The Effect of the Uniform Commercial Code on Secured Financing Transactions and Bankruptcy

Max Schwartz
THE EFFECT OF THE UNIFORM COMMERCIAL CODE ON SECURED FINANCING TRANSACTIONS AND BANKRUPTCY

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In view of the adoption of the Uniform Commercial Code by the State of New York, which goes into effect on September 27, 1964, it is well that the Bar be aware of the effect of the provisions of the Code on secured financing and be prepared and informed in the handling of security transactions under the Uniform Commercial Code and the Bankruptcy Act.

The Uniform Commercial Code has been adopted at the present writing by 27 states, including the neighboring states of Pennsylvania, New Jersey, Connecticut and Massachusetts.¹

The Code was drafted with the intent that it be uniform in the states adopting its provisions and with the underlying thought and hope of its drafters that the interpretation and construction of its provisions in one state would be followed in other jurisdictions.

While actual uniformity has not yet been realized, nevertheless the courts have expressed the thought and the admonition that the courts of all states should keep in mind the spirit and object of the Uniform Laws, and give the language of the Uniform Commercial Code a common

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construction so that the courts of the various states might come to the same conclusion.\(^2\)

The Uniform Commercial Code is of tremendous scope, covering all phases of commercial law. It is rapidly being adopted by the states throughout the Union and hence it is imperative that there be uniformity of interpretation and application of the provisions of the Code, in order that there may be certainty with respect to the construction of its provisions in litigation respecting all elements of secured transactions, particularly where there are innovations introduced intended to remedy the defects, weaknesses and gaps in the various statutes that have covered security transactions heretofore.

The initial decisions interpreting the Code become doubly important as, undoubtedly, they will be the guidestones for the interpretation of the same provisions in those jurisdictions that have adopted and will hereafter adopt the Code.

**Security Transactions Under Article 9**

The most important article of the Uniform Commercial Code, insofar as it affects security transactions, is Article 9. This article includes and applies to every kind of security transaction that is the subject of a voluntary contract between parties creating a consensual lien on personal property. It replaces present legislation dealing with or authorizing the creation of security interests or liens by way of a chattel mortgage, conditional bill of sale, assignment of accounts receivable, trust receipt and factor's lien. In fact, it replaces every type of consensual or contractual lien or encumbrance authorized by any act of legislation. It likewise applies to leases with the right to purchase, consignment transactions and security interests in fixtures attached to real estate. It does not apply to security interests in personal property arising and perfected under the federal statutes.

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\(^2\)Fairbanks Morse & Co. v. Consolidated Fisheries, 190 F.2d 817, 822 (3d Cir. 1951); National City Bank v. National Bank of Republic, 300 Ill. 103, 107, 132 N.E. 832, 833 (1921).
Under the Code, the form of the transaction and the distinction between the various types of securities, whether a chattel mortgage, conditional bill of sale, trust receipt or factor's lien, is immaterial.

New terminology is introduced doing away with the old familiar terms created by the individual statutes. Some of the definitions, as set forth in the Code emphasize the changes sought to be brought about:

(1) "Secured party"—replacing mortgagee, conditional vendor, entruster, factor and assignee—means a lender, a seller, or other party in whose favor there is a security interest; ³

(2) "Debtor"—replacing mortgagor, conditional vendee, trustee and assignee—means the person who owes payment or other performance of the obligation secured; ⁴

(3) "Security Interest"—replacing chattel mortgage, conditional bill of sale, trust receipt, factor's lien, assignment of accounts receivable—means an interest in personal property or fixtures which secures payment or performance of an obligation; ⁵

(4) "Security agreement" means an agreement which creates or provides for a security interest and sets forth the arrangement between the secured party and the debtor; ⁶

(5) "Collateral" means the property subject to a security interest, and includes accounts, contract rights and chattel paper, which have been sold; ⁷

(6) "Account debtor" means a person who is obligated on an account, chattel paper or contract rights; ⁸

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³ Uniform Commercial Code § 9-105(i) (hereinafter cited as U.C.C.).
⁴ U.C.C. § 9-105(d).
⁵ U.C.C. § 1-201(37).
⁶ U.C.C. § 9-105(h).
⁷ U.C.C. § 9-105(c).
⁸ U.C.C. § 9-105(a).
(7) "Chattel paper" means a writing which evidences a monetary obligation and/or a security interest in, or a lease of specific goods;⁹ and
(8) "Financing statements" means the document filed to give public notice.¹⁰

Under the Code a security interest is created and attaches when there is (1) an agreement between the lender and the debtor; (2) the giving of value by the secured party; and (3) the acquisition or the ownership of rights by the debtor in the collateral.¹¹

The security interest is perfected through taking physical possession of the collateral or by the filing of a financing statement executed by the debtor and the secured creditor, in accordance with the provisions of the Code.¹²

Where filing is required to perfect a security instrument the document filed is called a "Financing Statement."

While all of the elements must be present in order to have a valid security agreement, the events with respect to the acquisition of rights in the collateral, the giving of value, and the execution of the agreement may occur in any order. The interest, however, attaches only after all the events have taken place.¹³ If the collateral is in the possession of the secured party, the security interest will be good as against creditors and the trustee in bankruptcy, even though there is no written security agreement.¹⁴ Any other type of security interest can only be evidenced by a security agreement, in writing, signed by the debtor and, to be valid as against creditors and the trustee in bankruptcy of the debtor, the security interest must be perfected by the filing of a financing statement.¹⁵ This, normally, should take place before the advance of any value by the secured party.

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⁹ U.C.C. § 9-105(b).
¹⁰ U.C.C. § 9-402(1).
¹¹ U.C.C. § 9-204(1).
¹³ U.C.C. §§ 9-303.
¹⁴ U.C.C. § 9-203(1).
Contrary to the present law in New York and the rules in bankruptcy proceedings, after-acquired property may be covered by a security agreement. The Code specifically provides that the security interest in the after-acquired collateral shall be deemed to have been taken for new value and not as security for an antecedent debt.\(^6\)

Likewise, the Code provides that a security interest is not void or fraudulent as against creditors by reason of the rights given to the debtor to use, commingle or dispose of all or part of the collateral or its proceeds, or by reason of the failure of the secured party to require the debtor to account for the proceeds or to replace the collateral.\(^7\)

These provisions with respect to after-acquired property and the right of the debtor to use, commingle or dispose of the proceeds or the collateral, are new. In fact, they are contrary to the provisions in the existing specific statutes and legislation. Under present state law and the bankruptcy rules, the security arrangement would be void as against the trustee in bankruptcy. However, these provisions will be more fully discussed in the analysis of cases.

The document or writing that must be filed to perfect the security interest is known as a “financing statement.” It should contain the names, addresses and signatures of the debtor and the secured party, a description of the type or items of collateral covered, and a statement that the proceeds or the products of collateral are claimed as security, if such is the case. Products may be claimed as security when raw materials of a manufacturer are financed and proceeds may be claimed where inventory is financed. It does not have to be any more elaborate than as outlined to be a good, effective financing statement, as against creditors, the trustee in bankruptcy and the debtor.\(^8\)

The financing statement does not require an acknowledgment or affidavit. The description of the collateral should be as specific as the situation may permit, so as to reason-

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\(^6\) U.C.C. §§ 9-108, 9-204.
\(^7\) U.C.C. § 9-205.
\(^8\) U.C.C. §§ 9-402.
ably identify the articles covered.\textsuperscript{19} Thus, the present requirement to set forth serial numbers, applicable to descriptions in chattel mortgages and trust receipts is rendered unnecessary and eliminated.

The Code permits the creation of every kind and nature of security interest that could be created under pre-Code law. It still appears to be considered a good basic principle of operation to follow that which was good in pre-Code law when entering into security transactions.

Under the provisions of the Code an unperfected security interest is good as against all creditors, other than a lien creditor, an assignee for the benefit of creditors and a trustee in bankruptcy.\textsuperscript{20} There is no time limitation set forth in the Code for the filing of the financing statement or security agreement. Thus, if the transaction is perfected prior to bankruptcy, regardless of the lapse of time between the creation of the security interest and its perfection by filing, it is good as against any subsequent lien creditor. In the event of bankruptcy, a serious question arises, to wit: whether the security interest was filed within four months of the filing of the petition in bankruptcy with knowledge or reasonable cause to believe, on the part of the secured creditor, the insolvency or the imminency of insolvency on the part of the debtor. In other words, if the trustee in bankruptcy can establish the elements of a preference where the filing or perfection of the secured interest took place within four months of the filing of the petition, the security interest will be void as to the trustee in bankruptcy as a preference under Section 60 of the Bankruptcy Act. The bankruptcy courts have construed this section to this effect so that a delay of more than twenty-one days in the perfection of a security interest renders it subject to attack on the ground that it was given and created for a past consideration.\textsuperscript{21}

It is, therefore, recommended, to avoid any attack on the security and to preserve its priority over any sub-

\textsuperscript{19} \textit{U.C.C.} §9-110.
\textsuperscript{20} \textit{U.C.C.} §9-301.
\textsuperscript{21} \textit{In re} Smith, 205 F. Supp. 30 (E.D. Pa. 1962).
sequent lienor or security interest, that the financing state-
ment be filed promptly. If filed within ten days it will,
without question, cut off the possibility of any intervening
right or any intervening creditor to obtain priority. It will
eliminate any possible attack by a trustee in bankruptcy,
under Section 60 of the Bankruptcy Act, by reason of
delayed filing or that the security interest was perfected
after twenty-one days and for a past consideration within
four months of the filing of the petition in bankruptcy,
while the debtor was insolvent.

The Code also provides for priority to the secured
creditor as against a subsequent transferee in bulk, lien or
secured creditor, if the security interest is perfected by
filing within ten days after the collateral comes into the
possession of the debtor.22

A security interest in chattel paper or negotiable docu-
ments may be perfected by filing.23

A security interest in instruments or negotiable docu-
ments is perfected without filing or taking of possession
for a period of twenty-one days from the time it attaches,
but after the twenty-one day period, perfection depends
upon compliance with the applicable provisions of Article
9.24

If the security interest is not perfected before the
filing of an assignment for the benefit of creditors, or the
filing of a petition under the Bankruptcy Act, the interest
is void as to the assignee for the benefit of creditors, or
the trustee in bankruptcy.25

In New York the filing of the financing statement, to
perfect the lien of the secured creditor, must be made with
the Secretary of State at Albany, New York, and, in ad-
dition, if the debtor has a place of business in New York
and in only one county, in the office of the filing officer of
such county.26 With respect to the City of New York,
it means filing with the Register of the City of New York,

22 U.C.C. § 9-301(2).
23 U.C.C. § 9-204(1).
25 U.C.C. § 9-301(2), (3).
26 U.C.C. § 9-401(1)(c).
in the particular county wherein the debtor is located; in other counties of the state it means filing with the county clerk of the county.\textsuperscript{27} With respect to a debtor that is a domestic corporation, its residence is the county in which the principal office of the corporation is located, as designated in its certificate of incorporation.\textsuperscript{28}

With respect to a partnership, its residence is that county in which the certificate of partnership is filed in the office of the clerk of the county.\textsuperscript{29}

A filing made in the proper place continues effective even though the debtor's residence or place of business or the location of the collateral is thereafter changed.\textsuperscript{30} The filing of a financing statement is effective for a period of five years from the date of filing unless an earlier maturity date is stated, in which event, it is effective for a period of sixty days after the maturity date. The effectiveness of the financing statement lapses on the expiration of said period unless a continuation statement is filed which is good for another five years.\textsuperscript{31} A continuation statement may be filed by the secured parties within six months before and sixty days after a stated maturity date of less than five years, or within six months prior to the expiration of the five year period. It must be signed by the secured party: the original statement must be identified by file number and a statement made that the original statement is still effective. Succeeding continuation statements may be filed in the same manner. If no continuation statement is filed before the end of the effective period, the effectiveness of the statement lapses, and the security interest becomes unperfected.\textsuperscript{32}

In summary, a security agreement is any agreement between the debtor and a secured creditor in which the debtor agrees that the secured party is to have a security interest in personal property. It has to describe the

\textsuperscript{27} U.C.C. §9-401(1)(a), (d).
\textsuperscript{28} U.C.C. §§ 9-401(1)(e), (i).
\textsuperscript{29} U.C.C. §9-401(e)(iii).
\textsuperscript{30} U.C.C. §9-401(3).
\textsuperscript{31} U.C.C. §9-403(2), (3).
\textsuperscript{32} U.C.C. §9-403(3).
collateral that it is securing. It makes no difference in whom title to the property is vested. The secured party acquires a security interest in the property by virtue of the security agreement, which, if perfected by timely filing, is good as against any subsequent transferee, levying creditor or trustee in bankruptcy. The security interest may be taken to secure advances to be made in the future. An unperfected security interest is good as against everyone except another secured party who perfects first and who had no notice of the earlier secured interest, or an actual lien creditor, or a trustee in bankruptcy. The statement must contain the signatures and addresses of both the secured party and the debtor.

The section of the Code that is perhaps of greatest importance to those dealing in secured financing is section 9-306. This is the section spelling out the nature and extent of the secured party's interest in the proceeds derived from the disposition of the collateral, whether sold, exchanged or otherwise disposed of.33

The security interest continues in the collateral notwithstanding the disposition of the same by the debtor, and also continues in any identifiable proceeds, including collections received by the debtor.34 The security interest in the proceeds is a continuously perfected security interest but it ceases to be perfected and becomes unperfected ten days after receipt of the proceeds by the debtor, unless the financing statement covering the original collateral also covers the proceeds.35

In the event of insolvency proceedings (which would include assignments for the benefit of creditors, as well as proceedings under the Bankruptcy Act) a secured party with a perfected security interest in proceeds has a perfected security interest in identifiable non-cash proceeds, which would be any proceeds other than money, checks or the like;36 in identifiable cash proceeds not com-

33 U.C.C. § 9-306(1).
34 U.C.C. § 9-306(2).
35 U.C.C. § 9-306(3).
mingled; 37 in identifiable cash proceeds in the form of checks and the like, not deposited; 38 and in all cash and bank accounts of the debtor that have been commingled and deposited in the bank account. The right of the secured party as to these latter funds is subject to the right of set off and limited to the amount of cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings, and deposited in the bank account less the amount of cash proceeds received by the debtor and paid over to the secured creditor, during the ten day period. 39

Section 9-306 is derived from Section 10 of the Uniform Trust Receipts Act, which has been subject to much controversy, giving rise to conflicting opinions. It is important to note, however, that cash and non-cash proceeds can be claimed under a perfected security interest against a trustee in bankruptcy so long as they are identifiable, regardless of the time of their receipt. 40 The security interest enforceable as against the trustee in bankruptcy as to proceeds which are not identifiable and which have been commingled or deposited in a bank account is limited to the amount of the cash received within ten days of the filing of the bankruptcy proceedings. 41 This provision is now applicable not only to situations formerly limited solely to trust receipt transactions but to every type of security interest and transaction.

In order to create a security interest, valid under the Code and good as against the trustee in bankruptcy it will be necessary to adhere to and comply strictly with the provisions of the Code with respect to the attachment and perfection of the security interest, and even though there is strict compliance with these provisions, it is essential to be mindful of the provisions of Sections 60 and 70(c), (e)

37 U.C.C. § 9-306(4) (b).
38 U.C.C. § 9-306(4) (c).
39 U.C.C. § 9-306(4) (d) (i), (ii).
of the Bankruptcy Act and their effect upon the provisions of the Code.

**The Effect of the Bankruptcy Provisions On the Code**

Notwithstanding any statement or provision in the Code, to the effect that the Bankruptcy Act supplements the provisions of the Code, the provisions of the Bankruptcy Act are paramount to the provisions of the Uniform Commercial Code, just as the provisions of the Bankruptcy Act are paramount to the state laws with respect to any particular secured transaction or consensual lien. If there is a conflict between the provisions of the Bankruptcy Act and the provisions of the Code, the Code must be held to be subordinate and yield to the provisions of the Bankruptcy Act.\(^4\)

Under the "Supremacy Clause" of the Constitution, federal policy is paramount in the field of bankruptcy. States are not permitted by legislation to establish priorities contravening Section 64 of the Bankruptcy Act or establish statutory liens in violation of Section 67 of the Bankruptcy Act.\(^5\) It is, therefore, essential when entering into secured transactions that the secured creditor be mindful and take note of the provisions of Sections 60 and 70 of the Bankruptcy Act which give rise to rights on the part of the trustee in bankruptcy to challenge and attack the validity of a secured transaction.\(^6\)

The present Bankruptcy Act, though amended many times since its enactment in 1898, still gives rise to a tremendous amount of litigation respecting the validity of secured transactions. The litigation covers every type of security—chattel mortgages, conditional bills of sale, assignments of accounts, trust receipts, factors' liens and warehousemen's liens—notwithstanding the fact that secured

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\(^4\) U.C.C. § 1-103.

\(^5\) National Foundry Co. v. Director of Int. Rev., 229 F.2d 149 (2d Cir. 1956); MACLAUGHLIN, BANKRUPTCY § 117 (1956).

\(^6\) In re Crosstown Motors Corp., supra note 41; National Foundry Co. v. Director of Int. Rev., supra note 43.

\(^6\) Bankruptcy Act §§ 60(a)(1), (2), (7), (8), 70(c), (e).
creditors and their attorneys have had ample opportunity to familiarize themselves with the provisions and the statutes authorizing the secured transactions, and the benefit of judicial decisions interpreting the legislation authorizing the transactions. It is the hope of the draftsmen of the Code that greater protection will be accorded to the secured creditor and the volume of litigation materially reduced.

Under pre-Code law, the attack of a trustee in bankruptcy upon a secured transaction in connection with assignment of accounts was primarily based upon retention of unfettered dominion and control on the part of the assignor,46 the failure to police the secured transaction47

46 Benedict v. Ratner, 268 U.S. 353 (1925); In re New Haven Clock & Watch Co. (First National Bank v. O'Keefe), 253 F.2d 577 (2d Cir. 1958). In this excellent and exhaustive opinion the court found that there was adequate policing of the assigned accounts, that there was no reservation of dominion and control on the part of the assignor and distinguished factually as well as legally Benedict v. Ratner. It upheld the assignment as against the attack of the trustee under § 67(2) but indicated however, that the provision for attorneys' fees might be subordinated to the lien of the government for taxes, if the government's lien was perfected prior to the attorneys' lien becoming choate. There had to be strict adherence to the terms of the security agreement, and where there was an arrangement for the substitution of collateral, the new had to be substituted for the old before the proceeds of the old collateral could be retained by the assignor in order to avoid the effect of Benedict v. Ratner, and to preserve the validity of the security as against the trustee in bankruptcy. See also Walker v. Commercial Bank of Little Rock, 217 F.2d 677 (8th Cir. 1954).


Assignments of account have been adjudged invalid as against a trustee in bankruptcy by reason of failure to police the assignments, particularly with respect to return of merchandise. Lee v. State Bank & Trust Co., 38 F.2d 45 (2d Cir. 1930), modified, 54 F.2d 518 (2d Cir. 1931), cert. denied, 285 U.S. 547 (1932). See, also, Brown v. Leo, 12 F.2d 350 (2d Cir. 1926); Bloch v. Mill Factors Corp., 134 F.2d 562 (2d Cir. 1943).

Assignments made under a master factoring agreement to the extent of being for a past consideration have been held void as to the trustee in bankruptcy while those for a present advance have been held to be valid. In re Ace Fruit & Produce Co., Inc., 49 F. Supp. 986 (S.D.N.Y. 1943). Assignments under a factoring agreement are valid and apply to all claims as against all indebtedness owing up to the point and date where the secured creditor acquires knowledge of the debtor's insolvency. As to all assignments made prior to knowledge of insolvency, the secured creditor has a right to apply all security held as against the entire indebtedness owing regardless of the individual amount of the advances or the dates thereof. The assignment and the security arrangement is valid only to the extent of the present actual advance made. Wolf v. Aero Factors Corp., 126 F. Supp. 872 (S.D.N.Y. 1954), aff'd, 221 F.2d 291 (2d Cir. 1955).
and the taking of present security for a past consideration. With respect to chattel mortgages and conditional bills of sale, the attack was based upon either delay in filing, failure to file in the proper places as required by the statute, or failure to comply with the statutory provisions with respect to the execution and filing of the instrument.

With respect to trust receipts, factors’ liens and warehousemen’s liens, the same grounds of attack were present, to wit: failure to comply with the statutory provisions with respect to the execution and the filing of the same.

48 The rights of the parties are to be determined by what they actually do rather than by the provisions of a contract which they may disregard. Mount v. Norfolk Savings & Loan Corp., 192 F.2d 286 (4th Cir. 1951).

49 In re Morasco, 233 F.2d 11 (2d Cir. 1956); Oliver Machinery Co. v. Bissell, 261 F.2d 596 (6th Cir. 1958) (per curiam).

50 In re Steen, 257 F.2d 297 (7th Cir. 1958), wherein the court held a conditional bill of sale void by reason of the failure to comply with the laws of Texas, to which state the chattels were originally delivered, even though they had been removed and were in the State of Illinois at the time of bankruptcy, and Illinois law did not require the filing of a conditional bill of sale. The validity of the assignment of accounts was sustained where the assignment had been filed in accordance with state law and the assignor had not retained unfettered dominion and control over the proceeds of the collections, Second National Bank v. Phillips, 189 F.2d 115 (5th Cir. 1951).

51 The right of a trustee to attack the validity of an assignment of accounts receivable under state law is based upon the exercise of the rights of creditors under the provisions of § 70(c) and (e) of the Bankruptcy Act. Costello v. Bank of America National Trust & Sav. Ass’n, 246 F.2d 807 (9th Cir. 1957); Blackford v. Commercial Credit Corp., 263 F.2d 97 (5th Cir. 1959).

The failure to file a conditional bill of sale in the county of the residence of each partner where the purchase is made renders the same void as against the trustee in bankruptcy for failure to comply with the filing requirements of the state law, Weingarten v. Universal C.I.T. Credit Corp., 302 F.2d 1 (2d Cir. 1962).

52 The Factor’s Lien Act is not applicable to an extension of credit for goods or merchandise sold and a factor’s lien granted to the manufacturer of shoes by the purchaser thereof was void as against the trustee in bankruptcy as the Factor’s Lien Act is applicable only to secure moneys loaned and advances made. In re Tele-Tone Radio Corp., 133 F. Supp. 739 (D.N.J. 1959); In re Freeman, 294 F.2d 126 (3d Cir. 1961).

As to what constitutes a field warehousing lien, see Lawrence Warehouse Co. v. McKee, 301 F.2d 4 (5th Cir. 1962), wherein the court defined a warehouse lien as an arrangement whereby a wholesaler, manufacturer or merchant finances his business through the pledge of goods remaining in and on his premises. It is a limited type of warehousing as distinguished from public warehousing. Normally, the lien is coupled with a field warehousing arrangement wherein a warehousing company is employed by the debtor to establish and operate a field warehouse as to merchandise in the premises of the debtor. To have a valid field warehousing lien good as against a trustee in bankruptcy there must be policing and the debtor must not retain
time filing,\textsuperscript{53} failure to police,\textsuperscript{54} and retention of unfettered
dominion or control of the collateral by the debtor.\textsuperscript{55}

Secured transactions and particularly assignments of
accounts were frequently and successfully challenged by a
trustee in bankruptcy under the rule of Benedict \textit{v. Ratner}\textsuperscript{56}
that the secured transaction was void as to the trustee in
bankruptcy by reason of the fact that the debtor was deemed
to have retained unfettered dominion and control over the
security. This was based upon the right and the opportunity
afforded the debtor to use and commingle the proceeds
resulting from the disposition or liquidation of the collateral,
whether the same consisted of accounts receivable or
chattels. This same rule was invoked if the debtor had
the right to dispose of returned merchandise and commingle
and use the same in the conduct of his business.\textsuperscript{57}

dominion and control over the collateral or its proceeds. Bostian \textit{v. Park
Nat'l Bank}, 226 F.2d 753 (8th Cir. 1955); Swetnam \textit{v. Edmund Wright
Ginsberg Corp.}, 128 F.2d 1 (2d Cir. 1942); Ribaudo \textit{v. Citizens Nat'l Bank},
261 F.2d 929 (5th Cir. 1958); \textit{In re United Wholesalers, Inc.}, 274 F.2d 316
(7th Cir. 1960).

\textsuperscript{53} \textit{In re Kessler}, 90 F. Supp. 1012 (S.D. Cal. 1950); \textit{In re Francino's
Grill, Inc.}, 26 F. Supp. 856 (S.D.N.Y. 1939); General Motors Acceptance
Corp. \textit{v. Coller}, 106 F.2d 584 (6th Cir. 1939); Zamore \textit{v. Goldblatt}, 194 F.2d

\textsuperscript{54} \textit{In re United Wholesalers, Inc.}, \textit{supra} note 52.

\textsuperscript{55} Bostian \textit{v. Park Nat'l Bank}, \textit{supra} note 52; Swetnam \textit{v. Edmund
Wright Ginsberg Corp.}, \textit{supra} note 52; \textit{In re United Wholesalers, Inc.},
\textit{supra} note 52.

\textsuperscript{56} 268 U.S. 353 (1925).

\textsuperscript{57} See Lee \textit{v. State Bank & Trust Co.}, 38 F.2d 45 (2d Cir. 1930),
\textit{modified}, 54 F.2d 518 (2d Cir. 1931), \textit{cert. denied}, 285 U.S. 547 (1932),
with respect to the rights of creditors under state law and the right of a
trustee to exercise the same under the provisions of §70(c) and (e).
It should be noted that assignments of accounts receivable made after
the filing of an involuntary petition in bankruptcy but before adjudication,
even for a present consideration, have been held to be void as against the
trustee in bankruptcy under §70(d)(3) unless authorized by the
bankruptcy court, \textit{In re Autocue Sales & Distributing Corp.}, 162 F. Supp. 17
(S.D.N.Y. 1958), \textit{aff'd sub. nom.}, Kohn \textit{v. Myers}, 266 F.2d 353 (2d Cir.
1959). Assignment of accounts receivable to become due in the future under
a contract presently in existence is a valid and legally enforceable
assignment as against a trustee in bankruptcy. \textit{In re Luscombe Engineering Co.},
268 F.2d 683 (3d Cir. 1959). Distinguishing what is after-acquired property
from property in existence and an assignment valid as against a trustee,
see Rockmore \textit{v. Lehman}, 129 F.2d 892 (2d Cir. 1942), \textit{reversing}, 128 F.2d
564 (2d Cir. 1942) to the effect that \textit{assignments of existing contracts} are
to be distinguished from an agreement to assign rights not yet in being and
that an assignment of an existing contract under which moneys will become
due in the future is valid as against the trustee in bankruptcy. To the
Other transactions and particularly those involving chattel mortgages and conditional bills of sale were challenged as void as against the trustee in bankruptcy if the instruments were filed and recorded more than twenty-one days after execution or if they were not executed and filed strictly in accordance with the statutory provisions authorizing the same.\(^{58}\)

\(^{58}\) In re Morasco, supra note 49.

Failure to file the chattel mortgage or conditional bill of sale was not cured by taking possession or repossessing the property. The act of repossession was not retroactive but the perfection of the lien and if it took place within four months of the filing of the petition with knowledge of insolvency, then such act would be a preference under § 60 of the Bankruptcy Act. In re Huston, 143 F. Supp. 40 (N.D. Ohio 1956); England v. Moore Equipment Co., 94 F. Supp. 532 (N.D. Cal. 1950); Tyler State Bank & Trust v. Bullington, 179 F.2d 755 (5th Cir. 1950).

However, actual possession fulfills the requirement of filing and dispenses with the need of filing either as to a chattel mortgage or a warehouse receipt. Union Bank & Trust v. Azar, 316 F.2d 433 (5th Cir. 1963).

A chattel mortgage or a conditional bill of sale has to be filed in the county designated as the principal place of business in the certificate of incorporation in addition to the county where the chattels are located to be valid as against a trustee in bankruptcy. Constance v. Harvey, 215 F.2d 571 (2d Cir. 1954); In re Norma Footwear Corp., 2 App. Div. 2d 24, 153 N.Y.S.2d 80 (1st Dep't 1956); In re Savage Mills, Inc., 170 F. Supp. 559 (E.D.N.Y. 1959).

With respect to chattel mortgages and conditional bills of sale, the entire agreement or instrument constituting the chattel mortgage or conditional bill of sale has to be filed to be valid as against a trustee in bankruptcy. Hoffman v. Cream-O-Products, 180 F.2d 649 (2d Cir.), cert. denied, 340 U.S. 815 (1950). Chattel mortgages and conditional bills of sale likewise have been held void for failure to file in accordance with the state law, particularly with respect to the filing of conditional bills of sale in the respective counties of residence of the individual partners. Virshup v. Industrial Bank of Commerce, 272 F.2d 43 (2d Cir. 1959); Weingarten v. Universal C.I.T. Credit Corp., supra note 51. The failure to comply with state law as to the statement of the consideration paid for a chattel mortgage renders the same void as to a trustee in bankruptcy. Basic Tool Industries, Inc. v. Wkle, 298 F.2d 129 (9th Cir. 1961). Failure to properly renew a chattel mortgage renders the same void and if void as to one creditor, it was void as to all creditors under the rule of Moore v. Bay, 284 U.S. 4 (1931); In re ETC, Inc., 198 F. Supp. 53 (W.D. Mich. 1961); Zamore v. Goldblatt, supra note 53. Failure to set forth the correct serial numbers of a machine would render a chattel mortgage void as to the trustee in bankruptcy, In re Marshall Engineering Co., 213 F. Supp. 813 (S.D. Me. 1963).

With respect to leases with an option to purchase or the right to receive a deed or bill of sale on final payment, the courts have held such a transaction to be a conditional bill of sale. First Nat'l Bank v. Phillips, 261 F.2d 588 (5th Cir. 1958); In re Midwest Airmoving Corp., 277 F.2d 792 (6th Cir. 1960); American Can Co. v. United States Canning Co.,
Secured transactions are also subject to attack by the trustee under the rule of Moore v. Bay holding that if the secured transaction is void as to one creditor it is void as to the aggregate of the claims of all creditors.

Prior to the Code the business community and particularly banks and finance companies sought an arrangement whereby the bank or finance company could safely advance money and be protected by a valid security in a transaction whereunder the buyer purchased merchandise either for processing, manufacturing or for resale. If the bank or finance company sought to utilize, as security, inventory which the buyer was free to use and sell, the result usually was that in the event of the ensuing bankruptcy of the buyer, the lender (bank or finance company) would find the trustee in bankruptcy of the buyer prevailing over the claimed security.

If the parties resorted to a two-party transaction, that is, the buyer-dealer and the finance company, the transaction, even though designated as a trust receipt transaction, was uniformly struck down and held null and void as against the trustee in bankruptcy, on the ground that the transaction was a chattel mortgage, based upon the fact that the buyer was the owner of the goods and the security he gave to the bank was a lien on his own personal property. Being a lien, it was deemed to be a chattel mortgage, which was void unless filed in compliance with the requirements of the state law.


A lease with an option to purchase is deemed to be a conditional bill of sale and unless filed in accordance with state law is void as to a trustee in bankruptcy. In re Herold Radio & Electronics Corp., 218 F. Supp. 284 (S.D.N.Y. 1963).

For failure to refile a conditional bill of sale on the removal of the property from California to New York, the conditional bill of sale was held void as against the trustee in bankruptcy. Brown v. American Trust Co., 186 F. Supp. 249 (N.D. Cal. 1960).

58 284 U.S. 4 (1931).

60 Miller v. Sulmeyer, 263 F.2d 513 (9th Cir. 1959); Zamore v. Goldblatt, supra note 53.

61 In re Chappell, 77 F. Supp. 573 (D. Ore. 1948); In re San Clemente Electric Supply, 101 F. Supp. 252 (S.D. Cal. 1951); B-W Acceptance Corp. v. Colley, 256 F.2d 937 (10th Cir. 1958); Taube v. Ingraham, 290 F.2d 288 (8th Cir. 1961).
Trust receipt financing came into use and was employed originally in connection with importing transactions, where the goods were directly consigned by the seller to the bank or finance company, which paid the draft and released the merchandise to the buyer under a pledge or security title arrangement. As it has developed, a trust receipt is essentially a security interest whereby the financer of the purchase of the merchandise takes title to the inventory but delivers possession of the same to the buyer-dealer on the latter's receipt that the inventory is held in trust pending payment to the financer.\(^6^2\)

The trust receipt transaction is to be distinguished from a consignment transaction. The consignment transaction creates the relationship of principal and agent. There is no obligation on the part of the consignee to pay for the merchandise. He is not the buyer. Title does not come from the consignee but from the consignor to the purchaser.\(^6^3\)

In a trust receipt transaction, there is a sale subject to the terms and conditions of the financing agreement. The sales price is fixed between the entruster (bank or finance company) and the buyer-dealer, as trustee. Upon the sale of the merchandise the excess over the invoice price belongs to and is the property of the dealer. Title flows from the dealer to the purchaser.\(^6^4\)

Prior to the adoption of the Code there was no provision for the filing of any documents respecting a consignment transaction. It was a transaction that created a secret lien, and was valid as against the trustee in bankruptcy.\(^6^5\)

Under the Code a consignment transaction is deemed to be a security transaction,\(^6^6\) and must be perfected by

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62 Discussing two-party and three-party trust receipt transactions and the need for filing in accordance with state laws in a state where the Uniform Trust Receipts Act has not been adopted, even though filed in the state where the trust receipt transactions took place, see Chattanooga Discount Corp. v. West, 219 F. Supp. 140 (N.D. Ala. 1963).


64 A trust receipt transaction does not apply to a single transaction whether of a loan or a sale of merchandise, Sammet v. Mayer, 108 F.2d 337 (2d Cir. 1939).


66 U.C.C. § 2-326(3).
the filing of the financing statement required of all security financing, in order to protect the security interest. Failure to file the requisite notice to protect the security interest will render the transaction void as against the trustee in bankruptcy.

Under the Uniform Trust Receipts Act there had to be compliance with the provisions with respect to filing within twenty-one days, refileing, policing, description of the collateral subject to the trust receipt, for failure of any one of which the transaction would be held void as against the trustee in bankruptcy. There was also considerable litigation regarding the interpretation of Section 10 of the Uniform Trust Receipts Act, which has been considerably clarified and improved in the present Code, under the provisions of Section 9-306(4).

Section 10 of the Uniform Trust Receipts Act provides that the entruster (the finance company) shall have a security interest in and to the proceeds or the value of the proceeds, whether identifiable or not, of the goods, documents and instruments subject to the trust receipt, if said proceeds were received by the trustee (the borrower-bankrupt) within ten days prior to either an application for the appointment of a receiver of the trustee (borrower).

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68 In re Schepler, (D.C. Pa.) CCH 60255.
69 General Electric Credit Corp. v. Davis, 224 F.2d 322 (4th Cir. 1955).
70 In re Lexington Appliance Co., supra note 63, wherein at the end of the year the finance company failed to refile the trust receipt financing statement and during the next ensuing year the dealer became a bankrupt and the court held that the failure to refile rendered the trust receipt void as against the trustee.
71 McCloskey v. Henry Schroder Banking Corp., 7 Misc. 2d 501, 168 N.Y.S.2d 522 (Sup. Ct. 1957), wherein the court held that the trust receipt transaction must be policed with respect to the disposition of the proceeds of the sale of the merchandise in order to preserve the lien, and for failure to do so, the transaction was void and the bank a general unsecured creditor.
74 In re Crosstown Motors, Inc., 272 F.2d 224 (7th Cir. 1959), cert. denied sub. nom., Commercial Credit Corp. v. Allen, 363 U.S. 811 (1960); In re Harpeth Motors, 135 F. Supp. 863 (M.D. Tenn. 1955); English v. Universal C.I.T. Credit Corp., 278 F.2d 750 (5th Cir. 1960).
or the filing of a petition in bankruptcy or judicial insolvency proceedings by or against the trustee (borrower) or demand made by the entruster for prompt accounting and to a priority to the amount of such proceeds or value.

This provision in In re Crosstown Motors, Inc.,\textsuperscript{75} was held to create merely a priority which was valid under state law, if asserted promptly and prior to the filing of the petition. The priority was lost and void as against the trustee in bankruptcy under the provisions of Section 64 of the Bankruptcy Act, for the reason that the statute attempted to create a priority which was in contravention to and void as in violation of Sections 60 and 64 of the Bankruptcy Act.

The ruling of the court emphasized the need of strict policing of the secured transaction, the obligation to make frequent audits with prompt demands and action if any trust receipt property was found to have been sold out of trust and no proper accounting made for the proceeds.

In the Crosstown Motors case the court also set aside a trust receipt given in partial satisfaction of the borrower-bankrupt's obligations for the proceeds of the sale of cars previously disposed of upon the ground that the new security constituted a voidable preference in that the new trust receipt was given for a past consideration within four months of the filing of the petition in bankruptcy and at a time when the borrower-bankrupt was insolvent and the finance company had knowledge of the insolvent condition.

The court further held that the provision with respect to a lien upon the proceeds deposited in the bankrupt's bank account within ten days of the bankruptcy constituting a trust fund without tracing its funds merely created a priority void as against the trustee under Sections 64 and 67(c)(2) of the Bankruptcy Act. On appeal the United States Court of Appeals held that the provisions of Section 10 of the Uniform Trust Receipts Act created only a priority right and not a lien right.

\textsuperscript{75} In re Crosstown Motors, Inc., \textit{supra} note 74
In In re Harpeth Motors,\textsuperscript{76} section 10 was held to create a lien right in the trustee-finance company, which was good as against the trustee in bankruptcy.

The ruling in the Crosstown Motors case was not followed in the subsequent case of English v. Universal C.I.T. Corp.,\textsuperscript{77} which approved of and followed the Harpeth ruling that the entruster finance company did have a lien on the proceeds deposited within ten days of the bankruptcy proceedings. Perhaps the conflict in decisions is not irreconcilable and may be explained by reason of the fact that the court in the Harpeth Motors decision deemed that the state legislature, in enacting the Uniform Trust Receipts Act, intended by section 10 to create a lien right in the entruster finance company rather than a mere priority. Hence, the provision gave rise to a consensual lien just as in the case of a lien created by a chattel mortgage, conditional bill of sale or trust receipt pursuant to state statute.

The ruling in the Crosstown Motors case may be explained by the specific language in the Uniform Trust Receipts Act adopted in Illinois and the history and intent of the provision of section 10 of that act. The referee in bankruptcy, who initially passed upon the issues in Crosstown Motors, referred to the construction given Section 10 of the Tennessee Trust Receipts Act by the district court of Tennessee in the Harpeth Motors case; the Tennessee Legislature had intended to create a lien both on the proceeds derived from sale and on all other assets of the bankrupt. The referee found, however, that the Illinois Legislature did not intend to create a lien valid against the rights of the trustee in bankruptcy or against the general assets of the bankrupt. Section 10 of the Illinois Act was only intended to create a preference or priority in the distribution of such assets.

Hence, the distinction in the decisions—in the Crosstown Motors case, the court construed the provisions of Section 10 of the Illinois Uniform Trust Receipts Act as

\textsuperscript{76} In re Harpeth Motors, \textit{supra} note 74.

\textsuperscript{77} English v. Universal C.I.T. Credit Corp., \textit{supra} note 74.
creating merely a priority in accordance with the intent and purpose of the state legislature. In the Harpeth Motors case it was found that the intent and purpose of the state legislature in enacting Section 10 of the Tennessee Trust Receipts Act was to create a lien.

The more sound view with respect to the intent and purposes and effect of Section 10 of the Uniform Trust Receipts Act appears to be expressed In re Harpeth Motors and English v. Universal C.I.T. as the provisions of the statute give rise to the consensual lien just as any other lien created or authorized by state law. Section 9-306(4) of the Code by its provisions creates a consensual lien, valid under state law and which should be good as against a trustee in bankruptcy.

INTERPRETATION OF THE CODE BY THE BANKRUPTCY COURTS

Notwithstanding the great hopes held out by the new provisions of the Code, there have been a number of decisions in the bankruptcy courts striking down secured transactions at the instance of trustees in bankruptcy. Thus as there had been considerable litigation with respect to the place of filing of a chattel mortgage or conditional bill of sale, so too, there is considerable litigation with respect to the place of filing of the financing statement under the Code. Likewise, the other provisions of the Code have been the subject of scrutiny by the bankruptcy courts. An examination of the cases indicates that the bankruptcy courts have sustained the validity and given effect to the changes sought to be effected by the provisions of the Code, notwithstanding the fact that they may be at complete variance with prior state legislation and case law.

Filing — Perfection — Sections 9-109 and 9-401

In the case of In re Shepler,78 farm implement chattels were shipped by the manufacturer to the debtor-bankrupt, on consignment. Upon the ensuing bankruptcy, the trustee in bankruptcy sought to have the consignment arrangement

adjudged null and void, by reason of the failure of the manufacturer to file the proper security instruments, on the ground that the chattels came within the meaning of section 9-109 of the Code and were subject to its filing provisions. The court held that the consignment arrangement between the manufacturer and the bankrupt was void by reason of the failure to file the required financing statement under section 9-401(1)(a), and accordingly held that the manufacturer was a general unsecured creditor of the bankrupt estate.

This case merely illustrates the need for compliance with the provisions of the Code, particularly with respect to the filing of the financing statement to protect the security interest.

As to the need for strict compliance, the court, in the case of In re Excel Stores, Inc.,79 presented with the question as to the validity of the security interest created by an instrument purporting to be a conditional sale contract signed and filed against "Excel Department Stores" whereas the real and actual name of the corporation was "Excel Stores, Inc.," held that the instrument was void as a security interest under the Connecticut Commercial Code as the misnomer of the corporate entity constituted a material variance sufficient to mislead creditors relying upon the public record.

In the case of In re Kane,80 the financing statement filed by the alleged secured creditor was a photocopy of the financing statement. The court held that under the Pennsylvania Uniform Commercial Code this was not in compliance with the signature requirements of the financing statement required to be filed, by reason of which the instrument was void as against the trustee in bankruptcy.

In the case of In re Lua's Superette, Inc.,81 the bankrupt had bought certain merchandise delivered subject to

a conditional bill of sale, which was assigned to the Commercial Credit Corporation. On the bankruptcy of the buyer the finance company sought to reclaim the chattels claiming the purchase order was filed as a financing statement with the Prothonotary of Lehigh County and another financing statement filed with the Prothonotary of Northampton County, Pennsylvania, in compliance with the provisions of the Pennsylvania Uniform Commercial Code.

In finding that the security interest was unperfected and void as against the trustee, the court said:

A security interest in equipment as was involved herein is perfected under the Uniform Commercial Code by filing a finance statement. The present transactions occurred prior to the effective date of the 1959 Amendments to the Code. Section 9-401(1)(a) as it then existed provided that proper filing . . . must be completed with the Secretary of the Commonwealth, and if the debtor's business is in a single county, then also with the prothonotary of that county. Petitioners . . . failed to file the financing statement with the Secretary of the Commonwealth.82

The finance company also raised the defense of good faith filing under the provisions of section 9-401(2). This defense was rejected on the ground that for the finance company to succeed it would have to show either proper filing or knowledge of the existence of the security interest on the part of all creditors. This the finance company did not do and the court accordingly held the security interest not perfected.

In the case of In re Smith,83 the court was confronted with a reclamation proceeding in which the issue was raised as to the validity of the security interest of the finance company under the provisions of the Code in Pennsylvania. The security interest was evidenced by a conditional sales contract, which had been filed with the Prothonotary of Berks County where the debtor did business, but had never been filed in the office of the Secretary of the Commonwealth. The Pennsylvania Uniform Commercial Code provides that a security interest in chattels or equipment, to be perfected, must be filed in the office of the

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Secretary of the Commonwealth and in the office of the prothonotary in the county in which the debtor does business. The finance company had tendered a financing statement for filing with the Secretary of the Commonwealth which statement failed to set forth the debtor's address, by reason of which it was returned to the finance company. The statement was never resubmitted for filing, even though the secretary's office had enclosed a form of financing statement to be filled out, advising that there had been no mailing address for the debtor on the original statement. On these facts the court held that there was a failure on the part of the financing company to comply with the filing provisions of the Code; the security interest had not been perfected, and by reason thereof it was void as against the trustee as the burden was on the finance company to show that there had been compliance in all respects with the provisions of the Code, to perfect the security interest.

In the case of In re Dumont-Airplane & Marine Instruments, the court was confronted with the question of the validity of the security interest, under the Uniform Commercial Code in Pennsylvania, with respect to chattels that had been removed from West Virginia to Pennsylvania. A chattel deed of trust was recorded in West Virginia in connection with the sale of chattels. Upon the removal of these chattels, with the consent of the mortgagee, to Pennsylvania, the mortgagee filed a chattel deed in the office of the Prothonotary of Fairfield County, Pennsylvania, but did not file a chattel deed or financing statement with the Secretary of the Commonwealth.

In the bankruptcy proceeding the trustee questioned the validity of the security interest and the court held that Pennsylvania law was controlling and as the Uniform Commercial Code required re-recording for the protection of the security interest on property in the state that was subject to a valid security interest in another state and as the filing was required within four months after the property

was brought into Pennsylvania, and as the security interest had not been perfected because of the failure to file the financing statement with the Secretary of the Commonwealth as required by the Code, the security interest and chattel mortgage was void as against the trustee and under section 70(c) the trustee was vested with the right of a lien creditor as to whom the security interest of the mortagee was void.\textsuperscript{86}

These cases illustrate the need for strict compliance with the provisions of the Code with respect to the manner and places of filing of the financing statement in order to protect the security interest. In effect these cases follow the prior case law with respect to the strict requirements imposed by the court regarding the filing, the places of filing of chattel mortgages, conditional bills of sale and other security instruments.

**Time of Filing — Section 9-301**

Perhaps a case of first impression interpreting the provisions of the Code with respect to the time of filing or perfecting of a security interest is in In re *Smith*,\textsuperscript{87} which follows the prior case law with respect to the effect of Section 60 of the Bankruptcy Act upon secured transactions. There a security agreement and financing statement in connection with the sale of air conditioning and heating equipment was executed on September 30, 1960. The secured creditor discounted the security agreement and financing statement with a bank. When the installments were not paid, the secured creditor repurchased the papers

\textsuperscript{86} Other cases holding the security interest unperfected and void as to the trustee either for failure to file or for failure to file with the secretary of state, and also in the local office of the county where the debtor does business, as required by the provisions of the Code: In the Matter of Luckenbill, 156 F. Supp. 129 (E.D. Pa. 1957); In re Babcock Box Co., 200 F. Supp. 80 (D. Mass. 1962). The assignment to a surety of moneys due and to become due the subcontractor under his contract to the surety in connection with bonds furnished by the surety was a contract right under §9-301, and if not perfected by filing under §§9-302 and 9-403, was invalid as against lien creditors and the trustee in bankruptcy. United States v. G. P. Fleetwood & Co., 165 F. Supp. 723 (W.D. Pa. 1958).

from the bank and discovered that the documents had not been filed in accordance with Section 9-401 of the Pennsylvania Uniform Commercial Code. The secured creditor immediately filed the necessary papers in the office of the Prothonotary for Berks County and in the office of the Secretary of the Commonwealth. The filing took place on August 25, 1961. On August 28, 1961, the bankrupts filed a voluntary petition in bankruptcy and were adjudicated on that day.

The court held that the filing of the security interest put the secured creditor in the status of a lien creditor to reclaim its property from the bankrupt's estate, but as the filing took place three days before the filing of the petition in bankruptcy and adjudication, it examined into the question of a preference being present under Section 60(a) and (b) of the Bankruptcy Act.

The court found that the filing of the security interest three days before the bankruptcy constituted a "transfer" under section 60(a) and (b) and as the debt covered by the security interest was created eleven months prior thereto, the transfer was for a past indebtedness. 88

The court also found that the transfer was made while the bankrupt was insolvent; that the transfer enabled the secured creditor to obtain a greater percentage of his debt than other creditors of the same class; that the petitioner had reasonable cause to believe that the debtor was insolvent at the time the transfer was made, and accordingly held that the delay in the filing, which was over eleven months, rendered the security interest voidable by the trustee as a preferential transfer. 89

This case illustrates that delay in filing of the financial statement can be fatal to the security. It is the first interpretation of the provisions of section 9-301. It emphasizes the need strictly to observe not only the provisions of the Code, but also the provisions of the Bankruptcy Act. Just as chattel mortgages and conditional bills of sale filed

88 Bankruptcy Act § 60(a).
89 Bankruptcy Act § 60(a)(7)(b); In re Morasco, 233 F.2d 11 (2d Cir. 1956).
after twenty-one days were deemed to have been given for a past consideration under Section 60(2), (7) of the Bankruptcy Act, so will a security interest under the provisions of the Code be deemed to have been given for a past consideration and will be voidable at the instance of a trustee in bankruptcy, unless the financing statement is filed and security interest perfected within twenty-one days of the giving of value by the secured creditor (in order to avoid the effects of section 60 and its subdivisions).

**Sufficiency of Description — Section 9-110**

It has been indicated that the provisions of the Code are much more lenient in connection with describing collateral subject to the secured instrument and this is illustrated in the decision of In re Drane.\(^9\) There the court was presented with the question as to the sufficiency of the description of the chattels covered by the security interest under the provisions of the Uniform Commercial Code in effect in Kentucky.

The Kentucky Code, similar to the New York Code, provides that the financing statement contain a description of the personal property covered, which is sufficient whether or not it is specific, if it reasonably identifies what is described. Here the mortgage described the furniture as a two-piece living room suite, a five-piece chrome dinette set and a three-piece panel bedroom suite in the home of the debtor, citing his address. The court held this was a sufficient description and that the security interest was good as against the trustee.\(^9\)

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\(^9\) Also holding the description sufficient and the use of serial numbers unnecessary, National Dime Bank v. Cleveland Bros., 20 Pa. D. & C. 2d 511 (1959). As to the sufficiency of the description of the property in a financing statement, see Girard Trust Corn Exchange Bank v. Warren Lepley Ford, Inc., (No. 2), *supra* note 87, wherein the court held that listing of articles by serial number was unnecessary and a general description sufficient. The financing statement covering all present and future accounts receivable was held to sufficiently identify the collateral security so as to be good against lien creditors and a trustee in bankruptcy. Industrial Packaging Products Co. v. Fort Pitt Packaging Int'l, Inc., 399 Pa. 643, 161 A.2d 19 (1960).
After-Acquired Property and Commingling of Funds Under Sections 9-108, 9-204, 9-205 and 9-306

A very interesting decision analyzing at length and interpreting the provisions of Sections 9-108, 9-204, 9-205 and 9-306, of the Code is *Howarth v. Universal C.I.T. Credit Corp.* In this proceeding the trustee instituted an action against U.C.I.T. to recover preferential payments and preferences made within four months of the filing of the petition in bankruptcy, under Section 60 of the Bankruptcy Act. An involuntary petition in bankruptcy was filed against the automobile dealer on January 6, 1958, upon which it was adjudicated a bankrupt on February 13, 1958. Prior to bankruptcy and on February 5, 1957, a loan agreement had been executed by U.C.I.T. with the dealer under which it advanced to the dealer $75,000, and the dealer executed a chattel mortgage covering certain chattels. U.C.I.T. protected its security interest in these chattels by filing a financing statement in accordance with the provisions of the Uniform Commercial Code. Prior to September 28, 1957, the dealer also executed, in favor of the U.C.I.T. used car trust receipts and also signed certain bailment leases. In August of 1957 and some time prior thereto U.C.I.T. advanced to the dealer, or on its behalf, pursuant to an agreement for wholesale financing, dated December 31, 1954, the sum of $437,972.84 for 201 new autos, each secured under the terms of a new car trust receipt. On March 3, 1955, U.C.I.T. perfected its security interest in used motor vehicle equipment, accessories or replacement parts and proceeds by properly filing a financing statement under the provisions of the Code. Prior to September 28, 1957, 110 of the new automobiles had been sold out of trust by the dealer, leaving 91 new cars which U.C.I.T. repossessed and sold for $188,268.52, leaving $249,704.52 due from the dealer to U.C.I.T. for new cars sold out of trust.

Between September and October 1957, the dealer transferred to U.C.I.T. bank cash, shares of stock of Ford Motors, customer’s receivables, seventy used cars, motor parts and

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accessories. These transfers were made by the dealer for its past debts at a time when the debtor was insolvent and U.C.I.T. had reasons so to believe. The trustee contended that the transfer of all of these assets constituted preferences within the meaning of Section 60 of the Bankruptcy Act as the effect of the transfer was to enable U.C.I.T. to obtain payment of a greater percentage of its debt than the dealer's other unsecured creditors, except as to those items in which U.C.I.T. had a perfected security interest.

With respect to the dealer's bank account in the sum of $6,734.21 which was garnisheed under a writ of attachment in favor of U.C.I.T., the court held that the lien was obtained within four months of the bankruptcy while the dealer was insolvent and therefore the attachment and judgment were null and void as against the Trustee in bankruptcy under Section 67 of the Bankruptcy Act. The court found that the bank account was not under the control of U.C.I.T. and the source of the funds therein not identified. U.C.I.T. was not able to trace any other money in the bank to the sale by the trustee of collateral on which the bank held a security interest. Although U.C.I.T. urged that the money must have come from the sale of property in which it had a security interest, the court said this was an unwarranted assumption as the money could have come from services rendered, loans, or the sale of the dealer's own common stock. It could not assume the source of the money in the bank. The burden was on U.C.I.T. to trace the funds in the bank to the cash proceeds received by the dealer from the disposition of the collateral. This was not done. The cash was received by the dealer and deposited more than ten days prior to the bankruptcy proceeding. Hence, the funds were not identifiable cash proceeds received from the sale or disposition of any collateral recoverable by U.C.I.T. under section 9-306 pursuant to which the funds were free from any security interest of U.C.I.T.

With respect to the shares of Ford stock transferred within four months of the bankruptcy by the dealer to U.C.I.T., the court held there was no tracing of proceeds or funds from the disposition of collateral subject to the security interest of U.C.I.T. to indicate where the moneys
came to enable the dealer to purchase these shares of stock. The shares of stock were not identifiable proceeds of any security and accordingly the court held that the transfer of the stock to U.C.I.T. was not subject to any security interest and, having taken place within four months of bankruptcy, was a voidable preference recoverable by the trustee in bankruptcy under Section 60 of the Bankruptcy Act.

As to accounts receivable the court found that within four months of the filing of the petition the dealer had transferred customer's receivables by cash and checks to U.C.I.T. in the sum of $10,847.75. Of this sum $1,100.00 was identified as cash proceeds from the sale of two new cars on which U.C.I.T. had a perfected security interest, leaving in dispute $9,747.75, which made up of commingled cash proceeds arising from the sale of five cars, parts and services.

The court found that it could not ascertain whether any of the articles sold was covered by a perfected security interest, and even if it were assumed that some of the accounts arose from the sale of cars, it still could not ascertain whether or not any portion of the accounts arose from services rendered by the dealer, and as U.C.I.T. did not hold a security interest in proceeds received from the sale of services, it was not entitled to retain proceeds which may have come from this source and, interpreting section 9-306 the court said:

[As we understand the Uniform Commercial Code, in insolvency proceedings the secured creditor is only entitled to commingled cash when it is received as proceeds of collateral within ten days of the filing of the petition.]

For these reasons, the court held the trustee was entitled to recover $9,747.75.

The court found that the eleven used vehicles were financed by U.C.I.T. as evidenced by the used car trust receipts; that it had obtained a security interest under the agreement for wholesale financing covering new and used merchandise, and the used car trust receipts. This security

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93 Id. at 283.
interest was perfected by the filing of the financing statement in the office of the Secretary of the Commonwealth and the Secretary of Allegheny County where the dealer did business. The court held that U.C.I.T. had a valid lien, stating that:

[I]t seems certain that a finance company which advances money for wholesale financing of new cars can perfect a valid security interest therein by filing a financing statement in the office of the Secretary of the Commonwealth—and the Prothonotary of the County in which the dealer does business.  

Likewise, the court held that a lender could also perfect a valid security interest in used cars by the same method employed to perfect a security interest in new cars.

The court also stated that although $6,340.00 had been advanced by U.C.I.T. on the eleven used cars, it was entitled to retain the excess realized on the sale of the cars in the sum of $1,465.00, as the cars realized the sum of $7,805.00, in view of the provision in the agreement for financing, as follows: "Until payment in full, the dealer will hold the proceeds separately and in trust for you (U.C.I.T.)."

The court said the documents provided, in substance, that U.C.I.T. was to have a security interest in "trade-ins" and that these cars were identifiable proceeds covered by the financing statement. Further, it held that the finance company had a perfected security interest in such proceeds, good as against the trustee and that section 9-306 was not in conflict with Section 60 of the Bankruptcy Act, and the perfected security interest in the proceeds was enforceable against the trustee.

The court found that the chattel mortgage and loan agreement executed by the dealer created a security interest in the dealer's inventory of all parts and accessories then owned or which might thereafter be acquired, and that the chattel mortgage specifically covered "our complete inventory of all parts and accessories now owned or which may hereafter be acquired," and the court held the security interest was perfected when U.C.I.T. filed a financing

94 Id. at 284.
statement in February of 1957, covering the replacement parts and accessories for new and used cars.

The court further held that the description in the financing statement was sufficient to effect a security interest in these items, stating:

We find that the security agreements . . . and the Financing Statement reasonably identify the motor parts and accessories in Spohn's (dealer) inventory, and that the description in the Financing Statement is sufficient to give notice to potential creditors. Therefore, U.C.I.T. is entitled to retain the money received from the sale of these items.  

You will note that this case covers the subject not only as to the description and the sufficiency of a reasonable description, the provision with respect to a security interest in chattels to be acquired in the future, but also the various phases of trust funds, tracing of trust funds and identifiable proceeds and non-identifiable proceeds.  

It will be observed that this case covers many of the provisions of article 9 sustaining their validity as against the trustee in bankruptcy and as against the provisions of Sections 60, 67 and 70 of the Bankruptcy Act.

It would appear that under the provisions of the Code, security agreements providing for a security interest in after-acquired property are good and valid as against a trustee in bankruptcy; that the description of the collateral need not be specific but general and reasonable enough to describe sufficiently the same; that the right of the debtor to commingle and use the proceeds of the collateral does not destroy or render invalid the security interest but merely diminishes the security available for the secured creditor in the event of bankruptcy and that the secured creditor is entitled to recover all proceeds that may be traced or identifiable, as well as to recover funds derived from the sale of collateral and not identifiable, deposited within ten days of the filing of the petition in bankruptcy.

95 Id. at 287.
It will be observed that the courts have adopted a more liberal attitude with respect to the nature and sufficiency of the description and if it reasonably identifies the property, the financing statement will be held to be sufficient and the security interest valid as against the trustee.

This decision is authority that, as to the provisions of sections 9-108 and 9-204, the bankruptcy court will give effect and uphold the validity of a security interest covering after-acquired property.

Prior to the Code and under prior state legislation as to chattels mortgages, the after-acquired clause was ineffective and held void as against the trustee in bankruptcy.97

It will be observed that the court in Howarth also sustained the validity of the security interest notwithstanding the fact that the debtor had unfettered dominion and control over the secured property and the proceeds thereof. Here we have a clear-cut case where the debtor exercised the right to sell the equipment and merchandise subject to the security interest and use the same in the regular course of conduct of business without policing and without segregating the proceeds. However, it is to be noted that the security interest, on bankruptcy, was limited to the property at hand, so that the loss by reason of the use and disappearance of the secured property was borne by the secured creditor.

It is also to be noted that the court upheld the right of the secured creditor to recover the proceeds deposited and commingled in the bank account of the bankrupt within ten days prior to the filing of the petition under the provisions of section 9-306(4).

Supremacy of the Bankruptcy Act Over the Code

In the case of In re Laskin,98 the question presented to the court was the right of the trustee to offer proof as evidence outside the note with respect to the execution and the parties liable thereon. The Pennsylvania Uniform Commercial Code provides that evidence outside the note is not admissible. The trustee sought to show that the

97 Eberly v. Dudley, 314 F.2d 8 (9th Cir. 1962).
bankrupt was not personally liable on the note which had been executed by him, but did not indicate on its face that it had been executed in a representative capacity on behalf of the corporation. The district court held that in case of a conflict between the provisions of the Bankruptcy Act and the Uniform Commercial Code, the provisions of the Bankruptcy Act prevail and supersede the provisions of the Code. The court held that the bankruptcy court was a court of equity; that the referee was not estopped from receiving the evidence of circumstances outside the note and sifting the circumstances under which the note was executed and from the evidence produced to reject the claim asserted against the estate, on the ground that it had not been executed by the bankrupt personally but only in a representative capacity, on behalf of the corporation.

In the absence of bankruptcy, the provisions of the Code would be binding. In the case of In re Mort Co., a C.O.D. sale was made, against which the buyer issued his check with sufficient monies in his bank account to pay the check. Two days later the buyer went into bankruptcy and thereafter when the check was presented for payment the bank refused to pay the same. Upon the seller's application in the bankruptcy proceeding to reclaim the sales price represented by the amount of the check, the court held that under the provisions of the Code—section 2-507(2)—the sale was not on credit but on condition of payment, so that the seller had the right to reclaim and, as there were sufficient monies in the bank to cover the check, the seller was entitled to recover the proceeds of the check.

Limitation of Right of Reclamation—Sections 2-702, 2-703, 2-403, 9-301 and 2-326(2)

Under the Pennsylvania Code, as originally enacted, the trustee was in the position of a lien creditor, and in the case of In re Kravitz, the trustee prevailed even

101 278 F.2d 820 (3d Cir. 1960).
against the reclaiming creditor who had delivered the merchandise within ten days of the filing of the petition, on the theory that the reclaiming creditor could not prevail over a lien creditor, and as the trustee was in the position of a lien creditor, the trustee prevailed over the reclaiming creditor.

The New York and Illinois Codes contain a modification of the Pennsylvania Code eliminating from section 2-703 the words "lien creditor" so that the creditor has the right to reclaim even as against the trustee where the delivery is made within ten days of insolvency.

Rights as Between Successive Secured Creditors

In Thompson v. O. M. Scott Credit Corp., the first secured creditor perfected a security interest in after-acquired inventory of a business conducted as a partnership under a fictitious name, and in filing the financing statement did not name the assumed name of the business but named the individual partners as the debtors.

Later, the second secured creditor furnished inventory under a purchase money security interest and filed a financing statement giving the fictitious name of the partnership. The second secured creditor did not give notice to the first that he was furnishing inventory under a purchase money security interest, as required by section 9-312 (3). In the ensuing suit involving the conflicting claims to the inventory between the first secured creditor, under the amplified property clause in his financing statement, and the second secured creditor under the purchase money security interest, the court held that the second secured creditor knew the business was conducted under a fictitious name, and that the filing of the certificate by the first secured creditor was a matter of public record, which contained the actual names of the partners, and that the second security creditor should have checked the financing statement against

102 28 Pa. D. & C. 2d 85 (Chester County Ct. 1962), where the security interest was not perfected within ten days and the rights of an innocent purchaser intervened, the purchaser prevailed over the secured creditor.
the name of the individual partners, which would have prompted the giving of notice to the first security creditor.

The failure of the second security creditor to give notice to the first lost to the second security creditor the priority to which he might have been entitled, holding that the first security creditor had acted properly in filing the financing statement naming the individual partners, and under section 9-312(5) (a) entitled him to priority as the second creditor failed to give notice to the first as required by the Code.

CONCLUSION

The Uniform Commercial Code effects many changes in the status of secured obligations. It simplifies the documents to be executed to evidence a secured interest. All that is required is the agreement between the parties and the execution of a simple financing statement indicating the collateral which may include not only accounts receivable, furniture, fixtures, machinery and equipment, but inventory, including a shifting stock of inventory, as well as the proceeds realized from the sale of the inventory.

The Code will permit the creation of a security interest that covers not only property in being but after-acquired property.

A major change is the elimination of the Benedict v. Ratner rule which so frequently invalidated security arrangements upon the ground that the debtor had retained dominion and control over the collateral.

These provisions of the Code have been sustained as against a trustee in bankruptcy. It is to be hoped that these decisions will be followed in all jurisdictions so that there may be a more liberal interpretation of the provisions of the Code in order to afford greater protection to the secured creditor in the ever expanding business growth of the country.