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BANKRUPTCY'S CHALLENGE TO THE FLOATING LIEN

I. INTRODUCTION

Whether compliance with the requirements of Article 9 adequately safeguards the interests of a creditor secured by the so-called "floating lien" will be tested in an attack based on sections 60¹ and 64² of the Federal Bankruptcy Act. The following hypothetical will serve to illustrate both the premise and the scope of our inquiry.

On April 1, *E*, a prospective creditor, files a financing statement adequately describing *R*'s inventory and containing a claim to proceeds from the sale of such inventory. On April 15 a written security agreement containing an after acquired property clause is executed and *E* advances the loan to *R*. On October 1, *X*, an unsecured creditor of *R*, files a petition to have *R* declared bankrupt. During the four months prior to the filing of the bankruptcy petition *R* received several shipments of new inventory that became part of the collateral securing *E*'s advance of April 15. At all times during the four month period *E* knew *R* was insolvent.

Under the Code, *E*'s security interest became perfected on April 15³ and automatically attached to each new shipment of inventory⁴ and to the proceeds from sales.⁵ The trustee in bankruptcy is, therefore, powerless under sections 70(c)⁶ and 70(e)⁷ of the Bankruptcy Act because *E*'s interest was at all times perfected. Two questions remain, however. First, can the trustee recover the inventory received during the four month period by proceeding under section 60 of the Bankruptcy Act, which provides that certain transfers are voidable as preferences even though there has been strict compliance with applicable state law governing perfection? Second, can the trustee prevent our creditor from claiming under Code section 9-306(4)(d)⁸ the

1. Bankruptcy Act § 60, 11 U.S.C. § 96 (1964).

2. Bankruptcy Act § 64, 11 U.S.C. § 104 (1964).

3. S.C. CODE ANN. § 10.9-303 (1966).

4. *Id.* § 10.9-204.

5. *Id.* § 10.9-306.

6. Bankruptcy Act § 70(c), 11 U.S.C. § 110 (1964). For complete discussion see pp. 746-53 *infra*.

7. *Id.* § 70(e), 11 U.S.C. § 110 (1964). For complete discussion see pp. 753-58 *infra*.

8. S.C. CODE ANN. § 10.9-306(4)(d) (1966).

unidentifiable and commingled proceeds (a variant that will be added later) received within ten days of bankruptcy on the ground that this section creates an illegal state priority in contravention of the Bankruptcy Act which has pre-empted the area of priorities in section 64?

II. SECTION 60 OF THE BANKRUPTCY ACT

Simply stated, a preference is any transfer⁹ of property by an insolvent debtor to satisfy or secure an antecedent debt. It should be remembered, however, that not all preferences are invalid. Before being stigmatized as a voidable preference the transfer must fall within the language of section 60.¹⁰

The original anti-preference provision enacted in 1898¹¹ provided that a preference made within four months of bankruptcy was voidable by the trustee in bankruptcy if the party receiving the transfer had reasonable cause to believe that a preference was intended.¹² It did not, however, contain a "perfection clause" as we understand that phrase today and thus left the crucial decision of determining the time of transfer to the courts during a period when the judicial attitude toward secured commercial transactions was more than hospitable.¹³ This is perhaps best illustrated by returning to our hypothetical under a slightly changed factual pattern. Assume that *E*, instead of filing on April 1, waited until September 15. Since *E*'s security interest was not perfected until filed, he is apparently now subject to all the rigors of the bankruptcy trustee. When *Sexton v. Kessler & Company*¹⁴ presented our hypothetical for decision, however, a unanimous Court, speaking through Mr. Justice Holmes said:

9. Bankruptcy Act § 1 (30), 11 U.S.C. § 1 (1964) provides:

"Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein . . . ; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor.

10. Bankruptcy Act § 60, 11 U.S.C. § 96 (1964).

11. At common law an insolvent debtor had the right to prefer one creditor over another. *Grandison v. Robertson*, 231 F. 785 (2d Cir. 1916).

12. This provision now appears as § 60(a)(1) and the first sentence of § 60(b) of the Bankruptcy Act, 11 U.S.C. § 96 (1964).

13. See 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 45.3.3, at 1301 (1965). It should be noted that the various elements of a voidable transfer are dependent upon the time of transfer for their existence.

14. 225 U.S. 90 (1912). In that case the debtor had promised to secure an English creditor by pledge. The pledge was not delivered, however, until two weeks before bankruptcy four years later. For a case in which the collateral involved was inventory see *Thompson v. Fairbanks*, 196 U.S. 516 (1905).

While the phrase "equitable lien" may not carry the reasoning further or do much more than express the opinion of the court that the facts give a priority to the party said to have it, we are of the opinion that the agreement created such a lien at least; or, in other words, that there is no rule of local or general law that takes from the transaction the effect it was intended to produce. When the English firm took the securities, [*i.e.*, perfected its interest], it only exercised a right that had been created long before bankruptcy, and in good faith.¹⁵

The doctrine of "relation back" served to perfect the lien at the time of agreement and thus no preference existed.

This manner of judicial favoritism toward a transaction obviously antagonistic to the policy objectives of the Bankruptcy Act supplied the incentive for a "crusade against equitable liens" that gathered force during the 1920's and 1930's.¹⁶ In 1938 Congress responded to this movement by adding the following language to section 60(a):

A transfer shall be deemed to have been made at the time when it became so far perfected that no *bona fide purchaser* from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and if such transfer is not so perfected . . . it shall be deemed to have been made immediately before bankruptcy.¹⁷

Although the dissatisfaction with *Sexton* did not extend to every lien sometimes referred to as "equitable,"¹⁸ the apparent effect of measuring the trustee's rights by a *bona fide purchaser* standard was to destroy many types of liens acquired in good faith and for value because they were subordinate to the rights of ordinary buyers. This became clear when the Court in *Corn*

15. *Sexton v. Kessler & Co.*, 225 U.S. 90, 98-99 (1912). Professor Gilmore suggests we would be much better off today had Holmes used the word "imperfect" or "unperfected" instead of the phrase "equitable lien." 2 G. GILMORE, *supra* note 13, at 1301.

16. See 2 G. GILMORE, *supra* note 13, at 1302.

17. Bankruptcy Act § 60(a), 11 U.S.C. § 96 (1964) (emphasis added).

18. 2 G. GILMORE, *supra* note 13, at 1302. The purpose of the 1938 amendment was to invalidate the *Sexton* type secret lien. See McLaughlin, *Defining a Preference in Bankruptcy*, 60 HARV. L. REV. 233, 251 (1946).

*Exchange National Bank & Trust Company v. Klauder*¹⁹ invalidated as a matter of law an assignment of accounts receivable taken by the bank well before the four month period because it failed to notify the account debtors, which, under the applicable state law, was necessary in order to cut off the rights of subsequent assignees. This result was reached despite the fact that the transfer was contemporaneously made with the advancement of credit.²⁰ Non-notification accounts receivable statutes²¹ were immediately enacted in those states which could conceivably be thought to be English rule states.²² Under these statutes the assignment creditors were given an indefeasible lien over subsequent assignees so that their interest was perfected when filed for purposes of section 60 of the Bankruptcy Act. While these statutes provided an answer to *Klauder* in the area of accounts receivable, the persistent vulnerability of transactions similar to our hypothetical is readily apparent for the simple reason that a buyer out of inventory in the ordinary course of business has always taken and presumably will always take free of even a perfected security interest.

No case arose under the 1938 amendment to challenge a security interest in after acquired property²³—a fact which in itself may be of lasting significance—but the threat came clearly into focus when a district court in the case of *In re Harvey Distributing Company*²⁴ invalidated a lien duly executed and perfected under the Uniform Trust Receipts Act. The court struck down “this healthy and ‘above the Board’ business”²⁵ arrangement be-

19. 318 U.S. 434 (1943). Prior to this decision an assignment of accounts receivable was generally invulnerable to attack. See Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 RUTGERS L. REV. 518, 544 (1960).

20. The trustee successfully contended that since the assignments were not perfected against the subsequent “bona fide purchasers” when transferred they must be deemed to have been made immediately before bankruptcy and thus for an antecedent debt. See Countryman, *The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act*, 16 LAW & CONTEMP. PROB. 76, 80 (1951). Compare *In re Vardaman Shoe Co.*, 52 F. Supp. 562 (E.D. Mo. 1943) with *In re Rosen*, 157 F.2d 997 (3d Cir. 1946).

21. E.g., S.C. CODE ANN. §§ 45-201 to -211 (1962).

22. Pennsylvania, whose state law was applicable in *Klauder*, followed the English rule. For a complete discussion of the various pre-Code rules governing perfection see Friedman, *The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under the Code*, 108 PA. L. REV. 194 (1959).

23. Hypothetical arguments supporting the position of both the trustee and the secured party can be found in 2 G. GILMORE, *supra* note 13, at 1311.

24. 88 F. Supp. 466 (E.D. Va. 1950), *rev'd sub nom.* *Coin Machine Acceptance Corp. v. O'Donnell*, 192 F.2d 773 (4th Cir. 1951). On appeal the 1950 amendment was held to apply retroactively.

25. *Coin Machine Acceptance Corp. v. O'Donnell*, 192 F.2d 773, 776 (4th Cir. 1951).

cause the trustee (under the trust receipts) was at liberty to sell to buyers in the ordinary course of business free of the entruster's security interest.²⁶ Such "plain meaning" interpretation led Congress to elevate the trustee in bankruptcy to the position of a lien creditor in 1950 so as to clarify existing doubts among lending institutions regarding the validity of security taken for value and in good faith.²⁷ The pertinent provisions of section 60 now provide:

(a) (1) A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(2) 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. . . . [I]f any transfer of . . . property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this title, it shall be deemed to have been made immediately before the filing of the petition.

(3) The provisions of paragraph (2) of this subsection shall apply whether or not there are or were creditors who might have obtained such liens upon the property other than real property transferred

. . . .

(6) The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section. . . .

26. *In re Harvey Distrib. Co.*, 88 F. Supp. 466, 468 (E.D. Va. 1950).

27. The legislative history makes it clear that Congress also intended "to retain unimpaired the basic object of the 1938 amendment which eliminated the 'relation back' doctrine of *Sexton v. Kessler*." H.R. REP. 1293, 81st Cong., 1st Sess. 6 (1949).

(7) [I]f the applicable law requires a transfer of property other than real property for or on account of a new and contemporaneous consideration to be perfected by recording, delivery, or otherwise, in order that no lien described in paragraph (2) of this subsection could become superior to the rights of the transferee therein . . . the time of transfer shall be determined by the following rules:

I. Where (A) the applicable law specifies a stated period of time of not more than twenty-one days after the transfer within which recording, delivery, or some other act is required, and compliance therewith is had within such stated period of time; or where (B) the applicable law specifies no such stated period of time . . . and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made or suffered at the time of the transfer.

. . . .

(b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent

(c) If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him²⁸

III. ARTICLE 9

The Bankruptcy Act defers to state law the steps required for perfection.²⁹ Therefore, when speaking about a security interest it is necessary to look to the Code to determine when perfection takes place.³⁰ This will reveal the time of transfer by which the various elements of a preference are tested and it thus becomes possible to ascertain whether a voidable preference exists.

28. Bankruptcy Act § 60, 11 U.S.C. § 96 (1964) (emphasis added).

29. *Corn Exchange Nat'l Bank & Trust Co. v. Klauder*, 318 U.S. 434 (1943).

30. Perfection takes place when the security interest has attached and the applicable steps required for perfection (*e.g.*, filing) have been completed. S.C. CODE ANN. § 10.9-303 (1966). For complete discussion *see* pp. 704-19 *infra*.

A. *The Twenty-One Day Grace Period in Bankruptcy*

It is important to keep in mind that perfection must be timely if the transaction is to escape classification as a transfer for an antecedent debt. With the exception of a purchase money security interest which must be perfected within ten days,³¹ the Code does not specifically provide an allowable period within which to complete perfection. Since the Bankruptcy Act allows a twenty-one day grace period for perfection where no stated period is provided by state law,³² the question which naturally arises is whether such a delay is permissible under the Code. In other words, assume again that *E* did not file on April 1 as originally stated. Can he delay filing until twenty-one days after the loan is made and remain invulnerable to the trustee's attack under section 60?³³ The bankruptcy provision is obviously intended to recognize the impossibility of a purely contemporaneous transaction so the logical answer would seem to be in favor of allowing the delay.³⁴ However, the answer is not that simple.

The Code drafters intended to favor the purchase money secured party in a contest with his non-purchase money competitor and, to accomplish this, gave him an additional ten days to perfect his interest. But when faced with the bankruptcy language which limits the grace period to "a stated period of time" if less than twenty-one days is specified by state law, the anomalous result which follows, after accepting the full period for our "ordinary" secured creditor, is that the favored party loses his priority eleven days sooner than his competitor. This happenstance of legislation could be resolved by interpreting section 60(a)(7) of the Bankruptcy Act as adopting the shortest period allowed by state law and by taking Article 9 as stating a period of zero, or by allowing the twenty-one day period to extend to both types of secured interest.³⁵ It is obvious, however, that neither of these solutions is consistent with the language of the

31. S.C. CODE ANN. § 10.9-301(2) (1966).

32. Bankruptcy Act § 60(a)(7), 11 U.S.C. § 96 (1964). It should be noted that the twenty-one day provision only applies when the transaction was in its inception one for contemporaneous consideration.

33. The "or otherwise" phrase in § 60(a)(7) of the Bankruptcy Act seems to contemplate the Code's concept of perfection occurring when the last event required by § 10.9-303 takes place.

34. The experts generally agree that the twenty-one day period exists under the Code. See, e.g., Kennedy, *The Support of the Uniform Commercial Code on Insolvency: Article 9*, 67 *Com. L.J.* 113, 119 (1962). But see *South Carolina Nat'l Bank v. Guest*, 232 S.C. 367, 102 S.E.2d 215 (1958).

35. See 2 G. GILMORE, *supra* note 13, § 45.8, at 1325.

Bankruptcy Act. With no logical direction in which to turn, one eminent authority suggests the courts might just as easily resolve the question "by rolling the dice."³⁶ Whatever the solution in bankruptcy, it must be remembered that the practical reality of the Code's "first to file" rule of priority³⁷ does not favor even a slight delay.

B. *Validity of Section 9-108*

The more realistic difficulty facing our creditor arises with respect to the shipments of new inventory received during the four months prior to bankruptcy without new and contemporaneous value passing to our debtor, *R*. This involves a conflict between sections 9-108 of the Code³⁸ and section 60(a) of the Bankruptcy Act.³⁹ The Code section provides:

When 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 part by after-acquired property *his security interest in the after-acquired property 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.⁴⁰

The effect of this language is the creation of a legal fiction. It determines that a debt which is in fact antecedent to a subsequently perfected security interest shall not be considered as antecedent—a presumption that is not only contrary to the facts, but one which in light of the Code requirement that a debtor have rights in the collateral before the security interest can attach⁴¹ cannot be reconciled with the plain implication of *Corn Exchange National Bank & Trust Company v. Kluder*.⁴² This is not to imply that all legal fictions are bad, because that is certainly not the case. Recognition of its existence does, however, illustrate one aspect of the difficulty.

36. *See id.* at 1329.

37. S.C. CODE ANN. § 10.9-301 (1966).

38. *Id.* § 10.9-108.

39. Bankruptcy Act § 60(a), 11 U.S.C. § 96 (1964).

40. S.C. CODE ANN. § 10.9-108 (1966) (emphasis added).

41. *Id.* § 10.9-204(1).

42. 318 U.S. 434 (1943).

Commenting upon the potential effectiveness of the section, the Code drafters state that the "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."⁴³ Apparently, this "principal application" represents the section's only application. Its single purpose has been described as an attempt to emasculate section 60(a) of the Bankruptcy Act by replacing judicial determination of the issue of antecedency with a simple fiat to the effect that the debt is not antecedent to the transfer.⁴⁴

Apart from the policy considerations of whether the Bankruptcy Act should accommodate section 10.9-108, the determination of what is or is not an antecedent debt is largely a matter which falls within the doctrine of pre-emption.⁴⁵ Neither the Bankruptcy Act nor the Code attempt to define the term antecedent debt. It has been suggested, however, that bankruptcy section 60(a) (7) settles the issue by implication.⁴⁶ The point made is that the grace period provided in the Bankruptcy Act is meaningless if it does not offer some insight into what constitutes an antecedent debt.

Several respectable arguments have been advanced for sustaining the lien on after acquired property. Possibly the best proposal is that the new inventory is but a "substitution of collateral" for that initially in stock when the security interest first attached. Drawing an analogy between the substitution cases⁴⁷ in which a pledgor has been allowed by the pledgee to exchange new security of equal value for that originally pledged and the subsequent acquisitions of inventory, it is reasoned that the policy of section 60 rejects only those transfers which serve to diminish the insolvent estate. Section 10.9-108⁴⁸ attempts to fit into this concept by limiting the after acquired lien to collateral obtained "in the ordinary course of business or under a contract of purchase made pursuant to the security agreement." Lending

43. S.C. CODE ANN. § 10.9-108, Comment 1 (1966).

44. Comment, 37 ST. JOHN'S L. REV. 392, 400 (1963).

45. For complete discussion of the Bankruptcy Act's supremacy see pp. 744-46 *infra*.

46. See Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 RUTGERS L. REV. 518, 547 n.125 (1960); Coogan & Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture*, 69 YALE L.J. 201, 244 (1959).

47. E.g., *Stewart v. Platt*, 101 U.S. 731 (1879); *In re Pusey-Majnes-Breish Co.*, 122 F.2d 606 (3d Cir. 1941); *In re Manning*, 123 F. 181 (D.S.C. 1903). For complete listing of cases see 3 W. COLLIER, BANKRUPTCY 862, § 60.21 (14th ed. 1966).

48. S.C. CODE ANN. § 10.9-108 (1966).

additional support to this theory is the argument under section 60(c) of the Bankruptcy Act that "when the . . . [secured party] permits proceeds from past security to be released to the debtor, he is accomplishing the same result as the preferred creditor who extends new credit."⁴⁹

Another approach is based on the idea that the collateral is but "a unit presently and continuously in existence—a 'floating mass,' the component elements of which may be constantly changing without affecting the identity of the res."⁵⁰ Under this "unitary concept" the inventory "mass" is treated as coming into existence when the security interest first attaches. Subsequent acquisitions are given no identity but merely "flow" into the mass already in existence and thus are said not to be acquired by transfer.⁵¹ It may be argued that the Code, by requiring the debtor to have rights in the collateral before the security interest can attach,⁵² rejects the theory, but the argument ignores the main thrust of the concept—that the "mass" is the continuous collateral.

Our discussion thus far has been completely hypothetical and has provided little comfort to the holder of a security interest in inventory. The first confrontation of Code section 9-108 and bankruptcy section 60(a), under other than hypothetical circumstances, occurred in the case of *In re Portland Newspaper Publishing Co.*⁵³ The facts of this case pertinent to the question of whether a transfer of a prior security interest in accounts receivable which came into existence during the 60(a) four month period constituted a transfer for an antecedent debt are as follows. In 1963, Rose City Development Company loaned substantial sums of money to Portland Newspaper Publishing Company. To secure these loans, Portland and Rose City entered into a security agreement whereby Portland assigned to Rose City a security interest in all its present and future accounts receivable. A proper financing statement recordation under the Code was completed in November of 1963. In September of 1964, Portland went into receivership and in October of 1964 was adjudicated a bankrupt. The preference controversy con-

49. See generally 2 G. GILMORE, *supra* note 13, § 45.8, at 1325; Coogan & Bok, *supra* note 46, at 245.

50. Manchester Nat'l Bank v. Roche, 186 F.2d 827, 831 (1st Cir. 1951).

51. For a complete discussion of this theory see Henson, "Proceeds" Under the Uniform Commercial Code, 65 COLUM. L. REV. 232 (1965).

52. See S.C. CODE ANN. § 10.9-204(1) (1966).

53. 3 U.C.C. Rept. Serv. 194 (D.C. Ore. 1966).

cerns those accounts receivable in which Rose City claims an interest which did not come into existence under four months prior to bankruptcy. Referee Snedecor, in discounting the merit of the Code section, extensively reviewed the reasoning advanced by various analysts of the "clash in underlying philosophies"⁵⁴ and expressed his own antipathy toward the present trend in inventory and receivables financing.⁵⁵ The unitary and substituted collateral theories were discussed but neither was specifically accepted nor rejected. They were simply deemed inapplicable to the circumstances attendant in the case. On review by the District Court of Oregon, the Referee's intransigent attitude regarding the Uniform Commercial Code's sanction of modern accounts receivable financing principles did not prevail. The court held that the accounts receivable security interest was not a preferential transfer under the Bankruptcy Act. The district court recognized that revolving or flow accounts receivable financing has been a long standing and accepted method of responsible business practice. The court stated:

The trustee and Referee both concede that Rose City would have had a valid security interest if The Reporter [Portland] had deposited the collected accounts in a separate bank account for the benefit of Rose City and then received a new loan, daily if necessary, equal to the amount of the deposit. The Code allows a financial institution or other creditor to make a loan secured by present and future accounts and permits the debtor to use the full amount of the loan without routing the proceeds of the old accounts through a cash collateral account. The old method was both expensive and cumbersome and necessarily increased the cost of money. I can find nothing either illegal or unethical in the arrangement sanctioned by the Code.

Good business practice should be good business law.⁵⁶

54. *Id.* at 198.

55. The old fashioned method of operating a business on the strength of equity capital and unsecured bank credit based upon the financial integrity of the debtor seems to be giving way to the modern trend of financing business operations in reliance upon a floating lien on current assets with little or no regard for equity capital . . . These methods leave the daily suppliers and employees in a perilous position.

Id. at 214.

56. *In re Portland Newspaper Publishing Co.*, 371 F.Supp. 395, 400 (D. Ore. 1967).

Thus, under this decision, concomitant with the provisions of Code section 9-108, there is no preference when new accounts are substituted for old ones pursuant to a properly filed security agreement.

In *Rosenberg v. Rudrick*⁵⁷ decided just a few months before the district decision in *Portland Newspaper*, the District Court of Massachusetts, under factual circumstances not dissimilar to our hypothetical, faced the conflict more squarely than did Referee Snedecor. After rather summarily declaring that the test for determining the time of transfer under section 60(a)(2) of the Bankruptcy Act does not require full perfection, the court went on to uphold the validity of section 9-108 "in view of the fact that the Uniform Commercial Code has now been adopted by 48 states."⁵⁸ In viewing the inventory as a "single entity" or unitary mass Judge Ford made what possibly could be the most relevant observation to date—"The transaction here was not one of those which the provisions of section 60 were designed to avoid. *There was nothing here in the nature of a secret lien.*"⁵⁹ This characterization greatly influenced the *Portland Newspaper* court opinion which quoted several passages from *Rosenberg*.

Neither *Portland News* nor *Rosenberg* are dispositive of the question of conflict raised between sections 9-108 and 60(a); however, they clearly indicate the split of authority which awaits those provisions of the Code which, in any particular, invade upon accepted bankruptcy concepts.

C. *Commingled Proceeds*

To raise the issue of the second question presented it will be necessary to add a new variant to our hypothetical. Assume that on September 28, three days before the petition is filed, R deposits in his general checking account all proceeds from sales made within ten days of bankruptcy. During the bankruptcy proceedings E asserts a claim to the deposited proceeds pursuant to Code section 9-306(4)(d),⁶⁰ which in the event of insolvency

57. 262 F. Supp. 635 (D. Mass. 1967).

58. *Id.* at 639. With the exception of Louisiana all states have now passed the Code.

59. *Id.* at 639 (emphasis added). Another district judge has expressed the opinion that Code § 9-108 "is intended only as a purported definition of antecedent debt to attempt to override the alleged harshness of section 60 of the Bankruptcy Act." *In re Platt*, 257 F. Supp. 478, 482 (E.D. Pa. 1966).

60. S.C. CODE ANN. § 10.9-306(4)(d) (1966).

proceedings⁶¹ gives a secured party with a perfected security interest in proceeds a continued interest,

in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but . . . limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings⁶²

As previously noted, the conflict is based on the trustee's contention that this section creates an illegal state "priority."⁶³ If indeed a priority exists, the trustee will prevail. But if the section is construed to create a lien, the opposite result follows.

Again no reported case has raised the issue as presented under the Code. It is possible, however, to make more concrete observations concerning the Code section's validity by delving into its ancestry. The forerunner of section 9-306(4)(d) was section 10(b) of the Uniform Trust Receipts Act. That Act, which was never enacted in South Carolina, sought to alleviate the secured party's frustration in tracing proceeds by vesting in the entruster the right,

to *any proceeds* or the value of any proceeds (whether such proceeds are identifiable or not) of the goods, documents or instruments, if said proceeds were received by the trustee within ten days prior to . . . the filing of a petition in bankruptcy or judicial insolvency proceedings . . . and to a *priority* to the amount of such proceeds or value.⁶⁴

The first bankruptcy case to adjudicate a claim to unrelated proceeds under this section of the Uniform Trust Receipts Act was *In re Harpeth Motors, Incorporated*.⁶⁵ In sustaining the claim the court said:

61. The term "insolvency proceedings" is defined to mean "any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved." S.C. CODE ANN. § 10.1-201(22) (1966).

62. A security interest in proceeds is continuously perfected if claimed in the filed financing statement covering the original collateral. S.C. CODE ANN. § 10.9-306(3)(a) (1966).

63. With one exception not here relevant (rent), section 64 of the Bankruptcy Act prohibits all state created priorities. See Bankruptcy Act § 64, 11 U.S.C. § 104 (1964).

64. UNIFORM TRUST RECEIPTS ACT § 10(b) (emphasis added).

65. 135 F. Supp. 863 (M.D. Tenn. 1955).

[T]he statute with respect to the value right or claim of the entruster goes much further than to create a mere priority in the distribution of the assets of the trustee in insolvency proceedings, for it creates in the entruster's favor a claim . . . having the same status as a lien claim and enforceable as such independently of an insolvency or bankruptcy proceeding.⁶⁶

It should be noted that Judge Miller clearly contemplated section 10(b) operating in a priority contest outside of bankruptcy. This, of course, would not be the case under the Code.⁶⁷ That *Harpeth* was never appealed may also prove significant.

The Seventh Circuit had the question before it in the case of *In re Crosstown Motors, Incorporated*⁶⁸ but held that section 10(b) was an attempt to create a priority invalid under section 64 of the Bankruptcy Act. Reading literally the word "priority"⁶⁹ the court reasoned that "[W]hen § 10 . . . is silhouetted against its historical background the reason for the absence of the word 'lien' and the use of the word 'priority' is pellucid."⁷⁰ The "pellucid" reference to the section's "historical background" seems inconsistent because section 64 of the Bankruptcy Act was not enacted until 1938,⁷¹ five years after the Uniform Trust Receipts Act was approved by the National Conference of Commissioners on Uniform State Laws. The field of state-created priorities had, therefore, not been pre-empted when the word "priority" was inserted in section 10(b) of the Uniform Trust Receipts Act and it can hardly be imagined that the drafters of that section intended its effect to be dependent on such unpredictable events.

Although section 9-306(4)(d)⁷² is the lineal descendant of section 10(b),⁷³ it differs significantly in two respects. To avoid the coldness of *Crosstown's* literal interpretation the phrase "perfected security interest" has been substituted for the word "priority." Perhaps of more importance, however, is the scope of the Code section's coverage. Under the Uniform Trust Re-

66. *Id.* at 868.

67. See S.C. CODE ANN. § 10.9-306(4) (1966).

68. 272 F.2d 224 (7th Cir. 1959).

69. See UNIFORM TRUST RECEIPTS ACT § 10(b).

70. 272 F.2d 224 (7th Cir. 1959).

71. Bankruptcy Act 64, 11 U.S.C. § 104 (1964).

72. S.C. CODE ANN. § 10.9-306(4)(d) (1966).

73. UNIFORM TRUST RECEIPTS ACT 10(b).

ceipts Act the entruster's claim extended to the "general assets" of the insolvent. The Code provision cuts back on this claim by limiting it to no more than "money in the bank." The principal effect, therefore, is that the "policing" techniques developed to comply with *Benedict v. Ratner*⁷⁴ live on as a credit matter in the application of this section. If for no other reason than this, the section should be entitled to favorable treatment in bankruptcy.⁷⁵

74. 268 U.S. 353 (1925).

75. See generally Henson, *supra* note 51.