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ARTICLE 9 AND THE BANKRUPTCY ACT

I. General Conflict in Purposes

The fundamental theory undergirding the concept of insolvency proceedings and application of the Federal Bankruptcy Act may best be summarized as an attempt to equalize the creditors of the insolvent debtor. The basis of such a theory lies in the belief that it serves a broad and equitable interest in regulating the "carving up" of a debtor after his solvency is gone. The Bankruptcy Act, in its effort to effectuate this purpose of equalizing the distribution of assets to creditors, establishes regulatory barriers about the bankrupt to prevent one or several creditors from gaining advantage over others less alert.

The central figure in the scheme of equalization is the trustee in bankruptcy, who stands as the representative of all unsecured creditors and not merely as the alter ego of the bankrupt. As to all property of the bankrupt on the date of bankruptcy the trustee is vested with all the rights, remedies and powers of a creditor holding a judicial lien on the property; therefore, he stands under the act ahead of any unperfected security interest. As such an ideal lien creditor, the trustee is empowered to avoid judicial liens obtained within four months of bankruptcy, or to preserve them for the benefit of the bankrupt estate. In delineated instances, the act provides for postponement, restriction or invalidation of non-possessor statutory liens on personal property. It provides for the setting aside of fraudulent transfers made within one year of bankruptcy, or for longer periods of time if applicable state law so requires. Among the most formidable and important of the trustee's powers lies in his ability to vacate preferential transfers from the bankrupt's property which are perfected within four months of bankruptcy. The trustee may reject executory contracts, and the act limits the amount of provable damages resulting from the rejection of unexpired

2. Date of bankruptcy refers to the date on which the petition is filed. Bankruptcy Act § 1(13), 11 U.S.C. § 1(13) (1964).
3. Id. § 70(c), 11 U.S.C.A. § 110(c) (Supp. 1966).
5. Id. § 67(c), 11 U.S.C. § 107(c).
6. Id. § 67(d), 11 U.S.C. § 107(d).
7. Id. § 70(e), 11 U.S.C. § 110(e).
9. Id. § 70(b), 11 U.S.C. § 110(b).
leaseholds. Post bankruptcy interest is not generally provable as part of a claim, and the act proscribes or limits penalties or forfeitures on debts owing to either the United States or any state.

Despite the thrust of its objective, the Bankruptcy Act has not achieved a total leveling process among creditors, and not all creditors are rendered equal in fact. Within the act itself priorities among claiming creditors are created, and further provisions establish or provide for perfection of statutory liens. Provisions such as the latter two inject a degree of imbalance into the equation of creditors concept, but little doubt exists that the trustee and the bankruptcy courts are imbued with the authority to effectuate what is within the contemplation of the Bankruptcy Act a just and fair distribution to creditors.

Article 9 of the Uniform Commercial Code, rather than lumping all creditors together in a non-differentiated class, creates or permits the creation of security interests in personal property, thereby creating the preferred or secured creditor. At the very foundation of the article is the validation and strengthening of the position of the secured creditor as against all other interests.

This enactment supersedes all previous state legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts, factor's liens, and assignments of accounts receivables. The commendable objective of Article 9 is to replace diverse technicalities with simplified and uniform rules, with a view towards more efficient and economical operation of today's immense variety of secured financing transactions. As a concomitant of this objective, the general paramountcy of secured over non-secured lenders has been established.

The basic premise upon which Article 9 is founded runs inherently contrary to the undergirding principles of proceedings in federal bankruptcy; therefore, conflicts are inevitable and problems in application will be increasingly surfaced during the "formative years” of Article 9 development. There exists a built-

10. Id. § 63(a) (9), 11 U.S.C. § 103(a) (9).
11. Except where a consensual lien is adequately secured. Id. § 63(a) (1), 11 U.S.C. § 103(a) (1).
12. Id. § 57(j), 11 U.S.C. § 93(j).
13. Id. § 64, 11 U.S.C. § 104.
14. Id. §§ 67(b), 67(c), 11 U.S.C. §§ 107(b), 107(c).
in potential for conflict. The trustee in bankruptcy, as representative of all unsecured creditors claiming an interest in the bankrupt estate, is both empowered and obligated to accumulate for distribution as much in assets as possible. On the other hand, Article 9, as bastion for the insolvent's secured creditors, must withstand the trustee's vigorous assaults. In many instances the confrontation will not merely arise as a conflict of laws, but will represent a clash in underlying philosophies.

II. THE UCC, THE BANKRUPTCY ACT AND THE PRE-EMPTION DOCTRINE

As has been noted, the basic philosophies represented by the Federal Bankruptcy Act and the Code are antagonistic. For this reason there are understandably specific provisions of the two separate bodies of law which will, at best, find accommodation with the other difficult. Particularly during the formative years of Uniform Commercial Code interpretation in conjunction with bankruptcy proceedings, the concept variously referred to as "paramountcy," "supremacy" or "pre-emption" will be of much interest. The Constitution of the United States\textsuperscript{17} establishes in Congress the "power to... establish... uniform Laws on the subject of Bankruptcies throughout the United States." In response to this mandate Congress enacted the Bankruptcy Act;\textsuperscript{18} therefore, its provisions must be regarded as paramount to any state law on the subject.\textsuperscript{19}

Section 1-103\textsuperscript{20} of the Code, an element of state law, provides that "[u]nless displaced by the particular provisions of this Act, the principles of law and equity, including...the law relative to...bankruptcy...shall supplement its provisions."\textsuperscript{21} This statement notwithstanding, as an increment of state law, any provision of the Code found to be in conflict with the operation of the Bankruptcy Act must be deemed subordinate to its terms.\textsuperscript{22} In considering the validity of a state insolvency statute in \textit{International Shoe Company v. Pinkus},\textsuperscript{23} the Supreme Court

\begin{footnotesize}
18. 30 Stat. 544 (1898).
21. Id. (emphasis added).
23. 278 U.S. 261 (1928).
\end{footnotesize}
determined that "a State is without power to make or enforce any law governing bankruptcies that . . . conflicts with the national bankruptcy laws,"\textsuperscript{24} and that "states may not pass or enforce laws to interfere with or complement the Bankruptcy Act."\textsuperscript{25} It has been abundantly illustrated, through the Constitutional directive giving rise to enactment of the Bankruptcy Act and the interpretation of that act, that any uniform system of laws regulating bankruptcies must be enacted by Congress. \textit{Hammond v. Lyon Realty Company},\textsuperscript{26} extended the pre-emption concept by holding that "not only those state laws which purport to cover the whole field of insolvency administration are superseded by the national bankruptcy law, but all other state laws to the extent that they hamper or restrict its proper operation."\textsuperscript{27} In applying this principle, the courts have consistently voided partial provisions of state statutes which are in conflict with federal bankruptcy legislation.\textsuperscript{28}

Invalidation of provisions of state enactments occurs only where they appear to be in real conflict with the "bankruptcy purposes" of the Bankruptcy Act. Exemplary of this requirement of a real conflict in purpose is \textit{Kesler v. Department of Public Safety}.\textsuperscript{29} Significant to the present consideration is the Supreme Court's language that the purpose of the contested state statute "is wholly unrelated to the considerations which propelled Congress to enact a national bankruptcy law,"\textsuperscript{30} "is wholly unrelated to the purpose of the Bankruptcy Act,"\textsuperscript{31} and "the bearing of the statute on the purposes served by bankruptcy legislation is essentially tangential."\textsuperscript{32}

\textsuperscript{24} \textit{Id.} at 263-64.
\textsuperscript{25} \textit{Id.} at 265 (emphasis added). This statement has been followed or recognized in subsequent decisions, \textit{e.g.}, \textit{In re Prudence Co.}, 79 F.2d 77, 80 (2d Cir. 1935); \textit{Hammond v. Lyon Realty Co.}, 59 F.2d 592 (4th Cir. 1932).
\textsuperscript{26} 59 F.2d 592 (4th Cir. 1932).
\textsuperscript{27} \textit{Id.} at 595.
\textsuperscript{28} \textit{E.g.}, \textit{City of New Orleans v. Harrell}, 134 F.2d 399 (5th Cir. 1943) (Louisiana statute postponed administration expenses and wage claims in bankruptcy in favor of certain local tax liens); \textit{In re Prudence}, 79 F.2d 77 (2d Cir. 1935) (New York statute exempted a certain class of corporations from bankruptcy proceedings from which they were not exempted under the Bankruptcy Act); \textit{Appling v. Brueckner}, 97 Cal. App. 750, 275 P. 382 (1929) (California statute allowed payment of preferences in violation of Bankruptcy Act); \textit{In re Mills}, 76 F. Supp. 764 (D. Va. 1948); \textit{Public Finance Corp. v. Londeree}, 200 Va. 407, 106 S.E.2d 769 (1959) (Virginia statute restricted presentation of certain evidence in bankruptcy proceedings).
\textsuperscript{29} 369 U.S. 153 (1962).
\textsuperscript{30} \textit{Id.} at 171.
\textsuperscript{31} \textit{Id.} at 154 (emphasis added).
\textsuperscript{32} \textit{Id.} at 174.
The Uniform Commercial Code is not essentially directed toward the general regulation of insolvency proceedings; therefore, it should not fall within the prohibition enunciated in Pinkus. It is not so certain, however, that various provisions of the Code to the extent that they may affect bankruptcy, will not fall within the ambit of Hammond. Of course a determination of the precise extent to which provisions of the Code are in conflict with the purposes of the national bankruptcy law will in many instances only be clear after judicial interpretation.

The first confrontation of Article 9 with the Bankruptcy Act, under other than hypothetical circumstances, occurred in the Referee's hearing in In re Portland Publishing Company. The Referee here avoided a direct ruling on supremacy and the decision was not dispositive of any substantive conflict between the conflicting bodies of law. The Referee's decision was hotly contested by the proponents of the Uniform Commercial Code because it seemed to indicate that in federal bankruptcy courts, a cool reception awaited Code provisions such as section 9-108 which modify traditional bankruptcy law concepts. However, the Referee's view did not prevail in the Oregon District Court. That court held that a valid security interest in accounts receivable, filed before the commencement of the 60(a) four month period, which contemplates substitution of new accounts receivable for released old accounts, does not amount to using an antecedent debt for security, thus constituting a voidable preference. The court has accepted the Code idea that a security interest in revolving or flow type accounts receivable comes into existence when the agreement is made and not in the future as the various accounts contemplated come into existence. Thus has the Code successfully brought the "mountain to Mahomet".

III. THE STRONG ARM CLAUSE

The structures and procedures required by Article 9 relative to the perfection of security interests in personal property should


serve to alleviate some of the controversies which have plagued courts in interpreting the "strong arm provision"\textsuperscript{35} of the Bankruptcy Act. At the heart of the problem is a confusing history of determinations surrounding the precise extent of the trustee's powers as a lien creditor.

Section 70(c) states:

The trustee may have the benefit of all defenses available to the bankrupt . . . . The trustee shall have as of the date of bankruptcy the rights and powers of: (1) a creditor who obtained a judgment against the bankrupt upon the date of bankruptcy, whether or not such a creditor exists, (2) a creditor who upon the date of bankruptcy obtained an execution returned unsatisfied against the bankrupt, whether or not such a creditor exists, and (3) a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property . . . upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists. If a transfer is valid in part against creditors whose rights and powers are conferred upon the trustee under this subdivision, it shall be valid to a like extent against the trustee. In cases where repugnancy or inconsistency exists with reference to the rights and powers in this subdivision conferred, the trustee may elect which rights and powers to exercise with reference to a particular party, a particular remedy, or a particular transaction, without prejudice to his right to maintain a different position with reference to a different party, a different remedy, or a different transaction.\textsuperscript{36}

The foundation of the strong arm provision has resided in the Bankruptcy Act since its earliest enactment;\textsuperscript{37} however, the section has undergone significant change during the course of its interpretative development. The most recent of these changes was directed toward increased discretion and power in the trustee.\textsuperscript{38}

In 1981, the venerable Justice Holmes made no reference to the then existing counterpart of section 70(c) when he wrote for a

\textsuperscript{35} Bankruptcy Act § 70(c), 11 U.S.C.A. § 110(c) (Supp. 1966).
\textsuperscript{36} Id., as amended, Pub. Law 89-495 (July, 1966).
\textsuperscript{37} Bankruptcy Act § 70, 30 Stat. 565-66 (1898).
unanimous Court in Moore v. Bay.\textsuperscript{39} It has been suggested, however, that if that decision—often criticized for its brevity and ambiguity\textsuperscript{40}—had been carefully explained to encompass its natural limits, consideration both could and should have been given the strong arm provision, thereby alleviating much subsequent controversy as to its proper consequences.\textsuperscript{41} In Moore v. Bay, a mortgage which had been executed without recordation of intention was denied priority over creditors who extended credit after recordation, and the transaction was held wholly voidable by the trustee in bankruptcy. The importance of the decision lies in the directive that the trustee avoids the mortgage entirely and not merely to the extent of the prefiling claims. However, Gilmore suggests that the decision should have expressly stated that, (1) the trustee acquires the rights of all prefiling creditors under section 70(e), and (2) the trustee has the status of a lien creditor under the strong arm provision.\textsuperscript{42}

Although the Court in Moore v. Bay avoided a logical opportunity to shed interpretative light upon the relationship between the section 70(e) and 70(c) provisions, a federal district judge sought to establish the meaning of the strong arm clause in In re Waynesboro Motor Company.\textsuperscript{43} Under the state law applied through section 70(e), the trustee clearly had authority to regard a number of repossessed automobiles as part of the bankrupt dealer’s inventory. In classic style, however, the judge attributed the authority of the trustee to the strong arm clause:

\begin{quote}
[T]he trustee in bankruptcy . . . stands here as the ideal creditor, irreproachable and without notice, armed cap-a-pie with every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings.\textsuperscript{44}
\end{quote}

The confusion concerning application of the strong arm provision and the extent of the trustee’s power are illustrated by the foregoing cases. In more recent considerations, neither less furor nor more certainty has come out of decisions in which the courts

\textsuperscript{39} 284 U.S. 4 (1931).
\textsuperscript{40} J. MacLachlan, Bankruptcy § 284 (1956).
\textsuperscript{41} 2 G. Gilmore, Security Interests in Personal Property § 45.3.2, at 1293 (1965).
\textsuperscript{42} Id.
\textsuperscript{43} 60 F.2d 668 (S.D. Miss. 1932).
\textsuperscript{44} Id. at 669. This language is quoted and discussed in 2 G. Gilmore, supra note 41, at 1293.
have pondered filing rules similar to that encountered in *Moore v. Bay.*

In *Constance v. Harvey* it was found that the trustee's ideal lien creditor status makes no difference for purposes of avoidance of a mortgage. The ideal creditor was one who had extended credit before the mortgage was filed; therefore, section 70(c) rights were to be measured by the rights of such a creditor even though no such creditor existed as of the date of bankruptcy. Application of this interpretation was generally criticized and followed only within the Second Circuit.

The Supreme Court overruled *Constance* by its consideration of essentially the same filing rule in *Lewis v. Manufacturers National Bank.* In enunciating the fallacy of the *Constance* construction of section 70(c), the Court stated that such a reading "would give the trustee power to set aside transactions which no creditor could avoid and which injured no creditor." The Court refused to countenance such an unjustifiable windfall to unsecured creditors simply by reason of the debtor's bankruptcy. The *Lewis* court intimated that while the trustee's powers may not be dependent upon, or linked to, the rights of existing creditors in all sections of the Bankruptcy Act, they are so linked under the strong arm clause.

In *Pacific Finance Corporation v. Edwards* a most literal interpretation of the "spirit" of the *Lewis* decision was adopted and a conditional sales contract filed late was deemed void as to subsequent creditors. The question posed by the court was whether or not section 70(c) vests in the trustee as of the date of bankruptcy the rights and powers of a lien creditor, whether or not such a creditor actually exists, in the absence of a creditor

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45. The rule was first considered in *Karst v. Gane,* 136 N.Y. 316, 32 N.E. 1073 (1933).


48. Contri v. Volper, 229 F.2d 317 (2d Cir. 1956). *Cf.* England v. Sanderson, 236 F.2d 641 (9th Cir. 1956) (theory of *Constance* followed in limiting an exemption allowable in bankruptcy). The *Constance* opinion has been expressly rejected in some cases, *e.g., In re Alkasovich,* 275 F.2d 454 (6th Cir. 1960); *In re Billings,* 170 F. Supp. 253 (W.D. Mo. 1959).


50. Id. at 608-09.

51. 304 F.2d 224 (9th Cir. 1962).
who could have obtained a lien at the date of bankruptcy.\textsuperscript{52} The court considered carefully the language of the strong arm clause and answered the question in the negative. Section 70(c) applies only where there is property "upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy."\textsuperscript{53} "Creditor" here was held to mean an actual creditor. The remaining language of the section itself was relied on to buttress the "actual creditor" construction. The court found that the phrase "whether or not such a creditor actually exists" refers only to a "creditor then holding a lien thereon."\textsuperscript{54}

Under this construction the trustee is empowered to exercise the powers given him even if no actual creditor has obtained a lien, but he cannot do so if no actual creditor could have obtained a lien. In the factual circumstances of Pacific Finance, no actual creditor existed; consequently, the trustee could not acquire the status of a hypothetical lien creditor. The period of time during which a creditor who is able to attack the transaction might have come into existence is extended to the date of bankruptcy. The court equated this situation with that in Lewis, in which no creditor able to attack came into existence during the time of non-recording of the chattel mortgage.\textsuperscript{55}

The Washington rule before the Pacific Finance court represents an inverse reflection of the rules of Moore v. Bay, Constance and Lewis. In these latter three cases, delayed filing rendered a chattel mortgage voidable by pre-filing creditors; whereas, in Pacific Finance delayed filing made a conditional sale voidable by subsequent creditors.

In the view of one highly regarded authority, the Pacific Finance decision represents the conclusion that Moore v. Bay would have reached if that opinion had been expanded to its natural bounds: "§ 70(c) merely supplements § 70(e) by conferring lien status on the trustee in his representation of existing

\textsuperscript{52} Id. at 228.
\textsuperscript{53} Bankruptcy Act § 70(c), 11 U.S.C.A. § 110(c) (Supp. 1966).
\textsuperscript{54} Pacific Finance Corp. v. Edwards, 304 F.2d 224, 228 (9th Cir. 1962).
\textsuperscript{55} The Pacific Finance decision has stirred conflicting opinions among commentators in the fields of bankruptcy and commercial law. For a critical view of the decision, see King, Pacific Finance Corporation v. Edwards: Another Misreading of Section 70(c) of the Bankruptcy Act, 38 Ref. J. 56 (1964). For a rebuttal to Professor King's criticism, see Wiley, In Defense of Pacific Finance Corp. v. Edwards, 38 Ref. J. 117 (1964) and for a reply argument, see King, Pacific Finance Corp. v. Edwards: Closing Argument, 39 Ref. J. 21 (1965).
or actual creditors if applicable state law provides that only lien creditors can avoid the challenged transaction.\textsuperscript{56}

The extension of section 70(c) powers and rights which were suggested by \textit{Constance} and denied by \textit{Lewis} and \textit{Pacific Finance} could not have arisen under Article 9 of the Code.

Section 9-301(1)(b) provides that an unperfected security interest is subordinate to the rights of "a person who becomes a lien creditor without knowledge of the security interest and before it is perfected."\textsuperscript{57} Once an Article 9 security interest has been perfected, regardless of delays which may have occurred in perfecting, no class of creditors, prior or subsequent, can avoid the security interest by acquiring a lien on the collateral.

If perfection of the security interest is delayed and the petition in bankruptcy is filed before perfection occurs, the referee can avoid the security interest. After bankruptcy there will necessarily be actual creditors whom the trustee represents under section 70(e), and as representative, the trustee will have the status of a lien creditor under section 70(c). With the status of lien creditor the trustee is empowered to avoid any unperfected security interest under section 9-301(1)(b). The only actual creditor who could avoid the security interest would be one who both acquired a lien before perfection and was without knowledge. Arguably, if Article 9 were considered alone, the trustee could not prevail if it could be shown that all creditors did have knowledge of an existing unperfected security interest in the collateral.\textsuperscript{58} With knowledge of the unperfected interest no creditor could have acquired a valid interest even if he had acquired a lien.

If \textit{Lewis} and \textit{Pacific Finance} were construed to mean that the trustee, under section 70(c), prevails only where he stands as representative of a creditor who could have avoided the security interest by acquiring a lien, it should logically follow that the trustee must find at least one creditor without knowledge if he is to avoid an unperfected security interest under Article 9.\textsuperscript{59} Such a creditor without knowledge here would be similar to a pre-filing creditor in \textit{Lewis} or a subsequent creditor in \textit{Pacific Finance}. However, though this may be a logical deduction, it is not an accurate representation of bankruptcy law today.

\textsuperscript{56} 2 G. Gilmore, \textit{ supra} note 41, § 45.3.2, at 1295.


\textsuperscript{58} 2 G. Gilmore, \textit{ supra} note 41, § 45.3.2, at 1296.

\textsuperscript{59} \textit{But see}, \textit{ id}.
Section 9-301(3)\textsuperscript{60} provides the Code's definition of a lien creditor and designates creditors' representatives in insolvency proceedings as lien creditors within the meaning of Article 9. This section provides:

Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest.\textsuperscript{61}

This section implies that the knowledge of the creditors, if all creditors had knowledge, is imputed to their representative. The language and intention of this section will undoubtedly be applicable to receivers or creditors' assignees in state proceedings, but it is not so clear that the literal language of the section will be strictly construed as it applies to the trustee in bankruptcy. The federal bankruptcy concept, establishing the trustee as an ideal, hypothetical lien creditor, "irreproachable and without notice,"\textsuperscript{62} is probably strong enough to shield the trustee from the necessity of proving that he represents at least one creditor without knowledge of the security interest.

There is one caveat to the general proposition that an unperfected security interest can always be avoided by the trustee in bankruptcy. For most purposes the date of filing of a petition in bankruptcy occasions a "freezing" of property interests in the bankrupt's assets. Where state law has provided a grace period for filing, however, the courts have allowed a relation back against the trustee. The doctrine of relation back becomes operative after the date of bankruptcy only where a security interest is placed on record before expiration of the allowable grace period.\textsuperscript{63}

Most Article 9 security interests are deemed perfected at the time that the requisite "act of perfection" takes place (usually, recordation or possession).\textsuperscript{64}

The perfection is without relation back to an earlier date. Section 9-301(2),\textsuperscript{65} however, with respect to purchase money
security interests, provides a ten day grace period for filing. Under this provision, the secured party is given ten days to file, subsequent to the debtor's possession date. If he files within the grace period, he takes priority over the claims of any creditors who acquire liens between the time of attachment of his security interest and his filing date.

The section 9-301(2) grace period is analogous to the pre-code grace periods which have existed in many states. It is reasonable that the relation back problem under the purchase money security interest provision will be treated as before and will operate against the referee in bankruptcy in the same way as it operates against other creditors.⁶⁶

IV. THE TRUSTEE IN THE SHOES OF ACTUAL CREDITORS

The long criticized opinion of Moore v. Bay⁶⁷ has already been considered in the initial treatment of the interpretation of the status of a section 70(c) lien creditor. Over the years the real substantive disruption caused by the decision has arisen more often in consideration of the trustee in bankruptcy under section 70(e) of the Bankruptcy Act.⁶⁸

While section 70(c) has been referred to as the "strong arm" clause in bankruptcy, section 70(e) could properly be labeled its "long arm" clause. The applicable provision states:

A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this title which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this title, shall be null and void as against the trustee of such debtor.⁶⁹

Based upon a construction of this language the doctrine of Moore v. Bay is essentially that where a transfer may only be vulnerable in part in the ordinary course of events, it becomes totally invalid in the extraordinary event of bankruptcy. This rule becomes operative only where the security interest of a creditor is vulnerable to attack by invocation of some applicable state law governing the transaction.⁷⁰ Whether the attack to be

⁶⁶ See, Coogan, supra note 63, § 10.03.
⁶⁷ 284 U.S. 4 (1931).
⁶⁹ Id.
made upon the security interest is successful or not is deferred by the Bankruptcy Act to an interpretation of state law and the relevant rights of actual creditors. If the state law insulates the secured creditor from attacks by the bankrupt's other creditors, the security interest is likewise immune to attack by the trustee in bankruptcy because section 70(e) confers upon him only the standing afforded an actual creditor. The trustee, however, is not merely subrogated to the rights and powers of the actual creditors having provable claims. Under Moore v. Bay the trustee rises above the avoiding capabilities of the actual creditors; he can avoid in toto whereas they avoid pro tanto. But he is helpless under section 70(e) unless the actual creditors have at least a power of partial defeasance.

The situation in which the doctrine of Moore v. Bay operates arises under the type of state statute designed to protect the interests of interim creditors.

The fundamental purpose of a statute requiring the filing of chattel mortgages is protection of creditors, as well as subsequent purchasers of mortgages, who deal with the mortgagee upon the assumption that the property in his possession is unencumbered. . . . The "creditors" referred to in the statute have been held to be those who become such in good faith and without notice, in the interim between execution and filing of the mortgage.\(^{71}\)

This type of statutory policy does not afford a creditor any protection against one who extends credit to the debtor after creation, but before perfection, of a security interest. The want of some reasonable grace period in which to perform the routine mechanics of perfection is not ordinarily unduly prejudicial to the secured creditor. The interim creditor's claim is simply paid off by the secured party. Where bankruptcy intervenes, however, the cruel dimension of Moore v. Bay is surfaced. The interim creditor, regardless of the size of his claim against the bankrupt, can no longer simply be paid off, and his very existence completely destroys the security interest in favor of the trustee in bankruptcy.\(^{72}\)

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\(^{71}\) General Motors Acceptance Corp. v. Coller, 106 F.2d 584 (6th Cir. 1939).

\(^{72}\) E.g., Miller v. Sulmeyer, 263 F.2d 513 (9th Cir. 1959); Exchange Bank v. Morgan, 222 F.2d 567 (8th Cir. 1955); American Trust Co. v. New York Credit Men's Adjustment Bureau, 207 F.2d 685 (2d Cir. 1953); Zamore v. Goldblatt, 194 F.2d 933 (2d Cir. 1953); In re J. P. Corley Lumber Co., 115 F.2d 119 (5th Cir. 1940); Friedman v. Sterling Refrigerator Co., 104 F.2d 837 (4th Cir. 1939).
The harsh reality of just such a fortuitous circumstance is graphically illustrated by Mercantile Trust Co. v. Kahn. A chattel mortgage securing a note of $1,678 was executed on October 18, 1947 and recorded seven days later on October 25. The debtor, during this one week interval between execution and perfection, purchased a pair of shoes on credit. The price of the shoes was $4.64. Under Missouri law the chattel mortgage was void as to the shoe seller because unrecorded at the time of his credit sale. Ordinarily, the mortgagee would simply take care of the shoe claimant at the time of foreclosure, but the chattel mortgagor went into bankruptcy in February, 1950, two and one-half years after execution of the chattel mortgage. Under application of the Moore v. Bay doctrine, the $1,678 mortgage was in effect completely destroyed because of the $4.64 claim. The mere existence of this potentially disastrous blow to a security interest can have serious and disruptive consequences with regard to secured financing transactions.

Neither meticulous care nor expensive precaution is adequate protection in the shadow of Moore v. Bay. Absent simultaneous creation and perfection of a security interest, the possibilities are virtually endless for the establishment of a small interim creditor. Applications of the doctrine run contrary to general business practices and commercial reasonableness; yet direct abrogation of the doctrine of Moore v. Bay must lie either with Congress or the bankruptcy courts, and political overtones have stalled most efforts in behalf of such a frontal attack.

Consistent with its overall attempt to solidify secured financing transactions in favor of the secured creditor, Article 9 has taken aim at the doctrine enunciated in Moore v. Bay. Those who sought to abolish it prior to the draft of Article 9 overlooked the possibility of indirect attack through destruction at the state level of the right of a simple interim creditor to prevail over an unperfected security holder.

73. 203 F.2d 449 (8th Cir. 1953).
74. See, J. MacLachlan, supra note 40, § 285, at 334, n. 9.
75. E.g., In re Tobias, 150 F. Supp. 288 (W.D. Mich. 1957) (chattel mortgage executed by restaurateur at 4 o'clock p.m. and recorded the following morning was defeated because of the credit sale of a small quantity of ice cream between 7 and 8 o'clock a.m. on the day of recordation).
76. See, e.g., Exchange Bank v. Morgan, 222 F.2d 567 (8th Cir. 1955) ($7,500 mortgage avoided by the court’s reliance on a rebuttable presumption, contrary to fact, concerning the time within which filing took place); General Motors Acceptance Corp. v. Coller, 106 F.2d 584 (6th Cir. 1939) (interim creditors should not be subordinated to the procedural routine of any mortgage over which they can have no control or knowledge).
77. J. MacLachlan, supra, note 40, § 285, at 334.
Sections 9-201\textsuperscript{78} and 9-301\textsuperscript{79} of the Code basically effect the removal of the crutch whereby the trustee in bankruptcy assumes the standing of an interim creditor; consequently, the \textit{Moore v. Bay} doctrine is severely blunted as a bankruptcy weapon.

Section 9-201 establishes the general validity of the security interest subject only to the restrictions placed upon that validity within the Code or specifically reserved to other laws or regulations.\textsuperscript{80} Essentially, the security interest is effective and binds all creditors of the debtor.

Under section 9-301, consideration is given to the types of third parties and circumstances under which an \textit{unperfected} security interest may be defeated.\textsuperscript{81} The unperfected security interest is obviously subordinated to the claims of a perfected secured creditor.\textsuperscript{82} Additionally, however, the unperfected creditor is deferred to the interests of lien creditors who acquire liens without knowledge of the security interest and before perfecting\textsuperscript{83} and to the interest of certain purchasers \textit{not} operating in the ordinary course of business.\textsuperscript{84} Of particular emphasis here should be the fact that in neither section has the unperfected security interest been subordinated in any manner to the interest of a simple interim creditor.

The net result of these provisions ... is that an unperfected Security Interest is valid and enforceable against rights of general, non lien creditors, and, with the exception of the ten day period for purchase money Security Interests, an unperfected Security Interest is subordinate to the rights of all other third persons.\textsuperscript{85}

Implementation of these provisions has in large measure sterilized the doctrine enunciated in \textit{Moore v. Bay}. Some tangential or marginal situations in which it may retain a degree of potency have been suggested.\textsuperscript{86} Despite the potentiality of some

\begin{flushleft}
79. Id. § 10.9-301.
81. See Id. § 10.9-301.
83. Id. § 10.9-301(1)(b). Note also the 10 day grace period for filing a Purchase Money Security Interest. S.C. Code Ann. § 10.9-301(2) (1966).
\end{flushleft}
remaining vestige of life in these fringe areas, enactment of Article 9 by the states effectively neutralizes the acid effect of Moore v. Bay as a practical consideration in security financing.

A consideration of section 9-205 is very relevant to any discussion of potential effects which Article 9 may have upon application of section 70(e) of the Bankruptcy Act. Article 9 expressly validates the floating charge or lien on a shifting stock. The objective of section 9-205 is to implement the establishment of this “arrangement for effective inventory financing and the use of accounts receivable as collateral to secure working capital advances by a revolving fund.”

The most serious obstacle to this commercially sound objective is the doctrine of Benedict v. Ratner. The rule, enunciated there and through a long line of decisions, holds a security interest void as to third parties where the secured creditor permits the debtor to exercise dominion over the security collateral or proceeds from it. In Benedict, this doctrine was applied in federal bankruptcy to invalidate an assignment of accounts receivable. The debtor-bankrupt was given unfettered dominion over collections against the assigned accounts and was under no duty to account to the creditor-assignee. Mr. Justice Brandeis concluded for the Court that such an uncontrolled security arrangement was a sham and fraud under the applicable state law as to other creditors. Under the Bankruptcy Act any such transfer deemed fraudulent by the state law is voidable by the trustee in bankruptcy.

Lee v. State Bank & Trust Company is illustrative of the extent to which the “dominion rule” has been applied against an otherwise good security interest. There a pledge of accounts was voided because the debtor-pledgor was allowed dominion over goods which only represented approximately one per cent of the total collateral. Despite the undesirable and burdensome commercial effect visited upon secured creditors who required no policing of the collateral under the terms of their security inter-

88. See id. §§ 10.9-201 through 10.9-204 and accompanying S. C. Reporter's Comments.
90. 268 U.S. 353 (1925).
91. See cases collected in Annot., 73 A.L.R. 236 (1931).
93. 38 F.2d 45 (2d Cir. 1930).
est, the Benedict doctrine was adopted by a majority of American jurisdictions.\textsuperscript{94}

Section 9-205 provides:

A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, comingle or dispose of all or part of the collateral . . . or proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral.\textsuperscript{95}

The provision prohibits invalidation of a security interest as fraudulent merely by reason of liberty in the debtor to exercise dominion over the collateral without an accounting.\textsuperscript{96} This represents an express rejection of the Benedict rule.\textsuperscript{97}

Although the matter of the dominion rule arises most frequently in conjunction with federal bankruptcy proceedings, the rule of Benedict v. Ratner is not itself a rule of federal bankruptcy law.\textsuperscript{98} Section 70(e) of the Bankruptcy Act gives to the trustee the rights of actual creditors as prescribed by state law. Because this act reserves to state law the factual determination of fraudulence in a security interest arrangement, the rule of section 9-205 will have application in bankruptcy as well as in the state courts.

\textsuperscript{94} See note 91 supra.
\textsuperscript{96} The basis of the rejection of the Benedict principle is that it is really a credit matter and should not influence any determination of the essential validity of the security arrangement. Business reasons may compel policing or accounting arrangements, as may be agreed upon between the lender and his debtor, and this rejection of the Benedict rule does not prejudice continuation of such "credit matters" between the parties.
\textsuperscript{97} South Carolina may not have accepted the prevailing view of the Benedict doctrine and the rule of section 10.9-205 seems to be in accord with existing law as expressed in Marshall v. Crawford, 45 S.C. 189, 22 S.E. 792 (1895) and Porter v. Stricker, 44 S.C. 183, 21 S.E. 635 (1894).
\textsuperscript{98} Benedict v. Ratner purported to state the law of New York and is not a rule of federal bankruptcy law. Therefore, no pre-emption problem exists and the principle can be rejected as a matter of state law.