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THE LAZY LAWYER'S GUIDE TO SECURED TRANSACTIONS UNDER THE CODE

*Peter F. Coogan**

IT is expected that few, if any, who can really qualify as "lazy lawyers" will read this paper. There is, however, an obvious need for a reasonably simple statement which a young lawyer, for example, may find helpful in explaining article 9 of the Uniform Commercial Code[1] to the partners in his firm, or a lender's lawyer may use in explaining the essentials of article 9 to a borrower's counsel who has only occasional contact with secured transactions—or, in either case, vice versa.

It is just possible that in reading this paper for the purpose of enabling him to explain it to others, even the non-lazy lawyer may pick up a thought or two for himself. If read with that idea in mind the reader may change the title to "The Intelligent Lawyer's Guide to Secured Transactions Under Article 9."[2] If the reader lives in an area where to be lazy is to be condemned and to be intelligent is to be suspect, he may prefer to read this under the title, "Article 9: Something Old, Something New." It is not assumed that the lazy lawyer to whom this explanation is to be made is stupid—he may in fact be too intelligent to spend many hours in doing for himself what others may help him do in a few hours.

Since eighteen states have adopted the Code, no lawyer with any commercial practice can any longer escape learning something about it.[3]

* Lecturer, Harvard Law School; Member, Massachusetts Bar, Sponsors' Subcommittee on Article 9 of The Uniform Commercial Code, National Bankruptcy Conference. It is expected that this article will be a chapter in a book on article 9 by the author and his associates.—Ed.

1 UNIFORM COMMERCIAL CODE, 1958 OFFICIAL TEXT WITH COMMENTS, published by the American Law Institute and the Commissioners on Uniform Laws (hereinafter cited U.C.C. with a section number, *e.g.*, U.C.C. § 9-304).

2 Compare INTELLIGENT WOMAN'S GUIDE TO SOCIALISM AND CAPITALISM by George Bernard Shaw (1928).

3 The Uniform Commercial Code has been adopted in eighteen states. The statutes of the adopting states with their effective dates are as follows: Alaska Laws 1962, H.B

The lawyer who is too lazy, too busy, or too intelligent to worry today about something that may not come up for another five years can safely postpone obtaining anything more than a general knowledge of some of the Code's articles until the occasion for a more thorough knowledge arises. A lawyer who drafts letters of credit must, of course, become acquainted with the new and interesting set of rules for their use set forth in article 5. Counsel for a public warehouse will need to know how article 7 on Documents of Title changes the Uniform Warehouse Receipts Act[4] and the Bills of Lading Acts.[5] But a lawyer who has never had occasion to use a letter of credit or almost never handles a documentary transaction may be excused for not, at this time, learning all there is to know about article 5 or article 7. Depending upon his practice, a lawyer may apply the same reasoning to the necessity for learning now about article 6 on bulk transfers, article 4 on bank collections, or even article 3 on commercial paper. But almost every lawyer with any commercial practice deals with the law of sales (recodified in article 2) and one or many forms of chattel security law (codified for the first time in article 9). Those who need article 2 most will already be conversant, often by chapter and verse, with its predecessor, the Uniform Sales Act.[6] The similarities between article 2 and the old law are striking, and the differences not hard to pick up. Some of the words, and fewer of the ideas, are new, but article 2, like the Uniform Sales Act, obviously deals with problems of sellers and buyers. On the other hand, both the words and the concepts of article 9 seem very different from those of any similar body of non-Code law. Although it has absorbed two uniform laws,[7] article 9 does not

120 (Jan. 1, 1963); Ark. Acts 1961, No. 185 (Jan. 1, 1962); CONN. GEN. STAT. REV. tit. 42a (Supp. 1959) (Oct. 1, 1961); Ga. Laws 1962, No. 713 (April 1, 1963); Ill. Laws 1961, S.B. 198 (July 1, 1962); KY. REV. STAT. § 355.1-.101 (1958) (July 1, 1960); MASS. GEN. LAWS ANN. ch. 106 (Supp. 1958) (Oct. 1, 1958); Mich. Laws 1962, S.B. No. 1047 (Jan. 1, 1964); N.H. REV. STAT. ANN. ch. 283a (1961) (July 1, 1961); N.J. STAT. ANN. tit. 12A (Supp. 1961) (Jan. 1, 1963); N.M. STAT. ANN. ch. 50a (Supp. 1961) (Jan. 1, 1962); N.Y. Laws 1962, ch. 553 (Sept. 27, 1964); OHIO REV. CODE ANN. § 1301.01 (Baldwin, 1962) (July 1, 1962); OKLA. STAT. tit. 12A, § 1-101 (1961) (Jan. 1, 1963); Ore. Laws 1961, ch. 726, §§ 71.1010-79.5070 (Sept. 1, 1963); PA. STAT. ANN. tit. 12A, § 1-101 (1954) (July 1, 1954); R.I. GEN. LAWS ANN. tit. 6a (Special Supp. 1961) (Jan. 2, 1962); Wyo. Laws 1961 ch. 219 (Jan. 1, 1962).

4 3 UNIFORM LAWS ANNOTATED (1959) [hereinafter cited as U.L.A.]

5 4 U.L.A. (1922).

6 1 U.L.A. (1950).

7 UNIFORM CONDITIONAL SALES ACT, 2 U.L.A. (1922) and the UNIFORM TRUST RECEIPTS ACT, 9c U.L.A. 220 (1957).

follow the recognizable pattern of either of them or of any other single previous statute.

If we could assume that our learner had absolutely no knowledge of article 9, we could proceed directly to help him correlate that which he knows with that which he must now learn. But we must assume that by this time even our lazy lawyer has been exposed to some of article 9's new language and concepts—just enough perhaps to puzzle him. If we are to help him understand article 9 with a modest effort, we must see what it is that is likely to make his task seem more difficult than it is.

I. SOURCES OF CONFUSION IN ARTICLE 9

The very first paragraph of the "Official Comments" seems to throw out all of the typical lawyer's knowledge of chattel security law. It reads:

> "This Article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures. It supersedes existing legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts, factor's liens and assignments of accounts receivable (see Note to Section 9-102)."[8]

Our lawyer reads further:

> "Under this Article, the traditional distinctions among security devices, based largely on form, are not retained; the Article applies to all transactions intended to create security interests in personal property and fixtures, and the single term 'security interest' substitutes for the variety of descriptive terms which has grown up at common law and under a hundred-year accretion of statutes."[9]

And again:

> "Under the Article distinctions based on form (except as between pledge and non-possessory interests) are no longer controlling. For some purposes there are distinctions based on the type of property which constitutes the collateral—industrial and commercial equipment, business inventory, farm products, consumer goods, accounts receivable, documents of

8 A.L.I., UNIFORM COMMERCIAL CODE 1958 TEXT AND COMMENTS 587 [hereinafter cited as U.C.C. 1958 TEXT AND COMMENTS].

9 *Id.* at 589.

title and other intangibles—and, where appropriate, the Article states special rules applicable to financing transactions involving a particular type of property."[10]

These excerpts from the comments may give to the lawyer who reads 9-102 for the first time the impression that he is saying goodbye to all of his present knowledge of chattel security law. The idea that he must now learn about distinctions based on the type of collateral is reinforced by the first sentence of its first operative section. This reads:

> ". . . this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state
> (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including *goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights*; and also
> (b) to any sale of accounts, contract rights or chattel paper."[11]

The *1958 Official Text* contains a five-page catalog[12] of the sections relating to each category of collateral, which seems to reinforce the reader's impression that the application of the Code's rules turn largely on these categories. After almost seven pages of text and comments on what to him seems a highly specialized problem of how the Code applies in multi-state transactions,[13] followed by three pages of text and comments[14] telling him the secured transactions to which article 9 does not apply, he comes back to ten more pages of text and comments on definitions. This makes a total of about fifteen pages of text and comments on definitions, without counting what are probably the two most significant: "security interest"[15] and "buyer in the ordinary

10 *Ibid.*

11 U.C.C. § 9-102 (Emphasis added).

12 U.C.C. 1958 TEXT AND COMMENTS 592-96.

13 *Id.* at 597-603.

14 *Id.* at 603-06. Section 9-104 excludes four types of transactions: (a) Transactions involving noncommercial intangible property, such as the right to damages in a tort action and assignment of wages. (b) Transactions, the subject matter of which is covered by a federal statute. See, *e.g.*, Ship Mortgage Act of 1920, 41 Stat. 1000, as amended, 46 U.S.C. §§ 911-84 (1958). (c) Transactions governed by some special bodies of law, for example, equipment trusts covering railway rolling stock. (d) Transactions covering real estate, except that the use of fixtures as security is not excluded.

15 This is one of the few definitions which are basic. Section 1-201(37) reads as

course of business."[16] These are defined in the front of the book, in 1-201(37) and 1-201(9), respectively. Nor do these fifteen pages include "proceeds," which is defined in 9-306.

The meaning of some of these new definitions is so obvious that definition is almost superfluous. "Secured party" and "debtor" are common terms to describe the parties heretofore referred to as pledgee and mortgagee and pledgor and mortgagor, etc.; "security agreement" is a name for the various instruments that are used to create different security interests under the pledge, chattel mortgage and the like. But in neither place do we find a definition of "perfected security interest," the obtaining of which seems to be the object of the exercise, nor do we find a definition of the troublesome term "fixture."

At this point our lawyer catches the apparent spirit of the game, and tries to find out just why these categories of collateral are so important. He picks two that sound both significant and reasonably familiar—"equipment"[17] and "inventory."[18] Must he

follows: "'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (§ 2-401) is limited in effect to a reservation of a 'security interest.' The term also includes any interest of a buyer of accounts, chattel paper, or contract rights which is subject to Article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under § 2-401 is not a 'security interest,' but a buyer may also acquire a 'security interest' by complying with Article 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a 'security interest' but a consignment is in any event subject to the provisions on consignment sales (§ 2-326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that on compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security."

16 The definition of this term, unlike many others that seem important, contains a lot of substantive law. Section 1-201(9) reads as follows: "'Buyer in the ordinary course of business' means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. 'Buying' may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

17 U.C.C. § 9-109(2): "Goods are . . . 'equipment' if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods."

18 U.C.C. § 9-109(4): "Goods are . . . 'inventory' if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he

use a different form of security agreement[19] for inventory than he would for equipment? Does the place or the method of filing depend on a determination of whether his collateral is inventory or equipment? After reading the elaborate definitions of the two terms in 9-109, he goes through the Code to determine just what are these distinctions based on "the type of property which constitutes the collateral."[20]

Our lawyer goes through article 9 section by section—9-110 on sufficiency of description does not mention either category—nor does 9-111, or 9-112, or 9-113. Neither "inventory" nor "equipment" is found in sections 9-201 through 9-208, or in the following 9-301 through 9-311. Finally, in 9-312(3)[21] he finds the word "inventory" for the first time; but its meaning here would be perfectly obvious without a definition. "Equipment" in the fully defined sense does not appear until nearly the end of the book—the last sentence of 9-503, and here only in connection with a point of less than earth-shaking consequence.[22] He does find, however, that the place of filing does depend on whether certain collateral is farm products[23] or consumer goods (9-401).[24] Surely there must be some greater significance to these terms which eludes him. Why else would so many pages of text and comment be given to these definitions?

Postponing his search for the hidden significance of these definitions, our lawyer looks for directions telling him how to create the simple, common, garden variety of security transactions like those he caused to be created and perfected through the use

has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment."

19 Section 9-105(1)(h) reads: "'Security agreement' means an agreement which creates or provides for a security interest."

20 U.C.C. 1958 TEXT AND COMMENTS at 589.

21 The requirement for obtaining a purchase money priority in inventory is more stringent than that of non-inventory collateral. *Cf.* U.C.C. § 9-312(3), (4).

22 After default, the secured party may make equipment unusable even though still in the debtor's possession.

23 In effect, there can be no buyer in ordinary course of business who takes free of a security interest in farm products. U.C.C. § 9-307. And the place of filing will be local. U.C.C. § 9-401.

24 Consumer goods is almost self-defining—goods bought primarily for personal or family use. U.C.C. § 9-109(1). Section 9-204(4)(b) limits the use of an after-acquired property clause where consumer goods are involved. As with farm products, filing is likely to be local; and limited protection can be obtained without filing for purchase money security interests in consumer goods other than motor vehicles and fixtures. See U.C.C. §§ 9-302(1)(c), 9-307(2).

of the pledge,[25] chattel mortgage,[26] or conditional sale.[27] The conditional sales contract has been the most used chattel security device over the years; its popularity is due, at least in part, to the fact that its use almost insures *against* the necessity on the part of either the financer or his lawyer to think through the puzzling business and legal problems of after-acquired property and future advances. Almost by definition a conditional sale covers only the specific property being acquired through the transaction which creates the security interest, and almost of necessity it protects only the debt created in acquiring the collateral. By the simple expedient of filing promptly—and even that step is not necessary in some jurisdictions[28]—the secured party protects himself against an attack by debtor's trustee in bankruptcy, whether as a preference under section 60 of the Bankruptcy Act or otherwise. But the Code seems not to contemplate this kind of security transaction, specific both as to the debt protected and the collateral covered; rather it speaks of a "floating lien," or continuing general lien, on a floating mass of assets—particularly those which change in kind and quantity and on which the creditor of necessity must allow the debtor considerable "dominion." Moreover, instead of discussions of the simpler forms of security transactions our lawyer finds such topics as "When After-Acquired Collateral Not Security for Antecedent Debt" (9-108), "When Security Interest Attaches; After-Acquired Property; Future Advances" (9-204) and "Use of Collateral Without Accounting Permissible (9-205). Section 9-306 talks about "proceeds," a concept almost absent from the garden variety security financing. Each of these terms—after-acquired property, future advances, proceeds—immediately brings to mind one or more of the horrid bankruptcy and tax lien problems which the lazy lawyer was too intelligent to worry about so long as he could find a way to create a security interest which avoided these problems.

Article 9 contains almost none of the language derived from the law of the simple security devices. To the extent that the language of article 9 is not entirely new, it more nearly resembles

25 Gilmore & Axelrod, *Chattel Security*, 57 YALE L.J. 517, 521 (1948).

26 *Id.* at 530.

27 *Id.* at 541.

28 See authorities cited in 4 COLLIER, BANKRUPTCY ¶ 70.19[9], at 1132 n. 39 (14th ed. 1959).

the language of the relatively unfamiliar and newer devices of the Uniform Trust Receipts Act (*e.g.*, "security interest,"[29] "proceeds"); and the comments use terms associated with the so-called factor's lien acts (*e.g.*, "continuing general lien"[30]). But many good lawyers, even those with substantial commercial practices, have never had occasion to become acquainted even with the language, much less the concepts or mechanics, of either of these newer chattel security acts. For sound economic reasons, the varying state versions of the newest of these, the factor's lien acts, have generally been availed of only by the more sophisticated lenders and by them only when no other security device satisfied the situation even moderately well.[31] It is perhaps not inaccurate to say that the Uniform Trust Receipts Act has worked so well in moving to market billions of dollars worth of automobiles, refrigerators and other hard goods that few lawyers have had occasion to master its superb but almost incomprehensible legal niceties.[32] A lawyer may have automobile or appliance dealer clients whose commercial life is dependent upon obtaining financing through the trust receipt; nevertheless, counsel for the dealer seldom even sees the form of trust receipt documents which his client signs. The forms were drawn and the financing supervised by literally a handful of lawyers who represent the specialized financing firms who do the bulk of this very important financing business. It is not surprising, therefore, that language and concepts of the Code derived from the Uniform Trust Receipts Act do not make the average lawyer feel at home with the new product.

29 UNIFORM TRUST RECEIPTS ACT §§ 1, 10.

30 See U.C.C. 1958 TEXT AND COMMENTS 631-32; N.Y. PERS. PROP. LAW § 45.

31 The writer found that less than 100 filings had been made in Massachusetts under its factor's lien act during the twelve months prior to the U.C.C.'s going into effect, while almost 30,000 filings under the chattel mortgage act had been made in Boston alone during the same twelve months.

32 "The Uniform Trust Receipts Act is a perplexing maze of technical phrases wholly incomprehensible without an extensive study of the background and development of the security device known as the trust receipt. To avoid trespassing upon the traditional and well defined fields of such common security devices as the pledge, conditional sale and chattel mortgage, most of the act is devoted to definition, limitation and restriction of the arena in which the new device is to play its part in the world of commerce . . . . Stripped of all technical verbiage a trust receipt has been well defined as 'a useful and convenient method of financing commercial transactions by means of which title passes directly from the manufacturer or seller to the banker or lender who as owner delivers the goods to the dealer in whose behalf he is acting secondarily, and to whom title goes ultimately when the primary right of the banker has been satisfied.'" In re Chappell, 77 F. Supp. 573, 575 (D. Ore. 1948).

II. THE CONTINUING GENERAL LIEN AND THE FLOATING LIEN: POTENTIALS AND PERILS

In the hope that theoretical difficulties may dissolve when the Code's provisions are applied to a concrete case, our lawyer decides to use a current financing problem to test his understanding of article 9. At this point he sees the Code as a means of creating a single security interest, amorphous in character, both as to property covered (presently owned and after-acquired) and debt protected (presently outstanding and future advances), with the debtor being allowed to exercise unfettered "dominion" over the collateral.

Suppose that our hypothetical lawyer is asked by his client, a small manufacturing corporation, to suggest a device by which it can obtain 200,000 dollars which it will need over the next year or two for expansion. Although the key executives have invested their lifetime savings in their corporation, like so many modern users of secured credit the company needs more money because demand for its products has outgrown what can be produced with the capital supplied by its original backers. In spite of its success, the company has not yet earned the right to the required amounts of equity capital or of unsecured debt. The company officers have been told by their former employer that for an agreed consideration he will lend their company the needed 200,000 dollars if they can suggest a security device (or devices) by which his risk will be protected in the event that the hopes and expectations of all of them should prove wrong and the company should end up in bankruptcy.

From his reading of the Code our lawyer might draw up the following agreement:[33]

> Louis Lender hereby agrees to lend to Widgets, Incorporated such amounts as may from time to time be agreed upon. To secure its obligation to repay such indebtedness not later than four years from the date hereof, Widgets, Incorporated hereby creates in favor of Louis Lender a security interest in all of Widgets, Incorporated's present and future accounts, chattel paper, contract rights, documents of title, equipment (including, without limitation, lathes, milling machines, stamp-

33 If this agreement now seems too absurd even for a lawyer who handles security transactions only as one of his many activities, compare the case imagined only a few years ago by a leader of the chattel security bar, 2 N.Y. LAW REV. COMM'N, HEARINGS ON THE UNIFORM COMMERCIAL CODE 1147-54 (1954).

ing presses, drill presses, cutters, shearers and other metal-working machines of all types and descriptions), inventory (including, without limitation, steel and other metal bars, sheets, pipes, nuts, bolts, rivets, goods in process, and finished products of all types and descriptions) and general intangibles. Widgets, Incorporated shall be free to process, use, sell or otherwise dispose of any of the collateral hereunder, but the security interest hereby created shall continue in the proceeds and products of any such collateral, and in any other personal property hereafter acquired, whether as replacements or substitutes for such collateral or otherwise.

[Signature and address of Widgets, Incorporated]

[Date]
Accepted:
[Signature and address of Louis Lender]

The parties in this instance might well have used as the "financing statement" required to be filed under part 4 of article 9 a copy of this agreement itself. We will assume, however, for the sake of raising the problem that they filed a statement which met only the minimum essentials of 9-402, namely, one which gave only the signatures and addresses of the debtor and secured party and an indication of the "types" of the collateral with no description of the debt.

The parties here have no doubt created a security interest which we might call a continuing general lien or a floating lien.[34] The use by the parties of a number of the liberties permitted (but never required) by the Code has this result: The parties in one instrument and with one filing have tied up a considerable portion of Widget's currently-owned and, with exceptions, after-acquired property to secure whatever debt may from time to time be owing by the company to this creditor. The lien floats from present assets to the company's interest in after-acquired assets, in whatever form they may be. Further, the company can dispose of any of the collateral without accountability. This hypothetical case gives us a convenient means of describing some of the ideas of the Code which are thought to be new, and to see the extent

34 These two terms are used in the comments but neither is used in the text itself. See, *e.g.*, Comments to § 9-205. These terms are not exact and are not synonymous.

to which they are new. We will therefore describe these concepts more fully before coming back to the question of whether this kind of security interest serves the purpose it is intended to serve for either the lender or the borrower.

A. *Scope of Security Agreement*

Under the Code it is possible for a debtor to create a security interest on all of his currently-owned personal property, tangible and intangible; further, he can do this with a single instrument which need only meet the requirements of an ordinary contract—no oath, affidavit, statement of consideration, or other formality is required. To what extent does the Code here change the old law? In ultimate effect, not at all; in mechanics, considerably. Not infrequently, particular forms of acknowledgments, affidavits[35] or oaths were required, differing from state to state,[36] and even within a state for different devices. The Code goes on the assumption that these supposed deterrents to fraud are ineffective and are not needed.

Under the old law a debtor could effectively hypothecate all of his currently-owned tangible and intangible personal property, but not with one instrument (unless state law permitted the use in one piece of paper of two or more separate security devices). He could secure a loan through a security interest in his fixed assets only through a chattel mortgage, unless it was the kind of property practically capable of being physically pledged. The conditional sale could cover the same kind of collateral but only in a transaction which resulted in the debtor's purchase of that collateral. In many states a chattel mortgage theoretically could have covered inventory as well as fixed assets but the mechanical requirements of description, recording, etc., made it practically unavailable. On the other hand the Uniform Trust Receipts Act

35 Many cases can be found where security interests do not become perfected because of such formal defects as failure to file an affidavit of good faith. See, *e.g., In re* Urban, 136 F.2d 296 (7th Cir. 1943) (no affidavit that chattel mortgage was bona fide mortgage); *In re* Leven, 42 F. Supp. 484 (D. Md. 1941).

36 See, *e.g.,* Maguire v. Gorbaty Bros., 133 F.2d 675 (2d Cir. 1943). The Second Circuit held that a conditional sale executed in New York, apparently in accord with New York laws, was not entitled to protection of the filing system in Connecticut which required a different set of mechanics. For a modern illustration of decisions which turn upon mechanical aspects, see Topper v. Jeffrey Mfg. Co., 191 F. Supp. 105 (S.D. Ohio 1960). The question here was whether an affidavit affixed to the conditional sale agreement by staples met the requirement of the Ohio statute that an oath be "thereon."

and the factor's lien acts are by their terms limited to inventory[37] (and accounts receivable and chattel paper produced through its sale), and the trust receipt, like the conditional sale, can be used only to secure the purchase price of new goods and not a loan against those already owned.[38] The accounts receivable statutes, of course, could cover only accounts. Each of these devices has its own set of rules for execution, filing, priorities and remedies.

Under the Code a single security agreement can cover any number of categories of collateral. We might well excuse our lawyer for wondering whether the comments about rules under the Code being based on the nature of collateral does not miss the mark; if there is a change, one might quite properly say that under the Code there are fewer, not more, distinctions in rules based on the nature of the collateral.

We may turn our attention now from changes in mechanics to changes in social philosophy. At least several decades before the Code was thought of, the idea was accepted that a debtor could hypothecate some, or even all, of his personal property. To accomplish that purpose under non-Code law the debtor had to execute a number of different instruments and, often, do so at different times. Under the Code he can do the same thing with one instrument. To the extent that requirements for different forms were intended to discourage the use of chattel security, the Code does mark a change in social philosophy—but only to that extent. To the extent the state has expressed its social thinking in specific statutes such as those on usury, requirements for disclosure of finance charges, and the like, adoption of the Code makes no change.

B. *After-Acquired Property*

The Code enables the parties in their security agreement to cover not only currently-owned collateral but also to provide for that to be acquired in the future. Again, the change from pre-Code law is basically mechanical rather than substantive. Under neither the old law nor the new can an agreement create a present security interest in collateral which is non-existent, or even in

37 UNIFORM TRUST RECEIPTS ACT § 15; Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289 (1962) [hereinafter cited Coogan, *Public Notice*].

38 Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 HARV. L. REV. 838, 845 (1959) [hereinafter cited as Coogan, *Priorities*].

existent collateral in which the debtor has no rights. The question is by what mechanics can the parties provide for a security interest to arise when the debtor does get rights in the collateral. Under the typical chattel mortgage act or typical conditional sales act, it was necessary for the parties to perform two acts at, or after, the time the debtor acquired rights in certain new fixed assets—execute a new agreement and make a new filing. For acquisition of new fixed assets, the conditional sale has been the most commonly-used security device; in some states its twin, the purchase money chattel mortgage, was more common.[39] Where the collateral was inventory, the trust receipt was the common purchase money device. The Uniform Trust Receipts Act popularizes a new concept in filing—let one filing cover any number of transactions within the period for which the filing is valid. This notice-filing idea was picked up by other security systems for the debtor's liquid assets. The debtor can, under differing mechanics of the Uniform Trust Receipts Act, the accounts receivable statutes, and the factor's lien acts, create a perfected security interest in new property with one act—the execution and delivery to the secured party of a single piece of paper describing the new collateral—sometimes requiring words of conveyance and sometimes not. But where the seller of the goods was also the financer, neither the trust receipt[40] nor the factor's lien[41] is permitted. Whether the financer is the seller or a lender is not important under the Code; the purchase money security interest is available to either, and without regard to the character of the goods. If, under the Code, (a) the original agreement so provides, (b) the original filing was sufficiently broad, and (c) there is at the time an obligation to be secured, the debtor can provide that new property of any kind will automatically become subject to a perfected security interest, excepting only the kinds in which a security interest can be created through delivery of possession (*e.g.*, stocks and bonds).[42] Obviously the creditor can-

[39] It was generally believed that conditional sales were used very little in Ohio because one who used the conditional sale contract may have been obligated to refund a certain percentage of the purchase price in the event that the goods were repossessed. There was no similar requirement under the state's Chattel Mortgage Act. See generally annotations to article 9 in OHIO LEG. SERV. COMM'N, OHIO ANNOTATIONS TO THE UNIFORM COMMERCIAL CODE, BUL. No. 1958-1 (Reprint 1960).

[40] See Coogan, *Priorities*, *supra* note 38, at 838, 845.

[41] *In re* Freeman, 294 F.2d 126 (3d Cir. 1961); Coogan, *Public Notice*, *supra* note 37, at 316.

[42] U.C.C. §§ 9-304(1), 9-305.

not obtain possession of the collateral before the debtor acquires rights in it.

But neither under the old law nor the new is an after-acquired property clause anything like the equivalent of a security interest on currently-owned collateral. Under the old law, sometimes the agreement, without any intervening act, created an interest good between the parties; but the debtor could after acquisition of new collateral refuse to execute the necessary instrument or make the necessary filing to make it good against third parties. Under both the old and the new law the debtor can make an after-acquired property clause ineffective by acquiring some or all of his new property subject to a security interest. Under the Code, and sometimes under non-Code law, the purchase money priority may be given not only to the person who directly furnishes the new goods[43] but also to one who enables the debtor to get the new assets by furnishing the money. No state law can, however, prevent a "transfer" of after-acquired property from being upset as a voidable preference under section 60 of the Bankruptcy Act,[44] if the transfer took place within four months of bankruptcy and if the other requisites of a voidable preferential transfer are present. And until the Congress or the Supreme Court clarifies the question as to what liens are superior to a subsequent federal tax lien, a creditor cannot assume that his lien on any collateral acquired after the date of an assessment, or at least after the filing of a tax lien, by the Internal Revenue Service will not be junior to the tax lien.[45] This quick summary must suffice for a difficult topic.

43 U.C.C. § 9-107(b).

44 Bankruptcy Act § 60, as amended, 52 Stat. 869 (1938), 11 U.S.C. § 96 (1958). For a description of these problems, see Gordon, *The Security Interest in Inventory Under Article 9 of the Uniform Commercial Code and the Preference Problem*, 62 COLUM. L. REV. 49 (1962). It does not seem to me that the answer is necessarily as clear as that excellent article assumes, but the lazy lawyer is well advised to steer clear of the problem. In this discussion no attention is given to § 9-108; this section may come in handy if a preference problem develops, but again safe counselling may avoid that problem. But this writer finds greater difficulty in accepting the more comforting conclusions expressed by Friedman, *The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under the Code*, 108 U. PA. L. REV. 194 (1959).

45 United States v. Ball Constr. Co., 355 U.S. 587 (1958); United States v. Crest Finance Co., 291 F.2d 1 (7th Cir. 1961), *vacated and remanded mem.* 368 U.S. 347 (1962). For post-*Ball* treatment, see PLUMB & WRIGHT, FEDERAL TAXATION (1961); Myers, *The Fall and Rise of the Security Interest*, 6 PRAC. LAW. 60 (Dec. 1960); Plumb, *Federal Tax Collection and Lien Problems*, 13 TAX L. REV. 247 and 459 (1958). For an excellent pre-*Ball* treatment, see Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien*, 63 YALE L.J. 905 (1954).

C. *Future Advances*

The parties may agree to protect future advances as well as present obligations. Under some branches of the old law it is not mechanically possible to cover future advances because the debt must be described with particularity[46] or because some kind of an affidavit or oath is required which must describe the debt in a way that would not include future advances.[47] Under other bodies of non-Code law future advances can be covered,[48] with varying degrees of priority given to those advances. The Code allows the parties to agree that a security interest will cover future advances,[49] but, as we shall see in our discussion of priorities, there is also nothing in the Code that guarantees to any creditor that advances made by him at some time in the future may not be subordinate to certain interests in the collateral created during the time which intervenes between the execution of the agreement and the making of the advance.[50] And, worse, it is quite possible that advances made after the date of a federal tax assessment will be junior to the federal tax so assessed.[51] Under this arrangement, a secured creditor might well make some advances after a tax lien had effectively come ahead of his later advances.

D. *Notice Filing*[52]

The Code permits the parties to choose, with respect to any kind of device and any kind of collateral, between filing a copy of the instrument itself (provided that it meets the minimum requirements of 9-402) or a very sketchy document which does no

46 For differing views on the specificity necessary for adequate description of future debts which are to be covered, see, *e.g.*, Rhode Island Hosp. Nat'l Bank v. Larson, 137 Conn. 541, 79 A.2d 182 (1951) (specific date of monthly payment not specified); Word v. Cole, 122 Ark. 457, 183 S.W. 757 (1916) (description sufficient if record searcher put on notice, but intention to secure future advances not presumed); Frank H. Buck Co. v. Buck, 162 Cal. 300, 122 P. 466 (1912) (need not specify nature of amount of future advances if can be learned by diligent inquiry); Divver & Gunton v. McLaughlin, 2 Wend. 596, 599 (N.Y. 1829) (chattel mortgage cannot secure future advances unless intent clearly shown on its face). The general tendency has evidently been to allow mortgages to cover future advances if they give sufficient notice and indicate the proper intent; third parties who search the records to find outstanding security interests are expected to learn specific matters on their own.

47 The annotations to article 9 for the different states can profitably be consulted. See, *e.g.*, annotations to § 9-204, OHIO LEG. SERV. COMM'N, *op. cit. supra* note 39.

48 Coogan, *Public Notice*, *supra* note 37, at 312.

49 U.C.C. §§ 9-204(3), (5).

50 Coogan, *Priorities*, *supra* note 38, at 852, 878.

51 United States v. Bond, 279 F.2d 837 (4th Cir. 1960) (advance made after filing of tax lien but pursuant to pre-tax-lien real estate mortgage subordinated to tax lien).

52 Coogan, *Public Notice*, *supra* note 37, at 311.

more than give the signatures and addresses of the debtor and of the secured party and identifies the collateral by "type." This kind of filing merely indicates that one of the parties is or may become a secured party and the other is or may become a debtor, pursuant to an existing security agreement, or one or more security agreements contemplated to be executed in the future, or one or a number of security agreements not even thought of at the time the financing statement is filed. Under pre-Code law, sometimes no filing is required for conditional sale contracts; but where filing is required the entire instrument must be filed.[53] Chattel mortgage law, with a handful of exceptions,[54] likewise requires filing of the complete instrument. Laws governing trust receipts, factor's liens and assignments of accounts receivable almost invariably not only permit but require the use of something similar to the Code's notice filing.[55]

E. *The First-to-File Rule*

Under the Code, considerable advantage may be given by 9-312(5)(a) to the person who is the first to file with respect to a given class or classes of collateral. So long as the debt of the first to file is unpaid and the financing statement remains on file, no other secured party can come ahead of him except a purchase-money secured party who directly or indirectly enables the debtor to acquire new goods.[56] This is an over-simplification of the rule but will suffice for the present.

F. *Dominion Reserved*

The Code permits the parties to agree upon the amount of dominion over the collateral which may be exercised by the debtor. Some of the states, including Ohio,[57] Illinois[58] and New York,[59] have for many years condemned as fraudulent a security agreement which allowed the debtor to exercise what the courts later determined to be too much "dominion" over the collateral. Many cases, usually thought to be epitomized by *Benedict v. Ratner*,[60]

53 *Ibid.*

54 See, *e.g.*, COLO. REV. STAT. ANN. §§ 20-2-1 to -3 (1953); N.J. STAT. ANN. § 46:28-5.1 (1940); N.Y. LIEN LAW § 230-c.

55 Coogan, *Public Notice, supra* note 37, at 311.

56 U.C.C. §§ 9-312(4), (5)(a); Coogan, *Priorities, supra* note 38, at 857.

57 Freeman v. Rawson, 5 Ohio St. 1 (1855).

58 Davis v. Ransom, 18 Ill. 396 (1857).

59 Brown v. Leo, 12 F.2d 350 (2d Cir. 1926).

60 268 U.S. 353 (1925).

evolved the rule that where the debtor was allowed to use or sell the collateral without accountability, the secured party lost not only the collateral so disposed of but he lost any other collateral covered by that security agreement.[61] The philosophy of these cases might be roughly summed up by saying that a secured party must act like a secured party at all times and not only in the event his debtor becomes insolvent. This philosophy was rejected at least a century ago in other states, including Michigan,[62] Iowa[63] and Massachusetts.[64] Almost every state has cut down on the New York rule in some respects, through provisions in its factor's lien act and its accounts receivable statute.[65] The Code adopts the rule of the latter group of states; it leaves the parties free to decide upon the degree of control which the debtor may exercise. This, of course, does not mean that the creditor who imposes no control will fare as well as the one who does.[66] Without the controls which produce the "accountability" the New York cases talk about, a secured party under a free-wheeling agreement may well find that, on the day of trouble, all of his collateral has been disposed of and the proceeds paid out in dividends or advances—or, more likely, lost in the company's operations. The cutting down of *Benedict* will be welcomed almost everywhere even if its main effect is only to eliminate the danger of some of the most farfetched extensions of the doctrine.[67]

G. *Misuse of the Code's Liberties*

In our hypothetical case, the parties have taken full advantage of most of the liberties made possible by the Code. We might at this point ask the question: Would either an intelligent borrower or an intelligent lender, or the counsel for either of them, be satisfied with the security interest so produced? When our lawyer examines the first-to-file rule of 9-312(5) he sees that the execution of this agreement and filing the hypothetical financing statement would make it virtually impossible to get a secured loan (other

61 Brown v. Leo, 12 F.2d 350 (2d Cir. 1926).

62 Gay v. Bidwell, 7 Mich. 519 (1859).

63 Hughes v. Cory, 20 Iowa 399 (1866).

64 Brett v. Carter, 4 Fed. Cas. 67 (No. 1844) (D. Mass. 1875); Briggs v. Parkman, 43 Mass. (2 Met.) 258 (1841).

65 See, *e.g.*, DEL. CODE ANN. tit. 6, §§ 1801-1807 (Supp. 1960).

66 Coogan & Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture*, 69 YALE L. J. 203 (1959).

67 Brown v. Leo, 12 F.2d 350 (2d Cir. 1926); Davis v. Ransom, 18 Ill. 396 (1857).

than one which creates a purchase money security interest) from anyone else without the consent of the original lender. This is not to say that there may not be situations in which a borrower may wisely tie himself firmly to one lender.

In the meantime our hypothetical lender explains to his counsel that while he has great confidence in his friends and former employees, he does feel that if he puts in 200,000 dollars he will in effect be a senior partner and is entitled to some voice in major policy matters. Here his counsel must say that this kind of security agreement gives him no control other than the influence he might exert by refusing to make further advances. Furthermore, the exercise by the parties of the privilege given by 9-205 may lead to the consequences previously mentioned—at the time of trouble there will be no collateral, or an insufficient amount of collateral, to cover the debt. He will also explain that any new collateral added during the four months prior to bankruptcy may be vulnerable as a preferential transfer. This is particularly true with respect to inventory. The lender will have to be prepared to fight off, if he can, the contention of the trustee in bankruptcy that each of the shipments of inventory received in the past four months constituted voidable preferences. Counsel might also explain that there are devices[68] (none of which is contained in this arrangement) whereby this problem can be very much reduced. Finally, counsel must point out that if there should be a tax lien slapped on the corporation's assets, any property acquired after the date of that lien will be subordinate to it.[69]

At this point all of the parties will be saying, "there must be a better way."

III. OLD-STYLE FINANCING UNDER THE CODE

Let us try another approach. Let us see to what extent we can do under article 9 what we have done under the old devices and the practices that go with them.

One can look at article 9 with either of two pairs of glasses. If we wear one pair, as our lazy lawyer did (and as the writers of

68 Use of a "revolving credit" mechanism not only avoids problems under Benedict v. Ratner, 268 U.S. 353 (1926), but also helps considerably in keeping the new security from becoming security for an antecedent debt. For a good example, see *In re* New Haven Clock & Watch Co., 253 F.2d 577 (2d Cir. 1958).

69 See authorities cited note 45 *supra*.

the official comments seem to have done), we emphasize everything that is different from pre-Code law—its abolition of terms like the conditional sale and the trust receipt, its great emphasis upon certain defined terms, and its emphasis upon differences in rules based on these categories of collateral. With the other pair of glasses we look at those features of the Code which are mere continuations, with changes of course, of much of the familiar law. It is the thesis of this article that while one can ultimately understand article 9 either way, wearing the second pair of glasses will enable the reader to do it in a fraction of the time required if he uses the first pair. We might at this point suggest to him that he look at article 9, not from the viewpoint of what is new and different from pre-Code chattel security law,[70] but what is old and familiar.

[70] There is no doubt that both the draftsmen and the sponsors overemphasized the degree of change made by article 9, but there are portions of the text and the comments which reflect a view different from that expressed by the excerpts reproduced at the beginning of this article. The first half of § 9-102 emphasizes the new language of categories of collateral. The second half is different: "(2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9-310."

We earlier quoted a sentence from comments to § 9-101 which stated that "the traditional distinctions among security devices based largely on forms are not retained." The author of the comment goes on to say, "This does not mean that the old forms may not be used, and Section 9-102(2) makes it clear that they may be."

Perhaps the better statement is that found in comment 2 under § 9-102: "2. The Article does not in terms abolish existing security devices. The conditional sale or bailment-lease for example is not prohibited; but even though it is used, the rules of this Article govern."

A few more extracts from the comments to § 9-101 are in point:

"When it is found that a security interest as defined in Section 1-201(37) was intended, this Article applies regardless of the form of the transaction or the name by which the parties may have christened it. The list of traditional security devices in subsection (2) is illustrative only; other old devices, as well as any new ones which the ingenuity of lawyers may invent, are included, so long as the requisite intent is found. The controlling definition is that contained in subsection (1) [of 9-101]. . . .

"Under this Article the traditional distinctions among security devices, *based largely on form*, are not retained . . . . [Emphasis added.]

"Under the Article distinctions based on form (except as between pledge and non-possessory interests) are no longer controlling . . . .

"The scheme of the Article is to make distinctions, where distinctions are necessary, along functional rather than formal lines."

The writer had no part in the intial formulating of article 9, or the original writing of the comments. He came into the vineyard only at the eleventh hour, as a member of the subcommittee on article 9, appointed by the sponsors to evaluate the suggestions and criticisms made principally by those who were the Code's first guinea pigs in Pennsylvania, of the New York Law Revision Committee, and of the Massachusetts sponsors of the Code (of which the writer was one). This committee had the last clear chance

We suggest that article 9 be examined in the light of this hypothesis: Article 9 represents neither more[71] nor less than a merger of the previously separate streams of chattel security law—those of the pledge, chattel mortgage, conditional sale, assignment of accounts receivable, trust receipt, factor's lien acts, and the like. The merger has produced a more nearly rational set of rules[72] under which the parties can create, perfect and enforce any of the different kinds of security interests produced under the pre-merger law, ranging from the solid pledge to something little removed, if at all, from a state-created priority.[73] Any lawyer can easily trace practically every important concept, and even every important mechanical device either to one or more of the pre-Code bodies of chattel security law of his own state or of a contiguous state. The bringing together of these rules into one statute is the Code's basic contribution to a more orderly chattel security system. Contrary to the impression created by the Official Comments, only minor differences in rules are based on the nature of the collateral. Terms like "inventory," "equipment," "consumer goods" are convenient handles to carry differences in the

to find the flaws in article 9. The article was to a large extent rewritten. By chance the writer had the assignment of checking the comments to part 1 of article 9 from which all of the above quotations are taken. He did insist that the comments to § 9-105, for instance, be organized less like a dictionary and more along the "functional" lines the Code talked about so much. *E.g.*, comment 2 brings together the terms relating to the parties, comment 3 those relating to the property subject to the agreement. But he did not at the time question the draftsmen's assumption that they had largely abandoned the old law, and had proceeded to create a new and rational chattel security system. The different view expressed here is pure hindsight.

71 Its social philosophy on the use of personal property to obtain goods or credit, of course, differs from that expressed in late nineteenth century statutes; but the change in this philosophy had been completed before article 9 was thought of. On the other hand, as we have noted, the Code does not specifically repeal the types of statutes which set forth some social standard—such as a limitation on interest rate by usury laws or a requirement for a specific kind of factual disclosure. These may be limited by the use of the Code's convenient term "consumer goods" but they are still there. U.C.C. §§ 9-201, 9-203(2).

72 The phrase "a more nearly rational set of rules" is used advisedly. While article 9 presents a tremendous step forward, only the uninitiated could hope that all the quirks and uncertainties of chattel security law developed over the centuries could have been eliminated at one fell swoop. See Coogan, *Security Interests in Fixtures Under the Uniform Commercial Code*, 75 HARV. L. REV. 1319 (1962).

73 Section 9-306, for instance, in words creates a security interest in non-identifiable proceeds under certain circumstances. *But see In re* Crosstown Motors, 272 F.2d 224 (7th Cir. 1959), for treatment of a somewhat comparable provision under the Uniform Trust Receipt Act; Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 RUTGERS L. REV. 518, 531-35 (1960).

business rather than the *legal* side of the security transaction.[74] These terms have the apparent importance they do because an earlier draft of article 9 had elaborated complete sets of rules for each category. When the draftsmen partially realized the extent to which they had brought all the old rules into a unitary system, they dropped the separate systems of rules but kept the definition in a place of honor. In the process of merging, provisions which were needed to distinguish between the law governing the different devices[75] to a considerable extent became unnecessary and were dropped; along with them were dropped also the requirements (*e.g.*, affidavits and oaths) no longer believed to serve any useful purpose.

But even Gertrude Stein could not say that under the Code "a security interest is a security interest is a security interest." Differences based on the functions performed by the different security devices have survived, almost without exception. This means much more than the survival of differences between the pledge and the non-possessory interests. The Code preserves, for example, the difference between a security interest created to finance the purchase of goods (a "purchase money security interest") and one securing a loan or other non-purchase money obligation (typically created by use of the chattel mortgage). Moreover, the Code distinguishes between the different purchase money interests represented by the pre-Code conditional sale and that produced through use of a trust receipt: the former is now a purchase money security interest in equipment of a business or consumer goods of a non-business entity; the successor to the trust receipt is a purchase money security interest in inventory. Further, the old devices often did represent real functional differences. "Conditional sale financing," or "trust receipt financing" each represent a cluster of business practices with its own cluster of business risks. These differences in financing patterns not only may but should be continued under the Code, whether one calls his paper by the new name "security agreement" or one of the old terms like "conditional sale" or "trust receipt." A code-created security interest in most categories of collateral may be possessory or nonpossessory; it may or may not be a purchase money interest. The form *does* count.

74 See early drafts of what is now article 9.
75 Coogan, *Priorities*, *supra* note 38, at 838, 845.

A somewhat far-fetched figure of speech may help to state our thesis in a different way. Every secured lender with any extended experience has learned to his sorrow that a security interest is not a policy insuring him against loss of the indebtedness secured thereby. Suppose we imagine that a secured party has four ships on which he wants Lloyd's (for appropriate premiums) to cover the risks that the various security interests do not protect against. The ship Conditional Sale will carry the lowest premium; typically the collateral is new, readily identifiable equipment; there is almost no risk that someone other than the debtor has a property interest in it; it is not the type of property as to which there can be a "buyer in ordinary course of business" who would take free of the security interest. The ship Chattel Mortgage likewise covers equipment, but there is some chance that the debtor doesn't own it at all, that he has given some interest in it to someone else—voluntarily through another chattel mortgage or involuntarily through legal proceedings conducted against him by another creditor. Credit insurance on the cargo of inventory carried by the ship Trust Receipt may be low or high, depending upon what the cargo consists of, and upon whether payment is to be made only after the inventory is processed or before the "trustee" is allowed to exercise his "dominion" over it. The risk that someone other than the debtor has a property interest in the inventory cargo is low, like the similar risk in the cargo of Conditional Sale. The credit risk on the cargo of Factor's Lien may be very high; its inventory cargo is likely to be in various stages of processing, with no cash coming in until processing is completed. Suppose payment of a debt secured by a cargo of raw wool is not to be made until converted into cloth, the cloth into accounts and the accounts into cash. At the time of trouble, some of the wool is still in bales and some has been converted into finished cloth. Both the raw wool and the finished cloth are salable, even if only at distress prices. But can the secured party realize on the wool which is at a half-way stage between the two? Pulling it off the machines will cost more than the price it brings as waste. Only a sophisticated lender can evaluate the risks here.

In the past, we may sometimes have distinguished one ship from the other by the color and nature of the barnacles which attached to its hull, rather than by the cargo carried. The Code has stripped these separate ships of the barnacles which have

attached to each over the years, but it hasn't altered the fact that security interests created by different devices frequently represented different risks. If this is true, one should under the Code select his security device—or if you prefer, his financing pattern—much as he did under pre-Code law. We may put it more strongly: while the Code makes it no longer necessary to create and perfect each kind of security interest through a different device, the lawyer had better analyze his security interests along the old patterns if he is to evaluate intelligently what his client is getting in the way of protection.

The first question, then, our lawyer will ask himself is: what device or what pattern of financing would I have used pre-Code? He may follow this with a second: does adoption of the Code require any change in what I did under the old law?

As mentioned earlier, the most commonly used security device in most states has been the conditional sale.[76] Can our lawyer use that device for his hypothetical corporation? On inquiry, it turns out that the 50,000 dollars which his client needs now will be used to purchase a new metal spinning machine. We will assume that the spinner is not a fixture. We will further assume a schedule of payments which assumes payment in full well before the end of the collateral's life. Here is a specific security for a specific debt—no after-acquired property, no future advances on this part of the company's financing. How does one proceed from here? To use the Code's high-sounding language, how does one cause a security interest to "attach" and to be "perfected"? To shorten that a bit: how does one create a perfected security interest in equipment? Here we can assure our lawyer that he has been doing just that every time he has a client execute and file a conditional sales contract. For this bit of wisdom, your lawyer should be as grateful to you as was Molière's M. Jourdain when he learned from the philosopher he paid to turn him into an educated gentleman that he had been talking prose for forty years without knowing it.[77]

But if we must analyze the steps, we can say that a perfected security interest comes into existence upon the happening of

[76] See generally SEIDMAN, FINANCE COMPANIES AND FACTORS (1949). See also Hogan, *Financing the Acquisition of New Goods Under the Uniform Commercial Code*, 3 BOST. COL. IND. & COMM. L. REV. 115 (1962).

[77] MOLIÈRE, THE WOULD-BE GENTLEMAN, in EIGHT PLAYS 346 (Mod. Col. Lib. ed. 1957).

whichever is the last of four steps: (1) the debtor gets an interest in the collateral; (2) the secured party gives value, usually by furnishing goods or money, or commits himself to do either, thereby creating an obligation to be secured; (3) the parties reach an agreement which, to be enforceable against the debtor, must be in writing, except that delivery of the collateral is itself evidence of the agreement; and (4) public notice is given, except in the few situations, principally of a semi-commercial nature, where it is excused.[78]

Molière's would-be gentleman would be amazed to learn that steps (1), (2), and (3) are taken automatically upon the signing of a conditional sale contract. But the security interest which thus "attaches" becomes only an unperfected security interest under the Code. Since an unperfected security interest may be defined as one not good against the trustee in bankruptcy of the debtor, we may be excused for not pursuing this concept further. We might here repeat that while under the old law usually a conditional sale contract could be used only where the parties, at least at the moment of signing, were vendor and vendee, under the Code one whose money enables the debtor to acquire the collateral can also acquire a purchase money interest. Sometimes under non-Code law the same effect can be created through use of a purchase money chattel mortgage, but usually the transaction is then subject to a different set of rules. But again, this old pattern should be followed where feasible: vendor and vendee execute the conditional sale agreement and the vendor then sells it (chattel paper) to the lender. These steps may be taken in any order, but all four steps, including the giving of public notice, must be taken before the interest is perfected.

Public notice may be given by delivering the collateral to the creditor or someone holding it on his behalf, or by filing in some public office. Some collateral, like stocks and bonds, can be perfected only through possession, and for intangibles, where delivery is impossible, filing alone is permitted. But usually public notice can be given by delivery or filing. (To be more accurate,

78 A purchase money security interest in consumer goods and lower-priced farm equipment (other than fixtures and motor vehicles) may be perfected with neither filing nor delivery of possession, but its protection against certain purchasers is less. U.C.C. §§ 9-302(1)(c), (d), 9-307(2). Certain trust-receipt-type transactions can be perfected for not more than 21 days—but again the protection is less than that gained through filing.

possession is the key; but that usually requires a delivery.) But delivery of the spinning machine here doesn't make sense, hence, filing is the only practical method. How, what, where and when to file? Filing here can be done either in the name of the original secured party (the vendor) or in the name of the financer, his assignee.[79] If filing has been made by the vendor, protection is thereby gained against the company's creditors; this filing remains good after purchase of the chattel paper by the financer, and assuming that the lender takes possession of the chattel paper, vendor's creditors can claim no interest in it.[80] But he may prefer to be the secured party of record, and this he can do either by making the original filing in his name or by filing a notice that the vendor's interest has passed to him. As noted, the parties may file as a "financing statement" either a copy of the security agreement, containing the signatures and addresses of the debtor and the secured party, or they can file an abbreviated statement. The lazy lawyer will do well (at least until he has thought through all the problems of filing) to file a copy of the agreement itself. In any event there is no excuse in our hypothetical for covering anything more in the financing statement than this one specific spinning machine, describing it as specifically as feasible.

Where to file is a matter of reading the state's version of 9-401.[81] If there is a question as to whether an exemption from filing is available, the lazy answer is to resolve the doubt by filing; if there is a question as to whether to file in one office or more than one, the lazy—and safer—answer is to file more than once. When to file is easy—as early as possible, but by all means within ten days after the debtor gets possession of the collateral. One can file later, but this will be inconsistent with our lawyer's aim to do no unnecessary thinking. If he files after ten days, he cannot evaluate the security interest so perfected unless he studies the rules on priorities among other holders of Code-created security interests

79 U.C.C. §§ 9-401 to -407.

80 The Code permits the purchaser of the conditional sales contract to leave it in the possession of the vendor of the original collateral and vendor (assignor) of the chattel paper if perfection against the vendor's creditors is obtained by filing, but this is one of those liberties under the Code which should be used only by one who is willing to study the effect of taking short cuts. Under § 9-308 another purchaser of this chattel paper can get superior title to it if he pays for it and takes delivery, so long as he does not have actual notice of the particular security interest of the one who perfected through filing.

81 Haydock, *Certainty and Convenience: Criteria for the Place of Filing Under the Uniform Commercial Code*, 3 BOST. COL. IND. & COMM. L. REV. 179 (1962).

and he must study possible preference problems under the Bankruptcy Act. The lazy—and the efficient—thing to do is to file promptly and thus get the benefit of the special purchase money priority under 9-312(4). Since his collateral is not inventory[82] if he filed within the ten-day period, he need not even check the record, because his security interest is tops.

IV. THE "PERFECTED SECURITY INTEREST"

The term "perfected" obviously comes from section 60 of the Bankruptcy Act. Putting that act and the Code together we might try this definition: A perfected security interest is one which *generally* is good against the debtor, most buyers of the collateral, general creditors (including any who later obtain a lien by legal proceedings), the debtor's trustee in bankruptcy, and the federal tax collector. It may be subject to a priority in favor of another secured party or the holder of a lien created by statute, such as a materialman's lien, or to the rights of some buyers.

Suppose we test this conditional sales contract covering the metal spinner. Assuming no violation of a "police type" statute like a usury law which makes a security agreement void, this interest is good against the debtor. The debtor could cause the machine to be misused, and it may depreciate for other causes, but, unlike inventory, it probably will stay right where it is installed for a long time. By taking an assignment of the vendor's interest in the conditional sales contract the lender gets the vendor's title, thus eliminating any question of the debtor's having created some other interest in the collateral. A debtor's equipment is not the type of goods, like most inventory, which is held out for sale: no one who buys the spinner from him can be a "buyer in the ordinary course of business"[83] who would take free of the security interest. The kinds of actual fraud which would enable either a lien creditor or a trustee in bankruptcy to set aside the lien are almost inconceivable. More in point, since the consideration was furnished at the time the security was given, no possible preference[84] problems can exist (assuming that filing

82 The requirements for inventory are more strict because there is more chance that there is a general inventory financer in the picture. See U.C.C. § 9-312(3). We are assuming throughout that the collateral is not a fixture.

83 U.C.C. § 1-201(9).

84 See generally 3 COLLIER, BANKRUPTCY § 60.36 (14th ed. 1950). Since the ten-day requirement is aimed at establishing a priority, and nothing prevents perfection at any

was done not later than ten days after the debtor got possession of the spinning machine). Even the Internal Revenue Service cannot find any reason for saying that this security interest covering specific collateral and securing the purchase price of that collateral is inchoate. All in all, the lender has a high-quality security interest.

But our lawyer's client is going to need to borrow more than the 50,000 dollars this machine will cost. The chances are that there will be other expenditures required for new equipment, and a separate conditional sale agreement can be used for each transaction. By a series of separate transactions he avoids after-acquired property and future advance problems.

At this point we might bring in the oldest, the best and simplest of all chattel security devices—the pledge. We need not give it much consideration, however, for two reasons: (1) only rarely does a small manufacturer have anything pledgeable; and (2) the law of pledge has been carried forward in the Code almost in its entirety.

If not enough money can be put in against new equipment, the next transaction to consider may well be a loan secured by presently-owned equipment—the typical chattel mortgage type transaction. This time it will be necessary to check the records[85] to make sure that no one else has an earlier filing with respect to either the particular equipment on which a security agreement is contemplated or a filing which, in general language, covers the same "type" of collateral. Suppose that the parties have agreed that the next 75,000 dollars is to be supplied on the security of certain large milling machines with an aggregate fair market value of 110,000 dollars. Taking an officer's statement that these machines are owned free and clear as a starting point, our lawyer prepares a chattel mortgage describing the machines with reasonable particularity.[86] (We will assume again that the equipment is not a fixture.) The chattel mortgage is signed on behalf of the

time, the bankruptcy act's 21-day period should apply. But to avoid thinking through this problem, our lazy (and efficient) lawyer will file within ten days. *Compare* Coogan, *Public Notice, supra* note 37, at 300 *with* Kennedy, *supra* note 73, at 529.

85 Coogan, *Public Notice, supra* note 37, at 289.

86 We will assume again that the equipment is not a fixture. The chattel mortgage is signed on behalf of the debtor. As pointed out in discussing the conditional sale, if a copy of this agreement is to be filed as a financing statement, it must also contain the signature and address of the lender. This is a new requirement of the Code. If the parties wish to file a separate financing statement, that also must contain the signatures and addresses of both parties.

debtor and contains its address. As pointed out previously in discussing the conditional sale, if a copy of this agreement is to be filed as the financing statement, it must also contain the signature and address of the lender. Although the description of the collateral in the abbreviated form may be by "type," in this case the description of the collateral ought to be a verbatim copy of the description used in the agreement. In either case, our lawyer gets his own filing on the record.

Before the 75,000 dollars is paid over, our lawyer checks the records in the filing office. Assume that he finds nothing on the Code records and nothing in any pre-Code filing system that might be applicable. After the lender assures himself that his debtor actually has possession of the collateral, he makes the advance, and it is this step which causes a perfected security interest to be created.

Now let us change our assumption: Assume that the lender's lawyer finds on the record a financing statement in favor of Pneumatic Press Co. which claims "machine tools." Our lawyer's client shows him a conditional sales contract that covers a single pneumatic press. Can the lender's counsel allow his client to advance his 75,000 dollars? Could our lawyer give the lender an acceptable opinion? The answer is "No." While the mere filing of Pneumatic Press's financing statement creates no security interest, and the existing security agreement covers only this single machine, it is possible that Pneumatic might, through execution by the parties of a later security agreement, obtain a security interest which will take priority over our financer under the "first-to-file" rule.

V. THE CODE'S PRIORITY RULES[87]

Even a lazy lawyer must know the elements of the Code's priority system. It does little good to create a perfected security interest if it may become subordinate to another security interest which absorbs all the value in the collateral. First, a Code-created interest is subject to any non-Code conditional sale or other non-Code interest created by contract prior to adoption of the Code. Under 9-310 it is also subordinate to any statutory lien accompanied by possession of the collateral, such as one for materials supplied or work performed, unless the statute creating that lien

87 Coogan, *Priorities, supra* note 38, at 838, 845.

provides otherwise. Such liens ordinarily can be created only to the extent of value added by the one who got the lien. We have previously mentioned the much more serious problem: the possibility that subsequent federal tax liens may come ahead of a security interest. And state law may create priorities for state taxes. Fortunately, losing out to one with a higher priority does not ordinarily expose the secured party to an attack by the trustee in bankruptcy. But we are concerned mainly with other Code-created security interests which come ahead.

If the collateral is of the type regularly held out by the debtor for sale (likely to be inventory), one who qualifies as a "buyer in the ordinary course of business" takes free of even a perfected security interest he knows all about, unless for some reason he knows that the sale to him was wrongful. Here one must study 1-201(9) to see who qualifies as such a buyer. This priority can be avoided by choosing collateral the debtor does not ordinarily hold out for sale—equipment rather than inventory.

We have already mentioned the first-to-file rule. Section 9-312(5) provides that where the two contesting Code-created security interests were both perfected through filing, priority is determined by the order of filing for the "types" of collateral covered by a given financing statement—regardless of the date upon which either security interest attached or was perfected, or the date upon which the parties first thought about creating the security interest in question. In our second hypothetical case above, what should the parties do when they find that someone has filed the apparently easy way by filing a blunderbuss financing statement which describes a single pneumatic press as "machine tools"? This is obviously a problem for the debtor and his counsel. Our lender can give no intelligent answer except "no" until the record is cleared or until Pneumatic Press gives him a satisfactory subordination agreement. Ordinarily the parties can amend the old agreement to claim what was intended—a security interest in this particular pneumatic press—by describing the press by model and number, and preferably by adding that a security interest is claimed only for its purchase price. With Pneumatic Press's revised filing on the record, our lender can go ahead with his own financing—but not until then. Our lazy lawyer will explain to his client's officers why the filing of an over-broad financing statement is just one step removed from signing blank checks; and this one

experience is likely to be the only time that any of the parties unnecessarily uses a type of filing which is likely to produce such complications. Where a course of dealing is contemplated, this kind of filing is quite a different matter. As we have also seen, there is a big exception to this "first-to-file" rule: a purchase money security interest perfected in the manner and within the time specified in 9-312(3) or (4), as the case may be, will come ahead as to that collateral regardless of who filed first or whether anyone else has an after-acquired property clause in an earlier agreement.

If one of the security interests is perfected by a method other than filing (principally by taking possession or by making a notation on a title certificate), the higher priority goes to the one who perfects first—*i.e.*, first takes the four steps to perfection. For example, *A* files with respect to industrial diamonds on October 1. He and the debtor sign an agreement, but *A* neither makes an advance nor commits himself to do so. On October 2 the debtor delivers the diamonds to Bank *B*, which makes an advance upon debtor's assurance that no debt is owed under the existing filing. On October 5 debtor obtains an advance from *A*. *B* wins. But suppose that *A* had actually made an advance the day before Bank *B* got possession and made its advance. Here *A* was the first to perfect, and therefore he wins over *B's* later perfected possessory interest. The point to remember is that one who perfects by filing cannot assume that the debtor has not delivered the collateral to one with a possessory interest; but, on the other hand, one who takes possession after an interest was perfected in the same goods through filing takes subject to that interest.

There are other priority rules, the most important being the group relating to fixtures. Here the Code is none too clear; fixtures is not a defined term under the Code. The Code does say (but not as clearly as it might) that the only time one cannot retain a security interest in goods *as goods* is when they are "in corporated into a structure" in the manner of bricks, cement, etc. The first sentence of 9-313(1) thus sets out the boundary between what might be called "straight" real estate and that part-realty, part-fixture category to which the Code applies the term "fixtures." No method of perfection will enable one to retain a chattel interest to goods incorporated into a structure. To retain a chattel interest in fixtures, one must perfect in the manner set forth in 9-313 (2) (3) and (4). And to determine the line between chattels

which, like a desk, retain their personal property character regardless of "attachment" to the realty, one looks to non-Code law. Often there does not exist the kind of non-Code delineation which 9-313(1) assumes there is to separate fixtures from chattels. The safer practical course is multiple filing: if the collateral is on the borderline between that, like a desk, which is always a chattel, and, that like a hot water heater, which may or may not be in the intermediate class to which the term fixtures can properly be applied, file wherever and however required by the Code, on the assumption that the collateral is a chattel and likewise on the assumption that it is a fixture. As noted above, the borderline between fixtures and straight realty should be determined by the first sentence of 9-313(1), but again there may be instances where the safer course is to file on the assumption that the collateral is a fixture, and obtain and record waivers from anyone known to have an interest in the realty, on the assumption that it will be found to be real estate. Under neither the old law nor the new can one operate in the fixture area with complete assurance that he has done the right thing, regardless of how much thought and effort goes into the process.[88]

VI. CONCLUSION

Article 9 is, on the whole, a considerably improved model of our old chattel security vehicle. Its rules generally make the creation of a perfected security interest more sensible. Continued use of the old devices like the conditional sale, chattel mortgage, the trust receipt, and the pledge are advisable because many of the differing business practices associated with the use of one or the other continue to make sense. But the secured party will no longer lose his security interest merely because he operated under the rules of the conditional sale if a court later decides that he should have operated under the rules of a chattel mortgage[89] or a pledge instead of a chattel mortgage or vice versa.[90] Nor need grown men

88 Coogan, *supra* note 72, at 1319.

89 *E.g.*, Hughbanks, Inc. v. Gourley, 12 Wash. 2d 44, 120 P.2d 523 (1941).

90 The difference between a possessory security interest (a pledge) and a non-possessory interest would seem crystal clear. *But see* the protest of a clear-thinking judge (Learned Hand) in *In re* German Publication Society, 289 Fed. 509 (S.D.N.Y. 1922). Even this elementary distinction was clouded with metaphysics and "the intent of the parties." See also cases under the old law and other excellent materials collected in DURFEE, CASES ON SECURITY 462-95 (1951).

spend time in a court of law arguing whether a conditional sale agreement is good or bad because the paper containing the "oath thereon" was fastened by brass staples instead of glue.[91] But this does not mean that there do not remain problems where adjustment must be made between legitimate differences in interests between secured and unsecured creditors and between different creditors holding security interests in the same collateral. These considerations bring in the Bankruptcy Act and the Code's rules determining priorities between secured parties. Neither makes easy bedtime reading, principally because the problems each attempts to resolve are not the easy ones that one can think about while inviting sleep. In general, the Code has rationalized the rules for giving of public notice as a means of avoiding a fraud on other creditors; the loss of a security interest held to be "fraudulent" because of failure to give notice in the required manner should almost never occur. But if a small businessman, before opening up a gift shop, gives a perfected security interest to his wife to secure his obligation to support her, the fact that he has technically complied with the Code will be of little help to the wife if bankruptcy follows. Preference problems are a different matter; here learning to make each transaction stand on its own feet, both as to collateral covered and debt secured, is better than speculating as to whether 9-108 will control in a bankruptcy proceeding. Fortunately this same procedure will accomplish two other purposes: it will establish the best defense against attack by the tax collector, and will enable the secured party to know just what collateral from time to time secures him.

91 Topper v. Jeffrey Mfg. Co., 191 F. Supp. 105 (S.D. Ohio 1960).