

## NOTE

### POLICING ACCOUNTS RECEIVABLE AND INVENTORY UNDER MODERN FACTOR'S LEGISLATION

#### THE FACTORING BUSINESS \*

The last thirty years have seen the development of a new source of credit for small businessmen—the assignment of accounts receivable as collateral security for loans, without notice to the account debtor. Several private finance companies began to operate in this field in the early twenties,<sup>1</sup> and since 1933 commercial banks have entered the business in increasing numbers.<sup>2</sup> This financing is commonly called “factoring,” and those engaged in it, whether private finance companies or commercial banks, will be referred to herein as “factors.” The modern factor differs from the “straight line” factor, who simply purchased accounts and notified the account debtor that payments were to be made to him, retaining no recourse against the seller of the accounts if account debtors defaulted.<sup>3</sup> For the modern factor, the assignment, whether drafted as a purchase and sale or as a security instrument,<sup>4</sup> functions as security for the borrower's personal obligation, and notification to the account debtor that the account is to be paid to the factor is a last resort, equivalent to foreclosure.<sup>5</sup> Modern factors may also lend upon the security of inventory, although accounts are preferred because the existence of a third-party obligation lessens the lender's risk.<sup>6</sup>

Accounts receivable financing begins when the borrower presents the factor with a schedule of accounts payable at specified intervals, usually thirty, sixty, or ninety days, together with copies of the invoice for each account. After investigating the borrower, his business and the particular invoices, the factor will calculate a value, or “aging,” for the accounts,

---

\* Observations in this Note as to the practical aspects of the factoring business are based upon interviews with private factors and commercial bank officials in the Philadelphia area.

1. SAULNER & JACOBY, ACCOUNTS RECEIVABLE FINANCING 47 (Nat. Bur. of Econ. Research 1943).

2. *Id.* at 53.

3. *Id.* at 17, 19.

4. The agreement may provide that the accounts are “sold” to the factor, but with recourse against the borrower if some go bad, or may simply provide that the accounts are to secure payment of a demand note which the borrower executes. Private finance companies naturally favor the former instrument, while commercial banks generally use the latter.

5. Such sudden liquidation of the loan quite often will withdraw so much money anticipated by the borrower, that he may be forced out of business. This effect is accentuated by the reaction of general creditors when they see the factor closing in.

6. Inventory loans are not uncommonly made as a prelude to accounts receivable financing to commence when the inventory is sold, where the borrower is doing a seasonal business, or as a temporary supplement to accounts receivable financing.

usually expressed in terms of a percentage of their face value. The loan will also be a certain percentage of face value, known as the "rate of advance."<sup>7</sup> As accounts become due, the borrower collects the checks paid by the account debtors and sends them to the factor at intervals depending upon the volume of sales. It is not uncommon for the borrower to remit checks daily. When the factor receives and cashes the checks, he repays himself for his rate of advance thereon and pays the borrower the excess. As often as the borrower remits the checks, he assigns new accounts, and the process begins all over again. Interest, or service charge in the case of private factors, is not deducted from the borrower's equity in every account as checks are remitted, but is deducted from the equity in checks coming in at fixed intervals.<sup>8</sup> The terms of this "revolving loan" arrangement are governed by a contract between the borrower and the factor which extends over a considerable period of time. The contract is usually renewed, so that the arrangement may continue for many years. The contract may provide for the assigning of all accounts,<sup>9</sup> or for such accounts as the parties shall choose. However, it is always provided that the borrower will not finance his accounts and inventory with any other concern during the term of the contract.<sup>10</sup> The factor retains the privilege of refusing to lend on accounts which are too risky, and of going upon a notification basis at any time. It is usually agreed that the factor shall have a lien on merchandise returned to or recovered by the borrower from account debtors.

Obviously, the factor's greatest problem in making such financing profitable is the devising of a policing system to prevent loss due to carelessness or fraud on the part of the borrower. A keystone in any policing system is requiring prompt remittance to the factor of all checks collected on the accounts.<sup>11</sup> This gives the factor instant warning of any decline in

7. A typical transaction might be the following: The account debtor owes \$100, due in 30 days. Since he runs a very reputable and prompt-paying concern, the "aging" might be 90% of face value (\$90). Commercial banks generally allow themselves a margin of 10% between aging and rate of advance. Thus the borrower would get \$80 immediately. Private factors, who rely to a lesser extent upon the general credit of the borrower, allow themselves a 20% margin; \$70 would therefore be advanced.

8. These intervals might be anywhere between one week and one month. During the intervals, the factor totals up all his advances and figures up his service charges on the total. This charge is either deducted from the total receipts on the last day of the period, or else the borrower sends his own check for the amount of the charges, after he receives the remainder of the money coming to him on the settled accounts.

9. Since "all accounts" would include some for which payment is made in cash, the contract will provide that, in such case, the borrower will take all cash proceeds to a bank, secure a cashier's check for the exact amount of the cash payments, and immediately send the cashier's check to the factor.

10. Factors justify this provision on the ground that if a borrower finances his accounts with two or more factors, he is likely to become confused as to which accounts are assigned to each factor, with the result that checks may be remitted to the wrong factor.

11. There are other aspects of policing, such as regularly auditing the borrower's books, investigating his invoices, investigating his physical plant and inventory, checking his financial statements, and policing the borrower's disposition of the loan, but the requirement that checks be promptly remitted remains a central feature.

the borrower's collections, and a somewhat delayed warning of any decline in sales. Also, by investigating the checks the factor can discover whether the borrower has been supplying him with false invoices and hence actually assigning him nothing, repaying the factor with his own money. In such a case, the borrower may be "kiting" his assignments, *i.e.*, keeping one step ahead of the factor by presenting to him the appearance of a growing business, making ever-increasing assignments of false accounts and securing larger and larger loans. For similar reasons, factors make use of the services of a field warehousing company when inventory financing is involved in the transaction, regardless of whether the security device is a field warehouseman's receipt or a factor's lien.<sup>12</sup>

In accounts receivable financing, unless the borrower is doing a seasonal business, the separate totals of loans outstanding and accounts assigned remain fairly constant at all times. For this reason, it may be suggested that the financing would be simpler if no checks were remitted and the borrower paid interest in regular installments on a single loan, secured by a fixed value of accounts to be replenished by new assignments as old accounts were paid. Factors consider such a method of financing impractical because of the necessity of requiring regular remittances in order to police their assignments, and do not feel that checking invoices would be sufficient in itself. For the same reason, factors are wary of substituting new accounts for old before the old accounts are paid, although this procedure may be resorted to occasionally and to a limited extent.<sup>13</sup> Due to the impracticability of requiring remittances of checks from retailers, who take such a large proportion of their payments in cash and handle multitudes of small checks, factors seldom lend to retailers.

#### BENEDICT V. RATNER<sup>14</sup>

In 1925 this decision set forth the rule that, in order to preserve a lien on accounts receivable, the lender must require the borrower to account for all the proceeds of assigned accounts, and must forbid the borrower to divert such proceeds to his own use. The lender's "consent" to such conduct on the part of the borrower invalidates the lien, whether the consent be express<sup>15</sup> or implied in fact.<sup>16</sup> Under this rule the lien is destroyed if the lender consents to the commingling of any of the proceeds with the borrower's own funds.<sup>17</sup> If the loan contract provides for a lien upon returned or recovered goods, as most do, the borrower must not be allowed to credit

---

12. The Factor's Lien Acts, discussed *infra*, do not require possession in the factor, either actual or constructive, as a requisite of a valid lien.

13. Obviously, bookkeeping difficulties also preclude the use of this procedure on any wide-spread scale.

14. 268 U.S. 353 (1925).

15. *Ibid.*

16. *E.g.*, *Mount v. Norfolk Savings & Loan Corp.*, 192 F.2d 286 (4th Cir. 1951); *Lee v. State B. & T. Co.*, 38 F.2d 45 (2d Cir. 1930).

17. *Markovitz v. Taylor*, 94 F.2d 782 (3d Cir. 1938), *affirming In re Ferguson Drug Co.*, 19 F. Supp. 206 (E.D. Pa. 1937).

the account debtor with the price unless he segregates the goods,<sup>18</sup> and perhaps not even if he segregates the goods;<sup>19</sup> and must not be allowed to dispose of the goods without remitting the proceeds. Otherwise, the lender's lien, not only upon the particular account, but on all other accounts assigned to secure the loan, is invalidated.<sup>20</sup> However, the lien remains valid when the borrower is permitted to use the proceeds of old accounts after substituting therefor new accounts of equal value.<sup>21</sup> In the field of inventory financing, where the lien is initially validated by the recording of a security instrument, the lender must require prompt remittance of the proceeds of the sale of inventory, or in some states, may substitute new inventory, in order to maintain the validity of the lien.<sup>22</sup>

These rules are said to rest upon the proposition that a reservation of "dominion" over the security by the borrower is logically inconsistent with the "effective disposition of title,"<sup>23</sup> so that when the rules are not observed, no security title is created and the arrangement becomes fraudulent as a matter of law. A less conceptual basis for the doctrine of *Benedict v. Ratner* may be a desire to prevent frauds upon § 60 of the Bankruptcy Act,<sup>24</sup> which provides for the avoidance of "preferences" by the trustee in bankruptcy. Under that section, a preference is defined as a transfer by an insolvent debtor of his property for the benefit of a creditor on account of an antecedent debt, which results in a depletion of the debtor's estate and the creditor's obtaining a greater percentage of his debt than some other creditor of the same class,<sup>25</sup> when the transfer occurs within four months before the filing of a petition in bankruptcy.<sup>26</sup> Such a transfer may be avoided by the trustee upon proof that the creditor had reasonable cause to believe that the debtor was insolvent at the time it was made.<sup>27</sup> Certain

18. *Bloch v. Mill Factors Corp.*, 119 F.2d 536 (2d Cir. 1941). This case seems to obligate the factor to take a factor's lien, where available, on returned goods, even though he does not view the transaction as an inventory loan in the conventional sense.

19. See *Peterson v. Nat. Discount Corp.*, 179 Wash. 108, 35 P.2d 1097 (1934).

20. See cases cited in Cohen & Gerber, *Mortgages of Account Receivable*, 29 GEO. L.J. 555, 570 (1941), and in Note, 24 N.Y.U.L.Q. REV. 598, 602 (1949).

21. *Second Nat. Bank v. Phillips*, 189 F.2d 115 (5th Cir. 1951), reversing *In re American Creameries*, 90 F. Supp. 618 (S.D. Texas 1950); *In re Pusey*, *Maynes Breish Co.*, 122 F.2d 606 (3d Cir. 1941).

22. See *Benedict v. Ratner*, 268 U.S. 353, 363-364 (1925); see cases cited in Cohen & Gerber, *Mortgages of Merchandise*, 39 COL. L. REV. 1338, 1345-1347 (1939). See also, 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES §§ 582-591 (rev. ed. 1940).

23. *Benedict v. Ratner*, 268 U.S. 353, 364 (1925).

24. 30 STAT. 562 (1898), as amended by 52 STAT. 869 (1938), 11 U.S.C. § 96 (1946), and 64 STAT. 24, 11 U.S.C. § 96(a) (Supp. 1950). See 11 U.S.C.A. § 96, Historical Note.

25. "Creditors who, in the absence of preferences, are entitled to receive the same percentage upon their claims out of the estate of the bankrupt, are members of the same class. Those who are entitled to different percentages are of different classes." 3 COLLIER, BANKRUPTCY 860 (14th ed. 1941).

26. *Id.* at 753.

27. *Ibid.*

preferences are also avoidable under some state statutes.<sup>28</sup> The possibility of fraudulent evasion of this legislation is that a debtor may, within the four months period, make such an avoidable transfer of accounts receivable which arose before the four months period; and, knowing that he or his creditors will shortly file a petition in bankruptcy, will date the assignment to make it appear that it was executed before the four months period. Here the only evidence which could prove the correct date of the assignment rests wholly in the hands of the parties.<sup>29</sup> Account debtors will not know when the assignment was made because it is a non-notification arrangement. Had the assignment been policed, however, it could be proved by the trustee that it was a preference, for the date of indorsement and cashing of remitted checks will indicate, roughly, at what time the assignment was made. This information can be obtained by consulting the account debtors or perhaps through their banks. The moving policy behind the *Benedict* rule may therefore be that, as a preventive measure, fraud should be presumed as a matter of law where there has been no policing, because of the danger that during the time there was no policing there also was no assignment. It is true that there is no policing when new accounts are substituted for old, which is permitted under the *Benedict* rule. However, the assignment here would involve accounts which did not arise until after the beginning of the four months period so that if the substitution gave the assignee accounts of greater value than the old,<sup>30</sup> the trustee would meet no problem of proof. It is noteworthy that in most jurisdictions there was no legislation providing for the recording of accounts receivable financing arrangements when *Benedict v. Ratner* was decided.<sup>31</sup>

On the other hand, the rule requiring policing of inventory loans arose while statutes providing for the recordation of chattel mortgages were in effect.<sup>32</sup> Actually, this rule was deemed a lenient exception to a general policy invalidating inventory liens, which was based upon the assumption that the borrower was the "ostensible owner" of his inventory, even if a chattel mortgage covering the inventory had been recorded.<sup>33</sup> It was thought that this ostensible ownership misled general creditors to their prejudice in estimating their credit risk. Apparently, the courts thought it unlikely that such creditors would search the records for a chattel mort-

---

28. *E.g.*, WASH. REV. CODE §§ 23.48.010—.070 (1951). See also 2 GLENN, *op. cit. supra*, note 22, §§ 387-393.

29. See Pemberton, *Notice Filing for Assignments of Accounts Receivable*, 13 LAW & CONTEMP. PROB. 643, 660 and 653-654, n. 38 (1948).

30. When the transfer within the four month period is made in part for fresh consideration, it is only avoidable *pro tanto*. 52 STAT. 869 (1938), 11 U.S.C. § 96(b) (1947). See 3 COLLIER, *op. cit. supra* note 25, at 1022.

31. Cohen & Gerber, *Mortgages of Accounts Receivable*, 29 GEO. L.J. 555, 573-575 (1941).

32. Cohen & Gerber, *Mortgages of Merchandise*, 39 COL. L. REV. 1338, 1339 (1939).

33. *Id.* at 1340-1342. The authors note that the exception is based upon the reasoning that the borrower who polices does so as the agent of the lender and that this makes the arrangement not inconsistent with the existence of a security title in the lender. *Id.* at 1345-47.

gage on inventory. The policing exception on inventory loans was a conveniently available doctrine extended to accounts receivable to advance a quite different policy in the *Benedict* decision.<sup>34</sup> It should be noted that not until fairly recently has it become common to lend on inventory, and not until quite recently has legislation been enacted providing for the separate recording of factor's liens on inventory.<sup>35</sup>

Although decided during the era of "federal common law," the *Benedict* case purported to announce the common law of New York,<sup>36</sup> and has been assumed by the federal courts in bankruptcy cases to be the common law of many states.<sup>37</sup> Some state courts have expressly followed the case,<sup>38</sup> and authorities consider it to be the majority rule.<sup>39</sup>

The application of the doctrine to cases where an assignment of accounts also provides for a lien on returned merchandise causes considerable inconvenience to factors. In most cases the amount of such merchandise is comparatively small and no attempt is made to segregate the goods and have the proceeds from their resale applied to the loan.<sup>40</sup> Instead, the borrower's equity in checks remitted from other accounts is debited with the rate of advance on the price of the returned goods, and the borrower then adjusts his ledgers to wipe out the account which arose from those goods. The purpose of the clause providing for a lien on returned goods is to protect the factor in case the proportion of returned goods becomes too high. In such a case a system for policing sales of the returned goods and requiring remittance of the proceeds will be put into effect. The provisions appearing most often in recent legislation dealing with the *Benedict v. Ratner* problem are those aimed at eliminating extreme applications of the rule in returned goods cases.<sup>41</sup>

#### RECENT LEGISLATION

Since the mid-forties, twenty-eight states have enacted legislation modifying or abolishing, in whole or part, the policing rule of *Benedict v. Ratner*. These provisions appear as parts of statutes known as "Accounts Receivable

34. See 2 GLENN, *op. cit. supra* note 22, § 590, to the effect that the inventory policing rule rests upon the doctrine of ostensible ownership.

35. See the statutes cited under the next sub-heading, notes 44 *et seq. infra*.

36. 268 U.S. 353, 359, 365 (1925).

37. 4 COLLIER, BANKRUPTCY 1389-1390 (14th ed. 1942).

38. *Id.* at 1390-1391.

39. *Id.* at 1397, where it also appears that the doctrine has not been abolished by the UNIFORM FRAUDULENT CONVEYANCE ACT, 9A U.L.A. (1951). As to the effect of this Act, see also Cohen & Gerber, *Mortgages of Accounts Receivable*, 29 GEO. L.J. 555, 571 (1941).

40. Where the amount of returned goods and price allowances to account debtors is quite small, the courts will not find that the lender consented to an exercise of "dominion" by the borrower so as to invalidate the lien. *Bloch v. Mill Factors Corp.*, 134 F.2d 562 (2d Cir. 1943); *In re Gandolfi & Co.*, 113 F.2d 300 (2d Cir. 1940). However, the difficulty is that the factor must guess what amount of returned goods and price allowances the courts will find to be so small as to be insignificant. *Cf. Zydney v. N. Y. Credit Men's Ass'n.* 113 F.2d 986 (2d Cir. 1940).

41. *E.g.*, *Lee v. State B. & T. Co.*, 38 F.2d 45 (2d Cir. 1930), and see note 40, *supra*.

Acts"<sup>42</sup> and "Factor's Lien Acts." There is some degree of overlapping between the two types of statutes so that, where both are in effect, the factor may find it necessary to comply with both in order to obtain maximum protection against the *Benedict v. Ratner* rule. Of course, the factor may use other devices for inventory financing, but will usually be required to police.<sup>43</sup> Eight of the ten Factor's Lien Acts dealing with the problem permit not only liens on inventory, but may be availed of to secure a lien on the accounts to arise from the sale of liened merchandise.<sup>44</sup> Only the New Hampshire Factor's Lien Act provides for taking a lien upon accounts not arising from the sale of liened merchandise;<sup>45</sup> in other states, as to such accounts, the Accounts Receivable Acts must be complied with. In financing accounts receivable some states require the filing of a notice of intention to assign accounts under an Accounts Receivable Act in order to acquire any lien;<sup>46</sup> in other states this is required only when the financing is on a non-notification basis.<sup>47</sup>

42. The provisions of these acts dealing with the *Benedict* problem were a side-light to the principal aim of these statutes, which was to abolish the "English" rule that a subsequent bona fide assignee for value, who notifies the account debtor of the assignment, prevails over a prior assignee who has not notified. 2 GLENN, *op. cit. supra* note 22, § 527. Such a change became necessary in jurisdictions adhering to this rule because of the Supreme Court's decision in *Corn Exchange Nat. B. & T. Co. v. Klauder*, 318 U.S. 434 (1943), that the trustee in bankruptcy was possessed of the rights of a hypothetical subsequent assignee for value and could hence prevail over the lien of a non-notifying assignee. See Koessler, *New Legislation Affecting Non-Notification Financing of Accounts Receivable*, 44 MICH. L. REV. 563, 575, 584-604 (1946). The *Klauder* case has since been nullified by amending § 60(a) of the Bankruptcy Act. 64 STAT. 24, 11 U.S.C. § 96(a) (Supp. 1950); See Countryman, *The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act*, 16 LAW & CONTEMP. PROB. 76, 87-89 (1951).

43. As to chattel mortgages, policing is required. See Cohen & Gerber, *Mortgages of Merchandise*, 39 COL. L. REV. 1338, 1345-1347 (1939). As to trust receipts, the situation is ambiguous. The UNIFORM TRUST RECEIPTS ACT § 10(b), (c) 9A U.L.A. (1951) imposes the *Benedict* rule as to proceeds of inventory, but is silent as to inventory itself. The Commissioners' Prefatory Note, 9A U.L.A. 274-283 (1951), however, discloses no intention to make any changes in the *Benedict* rule. See also § 17 of the Act.

As to conditional sales, there is a divergence of opinion among the courts, many holding that the *Benedict* rule does not apply. See 4 COLLIER, *op. cit. supra* note 37, at 1384-1385. Actually, a *Benedict* situation is unlikely to arise in trust receipt or conditional sale financing of inventory, since such lending is customarily done on a self-liquidating rather than a revolving long-term loan basis. As long as the lender has only the goods enumerated in the particular trust receipt or conditional sale document to rely upon, it is quite unlikely that he will be tempted to deviate from strict policing as to these goods.

44. ALA. CODE ANN. tit. 47, §§ 132(1)-132(8) (Michie Supp. 1949); Maine Pub. Laws 1945 c. 79; MINN. STAT. ANN. §§ 514.80-514.91 (1949); N.J. STAT. ANN. §§ 2:60-252 to 2:60-260 (Supp. 1951); N.Y. PERS. PROP. LAW § 45; VT. REV. STAT. §§ 2738-2751 (1947); W. VA. CODE ANN. §§ 3946(17)-3946(24) (Michie Supp. 1949); Wis. Laws 1951, c. 486. The only Factor's Lien Act containing a provision dealing with the effect of *Benedict v. Ratner* on accounts which does not provide for a lien upon any accounts is TEX. REV. CIV. STAT. ANN. art. 5506c (Vernon Supp. 1952). The Rhode Island statute (R.I. GEN. LAWS ANN. art. 447 (1938)) provides for a lien on accounts arising from liened merchandise, but does not deal with the *Benedict* problem.

45. N.H. LAWS 1951, c. 218, § 4, amending N.H. LAWS 1949, c. 156 and N.H. LAWS 1943, c. 161.

46. See, e.g., CAL. CIV. CODE tit. 14, § 3018 (Deering Supp. 1951); OHIO GEN. CODE ANN. §§ 8509-6(1) and 8509-5(1) (Page Supp. 1951).

47. See, e.g., N.C. GEN. STAT. § 44-80 (1950).

Most of these recent statutes are aimed at preventing extreme applications of the *Benedict v. Ratner* rule in cases where goods are returned to or recovered by the borrower.<sup>48</sup> These follow the lead of the New York Factor's Lien Act<sup>49</sup> in providing that if the borrower deals with returned or recovered goods as his own property or makes a price adjustment in favor of an account debtor, the lien of the lender upon any balance still owing on the particular account or on any other account shall not be invalidated merely because the lender consented to such conduct. The New York Act and Factor's Lien Acts in five other states<sup>50</sup> afford this protection to assignments of accounts when a factor's lien has been filed, whether or not the accounts arise from goods subject to the factor's lien. The Vermont statute extends this protection only to assignments of accounts arising from liened goods.<sup>51</sup> Accounts Receivable Acts in fourteen states afford this protection to all accounts receivable.<sup>52</sup>

Six states have adopted Accounts Receivable Acts which abolish the *Benedict* doctrine as to all assignments of accounts when the parties comply with filing provisions.<sup>53</sup> Factor's Lien Acts in two states abolish the doctrine both as to inventory and as to accounts arising from liened inventory when filing requirements have been satisfied.<sup>54</sup> Although there is an Accounts Receivable Act in New Hampshire,<sup>55</sup> the Factor's Lien Act in that state has recently been amended to permit the filing of liens not only upon merchandise but also upon accounts, whether or not the merchandise from which the accounts arise is also subject to the lien.<sup>56</sup> The amendment abolishes the policing rule as to all accounts receivable, provided that filing requirements have been met.<sup>57</sup> This was generated by a federal decision that the *Benedict* rule applied to accounts receivable under the New Hampshire Accounts Receivable Act.<sup>58</sup> On the other hand, there is not now and never has been any express provision in the Factor's Lien Act either

48. See note 40 *supra* and accompanying text.

49. N.Y. PERS. PROP. LAW § 45.

50. The Alabama, Maine, New Jersey, Texas and West Virginia statutes cited *supra*, note 44. The Texas statute provides only for the case of price adjustments by the borrower, and not for the case of the borrower who uses the proceeds of returned goods. TEX. REV. CIV. STAT. ANN. art. 5506c, § 6 (Vernon Supp. 1952). The Texas Act does not apply to any stock of goods exposed daily for retail sale in parcels. *Id.* § 10.

51. VT. REV. STAT. § 2748 (1947).

52. ALA. CODE ANN. tit. 39, § 212 (Michie Supp. 1949); CAL. CIV. CODE tit. 14, § 3025 (Deering 1949); COLO. STAT. ANN. c. 12(A), § 5 (Michie Supp. 1951); CONN. REV. GEN. STAT. § 6722 (1949); FLA. STAT. § 524.05 (1949); IDAHO CODE ANN. § 64-905 (1948); KAN. GEN. STAT. ANN. § 58-805 (1949); MAINE Pub. Laws 1945, c. 100, § 170-B; MASS. ANN. LAWS c. 107A, § 5 (1946); MINN. STAT. § 521.05 (1949); MO. REV. STAT. § 410.050 (1949); NEB. REV. STAT. § 69-616 (1950); TEX. REV. CIV. STAT. ANN. art. 260-1 (Vernon 1947); 5 UTAH CODE ANN. § 81B-05 (Supp. 1951).

53. Ga. Laws 1952, No. 811, § 8; MICH. STAT. ANN. tit. 14, § 19.846 (Rice Supp. 1951); N.C. GEN. STAT. § 44-83 (1950); OHIO GEN. CODE ANN. § 8509-6b (Page Supp. 1951); S.C. LAWS 1946, No. 433, p. 1324, § 1(7); 5 WASH. REV. CODE § 63.16.030 (1951).

54. MINN. STAT. § 514.89 (1949); Wis. Laws 1951, c. 486, § 241.145(10).

55. N.H. LAWS 1945, c. 19.

56. N.H. LAWS 1951, c. 218, § 1, amending N.H. LAWS 1943, c. 161 and N.H. LAWS 1949, c. 156.

57. N.H. LAWS 1951, c. 218, § 4.

58. Manchester Nat. Bank v. Roche, 186 F.2d 827 (1st Cir. 1951).



modifying or abolishing the policing rule as to inventory. In the face of this lack of statutory direction, the state supreme court held that the *Benedict* rule, which had been the common law of the state,<sup>59</sup> was abolished as to inventory, since the Act contained no provision requiring policing.<sup>60</sup> This is highly significant in that twelve states have enacted Factor's Lien Acts requiring filing, but containing no provision expressly approving or rejecting the *Benedict* doctrine.<sup>61</sup> Since the New Hampshire case is the only one construing this type of statute, it will undoubtedly be urged as precedent for the abolition of the doctrine as to inventory.

Some states have enacted Accounts Receivable Acts which do not require filing, but are merely aimed at changing the "English" rule requiring notice to the account debtor to protect an assignment of an account against a subsequent assignee.<sup>62</sup> A federal court has held that such a "validation" statute does not alter the rule of *Benedict v. Ratner*.<sup>63</sup> The same result would probably be reached under statutes requiring the notation of an assignment in the assignor's books to validate it against subsequent assignees.<sup>64</sup> It appears obvious that the statutes dealing only with the returned goods problem are intended to do away only with that extreme application of the *Benedict v. Ratner* rule.<sup>65</sup>

It is interesting to note that the Factor's Lien Acts and Accounts Receivable Acts generally follow the example of the Uniform Trust Receipts Act<sup>66</sup> in requiring only the filing of a general notice of the financing arrangement, without the necessity of filing amended notices specifically covering property acquired thereafter.<sup>67</sup>

#### CONCLUSION

It has been seen that factors consider that requiring prompt remittance of the proceeds of assigned accounts is necessary for their protection against

59. *In re Freeman*, 84 F. Supp. 441 (D.N.H. 1949) (recorded chattel mortgage); *Putnam v. Osgood*, 52 N.H. 148 (1872) (unrecorded chattel mortgage).

60. *Colbath v. Mechanick's Nat. Bank*, 96 N.H. 110, 70 A.2d 608 (1950).

61. CONN. REV. GEN. STAT. §§ 7255-7264 (1949); Del. Laws 1947, c. 163; MD. ANN. CODE art. 2, §§ 21-28 (Flack 1951); MASS. ANN. LAWS c. 255, §§ 40-47 (Supp. 1951); MICH. STAT. ANN. §§ 26.415(1)-26.415(12) (Rice Supp. 1951); Mo. REV. STAT. §§ 430.260-430.320 (1949); N.C. GEN. STAT. §§ 44-70 to 44-76 (1950); OHIO GEN. CODE ANN. §§ 8364-1 to 8364-6 (Page Supp. 1951); PA. STAT. ANN. tit. 6, §§ 221-229 (Purdon Supp. 1951); R.I. GEN. LAWS ANN. c. 447 (1938); S.C. CODE §§ 8785 to 8785-8 (1942); VA. CODE §§ 55-143 to 55-150 (1950).

62. See note 42 *supra*.

63. *Mount v. Norfolk Savings & Loan Corp.*, 192 F.2d 286 (4th Cir. 1951), construing VA. CODE §§ 11-5 to 11-7 (1950), since amended by VA. CODE § 11-6 (Supp. 1952).

64. N.D. Laws 1949, c. 113; PA. STAT. ANN. tit. 69, §§ 561-563 (Purdon Supp. 1951). A third such statute, Ga. Laws 1943, No. 178, was repealed by Ga. Laws 1952, No. 811.

65. See Malcolm, *The Act Relative to Assignments of Accounts Receivable—Of Interest to Small Business Concerns*, 30 MASS. L.Q. 23, 36-37 (Oct. 1945).

66. Section 13, 9A U.L.A. (1951).

67. *Factor's Lien Acts: E.g.*, OHIO GEN. CODE ANN. §§ 8364-1 to 8364-6 (Page Supp. 1951); *In re Wyse Laboratories, Inc.*, 55 Ohio Law Abs. 321 (Referee in Bankruptcy, S.D. Ohio 1949). *Accounts Receivable Acts: E.g.*, 1 TEX. REV. CIV. STAT. ANN. art. 260-1 (Vernon 1947); *Second Nat. Bank v. Phillips*, 189 F.2d 115 (5th Cir. 1951), reversing *In re American Creameries*, 90 F. Supp. 618 (S.D. Texas 1950); *In re Cummings*, 99 F. Supp. 690 (S.D. Texas 1951).

borrowers. Thus it may be seriously questioned whether abolishing the *Benedict v. Ratner* policing requirement would have any business effect. On the other hand, it is not the function of the law to punish lenders because they have been careless with their security, nor to stand in their way should they desire to find some better and cheaper method of policing, if such exists. It may well be that lenders, and especially banks, may be willing to make loans on inventory and accounts without the strict policing which the rule requires where the borrower's financial status is nearly sufficient to justify an open line of credit. When a statute permitting public recordation of accounts receivable financing arrangements exists and has been complied with,<sup>68</sup> the apparent justification for the rule—the danger of fraudulent evasion of statutes forbidding preferences—ceases; for then there can be no contest as to when the financing arrangement was made, and information as to the date when any particular account arose is not confined to the lender and the borrower. Should the financing arrangement on record provide for the assigning of only part of the borrower's accounts the danger that the borrower may preferentially assign additional accounts to secure the loan, hiding the fact of the preference, seems too small to justify retaining the rule. The fact that accounts receivable financing is done only on an exclusive basis, which assures the factor of the better accounts, coupled with the factor's customary reservations of safety margins between agings and rate of advance, reduces the probability that he would find himself in need of such a preference.<sup>69</sup>

So far as policing rules as to inventory rest upon the doctrine of ostensible ownership rather than upon the policy which entered the law with the *Benedict v. Ratner* decision, the rules would seem to be out-of-date. Inventory loans have now become sufficiently common that it does not appear that general creditors or the credit agencies from which they obtain their information may reasonably assume that inventory is a lien-free asset, especially when resort to the public records is facilitated by the separate filing of inventory liens. The Uniform Commercial Code, which contains broad filing requirements,<sup>70</sup> accepts this theory and expressly abolishes the *Benedict v. Ratner* doctrine as to both accounts receivable and inventory.<sup>71</sup>

---

68. Some borrowers object to the publicity of having their assignments recorded, on the ground that it makes them look like a poor risk to their general creditors. Perhaps some creditors do attach a stigma to debtors borrowing on their accounts, although this attitude dates from an era in which such financing was not common and only resorted to as a desperation measure. At the present time, the purpose of most accounts receivable financing is to provide funds for business expansion.

69. The probable result of retaining the *Benedict* rule in cases where some but not all the borrower's accounts are to be assigned under the arrangement on record would be that, in the future, recorded financing arrangements would provide that *all* accounts are subject to the lien. This follows from the fact that, in practice, the borrower is obligated by his agreement with the factor not to assign accounts to anyone else, and hence is indifferent as to whether some or all of his accounts are security for the loan.

70. § 9-302 (Official Draft 1952).

71. § 9-205 and comment (Official Draft 1952).