against a creditor under section 9-306(5)(d).[82] If the filing by Bank *B* names the buyer as the debtor, it would not provide notice to Seller's other creditors because the retailer's name would not appear in the financing statement. The goods at issue would appear to be encumbered only by the inventory financer's interest, if at all, and the question arises whether a third party creditor would take

80. 56 Misc. 2d at 267, 288 N.Y.S.2d at 533.
81. *Id.* at 268, 288 N.Y.S.2d at 534 (emphasis added).
82. *See* Skilton, *supra* note 14, at 183 n.199.

subject to Bank *B*'s interest. The third party should take free of Bank *B*'s interest since any filing would not list the retailer as a debtor and thus subsequent creditors would not be notified. The only way in which subsection (5)(d) should be given effect is if there is perfection as to the goods in the hands of Seller, after the return or repossession, naming the retailer as debtor. Ignoring the possibility of a shift of Bank *A*'s inventory interest to that of a (5)(d) creditor,[83] Bank *B* prevails over Bank *A* but should not prevail over purchasers or other creditors of the retailer.

In re De-Flectronics, Inc.,[84] which considers section 9-306(5) in a bankruptcy context, also predates *Osborn,* but it is not considered to be a seminal decision due in part to the erroneous belief that aspects of the returns section are clear in a bankruptcy context.[85] A bank, pursuant to an agreement between it and bankrupt Seller, had filed a financing statement covering accounts and proceeds of accounts under which accounts were periodically assigned. One account assigned to the bank represented goods which had not left the bankrupt's possession; another assigned account represented goods which had left, but had returned. A judgment creditor of Seller executed on the goods; they were sold, and the proceeds were turned over to the trustee in bankruptcy. The bank, by virtue of its security agreement, claimed the funds in the hands of the trustee. The bankruptcy court held for the trustee.

The court examined both the interest claimed by the bank in the account represented by the goods which had never left the bankrupt's possession,[86] and the interest claimed in the account repre-

83. *See* 2 GILMORE, *supra* note 3, at 739; text accompanying note 70 *supra.*

84. 4 UCC Rep. Serv. 450 (D. Conn. 1967).

85. *See* 2 GILMORE, *supra* note 3, at 738-39; Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9,* 14 RUT. L. REV. 518 (1960) [hereinafter cited as Kennedy].

86. The rationale applied by the *Sharp* and *Associates Financial Services* courts could not be used here, since accounts, and not chattel paper, are at issue. Had the purchaser of the goods left in the bankrupt's possession signed a conditional sales agreement, instead of purchasing an open account, and had that contract been assigned, presumably both interests could have been analyzed under § 9-306(5). This underscores the difference between accounts and chattel paper financing and is another basis for the justification of the lesser priority position accorded the accounts financer under § 9-306(5)(c). The differentiation is reasonable "because the accounts financer was not lending on chattel security and doubtless maintained a margin of reserves for such a contingency" as nondelivery of the goods. R. HENSON, HANDBOOK ON SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 139 (1973). In a factual setting such as that of *De-Flectronics,* forseeability of the contingency of

sented by the returned goods to determine whether the bank's security interest had attached.[87] Since there was no delivery of the goods that had never left the bankrupt debtor's possession, the bank could not have acquired any account from them prior to the judgment lien. Because delivery had been made in the case of the returned goods, the account had been perfected as to them.[88] In reference to the returned goods, the court noted that sections 9-306(5)(c) and (d) require that the bank, in order to protect itself from the bankrupt's creditors, had to have perfected as to the returned goods, either by filing or by taking possession. Failing this, the bank would lose its claimed interest since the trustee stands in the shoes of the bankrupt's creditors. The judgment lien is void as against the trustee since it was secured within four months of bankruptcy. But because the effect of declaring the lien void would be to give the bank its perfected security interest, the court ordered the judgment lien preserved for the benefit of creditors, destroying forever the bank's claimed interest.[89] Fortunately, the court declined to accept the bank's assertion that the bankrupt was its agent for resale; acceptance of this argument would have rendered meaningless section 9-306(5)(d).

Although the correctness of the *De-Flectronics* decision is unquestionable and it represents exemplary judicial reasoning, an issue left unanswered by the court is whether section 9-306(5) contemplates that an accounts financer who files, claiming proceeds, can convert a perfected accounts claim into a perfected claim in the goods upon

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nondelivery is unlikely. There is little the accounts lender could do to protect itself, at least as to the goods which were never delivered, short of policing the actions of the debtor. Thus, forseeability as a device to allocate the burden of loss seems untenable. If the priority is to be based on policy grounds, it should be stated in terms of the intangibility of accounts financing, rather than on the foreseeability of the accounts-proceeds problem.

87. Trustee in bankruptcy had argued that since no security agreement existed when the financing statement was filed, Bank *A* had no security interest. The court, however, concluded that the filing of a financing statement in advance is permissible, that perfection of the security interest occurs when the interest attaches, and that where accounts are involved, the attachment occurs when there is agreement that attachment occur, value is given and accounts come into existence. 4 UCC Rep. Serv. at 454.

88. *Id.*

89. The situation is analogous to the circuity argument advanced by Gilmore, in which the trustee prevails over the transferee of an account, who prevails over the inventory financer, who prevails over the trustee. Thus, the trustee loses where he should not. The solution in both situations is identical: preserve for the benefit of the bankrupt's estate the otherwise superior interest, and thereby avoid both. *See* 2 GILMORE, *supra* note 3, at 739. *See also* Kennedy, *supra* note 85, at 535.

their return. It can be argued that proceeds of receivables includes returned goods since a financer claiming receivables certainly would foresee returns and therefore should have an appropriate filing.[90] Thus, a filing claiming proceeds should be sufficient to convert the perfected accounts claim into a perfected claim to the goods upon their return.[91] Consideration of the policy of the Code with respect to accounts leads to two possible conclusions concerning the validity of this argument. Generally, the accounts financer does not look to the goods for satisfaction of his obligation; the goods become important only after their return or repossession. This explains the Code's subordination of the account financer's interest to that of the inventory lender.[92] The question then arises whether an accounts financer can circumvent the subordination of his interest to that of the inventory financer by filing as to accounts and returned goods.[93] Since section 9-306(5)(c) only subordinates the interest which arises by operation of law, and not that consensually arrived at, the accounts financer who files first and claims both accounts and proceeds in the form of returned goods should prevail over the inventory financer.

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90. Professor Kripke observes:

> What could be the proceeds of receivables? One answer is returned goods (inventory), as to which the priority issues are dealt with in section 9-306(5). There is surely no reason why the person claiming the receivables should not foresee returns, and have an appropriate filing.

Kripke, *supra* note 56, at 706.

91. Professor Kripke would argue that the word "proceeds" itself would be an insufficient description of the collateral, but that "proceeds, including returned goods" would suffice. Weiss, however, challenges Kripke's call for specificity, asserting that it will lead to boilerplate listings of all possible proceeds, and thus not clarify the problem at all. *See Weiss, supra* note 9, at 816-17. This writer prefers the Kripke approach but would maintain that foreseeability is only a partial answer.

92. As a result of that priority, the question frequently arose in the past whether the inventory financer who also took an interest in proceeds of inventory would prevail over the accounts financer. The 1972 version of the Code affords protection to the first to file as to the accounts, either as original collateral or as proceeds. *See* UNIFORM COMMERCIAL CODE § 9-312 (1972 version). *See also* Henson, *supra* note 59, at 76-77 (inventory financer prevails, even if accounts financer files first, since accounts financer's interest cannot attach until account comes into existence); Oldfather, *Floor Plan Financing under Article 9 of the Uniform Commercial Code*, 14 U. KAN. L. REV. 571, 584-85 (1966) (discusses opposing views and determines that the inventory financer should prevail); Scult, *Accounts Receivable Financing: Operational Patterns under the Uniform Commercial Code*, 11 ARIZ. L. REV. 1, 28 (1969) (first to file, either as original collateral or as proceeds, should prevail); Weiss, *supra* note 9, at 788 (if inventory financer files first he wins; in all other situations, the interests attach simultaneously and there is parity).

93. *See* ANDERSON, *supra* note 35, §§ 9-306:20 to 9-306:23, at 314-16. The author suggests that circumvention will be effected by such filing.

It should logically follow that the accounts financer also prevails, without refiling, over purchasers of the returned goods, creditors of the seller, and the trustee in bankruptcy. In effect, there has been a mere substitution of perfected interests, much like that which has long been accepted by a bankruptcy court when it deals with an inventory financer's interest.[94] This approach appears to satisfy the Code's general notice scheme; the financing statement of the accounts financer, who also claims returned goods, will list the Seller as debtor.

On the other hand, the granting of a perfected interest in returned goods to the accounts financer, as against the creditors of the retailer or his trustee in bankruptcy, may be unacceptable. It places a heavy burden on prospective creditors to determine whether goods have been returned and are subject to the accounts financer's claim. More importantly, if only the word "proceeds" is used to make the claim, it creates too general a category of covered goods. It creates something akin to a secret lien, and might well constitute a preferential transfer.[95] Determination of this final issue may depend on the factual setting. If returns are common in a particular industry,[96] and all parties are aware of that fact, the forseeability argument raised earlier gains strength, and the accounts financer who claims returned goods specifically probably ought to prevail. In other situations, it would seem that policy grounds would dictate the opposite result.[97] This approach would maintain a desirable balance among various financers and would offer protection for the nonfinancing

94. *See* Kennedy, *supra* note 85, at 534-35.

95. *See* Bankruptcy Act § 60, 11 U.S.C. § 96 (1970). Professor Kennedy asserts:

> Unless it is possible to show that as a matter of fact and law the security in the returned or repossessed goods is a continuation of or a substitution for a valid security interest, the reattachment appears to be a transfer to secure an antecedent debt and thus vulnerable to avoidance under section 60.

Kennedy, *supra* note 85, at 534.

96. For example, such returns are not unusual in the construction trade. *See* Levie, *supra* note 7, at 959.

97. This places a burden on the courts to determine the standard practices of various industries, but this determination may be made by focusing on the expectations of the parties. In industries where returns and accounts financing are common, such as in average-size retail businesses, the Code drafters or the courts could set up dollar limit guidelines upon which the rules could be operative. Security interests asserted below the minimum value woule be invalid. This practice is found elsewhere in the Code regarding farm equipment. *See, e.g.*, UNIFORM COMMERCIAL CODE § 9-302(1)(c). The farm equipment exception in § 9-302(1)(c) has been eliminated in the 1972 Code version, but not because the monetary limit was unsatisfactory.

participants, such as the buyer in ordinary course. Although this solution to the problem is not explicitly required under section 9-306, the difficulty with applying such an analysis would seem to be not in convincing the court of its correctness under the Code, but in persuading the court of its appropriateness factually and its consistency with bankruptcy law.

Another case, *In re Haugabook Auto Co.*,[98] is a typical section 9-306(5) situation compounded by a bankruptcy action. Nine automobiles sold by Seller, a bankrupt who transferred chattel paper to a bank, were subsequently repossesed by him, some without judicial process, some through levy and execution. Although the bank claimed a perfected security interest in the vehicles, the court held for the bankruptcy trustee. The majority of the court's opinion deals with establishing a course of dealing between the bank and Seller to demonstrate that the retailer repossessed the cars according to an agreement with the bank and was not, as the bank contended, merely holding them for their owners for the purpose of resale. The court disagreed with the bank's contention that it had at all times looked to the automobiles, and not to Seller, for satisfaction of the indebtedness. It ruled that titles to the cars were held by the bank solely to effectuate a practical business arrangement and not as evidence of a secured transaction. Determining that section 9-306(5) was applicable, the court found that the bank, which had not perfected its interest in the repossessed cars, lost to the trustee who stood as a subsection (5)(d) creditor.[99]

As a simple section 9-306(5) problem, the case does not appear to be unique. What is notable, however, is a portion of the opinion in which the court said one thing and apparently meant something else. The court unequivocally stated, "there is no secured transaction covering the vehicles between the bank and the bankrupt."[100]

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98. 9 UCC Rep. Serv. 954 (D. Ga. 1971).

99. *Id.* at 973.

100. *Id.* at 971.

101. Professor Gilmore states:

> The assignment of a security interest may be itself a transfer for security. In such a case both the original secured party (A) and his debtor (X) become debtors as to the assignee (B). To protect himself against A's creditors, B must . . . file a financing statement in which A is named as debtor . . . .
>
> . . . .
>
> If the underlying collateral is goods which belong to X (whether the goods are inventory, equipment, consumer goods or farm products), the security agreement cov-

This contention was made despite the fact that there were filed financing statements which listed the bank as an assignee of the retailer. The general rule, however, is that where the underlying collateral that forms the basis of the security agreement is goods, the security agreement covering them is chattel paper which is perfected either by possession of the paper or by filing.[101] Thus, it appears that there was clearly a secured transaction between the bank and bankrupt Seller, and that the bank had perfected by taking possession of the paper. However, the failure of the bank to perfect *as to the cars* would indicate that there was no secured transaction with respect *to them,* unless the assignment itself were enough to create one. Sections 9-302 and 9-405 cover assignments under the Code;[102] their combined effect is to continue the perfected nature of the interest by merely substituting one secured party for another. It seems that the court's statement must actually have been concerned with whether there could have been notice to the retailer's creditors of the bank's claim. Although a secured transaction covering the vehicles did exist between the bank and the retailer, the single filing, naming the purchaser as debtor and the bank as assignee, was insufficient to effect a perfected security interest in favor of the bank in the returned goods. If, in addition to the assignment, there had been another filing of the same statement indexed under Seller's name, the result might well have been different. There would be notice to Seller's creditors and compliance with the provisions of section 9-306(5)(d),[103] even without the Seller's consent or signature. This is an advantage to the assignee since an entirely new filing might be difficult, particularly if Seller is in no financial position to sign the financing statements.[104] Moreover, a second financ-

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ering them, executed by X in favor of A, is chattel paper; thus B must perfect against A's creditors, by filing or by taking possession of the security agreement, even though the assignment to him is an outright sale.

1 GILMORE, *supra* note 3, § 19.8, at 541.

102. *See* UNIFORM COMMERCIAL CODE §§ 9-302(2), 9-405(1), (2).

103. Although sufficient on its face, the transaction might constitute a preferential transfer in a bankruptcy context. *See* notes 112 & 113 and accompanying text *infra.*

104. UNIFORM COMMERCIAL CODE § 9-402 provides that a claim to proceeds could be offered for filing without the debtor's signature. Of course, that section would require acceptance of the claim to proceeds—that is, recognition that that which is being claimed is merely proceeds of an originally perfected interest. Although it may not have been necessary, § 9-405 was amended in 1972 to provide that if a separate assignment was filed by the assignee (*i.e.,* not merely the single financing statement with the assignment contained within it), it would be indexed under the grantor-assignor's name, thus affording notice.

ing statement may not be in the best interests of the accounts or chattel paper financer. It may be construed as a voidable new transaction, rather than a mere continuation of the original transaction.

More recently, outside the bankruptcy context, in *Bank of Beulah v. Chase*,[105] the North Dakota Supreme Court arrived at a commercially reasonable decision without following a complete section 9-306 analysis. The defendant Seller purchased an inventory of automobiles under a retail installment contract which was assigned to Bank *A*, the plaintiff. Seller sold an automobile to the buyer and transferred the resultant chattel paper to Bank *B*, the defendant, which took for value and in the ordinary course of its business. Seller failed to remit the funds obtained from Bank *B* to Bank *A*. When the buyer defaulted, Bank *B* repossessed the automobile.

The court's opinion was based on section 9-308 rather than on section 9-306.[106] Determining that the car was inventory, the court construed the second sentence of section 9-308 to give Bank *B* priority. A more persuasive analysis would focus on sections 9-306(5)(a) and (b). Under this approach, Bank *A* has a chattel paper interest in inventory and Bank *B* has a chattel paper interest in goods sold out of inventory. When the car was repossessed, Bank *A*'s interest, which had been perfected,[107] reattached to the car. Bank *B*'s interest under section 9-306(5)(b) is specifically given priority over the interest of Bank *A* to the extent that it was entitled to priority under section 9-308. The court, however, failed to utilize this analysis, and rested on section 9-308.[108] Although one cannot quarrel with the

105. 231 N.W.2d 738 (N.D. 1975).

106. Since § 9-308 is such an integral part of the § 9-306(5)(b) analysis, it is, of course, necessary to discuss it. However, the court failed to return to § 9-306(5) after its initial discussion of the applicable sections. *See* 231 N.W.2d at 742-46.

107. Bank *A* vehemently argued that its interest was perfected, that Bank *B*'s was unperfected, and that Bank *A* should thus prevail. The court responded with a quotation from Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 270, 288 N.Y.S.2d 525, 534 (1968), which placed the exposure of risk on the floor plan entruster based on policy considerations. *See* 231 N.W.2d at 745. Had the court applied §§ 9-306(5)(a) and (b), such policy maneuverings would have been unnecessary. See 2 GILMORE, *supra* note 3, at 739, for the argument that an unperfected § 9-306(5)(b) interest prevails over a perfected § 9-306(5)(a) interest.

108. The court's analysis could have led to further difficulty since the automobile was not really claimed merely as proceeds to inventory, but rather was claimed as a continuation of an original security interest under § 9-306(5)(a). In the *Beulah* case, the distinction may be one without a difference since whether the car is proceeds of inventory or original inventory makes no difference. For a discussion of when the difference in classifying as "continuously

court's application of the Code, the opinion represents another case of a court making a decision without a complete appraisal of the effect of section 9-306(5).

Other Potential Problems

Some problems under section 9-306(5) have not yet been encountered by the courts. For example,[109] after a sale of goods resulting in chattel paper which is transferred to Bank *A*, the goods are returned to Seller, and *then* an advance against the goods is made by an inventory financer, Bank *B*. The goods are subsequently resold, and both Bank *A* and Bank *B* claim the resultant chattel paper, Bank *A* asserting its claim to the new paper as proceeds of the original chattel paper, and Bank *B* asserting a claim to the new paper as proceeds of inventory. One commentator, insisting section 9-306(5) does not apply, has argued that by applying a purchase money security interest fiction, Bank *B* would prevail.[110] However, it can be asserted that section 9-306(5) would apply and effect the same result more directly than a purchase money fiction. The policy of the section dictates that the inventory financer should prevail, since the first financer could have perfected as to the returned goods, instead of relying merely upon its proceeds interest. The second financer is clearly a creditor of the retailer[111] within the meaning of section 9-306(5)(d); since the first financer failed to perfect as to the returned goods, the second financer should take free of the first financer's interest. Although a rule such as this places a heavy burden on the first financer, it has the commercially desirable value of making subsequent financing available to the retailer.

Another difficulty which may be encountered involves determining how to handle conflicts between the inventory lender and the holder of a negotiable instrument. Although this problem is not

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perfected" as opposed to "non-continuously perfected" becomes important in a returns setting, and in general, see Comment, *Conflicting Perfected Security Interests in Proceeds Under Article 9 of the Uniform Commercial Code*, 66 Mich. L. Rev. 517 (1968).

109. The question to be considered is raised in Levie, *supra* note 7, at 961.

110. *Id.* *See* notes 61-65 and accompanying text *supra*.

111. *See* text accompanying note 64 *supra*. Of course, if the inventory lender had an interest prior to the original sale, the situation becomes similar to where it attempts to change its status from inventory lender to a § 9-306(5)(d) creditor. *See* note 82 and accompanying text *supra*. At that point, it becomes a § 9-306(5)(a) claimant who loses to the § 9-306(5)(b) chattel paper transferee.

explicitly addressed by section 9-306(5), the statutory omission, according to Professor Gilmore, is due to the theoretical nature of the conflict.[112] Gilmore asserts that the problem is analogous to the chattel paper or account transfer.[113] Thus, he argues, such negotiable instruments should come under the returns section.

More fundamental difficulties demanding a careful analysis and application of the section may exist in the bankruptcy context. A threshold question is whether the interests asserted under section 9-306(5) are merely state-created interests which are invalid under federal bankruptcy law. Although section 9-306(5) ostensibly *creates* certain interests by operation of law, it would seem that these interests are either being enforced according to the manner in which the parties would have ordered, had they anticipated the return,[114] or recreated—in the sense that the interests which existed earlier are merely brought back into focus after the return. It has been suggested[115] that the reattached interest of the inventory financer is immune from attack by a bankruptcy trustee under sections 70(c) and (e) of the Bankruptcy Act.[116] Under section 60, however, reattachment of the interest within four months of bankruptcy may constitute a preferential transfer for or on account of an antecedent debt.[117] Comment 4 to section 9-306 of the Code states that there is a continuation of the interest of the inventory financer, as opposed to a break and subsequent reattachment. Although it might be argued that there has been a termination of the interest *in the goods,*[118] and that what "continues" is an interest in proceeds, it

112. 2 GILMORE, *supra* note 3, at 741-42.

113. Professor Gilmore reasons:

> If the purchaser of the instrument took free of the inventory lender's proceeds claim under § 9-309, he should continue to have a prior interest in the returned or repossessed goods, like the unpaid transferee of chattel paper under paragraph (b); if he did not take free under § 9-309, he should be subordinated, like the unpaid transferee of the account under paragraph (c); in any event, the interest in the instrument should shift to the returned or repossessed goods.

Id. at 741.

114. This is the view taken in Kennedy, *supra* note 85, at 533:

> Section 9-306 may therefore be properly viewed as regulating the mode of enforcement of consensual liens, in the same manner as state statutes have long regulated the enforcement of such consensual liens as chattel mortgages, conditional sales and trust receipts.

115. *Id.* at 543.

116. Bankruptcy Act §§ 70(c), (e), 11 U.S.C. §§ 110(c), (e) (1970).

117. Kennedy, *supra* note 85, at 534.

118. *Id.* at 535.

seems more reasonable to view the interest in the proceeds not merely as a continuation, but as a *substitution* of interests from goods to proceeds. A subsequent return of the goods is merely one more substitution. Under this analysis, the inventory financer who at some point properly perfected as to the proceeds should be protected. An inventory financer who perfected only as to the goods themselves would lose to the trustee. Similarly, the interest of a chattel paper or accounts financer who perfects as to repossessed or returned goods would prevail over the trustee.[119] A problem with this analysis, however, is that it conflicts with language in section 9-306(5)(a), which does not differentiate between interests based on formalistic proceeds perfection; it continues as perfected any interest that "was perfected at the time when the goods were sold,"[120] without regard to whether the interest in proceeds was also perfected.

A related question is whether the accounts financer can prevail against the trustee by claiming returned goods in his initial filing. He should be able to, assuming that the filing gives sufficient notice to the retailer's other creditors. However, the accounts financer must file as to the accounts as original collateral and it must file before the inventory financer files claiming the accounts as proceeds of the inventory.[121]

In the bankruptcy context, another question is whether the trustee, for purposes of avoiding the claim of an account or chattel paper transferee, may assert the rights of any creditor or only the rights of secured or lien creditors under section 9-306(5)(d).[122] Several factors support the conclusion that the trustee should be able to assert the rights of *any* creditor who becomes a creditor without knowledge of the account or chattel paper interest and before it is perfected. First, section 9-306(5)(d) does not specify that only lien creditors are affected; thus the section should include unsecured creditors in its coverage. Second, the interest being asserted is recreated by operation of law. Since no notice is afforded any creditor, it makes little sense to treat them differently. Finally, the creditor has advanced new value to the bankrupt retailer, ostensibly with the intention of

119. *Id.*

120. UNIFORM COMMERCIAL CODE § 9-306(5)(a).

121. This is true under the 1972 version of § 9-312, and under certain interpretations of the 1962 version of the section. *See* note 92 and accompanying text *supra*.

122. *See* Kennedy, *supra* note 85, at 535.

being repaid; to accord the transferee priority merely because the value was advanced in an unsecured transaction is to unreasonably alter a valid expectation. Although such a rule may work a hardship on the transferee, the alternative would reward non-filing transferees and would thwart the underlying principles of the Bankruptcy Act. Generally, it would seem that the better policy would be to establish a firm rule that accords with both the Code and the Bankruptcy Act.[123]

Conclusion

Section 9-306(5) is neither the best drafted section of the Uniform Commercial Code nor the worst.[124] Difficulties may be encountered in its application, but that indicates nothing more than that the subject matter is highly specialized, that unanticipated and troublesome changes occur in the conduct of business, and policy considerations may be subject to those changes. Basic returns problems are not so difficult or confusing that they defy solution. Even problems of priority confronted in more complicated and novel financing schemes should be foreseeable and their solution should be predictable by application of appropriate sections of the Code—with one eye consistently focused on commercial reasonableness. As this article has attempted to demonstrate, courts frequently have been less than exacting or entirely thorough in their section 9-306(5) analysis; often they have failed to take advantage of the section entirely.

Most commentators[125] have advised caution when dealing with a

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123. On the other hand, the granting to the trustee of an avoidable power based on unsecured claims may offend equitable considerations. For example, the following sequence of events could occur:

June 1—sale of gizmo to Buyer for $25,000.

June 2—sale of Buyer's paper to *A* who purchases for $20,000.

June 3—return of gizmo to Seller.

June 4—unsecured advance by *B* in the amount of $10.

June 5—*A* files as to the returned gizmo.

June 6—petition in bankruptcy filed.

The trustee in bankruptcy in this situation could argue that the appearance of *B* in the transaction is sufficient to dislodge *A*'s claim, not based upon the Bankruptcy Act (since arguably *A* is protected for ten days for the purposes of § 60, and there is no judicial lien creditor) but based upon the creditor language in § 9-306(5)(d). This argument may be accepted by a court in less extreme circumstances.

124. *But see Project, supra* note 19, at 922 n.743, which calls the section "one of the most poorly drafted" in the Code, a criticism with which this writer takes issue.

125. *See, e.g.*, Coogan & Gordon, *The Effect of the Uniform Commercial Code Upon Receivables Financing—Some Answers and Some Unresolved Problems*, 76 HARV. L. REV. 1529, 1566 (1963).

returns problem; attorneys who deal with secured transactions advise their clients to give constructive, actual, and any other kind of notice to any conceivably adverse claimant. As the preceding discussion indicates, this approach may be inadequate. Even with a myriad of filings, conflicting security interests should be resolved by the Code under section 9-306 (or section 9-312); there seems to be a certain futility in the traditional notice filings as a means of protecting against all possible contingencies. A chattel paper, accounts, or inventory financer could be better protected by a clear understanding of the meaning of section 9-306(5) and how it relates to the general scheme of the Code. The need for excess caution would be minimized since, in most returns cases, the Uniform Commercial Code and particularly section 9-306(5) provide a path to a sensible solution.