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SECTION 9-108 OF THE UNIFORM COMMERCIAL CODE: DOES IT INSULATE THE SECURITY INTEREST FROM ATTACK BY A TRUSTEE IN BANKRUPTCY?

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It is the thesis of this article that with regard to inventory and receivables financing, article 9 of the Uniform Commercial Code does not afford the protection necessary in the event of the debtor's bankruptcy. The problem does not concern the collateral in existence at the time of the original transaction between creditor and debtor but it involves collateral acquired subsequently.

Inventory and receivables financing agreements naturally will include stipulations providing for the inclusion of new inventory or receivables under the security agreement. In the case where such new collateral is acquired within four months prior to the filing of a petition in bankruptcy, will the security interest in the new collateral be subject to avoidance by the trustee in bankruptcy? This article concludes that it can be defeated by the trustee although the UCC did not intend this result.

Basically, this result can be traced to the language of the UCC; the remedy may, appropriately, be there as well. In the UCC, only four sections are particularly relevant to this result: sections 9-301, 9-303, 9-204 and 9-108. These must be read in light of sections 60(a) and 60(b) of the Bankruptcy Act.¹

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¹ 30 Stat. 562 (1898), 11 U.S.C. §§ 96(a), (b) (1964).

Voidable Preferences Under the Bankruptcy Act

Section 60(a) of the Bankruptcy Act sets forth the following elements necessary to constitute a transfer preferential:

- (1) a transfer of the debtor's property to a creditor;
- (2) for or on account of an antecedent debt;
- (3) within four months prior to the bankruptcy petition;
- (4) when the debtor is insolvent; and

(5) the effect of which is to give the creditor a greater percentage of his debt than other creditors in the same class would receive.

Section 60(b) adds a further element necessary to make the preference voidable:

(6) that at the time of the transfer the creditor receiving it had reasonable cause to believe the debtor was insolvent.

Our concern will be with elements (2), (3), (4) and (6). Elements (1) and (5) present no difficulty since, by definition, a transfer certainly includes the creation of a security interest² under the UCC and element (5) will be present in all cases where the others exist.³

The one factor common to elements (2), (3), (4) and (6) is the time factor. Without knowing the specific day on which the transfer occurred, it is impossible to determine whether the transfer was within the four-month period, whether it was for an antecedent debt, whether the debtor was insolvent and whether the creditor knew the debtor was insolvent. For the purposes of this article the discussion will be limited further by excluding elements (4) and (6) since insolvency and knowledge of it are strictly factual issues. It may be assumed that those elements exist on the key dates under discussion. In passing, it should be pointed out, however, that all elements in sections 60(a) and 60(b) must coexist in order for the transfer to be voidable; if any one is lacking, the trustee may not avoid the transfer as a preference.⁴

Thus, it is essential to know when a transfer has taken place. Section 60(a) provides a means for making this determination by

² The Bankruptcy Act defines "transfer" to include every mode of parting with an interest in property including the fixing of a lien on it. 30 Stat. 545 (1898), as amended, 11 U.S.C. § 1(30) (1964).

³ See generally 3 COLLIER, BANKRUPTCY ¶¶ 60.34, 60.35 (14th ed. 1964).

⁴ *Id.* ¶ 60.02.

establishing a test: transfers of personal property are considered to have taken place when they become perfected against judicial lien creditors.⁵ The Bankruptcy Act does not define the rights of a lien creditor vis-à-vis a transferee of a debtor's property; that definition is left to state law. In essence the trustee in bankruptcy is given, by section 60(a), the status of a judicial lien creditor. What rights he attains from that status are determined by state law, not the Bankruptcy Act; therefore, in speaking about security interests, it is necessary to refer to state law to learn when they become perfected against judicial lien creditors. That date will determine the existence of the elements of a voidable preference.⁶ In this connection it is also of some importance to note that the Bankruptcy Act uses the word "perfected." The transfer is deemed to have been made when it "became so far perfected" that no subsequent judicial lienholder could have avoided it.⁷ The next reference, then, must be to the applicable state law, article 9 of the Uniform Commercial Code.

UCC Section 9-301

The key section in article 9 providing for the order of priorities affecting lien creditors is section 9-301(1)(b). That section reads:

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

. . .

(b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected . . .

A lien creditor is defined in section 9-301(3) as "a creditor who has acquired a lien on the property involved by attachment, levy or the like" It also includes a trustee in bankruptcy but this inclusion does not affect the present discussion since this status is given the trustee by section 60(a) of the Bankruptcy Act.

⁵ Section 60(a) (2) states:

For the purposes of subdivisions (a) and (b) of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.

52 Stat. 869 (1938), as amended, 11 U.S.C. § 96(a) (2) (1964). Section 60(a) (7), 64 Stat. 26 (1950), 11 U.S.C. § 96(a) (7) (1964), also referring to the date of perfection, is not relevant here, although it raises another problem of conflict with the UCC. But that is another story.

⁶ See 3 COLLIER, *op. cit. supra* note 3, ¶ 60.39.

⁷ 52 Stat. 869 (1938), as amended, 11 U.S.C. § 96(a) (2) (1964).

Thus, section 9-301 makes unperfected security interests subordinate to judicial lien creditors. The lien creditor to have priority must obtain his lien before the security interest is perfected and without actual knowledge of it.⁸

We have so far moved from section 60 to section 9-301; we have determined that a transfer takes place when a lien creditor cannot acquire superior rights in the property and that a lien creditor can acquire rights superior to an unperfected security interest. Section 9-301 does not provide when or how a security interest is perfected. For these answers we must turn elsewhere.

UCC Section 9-303

Section 9-303 specifies, in general, *when* a security interest is perfected, but it does not detail *how* it is perfected. It provides:

(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

Two matters are worthy of note. First, this section uses the word "perfected." This is clearly a reference to the concept of perfection incorporated in section 60(a) of the Bankruptcy Act and the word apparently was chosen to conform article 9 with this part of the Bankruptcy Act.⁹

Second, two steps are required for full perfection. First, the security interest must attach; second, the applicable steps for perfection as required by other sections must be taken. Normally these steps will be by way of filing a financing statement or by the secured party's obtaining possession of the collateral.¹⁰ Thus, for the quality of perfection envisioned by section 9-301, to protect against intervening lien creditors, section 9-303 clearly requires that both stages be met. The step that occurs later determines the date on which the security interest achieves full perfection.

⁸ The "unless as otherwise provided" lead-off language has no relevance to this discussion because that refers to purchase money security interests. This article will not deal with interests of that type but only with the after-acquired property clause in the original security agreement.

⁹ See 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 435 (1965).

¹⁰ The applicable steps, under the Code, may include filing, UNIFORM COMMERCIAL CODE § 9-302, obtaining possession, UNIFORM COMMERCIAL CODE §§ 9-305, 9-304(1), or nothing at all except attachment. *E.g.*, UNIFORM COMMERCIAL CODE § 9-302(1) (d). Except for § 9-305, which deals with a pledge-like transaction, the proper step for perfection will depend upon the nature of the collateral, *e.g.*, inventory, consumer goods, instruments.

For our illustration, we assume a case of inventory or receivables financing; therefore, the applicable step for perfection would be that governed by section 9-302, *i.e.*, the filing of a financing statement. Such filing would constitute compliance with one requirement of section 9-303. However, in order to determine whether the other requirement has been complied with—whether the secured interest has attached—it is necessary to look beyond the terms of section 9-303. For this information we must turn to section 9-204.

UCC Section 9-204

As stated in Official Comment 1 to section 9-204: "Subsection (1) states three basic prerequisites to the existence of a security interest: agreement, value, and collateral. When these three coexist a security interest may, in the terminology adopted in this Article, attach." The "terminology adopted in this Article" is of particular significance. That terminology, as we have just seen, is used in section 9-303 to specify when a security interest is perfected; if not perfected it is subordinated to lien creditors; the possibility of a voidable preference then arises. It is, therefore, of singular importance to determine when a security *attaches*, and this is the heart of the problem under discussion.

Section 9-204 lists three elements needed for a security interest to attach. There must be an agreement that it attach, value must be given and the debtor must have rights in the collateral. Ordinarily the first two elements will occur simultaneously or substantially so (with the possible exception of future advances), but the third may occur at a later date. To make our hypothetical situation concrete, we may assume a loan against inventory presently owned and any to be acquired subsequently for 100,000 dollars. *S*, the secured creditor, and *D*, the debtor, execute a security agreement on February 15, the loan is made on that date and *S* properly files a financing statement on the same date. Also, on that date, *D* has in stock inventory valued at 125,000 dollars. With regard to this inventory, no problem exists. There was agreement (by virtue of the security agreement), value was given (100,000 dollar loan) and the debtor has rights in the collateral (he owns the presently existing inventory). Thus the security interest attached to the inventory, filing was accomplished and the security interest is fully perfected. Should *D* file in bankruptcy at any time thereafter, the security interest would not be subject to avoidance by the trustee. The transfer (security interest) will be deemed made on February 15, which even if within four months of bankruptcy, would

not be voidable because it was made for a contemporaneous consideration (100,000 dollar loan), not for an antecedent debt.¹¹

Since inventory is a fluctuating commodity, the agreement between *S* and *D* will contain an after-acquired property clause. If the original collateral consisted of accounts receivable instead of inventory, the same would be true. In any event, *D* orders 50,000 dollars worth of goods on open account from *W* on June 1, the order is accepted by *W* on June 2, the goods are processed for shipment on June 10, they are delivered to a carrier on June 15 and delivered to *D* on June 30. A question could be raised at this point regarding the ratio of the new goods to the pre-existent inventory on February 15—*i.e.*, by June 30 did *D* now have 175,000 dollars worth of inventory, the same 125,000 dollars worth or less than 125,000 dollars? Because we will assume that *D* filed a petition in bankruptcy on August 1, it is highly unlikely that his inventory would increase in amount. As the following discussion indicates, however, it should make no difference whether the overall stock is maintained in value or decreases in value, as would be likely. For purposes of argument, we will assume that beginning late in May, *D* was insolvent and *S* was aware of this fact.

During the ensuing bankruptcy proceeding the trustee investigates the *S-D* relationship and concludes that he cannot reach any of the original inventory which still remains in the stock of *D*. On the other hand, in testing out the secured interest on the subsequently acquired inventory a question is raised in his mind. When was the security interest perfected? Working his way through sections 9-303 and 9-204 he notes that the financing statement was filed on February 15, more than four months before bankruptcy. The agreement was made and value was given also on February 15, but when did the debtor obtain rights in the collateral?

To repeat, the Code states clearly that the security interest must attach, even though there has been filing, in order for it to be perfected. The security interest cannot attach until the debtor obtains rights in the collateral.

Although in our hypothetical there may be some uncertainty about the exact date on which *D* obtains rights in the subsequently acquired inventory,¹² it is apparent that the earliest date would be

¹¹ No question can arise under either §70(c) or §70(e) of the Bankruptcy Act since prior to bankruptcy the security interest was perfected and there could be no creditor with a provable claim by whom the transfer was voidable. 30 Stat. 566 (1896), as amended, 11 U.S.C. §§110(c), (e) (1964).

¹² As one of the requisites for a security interest to attach, the debtor must have rights in the collateral. UNIFORM COMMERCIAL CODE §9-204. It is curious that the Code, both in article 1 and article 9, contains no definition of "rights in the collateral." No help is given by the Code to determine when such rights are acquired or what test is to be used to determine that date. The language of this requisite in §9-204

June 1 and the latest June 30. Both dates are within the key four-month period prior to bankruptcy. For purposes of argument, the assumption is made that the actual date is June 10. Very clearly, the Code then provides that the transfer is made on June 10. That is the date on which the security interest attaches (section 9-204), it is the date on which it is perfected (section 9-303) and thus it is the date beyond which no lien creditor could obtain priority over the secured creditor (section 9-301).¹³ Since June 10 is the date on which the transfer is deemed to have been made, the elements of a voidable preference must exist, if at all, on that date. It will be seen that all exist.

On June 10, *D* was insolvent and *S* knew *D* was insolvent (by hypothesis). June 10 is within four months prior to the filing of the bankruptcy petition. These facts are clear and present no difficulty. The key element is whether or not the transfer was for an antecedent debt. Factually the answer is simple. At the time the transfer is deemed to have been made, June 10, no advance was made by *S*, no value was given and the inventory fell under the after-acquired property clause of the security agreement as additional security for the 100,000 dollar loan made on February 15. The transfer was for an antecedent debt. Analogies have been made to flowing rivers, both the Mississippi and the Rio Grande,¹⁴ to show that inventory is really one mass like a river with the components making up the mass changing with each new minute and each new day. Such arguments are quite poetic but what is not explained is how they are applicable to overcome a statutory ambiguity where none exists.

is similar to no other language in the Code. Where the debtor purchases the property which will serve as collateral, there are several possible times when he acquires rights in it: when the purchase contract is entered into, when the goods are identified to the purchase contract, when title to the goods passes to the buyer-debtor, when shipment commences or when delivery is effected. At least one court has suggested that mere possession of goods is not sufficient to invest the debtor with rights in the collateral. *Cain v. Country Club Delicatessen, Inc.*, 25 Conn. Supp. 327, 203 A.2d 441 (Super. Ct. 1964).

It appears that the debtor acquires rights in the collateral when, under a purchase contract, the goods are identified. Cf. UNIFORM COMMERCIAL CODE § 2-501. Section 2-501 provides that upon identification, the buyer acquires a special property in the goods, which although also undefined, is not a security interest, UNIFORM COMMERCIAL CODE § 1-201(37), but does give the buyer certain rights. See, e.g., UNIFORM COMMERCIAL CODE § 2-502. On the other hand, it could be argued that the key date should be that when title passes under § 2-401 because no section in article 2 specifically refers to the issue of *when* rights in collateral are obtained. See, for further discussion, 1 GILMORE, *op. cit. supra* note 9, at 353; Hogan, *Future Goods, Floating Liens, and Foolish Creditors*, in 2 COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, ch. 18B (1966).

¹³ For a possible argument to the contrary, see the discussion in the text at note 49 *infra*.

¹⁴ See Henson, "Proceeds" Under the Uniform Commercial Code, 65 COLUM. L. REV. 232, 233-34 (1965).

Article 9 is not ambiguous on the point under discussion. It explicitly states that a security interest cannot attach until the debtor obtains rights in the collateral.¹⁵ He cannot obtain such rights at least until he has contracted for the purchase of the property involved and perhaps even at some later date.¹⁶ The security interest cannot be perfected until it has attached.¹⁷ This is clear statutory directive. What room is left for interpretation or supplying intent? The clarity of the language and the obvious conclusion were well known to the Code's draftsmen. It was certainly understood that utilization of the concept of "attaching" tied in with perfection clearly could create a voidable preference situation when the security agreement covered after-acquired property.¹⁸ It was so clearly recognized that the security interest in attaching on the after-acquired property would be for an antecedent debt that section 9-108 was worded to prevent this particular result. As mentioned, the draftsmen of article 9 knew they were creating a preference case; but, they certainly did not intend there to be a preference voidable under section 60 of the Bankruptcy Act. To obviate the natural consequences flowing from sections 9-303 and 9-204, they proposed a definition of "antecedent debt" in section 9-108 which would deem the type of transfer under discussion to have been taken for new value.

UCC Section 9-108

For the purpose of application in insolvency proceedings, including bankruptcy, section 9-108 fits in with and must be read with section 9-204. Section 9-108 provides:

Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

With reference to the present discussion, this section provides simply that the security interest in the new inventory acquired in

¹⁵ UNIFORM COMMERCIAL CODE § 9-204(1).

¹⁶ See generally Hogan, *supra* note 12.

¹⁷ UNIFORM COMMERCIAL CODE § 9-303(1).

¹⁸ See UNIFORM COMMERCIAL CODE § 9-108, Comment 1; 1 COOGAN, HOGAN & VAGTS, *op. cit. supra* note 12, chs. 10, 11; 2 GILMORE, *op. cit. supra* note 9, § 45.6.

June is deemed taken for new value and not for an antecedent debt. This is so because *S* extended the loan on February 15 (gave new value), which was to be secured in part by after-acquired property, and *D* obtained the new inventory in the ordinary course of his business.

As far as state law is concerned, section 9-108 would fictionalize that the transfer (secured interest attaching to the new inventory) was made for new value. This the Code may certainly do by way of definition. For example, insolvency proceedings in New York would fall under the Debtor and Creditor Law, section 15(6-a) of which is a condensed copy of sections 60(a) and 60(b) of the Bankruptcy Act.¹⁹ In a proceeding under the state law, the Code's definition of antecedent debt, or new value, would control and, where applicable, the transfer would not be voidable as a preference. In its relationship to the Bankruptcy Act, however, the result is not so clear.

As mentioned at the outset, sections 60(a) and 60(b) of the Bankruptcy Act set forth the elements of a voidable preference. Some of these elements require definition and some definitions are found in the Act itself. "Transfer,"²⁰ "insolvency,"²¹ "creditor"²² and "petition"²³ are examples of words specifically defined. One element is clearly related to state law, *i.e.*, the rights of a judicial lien creditor to avoid or upset transfers. The words "antecedent debt" are neither specifically defined in the act nor are they referred to as defined by state law. No reference is made back to state law for the meaning to be given them. Thus, the question is whether state law, section 9-108 of the UCC, may properly and effectively give meaning to antecedent debt, for use in connection with the federal

¹⁹ N.Y. DEBTOR AND CREDITOR LAW § 15(6-a) (1965) provides:

The court shall have power:

. . . .

6-a. To authorize an assignee to bring an action, which he is hereby empowered to maintain, against any person, who with reasonable cause to believe the assignor was insolvent . . . has within four months of the assignment received a voluntary transfer from the assignor of money or property for or on account of an antecedent debt, the effect of which transfer is to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class, and the assignee may recover the property so transferred or its value. For the purpose of this section a transfer shall be deemed to have been made when it is so far perfected that no creditor having a judgment on a simple contract without special priority (whether or not such a creditor exists) could have obtained an interest superior to that of the transferee therein. A transfer not so perfected prior to the assignment shall be deemed to have been made immediately before the assignment.

²⁰ 30 Stat. 545 (1898), as amended, 11 U.S.C. § 1(30) (1964).

²¹ 30 Stat. 544 (1898), as amended, 11 U.S.C. § 1(19) (1964).

²² 30 Stat. 544 (1898), as amended, 11 U.S.C. § 1(11) (1964).

²³ 30 Stat. 545 (1898), as amended, 11 U.S.C. § 1(24) (1964).

statute, section 60(a) of the Bankruptcy Act. The Official Comment to section 9-108 answers the question very neatly:

The section makes explicit what has been true under the case law: an after-acquired property interest is not, by virtue of that fact alone, security for a pre-existing claim. This rule is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable as preferences. The determination of when a transfer is for antecedent debt is left by the Bankruptcy Act to state law.

This Comment proves too much. In the first sentence quoted, regarding prior case law on whether the transfer is for an antecedent debt, it is not indicated that the prior law did not involve the concept and rule of the UCC of a security interest *attaching*. It is the Code itself that creates something new in this regard. The need for the security interest to attach postpones the perfection date instead of permitting it to relate back to the time when value was actually given.²⁴ If this part of the Comment is speaking of policy, as does an earlier sentence which states that the transfer should not be considered for an antecedent debt, then one must look to the text of the *statute* to determine whether the policy has been carried out. Section 9-108 purports to comply with this policy but no help is given in determining whether it effectively does so.

The second sentence quoted indicates that section 9-108 was drafted with section 60 clearly in mind. The last sentence is the stumbling block. "The determination of when a transfer is for antecedent debt is largely left by the Bankruptcy Act to state law." No citation of authority is offered for this statement; no reference of any kind is made to any source for an explanation of it. Whence did it originate?

Professor Gilmore, one of article 9's draftsmen, says of section 9-108:

This provision is of course designed to provide a rule of state law which will be effective in bankruptcy proceedings to preserve such after-acquired property interests from invalidation as voidable preferences. Lawyers whose opinion is entitled to respect have expressed doubts that the provision will be effective, feeling that the federal bankruptcy courts will decide the question of transfer for antecedent debt as a matter of federal and not state law²⁵

²⁴ UNIFORM COMMERCIAL CODE §§ 9-204, 9-303(1).

²⁵ 1 GILMORE, *op. cit. supra* note 9, at 362.

It may be noted at this point that Professor Gilmore does not, in his treatise, refer to the Official Comment or offer any explanation for the statement that the Bankruptcy Act leaves to state law the determination of when a transfer is for an antecedent debt. Moreover, no explanation can be found in Coogan, Hogan and Vagts,²⁶ although both treatises discuss the basic conflict involved in much detail, based on arguments of policy.²⁷

Collier on Bankruptcy expresses a position opposite to Gilmore's.²⁸ It sets forth the proposition that only the determination of when a transfer is *perfected* is left to state law.

The idea of supremacy of state law is confined to the field just discussed, *i.e.*, what constitutes perfection of a transfer. This matter determined, the question of whether the transfer is preferential is settled by the general framework of § 60a, and its voidability by § 60b. . . . What constitutes the general framework of § 60 is a federal question, whether presented in a state or federal court, upon which the United States Supreme Court is the final arbiter.²⁹

As far as the UCC is concerned, it determines the date of perfection by reference to the applicable steps required and to the time when a security interest attaches. This is as far as the Code is permitted to go. Section 9-108 does not deal with the time or method of perfection. It seeks to offer a definition of antecedent debt—a definition that is distinctly contrary to that used by the courts in applying section 60(a) of the Bankruptcy Act. No case is cited to substantiate the assertion in the Official Comment that state law determines when a transfer is for an antecedent debt. On the other hand, no pre-Code case can be cited which holds directly that such determination must be a matter of federal law.³⁰ The whole wording and policy of section 60(a), however, certainly lead to this conclusion. The basic reason is that section 60(a) leaves to state law the determination of only one aspect of a preferential transfer, *i.e.*, the date on which the transfer is made. Once that question is resolved, section 60(a) requires the determination whether the transfer was for an antecedent debt or for a contemporaneous consideration. Was there a *quid pro quo* on that date leaving the debtor's estate substantially

²⁶ COOGAN, HOGAN & VAGTS, *op. cit. supra* note 12.

²⁷ See 1 COOGAN, HOGAN & VAGTS, *op. cit. supra* note 12, chs. 10, 11, 13; 1 GILMORE, *op. cit. supra* note 9, § 11.7, 2 *id.* §§ 45.6, 45.7.

²⁸ 3 COLLIER, *op. cit. supra* note 3, at 760 n.26, 960.

²⁹ *Id.* at 960.

³⁰ For cases construing the antecedent debt feature of a voidable preference, see 3 COLLIER, *op. cit. supra* note 3, ¶¶ 60.19, 60.39[4].

in the same condition it was in prior to the transfer? Antecedent debt has been given its usual and ordinary meaning through the years by all courts deciding this issue in preference cases.³¹ For state law to come along and offer a meaning wholly abnormal to the term certainly appears to be contrary to the purposes of section 60(a) and express congressional intent. Had Congress not meant for antecedent debt to have its clear meaning, one would suppose the Bankruptcy Act would contain a definition or would expressly require reference to state law for definition.

One post-UCC opinion has been referred to as making section 9-108 effectual in bankruptcy proceedings.³² This is an opinion by Referee Hiller in *In re Newkirk Mining Co.*³³ The reference is not well founded. *Newkirk* arose on a reclamation petition filed by a secured creditor which was opposed by the trustee in bankruptcy. The security agreement contained an after-acquired property clause and some of the property sought to be reclaimed was after-acquired. Significantly, no dates are mentioned in the opinion. When was the bankruptcy petition filed? When was the after-acquired property obtained? The court states merely that section 9-204(3) permits a security agreement to include after-acquired property. It then continues:

In an attempt to avoid, to some extent at least, a clash with Section 60 of the Bankruptcy Act, Article 9-108(2) provides that the security interest in after-acquired property is to be deemed as having taken "for value," and not as security for a pre-existing debt, so as to constitute a possible preference under Section 60 of the Bankruptcy Act.³⁴

Nothing further is said with regard to section 9-108. The language quoted is merely descriptive of the section and no indication, expressly or inferentially, is given regarding the effectiveness of section 9-108. This case, then, cannot be said to hold in favor of section 9-108; at most, it is mere dictum. In a later decision Referee Snedecor says that Referee Hiller's statement is dictum and that the after-acquired equipment was obtained by the bankrupt sometime before section 60's four-month period.³⁵ In this later decision there is, in fact, a direct holding that the federal law is supreme over the state law, that section

³¹ *Ibid.*

³² See WILLIER & HART, UNIFORM COMMERCIAL CODE REPORTER-DIGEST 2-983 (1965).

³³ 54 Berks Co. L.J. 179 (E.D. Pa. 1962).

³⁴ *Id.* at 180-181.

³⁵ *In re Portland Newspaper Publishing Co.*, 2 CCH BANKR. L. REP. ¶ 61,722 (D. Ore. 1966).

9-108 does not have any validity in determining what is an antecedent debt for purposes of section 60(a) of the Bankruptcy Act.³⁶

In this case, *In re Portland Newspaper Publishing Co.*,³⁷ the security agreement covering accounts receivable "now existing or hereafter arising"³⁸ was executed on November 22, 1963, and the financing statement was filed on November 26, 1963. Substantially all of the accounts on which a security interest was claimed came into existence after November 26 and within four months of the filing of the bankruptcy petition. Referee Snedecor met the issue head-on, progressing from section 9-204 as to when the security interest attached to section 9-108 purporting to declare the transfer for new value. After reviewing the text material available and noting that no cases had as yet resolved the conflict, he held in favor of the Bankruptcy Act's supremacy.

Cause and Effect

The proponents of the UCC provisions emphasize two points to substantiate the section 9-108 proposal. As the Official Comment indicates, pre-Code decisions did not consider after-acquired property clauses as involving transfers for antecedent debts.³⁹ This may well be, but by the same token pre-Code law did not in so many words postpone the time of perfection on after-acquired property to the date on which the debtor acquired "rights in the collateral."⁴⁰ The concept of "attachment" incorporated into the Code is something born with the Code. Before it came into being, courts did not have to apply express statutory provisions similar to sections 9-303 and 9-204 to the mortgages in question. Although it may be perfectly sound in general to state that the Code is based on prior law and practice, that the Code's provisions reflect the experience and background through the years of development with the basic security law and that such experience and background should be used in interpreting and construing the Code,⁴¹ the starting point for construction must be with the Code itself. If its provisions on any particular issue are clear and,

³⁶ *Id.* at 71,143-44.

³⁷ 2 CCH BANKR. L. REP. ¶ 61,722 (D. Ore. 1966). This decision is before the district court for review and the National Conference of Commissioners on Uniform State Laws has been granted permission to file a brief *amicus curiae*. 4 CCH INSTALLMENT CREDIT GUIDE, Rep. Letter No. 123, at 4 (July 19, 1966).

³⁸ *Id.* at 71,136.

³⁹ See also 2 GILMORE, *op. cit. supra* note 9, § 45.6; Henson, *supra* note 14. Mr. Henson states that § 9-108 is only a "statutory recognition of what has been accepted by bankruptcy courts in appropriate cases in times past" *Id.* at 236 n.21. The only answer is, so what? The courts, in times past, did not have to contend with statutory language now found in §§ 9-303(1) and 9-204(1).

⁴⁰ UNIFORM COMMERCIAL CODE § 9-204(1).

⁴¹ See 1 GILMORE, *op. cit. supra* note 9, at vii-viii.

in particular, novel in some respect, then what was may not necessarily equal what is. Section 9-303 states when a security interest is perfected; section 9-204 postpones the date of perfection; but section 60(a) refers to state law only for a determination of the date of perfection. The conflict between section 9-108 and section 60(a) then arises, and regardless of earlier law or policy reasons, a state's definition of antecedent debt or any other element of a voidable preference, particularly an out of the ordinary definition, should have no bearing.⁴²

The second basic argument offered to uphold section 9-108 is the substitution theory.⁴³ The newly acquired inventory or accounts are mere substitutions for the earlier existing inventory or accounts to which the security interest attached and was therefore perfected beyond the critical four-month period. In other words, on February 15 *D* had 125,000 dollars worth of inventory; on June 15 he had 125,000 dollars worth of inventory, all of which, though newly acquired, may be considered a substitution of the original inventory. The secured interest is not enhanced; the debtor's assets are to no greater extent being withheld from general creditors, and the secured creditor gets only what he bargained for when he made the advance to the debtor. This argument is sound. It makes sense. But it is irrelevant. It would be relevant and should be a definite policy consideration only if sections 9-303 and 9-204 were not in the Code.

Section 9-204 grants explicit permission for the use of after-acquired property to secure loans;⁴⁴ but just as explicitly it postpones attachment of the security interest until the debtor acquires rights in the collateral⁴⁵ or until accounts come into existence.⁴⁶ Section 9-303

⁴² It is argued that "section 9-108 is not an effort by a state statute to legislate a new definition for the benefit of bankruptcy proceedings; if it were, it certainly would not be given any effect in bankruptcy." Henson, *supra* note 14, at 236 n.21. However, as the Official Comment itself indicates, the section is certainly for the benefit of bankruptcy proceedings. When § 9-108 purports to give a meaning to "new value" by providing that what is an antecedent debt is deemed not an antecedent debt, how far away from definition can this be? Again, however, the entire problem stems not from § 9-108 as such; it derives from the postponement effects of § 9-303(1) and § 9-204(1), which do not appear to have had any counterpart in pre-Code law.

⁴³ See *In re Portland Newspaper Publishing Co.*, 2 CCH BANKR. L. REP. ¶ 61,722 (D. Ore. 1966); Henson, *supra* note 14. Ordinarily, a substitution of collateral does not create a preference, but the substitution and release of collateral must be simultaneous. 3 COLLIER, *op. cit. supra* note 3, ¶ 60.21. But if new accounts are assigned for old collected accounts within the four-month period, a preference is created. *Ibid.* In the problem under discussion, there is no contemporaneous substitution because the old accounts were presumably collected or the old inventory sold in the regular course of business. The Code does not require the debtor to account for the proceeds, UNIFORM COMMERCIAL CODE § 9-205, but this flexibility does not affect the § 60 voidable preference problem. See also 1 COOGAN, HOGAN & VAGTS, *op. cit. supra* note 12, ch. 11.

⁴⁴ "Except as otherwise provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement." UNIFORM COMMERCIAL CODE § 9-204(3).

⁴⁵ UNIFORM COMMERCIAL CODE § 9-204(1).

⁴⁶ UNIFORM COMMERCIAL CODE § 9-204(2)(b).

says there can be no perfection until the security interest attaches. In view of the clear statutory mandate, how can considerations of policy be relevant? How can one avoid this language by offering a substitution of collateral theory? As Referee Snedecor so neatly put it: "We must remember that we are dealing with a new statute which must be accepted on its own terms" ⁴⁷ If there were ambiguity in the terms of the statute, if there were silence on one of these points, there would be room for interpolation of ideas, for construction and for giving full effect to the Code's intent. No such room is offered. The Code itself set the rules of the game and the courts must play the game according to those rules.

Proposals

The fault, if one can use that term, for creating the conflict is in the UCC and not in the Bankruptcy Act. There is no question that the draftsmen of the UCC were well aware of the elements of a voidable preference when article 9 was being written. Why they chose to use the language they did is an open question. Why, in drafting article 9, they chose deliberately to create this conflict is a puzzling question.

Professor Gilmore, one of the draftsmen, states: "It is unfortunate that the draftsmen did not hit on a more neutral way of expressing an idea which, although it is surely one on which reasonable men can differ, is neither shocking nor ludicrous." ⁴⁸ It may be neither shocking nor ludicrous but it is puzzling. The language he refers to is the section 9-108 language; this language is immaterial. What is material is the tie-in between sections 9-303 and 9-204. Without its cross-reference or without the postponement of the time of attaching, there would be no section 60 conflict and no antecedent debt problem. What is shocking is that this conflict was deliberately created.

What solutions are possible? One possibility is that the problem will be solved by the United States Supreme Court. But much time will pass before the Supreme Court acts. During this time, courts, lawyers and secured lenders will be enveloped by a good deal of uncertainty. This solution is not a very helpful one, obviously.

Another possibility is statutory amendment. Either the Code or the Bankruptcy Act could be changed to resolve the conflict. Because of the complexity of both statutes, however, an amendment cannot be hurried. Perhaps the Bankruptcy Act could define "antecedent" debt in section 1 to conform to the Code's definition in section

⁴⁷ *In re Portland Newspaper Publishing Co.*, 2 CCH BANKR. L. REP. ¶ 61,722, at 71,141 (D. Ore. 1966). See note 43 *supra*.

⁴⁸ 2 GILMORE, *op. cit. supra* note 9, at 1309-10.

9-108. The difficulty would be that since section 9-108 is not the only part of the Code that presents section 60 problems, it may be necessary to tackle section 60(a) as a whole. Amending section 9-204 or 9-303 of the Code is possible. But rewording section 9-108 would not be enough. It should be recognized that the federal law defines the elements of a voidable preference.⁴⁹ Since section 60(a) refers to state law for perfection, the perfection sections of the Code should be the source for change.

For example, what is the need for section 9-204(1) in the first place? The idea of when a security interest "attaches" does not seem to have much utility, although it does make explicit that there must be an obligation and agreement. Why not delete the reference to the debtor's rights in the collateral? Why could not perfection (incorporating sections 9-303 and 9-204) depend on the existence of a security agreement, an obligation (value) and filing (or whatever other steps for perfection are required)? It even seems possible to untie section 9-204 from section 9-303 and not to require attachment for perfection. Section 9-204 could stand alone, coming into play only in cases of priority conflict under section 9-312(5)(b). The underlying basis for these thoughts is that the security interest in after-acquired property could be considered perfected at the time the financing transaction and filing occur without any need to wait for the debtor to acquire the property. There would then be no problem with the section 60(a) four-month period or antecedent debt element.

A Last Alternative

It has been noted that section 60 refers to state law for the time of perfection of a security interest. The Bankruptcy Act sets up a judicial lien creditor test.⁵⁰ When the transfer is so far perfected that no judicial lien creditor could have obtained rights in the property superior to those of the transferee, the transfer is deemed made. The foregoing analysis emphasized the point that the UCC postpones perfection as such, in after-acquired property, to the date when the debtor acquires rights in the collateral. But this is *merely* a postponement of when the security interest is perfected. The mere fact that perfection is postponed does not necessarily mean that a judicial lien creditor could intervene and obtain priority. If reference is made back to the hypothetical, this thought can be spelled out more clearly.

After February and before June, say on March 15, *C*, who had obtained a judgment against *D*, acquires a lien by delivery of a writ

⁴⁹ 30 Stat. 562 (1898), as amended, 11 U.S.C. § 96(b) (1964).

⁵⁰ See note 5 *supra*.

of execution to the proper enforcement officer. Clearly on March 15 *C*'s lien does not encompass *D*'s June inventory; it is not in existence. When *D* acquires the June inventory, *S*'s secured interest automatically attaches without any further act by *S*. There is no way in which *C* could defeat *S*'s secured interest. In supposing this type of problem, Professor Gilmore takes the position that the lien creditor would lose to the secured creditor.⁵¹ Assuming this to be the case, the analysis boils down to the situation where the transfer occurs in June but no intervening lien creditors could have obtained superior rights in the collateral *at any time*; not between February and June and not after June. Thus June is not the key date to determine the time of the transfer. As far as after-acquired inventory is concerned, the rights of lien creditors are to be tested in February, when the security agreement was entered into, value was given and filing occurred. This was beyond the four-month period, and contemporaneous consideration passed. It is not sufficient, therefore, to look solely to the time of the transfer, *i.e.*, attachment under section 9-204; it is necessary to look also to section 9-301(1)(b) which gives rights to lien creditors. Even though attachment is postponed, lien creditors' rights have ceased to exist even before attachment; the transfer should be deemed made without reference to the time the debtor obtains rights in the collateral.

This argument rests on the assumption that the security interest attaches automatically and before the judgment lien does. In fact, both attach simultaneously, so the answer is not that clear. Both Professor Gilmore and Mr. Coogan see problems in the area of intangibles financing on this very issue and they conclude that neither the Code nor the non-Code state law provides the priority answer.⁵² The argument, therefore, is offered on this "if" basis only, and the particular language of non-Code procedural law affecting the judgment creditor's rights must be consulted in each state.

Conclusion

What article 9 seeks to accomplish is clear. That inventory and receivables financing require for full practical effectiveness the permissive use of the after-acquired property features of the Code is also clear. The present method of accomplishing the stated purpose, however, defeats that purpose. Relief is needed and soon. Not even the last offered solution is free from doubt and it should not be required. Amendatory legislation is a sensible answer; in the meantime the financing world will have to take chances.

⁵¹ 2 GILMORE, *op. cit. supra* note 9, § 35.6, at 936.

⁵² 2 COOGAN, HOGAN & VAGTS, *op. cit. supra* note 12, §§ 21.01-21.04; 1 GILMORE, *op. cit. supra* note 9, at 398.