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Section 60 and Article 9: Perfection of Security Interests

INTRODUCTION

Section 60(A) (1) of the Bankruptcy Act, pertaining to preferences, has been the source of much controversy. From this controversy stems such self-explanatory articles as “Sick-Sixty” and “Much Ado About Nothing.” Certainly, Section 60 has been “sick” and perhaps there has been much “ado” about nothing, but this furor has led to some definite changes in the law and to enough recorded comment to produce a good-sized volume. Reader familiarity with the subject is of necessity presupposed in any work in this field purporting to be in the nature of a short or general survey.

This note deals with the historical events from which the present Section 60 evolved, beginning with the period prior to the passage of the Chandler Act in 1938, and traces the law through its various stages of growth and interpretation up to the present seeming conflict with the Uniform Commercial Code. A résumé of pre-Chandler Act developments, before the removal of the “relation back” concept that led to its revision, is also included. Problems arising subsequent to the passage of the Chandler Act are discussed, including the panic induced by the now famous *Corn Exchange Nat'l Bank v. Klauder,* and *In re Vardaman Shoe Co.* line of cases. A brief review of the cases immediately preceding passage of the present Section 60 supplies the necessary historical background.

The purpose of Section 60 was never really questioned. This pur-

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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. Bankruptcy Act § 60(a) (1), 11 U.S.C. § 96 (1958).


The notion behind Section 60 is extremely simple and has remained
pose was simply to prevent an insolvent debtor contemplating bankruptcy from defeating his creditors shortly before the filing of the bankruptcy petition. Though the theoretical concept behind this Section may have been clear, attempts to effectuate this purpose have led to anything but clarity in the application of these concepts. The history of Section 60 shows three periods, one favoring the secured creditor, one favoring the trustee in bankruptcy, and the present period which, if the 1950 Amendment to Section 60 serves its intended purpose, will fairly well balance the two interests.

A. THE PRO-SECURED CREDITOR PERIOD

Between 1898 and 1938, when the Chandler Act revision of the bankruptcy law was passed, the conflicts between the secured creditor and the trustee in bankruptcy usually resulted in the creditor's claim being upheld. Either the "relation back" concept or the "pocket lien" theory would be used to justify this result. Consequently, the pendulum swung so far in favor of secured creditors that the trustee in bankruptcy was virtually without power to set aside any "preferential transfer."

One of the most frequently cited cases from this period is *Seton v. Kessler & Co.*, a 1912 case concerning a New York bank and its English correspondent. Kessler & Co. of New York became insolvent and Kessler & Co. of Manchester took possession of certain bonds kept on file in the vaults of the New York bank as security for the credit extended by the English house. This taking was effected within a four month period before the petition in bankruptcy was filed. The court upheld the transfer on the grounds that there was an equitable lien which arose from the mere promise of the New York bank to
put up security. The transfer was thus allowed to "relate back" to the
time of the promise, which was made beyond the four month limit of
the bankruptcy act and thus was valid.

Some three years later, the case of Bailey v. Baker Ice Machine
Co.\textsuperscript{2} arose, followed by a series of cases from which the now-familiar
term "pocket lien" originated. The Baker case involved a conditional
sale by Baker Ice Machine Co. that was upheld even though the
contract evidencing the sale was not filed until a time when it took on
the elements of a voidable transfer.\textsuperscript{13} Carey v. Donohue\textsuperscript{14} and Martin
v. Commercial National Bank\textsuperscript{15} followed closely with similar holdings.
The result was that the "Supreme Court recognized as valid deeds,
mortgages, and other lien instruments on both real and personal
property, however belatedly recorded or not recorded at all, merely
because the applicable state recording statute did not make them
invalid against judgment creditors, as such."\textsuperscript{16} Thus a trustee in
bankruptcy found it very difficult to effectively represent the interests
of unsecured creditors as intended under Section 60. There were a
few scattered amendments\textsuperscript{17} preceding the Chandler Act but not
until then was any concrete change really effected.\textsuperscript{18} As is often the
case, when a change comes it is sometimes overdone, and this may
have been true with the Chandler Act, which swung the pendulum
far to the side of the trustee in bankruptcy.

\textbf{B. The Pro-Trustee in Bankruptcy Period}

Until the Chandler Act was passed, the trustee had been in the
position of a judgment creditor in regard to the estate of the bank-

\begin{itemize}
  \item\textsuperscript{12} Bailey v. Baker Ice Machine Co., 239 U.S. 268 (1915).
  \item\textsuperscript{13} The contract was filed at a time when Grant Brothers were insolvent and
within the four months period prior to bankruptcy thus creating a transfer that
would have had the elements of a preference and been subject to attack by the
trustee. Instead of so holding the court said: "We think the better view . . . is
that the trustee take the status of such a creditor as of the time when the petition
was filed. Here the petition was filed almost two months after the contract was
filed for record, and therefore the trustee was not entitled to assail it under the
(1915).
  \item\textsuperscript{14} 240 U.S. 430 (1916).
  \item\textsuperscript{15} 245 U.S. 513 (1918).
  \item\textsuperscript{16} Kupfer, The Recent Amendment of Section 60-a of the Bankruptcy Act, 24
  \item\textsuperscript{17} See, e.g., 32 Stat. 799 (1903); 36 Stat. 840, 842 (1910); 44 Stat. 666
(1926).
  \item\textsuperscript{18} For a discussion of events and amendments preceding the Chandler Act, see
McLaughlin, Amendment of The Bankruptcy Act, 40 Harv. L. Rev. 341 (1927).
\end{itemize}
rupt. The new Section 60 (Chandler Act) put the trustee in the position of a hypothetical bona fide purchaser for value.\(^\text{19}\) The new clause, credited to Professor McLaughlin,\(^\text{20}\) stated that a transfer would not be deemed to have been made until so far perfected as to prevent even a bona fide purchaser from subsequently gaining any right in the property transferred which would be superior to the right of the transferee. At the time of the adoption of the Chandler Act there was some comment about the danger inherent in this extremely favorable position given the trustee in bankruptcy, but it was not until the landmark case of *Corn Exchange Nat'l Bank v. Klauder*\(^\text{21}\) that real concern arose. From then until the 1950 amendment, many writers pointed out the possible dangers inherent in the wording of Section 60’s bona fide purchaser test.\(^\text{22}\)

*Corn Exchange Nat'l Bank v. Klauder*\(^\text{23}\) has been universally recognized as the case that “started it all.”\(^\text{24}\) The *Klauder* case dealt with loans made on assignments of accounts receivable. Corn Exchange National Bank & Trust Co. was the lender and assignee of the accounts receivable, and Quaker City Sheet Metal Co. the borrower and assignor. Klauder was trustee in bankruptcy. In 1938, Quaker City Sheet Metal Co. found itself short of working capital. Some of its creditors (later representing a very high percentage of the claims provable in bankruptcy) agreed to subordinate their claims to new loans which would have to be made if the company was to obtain new working capital and remain in business. New money was thus obtained by assignment of accounts receivable to the assignee-petitioner Corn Exchange National Bank, and the company progressed for a time before going into involuntary bankruptcy on May 7, 1940. The assignments were recorded on the borrowing company’s books, but notice was not given to the debtors whose accounts were assigned to the petitioners. Pennsylvania law at that time followed the English

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20. Countryman, supra note 8, at 78-79.
22. See, e.g., Dulley, NACM Presents Views on 60 a, Credit & Financial Management 7 (June, 1948); Ireton, A Proposal to Amend Section 60a of the Bankruptcy Act, A6 Corp. Reorg. & Am. Bankr. Rev. 257 (1947); Lowenstein, Assignments of Accounts Receivable and the Bankruptcy Act, 1 Rutgers L. Rev. 1 (1947).
23. 318 U.S. 434 (1943).
view for assignment of accounts, which is, in effect, that a subsequent assignee can prevail over a prior assignee if he is first to notify the obligor of the assignment. Because of this rule, the trustee contended that the perfection necessary under the Chandler Act, Section 60, never occurred and that the transfer must be considered as taking place immediately before the adjudication of bankruptcy. The trustee was unsuccessful with the referee before whom the claim was initially brought, but the circuit court of appeals upheld his contentions and the case went to the United States Supreme Court on writ of certiorari. The Supreme Court sustained the circuit court and the position of the trustee by a very literal reading of the bankruptcy code. In making the decision the court recognized that the result might be harsh and indicated an awareness of the possible effect on non-notification financing, but said that it felt the spirit of the law was clear and that those possibilities provided no justification for removing the case from under the Act. The court cited the legislative history of the Act and the record of judicial decisions which it felt had defeated the intent of Congress time after time, and added simply that Congress presumably knew what it was doing and its evident intention would be followed. Thus the foundation for the line of thought which led to the 1950 amendment of Section 60 had been laid.

The clamor that arose following these decisions could be misleading. The damage to accounts receivable financing was not too great, since the states were free to adopt legislation to compensate for the construction the Court had placed on Section 60; and they did so rather quickly. What, then, was the real concern? Professor Vern Countryman set out what he thought were the major issues. Briefly,

25. 318 U.S. 434, 436 (1943). In so holding, the Supreme Court said of the Circuit Court's decision:

It held that the assignments were preferences under Section 60 (a) and therefore, under the terms of Section 60 (b), inoperative against the trustee.

This is undoubtedly the affect of a literal reading of the Act. Its apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state law would enforce against a good-faith purchaser.

26. In re Vardeman Shoe Co., 52 F. Supp. 562 (E.D. Mo. 1943), also dealing with accounts receivable, reached a similar result, if anything, carrying the damage to accounts receivable financing even further.

27. Conwill & Ellis, supra note 3, at 76.

28. Countryman, supra note 8, at 82-83, says:

Their alarm was now focused on three other horrible possibilities.

First, under a variety of inventory financing devices—principally trust receipts, conditional sales for resale, factors' liens, and chattel mortgages on a shifting stock of goods—the borrower is empowered to sell from stock in ordinary course of trade and the purchaser in ordinary course of trade takes
the problems as he presented them were, first, inventory financing arrangements which would remove the retailer's power to convey good title to a bona fide purchaser would defeat the whole purpose of the arrangement; second, there was a possibility that any delay in recording might result in the transfer being set aside as a transfer on account of an antecedent debt, and third, there was an inherent danger in priority conferred by statutory liens. Despite these contentions, the damage to accounts receivable financing received the emphasis and was the rallying point in seeking reform in the Act.

In 1947 a Professor of Law and a Graduate Fellow at Yale,29 commenting on proposed amendments to the Bankruptcy Act, minimized any threat to inventory financing under Section 60's bona fide purchaser test.30 The authors of that article pointed out that the feared results had not been realized in the ten years between the adoption of the Chandler Act and the writing of their article. They placed a good deal of faith in the ultimate wisdom of the courts to practically interpret Section 60.

In re Harvey Distributing Co.,31 decided almost on the eve of the passage of the 1950 amendment to Section 60, seemed to indicate that the concern over Section 60 had been well-founded, but after reversal on appeal it left in doubt what might really have happened had not the 1950 amendment to Section 60 intervened. The Harvey case involved the Coin Machine Acceptance Corporation, a manufacturer of coin-operated machines, and the Harvey Distributing Co., Inc., a wholesaler of these machines. The coin-operated machines were sold


30. Id. at 698, "It is highly improbable that any court would reach that result [allowing the trustee to prevail]. Section 60a should be interpreted in the light of its legislative history as striking at secret liens, previously protected by the doctrine of 'relation back,' not at legitimate security devices. . . ."

to Harvey by Coin Machine Corp. and the purchase was secured by trust receipts. The trust receipts were duly recorded under Virginia's Uniform Trust Receipts Act, the last of the receipts being recorded by March 18, 1948. On March 4, 1949 an involuntary petition in bankruptcy was filed against Harvey. The machines in question were in Harvey's possession and were taken by the trustee in bankruptcy and sold under an agreement that the proceeds would be retained pending the termination of the bankruptcy proceedings. The Coin Machine Corp. then filed a petition with the district court setting forth the above facts and contending that there was no interest in the machines covered by the trust receipts from which the bankrupt's estate could benefit. In substance, the Coin Machine Corp. then asked that it be declared a preferred creditor as to the proceeds realized from the sale of these machines by the trustee. The trustee in bankruptcy filed an answer alleging that under Section 60(a) he was entitled to retain possession of the machines and therefore to any proceeds from their sale. The question was whether or not Coin Machine Corp. had a perfected lien giving it status as a preferred creditor. The District Court held it did not have such a lien. The Court said that under Section 60 such a lien acts as a transfer and must be so far perfected as to be valid against any subsequent purchaser and if not so perfected prior to bankruptcy the transfer will be deemed to have occurred immediately prior to bankruptcy and thus within the four month statutory period, and voidable by the trustee. Harvey had the liberty to sell and convey good title and hence the lien was never so far perfected as to prevent a creditor or bona fide purchaser from the debtor from acquiring rights superior to the transferee Coin Machine Corp.

C. THE BALANCE OF POWER PERIOD

Following this ruling, Coin Machine Corp. took an appeal to the Court of Appeals for the 4th Circuit. During the intervening period, the 1950 amendment to Section 60 was passed and the position of the trustee in bankruptcy challenging the transfers as preferential had become that of a hypothetical lien creditor and time limits had been fixed to cure the problem of transfers on account of an antecedent debt. In view of this amendment, the Court of Appeals remanded the case to the District Court for reconsideration in the light of the new amendment. On retrial the District Court said it felt the new amendment had no bearing on the case at bar, which had arisen prior to

32. Id. at 468.
33. Ibid.
the adoption of the amendment, and that it was firm in its belief that the earlier language required it to uphold the trustee as indicated in the initial decision. The Court thus reaffirmed its original position, and the case again went to the Court of Appeals.

The Court of Appeals had two questions before it. First, was the amendment applicable; second, if it was not, had the lower court properly interpreted the pre-amendment language of Section 60? Obviously, if the first question was answered in the affirmative the second became moot. Nonetheless, the court undertook first to decide a question it might properly not have answered at all. The court started by giving its view as to the effect of the Chandler Act before the 1950 amendment.

In discussing the ruling of the District Court, the Court of Appeals cited the Moore-Tone article and expressed agreement with its reasoning. The court said that the intent of Congress in the Chandler Act had been obviously only to do away with highly prejudicial secret liens, not to set aside valid methods of financing. In his opinion, Judge Parker said: "It is hardly reasonable to suppose that Congress intended to strike down this healthy and 'above the board' business; and it is elementary that acts of Congress are to be given a reasonable interpretation and not one that leads to hardship and absurd results." Was this, then, a flat refutation of the fears of writers, creditors and others? This is a question that can never really be answered because the court's comments on it were in the form of dicta not essential to the decision of the case.

In what position, then, does this case leave the trustee? The actual decision would seem to make it clear that the fear of damage to financing arrangements created by the bona fide purchaser test had been removed by the new lien creditor test. In addition, this interpretation would have disposed of the problems which seemed bothersome under the pre-amendment Section 60 language.

36. 192 F.2d 773, 776 (4th Cir. 1951).
37. In that article it was pointed out that, despite the language of the Chandler Act Section 60, Mr. Tone and Professor Moore felt that the fears of the bona fide purchaser test being carried to extremes were unfounded and that it was highly improbable any court would reach such an unjust result. As was indicated much of the writing in this area was contrary to the view these men shared. See for example, Keeffe, Kelly & Lewis, supra note 2; Kupfer & Livingston, supra note 24.
38. 192 F.2d 773, 776 (4th Cir. 1951).
39. The court, after stating its view of the law prior to the 1950 amendment said, "We need not pass upon the question, however, for Congress, which intended no such result, has plainly said so and has amended Section 60, sub. a of the Bankruptcy Act in such way as to remove all doubts... and has given the amendment retroactive application." Coin Machine Acceptance Corp. v. O'Donnell, 192 F.2d 773, 776 (4th Cir. 1951).
The lower court view of the pre-amendment language shows the result that the new language was designed to prevent, and the Court of Appeals shows that such a result will definitely not be granted under the amended Section 60 lien creditor test. To be certain, the decision does leave the inference that much of the concern over Section 60 was unwarranted and perhaps based on an unreasonable interpretation of the statutory language. It would appear, then, that these fears were in fact based on the possibility that the courts would strictly and literally construe the language of Section 60. Such a possibility hardly seemed unreasonable in the light of the Klauder decision. It should also be remembered that much of the court's language was found in non-controlling dicta. Thus, it would be unwise to assume that a decision in line with the lower court's view was either "unreasonable" or "absurd" before the adoption of the 1950 amendment.

Since the Harvey decision in 1951 there have been few cases dealing with the new changes in Section 60, but a great many more cases have dealt with other problems of bankruptcy. In the last few years

40. The lien creditor test is contained in Section 60(a) (2).

41. The court in discussing this problem said it was "elementary that acts of Congress are to be given a reasonable interpretation and not one that leads to hardship and absurd results." Coin Machine Acceptance Corp. v. O'Donnell, 192 F.2d 773, 776 (4th Cir. 1951).

42. It was surely not entirely without provocation that the authors began an article on Section 60 entitled "Sick Sixty" by saying: "Think of the effect on business if the headlines of the Wall Street Journal this morning proclaimed: Supreme Court Voids All Security Devices As Bankruptcy Preferences." See Keeffe, Kelly & Lewis, supra note 2.

43. In support of this view there were opinions expressed as recently as July 1950 professing that such would come to pass barring the intervention of an amendment. Kupfer, supra note 16.

44. See, e.g., Porter v. Searle, 228 F.2d 748 (10th Cir. 1955); In re American Merchandising Co. 136 F.Supp. 952 (D.N.J. 1955).

45. See, e.g., Dudley v. Dickie, 281 F.2d 360 (9th Cir. 1960) (recording mortgage and perfection of title); Mayo v. Pioneer Bank & Trust Co., 270 F.2d 823 (5th Cir. 1959) (basic requirements of perfection); Gordon v. Spalding, 268 F.2d 327 (5th Cir. 1959) (purpose generally); Cohen v. East Netherland Holding Co., 258 F.2d 14 (2nd Cir. 1958) (possession of real property constructive notice); National Discount Corp. v. Tyson, 247 F.2d 18 (4th Cir. 1957) (general elements of preference); McKnight v. M. & J. Finance Corp., 247 F.2d 112 (4th Cir. 1957) (necessity of notice to effective filing); Matter of Ideal Mercantile Corp., 244 F.2d 828 (2nd Cir. 1957) (law governing perfection of transfer); Greenblatt v. Utley, 240 F.2d 243 (9th Cir. 1956) (filing mechanic's lien under local law); Marks v. Goodyear Rubber Sundries, Inc., 238 F.2d 533 (2nd Cir. 1966) (reasonable cause to suspect insolvency); Matter of Michael Morasco, 233 F.2d 11 (2nd Cir. 1956) (conditional sale, notice and filing as a transfer); Pacific Indemnity Co. v. Grand Avenue State Bank of Dallas, 223 F.2d 513 (5th Cir. 1955) (rights of surety); Lang v. First Nat'l Bank of Houston, 215 F.2d 118 (5th Cir. 1954) (reasonable
the main disputes regarding the trustee's power have centered on Sections other than 60.\textsuperscript{46} It has been suggested that these problems may eventually be cured as more states adopt the Uniform Commercial Code.\textsuperscript{47} However, the Uniform Commercial Code is not the whole answer, since the biggest controversy involving Section 60 today is directly concerned with the Uniform Commercial Code.

D. SECTION 60 AND ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE

The biggest cause of concern now seems to be over the possible conflict between Section 60 and Article 9, the Secured Transaction Article of the Uniform Commercial Code, which has been adopted in nine states\textsuperscript{48} and for which bills have been prepared or are in the course of preparation in at least six more. Code bills are expected to be introduced into 15 state legislatures in 1961 alone.\textsuperscript{49} This activity

46. The main problems in the last few years have concerned other sections applicable to the trustee's powers and have centered around section 70(e) and 70(e). See MacLachlan, The Impact of Bankruptcy on Secured Transactions, 60 Colum. L. Rev. 593, 603-08 (1960).

47. At the time of the MacLachlan article, supra note 46, the U.C.C. was said to be adopted in some form by Pennsylvania (1953), Massachusetts (1957), Kentucky (1958), and Connecticut (1959).


49. Bills are reported prepared or in preparation in California, Illinois, Maine, Missouri, Montana, North Dakota, Ohio, Oklahoma, Oregon and Washington.
clearly indicates the important role that the Code is certain to have in the future. As each new state adopts the Code the significance of any possible conflict with the Bankruptcy Act is greatly increased. Furthermore, as the bigger commercial states such as New York adopt the Code, the smaller states will almost certainly follow.

The purpose of Article 9 of the U.C.C. is to clear up the confusion surrounding secured transactions and to establish a definite, functional system of secured financing.50 The policy behind Article 9 is to aid the legal perfection of secured interests, to keep intact present procedures that give practical protection for the creditor, and to avoid distinctions based solely on form.51 The sections of Article 9 attempt to provide smoothly operating and economically feasible means of secured credit financing, while giving at the same time protection to subsequent creditors, secured or unsecured.

The most controversial provisions in the U.C.C. are Sections 9-108, 9-204(3), and 9-204(5). These sections are causing much alarm because of apparent conflict with Section 60.52 Section 9-204 presents the basic problem and Section 9-108 becomes involved as it attempts to head off the conflict before it can arise. Section 9-204 is concerned with the time when security interests attach, with after-acquired property, and with future advances. Section 9-204 states: "Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by

50. Shattuck, The Uniform Commercial Code—A Modernization of Commercial Law, 35 Wash. L. Rev. 398, 411 (1960). The two main objectives are said to be the improvement of legal principles governing commercial transactions and nationwide uniformity of these principles.


the security agreement." It further provides: "Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment." It is felt by some that the effect of these provisions is to favor the secured creditor over the general unsecured creditor. Article 9 validates the so-called "floating lien" and liens on a shifting stock. When this Article is coupled with a later provision, security interests in present or future assets are allowed even though the debtor is free to control the disposition of, or substitute for, the collateral. As the comment on this section points out, a debtor is thus permitted to commit all of his present and future assets to security purposes.

The conflict arises under present Section 60 of the Bankruptcy Act. It is perhaps both a philosophical and a physical conflict, but the actual conflict of the language is the one of interest here. As for the philosophical conflict, it has been suggested that the Bankruptcy Act is aimed at equal distribution and that this will not be possible under the U.C.C. since secured credit will encumber all assets available and general creditors will have nothing left to look to for satisfaction. After consideration it appears that this philosophical conflict is not too serious. Section 60 is aimed at equal distribution within the same class. In other words, Section 60 is directed at cases in which a party lends money either without disclosing the security he has obtained or on no security at all and then tries to claim a preferential position when his loan seems to be jeopardized, thus seeking an unfair advantage over other unsecured creditors who have relied on the debtor having free assets with which to meet their claims. It is safe to say that the basic policies of the two acts are not at all irreconcilable since both seek a definite framework within which sound secured credit practices may develop.

53. Uniform Commercial Code § 9-204(3).
54. Uniform Commercial Code § 9-204(5).
55. Levy, supra note 52, at 11, says it is apparent that Article 9 provides a means of substantially cutting down the yield for unsecured creditors as opposed to the secured creditors.
56. See Uniform Commercial Code § 9-204, comment 3 (1958 ed.)
57. Uniform Commercial Code § 9-205.
59. Countryman, supra note 8.
60. Coogan & Bok, supra note 52, at 244. "The typical transaction at which Section 60 is aimed is one in which a creditor provides money or goods on an unsecured basis and then after trouble seems imminent, jumps in to secure himself with assets which up to that moment have been available to all creditors."
61. Hanna, supra note 52, at 485, indicates that the basic purpose of Section 60 was to avoid secret liens and that the Uniform Commercial Code after-acquired property clause does not present this problem.
The real problem is the apparent conflict between the actual provisions of the U.C.C. and Section 60 when strictly or literally construed. The danger is that 9-204 and 9-108 transfers, while perfectly good against creditors under state law (where the U.C.C. has been enacted), may not withstand a trustee in bankruptcy's claim that they are transfers for an antecedent debt and voidable under the Section 60 rule against preferences. It was probably a fear of this result that led to the inclusion of the 9-108 provision. Article 9-108 attempts to remedy this situation by merely “deeming” such transfers to be made for “new value.” This type of reasoning brings to mind the oft-heard quote, “He’s not fooling any one but himself.” The question is whether the drafters have convinced any one but themselves by this provision. Unfortunately merely “deeming” a legal conclusion does not make it so.

The position of the trustee in bankruptcy in attacking such a transfer under this article will undoubtedly be that a state law cannot conflict with the Federal Bankruptcy Law in this way. It has certainly been the policy that state law governs matters such as perfection under the Act, but this has been where there was a bona fide state enactment under consideration. In the present case the drafters have anticipated a conflict with the fed-

62. Uniform Commercial Code §§ 9-204(3), 9-204(5) and 9-108, are said to conflict with the preference section of the Bankruptcy Act, Section 60.

63. Uniform Commercial Code § 9-108 is said to implement § 9-204(3) and (5).

Section 9-108 states:

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

64. One of the elements of a preferential transfer under Section 60(a) (1) of the Bankruptcy Act is that a transfer be “for or on account of an antecedent debt.” See MacLachlan, Law of Bankruptcy 285, § 248 (1956).

65. Kennedy, supra note 52, at 546-47.

The draftsmen of the Uniform Commercial Code were painfully cognizant of the problem posed by the possible application of section 60-a to strike down security transactions covering after-acquired property received by the debtor during the four month period before bankruptcy and they sought to deal with it. . . .

By a tour de force ventured in section 9-108, however, the security interest in after-acquired collateral is to be deemed “taken for new value and not as security for an antecedent debt. . . .”

66. Spivack, supra note 52.

67. See, e.g., Matter of Ideal Mercantile Corp., 244 F.2d 829 (2nd Cir. 1957); Manchester Nat'l Bank v. Roche, 186 F.2d 827 (1st Cir. 1951); Shiro v. Drew, 174 F.Sup. 495 (S.D. Me. 1959); Stone v. Mondie, 157 F.Sup. 929 (W.D. Ok. 1957).
eral law and by an exercise in semantics have tried to avoid the consequences by "deeming" the transfer to have been made for "new value" and thus removing the antecedent debt problem. It is questionable whether this is an area in which state law is to control. The factual situation has not been changed; all that has been done is to change the legal label attached to the transfer. It is doubtful whether this will be allowed. 68

There have been various thoughts on the validity of such a provision, but there is enough agreement on the presence of a problem that the problem seems certain to arise. 69 In fact, as one author suggests, if the drafters themselves feared the bankruptcy implications of Article 9-204 enough to provide a corrective section in 9-108, how can they expect the courts to be satisfied that no conflict exists? 70 This same author further points out that it is quite possible the courts will regard this word play as mere sham and look through it to the substance of the transactions. This is highly probable, the author says, when viewed in the light of Section 60 history. The "relation forward" idea of consideration given to coincide with the acquisition of future property is really nothing more than the reverse of the "relation back" concept of Sexton v. Kessler & Co. 71 and other cases which were destroyed by the Chandler Act. 72 Arguments that the U.C.C. provisions should withstand the impact of bankruptcy indicate

68. Coogan & Bok, supra note 52, at 248. As to 9-108, the trustee would take the position that a state statute cannot by language which "deems" the transfer not to have been made for an antecedent debt override the Bankruptcy Act. Kupfer, Secured Claims in Bankruptcy Proceedings, 28 N.Y.S.B. Bull. 40, 51 (1956).

Those who assert the legal impregnability of the floating lien rely on the doctrine that the validity of a secured lender's title is governed by state law, and that, in any transaction to which the code may be applicable, the 'relation-back' thesis of Sections 9-108 (2) and 9-204 insures the safety of the lender's fortress, but when bankruptcy supervenes, the Bankruptcy Act emerges as paramount, and in the view of many there is at least the possibility of a direct conflict between its policy and that of the code on this point. The resolution of the conflict is far from a foregone conclusion. . . . Some of us . . . will think twice before advising . . . that reliance can safely be placed upon it.

69. Friedman, supra note 52, at 195. "[T]he real threat to article 9 transactions is posed by the trustee in bankruptcy; and this is so despite an attempt by the drafters to frame the Code provision in a manner designed to escape the wide avoidance powers of the trustee." Kripke, supra note 52, at 195. "[I]t may be questioned whether any state legislation can affect the definition of preference in the Bankruptcy Act."

70. Friedman, supra note 52, at 219.

71. 225 U.S. 90 (1912). See Friedman, supra note 52, at 220.

72. Kennedy, supra note 52, at 548. "Any security transaction which can escape the impact of section 60 of the Bankruptcy Act only by an application of the discredited doctrine of relation back must be regarded as of tenuous validity."
doubt by the very way in which they are asserted. At best it must be clear that there is great doubt as to the effectiveness of the Article 9 provisions creating floating liens or liens on after-acquired property.

Having discussed this conflict, it is evident that like all problems, there must be two views. Many feel that state law will prevail and that the problem is more academic than anything else. It has been suggested that Bankruptcy Law has always bowed to state law on the validity of such matters. This thought is based on the idea that the deficiency, if any, in 9-204 will be cured by 9-108 and its “new value” provisions. But this circular reasoning only begs the question of whether such a provision can stand. Where a direct conflict arises between federal and state law it has been held as recently as 1954 that the federal concept must prevail. This seems the only logical conclusion because surely states cannot thwart Federal law by simply attaching a different legal result to the very same facts by a mere tag. In view of the evident conflict, such a holding seems to make the validity of these provisions doubtful indeed. But, it is said by some that what 9-108 and 9-204 seek to do is not an attempt to defeat the policy of Section 60 against preferential transfers. It is felt by some that the result of 9-204 is even highly desirable. This seems to be the prevalent view today, but whether this result can be attained by the present provisions, and not the desirability of the result, is the question at hand. Perhaps it may be necessary to change Federal law to avoid the challenge to these transfers. The uniformity and certainty that the U.C.C. strives for would be quite welcome, notwithstanding the fact that it may lead to a tying up of all of a debtor’s assets as security for one creditor, killing off the general creditor’s claims. It has further been said that, even if legally valid, it is undesirable to allow a borrower to tie up all collateral in this way, as it tends to promote extension of credit to bad credit risks.

As to the desirability of the provisions from a policy standpoint, the best view seems to favor the U.C.C.’s approach. As one writer points out, hostility to secured credit does not stop it but only makes it more costly. To this might be added that it makes it more com-

73. Birnbaum, supra note 51, at 357. “If Section 9-108(2) survives the impact of the Bankruptcy Act, as it should, a valuable result will be achieved. . . .”
74. For a hypothetical example of this problem see Kupfer, supra note 52, at 281.
76. Everett, Securing Security, 16 Law & Contemp. Prob. 49, 55 (1951). “[T]here can be no charge that the codifiers have called black white, called old value new, in order to defeat the Bankruptcy Act’s policy against preferences.”
77. Gilmore, supra note 52, at 34.
78. Kupfer, supra note 52, at 283.
79. Birnbaum, supra note 51, at 353.
plicated and difficult for a party to be sure just what assets are his collateral. With the open and notorious system of the U.C.C. a party can know what is available as collateral and what secured creditors are ahead of him, and the harm to the unsecured creditor is greatly lessened.

CONCLUSION

Despite the tremendous mass of comment and criticism of Section 60 by lawyers and legal writers, the implications of the Section have not seemed to bother the business world other than as a hypothetical difficulty. The approach has been a kind of, "We'll cross that bridge when we come to it." Since 1938 and the Chandler Act, the volume of financing has increased to a fabulous level, much of it under trust receipts and other kinds of so-called "floating liens." Business, then, has not been reluctant to engage in this kind of financing, notwithstanding the fact that the transfers can be voided even without a showing that there was any fraudulent intent.

The question ultimately must be, "Was all this clamor really necessary?" The answer must await the day when some courageous trustee meets Article 9 head on in the arena of the courts.

80. The dollar value of inventories in 1940 by industries was 12.8 billions for manufacturing, 3.2 billions for wholesale trade, and 6.1 billions for retail trade. In that same year, private debt (not including farm debt) amounted to 37.7 billions of short-term corporate debt, 26.0 billions of non-corporate mortgaged debt, and 17.9 billions of non-corporate non-mortgaged debt. By 1959, inventories had increased to 51.1 billions for manufacturing, 12.6 billions for wholesale trade, and 24.2 billions for retail trade, while private debt (not including farm debt) had risen to 179.1 billions of short-term corporate debt, 160.8 billions of non-corporate mortgaged debt, and 81.2 billions of non-corporate non-mortgaged debt. Statistical Abstract of the United States 388, 498 (1960). Much of the borrowing was no doubt for the purpose of financing the increased inventories.