A Plea for the Financing Buyer*

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Article 9 of the Uniform Commercial Code explicitly sanctions a security interest capable of "floating" over all of a borrower's personal property, including property that is "after-acquired." Its firm endorsement of the floating lien constitutes one of the Code's most significant contributions to the law of chattel security. The draftsmen of Article 9 recognized, however, that there are difficulties inherent in allowing unbridled floating liens. Under such a provision, an unyielding creditor may be able to frustrate future outside borrowing by his debtor, since any future lender will be confronted with the fait accompli of a prior perfected security interest that gives the already secured party priority even for subsequent advances.

* The authors wish to thank Professors Grant Gilmore, Ellen Ash Peters, and Robert Charles Clark, all of the Yale Law School, for their valuable comments on an earlier draft.
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1. The Uniform Commercial Code [hereinafter cited as the Code or by section only] has been described as a "floating lien" statute. (Unless otherwise specified, citations will be to the 1972 official text of the Code.) The floating lien concept refers to the provisions of Article 9 whereby "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral" (§ 9-204(1)); whereby "[o]bligations... may include future advances..." (§ 9-204(3)); whereby a security interest shifts automatically to the proceeds of collateral upon disposition thereof (§ 9-306); and whereby the rule of Benedict v. Ratner, 268 U.S. 353 (1925), is abrogated (§ 9-205). See Gilmore, The Purchase Money Priority, 76 Harv. L. Rev. 1339, 1343 & n.1 (1963); Coogan, Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien," 72 Harv. L. Rev. 838, 839-40, 850-55 (1959); cf. Gilmore, Chattel Security (pt. II), 57 Yale L.J. 761, 776-81 (1948); Llewellyn, Problems of Codifying Security Law, 13 Law & Contemp. Prob. 687, 699-701 (1948).


4. Through a combination of the validation of after-acquired property clauses in § 9-204(1) and the validation of future advances in § 9-204(3), a secured lender could severely restrict the ability of a creditor to find future outside lending.
Article 9 mitigates this undesirable consequence of the floating lien by affording a special priority to the "purchase money" lender. The Code's favorable treatment of the purchase money lender rests on a general policy, manifested in diverse areas of bankruptcy and security law, of giving new money priority protection over old. The

5. Section 9-107 defines a purchase money security interest:
A security interest is a "purchase money security interest" to the extent that it is
(a) taken or retained by the seller of the collateral to secure all or part of its price; or
(b) taken by a person who by making advances or incurring an obligation gives
value to enable the debtor to acquire rights in or the use of collateral if such
value is in fact so used.
Sections 9-312(2) and 9-312(4) are the basic sections giving priority to the purchase money security interest. See also § 9-313(4)(a).

6. In corporate reorganizations under the Bankruptcy Act, the favored treatment accorded new money may be seen in the priority given to trustee's certificates and to creditors whose claims meet the requirements of the "six-month rule." In the former, expenditures authorized by a bankruptcy trustee during the reorganization itself are given priority over secured creditors, on the theory that this new money is money which enables the debtor to continue operation. Bankruptcy Act § 116, 11 U.S.C. § 516 (1970). Trustee's certificates developed out of the early equitable device of "receiver's certificates," see Meyer v. Johnson, 53 Ala. 237 (1875); F. CLEVELAND & F. POWELL, RAILROAD FINANCE 245 (1912). For a discussion of trustee's certificates in the context of the "Immediate Need for New Money," see 2 A. DEWING, THE FINANCIAL POLICY OF CORPORATIONS 1345-46 (5th ed. 1953).

The six-month rule, first stated by the Supreme Court in Fosdick v. Schall, 99 U.S. 235 (1878), gives special priority to claims for labor, supplies, and materials furnished to the debtor within a reasonable time prior to bankruptcy that enabled the debtor to continue operation. In re New York, N.H. & H.R.R., 278 F. Supp. 592 (D. Conn. 1967), aff'd, 405 F.2d 50 (2d Cir. 1968), cert. denied sub nom. Abex Corp. v. Trustees of Property of New York, N.H. & H.R.R., 394 U.S. 999 (1969); FitzGibbon, The Present Status of the Six Months' Rule, 34 COLUM. L. REV. 220 (1934). The justification for the rule is based on an equitable principle that all the creditors have benefited from the continued operation of the corporation made possible by the supplier-creditors. In re New York, N.H. & H.R.R., 405 F.2d at 52.

7. In security law, the special priority accorded new money is apparent not only in the treatment of the purchase money lender, but also in such diverse areas as maritime liens and the so-called "doctrine of fixtures." In maritime liens, the general rule is that the newer the money, the higher the priority. As stated by Justice Johnson in The St. Jago de Cuba, 22 U.S. (9 Wheat.) 409, 416 (1824): "[I]n every case, the last lien given will supersede the preceding ... The vessel must get on; that is the consideration that controls every other." In the statement that "the vessel must get on" may be seen an underlying justification of the new money doctrine. See G. GILMORE & C. BLACK, THE LAW OF ADMIRALTY 743 (2d ed. 1975).

The idea that new money should be given priority over old was also influential in shaping the impact of chattel security law on the so-called "doctrine of fixtures." See 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 28.3-4, at 758-59 (1963); cf. Coogan, The New UCC Article 9, 86 HARV. L. REV. 477, 498 n.64 (1973).

8. See sources cited in notes 25-26 infra. While many statements are found which accept the new money doctrine, the economic or jurisprudential rationale for the existence of that preference has never been explored fully. Cf. sources cited in note 25 infra. For purposes of this article, the correctness of the doctrine is not questioned.

The Code uses the purchase money security interest priority to limit the reach of the floating lien. Gilmore, The Purchase Money Priority, supra note 1, at 1334: "No previous security statute has so warmly embraced the once-despised after-acquired property interest. It is also true that no previous statute has so sternly insisted on the priority for purchase money interests."
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purchase money loan is not, however, the only way in which "new" money may be injected into an ongoing business. The financing buyer—the buyer who pays in advance to enable his seller to manufacture the very goods for which he has contracted also furnishes new money which performs essentially the same financing function as the purchase money loan. 10

We shall analyze the unhappy status of the financing buyer under the Code and show that the draftsmen of the Code did not make entirely effective its general policy of providing priority for injections of new money. Both as buyer and financer, the financing buyer is confronted with a morass of conflicting Code provisions that make his position unclear and insecure. Although Article 2 contains the vestiges of an attempt to improve the status of the financing buyer, 11 for any real security during the manufacturing process the financing buyer must look to Article 9. 12 But while the financing buyer may

9. The term "financing buyer" is used to describe the prepaying buyer who is also serving a financing function. As such, the term does not include the prepaying buyer who is not a financer: the buyer who simply pays for an item and does not take immediate possession. See generally Gordon, The Prepaying Buyer: Second Class Citizenship Under Uniform Commercial Code Article 2, 63 Nw. U.L. Rev. 565 (1968).

10. The similar function that the purchase money lender and the financing buyer perform in injecting new money into an enterprise may be demonstrated by restructuring the form, but not the substance, of the transaction involving the financing buyer. A financing buyer is advancing money to enable a seller to manufacture, say, chairs. (The chairs will be sold to the financing buyer, but for the moment that is not essential.) Now, the seller will take the money received from the financing buyer and use that money (by hypothesis) to manufacture the chairs. It will use the bulk of the money to buy materials and to pay labor. As to the material which the seller buys, the financing buyer is but a financer for the seller's acquisition of that material. The seller could equally have acquired the material if the materials suppliers had been willing to supply it on credit. Those suppliers, then, would appear to be classic candidates for becoming purchase money lenders, under § 9-107(a) and § 9-312(3). Under the traditional view, see note 124 infra, another party could finance the sale of the same material, under § 9-107(b), instead of the supplier selling the collateral and taking back a security interest under § 9-107(a). The financing buyer, in practical effect, is nothing but such a financer. The difference in form is that the financing buyer is not explicitly and directly tied to a materials sale, but rather to a subsequent sale. Yet, economically it is performing the same function.

11. See pp. 11-16 infra.

12. To the extent the financing buyer asserts his rights as a secured party under Article 9, he may find it difficult to continue to assert his Article 2 rights as a buyer. Some of these Article 2 rights may be important outside of insolvency. For example, assuming a rising market (where the value of contract goods increases after prepayment of the purchase price), the seller might renege on the contract because he is able to resell the contract goods to a third party for a greater price. Under Article 2, the financing buyer would possibly have the right to specific performance (if the goods were specially manufactured and considered sufficiently "unique"), § 2-716(1), and would certainly have the right to cover, § 2-712. Under Article 9, however, the financing buyer might be limited to recovery of his purchase price (out of "proceeds" of the sale to the third party). A junior lienor could demand refund of the excess of the proceeds over the purchase price, § 9-504(2) ("If the security interest secures an indebtedness, the
easily take and perfect an ordinary Article 9 security interest, such an interest, unlike the special protection afforded purchase money lenders, only insulates the financing buyer against the competing claims of unsecured and subsequent Article 9 secured creditors. To get protection against a secured creditor with a prior, floating lien, the financing buyer must conform to the requirements of § 9-107; secured party must account to the debtor for any surplus...”). The financing buyer, as a result, would be deprived of the benefit of his bargain. See also § 9-505(2).

This result seems to be anomalous. The Code apparently contemplates a party being both a buyer and a secured party—§ 1-201(37) says as much (“a buyer may also acquire a ‘security interest’ by complying with Article 9”). Although such a dual status is contemplated by § 1-201(37), however, no accommodation for this dual status has been made in Article 9. Instead, § 9-504(2) appears to limit the financing buyer to his right as a secured party.

Yet, § 9-504(2) also makes an exception for buyers of intangibles: “[I]f the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus ... only if the security agreement so provides.” This recognizes that secured parties that are also buyers do have a different status than a mere secured party. See § 9-504, Comment 3. The Code, however, faltered in implementing that perception by limiting the exception to buyers of intangibles. To harmonize Article 2 with Article 9, that exception should be extended to cover buyers of tangibles as well. Otherwise, the financing buyer who wishes to take a security interest (in order to gain greater protection in case of insolvency) at the same time loses his Article 2 remedies designed to protect for him the benefit of his bargain. See Speidel, Advance Payments in Contracts for Sale of Manufactured Goods: A Look at the Uniform Commercial Code, 52 Calif. L. Rev. 281, 300-05 (1964). He concludes:

If the buyer has in fact made advances and if a security interest has in fact been created and perfected in inventory to be manufactured for sale to the buyer, neither the seller nor third parties can legitimately complain if the security interest is in fact used to expand possessory remedies to achieve article 2 results. While the “financing” buyer’s right to possession is derived from article 9, its motivation and the resulting incidents of ownership are more consistent with a sale than simple security.

Id. at 305.

The nonuniform amendment to § 2-402 added by Connecticut in 1961, Conn. Gen. Stat. Rev. § 42a-2-402(3) (Supp. 1961) (renumbering UCC § 2-402(3) as § 42a-2-402(4)), appears to be an attempt to resolve the dilemma of the financing buyer caught between Articles 2 and 9. The Connecticut amendment states:

When a seller remains in possession of goods which have been sold or identified to a contract for sale..., the buyer... of such goods may protect his interest by complying with the filing provisions of Article 9. On compliance the buyer... has, against creditors of and purchasers from the seller, the rights of a secured party with a perfected security interest. Such filing does not, of itself, make the interest of the buyer... a security interest, as defined by subsection (37) of section 42a-1-201.

Clearly, the object of this amendment is to improve the status of the financing buyer. The draftsmen, however, apparently recognized the difficulties faced by a financing buyer who actually takes an Article 9 security interest, and attempted to resolve these difficulties in the buyer’s favor by giving him the benefits, but not the burdens, of the holder of an Article 9 security interest. This amendment attempts to straddle Articles 2 and 9, by giving this specially defined class of buyer the protection afforded by Article 9 without, however, subjecting them to a dilution of their Article 2 rights. (Note, however, that the Connecticut amendment does not give the financing buyer the status of a purchase money lender. Consequently, whether a prior secured party, holding a security agreement with an after-acquired property clause, would be able to defeat the financing buyer remains unresolved. See pp. 27-30 infra.)
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that is, he must himself become a purchase money secured party.13 However, the present definition of a purchase money security interest was not formulated with the financing buyer in mind. As we shall see, it is all but impossible in practice for the financing buyer to attain the status of a purchase money lender.14

After contrasting the treatment of the purchase money lender and the financing buyer under both the pre-Code case law and the Code itself, we shall argue that the policies underlying the Code make entirely anomalous the disparate treatment which these two forms of new money financing presently receive, and that these same policies require that the financing buyer be given the legal protection now afforded the purchase money lender.

I. Pre-Code Status of the Purchase Money Lender
and the Financing Buyer

A. The Purchase Money Lender

At common law, the purchase money security interest, as a security interest in existing personal property, was always held to be valid against unsecured and subsequent secured parties.15 In fact, the purchase money lender has never had more than one serious competitor: the prior secured creditor claiming under an after-acquired property clause. Consequently, so long as security interests in after-acquired property were held invalid, the purchase money lender needed no special priority in order to protect himself.

During the 19th century, the courts were generally hostile to security interests in after-acquired property.16 The only important exception was in the specialized area of railroad financing, where the idea that a debtor could encumber his future assets won approval, as early as 1860, in Pennock v. Coe.17 Although recognition of security interests in after-acquired property was at first limited to railroad corporations,18 in the early years of this century the concept under-

17. 64 U.S. (23 How.) 117, 125, 130 (1860).
18. 2 A. MACHEN, MODERN LAW OF CORPORATIONS § 1854 (1908).
went an expansive development.\textsuperscript{19} With respect to equipment financing in general, the import, if not always the language, of the case law was relatively clear by the 1930's: the lien of a mortgage could cover after-acquired equipment, and was valid against competing claimants.\textsuperscript{20}

The special priority of the purchase money security interest was established almost as soon as it was questioned.\textsuperscript{21} In \textit{United States v. New Orleans R.R.},\textsuperscript{22} the holder of a purchase money security interest challenged the priority of a lien on the debtor's after-acquired property. This was the first time the question had been brought before the Supreme Court, which easily resolved the conflict in favor of the purchase money lender:

A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor's hands. If that property is already subject to mortgages or other liens, the general mortgage does not displace them, though they may be junior to it in point of time. It only attaches to such interest as the mortgagor acquires; and if he purchase property and give a mortgage for the purchase-money, the deed which he receives and the mortgage which he gives are regarded as one transaction, and no general lien impending over him . . . can displace such mortgage for purchase money.\textsuperscript{23}

In affirming the special priority of the purchase money security interest, the \textit{New Orleans Railroad} case merely extended the logic of a doctrine whose roots can be traced back to 1631.\textsuperscript{24} Since the credit supplied by the purchase money lender is what makes the debtor's acquisition of the collateral possible, it is just, as well as financially necessary, that the purchase money lender should prevail over other

\textsuperscript{19} See Mason v. Citizens Nat'l Trust & Sav. Bank, 71 F.2d 246 (9th Cir. 1934); \textit{In re Median Quarry Co.}, 179 F. 929 (W.D.N.Y. 1910); \textit{In re Adamant Plaster Co.}, 137 F. 251, 255 (N.D.N.Y. 1905); Mallory v. Maryland Glass Co., 131 F. 111, 113 (C.C.D. Md. 1904); Gilmore, \textit{The Purchase Money Priority}, supra note 1, at 1349.

\textsuperscript{20} Cf. 1 G. Gilmore, \textit{supra} note 7, at 38-39.

\textsuperscript{21} Gilmore, \textit{The Purchase Money Priority}, supra note 1, at 1344:

The after-acquired interest, wherever it has been recognized as valid against the borrower's creditors and in his bankruptcy, has been subordinated to subsequent purchase money interests which arise in connection with the financing of new acquisitions by the borrower.

See also id. at 1349.

\textsuperscript{22} 79 U.S. (12 Wall.) 362 (1871).

\textsuperscript{23} Id. at 365.

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secured parties in any priority dispute regarding the collateral itself.\(^2\) The priority accorded the purchase money security interest has always reflected the assumption that new money confers special benefits on the debtor, and therefore deserves special protection.\(^2\)

During the 75-year period following the *New Orleans Railroad* case, the priority of the purchase money security interest was firmly established in virtually every area of financing in which security interests in after-acquired property came to be recognized.\(^2\) Of course, this priority was not unrestricted. To protect against fraudulent claims


A more illuminating analysis [for the priority of the purchase money lender] would rest the priority of the purchase money mortgage or its analogue on considerations of fairness and financial expediency. Thus, although the first mortgagee's right may relate back to an earlier agreement, it would seem that the equities attach to the property simultaneously, and *prima facie* that of the later lender should prevail, for his money made the acquisition possible. Indeed, if the corporation cannot offer him such security, it may be unable to finance even those acquisitions necessary for current operations.

See Shanker, *An Integrated Financing System for Purchase Money Collateral: A Proposed Solution to the Fixture Problem Under Section 9-313 of the Uniform Commercial Code*, 73 Yale L.J. 788, 791-92 (1964) ("Section 9-313's present approach [favoring the purchase money lender] seems to be based on the notion that the fixture secured party made possible the addition of new value, namely a fixture, to the land... Thus, it seems only fair that prior real estate interests be subordinated to the fixture security interest.... The law regards the purchase money secured party as having a special equity in the new asset which his funds made possible, an equity sufficient to override any claims of prior parties to the same new asset."). See also Holt v. Henley, 232 U.S. 637 (1914); Porter v. Pittsburgh Bessemer Steel Co., 122 U.S. 267 (1887); Farmers' Loan & Trust Co. v. Denver, L. & G. R.R., 126 F. 46, 49 (8th Cir. 1903); Harris v. Youngstown Bridge Co., 90 F. 322, 329 (6th Cir. 1898); J. White & R. Summers, supra note 3, § 25-5, at 914; Skilton, *Security Interests in After-Acquired Property Under the Uniform Commercial Code*, 1974 Wis. L. Rev. 925, 1014; Note, supra note 15, at 1160.


The purchase-money priority contained in section 9-312(3) and (4) stems from the traditional preferred position accorded by the law to the lender supplying either the capital with which to acquire new goods or equipment or to the seller of such goods on a deferred payment basis.

based on hindsight wisdom, certain procedural requirements were imposed upon the lender who wished to claim the special status of a purchase money lender.\(^\text{28}\) Among the most important were rudimentary tracing requirements: at the time the collateral was purchased, there had to be some overt conduct linking the asserted security interest with the act of acquisition.\(^\text{29}\) These tracing requirements, however, existed solely to protect against potential abuses of the basic and accepted doctrine that purchase money security interests are entitled to a special priority. A genuine purchase money lender had nothing to fear; without question, he enjoyed a favored position in the chaotic world of pre-Code chattel security law.\(^\text{30}\)

Although the purchase money priority was well established by the time of the drafting of the Uniform Commercial Code,\(^\text{31}\) the conflict between the purchase money security interest and the security interest in after-acquired property had been limited to disputes involving fixed equipment. Since security interests in after-acquired inventory had not been widely validated, the conflict did not extend to inventory financing.\(^\text{32}\) Nevertheless, the rationale underlying the purchase money

\(^{28}\) Note, \textit{supra} note 25, at 474-75. See, \textit{e.g.}, \textit{In re} New York, S. & W.R.R., 109 F.2d 988, 992 (3d Cir. 1940); \textit{In re} Quigley Motor Sales, Inc., 75 F.2d 253, 254 (2d Cir. 1935); \textit{In re} Chubby's Parkchester, 94 F. Supp. 701, 704 (S.D.N.Y. 1951); cf. \textit{§} 9-107, Comment 2; \textit{American Law Institute \\& Nat'l Conf. of Comm's on Uniform State Laws}, 1956 \textit{Recommendations of the Editorial Board for the Uniform Commercial Code} 262.


\(^{30}\) \textit{See 1 L. Jones, A Treatise on the Law of Mortgages of Real Property} \textit{§ 582, at 789 (8th ed. 1926).}

\(^{31}\) \textit{§} 9-312, Comment 3; \textit{American Law Institute \\& Nat'l Conf. of Comm's on Uniform State Laws, Uniform Commercial Code} \textit{§ 8-105, Comment 2} (Sept. 1949 Revisions) [hereinafter cited as \textit{September 1949 UCC}]; 3 \textit{N.Y. State Law Review Comm'n, 1955 Report} 2062; \textit{Texas Legislative Council, Staff Monograph, Analysis of Article 9 of the Uniform Commercial Code} 18, 76 (1954). The priority, however, arguably was not extended to permanent fixtures. \textit{See United States v. New Orleans R.R., 79 U.S. 362, 365 (1870)} ("Had the property sold... to the railroad company been rails... or any other material which became affixed to and a part of the principle thing, the result would have been different.") (dictum); Gilmore, \textit{The Purchase Money Priority, supra} note 1, at 1347-48; Porter v. Pittsburg Steel Co., 122 U.S. 267, 268-69 (1887). Even this category was subsequently construed narrowly. Detroit Steel Cooperage Co. v. Sisterville Brewing Co., 235 U.S. 712, 717 (1914); Holt v. Henry, 222 U.S. 637, 641 (1914); People's First Nat'l Bank v. Cee Mfg. Co., 67 F.2d 312, 314 (5th Cir. 1933); Palm v. Bachrach, 5 F.2d 125, 127 (D.C. Cir. 1925); First Nat'l Bank v. Bank of Waynesboro, 292 F. 754, 756 (6th Cir. 1919); W.A. Liller Bldg. Co. v. Reynolds, 247 F. 90, 92 (4th Cir. 1917); State Bank v. Idaho-Oregon Light \\& Power Co., 219 F. 594, 597 (S.D. Idaho 1914); Houlton Sav. Bank v. American Laundry Mach. Co., 9 F. Supp. 112, 114 (N.D. Me. 1934); Hayford v. Wentworth, 97 Me. 347, 54 A. 940 (1903); Gilmore, \textit{The Purchase Money Priority, supra} note 1, at 1349-53; Note, \textit{supra} note 15, at 1160.

priority had never been limited to any specific type of collateral. It was only natural, therefore, that when the draftsmen of the Code generalized the validity of security interests in after-acquired property, they generalized as well the idea that purchase money security interests should be given a special priority over competing claims.\textsuperscript{33}

B. The Financing Buyer

The pre-Code history of the financing buyer tells a sadder story. Whether asserting his rights as buyer or as creditor, the financing buyer encountered legal doctrines that made his status far less secure than that of the purchase money lender.

To the extent that the financing buyer had not yet taken possession of any goods whose manufacture had been completed by the seller, the "ostensible ownership" rule subordinated his ownership rights in the goods to the rights of intervening third parties.\textsuperscript{34} The doctrine of "ostensible ownership" was based on the assumption that the buyer, by allowing his seller to remain in physical possession of the goods, had acquiesced in a continued appearance of ownership in the seller.\textsuperscript{35} Such a situation, the doctrine presumed, would prejudice third parties, who might rely on this appearance in extending fresh credit to the seller.\textsuperscript{36} Whether the seller's retention of possession

\textsuperscript{33} § 9-312, Comment 3; SEPTEMBER 1949 UCC, supra note 31, § 8-105, Comment 2.

One of the draftsmen of Article 9, Professor Gilmore, stated in the public hearing on the Uniform Commercial Code in New York, "I think some provision like 9-312(4) giving purchase money interests priority over after-acquired interests is essential. . . . It is an integral part of this whole floating charge set-up. The priority provisions are very closely bound to the treatment of the after-acquired property interest." 2 N.Y. STATE LAW REVIEW COMM'N, supra note 29, at 1184.


of the goods was considered conclusively\textsuperscript{27} or only presumptively\textsuperscript{28} fraudulent, the financing buyer was ordinarily at a disadvantage against levying creditors and, in some states, general creditors as well, in that they could treat the sale as a nullity.\textsuperscript{29}

Sections 25 and 26 of the Uniform Sales Act codified the common law doctrine of “ostensible ownership.” Section 25 subordinated a buyer whose seller had retained possession of the goods to any third party taking in “good faith and without notice of the previous sale,” by “sale, pledge, or other disposition thereof,” including by way of mortgage.\textsuperscript{30} Section 26 allowed the seller’s creditors to treat the sale as void where “the retention of possession is fraudulent in fact or is deemed fraudulent under any rule of law. . . .”\textsuperscript{31} As a result, under the Uniform Sales Act, the financing buyer lost not only to subsequent secured creditors who took without knowledge of the financing buyer’s interest in the goods, but also to levying creditors (with or without knowledge) where the transaction was deemed fraudulent.

Under pre-Code law, the financing buyer fared little better as creditor than he did as buyer. To the extent that he was asserting a security interest in goods not yet completely manufactured, the financing buyer had to overcome the widespread judicial disapproval of security interests in after-acquired inventory.\textsuperscript{32} And while a few


\textsuperscript{28} See, e.g., Bickart v. Sanditz, 103 Conn. 766, 136 A. 580 (1927); Patchin v. Rowell, 86 Conn. 372 (1912) (an all but conclusive presumption of fraud); Wooley v. Crescent Auto. Co., 83 N.J.L. 244, 83 A. 876 (Sup. Ct. 1912); Holley v. A.W. Haile Motor Co., 188 A.D. 798, 177 N.Y.S. 429 (1919); Note, supra note 36, at 94.

\textsuperscript{29} As to sales of chattels, “there were no validating statutes, and the only difference that emerged in the case law was whether the seller’s retention of custody made the transfer fraudulent per se or merely presumptively fraudulent.” E. Peters, Commercial Transactions 771 (1971). Some cases have held that the doctrine is limited to levying creditors. See, e.g., Gilbert v. Decker, 53 Conn. 401, 405 (1885); McGann v. Capital Sav. Bank & Trust Co., 117 Vt. 179, 89 A.2d 123, 128 (1952).


\textsuperscript{31} Uniform Sales Act § 26, 1 U.L.A. 393 (1950).


The “factor’s lien” acts perhaps could have been used to protect the financing buyer after the 1940’s. But they were never so used, Gilmore, The Purchase Money Priority, supra note 1, at 1377; were virtually undiscovered, Gilmore, The Secured Transactions Article of the Commercial Code, 16 Law & Contemp. Pros. 27, 42 (1951); and, in any case, “it has never been clear that the factor’s lien acts contemplated such arrangements. . . .” Gilmore, The Purchase Money Priority, supra note 1, at 1377.
early cases such as *Hurley v. Atchison, Topeka & Santa Fe Ry.* made use of the equitable pledge concept to rescue the financing buyer in his seller's bankruptcy, the equitable pledge was not recognized in all states, and where it was recognized, could generally be defeated by good faith purchasers and by levying creditors. As the case law developed, moreover, it displayed an unwillingness to make use of any conceptual device to protect the financing buyer against competing creditors, and the 1938 revision of the Bankruptcy Act, by killing equitable liens for purposes of bankruptcy law, probably killed the *Hurley* line of cases as well.

At the time of the drafting of the Uniform Commercial Code, the position of the financing buyer was an unenviable one. On the one hand, he faced the doctrine of "ostensible ownership," which usually operated to bar recovery vis-à-vis competing security claimants; on the other hand, he was confronted with the general ban on security interests in after-acquired inventory. In sum, the financing buyer was never accorded a special priority over prior secured claims comparable to the one enjoyed by the purchase money lender.

II. The Financing Buyer and the Draftsmen of the Uniform Commercial Code

As a result of the divergent treatment of the purchase money lender and the financing buyer under pre-Code chattel security law, similarities between these two classes of lenders were obscured. Nevertheless, the enormous difficulties confronting the financing buyer did not go entirely unnoticed. In the early drafts of the Code, an explicit attempt was made to raise the status of the financing buyer to one roughly comparable to that of an ordinary secured creditor; except for one fleeting moment, however, no attempt was made to give the financing buyer a special priority like the one already enjoyed at common law by the purchase money lender. Although these early changes, which were designed to improve the position of the financing buyer, were eventually dropped as unnecessary (because covered by

43. 213 U.S. 126 (1909).
44. Id. at 134. See also Gage Lumber Co. v. M'Eldowney, 207 F. 255, 259 (6th Cir. 1913).
the general rules of Article 9), they demonstrated a growing awareness of the anomalous position of the financing buyer in the law of chattel security.50

A specific section directed at improving the position of the financing buyer first made its appearance in the 1944 proposed draft of the Uniform Revised Sales Act—already subtitled the “Sales Chapter of Proposed Commercial Code.”51 Section 55, entitled “Lien for Enabling Advances,” stated that:

A buyer or financing agency on his behalf who advances to the seller all or part of the price as progress payments or otherwise to enable the goods to be grown, produced, processed or assembled during a season or a particular production operation acquires as against any person other than a purchaser in current course of trade a lien to the extent of the advance on any goods which have become identified as intended for the contract even though they have not reached a state obligating the buyer to take delivery.52

After noting that there had been a general failure to distinguish the enabling advance from the situation “involved in the transfer of goods on the eve of insolvency and out of current course of trade,” the Comment to § 55 turned to the plight of the financing buyer:

Where, however, the transaction is one occurring in current course and the buyer’s advances on the price are what makes possible the production or assembly of the goods, there is no reason to feel that the general creditors of the seller are disadvantaged by recognition of a lien in the buyer. The phrasing of the section makes it clear that the resulting lien is good against creditors without necessity for filing, recordation, or the taking of possession by the buyer.53

The first explicit attempt to give a measure of protection to the financing buyer was thus incorporated into an early draft of what was to become Article 2. Section 55 is, however, as notable for what it did not do as for what it did. Because it was so narrowly drawn, § 55 protected the financing buyer from the claims of general creditors only. Its protection did not extend to a “purchaser in current course

50. Latty, supra note 48, at 20.
51. ALI UNIFORM REVISED SALES ACT (Proposed Final Draft No. 1, 1944).
52. Id. at 187-88. The section was new with the 1944 draft of the Uniform Revised Sales Act; it was not present in the prior Second Draft of the Revised Uniform Sales Act. See Nat’l Conf. of Comm’s on Uniform State Laws, The Revised Uniform Sales Act (Report & Second Draft 1941).
53. ALI, supra note 51, at 188.
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of trade."  

And, under both the Uniform Sales Act and the Code, the term “purchaser” includes a person taking a security interest in collateral. For protection against subsequent secured parties, the draftsmen of § 55 stated that the financing buyer would have to look to “those chapters of this code which have to deal with chattel security,” as yet undrafted. However, since the financing buyer could acquire the § 55 lien without having to file or take possession, the limited scope of protection which it afforded—priority over general creditors—was not unreasonable. Moreover, as the comment recognized, § 55—even in its limited scope—represented a departure from the less benign pre-Code treatment of the financing buyer.

Section 55 made a brief appearance in the Code itself, as § 2-402 in the May 1949 draft, where it was accompanied by a comment emphasizing that the lien was “legal” as well as equitable. This section, however, disappeared in the 1950 draft of the Code, where it was replaced by the forerunner of current § 2-402. The disappearance of the 1949 version of § 2-402, together with a cryptic comment in the 1950 draft stating that “[a]n enabling advance on a particular contract of limited duration is recognized as in current course of trade and is specifically protected in the Act (Article 9),” indicated a decision to leave the protection of the financing buyer to Article 9. The reference to the financing buyer being “specifically protected” under Article 9 is a bit puzzling, however, since no section in the 1950 draft “specifically” addressed itself to the status of the financing buyer. Nevertheless, the suggestion that a financing buyer could protect himself against general creditors and subsequent secured creditors under Article 9 was correct. The “floating lien” provisions already incor-

54. Id. at 188. See also id. § 55, Comment: “The lien granted by this section can be defeated by the seller’s transfer under Section 58(2) to a good faith purchaser in current course.”


56. ALI, supra note 51, § 55, at 188 (Comment).

57. Id. Presumably, the Code policy against secret liens led to the abandonment of this provision in the 1950 draft of the Code. Latty, supra note 48, at 4.

58. AMERICAN LAW INSTITUTE & NAT’L CONF. OF COMM’RS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE § 2-402, at 131 (Draft May 1949) [hereinafter cited as May 1949 UCC]. It had previously been carried over, as § 54, in a 1948 draft of The Code of Commercial Law. CODE OF COMMERCIAL LAW, supra note 26, § 54.

59. MAY 1949 UCC, supra note 58, at 131-32 (Comment).


61. 1950 UCC, supra note 60, § 2-402, Comment 2, at 192.
porated into Article 9 made it possible for a financing buyer to take and perfect a security interest in the uncompleted goods whose manufacture he was financing.

The puzzling assertion in the 1950 Comment to § 2-402 that the financing buyer was “specifically protected” under Article 9 may have referred to a remarkable provision that had appeared in an earlier and tentative revision of the Article on Secured Transactions, but which was eliminated from the 1950 draft itself. In a draft of Code revisions circulated in September of 1949, the financing buyer not only was given the protection of a secured creditor, but also was given the same special status as the purchase money lender. This was done out of a conviction that the financing buyer is engaged in “another form of financing the acquisition of goods,” making his situation indistinguishable from that of the purchase money lender. Section 8-406, dealing with “Priorities Among Security Interests,” provided, in part, that:

(2) In the case of goods other than inventory (a) an interest attaching to secure a purchase money security interest (defined in Section 8-105) or to secure an enabling advance security interest (defined in Section 8-105) takes precedence over the interests attaching to the same collateral if the lender [perfection within 10 days of the borrower's acquisition of an interest in the collateral].

(3) In the case where the collateral is inventory, if two or more interests attach after a filing of each, the interest of a lender who first gives new value takes precedence if he gives notice


63. That is to say, the Code abrogated the specific problems that the financing buyer qua secured party faced under pre-Code law. See pp. 10-11 supra. See also 1950 UCC, supra note 60, at § 9-108(2).

64. SEPTEMBER 1949 UCC, supra note 31.

65. The September 1949 draft defined a purchase money security interest in § 8-105(3)(a). Section 8-105(3)(b) then defined a security interest as an “enabling advance security interest” if a buyer or a secured lender on his behalf makes advances or extends credit to a seller who is a manufacturer or a processor of goods to enable him to manufacture or process particular goods for the buyer during the period of six months following the advance and the collateral for the advance or credit is the goods, whether or not in a deliverable state, intended for the contract.

Comment 3 had the following to say about the enabling advance security interest:

Subsection (3)(b) is another form of financing the acquisition of goods. Instead of the seller or lender financing a buyer as in subsection (3)(a) [purchase money security interest], the buyer or a lender finances the production of the goods by the seller. The security interest arising from that type of loan is also accorded special treatment. ...
of his intended interest to lenders with earlier filings on or within ten days before the borrower receives the inventory subject to the competing security interests. . . . 66

It should be noted that the priority scheme contemplated by § 8-406(3) was based on the general assumption that new money deserves priority protection over old regardless of the form the new money may take.

While this elevation of the financing buyer to parity with the purchase money lender constituted a remarkable innovation in personal property security law, the attempt was short-lived. The September 1949 draft of § 8-406 appears to have had no roots in the Code, and it certainly had no influence on the Code's subsequent treatment of the financing buyer. Nothing like it appears either in the May 1949 or in the 1950 versions of the Code. 67 Sandwiched between these two "official" drafts, the September 1949 proposed draft of § 8-406 displays an explicit recognition of the fact that the purchase money lender and the financing buyer perform similar commercial functions and deserve equal legal protection. By the time of the 1950 draft this idea had already been lost or abandoned, and no section "specifically" dealing with the financing buyer appears anywhere in Article 9.

The financing buyer reappeared, however, in § 9-204(6) of the 1952 Official Draft of the Code:

When a buyer makes an advance or otherwise gives new value for the purpose of enabling his seller to obtain or manufacture goods, a security interest in favor of the buyer attaches to the goods by virtue of the contract for sale as soon as they have become identified to the contract. 68

While it is arguable that this special provision was unnecessary under the general Article 9 scheme, it evinces, once again, the desire of the draftsmen of the Code to improve the financing buyer's pre-Code status. Comment 9 to § 9-204 made this quite clear:

The result under the Uniform Sales Act has usually been adverse to the financing buyer either on the theory that there had not been a sufficient appropriation of the goods to pass title or on

66. Id. § 8-406.
67. The September 1949 draft, id., was submitted for discussion at the September 1949 joint meeting of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. The specific provisions contained in the September 1949 draft for protecting the "enabling advance security interest" do not appear in the Article on Secured Transactions tentatively approved at the joint meeting, AMERICAN LAW INSTITUTE & NAT'L CONF. OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE (Revisions, Oct. 1949).
68. § 9-204(6) (1952 version).
the theory that, assuming the appropriation, the seller's retention of goods sold was fraudulent under the familiar common law rule. . . . This subsection gives such a buyer the wherewithal to subject the goods, which are being manufactured for him and for which he has made advances, to a security interest in his favor. It should be noted that this subsection provides only that the security interest attaches; for the security interest to prevail over creditors in cases of the seller's insolvency the buyer will have to perfect his interest by filing.69

Like the 1949 version of § 2-402, the 1952 version of § 9-204(6) was eventually dropped from the Code.70 Today, the only remaining sections which explicitly deal with the financing buyer are § 2-501 and § 2-502. For reasons discussed below, these two sections give the financing buyer almost no help at all.71

The reason for the disappearance of § 9-204(6) and old § 2-402 is not hard to discover. While these sections indicated a desire to improve the pre-Code status of the financing buyer, in the last analysis they did nothing that the general provisions of Article 9 did not do equally well. By taking an Article 9 security interest, the financing buyer could obtain, with little difficulty, protection equivalent to that afforded by these two sections: in short, protection against unsecured and subsequent secured parties. These early, discarded sections thus gave the financing buyer the same protection as an ordinary secured creditor. By validating the "floating lien" on inventory, Article 9 made such protection generally available to financing buyers, and therefore rendered superfluous the earlier provisions of the Uniform Commercial Code which had been specifically designed to give the financing buyer the status of a secured creditor.72

III. The Situation of the Financing Buyer Under the Code

What is the fate of a financing buyer under the present version of the Code?73 Since this question is likely to arise most frequently and dramatically in the case of the seller's insolvency, we may frame

70. See AMERICAN LAW INSTITUTE & NAT'L CONF. OF COMM'RS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE (Official Draft, 1958).
71. See pp. 18-26 infra.
72. AMERICAN LAW INSTITUTE & NAT'L CONF. OF COMM'RS ON UNIFORM STATE LAWS, supra note 28, at 259. See also REPORT OF COMM'N ON UNIFORM STATE LAWS TO LEGISLATURE OF NEW YORK STATE 263 (1961).
73. For a discussion of some of the changes made by the 1972 Official Text in Article 9, see Googan, supra note 7.

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it more conveniently in the following way: what is the fate, under the Code, of a financing buyer whose seller becomes insolvent before the goods covered by the contract have been delivered to the buyer (or before their manufacture has been completed)? Consider the following hypothetical.

Company ABC is a small corporation engaged in the manufacture of home and office furniture, including chairs, tables and desks. Family Furniture, Inc., is a retail furniture outlet which, from time to time, has purchased furniture from ABC. On May 1, the president of Family Furniture telephoned the sales agent for ABC, indicating an interest in the purchase of 500 Model A desk chairs, a popular sales item at Family Furniture. On the telephone, the president of Family Furniture was told that the price of the particular plastic material used to trim all Model A chairs had risen sharply (because of the energy crisis), and that a less expensive substitute was not available. ABC lacked a liquid cash reserve large enough to purchase sufficient plastic and other materials necessary for the manufacture of 500 chairs. Family Furniture was told that if it prepaid the contract price, ABC could purchase the materials and begin production immediately. After considering the matter, Family Furniture decided to prepay to enable ABC to manufacture the chairs. The sales contract was signed on May 5.74

Two months earlier, in an attempt to alleviate increasing liquidity problems, ABC had borrowed $100,000 from the First United Bank. ABC’s note for the $100,000 was secured by an Article 9 security interest (chattel mortgage type) in ABC’s entire inventory. Prior to making its loan and entering into the security agreement, First United took all steps necessary to perfect its interest in ABC’s inventory by filing an Article 9 financing statement.75 Under the terms of the security agreement, the collateral for the loan included existing inventory plus any and all inventory which ABC might subsequently acquire.

On May 5, Family Furniture delivered a certified check to ABC in the amount of $20,000 (the full contract price of the 500 chairs). By Friday, June 13, ABC had completed the manufacture of 250 chairs, awaiting shipment in its storage room. The remaining 250 chairs were in various stages of assembly. However, because of continuing business losses, ABC had become insolvent. On the morn-

74. Family Furniture thus becomes a financing buyer in the classic sense: it is the advance of the purchase price by Family Furniture that makes possible the manufacture of the chairs by ABC. See generally Speidel, supra note 12.
75. See §§ 9-302, -303, -401, -402, -403.
The directors of the company decided that their situation was hopeless, and instructed counsel to enter a petition that afternoon to be adjudicated a bankrupt. ABC was so adjudicated, and bankruptcy proceedings ensued. Family Furniture, under its contract with ABC, and First United, under its Article 9 security agreement, both claimed an interest in the 250 completed chairs. In addition, both Family Furniture and the bank claimed an interest in the partially assembled chairs and in certain raw materials used in the manufacture of Model A chairs.

What does the Code tell us about Family Furniture's rights in this situation?

A. The Article 2 Rights of a Financing Buyer in his Seller's Insolvency

Section 2-502 is the logical starting point. Here, we learn that even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

According to § 2-501 (the "immediately preceding section"), "the buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers. . . ." Family Furniture's contract with ABC "refers" only to completed chairs, and not to the component materials out of which chairs are manufactured. Consequently, if Family Furniture has a § 2-502 "special property" of any sort, it is probably limited to the 250 chairs sitting in ABC's storage room. 76

There is a serious question, however, whether Family Furniture has a right under § 2-502 to recover even the completed chairs. According to § 2-502, Family Furniture may recover the chairs only if ABC became insolvent within 10 days after receipt of their purchase price. We know when ABC became bankrupt. But when did

76. See also § 2-502(2), which limits subsection (1) by giving the buyer the right to recover the goods "only if they conform to the contract for sale," if the buyer made the identification creating the special property. Family Furniture may also have a claim to the chairs that are in the process of manufacture, although not the raw materials, but only if the identification was "explicitly agreed to by the parties." § 2-501(1) & Comment 4. In the absence of an explicit agreement, § 2-501(1)(b) controls.
it become insolvent? ABC may very well have been insolvent before contracting with Family Furniture. In ABC's bankruptcy, Family Furniture will bear the heavy burden of proving that ABC became insolvent within 10 days after receipt of payment for the chairs.77

Let us assume that Family Furniture is able to clear this obstacle and establish that it does, indeed, have a right under § 2-502 to recover the 250 chairs. This right—which only runs against ABC—will be of little value to Family Furniture in ABC's bankruptcy: there is nothing in § 2-502 to suggest that Family Furniture's right of recovery is good against third parties. Consequently, § 2-502 does not give Family Furniture a right to the chairs which would prevail against either ABC's trustee in bankruptcy (who represents ABC's general creditors), or a secured party claiming an interest in the goods (such as First United). In order to discover what rights a § 2-501 "special property" gives as against third parties, we must look beyond § 2-502 itself. The relevant section is 2-402.78

Section 2-402 tells us that "rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods"79 un-
der § 2-502, unless "under any rule of law of the state where the goods are situated," retention of possession of the goods by the seller "is fraudulent," in which case "[a] creditor of the seller may treat a sale or an identification of goods to a contract for sale as void." Section 2-402(2) stipulates that "retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after sale or identification is not fraudulent."§

If ABC's retention of possession of the chairs was neither "in good faith and current course of trade" nor "for a commercially reasonable time," the power of general creditors to avoid Family Furniture's § 2-501 "special property" in the chairs will depend upon whether applicable state law makes "ostensible ownership" a fraud on third parties. If the law of the state which governs the Family Furniture-ABC transaction makes retention of possession by ABC fraudulent as to any class of creditors, Family Furniture's "special property" in the chairs will be vulnerable to that extent. Furthermore, supposing the sale to have been fraudulent as against any existing creditor of ABC, ABC's trustee in bankruptcy will be able to set aside Family Furniture's "special property" by exercising his § 70e and § 70c avoidance powers. And even if no such creditor exists, the trustee should also prevail against Family Furniture under § 60.

80. There is some authority for suggesting that a creditor need rely on § 2-402's concept of fraudulent retention of possession only where there has been a "sale." See pp. 22-23 infra. This is based on the rationale that an "identification" alone, without passage of title, "would not be considered fraudulent, since such property is available to the seller's creditors for levy without the aid of the doctrine of fraudulent conveyances." Texas Legislative Council, Staff Monograph: Analysis of Article 2 of the Uniform Commercial Code 141 (1953).

81. It might be argued that a "commercially reasonable time" encompasses the period of time necessary for manufacture of the goods. However, it has been noted that § 2-402(2)(b) takes away, for the most part, what § 2-402(2) appears to give. Cf. Gardner v. Sullivan & Crowe Equip. Co., 17 Cal. App. 3d 592, 596, 94 Cal. Rptr. 893 (1971); Spedel, supra note 12, at 28 & n.21.

82. Subsequent creditors, despite the apparent applicability of the general language of § 2-402(2), will not be able to rely on its protection. Instead, they must stand or fall as "purchasers," where the rules require a "purchase" for value in good faith and without notice of the earlier sale. See McGann v. Capital Sav. Bank & Trust Co., 117 Vt. 179, 89 A.2d 123 (1952); Peters, supra note 77, at 239.

83. Assuming that applicable state law makes ABC's retention of possession of the chairs fraudulent as against a particular class of creditors, and that a member of this class actually exists, Family Furniture's § 2-502 "special property" will also be voidable by ABC's trustee in bankruptcy, exercising his "inheritance" powers under § 70e of the Bankruptcy Act, 11 U.S.C. § 110e (1970). If the creditor in question had to obtain a judicial lien before he could treat Family Furniture's "special property" as void, see Peters, supra note 81, at 239, and he neglected to do so, ABC's trustee will still be able to avoid the "special property" by relying on his § 70c powers as supplementing his § 70e powers.

84. 11 U.S.C. § 96 (1970). If under state law Family Furniture's "special property" could be treated as void by any general creditor acquiring a lien (or indeed any creditor at all, since a "lien creditor" would fit within the definition of "any creditor"), Family Furni-
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B. The Financing Buyer and the Article 9 Secured Creditor

Apart from its rights against ABC's general creditors and trustee in bankruptcy, Family Furniture's priority contest with First United remains to be examined.

Since § 1-201(12) defines "creditor" to include secured creditor, First United may be able to defeat Family Furniture's § 2-501 "special property" (or even title) by invoking the avoidance privilege of § 2-402(2)—provided, of course, that retention of possession by ABC was fraudulent as against First United. However, First United does not even have to invoke its rights under § 2-402(2). Section 2-402(3)(a) states that "[n]othing in [Article 2] shall be deemed to impair the rights of creditors of the seller (a) under the provisions of the Article on Secured Transactions (Article 9) . . . ." First United is a "creditor" with an Article 9 security interest, and should therefore be adequately protected against Family Furniture by the priority of its interest in the chairs will have been unperfected, according to the § 60a(2) test of perfection, as of the time of ABC's bankruptcy. The creation of Family Furniture's "special property" therefore will be deemed to have occurred immediately prior to the filing of the petition, constituting a transfer for antecedent debt voidable by the trustee under § 60a(1), if all the other elements of a preference are present. Thus, it would appear that if applicable state law made ABC's retention of possession of the chairs a fraud on any of ABC's creditors, then ABC's trustee in bankruptcy will in all likelihood be able to set aside Family Furniture's § 2-502 "special property" in the chairs.

85. The term "identification," as used in § 2-402(2) is in parity with the concept of "special property," as it is identification which gives a special property interest, § 2-501. We will be deeply involved in the intricacies of a "sale" shortly. Pp. 22-23 infra. For now it need only be noted that a "sale" depends on the passage of title. Of course, if the goods have never been "identified," Family Furniture does not even have a "special property" in the goods, and would be at most a general creditor.

The outcome under § 2-402 remains the same whether Family Furniture has a special property interest in or title to the chairs.

86. There may be some question as to what a prior secured party must do in order to rely on the protection offered by § 2-402(2). It has been noted, for example, that the word "creditor" will not protect, at least in many states, a general creditor who attempts to "treat a sale...as void" by obtaining a security interest. Such an action would make the creditor a purchaser, and he would then be governed by the rules of a purchaser, not a creditor. See McGann v. Capital Sav. Bank & Trust Co., 117 Vt. 179, 89 A.2d 123 (1952); Peters, supra note 77, at 239. Thus, in order to "treat a sale...as void," the creditor must follow the legal steps enabling him to do so, which, generally, means levying on the goods.

That distinction, however, while it makes sense for a general creditor who, as a consequence, must levy, rather than take a security interest, does not necessarily make sense for a prior secured party who already holds a security interest. In such a case, the language of § 2-402 would suggest that the secured creditor, who need not take further action in order to acquire a security interest in the goods, should be protected without levying. See § 9-503, the "Secured Party's Right to Take Possession After Default," which would seem to be relevant with respect to § 2-402(2) via § 2-402(3)(a). Therefore, while the "general" creditor must pursue the prescribed course by levying, and not by taking a security interest, the secured party, by virtue of his presently existing security interest, already is armed with the "remedies which the law has provided" for him in § 9-503, and he may pursue those as though the fraudulent transfer had not been made.

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it enjoys as an Article 9 secured party.\textsuperscript{87} The relevant section is 9-201, which states that "a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors," except "as otherwise provided by this Act."

After payment of the money and before delivery of the chairs, Family Furniture is certainly a "creditor," within § 1-201(12); and after acquiring its "special property" interest, it would appear to be a "purchaser" within § 1-201(32) and (33).\textsuperscript{88} Consequently, Family Furniture will be subordinated to First United's Article 9 security interest unless Article 9 itself otherwise provides, which it does not.\textsuperscript{89} This result comports with the general policy of Article 9, which is to give Article 9 security interests a priority over unsecured interests in the same collateral.\textsuperscript{90}

Family Furniture might, however, make the following argument. While it is true that Family Furniture, both as creditor and purchaser, is subordinated to First United by § 9-201 (regardless of its possession of a "special property" interest in the chairs), Family Furniture, as a buyer, is entitled, under § 9-307(1), to take free of the bank's security interest in the chairs. Since the Comment to § 9-201 tells us that "[e]xceptions to this general rule arise where there is a specific provision in any Article of this Act," and explicitly refers to § 9-307, Family Furniture should prevail.

\textsuperscript{87} Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 241, 208 N.W.2d 97, 108 (1973): "Chrysler thus makes the anomalous and unacceptable claim that its buyer's interest [i.e., its "special property" interest] gives it a right superior to the holder of an antecedent perfected security interest."

\textsuperscript{88} Under § 1-201(32): "'Purchase' includes taking by ... any other voluntary transaction creating an interest in property." The contract for sale between Family Furniture and ABC would seem to give rise to an "interest in property" at the time the "special property" comes into existence via identification under § 2-501. Cf. L.B. Smith, Inc. v. Foley, 341 F. Supp. 810, 813 (W.D.N.Y. 1972).

\textsuperscript{89} Cf. Texas Legislative Council, supra note 80, at 141.

\textsuperscript{90} Family Furniture, as holder of a "special property" interest cannot rely on the general Article 9 priority provisions of § 9-312. According to § 9-312(5)(a) conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection. This provision, however, can only be used to ascertain the priority between conflicting "security interests." If we turn to § 1-201(37), we discover that "[t]he special property interest of a buyer of goods on identification of such goods to a contract for sale under Section 2-401 is not a 'security interest,' but a buyer may also acquire a 'security interest' by complying with Article 9." The conflict between Family Furniture's "special property" and First United's Article 9 security interest in the same collateral cannot be a conflict between "conflicting security interests," and therefore is not subject to the priority rule stated in § 9-312(5)(a).
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Section 9-307(1) provides that

a buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

As we have already seen, however, § 1-201(9) defines a “buyer in ordinary course of business” as one who takes by way of “sale.” According to § 2-106(1), “a ‘sale’ consists in the passing of title from the seller to the buyer for a price (Section 2-401).” Consequently, in order for Family Furniture to establish a § 9-307(1) priority in the chairs, it must be able to show that title had already passed to it.\footnote{Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 238-39, 208 N.W.2d 97, 106 (1973). The irony of all of this is that the Code explicitly tried to minimize the importance of the concept of title, § 2-401, Comment 1; Peters, supra note 77, at 201. Yet here we see that Family Furniture cannot even claim the applicability of § 9-307 unless title has passed. And, since we have concluded that Family Furniture will be subordinated unless it can find a provision which overrides § 9-201 (and § 9-307 appears to be the only candidate), “title” will be critical for Family Furniture. See Skilton, Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters), 1974 Wis. L. Rev. 1, 17-19.}

If we turn to § 2-401, we discover: 1) that title cannot pass until the goods are identified to the contract;\footnote{That is, identification to the contract is a necessary precondition for the passing of title. First Nat'l Bank v. Smoker, 286 N.E.2d 203, 212, \textit{rehearing denied}, 287 N.E.2d 786 (Ind. App. 1972).} 2) that identification to the contract does not automatically pass title, since the parties may provide otherwise;\footnote{For example, the parties may provide that title is to pass only upon the occurrence of some event subsequent to the time at which the goods become identified to the contract.} 3) that “unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods”; and 4) that a buyer’s “special property” in goods in the possession of his seller cannot be the same thing as title to the goods, since § 2-401(1) treats these as separate and independent interests.\footnote{W. HAWKLAND, supra note 34, at 100.} From all of this we can conclude that Family Furniture acquired title to (as opposed to a mere “special property” in) the chairs upon completion of their manufacture, and before delivery, only if its contract with ABC so provided,\footnote{It might even be possible to argue that the definition of “buyer in ordinary course of business” would apply to an enabling buyer \textit{only} upon delivery of the goods,} and that such a provision would be a precondition for Family Furniture asserting a priority against First United under § 9-307(1).\footnote{Peters, supra note 77, at 236-37.}

91. Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 238-39, 208 N.W.2d 97, 106 (1973). The irony of all of this is that the Code explicitly tried to minimize the importance of the concept of title, § 2-401, Comment 1; Peters, supra note 77, at 201. Yet here we see that Family Furniture cannot even claim the applicability of § 9-307 unless title has passed. And, since we have concluded that Family Furniture will be subordinated unless it can find a provision which overrides § 9-201 (and § 9-307 appears to be the only candidate), “title” will be critical for Family Furniture. See Skilton, Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters), 1974 Wis. L. Rev. 1, 17-19.
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94. Peters, supra note 77, at 236-37.
95. W. HAWKLAND, supra note 34, at 100.
96. It might even be possible to argue that the definition of “buyer in ordinary course of business” would apply to an enabling buyer \textit{only} upon delivery of the goods,
However, even if Family Furniture could establish that title to the chairs had already passed to it, because of a special provision in its contract, there are three cogent reasons why a court might nevertheless refuse to accord it a priority under § 9-307(1). In the first place, the validity of any priority claim which Family Furniture might assert under § 9-307(1) would depend on the terms of its private contract with ABC (i.e., upon the contract’s provisions regarding the passage of title), since absent such a private contractual term, Family Furniture would not be a “buyer in ordinary course of business” prior to delivery, when title presumptively passes. Not only would this place undue importance upon drafting technicalities, it would also, and more importantly, mean that Family Furniture’s priority had been “secretly” established, without any public recordation whatsoever. This result would appear to run counter to the policy of both Article 97 and the federal Bankruptcy Act.98

In the second place, awarding Family Furniture a § 9-307(1) priority over First United would result in an anomalous circuity: under § 2-402(2), a general creditor99 would be able to prevail over Family Furniture;100 under § 9-307(1), Family Furniture would prevail over First United, a secured creditor; and, in the bankruptcy of

and not before. This possibility arises from the following sentence in § 1-201(9) (emphasis added):

“Buying” may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

It is not logical to read the definition of “buyer in ordinary course of business” as requiring delivery under all contracts, see 2 G. Gilmore, supra note 7, § 26.6, at 696. But see Smith, Title and the Right to Possession Under the Uniform Commercial Code, 10 B.C. Int. & Com. L. Rev. 39, 61 (1969). However, the “receiving goods” language might suggest that delivery is required in the special situation involving a “pre-existing contract for sale.”

97. In re Automated Bookbinding Servs., Inc., 471 F.2d 546, 553 (4th Cir. 1972); Dunham, Inventory and Accounts Receivable Financing, 62 Harv. L. Rev. 588, 610-11 (1949); Latty, supra note 48, at 20; cf. Gilmore, supra note 42, at 30. Upon similar reasoning, the court in Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 240, 208 N.W.2d 97, 107 (1973), suggested on policy grounds that, whether strictly required by the definition of “buyer in ordinary course of business” or not, delivery should be a prerequisite to a claim under § 9-307(1).


99. A general creditor would be included under the term “creditor” as used in § 2-402(2). See § 1-201(12).

100. Family Furniture would not, in any case, take free of general creditors under § 9-307, as that section refers only to “security interests.” Under § 1-201(37), a “security interest” “means an interest in personal property or fixtures...” which the general creditor does not have. Cf. § 1-201(12) (distinction between general creditor and secured creditor).
ABC, First United would prevail over ABC's general creditors.

Finally, even supposing that title to the chairs passed to Family Furniture upon completion of their manufacture and that Family Furniture is therefore entitled to a priority under § 9-307(1), Family Furniture would nonetheless remain vulnerable under § 2-402(2) because ABC retained possession of the chairs. As we have already seen, under § 1-201(12), the term "creditor" includes a secured creditor. Thus, if retention of possession by ABC made Family Furniture's title to the chairs voidable by First United, then, although the bank would lose under § 9-307(1), it would win under § 2-402(2). Furthermore, if First United "may treat a sale . . . as void" under § 2-402(2), it is not at all clear that Family Furniture's interest in the goods is sufficient to make it a buyer in ordinary course of business and hence to bring it within the protective scope of § 9-307(1).

There would be little logic to a system in which a secured creditor loses where a general creditor wins. Yet, if § 9-307(1) is read independently of § 2-402, that result would appear to follow from the fact that secured creditors, but not general creditors, are subject to § 9-307(1). The assumption that a person who takes an Article 9 security interest should not be left in a worse position than if he had taken no Article 9 security interest at all, suggests that § 9-307(1) cannot be read to insulate a buyer who leaves goods in the possession of his seller from attack under § 2-402(2). Consequently, by acquiescing in ABC's retention of possession, Family Furniture may be deemed to have relinquished any "priority" claim it might otherwise have had under § 9-307(1).

These three considerations suggest

102. Family Furniture, however, might remain protected by the "commercially reasonable" exception to § 2-402(2). See note 81 supra.
104. Section 9-307 clearly did not contemplate the problem of the financing buyer, who leaves goods in the possession of the seller. Rather, the situation envisioned by the draftsmen was that of a person who "buys" inventory and carries it off at the time of sale. See, e.g., J. White & R. Summers, supra note 3, § 25-12, at 938. This conclusion, that § 9-307 was not intended as a panacea for the financing buyer who, by definition, leaves goods in the possession of his seller, is buttressed by an early draft of what was to become § 9-307. In a 1948 draft of the "Secured Commercial Transactions" article of The Code of Commercial Law, § 312 read as follows:
(1) A good faith buyer of goods in ordinary course of business takes free of an inventory lien even though there has been due filing and even though such buyer has knowledge of the lien or the financing statement. His rights accrue either on delivery or on payment, whichever is prior.
(2) . . . "Buyer in ordinary course of business" does not include . . . a buyer making enabling advances.
that Family Furniture will have a difficult time protecting itself as a buyer under § 9-307(1).\textsuperscript{103}

Although the provisions of the Code which bear on Family Furniture's right to the chairs in the possession of its bankrupt seller are sufficiently unclear to dissuade anyone from making an unqualified assertion as to what those rights might be, an educated guess is that:

1) depending upon the applicable state law of "ostensible ownership," Family Furniture may or may not prevail over general creditors claiming under § 2-402(2), and probably will not prevail over a trustee in bankruptcy;
2) in any case, Family Furniture, prior to passage of title, will be subordinated in priority to First United's perfected security interest in the same collateral; and
3) even after passage of title, if title passes before delivery, Family Furniture will probably be subordinated in priority to First United.

C. The Financing Buyer as an Article 9 Secured Creditor

Might Family Furniture have done anything to improve its position in ABC's bankruptcy? Section 1-201(37) provides that a buyer who has a "special property" interest in goods upon their identification to a contract for sale, may "also obtain" a security interest in the goods by complying with Article 9. If Family Furniture had filed a proper financing statement and executed a security agreement with ABC at the time it contracted for the chairs, and if the security agreement had provided that Family Furniture was to have a security interest in any and all chairs manufactured by ABC under the terms of the contract, Family Furniture's interest in the chairs undoubtedly would prevail against ABC's general creditors and trustee in bankruptcy. With a perfected security interest in the chairs, Family Furniture should also prevail against subsequent secured parties claiming an interest in the same collateral.\textsuperscript{106}

Retention of possession by the debtor of collateral securing an Article 9 security interest does not, by itself, make the interest voidable by third parties.\textsuperscript{107} Moreover, it is now well-established that a security interest in after-acquired property which attaches under a previously


\textsuperscript{106} See § 9-312(5)(a).

\textsuperscript{107} § 9-205.
filed Article 9 financing statement does not constitute a transfer for an antecedent debt.\textsuperscript{108} Had Family Furniture taken and perfected a security interest in the chairs at the time of its contract with ABC, its claims to the chairs could not be defeated on either of these two grounds.

Unfortunately for Family Furniture, an ordinary Article 9 security interest is not likely to prevail against the competing claim of First United. Under the first-to-file rule of § 9-312(5)(a),\textsuperscript{109} the bank's security interest in the chairs, which attaches under the after-acquired property clause of its security agreement with ABC, takes priority over Family Furniture's security interest, provided that Family Furniture filed its financing statement at the time it entered its contract with ABC (or, indeed, at any time subsequent to the time of First United's filing). Family Furniture would prevail over First United in ABC's bankruptcy only if Family Furniture's financing statement was filed before the bank's and covered the goods involved here. Unless Family Furniture has been financing ABC's business on a regular and continuing basis, it is unlikely that it will have made a filing at any time before contracting to buy the chairs.

If we assume that Family Furniture files an Article 9 financing statement at the time of its contract with ABC, there is only one way in which it can prevail over First United\textsuperscript{110}—by taking a purchase money security interest in the chairs covered by the contract. Section 9-312(3) provides, in part, that "a perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory," if the four conditions specified in § 9-312(3)(a)-(d) have been met. Although it is unnecessary, for our purposes, to review each of these conditions in detail, it is important to note that in order to establish an effective purchase money security interest in the chairs, Family Furniture would have to give notice to the bank, before filing its financing statement, that it "has or expects to acquire a purchase money security interest" in them.\textsuperscript{111}

To qualify for special treatment as a purchase money lender under § 9-312(3), Family Furniture must first bring itself within the defi-
tional ambit of § 9-107(b). According to that section, a security interest is a purchase money security interest to the extent that it is “taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.” Consequently, unless Family Furniture is able to demonstrate that the money which it prepaid to ABC was “in fact” used to “acquire” the chairs themselves, its security interest cannot qualify as a purchase money security interest. The safest, and perhaps the only way for Family Furniture to comply with the tracing requirement imposed by § 9-107(b) would be for Family Furniture to pay ABC’s suppliers directly, rather than simply hand the money over to ABC for expenditure in the manufacture of the chairs. Thus, in order to protect its rights as a purchase money lender, Family Furniture would be compelled to pay each individual supplier contributing any raw material to the manufacture of the chairs. Although such a procedure might well involve an expensive bookkeeping system that would raise the cost of the entire transaction sufficiently to make it unattractive to Family Furniture, a complicated series of individual payments of this sort would appear to be the only way in which Family Furniture could comply with the explicit tracing requirement of § 9-107(b).

Even if Family Furniture went to the expense of complying with the strict tracing requirement, it would find itself subject to an additional, and more serious, disability. In practice, the strict tracing requirement will necessitate the financing buyer’s paying the sup-

112. The drafting history of the Code indicates that the tracing requirement in § 9-107 is meant to be a strict procedural requirement, and that the lender had better prove how the debtor used the loan proceeds. In the 1952 Official Draft the definition of a purchase money security interest contained an additional subsection, 9-107(c), which stated that a security interest is a purchase money security interest to the extent it is taken by a person who for the purpose of enabling the debtor to pay for or acquire rights in or the use of collateral makes advances or incurs an obligation not more than ten days before or after the debtor receives possession of the collateral even though the value given is not in fact used to pay the price. The Comment indicated that this was done “to eliminate difficulties of tracing.” Id. See also September 1949 UCC, supra note 31, § 8-105 & Comment 2.

Section 9-107(c) was deleted by the Editorial Board of the Code in 1956, “for the reason that it extends the purchase money security interest concept too far.” AMERICAN LAW INSTITUTE & NAT’L CONF. OF COM’RS ON UNIFORM STATE LAWS, supra note 28, at 262. The message from the deletion is as clear as any message from the drafting history of the Code ever is: the tracing requirement is not to be taken lightly. The prudent practitioner would be “well advised to make his advance directly to the seller.” 2 G. GILMORE, supra note 7, at 782.


114. 2 G. GILMORE, supra note 7, at 782: “[N]o lender in his right mind will deliberately experiment;... he will make his loan before acquisition and he will make it directly to the seller.”
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pliers of his seller directly. Therefore the “collateral” in which the financing buyer is helping his seller acquire rights—and in which the financing buyer has a purchase money security interest within the meaning of § 9-107(b)—can only consist in the component parts of the finished product for which the financing buyer has contracted.115

Although § 9-315 states that a security interest in component parts “continues” in the assembled goods,116 this section itself poses two disturbing questions. First, is the security interest that “continues” in the finished product a purchase money security interest? There is no reason, based either upon the statutory scheme of the Code or upon general considerations of policy, why the transferred security interest cannot, or should not, remain a purchase money security interest.117 The language of § 9-315(2), however, is distressingly ambiguous on this score.118 Second—assuming the continuing security interest remains a purchase money security interest—to what portion of the value of the finished goods would such a security interest attach? Given that part of the value of an assembled chair is attributable to intangible value, such as labor, does the “continuing” purchase money security interest in the chair’s component parts also attach to this added value?119 A financing buyer can always acquire

115. An Article 9 security interest may indeed attach to the assembled chairs, assuming there is a financing statement and a security agreement to that effect, for the ordinary Article 9 security interest does not have to meet the § 9-107(b) tracing requirement. And, in § 9-107(b) itself, the language that causes trouble in this respect is the strict tracing requirement language of “if...in fact so used.” Absent that language, the assembled chairs, as well as the component parts, could qualify for a purchase money security interest, as the assembled chairs meet the test of being “collateral” in which the financing buyer is helping his seller “acquire rights.”

116. Section 9-315 deals with security interests in component parts that are “commingled” during the manufacturing or processing of a finished product, as opposed to those which are simply affixed, § 9-314.

117. Cf. 2 G. Gilmore, supra note 7, at 846 (“[T]he interest ‘continues’ in the product or mass; there can be no doubt that the ‘continuing’ interest is also perfected....”)

118. Section 9-315(2) tells us that the interests “rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the costs of the total product or mass.” The words “rank equally,” reinforced by the Comment’s statement that “[t]he rule stated treats all...interests as being of equal priority...,” cast grave doubts on the special priority given a purchase money lender vis-à-vis ordinary secured parties. And § 9-312 is expressly subordinated, by § 9-312(1), to “[t]he rule of priority stated in other sections of this Part....” Professor Gilmore, suggesting that “[i]t seems reasonable” that the purchase money lender should retain priority, provides a proposed reading of § 9-315 that enables the purchase money lender to do so. 2 G. Gilmore, supra note 7, at 854-56.

119. The “in fact so used” tracing requirement cannot be invoked to give a purchase money security interest in this portion, as “collateral” does not include intangibles, such as labor.

The pre-Code law gave a creditor a security interest in the entire finished product if he contributed the “principal materials.” See Pulcifer v. Page, 32 Me. 404, 405 (1851); Bancroft Steel Co. v. Kuniholm Mfg. Co., 301 Mass. 91, 96, 16 N.E.2d 78, 80 (1938); Mack v. Snell, 140 N.Y. 193, 195, 35 N.E. 493 (1893); 2 G. Gilmore, supra note 7, at 841-44.
an ordinary Article 9 security interest in the entire value of the completed chair, since the financing statement which specifies the collateral securing the buyer's advance will undoubtedly refer to the finished product the buyer is purchasing. 120 In order to obtain a purchase money security interest, however, a financing buyer must comply with the strict tracing requirement of § 9-107(b), which, as we have seen, would effectively restrict any purchase money security interest, in the first instance, to the chattel components of the completed goods. 121 Even if the financing buyer can acquire an ordinary Article 9 security interest in the entire chair, the strict tracing requirement coupled with § 9-315 means that, at best, he can have a *purchase money* security interest only to the extent of the value of the component parts. 122 As a consequence, even if Family Furniture were to go to the expense of complying with the strict tracing requirement of § 9-107(b), its status as a purchase money lender would be partial at best. Thus, although they perform functionally equivalent roles, even the most conscientious financing buyer will never achieve legal parity with the purchase money lender. 123

This strict tracing requirement falls in an exceptionally hard way on the financing buyer. In the typical purchase money financing situation contemplated by § 9-107(b) (e.g., the acquisition of new equipment by the debtor), 124 there not only will be no § 9-315 processing complications, but there also will be only one supplier in-

120. See p. 26 supra.
121. Section 9-315(2) is designed to deal with conflicting security interests. Yet the language is applicable to separate security interests owned by the same debtor. Therefore, § 9-315(2) appears to provide the test for ascertaining what happens to separate purchase money security interests in component parts as they become commingled in the finished product.
122. The rather murky formula contained in § 9-315(2) appears to bar the conclusion that the buyer's purchase money security interest in component parts can be enlarged, during the process of assembly or manufacture, to include that portion of the value of the completed goods which cannot be directly traced, within the meaning of § 9-107(b), to the financing buyer's enabling advance. See 2 G. Gilmore, *supra* note 7, at 852-53, 856; cf. Coogan, *supra* note 1, at 861 n.87. It is impossible to acquire, directly, a purchase money security interest in the value of completed goods represented by intangible factors, see note 119 supra; § 9-315 ensures that the financing buyer cannot acquire such an interest indirectly.
123. To be sure, the financing buyer could achieve sufficient security against the holder of a floating security interest by obtaining a consensual subordination agreement. See note 110 supra. The fact remains, however, that the financing buyer is treated differently from the purchase money lender, for a subordination agreement requires the consent of the subordinated party.
124. Most writers, indeed, seem to assume that § 9-107(b) is but another way of financing a § 9-107(a) transaction. That is to say, instead of the seller selling the collateral and taking back a security interest, another party finances the sale of the same collateral. See, e.g., O. Spivack, *supra* note 42, at 97; J. White & R. Summers, *supra*
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volved, and therefore only one check for the secured party to write. As it stands now, however, § 9-107(b) places a large obstacle in the way of any financing buyer who wants to establish a purchase money security interest in the goods to which his contract refers. If Family Furniture could acquire a purchase money security interest in the chairs, its claim would take priority over the competing claim of the bank. But for a financing buyer like Family Furniture, the tracing requirement imposed by § 9-107(b) in all likelihood makes the acquisition of a valid purchase money security interest covering the entire value of the assembled chairs impossible, and a purchase money security interest even to the extent of the value of the component parts, unnecessarily expensive.

IV. Protecting the Financing Buyer

Under pre-Code law, the purchase money lender enjoyed a pre-eminent position among creditors, since his claim would prevail even against that of a prior secured party asserting an interest in after-acquired collateral. The common law was less generous to the financing buyer, whose vulnerability to third parties was almost unlimited.

The situation of the financing buyer has been improved considerably by the Uniform Commercial Code. The draftsmen of the Code felt, from the beginning, that the financing buyer had been badly treated at common law, and early versions of the Code already contained specific provisions designed to afford him greater protection.

note 3, § 25-5, at 914-15; Coogan, supra note 1, at 846; cf. Taylor Mobile Homes v. Founders Inv. Corp., 7 UCC Rep. Serv. 1363, 1366-67 (Fla. Dist. Ct. App. 1970) ("From the foregoing provision of the Code [§ 9-107] it clearly appears that a purchase money security interest is applicable only to property which has been the subject of a sale from the creditor to the debtor... or in which the money advanced by the creditor was used by the debtor in purchasing the collateral in which the creditor claims the security interest"); 4 R. ANDERSON, UNIFORM COMMERCIAL CODE 92 (2d ed. 1971). While it has been recognized that it would be desirable for the financing buyer to attempt to become a purchase money lender, Speidel, supra note 12, at 295, the obstacles in his path have not been perceived.

Indeed, in Chrysler Corp. v. Adamic, Inc., 59 Wis. 2d 219, 208 N.W.2d 97 (1973), the court, confronted with this exact problem, did not even see § 9-107(b) as an available remedy for the financing buyer. In discussing how the Code "gives broad latitude whereby a prepaying buyer acting timely, can enter into suitable arrangements for his own protection," id. at 242, 208 N.W.2d at 108, the court saw that the buyer might take a security interest. As to the remaining problem of the prior perfected security interest, the court suggested that "Lakeshore [the prior secured party]... might well have been amenable to a Chrysler [the financing buyer] proposal that Lakeshore in part subordinate its security interest. In view of the size of this contract in proportion to the limited assets of the manufacturer, it was almost foolhardy for Chrysler to proceed in the face of the perfected security interest of Lakeshore." Id.

125. Because the rights of a secured creditor under Article 9 and those of a buyer under Article 2 may be mutually exclusive, the extent of the security interest might be measured by the value of the loan, and not by the value of the chairs (if the chairs have appreciated in value). See note 12 supra.
The object of these provisions was always the same: to give the financing buyer the status of an ordinary secured creditor. However, as the Code assumed its final shape, it became clear that this result could be achieved easily and inexpensively under the general provisions of the Article on Secured Transactions. Thus, the need was eliminated for a special provision protecting the financing buyer.

By complying with the filing requirements of Article 9, a financing buyer may obtain a security interest in the goods he has contracted to buy. However, although he is formally eligible for the special priority which Article 9 accords the purchase money lender, in practice the strict tracing requirement of § 9-107(b), when coupled with the problems created by § 9-315, effectively prevents the financing buyer from asserting a purchase money priority in the total value of the assembled goods. As a result, the pre-Code practice of treating the financing buyer and the purchase money lender in different ways is continued by the Code itself.

From the debtor's point of view, the purchase money lender and the financing buyer perform indistinguishable functions.126 Both supply new money which promotes the debtor's continued operation by enabling him to acquire additional assets.127 Why, then, should these two forms of new financing money be treated differently?

The most compelling argument is that the strict tracing requirement of § 9-107(b)—which is the root of this difference in treatment—is itself desirable. First, this tracing requirement helps to distinguish the true purchase money lender from the ordinary lender with "hind-sight wisdom" or fraudulent intent.128 Second, it protects other creditors by compelling the purchase money lender to keep a close watch over his debtor's affairs.129 The fact that a financing buyer generally will be unable to satisfy a strict tracing requirement is therefore reason enough to deny him priority over previously perfected security interests in the same collateral.130

126. See note 10 supra.
127. See, e.g., Speidel, supra note 12, at 303-04. In Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 208 N.W.2d 97 (1973), the court, recognizing that "Chrysler... was not only a buyer but was financing the manufacturing process," stated that "[from the viewpoint of equity this [the subordination of Chrysler to Lakeshore] is an unsatisfactory result, for the record shows that, prior to the replevin, Chrysler had substantially paid the contract price for all the goods involved." Id. at 241-42, 208 N.W.2d at 108. See Skilton, supra note 91, at 17.
130. Even this argument, it should be noted, only advances a reason for making a financing buyer comply with a strict tracing requirement before he can claim a purchase
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The first branch of this argument is easily answered. Whatever the dangers of fraud and hindsight, they are allayed by the special notice requirements to which anyone claiming a purchase money priority is made subject by § 9-312(3).\footnote{See O. Spivack, supra note 42, at 112-13; p. 8 supra.} If a financing buyer is required to give notice to other creditors that he "has or expects to acquire a purchase money security interest in inventory of the debtor"—and he should be\footnote{The concept of a "special privilege" carries with it a correlative concept of "special duties." Section 9-312(3)'s requirements of filing and notice, therefore, are the prerequisites for asserting a priority under that section.}—no interested party can claim to be unfairly surprised when the buyer asserts a special priority in his collateral.

The second, and more persuasive branch of the argument contemplates the following situation: \(A\) writes a check to \(B\) for $1000 to enable \(B\) to purchase a new machine; instead of using \(A\)'s loan for this purpose, \(B\) cashes the check and gambles the money away in Las Vegas; a few days later \(B\) draws a check on his business bank account to pay for the machine; the account in question contains nothing but proceeds from the sale of \(B\)'s inventory of widgets; \(C\) has a prior perfected security interest in \(B\)'s widgets, which under § 9-306(2) is continued in proceeds resulting from their sale. \(B\) subsequently becomes insolvent. If it is assumed that \(B\) would not have drawn $1000 from his business account to finance his gambling spree, then \(A\)'s carelessness in making his check payable to \(B\) rather than to the vendor of the machine has damaged \(C\), and it is unfair that \(C\) should suffer because \(A\) failed to do something he could easily have done. The strict tracing requirement of § 9-107(b), this argument would conclude, protects \(C\) by penalizing \(A\) for his carelessness.

To begin with, this argument sweeps too broadly. If \(A\) were an ordinary secured creditor, rather than a purchase money lender, \(C\) would still be damaged by \(B\)'s fraud unless the newly acquired machine is covered by \(C\)'s security agreement with \(B\).\footnote{If \(C\) is an inventory financer, he could (as hypothesized) continue his perfected security interest in the cash proceeds of the inventory under § 9-306(2). However, once the cash proceeds are used to buy subsequent collateral, \(C\) loses his priority unless he can satisfy the requirements of § 9-312(3)(a), which would require that the collateral acquired with the cash proceeds be described in \(C\)'s financing statement. If that were not done, when \(A\) buys a machine (assuming that the machine does not constitute inventory) \(C\) loses his priority claim to it. (If it were inventory, \(C\) would have a security interest in it under his original filing as to inventory.)} If it is not, \(C\) will lose to \(A\) despite the fact that \(A\), as an ordinary secured creditor, is under no duty to trace the expenditure of the funds he has lent.
to B. Consequently, the argument that a purchase money lender should be subject to strict tracing requirements in order to protect the debtor's other creditors is compelling only where the collateral securing the purchase money loan is the same as that securing the claims of competing creditors.

If we suppose that the purpose of A's purchase money loan was to enable B to acquire more widgets rather than a new machine, C will lose to A only if A has notified C of his anticipated purchase money interest in the widgets. Together with the stimulus provided by § 9-306(4), such notification should be ample warning to C that he had best keep a close eye on any widget proceeds still in B's control. If C is lax in doing so, there is no reason why he should be permitted to benefit from A's failure to guard against B's fraud. Thus, even in the case where A and C claim competing security interests in the same collateral, A's failure to comply with the strict tracing requirements of § 9-107(b) is likely to be offset by a corresponding failure on C's part to monitor the disposition of any widget proceeds to which he is entitled. In this situation, there is no compelling justification for subordinating A's interest in the widgets to C's.

Finally, it should be noted that the argument for imposing a strict tracing requirement on A in order to protect C rests on two questionable presuppositions. In the first place, the argument assumes that B will only gamble with the $1000 loaned to him by A. But if B is a hardened (or indeed a rational) gambler, it will be a matter

134. An ordinary secured creditor may lend money and take a security interest in any collateral at all—presently existing or after-acquired. There is no requirement that the money lent must be "traced" to the collateral claimed as security. Therefore, in the situation we have posited, if A claimed an ordinary security interest in the machine, he would have priority over C, as C did not have a security interest in anything but inventory (and, under § 9-306, cash proceeds).

135. Unless A has notified C of his anticipated purchase money security interest in the widgets, A would not be entitled to the special priority accorded a purchase money lender in § 9-312(3).

136. The "stimulus" provided by § 9-306(4) stems from that subsection's limiting claims to proceeds in insolvency to a maximum of those received within 10 days of the institution of insolvency proceedings. This limitation forces the party wishing to claim proceeds to maintain at least some watch over his debtor's affairs, in order to avoid sustaining a serious loss upon his debtor's insolvency. In essence, § 9-306(4) continues the substantive rule of Benedict v. Ratner, 268 U.S. 353 (1925), even though § 9-205 killed its procedural rigidities. See, e.g., Gilmore, Article 9: What it Does for the Past, 26 L. Rev. 285, 297-98 (1966).

137. Professor Gilmore has suggested that he considers the policing requirements engendered by Benedict v. Ratner, 268 U.S. 353 (1925), largely desirable. Gilmore, supra note 136, at 297.

138. Coogan, supra note 1, at 866: "In fields where resort to the factor's lien acts has been necessary, the requirement of notice to the general lienor should enable the latter to maintain the policing which he thinks necessary."

139. If B is rational, what triggers B's gambling urge is a realization that his company's assets have passed a threshold level, and has nothing to do with the source of those assets.
of indifference to him whether the $1000 comes from A's loan or the funds which constitute C's collateral. If A frustrates B by making his check payable to the vendor of the widgets, B can simply draw on his business account to bankroll his gambling venture.\textsuperscript{140} Assuming that B's passion for gambling increases with the aggregate value of his business assets, and that he has no metaphysical preference for A's money that would prevent him from gambling with C's, C will be hurt whether A meets the tracing requirements of § 9-107(b) or not. In this case, there is nothing A can do to prevent B's fraud on C—C is the only party in a position to protect himself, by monitoring his own collateral.\textsuperscript{141}

In the second place, the argument for imposing a strict tracing requirement on A rests on the assumption that A can satisfy the requirement easily and inexpensively. As we have seen,\textsuperscript{142} if A is a financing buyer, a direct result of the strict tracing requirement is that he will probably find it impossible to acquire a purchase money security interest covering the entire value of the contract goods. Even if it were not impossible, but merely costly, the argument that A should bear the burden of insuring C against B's fraud is less than persuasive, especially given the notice requirements of § 9-312(3). Unless we are prepared to say that the true rationale for giving A a purchase money priority is the fact that he has borne the cost of C's insurance, there is little reason why A should be held to the strict tracing requirements of § 9-107(b) where these requirements impose a considerable financial obligation upon the purchase money lender, as they would in the case of a financing buyer, and would protect other creditors only in a few extraordinary situations.

The argument that a strict tracing requirement is desirable because it compels the purchase money lender to protect competing creditors by monitoring his debtor's affairs is at best a weak one which applies only in a limited number of cases. More importantly, whatever benefits even arguably accrue from the strict tracing requirements of § 9-107(b) are of insufficient weight to override the basic policy underlying the purchase money priority: the protection of new money over old. Consequently, even though the financing buyer may be unable to comply with the requirements of § 9-107(b),

\textsuperscript{140} This assumes that B both buys the widgets and gambles. If he does both, the order of the transaction should be a matter of economic indifference to him. See note \textsuperscript{139} supra.

\textsuperscript{141} That is to say, C is responsible for letting B take the money and buy the widgets. Since this is inventory, C will have been notified by A. A has to notify C in order to take a purchase money priority over him. § 9-312(3).

\textsuperscript{142} See pp. 29-30 supra.
as a supplier of new money he should be entitled to the special protection which Article 9 affords the purchase money loan.\(^{143}\)

The financing buyer may be elevated to parity with the purchase money lender in two ways. The first would simply be to abolish the strict tracing requirement of § 9-107(b) by deleting the words “if such value is in fact so used.”\(^{144}\) Although the elimination of the § 9-107(b) tracing requirement may be desirable,\(^{145}\) it is also certain to be controversial.\(^{146}\)

A more conservative solution would be to add a new subsection (c) to § 9-107, based in large part on the September 1949 draft of § 8-105(3)(b), which would read as follows:

A security interest is a “purchase money security interest” to the extent that it is . . .

\(^{143}\) There is another reason why the financing buyer should be entitled to the protection of a purchase money lender. The financing buyer remains, after all, a buyer, and although he is unable to rely on the protection afforded to buyers by § 9-307, see pp. 22-26 supra, that result is simply a consequence of the fact that, because of the commercial needs of his seller, the financing buyer advances the purchase price of the contract goods before their delivery date. By affording the financing buyer the protection of a purchase money lender, the effect of the different timing of payment and delivery upon the rights of financing and ordinary buyers respectively would be eliminated. (However, the protection would probably not be entirely comparable. See note 12 supra.) This result cannot easily be achieved by a modification of § 9-307 itself, since such a modification would necessitate a change both in the Article 2 provision fixing the time for the passage of title, p. 23 supra, and in § 2-402, pp. 24-26 supra. Consequently, the least cumbersome method for affording the financing buyer protection equivalent to that enjoyed by an ordinary buyer under § 9-307 is to promote him to the status of a purchase money lender.

\(^{144}\) Abolishing the strict tracing requirement should eliminate any § 9-315coins mingling problems, because the financing buyer could then take a direct purchase money security interest in the completed goods as well as in their component parts, thereby avoiding § 9-315. See pp. 29-30 supra.

\(^{145}\) Because of the Code’s general policy of favoring new money over old. See, e.g., Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 241-42, 208 N.W.2d 97, 108 (1973); SEPTEMBER 1949 UCC, supra note 31, § 8-406(3). See also id. at 74 (Comment 3) (“In order to permit the expansion of business enterprises and the modernization of plants, it is necessary to allow the financing of new equipment free of the interests acquired under earlier financing arrangements.”) The strict tracing requirement was explicitly abandoned in the proposed Bankruptcy Act, currently pending before Congress, H.R. 10792, 93d Cong., 1st Sess. (1973). The proposed redraft of § 60 of the Bankruptcy Act specifically provides, § 4-607(3)(f), that “[a] security interest in property acquired by the debtor, if perfected when the debtor first acquires rights in the property, or within 10 days thereafter, is not voidable under this section to the extent that it secures new value previously given to enable the debtor to acquire the property.” “There is no requirement in the Draft provision [§ 4-607(3)(f)] comparable to that found in Code § 9-107(b) on Purchase Money Security Interests, that the advance be ‘in fact . . . used’ to acquire the property. That is to say, the Draft provision does not impose a tracing requirement.” NATIONAL BANKRUPTCY CONFERENCE, REPORT OF THE COMMITTEE ON COORDINATION OF THE BANKRUPTCY ACT AND THE UNIFORM COMMERCIAL CODE 14 (1970). See also Skilton, supra note 25, at 1002.

\(^{146}\) Cf. AMERICAN LAW INSTITUTE & NAT’L CONF. OF COMMISSIONERS ON UNIFORM STATE LAWS, supra note 28, at 262 (reason for deleting old § 9-107(c)).
A Plea for the Financing Buyer

(c) taken by a buyer who makes advances to a seller to enable the seller to manufacture, assemble or process goods for the buyer during the period of one year following the advance, and the collateral securing the advance consists of (i) materials acquired after the advance has been made which are necessary for the manufacture, assembly or processing of the contract goods, and (ii) goods manufactured, assembled, or processed after the advance has been made which could be used to satisfy the contract (whether or not in a deliverable state).147

No further change in the Code would be necessary;148 the new subsection would give the financing buyer a purchase money security interest in the goods he had contracted for, thereby making him eligible for the special priority of § 9-312(3). In this way, the financing buyer would be endowed with the rights, and charged with the duties, of a purchase money lender.

Although the latter approach lacks simplicity and elegance, it achieves the same result, so far as the financing buyer is concerned, as the abolition of the strict tracing requirement. Whichever approach is preferred, the time has come to improve the status of the financing buyer. Indeed, as we have suggested, the elevation of the financing buyer is dictated by the Code's own policy of giving new money priority protection over old. By promoting the financing buyer to parity with the purchase money lender, the Code can cure a longstanding anomaly in commercial law and effectuate the fair and uniform application of one of its own underlying policies.

147. The proposed section limits the priority to materials received or manufacturing steps taken after the advance of the money. This is to ensure that the financing buyer is, indeed, a "financing," and not merely a prepaying, buyer. The ordinary prepaying buyer does nothing to allow the manufacturer to move forward in the completion of the contract, and should not receive a special priority in the completed goods.

The relevant test should be, not the strict tracing requirement itself, but rather a test that looks to see if the financing money has actually been used in a manner that arguably enabled the debtor to progress towards completion of its contract with the financing buyer. This test is, itself, a kind of "tracing" requirement. It looks to any manufacturing steps taken after the receipt of the money from the financing buyer that further the production of goods that are for, or arguably could be for, the financing buyer. The existence of such a continuing manufacturing process signals that the money has been used in an "enabling" sense for that contract. The equities that attach to the purchase money lender, as a consequence, also attach here. Cf. Chrysler Corp. v. Adamatic, Inc. 59 Wis. 2d 219, 241-42, 208 N.W.2d 97, 108 (1973).

148. The financing buyer, in other words, would be able to achieve the special priority simply by complying with the requirements of § 9-312(3). In order to achieve special priority in subsequently acquired materials, as well as goods, notice to that effect would have to be given.