

THE PURCHASE MONEY PRIORITY

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For many years it has been recognized that a present security interest may be established in property to be acquired by the debtor in the future. When the subsequent acquisition is in turn financed by a purchase money transaction the question arises whether the lien of the original mortgagee or that of the purchase money creditor has priority. Professor Gilmore traces the historical priority given the purchase money interest, the areas in which the priority has been qualified, and the embodiment of the priority in the Uniform Conditional Sales Act. He then describes some of the solutions and raises some of the problems presented by Article 9 of the Uniform Commercial Code, discussing the Code's treatment of the purchase money interest in inventory, collateral other than inventory, and fixtures. He concludes by urging that defects in the Code be repaired in a uniform and careful manner rather than ignored or denied through fear that such repair would hinder general adoption of the Code.

I. PURCHASE MONEY INTERESTS, FLOATING LIENS AND ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE

A NOTABLE feature of the development of our personal property security law over the past hundred years has been the progressively greater recognition of long-term security interests in all the assets of a borrowing enterprise, whether owned by the borrower when the loan is made or subsequently acquired. We have passed from wholehearted acceptance of the self-evident proposition that a man cannot transfer property he does not own — *qui non habet, ille non dat* — to a somewhat grudging acceptance of the much less evident proposition that, for reasons which are no doubt sufficient even though they are rarely

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This article is an excerpt from a general discussion of the subject of priorities under Article 9 of the Uniform Commercial Code and pre-Code law in a forthcoming treatise on the law of personal property security transactions. All references to the Uniform Commercial Code are, unless otherwise indicated, to the 1958 Official Text and the accompanying Comments. It may clarify some matters for the reader if I point out that I served as Reporter for Article 9 of the Code from 1946 until 1952 and have subsequently been a member of the American Law Institute's subcommittee to consider suggestions for the amendment of Article 9.

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articulated, a business enterprise should be allowed to make an irrevocable commitment, for the benefit of its present creditors, of all its future property. As a matter of history, however, the triumph of the after-acquired property interest has been regularly followed by an important limitation or qualification. The after-acquired interest, wherever it has been recognized as valid against the borrower's creditors and in his bankruptcy, has been subordinated to subsequent purchase money interests which arise in connection with the financing of new acquisitions by the borrower.

Article 9 of the Uniform Commercial Code codifies both the triumph and the limitation. No previous security statute has so warmly embraced the once-despised after-acquired property interest. It is also true that no previous statute has so sternly insisted on the priority for purchase money interests.

Article 9 has often been referred to as a "floating lien" statute.¹ In this country floating lien is a term more often used in scorn or anger than in praise, although in England and Canada it has long been respectable for liens to float.² It is surely true that under the Article 9 provisions a secured party may take a security interest which "floats" over all of his debtor's present and future

¹ Presumably the "floating lien" description is a shorthand reference to a series of provisions in Article 9:

"Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors" (9-201). With limited exceptions as to crops and consumer goods, "a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement" (9-204(3)). "Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment" (9-204(5)). "A security interest is not invalid or fraudulent against creditors" by reason of the debtor's being given liberty to sell or otherwise dispose of the collateral without being under any duty either to account for proceeds or to replace collateral (9-205). And a security interest shifts automatically to the proceeds of collateral (9-306) (with limitations on the secured party's interest in proceeds which need not presently be explored).

² See Coogan & Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture*, 69 YALE L.J. 203, 251-59 (1959), for an interesting comparison of the English floating charge and the Article 9 floating lien. The reference in the text should not be taken to mean that the English floating charge is the same thing as an Article 9 security interest which takes full advantage of the floating lien provisions. Coogan and Bok point out that, under English law, the holder of a floating charge may be subordinated to unsecured creditors until the charge has "crystallized" (which is usually done through the appointment of a receiver). The authors conclude that "although the floating charge thus appears in many ways to be a second-rate security, its wide use would indicate that creditors find it a useful device despite its risks." *Id.* at 254-55. Among the English literature on the subject, see GOWER, *MODERN COMPANY LAW* 389-93 (2d ed. 1957); WALDOCK, *MORTGAGES* ch. 7 (2d ed. 1950); Pennington, *The Genesis of the Floating Charge*, 23 *MODERN L. REV.* 630 (1960).

assets. It is possible for a term loan to be secured by whatever assets may happen to be lying around at the time of default, without any requirement of policing by the secured party or of accounting by the debtor during the loan period.³ On one or another theory such a transaction was invalid under all the pre-Code security devices, with the possible exception of transactions within the scope of some of the factor's lien acts and some of the accounts receivable statutes passed in response to *Corn Exch. Nat'l Bank & Trust Co. v. Klaunder*.⁴

This aspect of Article 9 is its most controversial feature. The case against the floating lien, insofar as it does more than rely on the authority of precedent and the accumulated wisdom of the past, consists principally of two points: 1) the availability of a floating or blanket lien on all present and future assets will leave nothing to satisfy the claims of unsecured creditors and will consequently tend to dry up the sources of such credit; 2) the law should protect a necessitous borrower against himself by refusing to allow him to encumber all the property he may ever own in order to secure a present loan. Defenders of the Article (the present author is one) no doubt bear the burden of proof. Their case, as it has been most often expounded, rests not so much on the merits or the positive excellence of the floating lien as on an argument of *fait accompli*.

The position taken in defense is that under one or another of the many available security "devices" it has long been possible to encumber all a debtor's present and future property with valid, enforceable liens. To do so under pre-Code law was cumbersome, expensive and tricky; only the most expert lawyers could hope to avoid the many hidden pitfalls. But it could be done. The old rules had demonstrably broken down. The crumbling of the initially well-defined judicial position of hostility to anything resembling a floating lien must be taken as sufficient proof that commercial needs, entitled to protection, required the abandonment of a state of the law appropriate only to a more primitive stage of industrial development. The old rules, insofar as they have any surviving vitality, merely penalize legitimate transactions and serve as traps for the unwary and the unskilled. It is pointless to go on pretending that things cannot be done which in fact and law can be done. The floating lien should, therefore, be

³ Section 9-205 (see note 1 *supra*) is an express repealer of the rule of *Benedict v. Ratner*, 268 U.S. 353 (1925).

⁴ 318 U.S. 434 (1943).

recognized as valid and then cut down to size in situations where its unlimited and unrestricted application might lead to undesirable or unjust results.

There is general agreement that it would be unfortunate if creditors in Code states took to securing any extension of credit by placing a blanket lien on all the debtor's assets. Critics of the Article argue that this will in fact happen and that no one will be safe in extending unsecured credit. In this connection it may be pointed out that if a secured creditor is allowed to claim \$50,000 worth of assets in his debtor's insolvency proceeding, that is because at some time he contributed \$50,000 to the now insolvent estate. The law of fraudulent conveyances, decisional and statutory, remains in effect to invalidate conveyances for other than a fair consideration and the law of voidable preferences to invalidate transfers by insolvents shortly before bankruptcy. And, if the reader will forgive the statement of an elementary proposition, when a \$1,000 loan is secured by \$100,000 worth of assets, the secured creditor gets \$1,000, not \$100,000. The observation may also be ventured that, quite apart from Article 9, it is unsafe to extend unsecured credit today, if the debtor's insolvency before repayment is assumed. The records show that most estates administered in bankruptcy are eaten up by expenses of administration and other priorities (particularly those in favor of state and federal taxes) established by the Bankruptcy Act. It has been true for many years that an unsecured creditor stands to get very little or nothing if his debtor fails. This gloomy thought does not seem to have restricted the supply of unsecured credit. Article 9 at least gives creditors who provide the working capital for an enterprise the opportunity to protect themselves against the devouring monster of the statutory priorities. Nevertheless, we may concede that it would be unfortunate if every ten-dollar creditor took a blanket lien to secure his claim. At the very least this would be an unmitigated nuisance. There is no advantage in taking unnecessary security or in oversecuring a loan where some security may be appropriate. In operating under Article 9, a lawyer's duty may well be taken to include the task of educating his clients to act in accordance with these rather obvious propositions. There has not yet been enough experience in states where Article 9 is in effect to justify a prediction as to the outcome of this vexed question.

The Article 9 position is that, while the floating lien (if that is the proper designation) should be recognized as valid, appropriate limitations should be written into the statute to avoid unjust re-

sults. Of these limitations, the most important is the priority conferred on purchase money interests.⁵

A recurrent problem in the life history of an enterprise is how to provide for the financing of new equipment free of prior liens. The new equipment may be needed because the business is expanding or shifting to a new line of production or because new inventions have made the old equipment obsolete or because the old equipment has simply worn out. A prior mortgage contains an after-acquired property clause to which the new equipment will be subject. Where bonds have been issued under a corporate mortgage, it will be impossible to procure the assent of the scattered bondholders to a subordination of their lien, so as to make the new financing feasible. It might be argued that as a matter of justice and morals the prior mortgagee or the bondholders ought not to be subordinated without their consent. However that may be, the law's answer has been to provide some more or less complicated method of effecting the subordination. Under pre-Code law, this was most often done by a manipulation of title theory under the system of separate security devices. Most of the specialized devices were recognized as giving the security holder title and not "merely" a lien: this was true of the conditional sale, the security lease (which was the basis of the railroad equipment trust in the version known as the Philadelphia Plan), and the trust receipt. The way of defeating the prior mortgagee, recognized as effective under pre-Code law, was to have the security holder's title to the new equipment come directly from the manufacturer or seller. Thus, conceptually, the title to the equipment never vested in the mortgagor and the lien of the prior mortgage had nothing to bite on.

A solution of this sort was impossible under Article 9, because the Article not only destroyed the system of independent security devices but also refused to recognize any distinction between "title" security interests and "lien" security interests.⁶ Never-

⁵ For the purchase money priority under Article 9, see Parts IV-VII *infra*. Other limitations on the floating lien may be briefly mentioned. The effectiveness of an after-acquired property clause is severely limited where the collateral is crops or consumer goods (9-204(4)). On disposition of collateral, the secured party's interest shifts to the proceeds received by the debtor, but, in an insolvency proceeding, the right to recover proceeds which have been deposited in a debtor's bank account is limited to the amount of proceeds which have been received by the debtor during the period of ten days preceding the institution of the insolvency proceeding (9-306(4)). A "new value" status is denied to out-of-ordinary course acquisitions and to acquisitions not made within a reasonable time after new value has been given to enable their purchase (9-108).

⁶ "Each provision of this Article with regard to rights, obligations and remedies

theless, the result achieved under the pre-Code law was recognized as sound. The problem was handled as one of priorities and solved by the introduction of the concept of the "purchase money security interest."

There is much less novelty in Article 9 than meets the eye and most of that novelty is a mere matter of terminology. To understand what the Article is getting at, it is frequently helpful to set it in its historical perspective. In the following discussion we shall therefore review the development of the interrelated problems of the after-acquired property interest and the purchase money priority as they have presented themselves in various financing contexts. Our historical inquiry, which will be inescapably somewhat lengthy, will, it is hoped, throw some light on the Article 9 provisions which will then be reviewed in detail.

II. THE RAILROAD CASES

A. The New Orleans Railroad Case: Priority of the Purchase Money Interest

In 1858 and 1860 the New Orleans and Ohio Railroad Company executed mortgages which purported to cover all the company's property presently existing and to be thereafter acquired. Some years later the United States, which had become the holder of bonds issued under the mortgages, instituted proceedings which led to a decree of foreclosure and sale of the railroad's property. It then "transpired [according to the statement of facts in the litigation as it reached the United States Supreme Court] that a portion of the rolling stock, consisting of two locomotives and ten cars, had been sold to the railroad company by the United States in 1866, and that, simultaneously with the sale, the company gave to the United States a bond for the purchase-money, wherein it was stipulated that the latter should have a lien therefor upon the property sold" Upon this apparently belated discovery of its special interest in the two locomotives and ten cars, the United States, ceasing to make common cause with its fellow bondholders and their trustee, insisted that the "said locomotives and cars" should not be included in the property put up at the foreclosure sale. The "solicitors" for all parties agreed and the marshal was directed to set the locomotives and cars aside. The rest of the property was sold but brought less than the amount of the bonds. The court then proceeded to a determina-

applies whether title to collateral is in the secured party or in the debtor" (9-202).

tion of the priorities between the United States, as holder of the purchase money bond, and the bondholders claiming under the after-acquired property clauses of the mortgages. It appeared that the bond given for the purchase money had never been recorded and that its contents were unknown to any of the bondholders "except Mr. Trimble, the trustee of the mortgages." (Mr. Trimble had joined with the United States in instituting the foreclosure proceedings; the report of the case in 12 *Wallace* leaves the reader with the odd impression that Mr. Trimble, perhaps through forgetfulness, had not mentioned the purchase money bond to anyone until just before the marshal was about to sell the locomotives and cars along with the rest of the property.) The foreclosure court determined that the United States had a "superior equity" under the purchase money bond and "made a decree to that effect" (presumably that the locomotives and cars be turned over to the United States). This decree came on appeal to the Supreme Court, where it was unanimously affirmed. Justice Bradley wrote:

The appellants contend . . . that the decision upon the facts was erroneous; that the mortgages, being prior in date to the bond given for the purchase-money of these locomotives and cars, and being expressly made to include after-acquired property, attached to the property as soon as it was purchased, and displaced any junior lien. This, we apprehend, is an erroneous view of the doctrine by which after-acquired property is made to serve the uses of a mortgage. That doctrine is intended to subserve the purposes of justice, and not injustice. Such an application of it as is sought by the appellants would often result in gross injustice. A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor's hands. If that property is already subject to mortgages or other liens, the general mortgage does not displace them, though they may be junior to it in point of time. It only attaches to such interest as the mortgagor acquires; and if he purchase property and give a mortgage for the purchase-money, the deed which he receives and the mortgage which he gives are regarded as one transaction, and no general lien impending over him, whether in the shape of a general mortgage, or judgment, or recognizance, can displace such mortgage for purchase-money. And in such cases a failure to register the mortgage for purchase-money makes no difference. It does not come within the reason of the registry laws. These laws are intended for the protection of subsequent, not prior, purchasers and creditors.⁷

⁷ *United States v. New Orleans R.R.*, 79 U.S. (12 Wall.) 362, 364-65 (1871).

The *New Orleans Railroad* case has been stated in detail and quoted from at length in respectful tribute to a now long-forgotten monument of our jurisprudence. It was a great case in its day. And there may be food for thought in the reflection that the mighty structure of the railroad equipment trust — lawyer's law at its best — rested on the shaky foundation of the amateurish bond for purchase money devised by some anonymous government clerk in the process of disposing of surplus Civil War rolling stock and that, in the excitement of the foreclosure proceeding, the bond itself was apparently forgotten until the very last minute.⁸

Justice Bradley cites no authority for the basic proposition which seemed to him to determine the priorities, that: "A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor's hands." Nevertheless, the idea that a purchase money interest prevails over antecedent claims against the vendee or his property has venerable roots: a standard authority on mortgages traces it back to a case decided in 1631 and to Lord Coke's *Commentaries on Littleton*.⁹ The doctrine in its early stages seems to have been applied to protect the purchase money lienor against judgment creditors of his vendee and against claimants of dower, curtesy, community property and the like. The traditional rationalization of the doctrine in the real property field was the delightful idea of transitory or instantaneous seisin:

The idea is that title shot into the grantee and out of him again into the purchase money mortgagee so fleetingly — *quasi uno*

⁸ The classical early discussion of the railroad equipment trust is found in Rawle, *Car Trust Securities*, 8 A.B.A. REP. 277 (1885). According to Rawle, "The earliest instance of a car trust of the kind now commonly found was one created by the Lehigh Coal and Navigation Company of Pennsylvania in 1868, known as the 'Railroad Car Trust of Philadelphia.' The idea originated in the mind of the president of the company, Mr. Edward W. Clark, and its legal details were worked out by the late Charles Gibbons, of the Philadelphia bar." *Id.* at 277-78. In a note Rawle remarks that "the germ of the modern idea of a car trust" can be found in a series of transactions by which, starting in 1845, the board of managers of the Schuylkill Navigation Company financed the acquisition of equipment (canal boats, barges, and, later, rolling stock). *Id.* at 322. The Lehigh Trust of 1868 was thus contemporaneous with the foreclosure proceeding of the New Orleans Railroad, which reached the Supreme Court in 1870. Rawle cites the New Orleans case as having "decided" the priority of the purchase money interest over the lien of the earlier mortgage, *id.* at 306, but does not suggest that the case (in its earlier stages) was known to Mr. Gibbons. The Schuylkill Navigation Company's transactions did not come into any litigation which raised the priority question.

⁹ OSBORNE, MORTGAGES 558 n.37 (1951).

flattu, in one breath, as it were — that no other interest had time to fasten itself to it.¹⁰

However rationalized, the doctrine could not come into play in the precise situation which now concerns us — priority of the purchase money interest over an earlier perfected security interest in the debtor's property as a whole — until our legal system had evolved to the point of recognizing a full-fledged, perfected or legal interest in property acquired by the debtor subsequent to the date of the mortgage or other security transaction. Once such an interest is recognized, the priority problem follows almost as a matter of course. The reason why our priority problem first appears in the railroad equipment cases, and for a generation or more seemed to be exclusively a problem of railroad finance, is that the railroad mortgage was the first important type of security transaction in which American courts, and subsequently American legislatures, were induced, by the logic of circumstance, to recognize such an interest in after-acquired property. For present purposes it is enough to say that the majority (although by no means universal) rule in nineteenth century American jurisprudence had come to be that the mortgagee's interest in after-acquired property was "merely equitable" — that is to say, in modern terminology, unperfected — until the mortgagee, by some new act (taking possession of the property or filing a supplemental mortgage with respect to it), had caused his interest to "ripen" into a legal interest, had (as we should say) perfected the interest. Under such a state of law, the priority of the purchase money interest over the "merely equitable" or unperfected claim of the earlier mortgagee went without saying. The question would not become one worthy of judicial concern until the after-acquired property interest had, in some context, flowered as a legal or perfected interest.

B. Pennock v. Coe: The After-Acquired Property Interest

Ten years before the *New Orleans Railroad* case, the United States Supreme Court had given the weighty stamp of its approval to the idea that the special needs of railroad finance required that railroad mortgages (unlike other mortgages) should extend automatically to the railroad's after-acquired property. The arguments of counsel, as set out in the report of *Pennock v. Coe*,¹¹ give

¹⁰ *Id.* at 557-58. Professor Osborne comments that "Such a theory breaks down in lien states where the fee remains permanently in the grantee-mortgagor."

¹¹ 64 U.S. (23 How.) 117 (1860).

an idea of the novelty and difficulty of the case. Mr. Otis, for the mortgagees, started by conceding that the law was against him: "For the purpose of this argument, I am willing to admit it to be the general rule of the common law, that nothing can be mortgaged which is not in existence and does not belong to the mortgagor at the time the mortgage is executed."¹² However, he went on, it was clear from the authorities that "this rule is founded solely upon a technicality," "the rule of the civil law is the very reverse of that of the common law," and "courts of equity which are not trammelled by the technical rules of the common law . . . both in England and in this country, uphold such mortgages . . ."¹³ It was enough to argue that the interest should be upheld by courts of equity. The validity of the interest would normally come up in foreclosure, thought to be an equitable proceeding, but the procedural situation in *Pennock v. Coe* showed that any proceeding, however commenced, could be brought into equity: *Pennock* was a bill filed by the mortgage trustee to enjoin the execution of a judgment recovered "at law" by creditors of the railroad.¹⁴ The creditors had levied on some of the rolling stock, acquired after the date of the mortgage, and had advertised it for sale. The Supreme Court unanimously affirmed a lower court decree which had "perpetually enjoined" the sale. "[W]e are satisfied," wrote Justice Nelson, "that the mortgage attached to the future acquisitions, as described in it, from the time they came into existence"; thus the mortgage had a "superior equity" over the claims of the judgment creditors. In an interesting comment, which suggests that the Court was entirely aware of the economic realities with which it was dealing, Justice Nelson added: "There are many cases in this country con-

¹² *Id.* at 121.

¹³ *Id.* at 122-23. The leading American authority on the validity of the after-acquired property interest "in equity" was Story: *Mitchell v. Winslow*, 17 Fed. Cas. 527 (No. 9673) (C.C.D. Me. 1843); 2 EQUITY JURISPRUDENCE §§ 1040, 1040(b), 1055 (4th ed. 1846).

¹⁴ The "judgment creditors" were themselves the holders of bonds issued under a second mortgage, junior to the mortgage for whose benefit the injunction proceeding was brought. At this early stage in the development of corporate law, it seems to have been assumed that individual bondholders could bring suit on default and on recovery of judgment have an aliquot share of the corporation's assets devoted to payment of their claim. In the *Pennock* case the holders of the first mortgage bonds seem to have decided to avoid a foreclosure action and to secure a declaration in the injunction proceeding that all the railroad's property, whenever acquired, came under the lien of the first mortgage. Justice Nelson remarked that "the whole of the property mortgaged is insufficient to satisfy the bondholders under the first mortgage . . ." 64 U.S. (23 How.) at 131.

firming this doctrine, and which have led to the practice extensively of giving this sort of security [*i.e.*, mortgages with broad after-acquired property clauses], especially in railroad and other similar great and important enterprises of the day.”¹⁵ The decision in *Pennock v. Coe* evidently commended itself to the spirit of the times; not only did the state courts follow the lead of the federal courts but many state legislatures put the issue beyond doubt by enacting statutes which liberally validated the after-acquired property interest in mortgages issued by railroads, telephone and telegraph companies, and other public utilities.¹⁶

The sequence of *Pennock v. Coe* and *New Orleans Railroad* established the validity of the after-acquired property clause in certain types of industrial mortgages and the priority of subsequent purchase money interests over the mortgage claim. It was clear from the beginning that the purchase money priority was not dependent on the particular dress in which the purchase money transaction happened to be clothed. Justice Bradley had formulated the idea broadly in *New Orleans Railroad*: the after-acquired property interest “can only attach itself to such property in the condition in which it comes into the mortgagor’s hands. . . . It only attaches to such interest as the mortgagor acquires” It made no difference whether the purchase money lender reserved “title” to the property (as under a conditional sale) or claimed under a purchase money mortgage or was entitled under some more or less informal arrangement (such as the “bond for purchase money” in the *New Orleans Railroad* case) to a “vendor’s lien,” express or implied.¹⁷ Nor did it make any difference whether the purchase money interest itself was (as we should say) perfected: “[I]t is even held that if the property comes into the hands of the mortgagor subject to a lien which is good against him, though, for want of formalities, it is not good against his subsequently attaching creditors and third persons, it is nevertheless prior to the lien of a mortgagee under an after-acquired property clause.”¹⁸ Finally, the purchase money lend-

¹⁵ *Id.* at 130.

¹⁶ See 3 GLENN, MORTGAGES § 423 (1943).

¹⁷ Rawle, *supra* note 8, at 307.

¹⁸ *Harris v. Youngstown Bridge Co.*, 90 Fed. 322, 328-29 (6th Cir. 1898) (Taft, C.J.). Justice Bradley had remarked in the *New Orleans Railroad* case that “a failure to register the mortgage for purchase money makes no difference. It does not come within the reason of the registry laws. These laws are intended for the protection of subsequent, not prior, purchasers and creditors.” 79 U.S. (12 Wall.) 362, 365 (1871).

er's priority was not affected even by the fact that his interest was evidenced by a transaction clearly invalid (except between the immediate parties) under applicable state law.¹⁹ We have used the term "lender" to describe the holder of the purchase money interest: despite some dubiety in the early cases it had become reasonably clear by the end of the century that the priority could be claimed either by a vendor (or his assignee) or by one who had merely put up the money to finance the purchase.²⁰

C. Limitations on the Purchase Money Priority

If the purchase money priority, thus broadly conceived, had been allowed to flourish without limitation, the manipulators of corporate securities would have had a first-rate device for the easy and convenient defrauding of the holders of senior securities. The first mortgage bondholders would learn in the course of insolvency proceedings that the original property, on the faith of which they had bought their bonds, had been gradually dissipated and that all the replacements and expansions had come in subject to paramount purchase money obligations. The courts, no doubt obscurely aware of the possibilities of unfair dealing which the early cases opened up, in time developed a series of what might be called equitable limitations to the doctrine of purchase money priority.

One limitation operated against the claims of the directors, the management, or others in a close or confidential relationship to the mortgagor corporation. Although the opinions did not often use language of fiduciary obligation, the holdings were unmistakably clear that insiders could not take advantage of their position to vault over the heads of their existing security holders: they were under a duty to conclude transactions between themselves and the corporation in such a way that the lien of the existing mortgage would not be displaced; a failure on their part to carry out the duty was a species of fraud which would subordinate their claims, in form entitled to the purchase money priority, to those of the bondholders. The cases never went to the length of declaring that directors and other insiders were incapable, in a good faith transaction, of acquiring paramount claims, but the courts were careful to scrutinize transactions in which the purchase

¹⁹ See, e.g., *Myer v. Car Co.*, 102 U.S. 1 (1880) (Iowa conditional sale); *Fosdick v. Schall*, 99 U.S. 235 (1879) (Illinois conditional sale).

²⁰ *Cf.* Rawle, *supra* note 8, at 307; *Harris v. Youngstown Bridge Co.*, 90 Fed. 322, 329 (6th Cir. 1898) (Taft, C.J.).

money obligations ended up in the hands of those who were thought to be under a duty to protect the bondholders.²¹

It was a characteristic of nineteenth century judicial technique to attack unfair transactions indirectly rather than directly. Following this approach the courts learned, in balancing equities between mortgages and purchase money interests, to be quite technical about what constituted a purchase money claim; the purchase money priority, a modern commentator concluded, "can be assured . . . only if a carefully limited, and sometimes seemingly arbitrary, procedure is observed."²² To rank as purchase money, a claim must be, it was often said, "directly" related to the acquisition of the property. If on some theory "title" to the property vested in the mortgagor at any point, free of encumbrance, then the lien of the mortgage took hold and could not be displaced. Rawle speculated that if a railroad company built its own rolling stock "without a previous contract under which the trustee of the car trust association agreed to provide the necessary funds for that purpose, the property might be held to pass, as soon as completed, under the operation of the 'after-acquired' clause in a prior mortgage."²³ And although a lender as well as a seller could be entitled to purchase money rank, there must be satisfactory proof that the funds advanced were in fact applied to the purchase. As Chief Judge Taft put the matter in an exhaustive opinion in *Harris v. Youngstown Bridge Co.*:

When . . . that which is given the appearance of a vendor's or purchase-money lien is really only a device to secure money borrowed for other purposes of the mortgagor than the buying of the addition in question, then the attempt to supplant the first lien of the mortgage under the after-acquired property clause is a fraud upon the mortgage, and the pseudo purchase-money lien must be postponed to that of the mortgage.²⁴

Another limitation on the purchase money priority was hinted at in the early cases but never became clearly defined. Taft's language in the *Youngstown Bridge* case is once again instructive. The priority of the purchase money claim, wrote Taft,

²¹ See, e.g., *McGourkey v. Toledo & O. Cent. Ry.*, 146 U.S. 536 (1892); *Venner v. Farmers' Loan & Trust Co.*, 90 Fed. 348 (6th Cir. 1898).

²² Note, *Defeating the Priority of an After-Acquired Property Clause*, 48 HARV. L. REV. 474, 477 (1935). See also Note, *Priority of Purchase-Money Mortgages*, 29 VA. L. REV. 491 (1943).

²³ Rawle, *supra* note 8, at 307.

²⁴ 90 Fed. 322, 329 (6th Cir. 1898).

is not a fraud upon the mortgagee, or a violation of any right of his, in any case where the mortgagor is under no affirmative obligation to the mortgagee to acquire additions to the property, or to acquire them free of lien.²⁵

This remark, taken by itself, seems to say, or to come close to saying, that a clause in the mortgage which put the mortgagor under an "affirmative obligation" to acquire future property "free of lien" would be effective not merely between the parties (so as to make the acquisition of property subject to a purchase money interest a default under the mortgage) but against a subsequent purchase money claimant (at least if he had notice of the clause), whose claim would now be a "fraud upon the mortgage," a "pseudo purchase-money lien." That such an interpretation would go well beyond Taft's meaning is made clear by a later passage in his opinion:

There is a clear distinction between the obligations of a mortgagor under a mortgage in which the property described as mortgaged, though definitely described, is yet to be bought and constructed, and the obligations of one under a mortgage in which the property described as mortgaged is in existence as a completed thing, and the after-acquired property clause is inserted only to increase the original security.²⁶

The "clear distinction" is that the purchase money priority is recognized in the second class of cases (mortgage of a going enterprise, where the after-acquired property clause is inserted "only to increase the original security") but not in the first where the mortgage itself might be regarded as a kind of purchase money obligation, given to finance the original construction of the railroad, factory, or what not. In such a case, Taft continues, "the mortgagor is impliedly bound to buy and complete the thing mortgaged as described, and bring it under the lien of the mortgage, without burden or incumbrance."²⁷ The suggestion that

²⁵ *Ibid.*

²⁶ *Id.* at 329-30.

²⁷ *Id.* at 330. Taft cites *Wade v. Railroad Co.*, 149 U.S. 327 (1893), and *Venner v. Farmers' Loan & Trust Co.*, 90 Fed. 348 (6th Cir. 1898). *Youngstown Bridge* and *Venner* were decided by the Sixth Circuit on the same day, Taft and Lurton sitting on both cases. *Venner* (see note 21 *supra*) was essentially a case in which the taint of fraud denied an insider a purchase money priority. Taft's citation of it in this context indicates how the several "limitations" on the purchase money priority, which we have separated for discussion, in fact overlapped and coalesced. The idea that the original construction mortgage cannot be subordinated to the claims of suppliers and furnishers seems to originate in the first crop of railroad mortgage cases, the mortgages having been given to secure funds advanced for the

there are certain types of mortgages which, at least in certain types of situations, do not run the normal risk of subordination to subsequent purchase money interests is one which never quite emerged as a clearly defined "rule." No doubt the idea came to seem less important as the case of the "original construction mortgage" itself became less frequent. We shall have occasion, nevertheless, to revert to this shadowy ghost of an idea in our subsequent discussion.

D. "Loose Property" and "Permanent Structure"

The early, frequent, and indeed repetitious cases of railroad insolvencies may well have impressed the courts with the desirability of preserving something for the holders of the first mortgage bonds. The Supreme Court accomplished this by limiting the purchase money priority to acquisitions of rolling stock. This limitation was foreshadowed in *Galveston R.R. v. Cowdrey*,²⁸ a colorful case in which English bondholders were introduced to the rough-and-ready ways of Texas financiers. In the *Galveston* case one Pulsford, who had furnished the rails with which five miles of the road had been constructed, sought to have the Court declare a "first lien" in his favor on that portion of the road, with priority over the bonds. In explaining why Pulsford was not entitled to priority, Justice Bradley referred to the "inflexible rule" of the common law by which "whatever is affixed to the freehold becomes a part of the realty The rails put down on the company's road became a part of the road. . . . Pulsford, by allowing his property to go into or become part of the road, consented to its being covered by the mortgages in question."²⁹ In the *New Orleans Railroad* case, which squarely established the priority of the purchase money interest over the after-acquired property interest, Justice Bradley reaffirmed the distinction between rolling stock and the railroad's other property:

Had the property . . . been rails, as in the case of the *Galveston Railroad Company v. Cowdrey*, or any other material which became affixed to and a part of the principal thing, the result would have been different. But being loose property [*i.e.*, locomotives and cars], susceptible of separate ownership and separate liens, such liens, if binding on the railroad company itself, are unaffected by

purpose of "building and equipping" the railroad. See, *e.g.*, *Galveston R.R. v. Cowdrey*, 78 U.S. (11 Wall.) 459 (1871), discussed in the text following note 28 *infra*.

²⁸ 78 U.S. (11 Wall.) 459 (1871).

²⁹ *Id.* at 482.

a prior general mortgage given by the company, and paramount thereto.³⁰

Subsequently the Court made clear that the bondholders' priority as to the "permanent structure" of the railroad would be preserved, no matter what form of arrangement might be adopted between the railroad and its suppliers. In *Porter v. Pittsburg Bessemer Steel Co.*,³¹ it appeared that the Smith Bridge Company had constructed bridges for the Chicago and Great Southern Railway Company under contracts which provided that the bridges should remain the property of the Bridge Company until paid for and that, on default, the Bridge Company should have the right to remove the bridges. "[I]t is well settled, in the decisions of this court," Justice Blatchford wrote, "that rails and other articles which become affixed to and a part of a railroad covered by a prior mortgage, will be held by the lien of such mortgage . . . as against any contract between the furnisher of the property and the railroad company, containing stipulations like those in the contracts in the present case."³²

It was not clear, and it never became clear, whether the nineteenth century Supreme Court cases were announcing a rule of federal law, not subject to displacement by inconsistent state law, or whether a state statute, adopting a different approach, would have been allowed to prevail. The question was never clarified because the Court's resolution of the priority problem was, apparently, satisfactory to all concerned and became the established pattern for railroad finance. The "permanent structure" of the road was preserved as security for the bondholders; the rolling stock — "loose property" in Justice Bradley's phrase — came in subject to purchase money priority under one or another variant of the railroad equipment trust. In time a special theology or metaphysics was invented to explain the peculiar priority enjoyed by equipment trust obligations: a basic tenet of dogma was that the "equipment trust" was a device whose use was restricted to the financing of railroad equipment, or, perhaps, transportation equipment in general. We need not confine our thought within such narrow bounds: wherever the all-embracing mortgage has successfully established itself, the purchase money priority problem has received approximately the solution which the Supreme Court devised for it in the railroad context where it first appeared.

³⁰ 79 U.S. (12 Wall.) at 365.

³¹ 122 U.S. 267 (1887).

³² *Id.* at 283.

III. INDUSTRIAL EQUIPMENT FINANCING (HEREIN OF THE DOCTRINE OF FIXTURES)

Through the second half of the nineteenth century the use of mortgages with broad after-acquired property clauses seems to have spread from railroads to public utility companies and in time to manufacturing corporations which were in no way "affected with a public interest," as the public interest was then conceived. On the whole, nineteenth century law had been hostile to the after-acquired property interest. However, when the issue presented itself in the context of a corporate indenture of trust, securing widely distributed bond issues, the courts tended to assume, on the analogy of the railroad cases and without much discussion of theory, that the bondholders were entitled, in insolvency proceedings and against the claims of creditors, to the corporate property whenever acquired.³³ This relaxed handling of a tricky problem was made easier by the fact that the federal courts were the preferred forum for the debate, in equity receiverships and in proceedings under the Bankruptcy Act of 1898. Starting with Justice Story's celebrated decision in *Mitchell v. Winslow*,³⁴ the federal precedents had been much more hospitable to the after-acquired property interest than the precedents in most states. In those pre-*Erie* days, the federal courts did not, in questions of general commercial law, have to look too nicely to what the highest state court had said or might be expected to say. The corporate mortgagee's interest in after-acquired property came to be an accepted thing, at least as to subsequently acquired equipment and machinery. In general the courts held the line as to inventory and receivables and in time the draftsmen of corporate mortgages abandoned the attempt to include such fluid items in the security for the bonds.³⁵ As to the equipment, indeed, it was frequently

³³ Cases of the period are collected in 4 COOK, CORPORATIONS § 857 (7th ed. 1913); 2 MACHEN, CORPORATIONS § 1854 (1908).

³⁴ 17 Fed. Cas. 527 (No. 9673) (C.C.D. Me. 1843).

³⁵ *Zartman v. First Nat'l Bank*, 189 N.Y. 267, 82 N.E. 127 (1907), offers a relatively late example of a corporate mortgage secured both by inventory and by fixed equipment. The mortgage was held invalid against the mortgagor's trustee in bankruptcy as to the inventory. "No question is raised," said the court, "as to the lien of the mortgage upon machinery, tools and appliances . . ." After *Benedict v. Ratner*, 268 U.S. 353 (1925), the inclusion of inventory or receivables along with fixed assets in the mortgage security became perilous in the extreme. A recognized feature of the *Benedict* rule, which required the security holder to "police" the affairs of his borrower, came to be that a failure to comply with the rule as to part, even an infinitesimal part, of the security invalidated the entire transaction. See *Lee v. State Bank & Trust Co.*, 38 F.2d 45 (2d Cir. 1930), *cert. denied*, 285 U.S. 547 (1932).

easy to say that no recognition of an after-acquired property interest was technically involved; the equipment, on installation in the factory, might well itself have become real property under the doctrine of fixtures and would thus, as "accessions," come automatically under the lien of the mortgage.

A. Holt v. Henley: The Railroad Cases Adapted

We have seen how an apparently acceptable resolution of conflicting interests was arrived at in the railroad industry: the "permanent structure" of the road indefeasibly reserved to the bondholders, the rolling stock available for separate financing with purchase money priority. Thus the bondholders received a degree of protection while the railroads could finance their new equipment purchases free of the mortgage. It is in the nature of railroading that the "permanent structure," once built, continues indefinitely in existence; the principal need for large capital expenditures after the original construction of the road is for new and better rolling stock. Thus the judicially-devised solution left the railroads free to carry out programs of modernization without interference from the bondholders, while, at the same time, the equitably inspired limitations on the purchase money priority held in check, to some degree, the natural tendency of insiders to appropriate to their own use the security pledged to the bonds.

This ingenious solution could not, without alteration, be made to fit the pattern of the industrial, particularly the manufacturing, corporation. In the life history of the typical industrial enterprise, there is nothing which corresponds to the "loose property" — the rolling stock — of the railroad. Once the enterprise has become a going concern, what has to be replaced is the machines and other fixed equipment — because old machines have worn out, because more efficient processes have been invented, or because the enterprise, being successful, wishes to increase its productive capacity. By the turn of the century it had come to be agreed that the lien of a mortgage could be made to encompass these later additions to the plant. The next problem for decision was, inevitably, that of priority: could the new equipment be brought in free of the mortgage? At this point the railroad cases seemed to present a roadblock: the new equipment, once it had been built into the factory, did not in the least resemble "loose property"; it looked for all the world like part of the "permanent structure." If so, under the railroad precedents, the lien of the mortgage would be paramount over the purchase money interest.

When the priority issue was brought to the United States Supreme Court the mortgagee's argument from the railroad cases got nowhere. Since the spokesman for the Court was Justice Holmes, the mortgagees received their dusty answer, not in closely reasoned argument, but in crisp epigram whose literary quality they may have failed to appreciate. *Holt v. Henley*³⁶ involved priorities between a mortgagee and the conditional seller of a sprinkling system which had been installed in the plant of the Williamsburg Knitting Mill Company. The time sequence was unusual in that the conditional sale agreement was executed (by the seller, Holt, on August 28, 1909, and by the buyer, the Mill Company, on October 14, 1909) before the mortgage (which was dated November 23, 1909). However the installation of the sprinkler system was not begun until December 1909, and was completed in the following March. It does not appear from the Supreme Court's opinion whether the mortgagees, at the time the mortgage was executed or at the time they put up their money, were aware of the existence of the conditional sale agreement with Holt covering the sprinkler system. Justice Holmes remarked briefly that, "as the mortgage deed was executed before the sprinkler system was put in and the mortgagees made no advance on the faith of it, they were not purchasers for value as against Holt."³⁷ The system consisted of a fifty-thousand-gallon tank on a steel tower bolted to a concrete foundation and of pipes which connected the tank with the mill; clearly, under the doctrine of fixtures, the sprinkler system was "attached to the freehold" and had become realty. The mortgage, in any event, contained an appropriate after-acquired property clause. Certainly, on the analogy of the Supreme Court's railroad jurisprudence, the mortgagees should have won. However, said Holmes:

To hold that the mere fact of annexing the system to the freehold overrode the agreement that it should remain personalty and still belong to Holt would be to give a mystic importance to attachment by bolts and screws. . . . "[T]he mortgagees take just such an interest in the property as the mortgagor acquired; no more no less." *Fosdick v. Schall*, 99 U.S. 235.³⁸

Consistently with the railroad cases, Holmes held irrelevant the fact that Holt had failed to file or record his conditional sale contract (a Virginia statute made an unrecorded conditional sale

³⁶ 232 U.S. 637 (1914).

³⁷ *Id.* at 640.

³⁸ *Id.* at 641.

contract void against lien creditors and subsequent purchasers). The validity of the mortgage, including the after-acquired property clause, was assumed without discussion. Since Holmes was not purporting to overrule the railroad cases which had restricted the purchase money priority to "loose property," as against "permanent structure," he rephrased the distinction, translated into an industrial context, in this way:

The system was attached to the freehold, but it could be removed without any serious harm . . . other than the loss of the system itself. Removal would not affect the integrity of the structure on which the mortgagees advanced. . . . The case is not like those in which the addition was in its nature an essential indispensable part of the completed structure contemplated by the mortgage. The system although useful and valuable can be removed and the works still go on.³⁹

Shortly after *Holt v. Henley* and at the same term of court, a second case gave the Supreme Court, with Holmes again writing the opinion, further opportunity to explain how broad a rule of purchase money priority the *Holt* case was meant to stand for. *Detroit Steel Cooperage Co. v. Sistersville Brewing Co.*⁴⁰ involved tanks, fixtures, and fittings which had been installed in a brewery. According to Holmes, "the tanks were essential to the working of the brewery, and after they were installed the opening into the recess in which they stood was bricked up." "It may be assumed," Holmes added, "that they became part of the realty" Could these tanks be the "essential indispensable part of the completed structure" to which, Holmes had said in his *Holt* opinion, the rule of purchase money priority did not apply? No, said Holmes, repeating from the earlier opinion the line, which evidently pleased him, about the "mystic importance" of "bolts and screws":

The cases to which the possible exception left open in *Holt v. Henley* applies are principally those in which the property claimed has become so intimately connected with or embodied in that which is subject to the mortgage that to reclaim it would more or less physically disintegrate the property held by the mortgagee; e.g., *Porter v. Pittsburg Bessemer Steel Co.*, 122 U.S. 267. . . .

³⁹ *Id.* at 640-41.

⁴⁰ 233 U.S. 712 (1914). In the course of an action to foreclose the first mortgage, the conditional vendor had filed a "bill in equity" which prayed that the foreclosure sale be enjoined and the petitioner permitted to remove his property. It appears that the petitioner had offered to reimburse the mortgagee for any damage done by him in removing the property.

When the obvious destination of an article is to be incorporated into a structure in such a way that to remove it would destroy the other work, like bricks or beams in a building, there is . . . ground for not giving to title [*i.e.*, the purchase money interest] an absolute right of way.⁴¹

Thus, the conditional seller was entitled to tear down the brick wall and remove the tanks, whose presence was "essential to the working of the brewery."

B. A Federal or State Priority Rule?

The sequence of *Holt* and *Detroit Steel* could have left no doubt that the Supreme Court had committed itself, in the context of manufacturing plants, to an extremely broad rule of purchase money priority and to a corresponding diminution in the security of mortgagees. The distinction between "essential" and "non-essential" parts of the structure, suggested in *Holt*, becomes merely a "possible exception" in *Detroit Steel*, limited (if it exists at all) to "bricks or beams in a building." The two cases were less clear on an issue which had been left ambiguous since the days of the railroad cases: was the rule of the *New Orleans Railroad* case, of *Fosdick v. Schall*, and, now, of *Holt v. Henley* and *Detroit Steel*, a rule of federal law or would it give way to inconsistent state law? The brewery in the *Detroit Steel* case was located in West Virginia. Counsel for the mortgagees argued that West Virginia was a state which did not recognize purchase money priority in chattels which became fixtures (this, said counsel, was the "Massachusetts rule") and also suggested that even the limited purchase money priority which the Supreme Court had recognized in the railroad cases reflected the fact that the early railroad cases had come up from states which followed, not the Massachusetts rule, but the contrary "New York rule."⁴² Holmes took note of counsel's argument in the concluding paragraph of his *Detroit Steel* opinion. The West Virginia cases, he suggested, were not as clear as counsel thought they were; it was therefore unnecessary for the Court to decide what it would do if it appeared clearly that West Virginia law gave a mortgagee

⁴¹ *Id.* at 717. The *Porter* case, which Holmes cites, was one of the railroad cases which had limited the purchase money priority to the "loose property," holding specifically that the mortgage bondholders had priority over the claim of a conditional seller of bridges which he had constructed for the road. See p. 1348 *supra*.

⁴² See 233 U.S. at 713 (argument of counsel).

priority over a subsequent purchase money interest in fixtures.⁴³ Counsel in *Detroit Steel* had also argued that the purchase money interest yielded to the mortgage when the mortgage itself had been given to finance the construction: "The mortgagees . . . contemplated the future acquisition of tanks from some source. The Cooperage Company, when it furnished the tanks, contemplated that they were putting into the plant something that would make it a complete brewery, and an integral part thereof."⁴⁴ Holmes did not deign to notice this point in his opinion, which suggests, for what it is worth, that the developing rule of purchase money priority in this context was to be less limited than the rule that had been worked out in the railroad cases.

By 1920 it had become familiar learning that the lien of a mortgage, claimed under an after-acquired property clause or under the doctrine of fixtures (or, as was usually the case, under both), was in general subordinate to the purchase money interest in equipment subsequently furnished to the enterprise, even when the equipment was affixed to the realty. There were said to be a few minority or "Massachusetts rule" jurisdictions which denied the purchase money priority as to fixtures, but according to the author of a learned A.L.R. annotation, the Massachusetts rule was gradually losing ground, in part, as he expressed it, because of "the movement toward an equitable tempering of the rigor of the maxim, 'quicquid plantatur solo, solo credit.'" ⁴⁵

The railroad priority problem had been worked out principally by the federal courts under the superintendence of the Supreme Court. Except in the railroad cases, which were long looked on as *sui generis*, the federal courts did not have a monopoly; for a long period, both before and after the passage of the Bankruptcy Act of 1898, the priority issue was most often presented in state court foreclosure actions. As a result, instead of the one clear stream of federal jurisprudence, we find much apparent diversity of approach. At a later period, it is true, the federal courts took a predominant role as the priority problem came to be litigated prin-

⁴³ Holmes, however, citing *Burgess v. Seligman*, 107 U.S. 20 (1883), hints broadly that even with a state rule squarely opposed the Supreme Court would follow its own rule of purchase money priority.

⁴⁴ 233 U.S. at 715 (argument of counsel). See discussion of *Harris v. Youngstown Bridge Co.*, p. 1345 *supra*.

⁴⁵ Annot., 13 A.L.R. 460 (1921). The case annotated was *Beatrice Creamery Co. v. Sylvester*, 65 Colo. 569, 179 Pac. 154, 13 A.L.R. 448 (1919), holding that an unrecorded purchase money interest in silos had priority over a preexisting mortgage on the land on which the silos were built. Subsequent annotations on the subject are at 73 A.L.R. 755 (1931); 88 A.L.R. 1324 (1934); 111 A.L.R. 372 (1937); 141 A.L.R. 1288 (1942); 19 A.L.R.2d 1300 (1951).

cipally in bankruptcy and reorganization; by this time, however, the federal courts had been bound to state law precedents by *Erie R.R. v. Tompkins*,⁴⁶ and Justice Holmes's suggestion in *Detroit Steel* that priority might be a rule of federal law bore no fruit. The Supreme Court itself made no significant contribution to the priority question after the two 1914 cases previously discussed.

C. *The Minority or Massachusetts Rule*

The existence of a "minority rule" under which the truth of a proposition which is apparent to most courts is stubbornly denied by a few is always a matter of interest. Not infrequently an investigation undertaken in an appropriate spirit of skepticism will reveal that the so-called minority rule does not exist at all (in holdings as distinguished from dicta) or that the minority cases all involve a factual variant which is not present in the majority cases or that accident rather than design has led some courts to accept a deviant formulation. The state of law in a minority rule jurisdiction is apt to appear confused and inconsistent. This is not surprising, since the courts in such a jurisdiction find themselves in the position of saying one thing while they are doing the opposite, of paying lip service to a rule which exists only to be avoided, of building up artificial distinctions and legal fictions. The usual fate of a minority rule is to fade away and be forgotten although occasionally it meets a more instant end at the hands of court or legislature. In the process of decay such a rule can cause a considerable amount of discomfort in the host state.

The "minority rule" which denied the priority generally accorded to the purchase money interest in fixtures was associated with Massachusetts. The rule in Massachusetts was usually traced back to *Clary v. Owen*,⁴⁷ which involved water wheels and machinery installed in a mill; the mill was subject to a mortgage which antedated the agreement under which the water wheels were furnished. Judge Hoar wrote:

[I]t is contended that the mortgagor being in possession, and having agreed with Burghardt [the seller] that the wheels should remain the personal property of the builder until they were completed and provision made for paying for them, the wheels, having been set up under this agreement, could not be claimed and held by the mortgagee.

If this position were tenable, it would follow that the mort-

⁴⁶ 304 U.S. 64 (1938).

⁴⁷ 81 Mass. (15 Gray) 522 (1860).

gagor could convey to another a right in the mortgaged premises greater than he could exercise himself. . . . [W]e think it is not in the power of the mortgagor, by any agreement made with a third person after the execution of the mortgage, to give to such person the right to hold anything to be attached to the freehold, which as between mortgagor and mortgagee would become part of the realty.⁴⁸

The passage quoted is unquestionably a categorical denial of the purchase money priority with respect to goods which, having been "attached to the freehold," "become part of the realty." The facts of the case were, however, curious. The contract price for the water wheels was \$3,500, of which \$500 was paid in advance. The seller began work but before the installation had been completed the mill was destroyed by fire. The millowner then abandoned the mill. The seller, without completing the contract, retained the \$500 but never demanded payment of the balance or attempted to repossess his property. The mortgagee foreclosed and himself purchased the mill in its damaged state. After all this had happened, the seller failed and his "assignee in insolvency" brought an action against the mortgagee for conversion of the water wheels. It may be doubted that the most convinced judicial advocate of purchase money priority would have given judgment for the assignee.

In our quest for the origin of the "minority rule" we thus come upon a species of historical accident: an odd case, no doubt properly decided on its facts, with a quotable passage in the opinion which stated an extremely broad proposition. The subsequent development of the "Massachusetts rule" was aided by a railroad case which involved a claim for priority over a mortgage by a furnisher of rails.⁴⁹ In holding for the mortgagee, Judge Foster remarked: "Nor do we suppose that a mortgagor in possession is competent to bind existing mortgagees by any arrangement to treat as personalty annexations to the freehold."⁵⁰ We have seen that the United States Supreme Court reached the same conclusion as the Massachusetts court with respect to purchase money claims for rails.⁵¹ When, however, the Supreme Court reconsidered the priority issue in an industrial context, it had found no difficulty (speaking through Justice Holmes of

⁴⁸ *Id.* at 524-25.

⁴⁹ *Hunt v. Bay State Iron Co.*, 97 Mass. 279 (1867).

⁵⁰ *Id.* at 283.

⁵¹ *Galveston R.R. v. Cowdrey*, 78 U.S. (11 Wall.) 459 (1871), discussed p. 1347 *supra*.

Massachusetts) in giving judgment for the purchase money interest in equipment affixed to realty and essential to the operation of the plant. The Massachusetts court, having lost the services of Holmes' nimble mind, fared less well. It became the customary ritual for the court to start by announcing that "the general rule enunciated in *Clary v. Owen*, 15 Gray, 522, is that all property added to real estate after a mortgagee has acquired his title thereto inures to him except in cases where it is otherwise provided by agreement or by statute."⁵² Having satisfied the ritual the court would then look around, in an appropriate case, for an escape; the most usual was a finding that the goods furnished by the purchase money claimant had not become fixtures, and in time Massachusetts law became notable for the extraordinary subtlety of the distinction between fixtures and personalty.⁵³

The Massachusetts court applied the rule of *Clary v. Owen* — that is, held the purchase money interest subordinate — principally in cases in which the purchase money claimant had supplied fixtures or equipment to a building in course of construction, the mortgage itself having been given, almost contemporaneously with the purchase money agreement, to secure funds advanced to enable the construction to be carried out.⁵⁴ These cases reach the same result as many of the federal cases which are thought to exemplify the majority rule.⁵⁵ We may conclude that the results of the "minority rule" in Massachusetts were not substantially different from those arrived at in "majority rule" states. The principal difference was that Massachusetts had more priority

⁵² *Waverly Co-op. Bank v. Haner*, 273 Mass. 477, 480, 173 N.E. 699, 700 (1930).

⁵³ Compare *Hunt v. Bay State Iron Co.*, 97 Mass. 279 (1896) (rails furnished to a railroad are fixtures: mortgagee wins over purchase money claimant), with *Lorain Steel Co. v. Norfolk & B. St. Ry.*, 187 Mass. 500, 73 N.E. 646 (1905) (rails furnished to street railway company not fixtures: purchase money claimant wins over mortgagee).

⁵⁴ See, e.g., *Waverly Co-op. Bank v. Haner*, 273 Mass. 477, 173 N.E. 699 (1930) (mortgage, October 4; conditional sale of plumbing and heating equipment to new building, October 11, delivery of the equipment having been made between October 4 and 8); *Commercial Credit Corp. v. Commonwealth Mortgage & Loan Co.*, 276 Mass. 335, 177 N.E. 88 (1931) (new apartment building; construction loan mortgage dated February 12; conditional sale of refrigerators dated May 17).

⁵⁵ See *Harris v. Youngstown Bridge Co.*, 90 Fed. 322 (6th Cir. 1898) discussed p. 1345 *supra*; *Tippert & Wood v. Barham*, 180 Fed. 76 (4th Cir. 1910), where the court declared it was adopting the "Massachusetts rule," in circumstances that, the opinion explicitly states, weighted the equities in favor of the mortgage bondholders, whose money had been advanced to develop the water company by the acquisition of new property. The conditional vendor of water pipes lost to the mortgage trustee.

litigation of this type than did most other states. The court itself seems to have been not entirely happy with the subtlety of some of the distinctions which it had been obliged to make. Thus we find the court commenting in 1931:

The bald physical facts in the case at bar do not differ in essential particulars from those in [other cited cases] Whatever inconsistencies may appear between these several cases and the case at bar are superficial and not substantial, resting wholly upon different findings of essential facts and not resting in any degree upon different rules of law. . . . The governing principles of law are the same; the conclusion as to the facts may vary.⁵⁶

The volume on Massachusetts litigation makes one thing abundantly clear: the rule of *Clary v. Owen* did little or nothing to discourage purchase money financing of equipment installed in mortgaged property.⁵⁷

D. Section 7 and "Material Injury to the Freehold"

In the "majority rule" states the priority of the purchase money interest over the preexisting mortgage (whose lien is asserted under an after-acquired property clause or under the doctrine of fixtures) is conceded. The question then becomes how broad the rule of purchase money priority is to be, what factual variants will reverse the priorities. Even Justice Holmes in *Detroit Steel* had conceded that there were some accessions to the freehold which went to the mortgagee over the purchase money claimant,

⁵⁶ *Commercial Credit Corp. v. Commonwealth Mortgage & Loan Co.*, 276 Mass. 335, 340-41, 177 N.E. 88, 90 (1931).

⁵⁷ The Massachusetts cases are reviewed in Coogan, *Security Interests in Fixtures Under the Uniform Commercial Code*, 75 HARV. L. REV. 1319, 1325-26 (1962). Mr. Coogan comments that

In Massachusetts, removal is permitted if the goods are considered to have remained personal property despite the affixation. . . . The equities of the individual case are often of great influence, and this factor may make it very difficult to predict whether or not particular property remains personal. For example, in *Carpenter v. Walker*, 140 Mass. 416, 5 N.E. 160 (1886), the master found that a 5,600 pound engine, which was belted to shafting, cleated to the floor, and too large to go through the existing doors of the shed which housed it, remained personal property and could be removed by a chattel mortgage. Holmes, J., seemed surprised at this conclusion, but did not upset it.

Id. at 1325 n.13. For the later views of Holmes after his translation from Massachusetts to a larger scene, see *Holt v. Henley*, p. 1351 *supra* and the *Detroit Steel* case, p. 1352 *supra*. The Massachusetts legislature eventually (1943) passed a statute (repealed with the enactment of the Code) which removed specified types of equipment from the rule of *Clary v. Owen* and thus allowed the normal purchase money priority to be achieved without resort to the prestatutory ritual. For the text of the statute, see Coogan, *supra* at 1325 n.13.

although he seems to have felt that this category was limited to the "bricks or beams in a building."⁵⁸

The distinction between accessions which could be financed with purchase money priority over a mortgage, and those which could not, came to be phrased in terms of whether or not fixtures could be severed from the real estate and removed without causing "material injury to the freehold." Section 7 of the Uniform Conditional Sales Act, picking up this formulation from earlier cases and statutes, provides:

If the goods are so affixed to realty, at the time of a conditional sale or subsequently as to become a part thereof and not to be severable wholly or in any portion without material injury to the freehold, the reservation of property as to any portion not so severable shall be void after the goods are so affixed, as against any person who has not expressly assented to the reservation.

Section 7 goes on to provide that conditional sales of goods which, although affixed to realty, can be severed without "material injury to the freehold" must be filed for protection against "subsequent purchasers of the realty for value and without notice of the conditional seller's title." The conditional seller of such goods wins over a preexisting interest in the real estate even though he does not file. Thus certain types of goods (those that cannot be severed without "material injury to the freehold") go, on affixation, to feed the mortgage lien; apart from an express subordination, the mortgagee has an absolute priority. Indeed section 7 goes beyond a statement of priorities: an attempted conditional sale of such goods is "void." With respect to goods which, although on affixation they become part of the realty, can be severed without material injury, the purchase money interest represented by a conditional sale contract receives (even though itself unperfected) an equally absolute priority over the antecedent real property interest (mortgage, lease, contract of sale). That is to say, there are no limitations expressed in the statute on the absolute purchase money priority: it will be a point in our discussion whether the case law under section 7 has imposed any "equitable" limitations on the priority comparable to those which grew up in the nonstatutory case law earlier discussed.

The phrase "material injury to the freehold," which is not defined in the statute, is meaningless in itself: the courts are, in effect, directed to divide all kinds of property which are capable of being affixed to real estate into two heaps. As to one heap, in a

⁵⁸ See the *Detroit Steel* opinion quoted pp. 1352-53 *supra*.

priority dispute, mortgage wins over purchase money; as to the other heap, purchase money wins over mortgage. The draftsman of the act suggested, in his commentaries, that the class of goods to be put in the category "not severable without material injury" should be limited to structural materials which "are swallowed up or drowned in the realty," following this vivid phrase with a quotation from Justice Holmes' *Detroit Steel* opinion ("like bricks or beams in a building").⁵⁹ Except in two jurisdictions the courts have followed the draftsman's lead: in most UCSA states no cases have denied the purchase money priority on the ground that the goods (other than structural materials) have become so closely integrated with the realty as to be no longer severable without causing "material injury."

E. Minority Interpretations of Section 7

1. *The New Jersey Institutional Doctrine.*— One of the deviant jurisdictions was New Jersey which, in a series of cases decided during the 1930's, developed an approach to the "material injury" question which became known as the "institutional doctrine." Under the New Jersey gloss there was "material injury" whenever the removal of equipment impaired the "integrity" of the enterprise or institution, even though the removal did no physical damage to the structure. Although the New Jersey courts occasionally formulated the doctrine as a broad principle applicable to all types of structures, the doctrine was in fact applied almost exclusively to equipment (such as refrigerating units) installed in multiple-dwelling apartment houses of recent construction.⁶⁰ The limits of the doctrine (if it had limits) never became clear. There were suggestions at various times that it might apply to replacement equipment installed in old apartment houses as well as to original equipment installed in new ones, to single-family residential property as well as to large apartment houses,

⁵⁹ See 2A UNIFORM LAWS ANN. 98 (1924).

⁶⁰ Compare *Lumpkin v. Holland Furnace Co.*, 118 N.J. Eq. 313, 178 Atl. 788 (Ct. Err. & App. 1935); *Domestic Elec. Co. v. Mezzaluna*, 109 N.J.L. 574, 162 Atl. 722 (Ct. Err. & App. 1932); *MacLeod v. Walter J. Satterthwait, Inc.*, 109 N.J. Eq. 414, 157 Atl. 670 (Ch. 1932); *Future Bldg. & Loan Ass'n v. Mazzochi*, 107 N.J. Eq. 422, 152 Atl. 776 (Ch. 1931), all cases in which the mortgagee prevailed over the conditional vendor, *with Sellitto v. Heating & Plumbing Fin. Corp.*, 116 N.J. Eq. 247, 174 Atl. 147 (Ch. 1934); *Reliable Bldg. & Loan Ass'n v. Purifoy*, 111 N.J. Eq. 575, 163 Atl. 151 (Ch. 1932); *Bank of America Nat'l Ass'n v. La Reine Hotel Corp.*, 108 N.J. Eq. 567, 156 Atl. 28 (Ch. 1931); *Crown v. Regna Constr. Co.*, 104 N.J. Eq. 469, 146 Atl. 346 (Ch. 1929), all cases in which the conditional vendors were allowed to remove some or all of the goods.

perhaps even to commercial and industrial enterprises (at least small ones).⁶¹ Not the least interesting feature of the New Jersey doctrine is its disappearance from the New Jersey reports after 1940, following ten years of almost frantic judicial activity and at a point when it seemed that maximum confusion had been achieved.⁶² By way of imaginative speculation, it might be suggested that the New Jersey courts were less interested in priorities than they were in the plight of tenants in large apartment houses at a time when the collapse of real estate values had cast an unlovely light on some of the financing methods of the 1920's. Rather than see a substantial part of the population condemned to camping out on the New Jersey marshes without heat, light, or refrigeration, the courts ordered that the essential equipment be left in the apartment houses. This humanitarian gesture incidentally gave priority to the real estate mortgagee over the purchase money interest in the equipment.

2. *The Pennsylvania Industrial Plant Mortgage Doctrine.*—The other deviant jurisdiction was Pennsylvania, where strange and wonderful things transpired. In 1841, Chief Justice Gibson had said: "Whether fast or loose, therefore, all the machinery of a manufactory which is necessary to constitute it, and without which it would not be a manufactory at all, must pass for a part of the freehold."⁶³ This statement became the basis of the Pennsylvania Industrial Plant Mortgage Doctrine.⁶⁴ The case involved a dispute between a real estate mortgagee and an attaching creditor who had sought to levy on the machinery (including spare parts which were neither affixed nor in use) of an iron mill. By holding that all the machinery, "fast or loose," became part of the freehold, and thus subject to the mortgage, the court defeated the

⁶¹ The New Jersey cases were brilliantly analyzed by Professor Farnham of the Cornell Law School in the course of a study prepared for the New York Law Revision Commission. [1942] N.Y. LAW REVISION COMM'N REP. 10-21.

⁶² The "institutional" theory was given lip service in a recent case involving ovens installed on conditional sale in a restaurant for a tenant. The reservation of title was declared void as to the owner of the restaurant under the "institutional" doctrine, but the owner was held estopped to refuse to pay for the ovens because he had bought the fixtures at a bankruptcy sale expressly conducted subject to the lien of the conditional sale. *Uttinger v. Koopman*, 46 N.J. Super. 443, 134 A.2d 824 (App. Div. 1957). With the enactment of the Code in New Jersey, the "institutional doctrine" has gone to its final rest.

⁶³ *Voorhis v. Freeman*, 2 W. & S. 116, 119 (Pa. 1841).

⁶⁴ See Note, *The Problem of Fixtures in Relation to Pennsylvania Chattel Security Devices*, 13 U. PITT. L. REV. 574 (1952); Leary, *Financing New Machinery for Mortgaged Pennsylvania Industrial Plants*, 4 VILL. L. REV. 498 (1959); Robinson, McGough & Scheinholtz, *The Effect of the Uniform Commercial Code on the Pennsylvania Industrial Plant Doctrine*, 16 U. PITT. L. REV. 89 (1955).

creditor's levy. A commentator has suggested that this holding can only be understood in the light of the then state of Pennsylvania chattel security law: the devices of the chattel mortgage and the conditional sale had been outlawed and the unique Pennsylvania bailment lease had not yet come into use. There was thus no known way of financing on the security of chattel property until *Voorhis v. Freeman* suggested that all the equipment used in connection with a "manufactory" could be financed as if it were real property, "part of the freehold."⁶⁵ The doctrine of *Voorhis v. Freeman* was not restricted to "manufactories"; in the course of time it was "applied to a private house, a multi-story office building, a five-story apartment house, an ornamental iron works, food wholesaler, a restaurant, a stone quarry, and was considered in the case of a church and a hotel."⁶⁶ When the problem of the priority of a purchase money interest in equipment over an industrial plant mortgage came up, the Pennsylvania reaction was standard: the purchase money interest (typically represented by a bailment lease) prevailed.⁶⁷ Starting in 1915 the Pennsylvania legislature passed a series of acts which validated the previously outlawed conditional sale. With respect to goods affixed to realty, the 1915 act clearly gave priority to the conditional sale over the plant mortgage. By 1927 there had been adopted a variant of section 7 of the UCSA, which seemed, on the face of it, more favorable to the purchase money interest than the Uniform Act; under the Pennsylvania version, the conditional seller could remove his property even though the removal caused "material injury to the freehold," provided he posted satisfactory security for making the "injury" good. Some years later the Pennsylvania Supreme Court, in a decision that appears to have flabbergasted the Pennsylvania bar, decided that "material injury to the freehold" had to be construed in the light of the plant mortgage doctrine; that is, there would be a "material injury" whenever anything was removed which, under the plant mortgage doctrine, became part of the freehold.⁶⁸ This holding effectively negated the bond-posting provision, since it now appeared that the conditional seller would have to make good not merely the physical damage to the building but the difference in value between the "plant" as it was before and as it was after the removal. The legislature

⁶⁵ See Leary, *supra* note 64, at 502.

⁶⁶ *Id.* at 523.

⁶⁷ The cases are collected by Leary. *Id.* at 504-17.

⁶⁸ *Central Lithograph Co. v. Eatmor Chocolate Co.* (No. 1), 316 Pa. 300, 175 Atl. 697 (1934).

promptly amended the conditional sales act still again in an apparent attempt to protect the purchase money interest against the industrial plant mortgages. However, no one (except the judges of the Pennsylvania Supreme Court) had doubted that the 1927 act had done exactly that; until the court spoke again, who could know how successful the 1935 draftsmen had been? It also seemed possible that the court, if it chose to develop its new doctrine, might even reverse the priority of the bailment lessor over the industrial plant mortgagee. On the principle of letting sleeping dogs lie, no attempt was made, by legislative enactment, to deal with this possibility. It turned out that the Pennsylvania Supreme Court did not have another opportunity to speak squarely on the priority problem before 1954 when Article 9 of the Uniform Commercial Code went into effect.⁶⁹ Although the court has still not spoken, the Pennsylvania commentators seem to have no doubt that the Code firmly establishes the priority of the purchase money interest over the industrial plant mortgage.⁷⁰

F. Applications of Section 7

Between 1920 and 1940, and particularly during the 1930's, there was a considerable amount of priority litigation, both in UCSA and non-UCSA states.⁷¹ In general the litigation involved relatively small-scale financing: residential property, small factories, a few apartment houses. Comparable litigation in the context of the large corporation financing a multimillion-dollar acquisition of new equipment did not arise; it may be hypothesized that such priorities were worked out in the course of negotiations for reorganization without leaving traces in the case reports. With respect to the small-scale financing which was litigated, it is easy to understand the peak of the case load during the 1930's. The gradual disappearance of such litigation during the 1940's may be taken to reflect the cessation of new building during the war as well as wartime prosperity. It is more difficult to explain why there has not been a reappearance of priority litigation since the 1940's. There has been a great deal of new building, of plant modernization and expansion, of replacement of old equipment

⁶⁹ A 1940 case, startling in the fact that it involved a conditional sale of elevators filed under the 1925 act on which a balance was still due at the time of suit, 14 years after filing, was decided without reference to the 1935 amendment. *Land Title Bank & Trust Co. v. Stout*, 339 Pa. 302, 14 A.2d 282 (1940).

⁷⁰ See Robinson, McGough & Scheinholtz, and Leary, *supra* note 64.

⁷¹ See, collecting cases, Annots., 73 A.L.R. 755 (1931); 88 A.L.R. 1324 (1934); 111 A.L.R. 372 (1937); 141 A.L.R. 1288 (1942).

with new. There has also been a series of mild recessions which have led to a large number of bankruptcies, particularly among relatively small enterprises. As of 1950 an astute observer would have felt safe in predicting that the courts would soon be dealing with a new flood of priority cases. In fact there have been almost none. There must be reasons for this unlikely turn of events, but the present author does not know what they are. Since almost all the case law antedates 1940 and since methods both of construction and of financing have been revolutionized since 1940, an attitude of wary skepticism toward the following discussion will be appropriate.

1. *The General Priority of Purchase Money Interests.* — Except for the class of goods which, when affixed, cannot be severed without material injury to the freehold, UCSA section 7 apparently gives an absolute priority to the conditional seller over preexisting real estate interests, with no requirement that the conditional sale contract be filed. It is true that the act gives the priority more by indirection than by express statement. The first sentence of section 7 makes the conditional sale of goods whose removal would cause material injury to the freehold void except as to persons who expressly consent to the reservation of title. The second sentence covers the conditional sale of goods, which, although affixed, can be severed without material injury and provides that contracts covering such goods must be filed for protection against “subsequent purchasers of the realty.” Thus the first sentence requires assent only in the case of goods whose removal would cause material injury and the second sentence requires filing as to the second class of goods only with respect to subsequent purchasers. No court seems to have doubted that the proper construction of section 7 is to give the seller priority, without filing, over the antecedent real estate interest as to all goods severable without material injury.⁷²

2. *The Right To Remove.* — Furthermore, except in New Jersey and Pennsylvania, the courts have held that “material injury to the freehold” meant something like “irreparable physical damage to the structure”: goods could be removed even though they were essential to the functioning of the enterprise, even though they were bolted down or cemented in, even though the only way to get them

⁷² See, e.g., *People's Sav. & Trust Co. v. Munsert*, 212 Wis. 449, 249 N.W. 527 (1933), in which the Wisconsin court gives an elaborate analysis of § 7. See also *Keil Motor Co. v. Home Owners Loan Corp.* 43 Del. (4 Terry) 322, 47 A.2d 164 (Super. Ct. 1941). *But see* *Greene v. Elkins*, 134 Misc. 118, 235 N.Y. Supp. 438 (Sup. Ct. 1929), discussed in note 86 *infra*.

out was to break down the wall of the building.⁷³ While a few cases (both at common law and under the UCSA) required the conditional seller to repair damage done in the course of removal, the general view seems to have been that if there was a right to remove there was no duty to reimburse the owner or other interests in the real estate for damage.⁷⁴

3. "*Subsequent*" *Security Interests*.—The proposition that the conditional seller has priority over earlier interests in the realty but not (unless he has filed) over subsequent interests has led to some diversity of opinion about which interests are "subsequent."⁷⁵ A purchaser of the realty from the conditional buyer (or of his equity of redemption in the realty) is of course "subsequent." But how about a purchaser of the realty at a foreclosure sale held by a mortgagee whose mortgage antedated the conditional sale? And does it make any difference if the mortgagee is himself the purchaser?⁷⁶ The argument in favor of the purchaser (the conditional seller not having filed his contract) is

⁷³ For a dramatic example of this view, see *Jones v. Jos. Greenspon's Son Pipe Corp.*, 381 Ill. 615, 46 N.E.2d 67 (1943) (conditional seller of pipe and casing cemented into an oil well removed it by exploding a bomb inside the well to tear the equipment loose).

⁷⁴ The pervasive judicial conception of the irrelevancy of the conditional vendor's offer to pay damages, in determining rights to personal property in these cases, is well illustrated by *Viking Equip. Co. v. Prudential Ins. Co.*, 232 Ala. 543, 168 So. 566 (1936). The case involved a sprinkler system which would pass by accession to the mortgagee in the absence of a title-retaining agreement. The upper court approved the doctrine that a conditional sale contract prevents the fixture from falling under the mortgage lien if no material injury results from removal, but refused to upset the lower court's finding that material damage to the building would result in this case. The conditional vendor's offer to pay the \$800 estimated cost of restoration of the building (the offer being made after the lower court's decision) was characterized as "belated" and of no relevance in determining legal rights. The court declared that an offer to pay damages could not entitle the vendor to remove the sprinkler system if he had no legal right to do so, and the mortgagee prevailed.

⁷⁵ See, e.g., *In re Tonawanda Brewing Corp.*, 13 F. Supp. 345 (W.D.N.Y. 1936); *American Laundry Mach. Co. v. Larson*, 217 Wis. 208, 257 N.W. 608 (1934); *Brunswick-Balke-Collender Co. v. Franzke-Schiffman Realty Co.*, 211 Wis. 659, 248 N.W. 178 (1933). Several New York cases have held a prior mortgagee, making subsequent advances under a mortgage providing for such advances, protected as a subsequent purchaser for the amount advanced after affixation. See, e.g., *Central Chandelier Co. v. Irving Trust Co.*, 259 N.Y. 343, 182 N.E. 10 (1932); *New York & Suburban Fed. Sav. & Loan Ass'n v. Crescent Constr. Corp.*, 196 Misc. 532, 92 N.Y.S.2d 533 (Sup. Ct. 1949); *Lloyds First Mortgage Corp. v. Lombardo*, 227 App. Div. 400, 237 N.Y. Supp. 456 (1929).

⁷⁶ Generally, the mortgagee who purchases at his foreclosure sale is not held to be a protected "subsequent purchaser." See, e.g., *Keil Motor Co. v. Home Owners Loan Corp.*, 43 Del. (4 Terry) 322, 47 A.2d 164 (Super. Ct. 1941); *Standard Dry-Kiln Co. v. Ellington*, 172 N.C. 481, 90 S.E. 564 (1916).

that, being without notice of the purchase money interest, he has bid for the property in the belief that the fixtures were unencumbered. The argument in favor of the conditional seller, which is somewhat conceptual, is that the interest of the foreclosure purchaser (whether he is the mortgagee or a third party) derives from and must "relate back" to the mortgage and therefore cannot be "subsequent." In the usual case the conditional seller intervenes in the foreclosure proceeding before there has been a sale so that the purchase without notice rarely takes place.⁷⁷ If he lies back and does nothing until an innocent purchaser has bought the property, the purchaser (particularly if he has paid cash and not merely bid the property in for the unpaid balance of his mortgage) seems to have a good case for protection against the nonfiler.

4. *The "New for Old" Problem.* — Installation of new equipment in an old structure often means tearing out old equipment. The mortgagee of the old equipment, if dispute arises between him and the purchase money financier of the new equipment, will argue that the wrongful removal of his original security should have the result of subordinating the purchase money interest to the mortgage. In a New York case of this type it was apparently held that such a wrongful removal, carried out by the conditional seller in the course of installation of the new equipment, subordinated the purchase money interest *in toto* to the mortgage without regard to the value of the property removed, unless the conditional seller could bear the burden of proving that the property removed was useless and had no value at all.⁷⁸ The case involved the substitution of a steam heating plant for a seven-year-old hot air furnace in a building which appears to have been used as a residence; there was no proof of the value or condition of the hot air furnace or of what had happened to it except that it had been somehow "disposed of" by the conditional seller. The theory of the inadequate *per curiam* opinion in the appellate division was that the removal "impaired the security of the mortgage," was a wrongful act, and consequently required the subordination of the purchase money interest. Such a reversal of priorities, without regard to the values involved, seems too severe a sanction, even if the purchase money man is a wrongdoer. If he has

⁷⁷ See, e.g., *People's Sav. & Trust Co. v. Munsert*, 212 Wis. 449, 249 N.W. 527 (1933).

⁷⁸ *Roche v. Thurber*, 246 App. Div. 850, 285 N.Y. Supp. 82 (1936), *aff'd mem.*, 272 N.Y. 582, 4 N.E.2d 814 (1936). The case is discussed at length by Farnham, *supra* note 61, at 34-38.

taken the old equipment away and sold it, he should be required to account to the mortgagee for its fair value. If worn-out or inefficient equipment is replaced by new or better equipment, there is no impairment of the mortgagee's security.⁷⁹ It is of course possible to imagine the case of a mortgagor who improvidently replaces perfectly good equipment with equipment which is no better and may be worse while the conditional seller (the ethics of salesmanship being what they are) cheers him on. In such a case the priorities might appropriately be reversed, at least to the extent of the impairment of the mortgagee's security. But the mere fact that new equipment has been substituted for old does not require so drastic a solution.

G. *The Construction Mortgage Exception*

As we have seen, the construction mortgage has accounted for the most persistent exception to the rule of purchase money priority. In the construction mortgage cases the owner-mortgagor, being under a duty, express or implied, to the mortgagee to complete the structure free of paramount liens, has failed to do so — either because he has diverted the mortgage money to other uses or because the costs of construction have outrun his estimate. On such facts, from the days of the early railroad cases on,⁸⁰ the mortgagee has frequently prevailed over the purchase money claimant. The minority or Massachusetts rule, which is said to deny the priority of the purchase money interest over the mortgage, has been most often applied in favor of the mortgagee in cases where he has financed (or thought he was financing) the construction;⁸¹ the “institutional doctrine” which developed in New Jersey under section 7 of the UCSA was also in most cases invoked in favor of construction mortgagees.⁸²

The idea that the construction mortgage may be entitled to priority over the purchase money claims which accrue in the course of construction has thus shown an astonishing capacity to persist. This is the more surprising in view of the fact that no

⁷⁹ This view prevailed in *Keil Motor Co. v. Home Owners Loan Corp.*, 43 Del. (4 Terry) 322, 47 A.2d 164 (Super. Ct. 1941). See also *Woodliff v. Citizens' Bldg. & Realty Co.*, 240 Mich. 413, 215 N.W. 343 (1927) (old elevator, apparently not in use, replaced by new elevator; court refused to consider the replacement argument because of lack of evidence as to value and final disposition of old elevator; vendor permitted to remove new elevator).

⁸⁰ See, e.g., *Tippett & Wood v. Barham*, 180 Fed. 76 (4th Cir. 1910); *Harris v. Youngstown Bridge Co.*, 90 Fed. 322 (6th Cir. 1898), discussed p. 1345 *supra*.

⁸¹ See p. 1357 and cases cited note 54 *supra*.

⁸² See p. 1360 and cases cited note 60 *supra*.

“construction mortgage” doctrine, formulated as an exception to the general rule of priority, ever clearly emerged from the cases. It is rare to run across a statement as explicit as the following passage in the opinion of a California intermediate court of appeals, explaining the rationale of the leading California case of *Dauch v. Ginsburg*:⁸³

In the *Dauch* case the loan was made for the purpose of constructing a hotel building. The owner and the encumbrancer contemplated and agreed that the security for the loan should be not only the real property but also the completed hotel building. The conditional seller of the plumbing and heating equipment knew there was a prior encumbrance against the completed structure; knew that the building was being erected for a hotel and for no other purpose; knew that the hotel could not be operated if the equipment in question were removed; and knew that such a severance would substantially diminish the security of the prior encumbrancer. In such a case it was held that the rights and claims of the conditional seller of the equipment must yield to those of the prior encumbrancer.⁸⁴

There has never been a clear formulation in the cases of the policy which may underlie the persistent tendency of the courts in various jurisdictions under a great variety of theories to prefer the construction mortgagee. There seems to be an uneasy feeling that to subordinate the mortgagee in such a case would be somehow to work a fraud on him,⁸⁵ but exactly why this should be so is never pursued. By hypothesis the mortgagee has advanced his funds in the expectation that they would be used to finance the construction and that the completed structure (apartment house, hotel, factory or what not), free of paramount liens, would be his security. However, the owner-builder-mortgagor, in violation of his agreement, has brought in some or all of the equipment subject to purchase money claims. The mortgagee is naturally disappointed, but it remains true that the purchase money man has supplied the equipment and remains unpaid. Why should the mortgagee be made whole at his expense? Should not the mortgagee, instead of trusting the mortgagor to disburse the funds

⁸³ 214 Cal. 540, 6 P.2d 952 (1931).

⁸⁴ *Grupp v. Margolis*, 153 Cal. App. 2d 500, 504, 314 P.2d 820, 823 (Dist. Ct. App. 1957). In the light of that analysis of the *Dauch* case, the court refused to subordinate a purchase money interest in a case where it did not appear that the mortgagee had advanced funds for the specific purpose of enabling the mortgagor to acquire the property which later came in subject to a conditional sale agreement.

⁸⁵ *Cf.* the language of Taft, C.J., in *Harris v. Youngstown Bridge Co.*, 90 Fed. 322, 329 (6th Cir. 1898), quoted p. 1345 *supra*.

properly, have seen to it that the purchase money men were paid? It may be that the cases obscurely reflect the thought that, as between the typical mortgagee (or typical bondholder) and the typical purchase money man, the latter is in the better position to prevent the fraud. At all events, the consistency of result in cases of this type, no matter what doctrine the court swears its allegiance to, argues for the soundness of some underlying, albeit inarticulate, policy.

None of the cases arising under section 7 of the UCSA has discussed the possibility that an antecedent construction mortgage should win over the subsequent conditional sale of goods which could be severed without material injury to the freehold,⁸⁶ although there are section 7 cases in which the statement of facts suggests that a construction mortgage was involved; that is, the date of the mortgage is only a few days or weeks earlier than the date of the conditional sale.⁸⁷ Thus the apparently absolute priority which section 7 gives the conditional sale over the antecedent mortgage once the material injury hurdle has been jumped has not been whittled away by a case law exception in favor of construction mortgages. On the other hand, the possibility of such a reading of section 7 does not seem to have been brought squarely to the attention of any court.

⁸⁶ But see *Greene v. Elkins*, 134 Misc. 118, 235 N.Y. Supp. 438 (Sup. Ct. 1929), in which a conditional vendor of an elevator appears to have been subordinated to a preexisting mortgage. The express ground of subordination was that the conditional vendor had not filed, a holding which is in flat violation of § 7 of the UCSA, then in force in New York. Section 7 is set out p. 1359 *supra*; see cases cited note 72 *supra*. The mortgage which was given priority was, however, a construction mortgage. The opinion contains the following passage:

The instant case presents to a striking extent the danger to the existing incumbrancer. Mr. Greene [mortgagee] advanced money and materials to build the block in suit, and he sees the elevator installed and he had the right to suppose that the money he advanced was used to pay for it; but so far from that being the case, what he supposed had become a part of the block upon which he relied for security, was, if the [elevator] company's claim is sustained, the company's personal property, and can be severed, even though seventy per cent of the purchase price has been paid.

134 Misc. at 120, 235 N.Y. Supp. at 440.

⁸⁷ In addition to *Greene v. Elkins*, *supra* note 86, see, e.g., *People's Sav. & Trust Co. v. Munsert*, 212 Wis. 449, 249 N.W. 527 (1933). Another instructive case is *Central Chandelier Co. v. Irving Trust Co.*, 259 N.Y. 343, 182 N.E. 10 (1932), in which a building loan mortgagee, who made advances as construction progressed, won over a conditional seller of lighting fixtures who delivered the fixtures (but failed to file his contract) before the mortgagee made his final advance. The conditional seller was, however, allowed to reclaim some of the equipment which had been delivered but not installed. This seems to have been on the theory that the mortgage, as drafted, covered only equipment "attached to or used in connection with" the building, and that uninstalled lighting fixtures were neither "attached" nor "in use."

IV. THE ARTICLE 9 "PURCHASE MONEY SECURITY INTEREST"

A. The After-Acquired Property Interest Expanded

Under Article 9 the question of purchase money priority seems to take on dimensions which it did not have under pre-Code law.⁸⁸ The priority issue is essentially a function of the degree to which the law recognizes the after-acquired property interest as being fully perfected. Except for growing crops and consumer goods, Article 9 places no limitation on a lender's right to tie up all his debtor's future property.⁸⁹ Thus priority disputes between after-acquired and purchase money interests are at least theoretically possible over a much broader range than under pre-Code law.

Despite the theoretical possibility, it does not necessarily follow that the actual range of priority litigation will be any broader under Article 9 than in the past. If the pre-Code pattern under which the long-term financing of the fixed assets of an enterprise was divorced from the short-term financing of its inventory and receivables is maintained under Article 9, there is no reason to anticipate novel types of priority litigation. On the other hand, if secured parties rush in to take the fullest advantage of the so-called "floating lien" provisions of the Article there will be, next depression time, a rash of priority cases in unheard-of volume and in unfamiliar contexts. There has not been sufficient experience in states which have enacted the Code to substantiate a prediction whether lenders will conservatively adhere to the old pattern or whether they will rush down a steep place to destruction. What might be called the "don't be a pig" school of advice to Article 9 lenders has a fashionable currency and may be expected to have

⁸⁸ No attempt will be made in this paper to summarize and explain the basic concepts and general structure of Article 9. See Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code*, 63 COLUM. L. REV. 1 (1963); Coogan, *The Lazy Lawyer's Guide to Secured Transactions Under the Code*, 60 MICH. L. REV. 685 (1962). With respect to the Article 9 treatment of priorities, see Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 HARV. L. REV. 838 (1959). These and Mr. Coogan's other articles on Article 9 are highly recommended, indeed essential, reading.

⁸⁹ Section 9-204(3): "Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement." Subsection (4) contains the limitations to this general principle with respect to crops and consumer goods. Section 9-204(3), read in conjunction with other provisions of Article 9, makes entirely clear that the after-acquired property interest is fully perfected (assuming compliance with filing provisions) from the time the property is acquired by the debtor; it is, in the old-style terminology, a "legal," not an "equitable," interest.

some influence on lending patterns.⁹⁰ The present author is inclined to guess that the permissive floating lien, the whole-hog after-acquired property clause, will not be unduly exploited and that the nature of purchase money priority litigation will remain about what it has been under pre-Code law.

B. The Purchase Money Security Interest

The general approach to the question of purchase money priority is thus stated in the comment to 9-312:

Prior law, under one or another theory, usually contrived to protect purchase money interests over after-acquired property interests (to the extent to which the after-acquired property interest was recognized at all). . . . While this Article broadly validates the after-acquired property interest, it also recognizes as sound the preference which prior law gave to the purchase money interest.

The preference given to purchase money is worked out in a series of provisions which deal with inventory collateral, collateral other than inventory, and fixtures.⁹¹ Each of these provisions will require separate examination. The starting point of our discussion, however, must be the statutory definition of the term "purchase money security interest."

Section 9-107 provides:

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

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

⁹⁰ See, e.g., Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 HARV. L. REV. 838, 873-75 (1959); *Memorandum of Robt. Weeks*, [1956] 2 N.Y. LAW REVISION COMM'N REP. (Legislative Doc. No. 65) at 1080. See also the discussion of the controversy about the Article 9 floating lien in Part I *supra*.

⁹¹ For the sake of completeness, reference should also be made to 9-314 on accessions. The draftsmen seem to have assumed that the priority problems with respect to what are called "accessions" ("goods . . . installed in or affixed to other goods") are identical with the priority problems with respect to "fixtures" (goods affixed to real property). Thus 9-314 on accessions is a Chinese copy of 9-313 on fixtures. Whether or not the draftsmen were correct in their assumption, the problem of accessions is one of limited interest which could hardly be expected to excite the passions of even the most fanatical devotee of Article 9. It will not be further discussed in this paper.

1. *Purchase Money Interests in Intangibles.*—Traditionally the only type of purchase money interest which the law has concerned itself with has been the interest in goods. The use of the broad term “collateral” in 9-107 suggests the possibility of such an interest in some types of intangibles. In the nature of things it is almost impossible to conceive of a situation, other than the kind which practitioners refer to as “academic,” in which intangible money claims could be made the subject of a purchase money transaction. A hypothetical *A* might advance money to *B* to enable him to purchase a negotiable instrument from *C*, in which case *A* might be able to claim a “purchase money interest” in the negotiable instrument, but the case is clearly not worth bothering about. On the other hand a bank which acquires a document of title against honor or discount of a draft would seem to have a purchase money interest in the document (as well as in the underlying goods) both while it keeps the document in its possession and after it has turned the document over to its customer, the buyer. Furthermore, the species of property which the Code calls “general intangibles”⁹² could easily become the subject of a purchase money transaction. For example, an inventor transfers his patent (or rights under it) for a sum to be paid in installments, reserving a security interest until paid; or a bank lends money to the *X* Corporation for the purpose of enabling it to acquire the inventor’s patent, reserving a security interest in the patent. It is true that the comment to 9-107 talks only about the normal case of a purchase money interest in goods and that the use of the term “collateral” in the text of the section antedates the introduction of the term “general intangibles.”⁹³ There seems to be no reason, however, why the term “collateral” should have other than its normal meaning; the purchase money concept may thus, in an occasional case, apply to intangible property. In our subsequent discussion, however, we shall, avoiding flights of fancy, restrict ourselves to goods (and, to some degree, documents of title).

2. *Section 9-107(a).*—There is nothing novel in that part of

⁹² Article 9, in addition to dividing all “goods” into four defined categories (9-108), divides intangible claims into six categories. These are chattel paper, documents of title, instruments, accounts, contract rights, and general intangibles (the first three terms are defined in 9-105, the last three in 9-106). “General intangibles” is the residual or catchall category: “any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments.” The neophyte in the mysteries of Article 9 may be relieved to learn that not a great deal turns on this formidable array of definitions.

⁹³ “General intangibles” appears first in the 1957 draft of the Code, while “collateral” is used in the 1952 draft.

the definition which deals with the interest taken or retained by a "seller." Although "seller" is mercifully not subjected to definition, the term is evidently used in contrast with the "person . . . making advances or incurring an obligation" in 9-107(b): he is a seller "in the economic sense," as the old conditional sales cases used to say, not a lender of money.⁹⁴ A seller's security interest qualifies as "purchase money" only to the extent that it serves to "secure all or part of . . . [the] price." There have been occasional attempts to manipulate the conditional sale device in such a way as to make it cover obligations other than the unpaid purchase price of goods sold, but the manipulators have regularly failed in their attempts to square the circle.⁹⁵ In the same manner, it would be impossible for a seller to promote to purchase money rank under 9-107 any obligation which is not unpaid purchase price.

3. *Section 9-107(b)*.—The second branch of the definition includes some interests whose claim to purchase money rank may not have been clear under pre-Code law. It has always been clear that a person taking by assignment from a seller inherited the seller's purchase money interest and presumably it would never have been doubted that a person who, on the buyer's behalf, advances the purchase price directly to the seller has a purchase money interest. It has been less clear whether a person who advances money to the buyer, which the buyer then uses to pay the price, has such an interest; under pre-Code law he could not use the conditional sale device⁹⁶ and the traditional concept of the purchase money mortgage assumes that the mortgage runs in the first instance directly to the seller. Such a person does have a purchase money interest under paragraph (b) of 9-107. It should be noted, however, that the person claiming the purchase money interest will have to show both that his advance was made for the purpose of enabling the debtor to acquire the collateral and that it was in fact so used. To avoid what could turn out to be a complicated proof, a person who wants to be sure of having a purchase money interest will be well advised to make his advance directly to the seller (or by check made out to the seller's order).

⁹⁴ See *Hughbanks, Inc. v. Gourley*, 12 Wash. 2d 44, 120 P.2d 523 (1941).

⁹⁵ See, e.g., *Bucyrus-Erie Co. v. Casey*, 61 F.2d 473 (3d Cir. 1932).

⁹⁶ See, e.g., *Manlove v. Maggart*, 111 Ind. App. 398, 41 N.E.2d 633 (1942). Here money was lent to defendant to buy furniture. At a later date defendant executed to lender a conditional sale contract covering furniture. The court held replevin by lender would not lie since lender never acquired title to furniture. *Hughbanks, Inc. v. Gourley*, 12 Wash. 2d 44, 120 P.2d 523 (1941), was another case of this type.

If he pays over money to a debtor, who at some subsequent time pays over an equivalent sum to his seller, the difficulties of proof, both as to the purpose of the loan and as to its being "in fact so used," are obvious; the longer the time gap between the making of the loan and the acquisition of the property, the greater the difficulties.

There is nothing in the "in fact so used" language which should require courts to apply the artificial techniques which have been invented to "trace" money into and out of bank accounts, but on the other hand there is nothing to keep them from using such techniques. No doubt the language of paragraph (b) assumes the sequence of loan first and acquisition second or assumes that the loan and acquisition take place simultaneously. Suppose, however, that debtor acquires goods on Monday (on unsecured credit from his seller) and secured party advances the price on Tuesday. There is no doubt, we may assume, about the money being "in fact so used"; the question would be whether a loan made after acquisition could be fairly described as one made "to enable" the acquisition. Or, to make the case harder, assume that the buyer pays the price (or writes a check) on Monday and borrows that amount from the secured party on Tuesday. Now there is trouble both on the "to enable" side and on the "in fact so used" side. Nevertheless, in both the hypothetical cases just put a court could reasonably find that the secured party had acquired a purchase money interest. If the loan transaction appears to be closely allied to the purchase transaction, that should suffice. The evident intent of paragraph (b) is to free the purchase money concept from artificial limitations; rigid adherence to particular formalities and sequences should not be required.⁹⁷

4. "New Value" in 9-107(b).—The "person" described in paragraph (b) is evidently one who gives what the Uniform Trust Receipts Act called "new value." Early drafts of Article 9⁹⁸ attempted a comprehensive definition of the term "new value." Drafting difficulties led to the abandonment of the definition, although the term itself was retained. In 9-108, which deals

⁹⁷ Early drafts of 9-107 contained an additional paragraph (c) which envisioned a purchase money interest to the extent of value advanced for the purpose of financing new acquisitions within ten days of the debtor's receiving possession of the new goods even though the value was not in fact used to pay the price. The paragraph was deleted, according to the sponsors, because it extended the purchase money interest too far. See 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE § 9-107. It may be that the sponsors intended to exclude the type of purchase money interests suggested above in the second hypothetical.

⁹⁸ See § 8-105(2) (Oct. 1949).

with the problem of when interests in after-acquired property are to be considered as having been taken for new value or for old debt, there is a reference to a secured party who "makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value . . ." The comment to 9-108 suggests that

the several illustrations of "new value" given in the text [*i.e.*, advances, obligations, releases] . . . as well as the "purchase money security interest" definition in Section 9-107 indicate the nature of the concept. In other situations it is left to the courts to distinguish between "new" and "old" value, between present considerations and antecedent debt.

There is no apparent reason why the concept of "new value" with respect to a purchase money security interest under 9-107 should be any less broad than the concept as it appears in 9-108. Evidently no past consideration or antecedent debt will support the 9-107 purchase money interest. Something must be given, more or less simultaneously with the debtor's acquisition of property, which is intended to, and which does, enable him to acquire the property. The "something" need not be a purse of gold or its present-day negotiable equivalent. Taken literally, 9-107 seems to say that only "making advances" or "incurring an obligation" (which would presumably include a commitment to the debtor to make an advance as well as a binding promise, by way of guaranty or otherwise, to pay the seller) qualify as "value" for the purpose of 9-107. It is suggested, in line with the 9-108 comment, that the references to advances and obligations be taken in 9-107, as they clearly must be taken in 9-108, as merely illustrations of the underlying concept of "new value."⁹⁹

5. *The Debtor's Interest in the Property.* — The interest under paragraph (b), like that under paragraph (a), is restricted to the property acquired by the debtor by virtue of the purchase money loan. Paragraph (a) makes the point simply and directly, while (b) is wordy and circuitous, but there is no reason to doubt their identity of meaning. According to (b), the debtor may use the loan to acquire "rights in or the use of" the property. The idea seems to be that there can be a purchase money interest not only in property in which the debtor acquires rights of ownership but also in that which he is merely entitled to use — for example, in property under a "true" lease which is not intended for security, the "purchase money" loan going presumably to pay the

⁹⁹ Cf. § 9-107, comment.

rental. The concept of a purchase money interest in a leasehold (which would not, of course, be good against the lessor) does credit to the draftsmen's ingenuity but is unlikely to have much impact in the real world.

6. *Simultaneous Purchase Money Interests.*—It seems possible for there to be more than one purchase money interest in the same property. Assume, for example, that a lender makes an advance for fifty per cent of the purchase price, the seller retaining a security interest in the goods for the unpaid balance. The seller would have a purchase money interest under paragraph (a), the lender would have one under (b). Or two lenders could contribute toward the purchase money, each taking a paragraph (b) interest to the extent that his money was "so used." (If the debtor fraudulently procures two loans, each lender believing that he is to receive a purchase money interest, their interests in the purchased property would depend on whose money was "so used": if both lenders had been equally innocent, or equally careless, a fair solution would be to find that each of the victims had contributed money which was used toward the price.) In cases of the type just supposed, there is nothing in 9-107 to give priority to one of the purchase money interests over the other. If both of them attached and became perfected at the same time, they would presumably rank equally.¹⁰⁰ If they attached or became perfected at different times, priority between them would be regulated by 9-312(5).¹⁰¹

¹⁰⁰ Cf. § 9-315 ("Priority When Goods Are Commingled or Processed").

¹⁰¹ A road map to the highways and byways of the Article 9 treatment of priorities will be of great help to the unfamiliar traveler. A sequence of eleven sections (9-306 — 9-316) is exclusively devoted to this subject, and other sections outside the sequence are relevant in some priority situations. Most of these sections state special rules for more or less precisely defined priority situations. In Part VII of this paper we shall be concerned with 9-313, "Priority of Security Interests in Fixtures." Section 9-312 ambitiously undertakes to construct a series of general propositions to cover all cases not subject to one of the special rules stated in the other sections in the sequence. Subsection (1) is a list of other sections which state "rules of priority" in a variety of special situations. These rules of priority, according to § (1), "shall govern where applicable"; that is to say, take precedence in case of conflict, over the provisions of 9-312 itself. Three following subsections of 9-312 take up three special situations: § (2) deals with crop loans, § (3) with purchase money interests in inventory, § (4) with purchase money interests in collateral other than inventory. Finally, § (5) states a general, residual rule for determining priorities in cases not covered by the preceding subsections or by the other sections listed in § (1). (Subsection (6) is ancillary to § (5) and merely states a rule of interpretation for applying the provisions of § (5).) The residual rule of 9-312(5) is that competing interests rank in the order in which they are perfected. It is sometimes referred to as the "first to file" rule, which is accurate if all the interests involved have been perfected by filing.

V. INVENTORY

A. The Code Provisions

Section 9-312(3) provides:

A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and

(b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and

(c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

1. Scope of Priority Rules. — With this provision the Article 9 priority rules move into uncharted territory. Priority disputes between competing financiers of inventory have simply not arisen at the inventory stage, although there has been a considerable amount of litigation between inventory financiers using the trust receipt device and rival claimants to the “proceeds” after the inventory has been sold.¹⁰² To the extent that the factor’s lien acts may have authorized after-acquired interests in inventory, disputes between these and purchase money interests in inventory could, hypothetically, have arisen. However, it has never been clear that the factor’s lien acts contemplated such arrangements and no such practice has ever grown up. Inventory financing, under factor’s lien, trust receipt, or any other device, has always been “new value” financing of the purchase money type. Another hypothetical possibility has been a priority conflict between two or more inventory financiers, each of whom makes a new value (and, at least in intention, purchase money) advance against the same inventory, each having been deceived by the

¹⁰² The cases involved consumer paper such as conditional sale contracts. Typically the purchaser of the paper won over the inventory financier. See Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 *YALE L.J.* 1057 (1954). For the Code’s resolution of the problem, see 9-308.

borrower into thinking that his advance is the only one. Such a case came up at least once under the Uniform Trust Receipts Act and was decided in favor of the entruster whose money happened to go up first.¹⁰³ A harder case, which has never come up, would involve one lender who perfected his interest under the Trust Receipts Act and another who perfected his under a factor's lien act. The almost complete absence of such litigation suggests that the tight control which inventory financiers have learned (or been required) to keep over their debtors' operations has had the desirable result of preventing the situation from arising in the first place.

It is entirely possible that the inventory priority provisions of 9-312(3) will remain a dead letter, and it may be hoped that they will. They will come into play only if long-term lenders yield to the temptation of including the debtor's inventory in their security and if competing inventory lenders, although aware of each other's presence, nevertheless proceed on a "Damn the torpedoes — full speed ahead" approach. Both these contingencies seem as unlikely as they are undesirable.

2. "*Conflicting Security Interest.*" — The "conflicting" interest with which the purchase money interest may come into competition may be (1) an interest claimed under an after-acquired property clause by a secured party who has made no new advance against the property covered by the purchase money interest; or (2) an interest claimed by a secured party who has made such an advance but has done so under circumstances which do not entitle him to a purchase money security interest under 9-107.¹⁰⁴

The purchase money interest wins over the after-acquired property interest if the purchase money interest is perfected no later than the time when the debtor receives possession of the inventory and if the purchase money secured party has complied with the notification requirements of subsection (3).

3. "*Receives Possession.*" — This phrase is evidently meant to refer to the moment when the goods are physically delivered at the debtor's place of business — not to the possibility of the debtor acquiring rights in the goods at an earlier point by identification or appropriation to the contract of sale or by shipment of

¹⁰³ *Donn v. Auto Dealers Inv. Co.*, 385 Ill. 211, 52 N.E.2d 695 (1944).

¹⁰⁴ As pointed out p. 1376 *supra*, it is possible under 9-107 for there to be more than one purchase money interest in the same property. It does not seem, however, that these multiple interests could be in "conflict": they would represent contributions to the purchase price and could never add up to more than 100% of the price. Apart from the rule of 9-312(5) they seem entitled to share ratably, and neither § (3) nor § (4) of 9-312 would apply to the situation.

the goods under a term which throws their risk on the debtor. Normally, the inventory interest would be perfected by filing: the inventory secured party who wishes to be sure that he will be entitled to the 9-312(3) priority will therefore file his financing statement before he makes any advances to the debtor on his incoming goods. A bank which initiated a transaction by making an advance against a bill of lading could argue that its interest was first perfected by its possession of the bill of lading, continued perfected after the bill had been turned over to the debtor under the automatic (21-day) perfection provision of 9-304, and could be thereafter perfected indefinitely by filing after the debtor had received the goods.¹⁰⁵ This is, however, rather an argument to be made in litigation than a policy to be deliberately adopted before the event. The documentary bank, if it is well advised, will, like any other inventory financier, protect itself by an advance filing.

B. Notification

Before the debtor "receives possession," the purchase money secured party must not only have filed (or otherwise perfected his interest) but also have complied with the notification requirement. There is no formal requirement that the notification be signed or even that it be in writing: it must, however, have been "received" by the party entitled to the notification before the goods reach the debtor and must contain the information required by 9-312(3)(c). The notification may evidently be given either before or after the purchase money interest has attached, since it may state that the person giving the notice either "has or expects to acquire" a purchase money interest. Notification given after the debtor receives the goods is ineffective. However, it is possible for the interest to attach before possession is received if the debtor "acquires rights" in the goods under the contract of sale or shipment.¹⁰⁶ In view of the importance of the time sequences under subsection (3), all required notifications should be given well in advance of any particular transaction.

1. *Parties To Be Notified.* — Before making his own filing, the

¹⁰⁵ Under 9-304(5) the bank's interest, initially perfected by possession of the bill of lading, would, without filing, remain perfected for 21 days after the bill had been turned over to the debtor. Section 9-303(2) provides:

If a security interest is originally perfected in any way permitted under this Article and is subsequently perfected in some other way under this Article, without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this Article.

¹⁰⁶ For the rules concerning the "attachment" of a security interest, see 9-204.

purchase money party must search the files and give notice to all parties who are already on file with financing statements which cover the same types of inventory which the purchase money man intends to claim.¹⁰⁷ Unless the central filing provisions of the Article have been completely abandoned in a particular state,¹⁰⁸ it will be sufficient for the purchase money party to check the secretary of state's files.¹⁰⁹ The notification must go not only to all previous filers but to all secured parties whose interests are "known" to the purchase money man. A question could be raised whether the notification requirement applies to previous filings which for some reason are ineffective (because of lapse, failure to comply with formal requirements, filing in the wrong place). Since notification is cheap and easy and law suits are expensive and difficult, the part of wisdom is obviously to notify everyone in sight without regard to the quality of any particular interest.

2. *Period of Effectiveness.* — The notification, once given, is effective indefinitely (although it might be reasonable for a court to apply the 9-403 financing statement lapse provisions to notifications given under 9-312(3): if so, the notification would be effective for five years). That is to say, the notification preserves the purchase money party's priority with respect to not only the immediate transaction but any other transactions subsequently entered into. Article 9 contains provisions which go into elaborate detail on how the files can be cleared of financing statements which no longer represent existing obligations or commitments:¹¹⁰ there are no comparable provisions with respect to 9-312(3) notifications. As in the case of lapse, it would be reasonable to apply these financing statement provisions by analogy to the notifications. For example, a purchase money party who could be required to file a termination statement under 9-404 could also be required to send a notice of termination to recipients of his 9-312(3) notifications.

3. *Notification of Subsequent Interests.* — Once the purchase money party has filed his own financing statement, he is not re-

¹⁰⁷ The official draft of Article 9 contemplates in 9-401(1)(c) that all inventory filing must be made in the office of the secretary of state (even though there may be, in some cases, a requirement for an additional local filing).

¹⁰⁸ This has been done in the Kentucky version of Article 9, except in the narrow category of nonresidents without a principal place of business in the state. KY. REV. STAT. § 355.9-401(1) (Supp. 1962).

¹⁰⁹ There are some situations in which, under 9-103(2), filing with respect to certain types of inventory (mobile chattels held for lease) is to be made in the state in which the debtor's "chief place of business" is located and not in the state or states in which the inventory is located.

¹¹⁰ See § 9-404.

quired to make any further check of the files. As to parties whose filings are subsequent to his own (and who have not notified him of their intention to engage in purchase money transactions) his priority is not subject to the notification requirement, even though the transaction as to which he claims the priority is in its turn subsequent to the later filing. He must, however, notify parties whose interests attach subsequently to his date of filing if such interests are "known" to him. Pre-1956 drafts of 9-312(3) were at least ambiguous on the effectiveness of the notification as to subsequently filing parties; the early drafts could well have been read to mean that the purchase money party had to notify anyone who had filed at the time of any particular transaction, which in the case of a continuing inventory financing arrangement would, theoretically, have required a daily check of the files. The 1956 revision of 9-312 left no doubt that the date of the purchase money party's own filing was the cutoff point, except with respect to subsequent interests of which the purchase money party has actual knowledge.

4. *Problems of Notification Sequence.*—When the purchase money interest comes into conflict with an interest claimed under an after-acquired property clause by a secured party who makes no new advance against the newly acquired property, the notification mechanism seems to work simply and well. The after-acquired property interest is subordinated to the purchase money interest, as it should be. The holder of the after-acquired property interest has, by the notification, been advised of the true situation so that he will not be misled. The requirement that the purchase money interest be perfected not later than the time when the debtor receives possession of the goods is not burdensome, since, from the date of the purchase money man's own filing, his interest will be automatically perfected at or before the possession point.

The mechanism may not work quite so smoothly when the two interests which come into conflict are both new value interests, although the difficulties which can be hypothesized may be more apparent than real. Assume that *A* is engaged in purchase money financing of debtor *X*'s inventory of widgets and has filed a proper financing statement. *A* now receives a proper notification from *B* which states that *B* "has or expects to acquire" a purchase money security interest in *X*'s widget inventory. Must *A* now retire from the field? Or may he send a return notification to *B* (whose interest, it would seem, is now "known" to *A*) which states that *A* plans to go right on acquiring purchase money interests in the widgets? And (at least if he sends the return notification) may

he continue financing *X*, making sure that the money he puts up is "in fact . . . used" to acquire the widgets, so that his interest will be a "purchase money interest" under 9-107 and *B*'s will not? And what if *B* sends *A* a second notification, and so on in an endless series? Section 9-312(3) sensibly makes no attempt to answer these wild-eyed hypotheticals. In such a situation, *A* and *B*, once they have become aware of each other's presence, will be well advised to sit down together and come to an agreement: the notification mechanism will not solve their problems for them. If, in defiance of common sense, they engage in a battle of notifications, they should both be hung. It is not worth anyone's time to try to figure out the priorities between them.

5. *Notification as to Retained Interests After Surrender of Documents.* — Another hypothetical situation, which may deserve more careful analysis than the one just put, has to do with the bank which originally acquires its purchase money interest by making an advance against a bill of lading or other document of title which covers goods which are destined for the buyer's inventory. If the document is negotiable, as it almost always will be, there can be no doubt that, so long as the document remains outstanding and either in the bank's possession or for twenty-one days after the bank has turned it over to the buyer,¹¹¹ the bank's interest will prevail over any other competing interest (except that of a purchaser to whom the document is duly negotiated).

If the bank is reimbursed before it turns over the document, no priority trouble can arise. But suppose the bank, without having been reimbursed, turns over the document with the intention of reserving a security interest in the document (and the goods after the document has been surrendered) until paid. There is no difficulty under 9-312(3) about the bank's interest having been perfected before the debtor receives the goods. But must the bank, before the document has been surrendered, give a 9-312(3) notification to all secured parties who have filed or who are otherwise known to the bank? The filed interest might be held either by a party who claims all the debtor's property under a blanket after-acquired property clause or by the debtor's regular inventory financier who (if he is not notified of the bank's interest) might well be induced to make a new advance on the incoming stock. Unfortunately 9-304, which establishes the documentary interest, makes no cross-reference to 9-312(3).¹¹² Nor

¹¹¹ See note 105 *supra*.

¹¹² Section 9-312(1) provides: "The rules of priority stated in the following sections shall govern where applicable: . . . Section 9-304 on goods covered by

is there anything in 9-312(3) which seems to exempt from the notification requirement the holder of any purchase money interest, however acquired. The answer to the riddle may not be entirely clear, but the bank will be well advised to follow the rule: when in doubt, file (and notify). Thus banks which, under pre-Code law, have carried on the familiar sequence of a letter of credit followed by a trust receipt, should, in shifting over to operations under the Code, both file and notify parties who are already on file.

C. Purchase Money Priority in Proceeds

It is possible that the 9-312(3) priority applies only to the inventory itself and not to the proceeds which result when the inventory has been sold.¹¹³ When the proceeds come into existence, the special purchase money priority, it can be plausibly argued, vanishes and priorities between parties with conflicting security interest in the proceeds would be governed (in the usual case) by the "first to file" rule of 9-312(5),¹¹⁴ except as to a purchaser of chattel paper or instruments entitled to priority under 9-308 or 9-309. If what has just been said is true, the purchase money man's hard-won priority over "conflicting" interests does not survive the moment of sale: at that point any earlier filer (apart from special priorities under 9-308 or 9-309) would resume his "normal" priority over the interest perfected by a later filing. Thus an after-acquired property interest would, as to accounts resulting from the sale of inventory, win over the inventory financier who had put up the money to finance its purchase.

Since an inventory financier normally expects to be paid (and should be paid) from the proceeds, the result suggested in the preceding paragraph seems to be completely wrong and should be avoided if humanly possible.¹¹⁵ The result depends on the con-

documents . . ." Section 9-312(1) apparently means that the rules stated in any of the sections listed prevail over any of the rules stated in 9-312. (See note 101 *supra*.) The reference to 9-304, however, does not seem to carry the bank beyond the documentary stage, during which in any case its priority seems to be assured.

¹¹³ See Coogan, *supra* note 90, at 878 n.134.

¹¹⁴ See note 101 *supra*.

¹¹⁵ The present author has no memory that the question of limiting the purchase money priority to the inventory itself was ever discussed in the course of drafting 9-312(3). If the question was never raised, the present author (in his capacity as a draftsman) is to be censured for not having raised it. If the question was raised and the present author agreed that the priority should be so limited, he is to be censured for not having opposed the limitation. If the question was raised and

struction to be given the term "inventory collateral" in the preamble to 9-312(3): "inventory" is "goods," held for sale or lease; chattel paper, accounts or what not, whatever their origin, are clearly not "goods," hence not "inventory," hence not within 9-312(3). This is fair enough, but an argument contra is also possible. Thus: the accounts or chattel paper are not, of course, goods; they are intangibles. From another point of view, they are "proceeds": money claims which result from the sale of goods on credit. "Proceeds" is not one of the categories into which Article 9 initially subdivides all personal property; it is a term which is introduced at a later point in the Article¹¹⁶ and used for the purpose of explaining to what property an inventory financier's security interest shifts when the original collateral is disposed of. Priorities in the proceeds themselves are regulated in 9-306(5), 9-308, and 9-309. The perfected purchase money security interest in the inventory, which is given priority over "conflicting" interests under 9-312(3), continues perfected in the resulting proceeds, as stated in 9-306(3). There is nothing in 9-312(3) (except the use of the term "inventory collateral") which suggests that priorities established at the inventory stage should be reversed at the proceeds stage. Indeed, it is the general philosophy of the Article that priorities, once established, are not reversed. There is no great difficulty in construing the term "inventory collateral" to mean "inventory collateral including proceeds." If that is done the conclusion follows that the 9-312(3) priority carries over to the proceeds (unless displaced by a new priority under 9-308 or 9-309).¹¹⁷ If the argument just outlined is accepted, there is only one remaining difficulty: the notification mechanism of 9-312(3) requires the purchase money party to notify all parties who have filed financing statements covering "the same items or type of inventory." Assume that *A* has been financing debtor *X*'s receivables, and has filed a financing statement covering accounts but not inventory. If *B*, who now comes in as a purchase money financier of *X*'s inventory, is to get priority over

the present author opposed the limitation but was defeated, he is still to be censured for not having opposed the limitation more effectively.

¹¹⁶ Subsection (1) of 9-306 defines the term "proceeds."

¹¹⁷ Since the statutory text is ambiguous, the only way either the inventory man or the receivables man can be sure of having priority over the other is to get a subordination agreement from him. Whether, apart from contractual subordination, the inventory man or the receivables man should have priority may be a debatable question of policy. What is not debatable is that Article 9, once the policy issue has been resolved, should state a clear rule one way or the other. An amendment to the Article is clearly needed.

A not only as to the inventory but also as to the accounts, he should be required to notify *A*: if he does not notify *A* and *A* is induced to make new value advances on the resulting accounts (as he probably will under the usual revolving credit arrangement), *A* should win. If he does notify *A*, the situation resembles the "wild-eyed hypothetical" discussed a few pages back: *A* and *B* had better sit down and talk things over.

VI. COLLATERAL OTHER THAN INVENTORY

Section 9-312(4) provides:

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

1. *Scope of 9-312(4)*. — Although the subsection sounds as if it covered a great deal of ground, there are only a few situations in which it will have any effect. Other sections, which prevail over 9-312(4), deal with priorities in goods which become fixtures (9-313) or which are installed in or affixed to other goods (9-314) or which are commingled in a product (9-315). Farm products which are grown or raised by the debtor (such as crops or the increase of a herd of livestock) cannot become the subject matter of a purchase money interest, since the secured party's loan does not go directly into their purchase price. Nor could such intangibles as accounts, contract rights, chattel paper, or instruments normally be acquired by the debtor in a purchase money transaction. "Collateral other than inventory" thus comes down to equipment (other than fixtures and accessions), consumer goods (other than fixtures and accessions), farm products which are purchased by a farmer (for example, a new herd of livestock), and (but this is almost on a hypothetical level) general intangibles.

2. *Conflicting Security Interests*. — As we pointed out in our discussion of 9-312(3) there are two types of interest with which the purchase money interest may "conflict": after-acquired property interests and new value interests which do not technically qualify as purchase money interests under the 9-107 definition. Section 9-204(4)(b) in effect rules out after-acquired property interests in consumer goods (other than accessions), so that, with respect to such goods, the only "conflicting" interests which can be imagined are two new value interests, of which one qualifies

as a purchase money interest while the other does not (the consumer debtor has fraudulently induced two lenders to make loans against his new car, television set, or what not).

Most of the pre-Code priority litigation in this area had to do with equipment and consumer goods which had become (or were assumed to have become) fixtures. We may assume that this will continue to be true under Article 9, so that the great bulk of the cases will fall under 9-313 on fixtures and not under 9-312(4). The principal novelty under the Code will be that the dividing line between fixtures and loose property will become more important, since the conditions of priority are not identical under 9-312(4) and 9-313.¹¹⁸ In pre-Code litigation the dividing line was not sharply or clearly drawn; the Code is not, in this respect, necessarily an improvement.

3. *Notification.*— Unlike 9-312(3) on inventory, subsection (4) does not require the purchase money party to notify other secured parties of his interest. Thus the competing interests which may be subordinated to the purchase money interest do not receive the useful warning to which they are entitled in the inventory case. The comment briefly remarks that “since an arrangement for periodic advances against incoming property is unusual outside the inventory field, no notification requirement is included in subsection (4).” This may well be true, but the situation of the secured party who makes optional or obligatory “future advances” is worth considering. In general the future advance lender is given priority (under 9-312(5)) over lenders who make intervening advances. That is to say, if *A* makes an advance (to be secured by all the debtor’s property) on February 1, *B* makes a similar advance on March 1, and *A* makes a second advance on April 1, *A* has priority over *B* not only as to the February 1 advance but as to the April 1 advance. The rule of 9-312(5) is, however, expressly made subordinate to the rules stated in the other subsections of 9-312. Thus if *B*’s March 1 advance gave him a purchase money interest, which he perfects, *A* would be subordinated, with respect to the property subject to the purchase money interest, as to both the February 1 and April 1 advances. It is not suggested that this result is wrong, but it is clear that *A* cannot make his April 1 advance with any assurance that 9-312(5) gives him priority over security interests which represent intervening advances. Nor can he tell by checking the files whether any such security interests are entitled to the pur-

¹¹⁸ For the conditions of priority under 9-313 see Part VII *infra*.

chase money priority: a financing statement on file would not in all probability disclose the fact that a purchase money interest was involved. He can inquire from parties who have filed financing statements against his debtor whether they claim purchase money interests, and while no provision of Article 9 expressly requires such parties to answer such an inquiry, it is reasonable to assume that they will give the requested information. (But of course the fact that *B* thinks he has a purchase money interest does not necessarily mean that he has one.) The upshot of the discussion is that a lender, before agreeing to make future advances, should ponder the possible effect of 9-312(4).

4. *The Grace Period for Perfection.*— The one condition for priority under 9-312(4) is that the purchase money interest be perfected “at the time the debtor receives possession of the collateral or within ten days thereafter.” The meaning of “receives possession” has been discussed in connection with 9-312(3).¹¹⁹ Under subsection (3) the purchase money interest, to be entitled to the priority, must be perfected not later than the time the debtor receives possession; under subsection (4) there is an additional ten-day grace period for perfection. The history of the ten-day provision is curious. In pre-1956 drafts, the grace period was allowed both for inventory and noninventory interests. In the 1956 recommendations the grace period was abolished for both types of interest (so that the condition for priority under both subsection (3) and subsection (4) was perfection “at the time the debtor receives possession of the collateral”). In the 1958 draft the grace period was restored to subsection (4) (but not to subsection (3)) with the explanation that “the change . . . conforms to the business practice of filing after delivery in cases of purchase money security interests in collateral other than inventory.”¹²⁰ Thus, if the debtor insists that he must have the goods today, the purchase money financier can deliver them, without sacrificing his 9-312(4) priority, provided he perfects within the following ten days.

Section 9-301(2) also gives a ten-day grace period for filing with respect to purchase money interests; if the purchase money secured party files within ten days after the debtor comes into possession of the collateral, “he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.” Under 9-301(2), filing during the grace period does not give protection

¹¹⁹ See p. 1378 *supra*.

¹²⁰ Section 9-312, comment (Supp. 1958), at 17.

against pre-filing buyers and purchasers (other than transferees in bulk) who buy or purchase without actual knowledge of the purchase money interest. When 9-312(4) is added to 9-301(2), the purchase money party who files during the grace period is protected not only against bulk transferees and lien creditors but against the class of "purchasers" who hold competing or "conflicting" security interests. The 9-312(4) grace period can lead to results which may seem, at least superficially, odd. Assume that fraudulent debtor *X* induces both *A* and *B* to make advances on the security of a new machine which *X* is about to acquire; neither *A* nor *B* is aware of the other's presence and each expects to end up with a purchase money interest in the machine. Whether either of them does depends on whether *X* uses the funds advanced to pay the purchase price. Assume that *X* uses *A*'s money: *A* now has the purchase money interest and *B*, although he has given new value, does not. If *A* files within ten days after *X* gets the machine, 9-312(4) gives him priority over *B* even though *B* has filed first or *A* otherwise learns of *B*'s interest before his own filing. Indeed, since the 9-312(4) priority appears to be absolute, *A* would win even though he had known at the time of making his loan that *B* had also made a loan with the expectation of acquiring a purchase money interest. (If it appeared that *A* had somehow conspired with *X* for the purpose of defrauding *B*, there might be an action in tort in favor of *B*, but the chances of winning such an action would probably not seem bright to many lawyers.) Of course, the unhappy situation just discussed exists under Article 9 without regard to the 9-312(4) grace period: a parallel case can be put under 9-312(3) between two inventory financiers, but the grace period aggravates the situation.

VII. FIXTURES

Section 9-313 deals with priorities between chattel security interests in fixtures and interests in the real estate of which the fixtures have, conceptually, become a part.¹²¹ The section is not

¹²¹ The most notable contribution to the study of the Article 9 treatment of fixtures, under 9-313 and related sections, is Coogan, *Security Interests in Fixtures Under the Uniform Commercial Code*, 75 HARV. L. REV. 1319 (1962). Mr. Coogan concludes, after having established an irrefutable case, that 9-313 is seriously defective in several respects and should be redrafted in connection with a reconsideration of the entire fixture problem. Mr. Coogan does not dispute the policy which 9-313 was designed to carry out; his quarrel is with the method adopted to achieve the desired result and his point is that the subject of fixtures is a good deal more complicated than the draftsmen of 9-313 conceived it to be. One part of

restricted to purchase money interests. However, the financing of fixtures has traditionally been carried out on a purchase money basis: a nonpurchase money interest in fixtures, even if it were theoretically possible, has never been known under pre-Code law. While 9-313 is broadly drafted to cover any type of security interest which may attach to goods which are or become fixtures, there can be no doubt that the interests involved will be, in fact, purchase money interests, of the type which under pre-Code law were evidenced by conditional sale contracts and purchase money mortgages. We are thus justified in treating 9-313 as a special instance — indeed, the most important single instance — of the general rule of purchase money priority. The only practical importance of the fact that 9-313 is not technically restricted to purchase money interests seems to be this: the holder of the fixture security interest does not have to show, as a condition of his priority, that he has a “purchase money security interest” under 9-107; that is, if he is a lender, as distinguished from a seller, he does not have to show that his funds were “in fact . . . used” to pay the purchase money.¹²²

A. The Importance of Bolts and Screws in the Code

1. *The Distinction Between Goods Merged in and Separable From the Real Estate.* — In general 9-313, adopting the majority rule under pre-Code law, gives priority to the chattel interest over antecedent interests in the real estate. It has always been assumed that, even though the basic proposition of priority for the chattel fixture interest is accepted, there must be a limit beyond which goods, when incorporated in a structure, so lose their identity that they become for all purposes part of the real estate, cannot be separately financed as fixtures, and will automatically feed the lien of a real estate mortgage. Under pre-Code law this limiting

Mr. Coogan's analysis, which is directly relevant to the question of priorities in fixtures, is discussed pp. 1394-96 *infra*.

¹²² In our discussion of the purchase money priority sections, we considered the case of two lenders induced by a fraudulent debtor to make advances, each expecting to receive a purchase money interest in property to be acquired by the debtor. Which one gets the purchase money interest depends on whose funds the debtor uses to pay the purchase price; whoever ends up with the purchase money interest has priority under 9-312(3) and (4). If the hypothetical is reconsidered in the context of fixtures, it would seem that both the lucky lender who gets the purchase money interest and his less fortunate colleague are entitled to the 9-313 priority over the real estate interests. As between themselves, priority would probably continue to be determined under 9-312(4), and the purchase money interest would win if duly perfected (by filing, since fixtures are involved, with the real estate records under 9-401).

point was sometimes sought to be located under the formula of "material injury to the freehold": if removal of goods would cause "material injury" they could not be separately financed as chattels. Justice Holmes once suggested, more directly, that structural materials — "bricks or beams in a building" — were the sort of things which could not be divorced from the real estate.¹²³ Section 9-313, abandoning the "material injury to the freehold" formula, follows, albeit somewhat verbosely, the Holmesian line:

The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, brick, tile, cement, glass, metal work and the like and no security interest in them exists under this Article unless the structure remains personal property under applicable law.

The "unless" clause at the end of the sentence is a bow to the odd cases which hold that a building remains personal property.¹²⁴ If it does, then apparently there can be a security interest "under this Article" even in the structural materials; it does not follow, however, that, in such a case, the "rules of this section" would apply, since those rules deal only with real estate interests. The case would presumably fall under 9-314 on "accessions" or under the general priority rules of 9-312.

2. *The Practical Unimportance of the Distinction.* — Given the infinite variety of situations which the technology of building can offer for decision, no statutory formula could be devised which would clearly locate the dividing line between goods which are to be considered as having been for all purposes swallowed up in the real estate and those which remain subject to separate financing as chattels apart from the real estate. Fortunately, under the approach taken in 9-313, it is not really important to know where the dividing line is and the Holmesian sentence just quoted is, in truth, an unnecessary, although harmless, flourish. Under 9-313(5) the secured party must reimburse any encumbrancer or owner of the real estate (other than the debtor himself) "for the cost of repair of any physical injury" to the structure caused by his removal of the fixtures. Unless his fixtures are of the type described in the first sentence of 9-313(1), he has a theoretical right to tear down the structure, if that is the only way in which

¹²³ See p. 1353 *supra*.

¹²⁴ See, e.g., *Royal Store Fixture Co. v. Patten*, 183 Pa. Super. 249, 130 A.2d 271 (1957) (frozen custard stand); *Thompson Yards, Inc. v. Bunde*, 50 N.D. 408, 196 N.W. 312 (1923) (storage shacks).

he can remove his property; however, if he does tear down the structure, 9-313(5) requires him to rebuild it. Thus, without regard to 9-313(1), 9-313(5) makes it clear that as a practical matter the only goods as to which the 9-313 priority is worth having are goods which can be removed without seriously damaging the structure. Thus we need not concern ourselves with refined speculations whether such things as air conditioning systems and electrical connections built into the walls, removable only by tearing the walls down, are, or are not, "like" lumber, brick, tile, and so on.

B. No Code Definition of Fixtures

Like its predecessor, section 7 of the Uniform Conditional Sales Act, 9-313 makes no attempt to determine which goods become fixtures and which do not (except, of course, that the structural materials described in the first sentence of subsection (1) are conclusively determined to be fixtures). Apart from these enumerated materials "the law of this state other than this Act determines whether and when other goods become fixtures." In the pre-Code priority litigation in states which adopted the majority rule (the purchase money interest in fixtures has priority over an antecedent real estate interest), the distinction between fixtures and nonfixtures was taken rather lightly: if the purchase money interest won as to fixtures, it would win, a fortiori, as to nonfixtures; therefore, for the purposes of the case, the goods, however loosely attached, could be assumed to be fixtures. In so-called Massachusetts rule states (where, doctrinally, the priority was denied) the distinction took on importance as an escape from the announced rule; by holding, say, oil furnaces not to be fixtures, the court could give the purchase money interest the priority which Massachusetts doctrine apparently denied it.¹²⁵ Article 9 establishes the purchase money priority both as to fixtures and nonfixtures, so that the distinction might seem to be irrelevant as to the basic issue even in such a state. There are, however, two points at which the distinction is important.

1. *Importance of the Distinction Between Fixtures and Nonfixtures.* — (a) *Conditions of Priority.* — The first point goes to what may be called the conditions of priority. Section 9-313(2) provides that:

¹²⁵ For a discussion of the difficulties which 9-313 creates with respect to the determination of what goods are fixtures in a minority rule state, see p. 1394 *infra*.

A security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4).

Subsection (4) requires that the security interest be perfected (*i.e.*, filed) for protection against certain real estate interests which accrue after the security interest has attached. There is, therefore, no requirement that the fixture security interest be perfected (filed) for protection against real estate interests which are in existence at the time the security interest attaches; the priority is automatic and runs in favor of both the unperfected and the perfected security interest. In not imposing a perfection requirement with respect to preexisting interests, Article 9 follows pre-Code law, decisional and statutory, in all the majority rule states.¹²⁶ If, however, the goods, when attached, do not, under the local law, become fixtures, then the relevant priority section of the Code is 9-312(4), not 9-313(2). Under 9-312(4) there are two conditions for priority which do not exist under 9-313(2).¹²⁷ The first is that the interest be technically a purchase money security interest (but it may be safely assumed that in almost all cases this requirement will be met). The second is that the security interest be perfected not later than ten days after the debtor receives possession of the collateral. (It is not clear why there should be a perfection requirement as to nonfixtures.) Thus an unperfected interest which will win if the goods are fixtures will lose if the goods are not fixtures. Therefore in any situation where the secured party has failed to perfect within the 9-312(4) ten-day period, it may be anticipated that he will argue that the goods are fixtures, in order to escape into the safe haven of 9-313(2), while his opponent (who will be, as the footnote indicates, the holder of a mixed mortgage covering the debtor's real and personal property) will make the contrary argument.¹²⁸ Decision will then turn on what the non-Code law of fixtures hap-

¹²⁶ The idea that the purchase money interest is not subject to filing or recording requirements as a condition of perfection against preexisting interests goes back to the first of the nineteenth-century cases which established the purchase money priority in the context of railroad finance. See the quotation from Justice Bradley's opinion in the *New Orleans Railroad* case, p. 1339 *supra*. For the statutory adoption of the rule see the discussion of UCSA § 7, p. 1359 *supra*.

¹²⁷ Section 9-312(4) has been extensively discussed in Part VI *supra*.

¹²⁸ It may be assumed that the goods involved are (in Code terminology) either consumer goods or equipment; in either case, if they are not fixtures, 9-312(4) applies. They will certainly not be inventory, so that 9-312(3) will not apply. Of course, if the interest with which the Article 9 security interest competes is merely an interest in realty, which does not extend to personalty, then the

pens to be in the forum. The situation has one notably odd aspect: the pre-Code fixture cases will turn out, almost without exception, to involve situations in which it has been to the advantage of the real estate interest to prove that the goods were fixtures; now, by reason of the curious discrepancy between 9-312(4) and 9-313(2), the roles of the parties are reversed. The law of fixtures has never been noted for its consistency; it would be folly to predict results in the situation now hypothesized. A court convinced of the wisdom of the purchase money priority might be inclined to throw the case under 9-312(2); a court which thinks well of the perfection requirement might incline to the opposite solution.

(b) *Reimbursement for Damage in Removal.*—The second point at which the fixture-nonfixture distinction becomes relevant has to do with the secured party's right of removal. If the goods are fixtures (but not of the type described in the first sentence of 9-313(1)) he may remove them but must reimburse real estate encumbrancers "for the cost of repair of any physical injury" to the structure caused by the removal. (Pre-Code law was not entirely clear on this point, but it seems to have been generally assumed that there was no such duty of reimbursement: the right to remove the fixture was absolute, if it existed at all.¹²⁹) If the goods, although somehow attached to the real estate, are not fixtures, no provision of the Code requires the secured party to pay for incidental damage done in removing them: it may be assumed that there is no such duty. It is easy to imagine cases where the secured party, to avoid the reimbursement requirement, can argue plausibly that the goods are not fixtures, while the real estate encumbrancer can, with equal plausibility, argue that they are. In this situation, at any rate, the parties occupy their normal roles, instead of reversing them as in the 9-312(2) to 9-312(4) switch previously discussed.

priority question under 9-312(4) does not arise. The creditor, who holds the real estate mortgage, could not, in that capacity, defeat an unperfected security interest. He would (9-301) have to acquire a lien on the goods, without knowledge of the security interest and before it was perfected. The situation discussed in the text will arise, therefore, only when the holder of the real estate mortgage also claims a security interest in the debtor's personal property — *i.e.*, the standard form of corporate "mixed" mortgage which covers all the corporate debtor's assets, real and personal, with an after-acquired property clause as to the personal property. Since this type of mortgage is not used with respect to residential property and since in any event the Code (9-204) almost completely invalidates after-acquired property interests in consumer goods, the text discussion is relevant only with respect to commercial and industrial (typically corporate) property.

¹²⁹ See p. 1265 *supra*.

2. *The Inability of "Minority Rule" State Law to Provide an Adequate Concept of "Fixture."* — A recent discussion in this *Review* has tellingly pointed out the difficulties of operating the mechanism of 9-313 in states which did not, before the enactment of the Code, accept, as a matter of doctrine, the so-called majority rule of purchase money priority with respect to goods so affixed to the land or to buildings as to become realty but, nevertheless, to continue to be severable without causing "material injury to the freehold."¹³⁰ In majority rule states — the rule was sometimes associated with New York and was adopted in section 7 of the Uniform Conditional Sales Act — there was, so to say, a threefold division of property: straight real property, straight personal property, and an intermediate class which, although affixed and thus for most purposes real property, could nevertheless be severed and could thus be separately financed as chattels. In such states the term "fixture," used without definition in 9-313 and other sections of Article 9, will cause no great difficulty: it will be taken to refer to the intermediate class of property recognized under the pre-Code law, decisional or statutory. On the other hand, in the minority or Massachusetts rule states, the situation is quite different. In such states, the pre-Code law recognized only straight real estate and straight personal property, without any intermediate class. In such states the term "fixture" referred to materials which had been wrought into a structure and could no longer be severed from it. As the Ohio court put it: "A removable fixture as a term of general application, is a solecism — a contradiction in words. . . . A fixture is an article which was a chattel, but which by being physically annexed or affixed to the realty, became accessory to it and part and parcel of it."¹³¹ We suggested in our earlier discussion that in Massachusetts, and no doubt in other states thought to adhere to the minority rule, the purchase money priority was to a considerable degree maintained, despite the announced doctrinal position, by holding that goods, no matter how irrevocably wrought into a structure, nevertheless remained personal property.¹³² That is, goods which in New York were held to be "fixtures" (and therefore removable) were held in Massachusetts to be not fixtures but

¹³⁰ Coogan, *Security Interests in Fixtures Under the Uniform Commercial Code*, 75 HARV. L. REV. 1319 (1962). For a fuller description of the position taken by Mr. Coogan, see note 121 *supra*. The author acknowledges his indebtedness to Mr. Coogan with respect to the ensuing discussion.

¹³¹ *Teaff v. Hewitt*, 1 Ohio St. 511, 524, 527 (1853), quoted by Coogan, *supra* note 130, at 1344.

¹³² The Massachusetts rule is discussed pp. 1355-58 *supra*.

“personalty” (and therefore removable). The result was the same but the semantics were curiously different.

The Code has now been adopted (as the UCSA was not) in such minority rule jurisdictions as Massachusetts and Ohio. Lawyers in such states now find themselves in the painful situation of working with a statute which uses the term “fixtures,” without definition, to mean something quite different from the meaning of the same term in the state’s pre-Code law. To make matters worse, 9-313(1) provides that “the law of this state other than this Act determines whether and when other goods [*i.e.*, other than the structural materials referred to in the first sentence of 9-313(1)] become fixtures.” In transactions carried out under Article 9, a good deal turns on whether goods which are in various ways attached to land and buildings are or are not “fixtures.” Filing will be made in one place if they are and in another place if they are not.¹³³ And with respect to the priority of purchase money (or new value) interests over after-acquired property interests, the conditions of priority, as we have seen, are different under 9-313 from those which apply under 9-312(4).

If lawyers and judges in states which followed the minority rule before enactment of the Code turn to their pre-Code precedents to determine what are 9-313 fixtures — as 9-313 itself invites them to do — the result will be chaos. Section 9-313 is workable only against the background of the state of law which existed, pre-Code, in the majority rule states. If 9-313 is not amended, the only way of avoiding chaos is for the courts to hold that the enactment of 9-313 also, in some mysterious way, abrogated the state’s pre-Code case law on what are fixtures and substituted for it the case law of such a state as New York. This is asking quite a lot of any court.

3. *Amendment of 9-313 as a Solution.* — A more plausible escape from chaos is the amendment of 9-313. It is appropriate that the demand for a redrafting of the section should have originated in Massachusetts. One possibility is the inclusion in 9-313 of a statutory definition of “fixtures.” The draftsmen of the section, their thought focused on the majority rule states, avoided such a definition on the grounds that it was not absolutely necessary (as it was not in the states they were thinking of) and

¹³³ Under 9-401 filing with respect to goods which “are or are to become fixtures” is to be made “in the office where a mortgage on the real estate concerned would be filed or recorded.” Filing with respect to goods which are not fixtures or not meant to become fixtures would be made with separate chattel records, local or statewide or both. For some of the difficulties posed by the filing provisions see Coogan, *supra* note 130, particularly at 1334-38.

that it would be extremely difficult to draft (as indeed it would be). Conceivably, reconsideration of the fixture problem will suggest a completely different approach from that now embodied in 9-313.¹³⁴ If such a different approach is not discovered, the only solution (at least for the minority rule states) will be the inclusion of a fixture definition — whose drafting will no doubt prove to be as difficult as the original draftsmen had anticipated.

C. *New Developments in 9-313(3)*

1. *The Postaffixation Security Interest.* — Section 9-313(3) validates a type of security interest in fixtures which had been, for all practical purposes, unknown to pre-Code law: that is to say, an interest which “attaches to goods after they become fixtures.” Under subsection (3) such an interest is “valid against” (*i.e.*, has priority over) subsequent interests in the real estate provided the fixture interest is perfected (filed) before the subsequent interest attaches or in any event if the subsequent encumbrancer has knowledge of the fixture interest. However, the postaffixation security interest

is invalid against any person with an interest in the real estate at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as fixtures [*i.e.*, executed a subordination agreement].

It seems unlikely that there will be many lenders who will be tempted to experiment under 9-313(3). The subsection might prove helpful in the odd case where the security interest (because of delay in executing the security agreement or in the giving of value) did not, under 9-204, “attach” to the goods until after they were in place.¹³⁵

2. *A Clarification of “Subsequent Purchaser.”* — Section 7 of the Uniform Conditional Sales Act, like 9-313, required filing as a

¹³⁴ “Completely different,” that is to say, in the mechanism adopted; presumably the basic policy decision which 9-313 was meant to implement — priority for the new value chattel interest over prior and subsequent real estate interests — will not be questioned.

¹³⁵ As Coogan points out, *supra* note 130, at 1333-38, there will be cases in which at the time a chattel security interest attaches to goods it will not be known to what land they will subsequently be affixed or, indeed, whether they will ever be affixed. In such a case a secured party might not learn of a subsequent affixation until after the goods have become fixtures. If he is at that time required to make a filing with the realty records (see 9-401(1)(b)), the filing will, of necessity, be made after the affixation. Mr. Coogan, in the passage cited, reviews some of the problems which arise in this complicated situation.

condition of protection against "subsequent purchasers of the realty." Section 7 did not go into detail on who were "subsequent purchasers" and there was a fair amount of litigation, particularly with respect to purchasers at foreclosure sales where the mortgage being foreclosed was not itself subsequent to the conditional sale.¹³⁶ Section 9-313(4) supplies the detail which was lacking in section 7. The subsequent interests to which the unperfected fixture interest will lose are described in subsection (4) as being those acquired by purchasers "for value of any interest in the real estate," creditors with liens "on the real estate . . . obtained by judicial proceedings," and creditors with "a prior encumbrance of record on the real estate to the extent that . . . [they make] subsequent advances." Such interests prevail

if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected.

The final sentence of the subsection provides that: "A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section." Thus a prior mortgagee cannot promote himself to the status of "subsequent purchaser" by buying the real estate on foreclosure, even in the unlikely event that he bought without knowledge of the fixture interest and on the assumption that the fixtures were unencumbered.

3. *No Solution of the "New for Old" Problem.* — Section 9-313 is less helpful on another issue which has given some trouble under pre-Code law. This is what might be called the "new for old" issue:¹³⁷ on installation of new equipment (subject to the fixture interest) old equipment (subject to a preexisting mortgage) is removed. The removal, clearly, is wrongful as to the mortgagee. An occasional case has suggested that without regard to the relative values of the new and old equipment, the fixture party's participation in or knowledge of the wrongful act should strip him of the priority to which he would otherwise be entitled. Section 9-313 ignores the problem, so that the pre-Code precedents may have a continuing vitality.

4. *The Abolition of the New Jersey and Pennsylvania Deviations.* — Section 9-313 was drafted with anxious care so as to make crystal clear that neither the New Jersey Institutional

¹³⁶ See pp. 1365-66 *supra*.

¹³⁷ See pp. 1366-67 *supra*.

Doctrine nor the Pennsylvania Plant Mortgage Doctrine was tenable under the Code.¹³⁸ Subsection (5) on the right to remove requires the secured party to reimburse the holders of interests in the real estate (other than the debtor) "for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity to replace them." Thus, the refrigerating units can be removed from the apartment house, the elevators from the hotel, the organ from the church, the essential machinery from the factory: it makes no difference that the institution or enterprise, thus crippled, will be unable to carry out its sacred or profane function. The only condition on the right to remove is the obligation to repair "physical injury," for which "adequate security" may be demanded in advance by any party entitled to reimbursement; on failure of the fixture party to provide "adequate security," the party entitled would unquestionably have a right to a restraining order forbidding the removal until the security was posted.

D. The Construction Mortgage Exception Under the Code

In our discussion of pre-Code law, the suggestion has been put forward that the major exception (itself sometimes disguised as a "minority rule") to the normal priority of the purchase money interest involved the conflict between such an interest and another substantially contemporaneous new value interest, such as a construction mortgage. We also noted that section 7 of the Uniform Conditional Sales Act gave an apparently absolute priority to the purchase money fixture interest; research revealed no case in which any court had engrafted a "construction mortgage" exception on the section 7 priority, although it is also true that no case was found from which it appeared that the possibility or desirability of such an exception had been argued to the court.¹³⁹ Article 9, both in the purchase money priority subsections of 9-312 and in the fixture provisions of 9-313, follows section 7 in giving an apparently absolute priority to the purchase money or fixture interest. Indeed, as we have pointed out more than once, in a contest between two contemporaneous new value interests, Article 9 seems to award the priority to the one that happens to qualify

¹³⁸ On the New Jersey doctrine, see pp. 1360-61 *supra*; on the Pennsylvania doctrine, pp. 1361-63 *supra*.

¹³⁹ See *Greene v. Elkins*, 134 Misc. 118, 235 N.Y. Supp. 438 (Sup. Ct. 1929), digested in note 86 *supra* and accompanying text.

technically as the purchase money interest under the not uncompllicated language of 9-107.

If the Article is taken as it reads, there seems to be no chink through which the common law exception can creep to establish itself. And yet the exception seems to have much merit. Presumably the policy which underlies the rule of purchase money priority is that the "new money" should win over the "old money" because the new money has financed the acquisition of property which was never part of the original security, which was not counted on by the old money interest, and which will increase the earning power of the debtor enterprise. The case for preferring the purchase money interest becomes manifestly less compelling when both the competing interests have put up "new money"; when it appears that the property involved was supposed to be the security for the loan which is not technically the purchase money loan; when, finally, the result of following the normal priority rule may be to leave the nonpurchase money interest either with no security at all or with security which would never have supported the loan if the true situation had been known.¹⁴⁰

A bank which makes a construction loan can (and should) protect itself against the diversion of its funds and the threat of unpaid suppliers with purchase money claims by hold-back arrangements under which the loan will be paid down in installments as the construction progresses, with the final installment not due until completion. But bondholders represented by an inactive trustee are in no position to look after their own interests; nor are the passive investors in the several types of real estate syndication which became popular during the 1950's, some of which bore a suspicious resemblance to the trickier methods of high finance which were practiced during the 1920's.¹⁴¹

Section 1-103 of the Code provides:

Unless displaced by the particular provisions of this Act, the principles of law and equity . . . estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

This amiable truism must have some meaning. We have often been reminded that a bankruptcy court and, perhaps to an even

¹⁴⁰ If the Code authorities undertake a reconsideration of the Article 9 fixture treatment (see note 121 *supra* and text at p. 1395), the merits of the "construction mortgage" exception to the rule of purchase money priority might well be taken into account.

¹⁴¹ For an excellent description of the syndication practices, see Berger, *Real Estate Syndication: Property, Promotion, and the Need for Protection*, 69 *YALE L.J.* 725 (1960).

greater extent, a reorganization court is a court of equity, with broad powers and flexible procedures. The priority provisions of the Code seem in general to have been soundly conceived. In an appropriate case a court with equity powers might well look to the spirit of the Code, which is generous, instead of to its letter, which is occasionally rigid and restrictive.

VIII. CONCLUSION

At the outset of our discussion we proposed to review the Article 9 provisions on the purchase money priority in the light of an historical inquiry into the case-law origins of the priority. From the confrontation of Code and pre-Code law, we may conclude that the Article 9 treatment of the problem, while soundly inspired, was not entirely successful in its detail. There is difficulty with section 9-313 on fixtures, particularly in states which adhered to the minority rule before enactment of the Code. There are unexplained and unexplainable discrepancies between the conditions for priority under the fixture section and under the general priority rules of 9-312. There is doubt whether the purchase money priority in inventory under 9-312(3) does, or does not, carry over to the proceeds. The definition of "purchase money security interest" in 9-107 has elements of artificiality: the draftsmen might have been better advised if they had abandoned this technical construct altogether.

It is easy to exaggerate the importance of these and other defects. We have a long history of living with imperfect statutes, which the courts have gradually construed into a sort of sense. Indeed the statutory imperfections themselves may have their uses: the ambiguities, the contradictions, the unresolved or imperfectly perceived issues of policy facilitate the performance by the courts of their necessary task of making yesterday's statute responsive to today's needs. There is no reason to anticipate any more difficulty in living with these and other provisions of Article 9 — or of the Code as a whole — than there has been in living with some of the more obscure provisions of the Negotiable Instruments Law, the Uniform Sales Act, or the Uniform Trust Receipts Act.

One of the most difficult problems which the sponsors of the Code must face is what to do about the defects which have been, and will continue to be, revealed in its structure by analytical study and by experience in Code states. While the Code is still pending legislation in many states there is a natural temptation

on the part of its supporters to play down its minor vices and to trumpet forth its major virtues. The present author strongly supports the enactment of the Code in all states: with all faults, it is a considerable improvement over the pre-Code law in any state. It may be hoped that within the next few years most or all of the non-Code states will adopt the Code. At that point it may become possible to consider the problem of what to do about the Code's defects with fewer political overtones than now make themselves heard.

The history of uniform legislation in this country suggests that the amendment of uniform acts, once they have been widely passed, is extremely difficult to control. No amendments to the N.I.L. were ever proposed by the National Conference of Commissioners on Uniform State Laws: the N.I.L. itself, however, was widely amended state by state. Indeed, so many states amended so many sections of the N.I.L. in so many different ways that only by courtesy could that celebrated statute be referred to as a Uniform Act. The N.I.L. experience tells us that, if the Code sponsors do nothing to remedy defects, the states will take on the job themselves, with results which may range from the untoward to the disastrous.

Amendment of a complicated statute is a complicated process, not to be undertaken lightly. Our discussion of the purchase money priority problem has, it is hoped, shown that amendment of Article 9 in this respect will not be a Saturday afternoon's job for a hastily assembled committee. In the drafting of statutes there is a constant temptation to plug up the holes, as they are discovered, by adding new language. In the process the statute becomes verbose and incomprehensible. Simplicity and accuracy take a great deal of time. It would be desirable that, over the next several years, a serious study of the Code be undertaken with a view to recommending uniform amendments of the present official text. Such a project, appropriately publicized by the sponsors, might well preserve the Code from the fate which overtook the N.I.L. The worst things that could happen would be for the official Code line to become that the Code is the one perfect statute which the world has seen or, alternatively, for the sponsors to respond to *ad hoc* criticisms with *ad hoc* amendments. The pretense of perfection is perhaps absurd enough to be harmless. The real harm can be done by the overready provision of oversimplified solutions to underanalyzed problems.