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SECURED TRANSACTIONS—WHAT FLOATS CAN BE SUNK

JACK B. JUSTICE†

EVEN THE MOST CASUAL OBSERVER of developments in commercial law knows something about the floating lien, a “colorful term”¹ used to describe an arrangement under which a security interest attaches to a shifting body of collateral.² For example, a security interest may float from a retailer’s inventory to the accounts which arise when that inventory is sold, and it may also float to new inventory which the retailer later acquires. The floating lien, expressly validated by section 9-204(3) of the Uniform Commercial Code (Code),³ has often been litigated⁴ and analyzed at length by commentators.⁵

Recently, in a single decision, In re E.A. Fretz Co.,⁶ the United States Court of Appeals for the Fifth Circuit both launched and sank the “floating secured party,” a term utilized by the court to characterize an attempt to perfect a security interest by filing a financing statement naming as secured party a person other than the one to

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The author acknowledges the helpful comments of Carl W. Funk and Joseph A. Dworetzky.


2. See id. at 1016-17, 1016 n.21, 1017 n.22.


4. E.g., Biggins v. Southwest Bank, 490 F.2d 1304 (9th Cir. 1973) (valid security interest created as to after acquired demonstration vehicles purchased by dealer from its own inventory); Grain Merchants of Ind., Inc. v. Union Bank & Sav. Co., 408 F.2d 209 (7th Cir.), cert. denied, 396 U.S. 827 (1969) (transfer of security interest in accounts receivable “now or hereafter received” was transfer of all accounts receivable as an entity and occurred for bankruptcy purposes at time of filing of financing statement); In re Portland Newspaper Publishing Co., 271 F. Supp. 395 (D. Or. 1967), aff’d sub nom. DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969) (no preference for bankruptcy purposes occurred since transfer of security interest in present and future accounts receivable was viewed as single entity); Walter E. Heller & Co. v. Salerno, 168 Conn. 132, 362 A.2d 904 (1973) (plaintiff had perfected security interest in inventory acquired after merger).


6. 565 F.2d 366 (5th Cir. 1978). For a discussion of In re E.A. Fretz Co. which approves the Fifth Circuit’s decision but criticizes some of its reasoning, see 31 VAND. L. REV. 716 (1978).

(867)
whom the secured debt was owed.\textsuperscript{7} In using that term, the court's intention clearly was not to praise but to scorn.\textsuperscript{8}

There is another sense in which a security interest might be described as "floating." The Code explicitly recognizes that the obligations secured by a security interest\textsuperscript{9} may include "future advances or other value."\textsuperscript{10} For example, a series of loans may constitute future advances covered by a single security agreement.\textsuperscript{11} The term "other value" includes such disparate obligations as liability for an overdraft in a checking account\textsuperscript{12} or liability as an endorser of a note.\textsuperscript{13} The Fifth Circuit made a passing reference to this concept, which it described as "floating debt,"\textsuperscript{14} but apparently did not consider it relevant to the \textit{Fretz} case.

This article will use the \textit{Fretz} case as the context for a discussion of both floating secured parties and floating debt.

I. THE \textit{FREtZ} CASE

A. The Facts

On April 3, 1971, E.A. Fretz Co., Inc. (Fretz) gave Revlon, Inc. (Revlon) a security interest in Fretz's equipment and inventory, then owned or thereafter acquired, and the proceeds thereof.\textsuperscript{15} The security agreement explicitly provided that the security interest was to secure not only Fretz's debts to Revlon but also its debts to any affiliate of Revlon and its debts to others which Revlon or any affiliate of Revlon might acquire "by assignment or otherwise."\textsuperscript{16} On April 5, 1971, a financing statement naming Revlon as secured party was filed in the appropriate place.\textsuperscript{17} On June 30, 1971, Fretz gave Re-
public National Bank (Bank) a security interest in Fretz's inventory and its proceeds, and on August 11, 1971, a financing statement naming the Bank as secured party was filed in the appropriate place.\textsuperscript{18}

When Fretz subsequently filed a bankruptcy petition on August 23, 1972, it was indebted not only to Revlon and the Bank but also to two Revlon subsidiaries.\textsuperscript{19} On September 19, 1972, the two subsidiaries assigned their claims to Revlon.\textsuperscript{20} The bankruptcy judge held that all of Revlon's claims had priority over the Bank's claims, and the district court affirmed.\textsuperscript{21} On appeal, the Fifth Circuit reversed with respect to the claims assigned to Revlon by its subsidiaries.\textsuperscript{22}

It is not easy to identify the Fretz court's precise holding. Its opinion began with a statement that "[t]he most intriguing issue before it was "whether the Uniform Commercial Code, construed in light of the policies underlying the Bankruptcy Act, permits the use of floating secured parties" in secured transactions."\textsuperscript{23} The court stated "that the post-bankruptcy assignments of the subsidiaries' claims against Fretz to Revlon were ineffective to create perfected security interests in favor of" the subsidiaries,\textsuperscript{24} but its extended discussion of that proposition was superfluous since Revlon's claim was not based on an argument that a security interest had been granted to the subsidiaries.\textsuperscript{25}

Instead, Revlon maintained that the indebtedness which the subsidiaries had assigned to Revlon was secured by a perfected security interest granted to Revlon.\textsuperscript{26} That straightforward argument, whether sound or not, was not adequately addressed by the court. Revlon's argument can be elaborated in the following propositions:

1. Fretz had created in favor of Revlon a security interest which, by its terms, secured Fretz's debts to the subsidiaries.
2. The financing statement naming Revlon as secured party gave other interested persons notice that Revlon might have a security interest in the collateral described, thereby enabling them to

\textsuperscript{18} Id.
\textsuperscript{19} Id. at 368-69.
\textsuperscript{20} Id. at 368.
\textsuperscript{21} Id. at 369.
\textsuperscript{22} Id. The court noted that one of the subsidiaries had filed its own financing statement "some two months after" the Bank's statement was filed. Id. at 371 n.15. That filing did not, however, give the subsidiary priority over the Bank. Id. at 375.
\textsuperscript{23} Id. at 367.
\textsuperscript{24} Id. at 369.
\textsuperscript{25} Brief for Appellee at 18, In re E.A. Fretz Co., 565 F.2d 366 (5th Cir. 1978).
\textsuperscript{26} Brief for Appellee at 12, In re E.A. Fretz Co., 565 F.2d 366 (5th Cir. 1978).
make the inquiries “necessary to disclose the complete state of affairs,” including the fact that the security interest covered debt owed to the subsidiaries and debt which might later be assigned to Revlon.

3. Therefore, the security interest in favor of Revlon was perfected with respect to the debts to the subsidiaries.

The Fretz court addressed the second of these propositions, conceding that the Code requires only a notice filing, but did not otherwise consider Revlon’s argument. Instead, the court returned to its own theme that the subsidiaries themselves did not hold perfected security interests. Its reasoning can be stated as follows:

1. The Code requires a notice “that the secured party who has filed may have a security interest in the collateral described.”

2. The financing statement naming Revlon as secured party did not disclose that the subsidiaries might have a security interest in the collateral described.

3. Therefore, the subsidiaries did not have perfected security interests.

The Fretz court concluded its discussion of the Code with the following peroration:

We believe that in a world of huge conglomerates a construction of the UCC’s silence as to “floating secured parties” which would sanction such a weird device is clearly at odds with the “simple notice” requirements of § 9.402. Placing our imprimatur on floating secured parties would undercut “Article Nine’s perfection requirement [which] reflects a Code policy against secret security.”

Only after it had turned to a consideration of the applicable bankruptcy law did the Fifth Circuit acknowledge Revlon’s argument.

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27. U.C.C. § 9-402, Comment 2.
29. 565 F.2d at 370.
30. Id. at 371.
31. Id. at 370 (emphasis supplied by the court), quoting U.C.C. § 9-402, Comment 2.
32. 565 F.2d at 371.
33. Id. As indicated earlier, Revlon had conceded this conclusion. See text accompanying note 25 supra.
that a security interest for the debts to Revlon’s affiliates “was created in favor of Revlon ab initio and perfected when the Fretz-Revlon financing statement was filed.” The court, however, simply dismissed this argument without analyzing it. Moreover, although the Fifth Circuit asserted that to uphold Revlon’s claim would be inconsistent with the policy of bankruptcy law, the court purported to base its decision not on the bankruptcy law, but on the Code.

B. The Questions Posed by Fretz

As perceived by the Fifth Circuit, the question in Fretz was whether a security interest in favor of the subsidiaries could be created by a security agreement with Revlon and perfected by a financing statement which named only Revlon as secured party and made no reference to any security interest claimed by the subsidiaries. By framing the issue in that way, the court was easily able to conclude that the subsidiaries did not have perfected security interests.

The Fifth Circuit’s statement of the issue did not coincide with the claim, as asserted and argued before the court, that Revlon, and not its subsidiaries, had a perfected security interest which secured the debt originally owed to the subsidiaries and later assigned to Revlon. The court’s failure to address adequately Revlon’s argument may have resulted from the court’s perception that Revlon had in reality attempted to accomplish the perfection of a security interest in favor of its subsidiaries by filing a financing statement naming Revlon as secured party.

This article will proceed on the premise that such a perception is correct in the sense that the transaction could have been structured more forthrightly by creating security interests in favor of the subsidiaries and by filing financing statements naming them as secured parties. Proceeding from that premise, the issue in the Fretz case becomes whether the same objective could be achieved by the alternative structure employed by Revlon and its subsidiaries. More precisely, that issue raises the following questions:

1. Does the Code permit the creation of a security interest in favor of a secured party [Revlon] as security for the debtor’s obligations to persons [the subsidiaries] other than the secured party?

35. 565 F.2d at 374.
36. Id.
37. Id.
38. See id.
39. Id. at 369.
40. Id. at 370.
2. If the security interest described in question one is valid, is it perfected by the filing of a financing statement naming the secured party [Revlon] without disclosing that the secured obligations are owed to other persons [the subsidiaries]?

3. Is a security agreement effective under the Code to the extent that it purports to secure obligations later acquired by the secured party [Revlon] from other persons [the subsidiaries]?

4. If the security interest described in question three is fully effective, is it perfected by the filing of a financing statement naming the secured party [Revlon] without disclosing that it may cover obligations later acquired from other persons [the subsidiaries]?

5. If the security interests described in questions one and three are valid and are perfected in the manner described in questions two and four, does the Code give them priority over a security interest later perfected in favor of another secured party [the Bank]?

6. How are the answers to questions one through five affected by bankruptcy law?

Questions one and two deal with the floating secured party, and questions three and four deal with floating debt. Revlon's claims in the Fretz case would be supported by favorable answers to either questions one and two or questions three and four. Its claims would also have to survive a consideration of questions five and six. Part II of this article will deal with floating secured parties, and part III will deal with floating debt. Each part will consider the relevant priority and bankruptcy questions.

II. FLOATING SECURED PARTIES

The sinking of the floating secured party in the Fretz case has created a whirlpool which could engulf many financial institutions and other creditors. Many trust companies and other institutions and individuals hold security interests as trustees or agents for groups of lenders. It thus becomes necessary to determine whether they are floating within range of the Fretz decision and also whether they are shielded by protective devices not available to Revlon. The Fifth Circuit did not consider these questions, although Revlon made reference to them in a petition for rehearing which the court denied.

41. Petition for Rehearing of Appellee at 6-9, In re E.A. Fretz Co., 565 F.2d 366 (5th Cir. 1978).

42. Per curiam Order (5th Cir. Mar. 9, 1978). That order did modify the court's original opinion dated January 4, 1978 in two respects. First, it corrected footnote 15, which originally
The court also failed to provide any reasoned basis for distinguishing its decision from other precedents.

A. Pre-Code Decisions

An authoritative textbook on pre-Code law stated that a chattel "mortgage may be made to secure debts to others besides the mortgagee." 43 The author cited a Rhode Island decision upholding a chattel mortgage from a printer to a named mortgagee to secure "all sums now due or which may become due from . . . [the printer to the mortgagee] and to all other persons now or heretofore employed, or hereafter to be employed by . . . [the mortgagor] for the labor or other services of all such persons." 44 The United States Court of Appeals for the Sixth Circuit has also upheld an employer's mortgage to one employee as security for the wage claims of all employees. 45 Additionally, a New Hampshire court has upheld a mortgage which was given for the benefit of both the mortgagee and another named person. 46

In each of those decisions, the mortgages were given for the benefit of the mortgagee himself and a narrow class of additional creditors who were clearly identified. Similarly, the security interest in Fretz was given to secure Revlon and a narrow and clearly identified class of additional creditors, Revlon's "present and future divisions and affiliates." 47

Another group of pre-Code decisions upheld chattel mortgages given to mortgagors who had no interest of their own but merely held the mortgages for the benefit of other persons. 48 The utility of such arrangements was described by one court in the following way:

 stated that one of the subsidiaries had filed a financing statement "two months after bankruptcy." As indicated earlier, the modified opinion acknowledged that the financing statement was filed "some two months after" the Bank's statement was filed. See note 22 supra. Second, as a direct result of that correction, the court modified the last paragraph of its original opinion, which had stated that neither subsidiary had a valid lien. As modified, the opinion left that question unresolved as to the subsidiary which had filed its own financing statement. 565 F.2d at 375.

44. Spencer v. Pierce, 5 R.I. 63, 64 (1857), cited in L. Jones, supra note 43, § 84, at 157 n.47.
45. In re Jackson, 18 F.2d 462, 464 (6th Cir. 1927).
47. 565 F.2d at 368 n.2 (emphasis omitted).
48. In re Pilot Radio & Tube Corp., 5 F. Supp. 453, 455 (D. Mass. 1933), aff'd, 72 F.2d 316 (1st Cir.), cert. denied, 293 U.S. 584 (1934) (mortgage given by debtor to trustee for benefit of creditor); In re Babb, 41 F.2d 253, 255 (E.D. Ill. 1930) (mortgage given by bankrupt to trustee as security for bona fide debt to bank); Chafey v. Matthews, 104 Mich. 103, 105-06, 62
A mortgage to a third person would be as valid as a mortgage to a creditor. The choice of a mortgagee is a matter of convenience, and there can be no wrong, and there may be some advantage, in giving to all of the secured creditors a control over the security in which all are ratably interested, and it would effectually prevent any disputes as to priority. 49

The foregoing decisions appear to represent the rule generally followed before the adoption of the Code, although there was some dissent. In 1904, an Illinois court held invalid as against third parties a recorded mortgage which described the mortgagee as a trustee but did not identify the beneficiaries. 50 The court expressed concern that "no one was under any obligation to call upon and inquire of...[the mortgagee] what relation he sustained to the instrument or whom he was trustee for; but even had such inquiry been made, he could have given no information." 51 That decision had little, if any, precedential value after 1930, when a federal court expressly refused to treat it as an authoritative statement of Illinois law. 52

Other pre-Code decisions invalidating the use of floating secured parties were based on statutory provisions. For example, a New Hampshire statute required the recording of a prescribed form of affidavit which stated that the mortgage secured a debt owed to the mortgagee. 53 It was held that an affidavit in the statutory form was false and therefore ineffective with respect to a mortgage securing a debt owed to another person. 54 As will be seen, there is no similar problem under the Code.

51. Id. at 215.
52. In re Babb, 41 F.2d 253, 254 (E.D. Ill. 1930). In 1932, the Illinois Court of Appeals cited the Babb decision in upholding a chattel mortgage given to A as security for debts to B, C, and D. Citizens State Bank v. Senesac, 267 Ill. App. 288, 293-94 (1932). It should be noted that these two Illinois decisions can be distinguished. In the Senesac case, although the debts were in reality owed to B, C, and D, they were evidenced by a note made payable to A and then assigned to B, C, and D. Id. at 290. As a matter of form, therefore, the mortgage secured a debt nominally owed to the mortgagee. A similar arrangement was upheld in Gilmore v. Roberts, 79 Wis. 450, 46 N.W. 522 (1891).

The term "security interest" is defined in section 1-201(37) as "an interest in personal property or fixtures which secures payment or performance of an obligation." There is no basis, in either the text of or the comments to that section, for drawing an inference that the secured obligation must be owed to the secured party.

The term "secured party" is defined in the first sentence of section 9-105(1)(m) as follows: " 'Secured party' means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold." Considered by themselves, the words "or other person in whose favor there is a security interest" are sufficiently broad to include a person in whose favor a security interest is given as security for an obligation owed to another person. Contextual considerations, however, might require the implication of a narrower meaning.

First, it could be argued that "lender, seller or other person" suggests that the other person, like the lender and the seller, must be one to whom an obligation is owed. This interpretation could be buttressed by references to other sections of the Code. For example, section 9-107 provides that "[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" or "(b) taken by a person who by making advances or incurring an obligation gives value." Similarly, section 9-108 provides that a security interest in after acquired collateral shall be deemed to be taken for new value "[w]here a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value."

Another argument could be based on the second sentence of section 9-105(1)(m), which provides: "When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party." That provision might be interpreted as a

55. U.C.C. § 1-201(37).
56. Id.
57. Id. § 9-105(1)(m).
58. Id.
59. Id. § 9-107.
60. Id.
61. Id. § 9-108.
62. Id.
63. Id. § 9-105(1)(m).
limited exception to a requirement that the secured party be the person to whom the secured debt is owed.

Whatever impact these contextual arguments might otherwise have is nullified by the commentary of the principal draftsman of Article 9,\textsuperscript{64} Grant Gilmore, who, referring to the words “or other person” in the first sentence of section 9-105(1)(m), has stated: “[C]onceivably, A might make a loan to debtor X and have the resulting security interest run in favor of B. At least for formal purposes B would be the secured party, although, if he were merely A’s nominee, A would be the beneficial owner.”\textsuperscript{65} Discussing the second sentence of section 9-105(1)(m), Professor Gilmore continued:

This sentence seems to have been put in by excess of caution. It does no harm but, even without it, no one could have doubted that an indenture trustee was entitled to sign, file and so on for the bond holders. It goes without saying that the “trustee or other person” becomes a secured party only for formal purposes; the “holders” of [the] obligations” remain the beneficial owners of the interest. There appears to be no good reason (except to make things clear to the members of the corporate bar) why the sentence is restricted to transactions which involve “an indenture of trust, equipment trust agreement or the like;” presumably any sort of trustee, fiduciary or representative could qualify as “secured party,” for formal purposes, for those whom he represents.\textsuperscript{66}

In other words, section 9-105(1)(m) should not be viewed as limiting the use of surrogates as secured parties to transactions in which they are true fiduciaries. On the other hand, Professor Gilmore’s comments do imply that the secured party must have some representative relationship with the person to whom the secured obligation is owed. This implication will be discussed further in the next section of this article.\textsuperscript{67}

Other sections of the Code use completely neutral language that is consistent with Professor Gilmore’s interpretation of section 9-105(1)(m). For purposes of the Fretz case, the most significant is section 9-203(1),\textsuperscript{68} which provides that a security interest is not enforceable against the debtor or third parties “and does not attach unless (a) the collateral is in the possession of the secured party pur-

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\textsuperscript{64} Id. art. 9.
\textsuperscript{65} 1 C. GILMORE, supra note 5, § 10.4, at 305 (footnote omitted).
\textsuperscript{66} Id. (footnote omitted).
\textsuperscript{67} See text accompanying notes 105 & 106 infra.
\textsuperscript{68} U.C.C. § 9-203(1).
\end{flushright}
suant to agreement, or the debtor has signed a security agreement . . . ; and (b) value has been given; and (c) the debtor has rights in the collateral.” 69 There is no suggestion in section 9-203(1) that the “agreement” must be between the debtor and the person to whom the secured obligation is owed or that the “value” must be given by the secured party. The language of section 9-203(1) is completely neutral on both points. 70

Assuming that the secured party may be a person other than one to whom the secured debt is owed, questions arise concerning the type of filing required to perfect the security interest, whether the financing statement must disclose that the secured party is only a representative, and whether it must identify the beneficial owner or owners of the security interest.

In response to these questions, section 9-402(1) 71 provides simply that “[a] financing statement is sufficient if it gives the names of the debtor and the secured party.” 72 Comment two to section 9-402 73 states that the section adopts a system of “notice filing,” that “[t]he notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described,” and that “[f]urther inquiry from the parties concerned will be necessary to disclose the complete state of affairs.” 74

If the secured party is simply the person to whom the security interest is given, even when that person is only a substitute for the real creditors, the financing statement should be sufficient if it names that person. There is no need for the statement itself to disclose that the secured party is a representative or to identify the persons represented. It serves as notice that the secured party, as either the real or nominal owner, may have a security interest. Interested persons may then initiate further inquiries to determine the complete state of affairs.

C. Decisions Under The Code

With the exception of Fretz, the reported decisions are in accord with the foregoing analysis. For example, in Industrial Packaging

69. Id.
70. Another example of neutral language is U.C.C. § 9-208(2), which requires the secured party to respond to the debtor’s statement of “the obligation” without any suggestion that it refers only to an obligation owed to the secured party. Id. Similarly, U.C.C. § 9-504(1)(b) refers simply to “indebtedness secured by the security interest.” Id.
71. Id. § 9-402(1).
72. Id.
73. Id. Comment 2.
74. Id.
Products Co. v. Fort Pitt Packaging International, Inc., financing statements naming a trust company as secured party were filed in 1955 in connection with a transaction during which the debtor incurred obligations to the trust company. In 1957, the same debtor obtained a loan from a finance company and agreed to secure that loan by assigning its right in a government contract to the trust company as agent for the finance company. The 1955 filing covered accounts receivable, and no additional filing was made. When the debtor became bankrupt, its receiver asserted that the financing statements filed in 1955 did not perfect a security interest covering the obligation to repay the finance company's loan. The Pennsylvania Supreme Court held that the security interest was in fact perfected, stating that the Code does not require that the secured party named in a financing statement be "a principal creditor and not an agent."

In a more recent case, In re Cushman Bakery, Cushman Baking Company and Cushman Bakery (Cushman) had arranged to receive a loan from Seaboard Allied Milling Corporation (Seaboard). The loan was not made directly by Seaboard to Cushman, however, but through an intermediary, Bakers Management Corporation (Bakers Management), an affiliate of Seaboard. As security, Cushman gave Bakers Management a real estate mortgage and security interests in Cushman's personal property. Financing statements naming Bakers Management as secured party were filed. When Cushman subsequently became bankrupt more than four months later, its trustee challenged the security interest, arguing that the financing statements were defective because they failed to disclose Seaboard's interest. The United States Court of Appeals for

76. Id. at 645-46, 161 A.2d at 20.
77. Id. at 646, 161 A.2d at 20.
78. Id. at 648, 161 A.2d at 21.
79. Id. at 647-48, 161 A.2d at 21.
80. Id. at 648-49, 161 A.2d at 21-22.
81. Id. at 648, 161 A.2d at 21.
83. 526 F.2d at 25.
84. Id.
85. Id. at 26.
86. Id.
87. Id. at 27.
the First Circuit rejected that argument, citing *Industrial Packaging* and the discussion of notice filing in the comments to section 9-402, and held that the security interests were perfected.

There is, of course, a formal distinction between the arrangements in the *Industrial Packaging* and *Cushman* cases. In *Cushman*, the secured debt was held, at least nominally, by the secured party, but that was not the situation in *Industrial Packaging*. This difference is a possible ground for distinguishing the cases. It also is a possible basis for differentiating *Industrial Packaging* from two other decisions which held that a financing statement naming a bank as secured party is sufficient to perfect the entire security interest despite the fact that the bank has assigned participations, undivided fractional interests in both the secured debt and the security interest, to other persons. When, as a matter of form, the secured debt is owed to the secured party, it is inconsistent with the text of the Code to assert that the financing statement must disclose either the fact that others hold undivided fractional interests or the identity of those participants.


89. 526 F.2d at 29, citing U.C.C. § 9-402, Comment 2.

90. 526 F.2d at 34.

91. Id. at 25.

92. 349 Pa. at 646, 161 A.2d at 20.

93. See note 52 *supra*.

94. See *In re Fried Furniture Corp.*, 293 F. Supp. 92, 93 (E.D.N.Y. 1968), *aff'd per curiam*, 407 F.2d 360 (2d Cir. 1969) (where the Small Business Administration (SBA) had a 75% interest in a loan made by a bank, the SBA had a security interest perfected by the bank's filing); *Heights v. Citizens Natl' Bank*, 463 Pa. 48, 61-62, 342 A.2d 738, 744 (1975) (bank participating in a loan made by lending bank not required to perfect its security interest in the loan since the participating bank was a creditor of a secured creditor, the lending bank).

95. Section 9-302(2) of the Code, U.C.C. § 9-302(2), unambiguously provides that "no filing under this Article is required in order to continue the perfected status" of a security interest which has been assigned by the secured party. *Id*.

96. But see *Stahl & Pike, Loan Participations: Lead Insolvency and Participants' Rights (Part II)*, 95 BANKING L.J. 38, 63-67 (1978). These commentators appear to suggest that the financing statement should at least indicate that the named secured party is acting as a representative. *Id* at 67. This excessively conservative suggestion may have resulted from the author's confusion of two different questions: 1) the kind of filing required to protect the security interest against the debtor's creditors; and 2) the filing, if any, needed to protect the participants against creditors of the lead bank from which the participants acquired their participations. *See* id. at 63-67. The answer to the second question depends on how the relationship between the lead bank and the participants is characterized. If the participants are deemed to be creditors of the lead bank, they must file financing statements naming the lead bank as debtor. *In re Alda Commercial Corp.*, 327 F. Supp. 1315, 1318 (S.D.N.Y. 1971); U.C.C. § 9-302, Comment 7. In the typical participation arrangement, however, the participants are not creditors of the lead bank. *See Stratford Financial Corp. v. Finex Corp.*, 367 F.2d 569, 571 (2d Cir. 1966). Alternatively, when the lead bank's arrangement with its customer is not a secured loan but a factoring, an actual purchase, of accounts, the sale of the participations is a resale of interests in the accounts, which is itself a secured transaction under U.C.C. § 9-102(1)(b). In
The First Circuit, however, did not rely on any formal distinction in *Cushman*. Its opinion broadly stated: "The use of a nominee in real estate transactions, and as mortgagee in a recorded mortgage, has long been sanctioned as a legitimate practice. . . . The use of a nominee is likewise legitimate under the Uniform Commercial Code." 97

One other factual difference between these cases should be discussed. In *Industrial Packaging*, the debtor and the second lender had "entered into a written contract" by which the debtor "agreed to assign" the collateral to the trust company as the lender's agent. 98 There is no mention of any similar agreement in either *Cushman* or *Fretz*. It is nonetheless clear that the arrangement in *Cushman* was negotiated by persons who represented both Seaboard and Bakers Management and that Cushman consciously intended to secure Seaboard by giving a security interest to Bakers Management. 99 The facts were similar in *Fretz*, 100 where the bankruptcy judge found that the business of Revlon and its subsidiaries was essentially conducted by the same persons from a single office and that the credit relationship between Fretz, Revlon, and the subsidiaries had been under the control and supervision of a single person. 101

As emphasized earlier, the secured party in *Fretz* was Revlon itself, 102 and the security agreement between Revlon and Fretz satisfied the requirements of section 9-203(1). 103 If a security agreement expressly covers an obligation owed to a person other than the secured party, the other person is a third party beneficiary of that agreement, and it is difficult to discern any policy which would be served by requiring a second agreement between the debtor and the other person.

A different question would be presented by a situation in which a debtor and a secured party gratuitously agreed to secure an obliga-

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97. 526 F.2d at 30 (citations omitted).
98. 399 Pa. at 646, 161 A.2d at 20.
99. See 526 F.2d at 32.
100. See 565 F.2d at 367-69.
101. Bankruptcy Judge's Findings of Fact, Nos. 7-10, *quoted in* Brief for Appellee at 7-9, In re E.A. Fretz Co., 565 F.2d 366 (5th Cir. 1978). These findings were not challenged on appeal. 565 F.2d at 368 n.1.
102. See text accompanying note 26 supra.
103. See text accompanying notes 68-70 supra.
tion which the debtor owed to another person who had no relationship to the secured party and no knowledge of the arrangement.\textsuperscript{104} Much of the textual analysis of the Code in the preceding section of this article supports a conclusion that the debt to the stranger is secured. This result is supported by the principle that no knowledge on the part of a third party beneficiary to a contract is necessary to give him rights under it.\textsuperscript{105}

As indicated earlier, however, section 9-105(1)(m) and Professor Gilmore's commentary imply that the secured party must in some sense "represent" the person to whom the secured obligation is owed, and a finding that one person represents another should be based on some actual relationship between them.\textsuperscript{106} That relationship may be consensual, either explicitly as in \textit{Industrial Packaging} or implicitly as in \textit{Cushman} and \textit{Fretz}.\textsuperscript{107} A relationship based on the status of the parties, as in the case of a corporation and its subsidiary, should also be sufficient to establish the required representation.

Conversely, upholding the use of a floating secured party in the absence of any underlying relationship with the person to whom the secured obligation is owed would be inconsistent with the policy of section 9-208,\textsuperscript{108} which establishes a procedure under which the secured party can be required to provide information about the secured obligations.\textsuperscript{109} In order to respond to an inquiry under section 9-208, a floating secured party would need to have information about the obligations owed to the other person or be in a position to obtain that information.\textsuperscript{110} If there is no relationship between them, it is unlikely that the secured party would either have the necessary information or be in a position to obtain it.

For these reasons, a floating secured party should not be allowed to hold collateral for the benefit of others with whom it has no relationship based on either status or agreement.

It is interesting to note that the Fifth Circuit's opinion in \textit{Fretz} did not even cite \textit{Industrial Packaging}. \textit{Cushman} was mentioned only

\begin{itemize}
  \item \textsuperscript{104} This case could be distinguished from \textit{Industrial Packaging}, \textit{Cushman}, and \textit{Fretz}. For discussions of these cases, see notes 75-104 and accompanying text \textit{supra}.
  \item \textsuperscript{105} \textit{Restatement (Second) of Contracts} § 137, Comment a (Tent, Drafts Nos. 1-7, 1973).
  \item \textsuperscript{106} See text accompanying notes 59-66 \textit{supra}.
  \item \textsuperscript{107} For a discussion of these cases, see notes 75-104 and accompanying text \textit{supra}.
  \item \textsuperscript{108} U.C.C. § 9-208. For a discussion of this section, see text accompanying notes 121-24 \textit{infra}.
  \item \textsuperscript{109} U.C.C. § 9-208.
  \item \textsuperscript{110} \textit{Id}.
\end{itemize}
in a footnote in which the court observed that it had considered "many cases decided under UCC § 9-402 and other relevant sections and . . . [found] no precedent which would lead . . . [it] to a different result." 111 While the Fretz court might have distinguished Cushman on the formal basis suggested above, a careful examination of Industrial Packaging should have led the Fifth Circuit to a different conclusion in Fretz, particularly in view of its previous adherence to the principle that the court should pursue the Code's objective of uniformity 112 by recognizing the authority of decisions in other jurisdictions. 113 The Fifth Circuit's failure even to mention Industrial Packaging is inexplicable. The court should have been aware of the case because it cited Cushman,114 which relied principally on Industrial Packaging.115 The Fifth Circuit's failure to discuss the available precedents is also regrettable. An explanation of the court's statement that it had found no precedent which would suggest a different result116 might have assisted lawyers who must now attempt to navigate their clients around the Fretz decision. The only hint to the court's rationale appears in the form of a rhetorical question in a footnote: "Prior to assignment [of the subsidiaries' claims to Revlon], how could Revlon have had a lien to secure debt not owed directly to it?" 117 Guided only by this statement, lawyers may be able to prevent the sinking, even in the Fifth Circuit, of security interests now held by secured parties who are also the nominal holders of the secured debt. Those who were originally the nominal holders of secured debt that was subsequently assigned in whole or part to others may also be pro-

111. 565 F.2d at 372 n.19 (citations omitted). The footnote also cited In re Fried Furniture Corp., 293 F. Supp. 92 (E.D.N.Y. 1968), aff'd per curiam, 407 F.2d 360 (2d Cir. 1969), as one of the cases the court had considered. 565 F.2d at 372 n.19. See note 94 supra.
112. U.C.C. § 1-102(2)(e).
113. Silver v. Gulf City Body & Trailer Works, 432 F.2d 992, 993 (5th Cir. 1970). The Fifth Circuit in Silver noted that a lack of interpretative decisions by Alabama state courts on a particular section of the Code, along with "the law's expressed desire for national uniformity in commercial law, propels us to an examination of the decisional law of the other Uniform Commercial Code jurisdictions." Id. One state court has said that Code decisions should be treated as "compelling authority." Needle v. Lasco Indus., Inc., 10 Cal. App. 3d 1105, 1108, 89 Cal. Rptr. 593, 595 (1970).
116. 565 F.2d at 372 n.19.
117. Id. at 374 n.22.
tected. Outside the Fifth Circuit, courts should interpret the Code in accordance with the sounder decisions in *Industrial Packaging* and *Cushman*. These two cases, however, should not be interpreted even outside the Fifth Circuit, as an unrestricted charter for floating secured parties. Some waters should and will remain off limits.

D. Code Limits

If the Fifth Circuit had not sunk the floating secured party in *Fretz*, Revlon would have had priority over the Bank under section 9-312(5)(a),\(^{118}\) since both security interests were perfected by filing, and Revlon filed first.\(^{119}\) The priority of a floating secured party will not be that clear in all cases.

Consider the following hypothetical case. In 1975, a debtor gave a bank a security interest in equipment as collateral for a loan from the bank, and appropriate financing statements naming the bank as secured party were filed. In 1976, the debtor gave a finance company a security interest in the same equipment as collateral for a loan from the finance company, and appropriate financing statements naming the finance company as secured party were filed. In 1977, the debtor obtained a third loan from a wealthy, retired friend whose investments were being managed by the bank's trust department. The 1975 security agreement between the debtor and the bank was amended to provide that the security interest would secure the loan from the debtor's friend as well as the unpaid balance of the loan from the bank. Under the *Industrial Packaging* decision and the priority rule of section 9-312(5)(a), the debtor's friend would have priority over the finance company.\(^{120}\) It is important to consider whether that result could have been reversed if the finance company had required the debtor to use the procedure provided by section 9-208.

Section 9-208(1)\(^{121}\) provides that "[a] debtor may sign a statement indicating what he believes to be the aggregate amount of unpaid indebtedness as of a specified date and may send it to the secured party with a request that the statement be approved or corrected and returned to the debtor."\(^{122}\) Section 9-208(2)\(^{123}\) provides

\(^{118}\) U.C.C. § 9-312(5)(a).  
\(^{119}\) 565 F.2d at 367-69. See U.C.C. § 9-312(5)(a).  
\(^{120}\) For a discussion of *Industrial Packaging*, see text accompanying notes 75-81 supra. See U.C.C. § 9-312(5)(a).  
\(^{121}\) U.C.C. § 9-208(1).  
\(^{122}\) *Id.*  
\(^{123}\) *Id.* § 9-208(2).
that the secured party must comply with that request within two weeks, and that

[i]f the secured party without reasonable excuse fails to comply he
is liable for any loss caused to the debtor thereby; and if the debtor
has properly included in his request a good faith statement of the
obligation or a list of the collateral or both the secured party may
claim a security interest only as shown in the statement against
persons misled by his failure to comply.124

While the bank in the hypothetical would have had no obligation to
respond to a direct inquiry by the finance company, the finance com-
pany could have required, as a condition to making the loan, that the
debtor initiate a section 9-208 inquiry.125

In the hypothetical case above, let us suppose that in 1976 the
debtor sent the bank a correct126 written statement of the amount
which the debtor owed the bank and requested that the statement be
approved or corrected and returned. If the bank had failed to respond
within two weeks, it would be able to “claim a security interest only
as shown in the statement against persons misled by . . . [its] failure
to comply.”127 Alternatively, suppose that the bank made a timely
response to the debtor’s request and approved the debtor’s statement
of the amount due. Although section 9-208 does not explicitly state
the effect of a response by the bank, it could be interpreted as pro-
hibiting the bank from claiming a broader security interest as against
persons misled by the response.128

Under either of these suppositions, however, the finance com-
pany has not been misled concerning the state of affairs which existed
when the bank received the written statement. It has been deceived
only if it were entitled to assume that there would be no subsequent
addition to the secured debt owed to the bank. Section 9-208 does
not by its terms limit the bank’s priority as against the finance com-
pany to the state of affairs which existed when the bank received the

124. Id.
125. See id. § 9-208, Comment 2. See also First Nat’l Bank & Trust Co. v. Atlas Credit
Corp., 417 F.2d 1081, 1085 (10th Cir. 1969) (where bank filed financing statement covering
future advances, credit company permitted itself to be defrauded by failing to exercise the
opportunity to request information from bank before advancing money on same collateral).
126. If the debtor had understated the amount, § 9-208 would have had no effect on the
secured party’s rights against third parties unless the debtor’s understatement was made in good
faith. See 1 G. GILMORE, supra note 5, § 15.3, at 474-75.
127. U.C.C. § 9-208(2).
128. See id.
written statement. Moreover, nothing in section 9-312(5) warrants imposing such a qualification on the first to file rule of priority.

The stated purpose of section 9-208 is to complement the Code's system of notice filing by providing a procedure under which the secured party can be required "to disclose the complete state of affairs" for the benefit of the debtor and "subsequent creditors and purchasers." Unfortunately, the procedure provides more questions than answers. A secured party may not be able to determine whether any person has been misled by the secured party's response, or failure to respond, to the debtor's request under section 9-208. The debtor is not required to state the purpose of the request or to inform the secured party if its response is disclosed to a third party. It is also unclear whether a trustee in bankruptcy would be able to assert the rights of a hypothetical creditor who might have been misled. Whether a secured party must disclose that the security agreement contains a provision for future advances is also unresolved. Moreover, the effect of the secured party's overstatement of the debt is not explained. The Code's failure to furnish answers to any of these questions exposes section 9-208 as a severely defective provision. One may suspect that it was casually conceived and issued without the contemplation necessary to give it an effective form.

If the use of section 9-208 creates circumstances in which common law estoppel would apply, it may be appropriate to limit a secured party's priority. Otherwise, section 9-208 should not be treated as a qualification of the clearly stated priority rules of section 9-312.

129. Id. § 9-208.
130. Id. § 9-312(5).
131. Id.
132. Id. § 9-402, Comment 2.
133. Id. § 9-208, Comment 2.
134. Id. § 9-208(1).
135. One commentator has asserted that the "existence of such clause need not be revealed" in a response to a § 9-208 request. 5A BENDER'S UNIFORM COMMERCIAL CODE SERVICE, FORMS AND PROCEDURES UNDER THE UNIFORM COMMERCIAL CODE § 92.59, at 9-152.2 (1974).
136. Cf. United States v. Cleaners & Farmers Coop. Elevator Co., 314 F. Supp. 1148, 1151 (N.D. Ind. 1970) (where county supervisor had informed manager of elevator company that government had no lien on certain goods, government was estopped from asserting security interest in those goods, even though it had previously perfected its security interest in them); Ayers v. Yancey Bros., 141 Ga. App. 358, 361-62, 233 S.E.2d 471, 473-74 (1977) (trial court must make finding of fact concerning defendant's contention that the secured party had verified figures without any reference to the balance the secured party subsequently claimed it was owed).
137. One commentator has suggested that § 9-208 "may be construed to exist completely outside the priority rules." Cohen, The Future Advance Interest Under the Uniform Commer-
One other possible limitation under the Code can be considered by supposing that in the hypothetical case an unsecured creditor obtained a judgment lien on the debtor's equipment before the debtor obtained the third loan from his friend. Section 9-301(4)\textsuperscript{138} provides:

\begin{quote}
(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.\textsuperscript{139}
\end{quote}

If the friend's loan were made more than forty-five days after the lien arose and after the bank and the friend learned about it, the lien creditor would have priority under section 9-301(4). The result should be the same if either the bank or the friend knew about the lien, since the knowledge of one should be attributed to the other.\textsuperscript{140}

\section*{E. Bankruptcy Limits}

A new bankruptcy law, the Bankruptcy Reform Act of 1978, (Bankruptcy Reform Act)\textsuperscript{141} became generally effective on October 1, 1979.\textsuperscript{142} It superseded the Bankruptcy Act,\textsuperscript{143} which had been

\textsuperscript{138} U.C.C. § 9-301(4).
\textsuperscript{139} Id.
\textsuperscript{140} Section 9-301(4) was added when the 1972 Official Text was promulgated. Under the 1962 text of the Code, the priority of the lien creditor in the hypothetical case would depend on whether the bank is considered to have a single security interest covering the friend's loan and the bank's loan or a separate security interest for each. U.C.C. § 9-301 (1962 version). See notes 376-82 and accompanying text infra. Since the loans were made by different persons, the bank should be viewed as having two separate security interests, in which case the lien creditor would have the same priority under both the 1962 and 1972 text of the Code.
\textsuperscript{142} Bankruptcy Reform Act of 1978, § 402(a), Pub. L. No. 95-598, 92 Stat. 2682.
amended many times since its enactment. This article will consider the impact of the Bankruptcy Reform Act on floating parties and floating debt, using the Bankruptcy Act and decisions under it for guidance and illustration and, in some situations, for contrast.

The Fifth Circuit's discussion of the bankruptcy law in the Fretz case, however, is not helpful in this connection.\(^{144}\) Since the court proceeded from the premise that "the Revlon affiliates did not acquire a perfected security interest in the collateral when the Fretz-Revlon financing statement was filed,"\(^ {145}\) its discussion of bankruptcy law was directed only toward the "floating debt" problem raised by the security agreement's provision concerning debt which Revlon might later acquire by assignment.\(^ {146}\)

The First Circuit, on the other hand, analyzed the possible bankruptcy problems in the Cushman case,\(^ {147}\) with the expert assistance of Professor Vern Countryman, who represented the trustee in bankruptcy.\(^ {148}\) The court considered two lines of argument advanced by the trustee.\(^ {149}\)

The first theory was that the security interests were voidable under the so-called "strong arm" provision, which gives a trustee the status of a hypothetical lien creditor,\(^ {150}\) because the financing statement had the effect of "concealing a preference."\(^ {151}\) That reference cannot be understood without elaborating upon the earlier statement of the facts in Cushman.\(^ {152}\) Security interests which Cushman had given to Bakers Management were perfected more than four months before bankruptcy by the filing of financing statements naming Bakers Management as secured party.\(^ {153}\) Those security interests secured a loan made by Bakers Management as intermediary for its affiliate, Seaboard.\(^ {154}\) Upon receiving Bakers Management's $75,000 check for the loan proceeds, Cushman immediately gave Seaboard a check for $73,961.67 as payment for flour which Seaboard had earlier sold.

\(^{144}\) 565 F.2d at 374-75. See text accompanying notes 35-38 supra.

\(^{145}\) 565 F.2d at 374.

\(^{146}\) See text accompanying note 487 infra.

\(^{147}\) 526 F.2d at 30-37. For a discussion of Cushman, see notes 82-90 and accompanying text supra.

\(^{148}\) 526 F.2d at 25.

\(^{149}\) Id. at 27-34.


\(^{151}\) 526 F.2d at 30 (emphasis supplied by the court).

\(^{152}\) See text accompanying notes 82-90 supra.

\(^{153}\) 526 F.2d at 26-27.

\(^{154}\) Id. at 25-26.
to Cushman. This payment would have been a voidable preference under section 60a of the Bankruptcy Act if a bankruptcy petition had been filed against Cushman within the next four months.

The trustee maintained that the filing of financing statements disclosing that Seaboard had an interest in the secured transaction would have led other creditors to investigate Cushman's financial situation, discover its insolvency, and file a bankruptcy petition in time to void the transaction as a preference. The Cushman court observed that state law, not the bankruptcy law, governed the perfection requirements. Since the security interests were perfected under state law, they were valid even against a hypothetical lien creditor and therefore were not vulnerable to the trustee's strong arm powers.

The trustee's second line of reasoning was that the security interests were invalid under section 67d(2)(d) of the Bankruptcy Act, which made a transfer fraudulent if made "with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors." In accepting that argument, the bankruptcy judge stated that it was not necessary to consider whether Cushman had actual fraudulent intent. Instead, he relied on the intent of Seaboard, whose unique position gave it the power to control the disposition of Cushman's property. The First Circuit affirmed the district court's reversal, however, on the ground that "Seaboard clearly did not have such domination or control over Cushman as to dispense with the necessity of proving that Cushman actually intended to hinder, delay, or defraud its creditors."

The trustee had also relied on a line of cases holding that the failure to record a mortgage constitutes fraudulent intent. The
First Circuit easily distinguished those cases, reasoning that the failure to record a mortgage enables the mortgagor to obtain further credit on the basis of apparently unencumbered ownership of property and that the filing of financing statements naming Bakers Management as secured party had prevented that result in the Cushman case. Moreover, the First Circuit noted that "the bankrupt's use of a nominee as mortgagee has been held not to be even a badge of fraud."Having concluded that the Cushman transactions under consideration did not transgress any provision of the Bankruptcy Act, the First Circuit addressed the apparent frustrations of the bankruptcy judge, and perhaps counsel for the trustee, who must have recognized that the transactions were not literally proscribed by any provision of the Bankruptcy Act:

Although, as the district court noted, it may be wiser and more progressive public policy to require full disclosure of poten-tially preferential secured transactions, neither the Maine UCC nor the Federal Bankruptcy Act can be interpreted as adopting such a policy. Any changes in these laws is a function for legislation. Accordingly, the district court's decision that the secured transactions were properly perfected and not fraudulent is affirmed.

The First Circuit also noted that "[a] rule requiring the disclosure of potentially preferential secured transactions would present problems of its own." The identification of all persons having an interest in a secured transaction would not necessarily disclose a preference, since there is no public record of a debtor's payment of antecedent debt.

Moreover, potential preferences that do not involve secured transactions would not be affected by a rule relating only to secured transactions. It would be difficult to rationalize a rule which requires the disclosure of potential preferences only when they are related to secured transactions. There is no inherent difference in impact, and it is unlikely that a survey of bankruptcy cases would establish that preferences involving secured transactions are either more

168. Id. at 34.
170. 526 F.2d at 34 (footnote omitted).
171. Id. n.12.
172. Id.
173. Id.
numerous or greater in amount than those which involve simple payments to creditors.

One must consider whether a rule requiring the disclosure of potential preferences should be extended to cases of simple payments to creditors. It must also be determined whether public disclosure of all payments on account of antecedent debt should be required. If not, one must then determine the circumstances under which disclosure should be required. The answers to these questions appear obvious when one contemplates the enormous burden which would be imposed on creditors who attempted to comply with any such requirement. Creditors who chose to ignore it presumably would be left without the benefit of the temporal limitation on their exposure to the risk of having to return payments as preferences. These equally undesirable alternatives would probably lead to an increase in demands for payment on delivery. Such a development would not be welcomed by businessmen, each of whom is a creditor on some occasions, but a debtor on others. For these reasons, concern about concealed preferences is not a good starting point for an attack against floating secured parties.

Alternatively, the security interest in Cushman might have been set aside as a fraudulent transfer under section 67d(3) of the Bankruptcy Act if a bankruptcy petition had been filed within four months. That section makes a transfer fraudulent if: 1) it was made within four months before the filing of a petition initiating a bankruptcy proceeding; 2) the transferor was then insolvent or was thereby rendered insolvent; 3) the transferor was then contemplating the filing of a petition initiating a bankruptcy proceeding or contemplating liquidation of all or the greater portion of the transferor’s property; 4) the transferor intended to use the consideration obtained for the transfer to enable any creditor of the transferor to obtain a greater percentage of his debt than some other creditor of the same class; and 5) the transferee knew or believed, at the time of the transfer, that the transferor intended to make such use of the consideration.

The security interests in Cushman were not vulnerable under either section 67d(2)(a) of the Bankruptcy Act, because the loan by Bakers Management constituted fair consideration, or section 67d(2)(d), because the trustee failed to prove actual intent to hinder, delay, or defraud creditors. If the transaction had occurred within four months before bankruptcy, however, neither the giving of fair consideration by Bakers Management nor the trustee’s inability to prove actual fraudulent intent would have prevented the security interests from being set aside pursuant to section 67d(3).

The bankruptcy judge found that Cushman intended to pay the loan proceeds to Seaboard on account of antecedent indebtedness, that Bakers Management knew of that intention, and that Cushman was insolvent. If bankruptcy had occurred within four months, the only question under section 67d(3) would have been whether Cushman was contemplating bankruptcy. In that connection, the trustee probably would have been aided by inferences arising from objective facts to establish the necessary intent. As one author has noted:

It may of course be argued that if a debtor intends to enable one creditor to obtain a preferential advantage by virtue of a particular payment, he must be contemplating liquidation rather than continuation and eventual solvency; and that one who knows or believes that the debtor has such an intent must also be cognizant of his contemplation of liquidation. . . . It is at least dubious, however, that a debtor who knows that he is or will become insolvent when he makes a preferential payment to one or more of his creditors, should be permitted to contend that he nevertheless intended no preference because he expected to recover from his financial stringency. Such a contention was, at any rate, of doubtful validity under former § 3a(2), which required an intent to prefer as an element of the second act of bankruptcy.

179. 526 F.2d at 32. Section 67d(2)(a) of the Bankruptcy Act, 11 U.S.C. § 107(d)(2)(a) (1976), deems fraudulent as to creditors “every obligation incurred by a debtor within one year prior to the filing of a [bankruptcy] petition” if the obligation is “incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent.” Id.
180. 526 F.2d at 34. See note 162 and accompanying text supra.
181. For a discussion of this section, see notes 175-77 and accompanying text supra. See Steel Structures, Inc. v. Star Mfg. Co., 466 F.2d 207, 213 (6th Cir. 1972). The Steel Structures court observed that “under Sec. 67d(3) of the Bankruptcy Act, a finding of ‘fraudulent intent’ is not required, nor is the question of ‘fair consideration’ or ‘good faith’ involved.” Id.
184. 4 W. COLLIER, supra note 176, ¶ 67.38, at 554 n.28b. (citations omitted).
It would not have been necessary for the trustee to prove that the payment to Seaboard was itself voidable under the preference provisions of bankruptcy law. Accordingly, knowledge or belief on the part of Seaboard or Bakers Management as to Cushman's insolvency would not have been relevant.

There is also another significant difference between the preference and fraudulent transfer provisions of bankruptcy law. For purposes of the preference provisions, a transfer of personal property is deemed to have been made at the time it became perfected as against lien creditors. For purposes of the fraudulent transfer provisions, a transfer is deemed to have been made at the time it became perfected as against bona fide purchasers.

Article 9 of the Code does not use the term "bona fide purchaser." Article 2 on sales refers to a "good faith purchaser for value." Although the Code does not define that term as a whole, a definition can be constructed from the separate definitions of its parts. Article 9 does use the term "buyer in ordinary course of business," which is defined by section 1-201(9) as follows:

"Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. . . . "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving


186. See In re Cesari, 217 F.2d 424, 426-28 (7th Cir. 1954) (knowledge of bankrupt's insolvency not considered in determining the voidability of a transfer under § 67d(3) of the Bankruptcy Act).


189. U.C.C. art. 2.

190. Id. § 2-403(1).

191. See id. § 1-201(19) ("good faith"); id. § 1-201(33) ("purchaser"); id. § 1-201(44)(b) ("value").

192. For an example of the use of "buyer in ordinary course of business" in article 9, see id. § 9-301(1)(c).

193. Id. § 1-201(9).
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. 194

Under section 9-307, 195 a buyer in ordinary course of business 196 "takes free of a security interest . . . even though the buyer knows of its existence" and even though it is perfected. 197

Since section 1-201(9) requires a purchase from "persons in the business of selling goods of that kind," 198 the buyer in ordinary course of business clearly is not as broad a concept as the good faith purchaser. 199 On the other hand, "bona fide purchaser," as used in bankruptcy law, should be interpreted as including the narrower term "buyer in ordinary course of business."

As a result of the fact that a security interest in goods held by a debtor in the business of selling such goods, i.e., inventory, 200 can never be perfected against a buyer in ordinary course of business, 201 it is not so perfected as of the date on which a bankruptcy petition is filed against the debtor. Under the fraudulent transfer provisions of bankruptcy law, the transfer is therefore deemed to have been made immediately before the filing of the petition. 202 Consequently, a security interest in inventory would always be vulnerable to a challenge under section 67d(3) of the Bankruptcy Act, even if financing statements were filed more than four months before bankruptcy. 203

194. Id.
195. Id. § 9-307.
196. Id. § 9-307(1). A buyer of farm products from a person engaged in farming operations is expressly excepted. Id.
197. Id. See id. § 9-307, Comment 1.
198. Id. § 1-201(9).
200. Section 9-109(4) defines "inventory" as goods "held by a person who holds them for sale or lease or to be furnished under contracts of service." U.C.C. § 9-109(4).
201. Id. § 9-307(1). See notes 195-97 and accompanying text supra.
   For the purposes of this subdivision, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, but, if such transfer is not so perfected prior to the filing of the petition initiating a proceeding under this title, it shall be deemed to have been made immediately before the filing of such petition.
203. See notes 175-77 and accompanying text supra. The security interests in Cushman would have been subject to challenge on these grounds if the collateral had consisted of inven-
Although the Bankruptcy Reform Act contains no precise counterpart to section 67d(3) of the Bankruptcy Act, in many cases a transaction formerly voidable under that section will continue to be voidable\textsuperscript{204} under the principle of \textit{Dean v. Davis}\.\textsuperscript{205} In that case, the United States Supreme Court stated:

Making a mortgage to secure an advance with which the insolvent debtor intends to pay a preexisting debt does not necessarily imply an intent to hinder, delay or defraud creditors. The mortgage may be made in the expectation that thereby the debtor will extricate himself from a particular difficulty and be enabled to promote the interest of all other creditors by continuing his business. The lender who makes an advance for that purpose with full knowledge of the facts may be acting in perfect "good faith." But where the advance is made to enable the debtor to make a preferential payment with bankruptcy in contemplation, the transaction presents an element upon which fraud may be predicated. The fact that the money advanced is actually used to pay a debt does not necessarily establish good faith. It is a question of fact in each case what the intent was with which the loan was sought and made.\textsuperscript{206}

Despite the fact that section 67d(3) of the Bankruptcy Act was based on \textit{Dean}, the statutory language went beyond the facts of that case and has been criticized for interfering with legitimate business transactions.\textsuperscript{207} One probable effect of eliminating section 67d(3) will be a reversion to the standards of \textit{Dean}, thus increasing the trustee's burden of proof. The trustee will no longer be able to show merely that the transferor himself contemplated liquidation,\textsuperscript{208} but will need to demonstrate that the parties shared a common purpose.\textsuperscript{209}
will the trustee any longer be able to rely on inferences arising from objective facts in order to establish the necessary intent, but will now probably be required to establish a subjective intent approaching "actual fraud," and a transaction may be upheld if it was made in good faith with the reasonable expectation that the debtor would thereby regain solvency.

Another possible basis for an attack on a floating secured party by a bankruptcy trustee can be illustrated by the following hypothetical case. In 1975, a debtor gave a bank a security interest in the debtor's accounts as collateral for a loan from the bank, and appropriate financing statements naming the bank as secured party were filed. In 1976, the debtor, owing a substantial amount for raw materials which it had purchased on open account, agreed to secure that debt by a second security interest in its accounts. The second security interest was given to the bank as trustee for the finance company, however, and no new financing statements were filed. Two months later, a bankruptcy petition was filed against the debtor. Despite the fact that the second security interest was perfected by a financing statement filed more than ninety days before bankruptcy, it may be vulnerable to an attack under section 547 of the Bankruptcy Reform Act on the theory that the transfer resulting from the second security interest was made within ninety days before bankruptcy.

Under section 547(e), a transfer of personal property is deemed to have been perfected and made when no subsequent lien on such property could become superior to the rights of the transferee. The usual question under this section is whether a security interest has been perfected, by filing or otherwise, more than ninety days before bankruptcy, but that is not the only possible question. Filing the usual form of financing statement is not sufficient to create an enforceable security interest.

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210. See text accompanying notes 182-84 supra.
212. Prior to the Bankruptcy Act, courts required "actual fraud" to invoke the rule of Dean. See, e.g., Rittenberg v. Kaplan, 12 F.2d 95, 95 (S.D.N.Y. 1925); Stone v. Allied Clothing Corp., 140 N.J. Eq. 224, 236, 54 A.2d 625, 633 (Ch. 1947). See also Corker, supra note 206, at 208.
215. See id.
217. Id.
Section 9-203(1) provides that "a security interest is not enforceable against the debtor or third parties" unless, *inter alia*, "the debtor has signed a security agreement." 219 In the hypothetical case stated above, the debtor signed two security agreements, one securing the debt to the bank and the other securing the debt to the finance company. Although it might be argued that the first agreement satisfied the literal requirement of section 9-203(1) that "a security agreement" has been signed, the first agreement provided no security for the debt to the finance company and would not have been enforceable for that purpose. With regard to the security interest for the debt to the finance company, section 9-203(1) should therefore be interpreted as referring to the second security agreement. Since that security agreement was signed by the debtor within four months before bankruptcy, the security interest can be avoided as a preference if the trustee in bankruptcy can prove the other elements of a preference. 220 This analysis of the interaction between the Code and bankruptcy law's preference provisions is not, as it may first appear, in conflict with the decisions upholding the floating lien. 221 In those cases, the secured parties' claims were based on security agreements signed before the preference period began.

As a practical matter, the preference provisions and the principle of *Dean* provide a bankruptcy trustee with an effective means to sink most floating secured parties who threaten to interfere with the equitable administration of bankruptcy estates. Those who do not pose such a threat should be left beyond range of the trustee's artillery.

III. FLOATING DEBT

In prior discussions of the *Fretz* case, 222 Revlon was viewed as a floating secured party, the holder of a security interest securing a debt owed to another person. In this part of the article, Revlon will be viewed as the holder of a security interest securing floating debt, claims which it acquired after the execution of a security agreement that expressly secured all debts "now existing or hereafter arising, including without limitation any debt, liability or obligation owing

220. The required knowledge or belief as to the debtor's insolvency could be that of either the finance company or the bank as its agent. See 3 W. COLLIER, *supra* note 176, ¶ 60.55, at 1084-89.
221. See cases cited note 4 *supra*.
222. See notes 15-38 & 100-03 and accompanying text *supra*.
from Debtor . . . to others which REVLON, INC. . . . may have obtained by assignment or otherwise.” 223

Although the Fifth Circuit in Fretz noted that section 9-204 of the Code 224 “clearly contemplates and sanctions . . . floating debt (future advances),” 225 it did not consider whether Revlon’s claims might have been upheld under that section.

A. Pre-Code Decisions

Professor Gilmore has observed that decisions under the common law and chattel mortgage statutes exhibited “an anxious undertone of distrust” about security arrangements covering future advances, although the arrangements were generally upheld. 226 Moreover, he noted that “thunderings of judicial wrath” were often provoked by mortgages containing “dragnet” provisions. 227 The term “dragnet” is used to describe a clause which provides that the collateral is to serve as security for all indebtedness of any sort which the debtor may owe to the secured party at the time the agreement is executed or at any time thereafter. 228

Some courts have restricted the effectiveness of such provisions in real estate as well as chattel mortgages by applying a rule of construction which the United States District Court for the Eastern District of Arkansas stated as follows:

The “other indebtedness” secured by a mortgage may be either antecedent or subsequent. Where it is antecedent, it must be identified in clear terms, and where it is subsequent, it must be of the same class as the primary obligation secured by the instrument and so related to it that the consent of the debtor to its inclusion may be inferred. 229

Gilmore has quoted that statement with approval, referred to it as a “rule of reason and good faith,” and pronounced it “a fair summary of

223. In re E.A. Fretz Co., 565 F.2d 366, 368 n.2 (5th Cir. 1978) (emphasis omitted).
224. U.C.C. § 9-204.
225. 565 F.2d at 369.
226. 2 G. GILMORE, supra note 5, § 35.1, at 917.
227. Id.
228. Id., § 35.2, at 917-18. The typical dragnet case about which the courts are concerned involves a mortgage given to secure a small claim on the debtor’s property. Id. at 918. The mortgagee later extends additional credit which is covered by the dragnet clause. Id. In other cases, the mortgagee subsequently purchases, probably at a discount, the mortgagor’s other debts and adds them to the mortgage debt by use of the dragnet clause. Id.
general, as well as Arkansas, law." 230 A more thorough examination of the cases 231 demonstrates that Gilmore overstated matters.

In the first place, he failed to mention that several appellate courts had rejected the proposition, 232 sometimes called the "relatedness rule," that subsequent debt is not secured unless it is "of the same class as the primary obligation." 233 Second the decisionmaking technique used in the dragnet cases is not worthy of Gilmore's praise. Courts applying the relatedness rule professed to be ascertaining the intention of the parties to the mortgage. 234 The application of the rule, however, frequently produced a result which defied evidence of the parties' intention, including the specific language in which the intention was expressed. Such decisions provoked one commentator to observe "that the courts may employ a great deal of judicial discretion when professing to 'find the intention'" of the parties. 235

An illustrative case is National Bank v. Blankenship, 236 the decision which produced the statement applauded by Gilmore. 237 In Blankenship, a borrower had given a bank three separate deeds of trust, 238 each of which secured a different primary debt evidenced by a specifically described note. 239 One deed of trust provided that it also secured "any and all other indebtedness now or hereafter owing by . . . [the borrower to the bank] whether evidenced by note, account, endorsement or otherwise." 240 The others contained similar dragnet provisions. 241 The United States District Court for the Eastern District of Arkansas had to decide whether each deed of trust secured not only the note specifically described therein, but also the notes specifically described in the other two deeds and nine other

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230. 2 G. GILMORE, supra note 5, § 35.3, at 920-21.
231. For a collection of many of the cases, see Annot., 172 A.L.R. 1079 (1948).
233. See text accompanying note 229 supra.
237. See text accompanying note 230 supra.
238. 177 F. Supp. at 669-71.
239. Id.
240. Id. at 670.
241. Id. at 669-70.
notes evidencing loans to the borrower by the bank.\textsuperscript{242} The bank's witnesses testified that the loans had all been made for the purpose of promoting the borrower's general welfare, and the borrower testified that he understood that each piece of his property was security for everything which he owed the bank.\textsuperscript{243} Despite the testimony and the comprehensive language of the dragnet provisions, the court held that each deed of trust secured only the note specifically described therein.\textsuperscript{244} It is evident that the court was not ascertaining the intention of the parties, but for reasons of policy was resorting to a "unique interpretation"\textsuperscript{245} of the dragnet provisions in order to limit them.

The judicial hostility to dragnet provisions clearly reflected a suspicion that such provisions frequently were imposed on an unsuspecting debtor whose apparent assent was vitiated by his lack of actual awareness or understanding of the provision or by his disparate bargaining power.\textsuperscript{246} In other words, many of the dragnet decisions were early attempts to deal with what are now labeled contracts of adhesion or unconscionable contracts.\textsuperscript{247}

Although such decisions were based on sound intuition and motivated by laudable purposes, the courts almost never used candid analysis, relying instead on such covert tools\textsuperscript{248} as rules of construction.\textsuperscript{249} This usage of rules of construction to interfere with apparent agreements has been described by Professor Karl Llewellyn as follows:

\begin{itemize}
  \item \textsuperscript{242} Id. at 669.
  \item \textsuperscript{243} Id. at 674-75.
  \item \textsuperscript{244} Id. at 674.
  \item \textsuperscript{245} See Note, Unconscionable Contracts Under the Uniform Commercial Code, 109 U. PA. L. REV. 401, 409 (1961) (warranty disclaimer provisions subjected to "unique interpretation" in order to limit them).
\end{itemize}
Hence in the main we have our interference case by case. And in the main it moves by way of "construing" the particular language in question not to have intended the result it did intend. Life insurance is perhaps the classic instance. This procedure saves the lesser bargainor for the moment, and salves the court's conscience both as to justice and as to policy. Yet a specious salving. Such "construction" kills security in transactions, if "security" means predictability of actions at law. No man is safe when language is to be read in the teeth of its intent. 250

This process has produced varying results in the dragnet cases, as is illustrated by a series of Texas decisions.

The first Texas case, Freiberg, Kline & Co. v. Magale, 251 was decided in 1888. In Freiberg, a debtor executed a chattel mortgage to secure a specific debt arising from a sale of goods by the mortgagor, but the mortgage also contained a dragnet provision. 252 Thereafter, the mortgagee guaranteed a debt which the mortgagor owed to another creditor. 253 The mortgagee subsequently acquired the other creditor's claim against the mortgagor. 254 The Supreme Court of Texas held that the acquired debt was secured by the mortgage, stating:

The present mortgage provides for the securing of future indebtedness. We do not think that the character of this indebtedness was limited. It was contemplated that debts should accrue by reason of the sale of goods, but not from this cause alone. The mortgage expressly provides that indebtedness of any kind shall be secured by it. It then, to place the matter beyond doubt, provides for debts to accrue in any other manner than had been already stated. 255

When Wood v. Parker Square State Bank 256 reached the Texas Court of Civil Appeals in 1965, the court relied on Freiberg as a statement of the "recognized" Texas rule and held that a mortgage with a dragnet provision secured a claim against the mortgagor which the mortgagee subsequently acquired from another creditor. 257

251. 70 Tex. 116, 7 S.W. 684 (1888).
252. Id. at 117, 7 S.W. at 685.
253. Id.
254. Id.
255. Id. at 119, 7 S.W. at 686.
257. 390 S.W.2d at 836.
During the same year, however, the Texas Supreme Court changed course in *Moss v. Hipp*. In that case, Falls obtained an unsecured loan from Hipp and used the proceeds to make a down payment on a tractor. Falls then borrowed the balance of the purchase price from a bank. The bank's loan was evidenced by Falls' note, which Hipp guaranteed. Falls also gave the bank a chattel mortgage on the tractor as security for the bank's loan and "any other indebtedness then or thereafter owing to the holder of the note." When Falls later defaulted on his note to the bank, Hipp purchased that note and the chattel mortgage from the bank. Hipp then claimed that the chattel mortgage also secured the loan which he had made directly to Falls. At trial, Falls testified that Hipp and he had orally agreed that Hipp would pay the bank and that the tractor would secure all of Falls' indebtedness to Hipp. The trial court considered Falls' testimony inconclusive, holding that the mortgage did not secure Hipp's loan to Falls. The court of civil appeals reversed, but it was in turn reversed by the Texas Supreme Court, which reasoned that dragnet provisions "apply only to indebtedness which was reasonably within the contemplation of the parties to the mortgage at the time it was made." The court thus maintained that the trial court's holding should not have been overturned.

In the following year, *Wood v. Parker Square State Bank* was appealed to the Texas Supreme Court, and the decision of the court of civil appeals that the mortgage secured a claim against the mortgagor which the mortgagee subsequently acquired was reversed. The supreme court cited *Moss* and distinguished *Freiberg* on the ground that the other debt in that case had been guaranteed by the mortgagee who later acquired it.

258. 387 S.W.2d 656 (Tex. 1965).
259. Id. at 657.
260. Id.
261. Id.
262. Id.
263. Id.
264. Id.
265. Id. at 658 n.1.
266. Id. at 659-60.
268. 387 S.W.2d at 658 (citations omitted).
269. Id. at 660.
270. 400 S.W.2d 898 (Tex. 1966).
271. Id. at 902. See text accompanying note 257 *supra*.
272. 400 S.W.2d at 901.
273. Id. at 900.
The court of civil appeals followed the supreme court’s analysis in a 1967 decision, *Finger Furniture Co. v. Chase Manhattan Bank*, which involved a chattel mortgage securing a specific debt and “any other indebtedness for which any mortgagor herein may be or hereafter becomes liable to mortgagee.” Citing *Moss*, the court held that the dragnet provision did not secure an otherwise unmentioned debt which the mortgagor owed to the mortgagee at the time the mortgage was executed.

Three years later, the Texas Supreme Court changed course again in *Estes v. Republic National Bank*. The issue before the court was the extent to which a series of notes was covered by a deed of trust securing a specific note and “all other indebtedness, of whatever kind or character, owing or which may hereafter become owing” by the debtor to the creditor. Some of the notes were already outstanding when the deed of trust was executed, and some were issued subsequently. The *Estes* court held that all were secured by the deed of trust and that parol evidence was not admissible for the purpose of restricting the broad terms of the dragnet provision. The supreme court’s earlier decision in *Wood* was never mentioned.

Despite the labyrinthine course taken by the Texas Supreme Court, it is possible to reconcile the Texas decisions. It is apparent that a dragnet provision will be held to cover other debt arising directly from transactions between the debtor and the original secured party, whether the other debt arose before or after the creation of the security interest. A dragnet provision will not be held to cover other debt arising from a claim which the original secured party acquires from another creditor unless the claim is based on an obli-
gation of the debtor which the secured party has guaranteed. In no case will a dragnet provision cover other debt to an assignee of the original secured party even if the assignee has guaranteed the obligation specifically secured by the security agreement.

While this analysis may represent an accurate statement of Texas law, it is subject to criticism since it consists of a series of almost mechanical rules which bear little relation to the language of the instruments to which they apply or the actual intention of the parties to those instruments. Moreover, some of these rules are inconsistent with decisions in other jurisdictions.


Section 9-204(3) of the Code provides: "Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (subsection (1) of Section 9-105)." The intent of this section is explained in a comment as follows:

Under subsection (3) collateral may secure future as well as present advances when the security agreement so provides. At common law and under chattel mortgage statutes there seems to have been a vaguely articulated prejudice against future advance agreements comparable to the prejudice against after-acquired property interests. Although only a very few jurisdictions went to the length of invalidating interests claimed by virtue of future advances, judicial limitations severely restricted the usefulness of such arrangements. A common limitation was that an interest claimed in collateral existing at the time the security transaction was entered into for advances made thereafter was good only to the extent that the original security agreement specified the amount of such later advances and even the times at which they should be made. In line with the policy of this Article toward after-acquired property interests this subsection validates the future advance interest, provided only that the obligation be covered by the security agreement.

285. See Price v. Williams, 179 Ark. 12, 18-19, 13 S.W.2d 822, 824 (1929) (dragnet provision covers other debt to assignee of mortgage); First Nat'l Bank v. Byard, 26 N.J. Eq. 255, 256-57 (Ch. 1875) (dragnet provision covers other debt acquired by mortgagee); Strong Hardware Co. v. Gonyow, 105 Vt. 415, 419-20, 168 A. 547, 548 (1933) (dragnet provision covers other debt to assignee of mortgage which arose after assignment but not other debt previously acquired by assignee).
286. U.C.C. § 9-204(3).
287. Id. § 9-204, Comment 5.
This comment is in accord with Professor Gilmore's description of the hostility with which courts dealt with future advance agreements under the common law and chattel mortgage statutes, and it clearly indicates that section 9-204(3) was intended to eliminate pre-Code limitations "provided . . . that the obligation be covered by the security agreement." The only requirement is that the security agreement must adequately describe the obligations, including "future advances or other value," which are intended to be secured. Whether or not that requirement has been satisfied should be determined by reading and interpreting the security agreement.

To that extent, the Code's approach is consistent with that used in the pre-Code cases in which the courts purported to look for the intention of the parties to mortgages containing dragnet provisions. There is, however, no basis in the text of or comments to section 9-204(3) for assuming that the Code was intended to perpetuate any of the arbitrary rules which some courts applied in the pre-Code cases. It is surprising, therefore, to find Gilmore asserting that arbitrary limits can be read into section 9-204(3). A full quotation of his assertion is appropriate in view of its impact on the judicial treatment of section 9-204(3):

However "covered by the security agreement" is to be read, § 9-204(5) should certainly not be taken to overrule the so-called "dragnet" cases under pre-Code law. Legitimate future advance arrangements are validated under the Code, as indeed they generally were under pre-Code law. This useful device can, however, be abused; it is abused when a lender, relying on a broadly drafted clause, seeks to bring within the shelter of his security arrangement claims against the debtor which are unrelated to the course of financing that was contemplated by the parties. In the dragnet cases, the courts have regularly curbed such abuses: no matter how the clause is drafted, the future advances, to be covered, must "be of the same class as the primary obligation . . . and so related to it that the consent of the debtor to its inclusion may be inferred." The same tests of "similarity" and "relatedness," vague but useful, should be applied to § 9-204(5).

As under pre-Code law, the secured party must assume that there is a limiting point which all the drafting skill in the world

288. See text accompanying note 227 supra.
289. U.C.C. § 9-204, Comment 5.
290. Id. § 9-204(3). For a discussion of what is meant by advances, see notes 398-407 and accompanying text infra.
291. See notes 226-85 and accompanying text infra.
292. See 2 G. GILMORE, supra note 5, § 35.5, at 932.
will not overpass. The courts will disallow, as they have in the past, outrageous claims.293

Gilmore's view raises problems under section 1-102,294 the general construction section of the Code, which states that the Code's purposes are to simplify, clarify, modernize, and unify the law.295 As demonstrated in the preceding section of this article, the relatedness rule favored by Gilmore was not uniformly followed under pre-Code law.296 Accordingly, the survival of that rule in jurisdictions which did follow it will to that extent defeat the Code's objective of uniformity.297 In addition, the application of the pre-Code rules of construction frequently defeated the apparent intentions of the parties and produced varying results which are not easily rationalized.298 To the extent that the complex and confusing pre-Code rules are deemed to have survived the adoption of the Code, the law governing secured transactions surely will not have been simplified, clarified, and modernized.

One other section of the Code must be considered, although Gilmore did not cite it in support of his view that the relatedness rule survived the enactment of the Code. Underlying the relatedness test is the fear that a dragnet clause could be used abusively by a creditor.299 With respect to contracts for the sale of goods, this concern is codified in the doctrine of unconscionability, found in section 2-302,300 which provides:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall

293. Id. (footnotes omitted). In the above quotation, Gilmore refers to § 9-204(5) of the 1962 official text of the Code, which is identical to § 9-204(3) of the current text except for the addition of a cross reference added for purposes of clarity.

294. U.C.C. § 1-102.

295. Id.

296. See notes 232 & 233 and accompanying text supra.

297. The relatedness rule has survived under the Code. See, e.g., In re Eshelman, 10 U.C.C. Rep. (Callaghan) 750, 753 (E.D. Pa. 1972); John Miller Supply Co. v. Western State Bank, 55 Wis. 2d 385, 394, 199 N.W.2d 161, 165 (1972). For a discussion of the continued adherence to Gilmore's relatedness doctrine, see notes 308-55 and accompanying text infra.

298. See notes 334-85 and accompanying text supra.

299. See text accompanying note 293 supra.

300. U.C.C. § 2-302.
be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.301

Although that section does not apply to secured transactions,302 several courts have cited it as a source of principles to be used in dealing with unconscionable provisions in security agreements.303 Those principles can thus be utilized to invalidate unconscionable dragnet provisions in appropriate cases.304

The unconscionability policy embodied in section 2-302, however, clearly cannot sustain the relatedness rule. Subsection (2)305 directs a court to consider evidence of "commercial setting, purpose and effect" in determining whether a clause is unconscionable.306 Furthermore, a comment to section 2-302 explicitly rejects the prior practice of using rules of construction to deal with such clauses.307

None of the decisions discussed in the next section of this article cited section 2-302 or the principles which it embodies, and none resulted from the type of explicit determination of unconscionability required by section 2-302.

C. Decisions Under the Code

Although Professor Gilmore believes that the relatedness rule survives the enactment of the Code, several decisions indicate that not all of the courts concur with his conclusion. The first reported case in which the relatedness rule might have been applied to a dragnet provision in a Code security agreement was In re Midas Coin Co.,308 decided in 1967. Without any discussion of the point, the

301. Id.
304. Conversely, one court has held that a security agreement will not be treated as unconscionable if it reflects "a negotiated arm's length business transaction between sophisticated commercial parties." Interstate Security Police, Inc. v. Citizens & S. Emory Bank, 237 Ga. 37, 38, 226 S. E.2d 583, 584 (1976).
305. U.C.C. § 2-302(2).
306. Id.
307. Id. § 2-302, Comment 1.
308. 264 F. Supp. 193 (E.D. Mo. 1967), aff'd per curiam sub nom. Zuke v. St. John's Community Bank, 387 F.2d 118 (8th Cir. 1968). The disputed issue was whether the collateral, a coin collection, was money or goods. 264 F. Supp. at 195. The district court held that it was goods and that the security interest was perfected by possession. Id. at 199.
United States District Court for the Eastern District of Missouri stated that the security agreement covered not only the primary debt, a note, but also an overdraft in the debtor’s bank account with the secured party.\(^{309}\)

In a 1969 decision, *South County Sand & Gravel Co. v. Bituminous Pavers Co.*,\(^ {310}\) the Rhode Island Supreme Court expressly held that a security agreement with a broad dragnet provision covered not only the primary debt, notes, but also the debtor’s liability as an endorser of other notes held by the secured party and its liability for an overdraft in its bank account with the secured party.\(^{311}\) The court did not mention the relatedness rule in its decision. In the same year, however, a bankruptcy referee accepted Gilmore’s view that the relatedness rule remains valid under the Code, but held that the “other debt” in the case before it was sufficiently related to the primary debt to be covered by the dragnet provision in the security agreement.\(^{312}\)

*In re Zwicker*,\(^ {313}\) decided in 1971, also dealt with a claim for overdrafts in a bank account.\(^ {314}\) In that case, a bankruptcy court held that the overdraft claim was covered by the dragnet provision in the security agreement, although the primary debt, a loan, had been paid before the debtor became bankrupt.\(^ {315}\) The court acknowledged that it was “undisputed that the parties did not contemplate at the time the loan was made that overdrafts would take place.”\(^ {316}\) The court did not mention the relatedness rule, relying instead upon the continuing indebtedness of the debtor to the bank.\(^ {317}\)

Professor Gilmore’s views, however, were fully vindicated in two 1972 decisions. In *John Miller Supply Co. v. Western State Bank*,\(^ {318}\) the issue was whether a security agreement covering “all Debtor’s present and future debts, obligations and liabilities to ... [the se-
secured party], of whatever nature” secured the primary debt, a note, and also the debtor’s liability for damages under a contemporaneous contract which gave the secured party an exclusive agency to sell the debtor’s products.\textsuperscript{319} The court cited an earlier decision in which it had “recognized the desirability” of future advance provisions but had also “pointed out that such documents would be closely scrutinized and would be enforced only to the extent that the future transactions or liabilities sought to be secured were in the clear contemplation of the parties.”\textsuperscript{320} The court then quoted extensively from Gilmore’s discussion of dragnet clauses,\textsuperscript{321} mentioned his approval of the relatedness rule, and cited his conclusion “that the same rationale should be applied in the interpretation of transactions arising under the Code.”\textsuperscript{322} Applying those “generally accepted rules,” the court concluded that the debtor’s liability under the agency contract was “not within the clear contemplation and intent of the parties” and “not of the same nature or related to the types of indebtedness involved in the original financing agreement.”\textsuperscript{323} Accordingly, the court held that the liability under the agency contract was not secured.\textsuperscript{324}

In another 1972 decision, \textit{In re Eshelman,}\textsuperscript{325} a security agreement covering an automobile secured the note evidencing the purchase price of the automobile and also “all other liabilities of Debtor to Lender, now existing or hereafter incurred.”\textsuperscript{326} When the debtor became bankrupt, it owed a small balance of the purchase price of the automobile and a larger balance of a note evidencing a loan which it had later obtained from the secured party.\textsuperscript{327} The \textit{Eshelman} court held that the later loan was not secured since it was so unrelated to the first loan “as to negate the inference that the debtor consented to its inclusion.”\textsuperscript{328} Although the court cited Gilmore for the proposition that the relatedness rule survived the enactment of the Code,\textsuperscript{329}

\begin{flushright}
\textsuperscript{319} \textit{Id.} at 388-90, 199 N.W.2d at 162-63.
\textsuperscript{320} \textit{Id.} at 392, 199 N.W.2d at 164, \textit{citing} Capocasa v. First Nat’l Bank, 36 Wis. 2d 714, 154 N.W.2d 271 (1967).
\textsuperscript{321} 55 Wis. 2d at 392-94, 199 N.W.2d at 164-65, \textit{quoting} 2 G. Gilmore, \textit{supra} note 5, \textsection 35.5, at 931-32.
\textsuperscript{322} 55 Wis. 2d at 394, 199 N.W.2d at 165, \textit{citing} 2 G. Gilmore, \textit{supra} note 5, \textsection 35.2, at 920.
\textsuperscript{323} 55 Wis. 2d at 394, 199 N.W.2d at 165.
\textsuperscript{324} \textit{Id.}
\textsuperscript{326} \textit{Id.} at 751.
\textsuperscript{327} \textit{Id.}
\textsuperscript{328} \textit{Id.} at 753.
\textsuperscript{329} \textit{Id.} at 752, \textit{citing} 2 G. Gilmore, \textit{supra} note 5, \textsection 35.5, at 932.
\end{flushright}
the court cited no authority that the rule had ever been followed in Pennsylvania, the state whose law should have been applied to the case. 330

In the same year, however, the United States Court of Appeals for the Second Circuit decided In re Riss Tanning Corp., 331 which held that a dragnet provision in a security agreement for a note and chattel mortgage also covered the debtor's contemporaneous obligation under a real estate mortgage to the secured party. 332 Observing that New York courts had for many years construed such provisions liberally, the Second Circuit stated: "We should neither interpret away the obvious meaning of the words involved nor supply additional meanings to them." 333

The United States Courts of Appeals for the Ninth and Tenth Circuits followed that view in 1973. In re Public Leasing Corp. 334 dealt with a series of agreements, each securing a note for the purchase of a vehicle and "any and all liabilities . . . [of the debtor to the secured party] now existing or hereafter incurred." 335 Applying Oklahoma law, the Tenth Circuit held that each agreement secured all of the notes. 336 Although application of the relatedness rule might have produced the same result, the court did not utilize it, 337 but rather cited a "general rule that where the terms of a contract are clear and unambiguous there is no reason to resort to rules of construction." 338 In In re Iredale's Ltd., 339 the Ninth Circuit reversed a district court decision which had "failed to give effect to the expressed intentions of the parties" when it held that a dragnet provision did not cover an equipment lease. 340

330. See Aquilino v. United States, 363 U.S. 509, 512-13 (1960) (determination of taxpayer's interest in property is governed by state law); In re Cushman Bakery, 526 F.2d 23, 30 (1st Cir. 1975), cert. denied, 425 U.S. 937 (1976) (whether a security interest has been perfected against bankruptcy trustee is exclusively a question of state law); Kenneally v. Standard Elecs. Corp., 364 F.2d 642, 646 (8th Cir. 1966) (state law controls in determining validity of chattel mortgage provision in mortgagor's bankruptcy proceeding).

331. 468 F.2d 1211 (2d Cir. 1972).

332. Id. at 1213.

333. Id. (citation omitted). Because the security agreement unambiguously stated that the chattel secured the note as well as any other obligation "whether now existing or hereafter arising," the court concluded that "the chattel mortgage, by virtue of its 'dragnet' clause, stood as additional security for the then 'existing' obligation of the loan covered by the real estate mortgage. Id.

334. 488 F.2d 1369 (10th Cir. 1973).

335. Id. at 1375.

336. Id. at 1378.

337. The security agreements all concerned the conditional sale of trailers and trucking equipment in the context of a continuing business relationship. Id. at 1374-75.

338. Id. at 1377-78.

339. 476 F.2d 938 (9th Cir. 1973) (per curiam).

340. Id. at 939.
The next three decisions provided further evidence of the conflict concerning dragnet provisions. In one, the court accepted Gilmore's view that the relatedness rule remains valid under the Code, although it held that the "other debt" in the case before it was sufficiently related to the primary debt to be covered by the dragnet provision in the security agreement. In the second, the court did not even mention the relatedness rule in holding that a security agreement covered not only the primary debt, the purchase price of an automobile, but also a debt for the purchase price of an organ. In the third, the court cited the relatedness rule in holding that an agreement securing loans and "any other obligations of the debtor to the secured party" did not cover overdrafts in the debtor's checking account.

The issue reached the United States Court of Appeals for the Fifth Circuit in 1977 in Kimbell Foods, Inc. v. Republic National Bank. The security agreement in that case stated that it secured a note and "all other indebtedness at any time hereafter owing" by the debtor to the secured party. The issue before the court was whether the agreement secured an open account debt for inventory sold by the secured party to the debtor. The district court held that the open account debt was not secured because it was not of the same nature as the primary debt. Citing several of the Texas decisions discussed above, the district court expressed the conviction that a Texas court would reach the same conclusion.

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345. 557 F.2d at 493.
346. Id. at 493-94.
348. 401 F. Supp. at 325, citing Wood v. Parker Square State Bank, 400 S.W.2d 898 (Tex. 1966); Moss v. Hpp, 387 S.W.2d 656 (Tex. 1965); Finger Furniture Co. v. Chase Manhattan Bank, 413 S.W.2d 131 (Tex. Ct. App. 1967). Although the district court did not cite Estes v. Republic Nat'l Bank, 462 S.W.2d 273 (Tex. 1970), the Fifth Circuit cited Estes for the proposition that future advances clauses are valid. 557 F.2d at 495. For an in depth discussion of Texas law regarding future advances clauses, see notes 251-85 and accompanying text supra. The district court also relied on non-Texas law for the proposition that the relatedness rule controlled future advances clauses. 401 F. Supp. at 325, citing 2 G. GILMORE, supra note 5, § 35.5, at 931-33; In re Eshelman, 10 U.C.C. Rep. (Callaghan) 750 (E.D. Pa. 1972); National Bank v.
The Fifth Circuit reversed, stating that the district court had correctly interpreted Texas law but had applied it incorrectly. That characterization of the district court's opinion cannot be taken literally, however, since the Fifth Circuit proceeded to state the Texas rule without any reference to a relatedness test. The court asserted that the rule is simply that in order to be secured, the other debt must have been "reasonably within the contemplation of the parties" and that "a further extension of credit to the debtor by the lender is deemed future indebtedness reasonably contemplated by the parties when they execute a future advance clause." The Fifth Circuit observed that the district court had violated the parol evidence rule by admitting testimony relating to the subjective intention of the parties when they executed the security agreement and that it had compounded that "error by failing to consider the truest test of the parties' intention, the words of the contract clearly providing that the security agreement should cover future indebtedness."

In a very similar case, the Connecticut Superior Court more recently gave full effect to a dragnet provision, reasoning: "The strict construction of the so-called 'dragnet clause' in security agreements may have its proper place in appropriate equity proceedings ... but it clearly should not apply to security interests under the Uniform Commercial Code."

These last two decisions may indicate the demise of the relatedness rule preferred by Gilmore and the wider acceptance of a process of interpretation which is more consistent with the spirit and letter of the Code. It is likely, however, that the ghost of relatedness will survive to compete with the spirit of the Code.

D. Drafting Considerations

Draftsmen of security agreements may be able to hasten the demise of the relatedness rule by following the lesson of a 1972 decision

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349. 557 F.2d at 505.
350. Id. at 495.
351. See id.
352. Id. at 495, quoting Wood v. Parker Square State Bank, 400 S.W.2d 898, 901 (Tex. 1966).
353. 557 F.2d at 495.
354. Id. at 496.
355. Chrysler Credit Corp. v. Community Banking Co., 35 Conn. Supp. 73, 395 A.2d 727, 729 (Super. Ct. 1978) (citation omitted). Chrysler Credit, like Kimbell, concerned the applicability of a future advances clause to an open inventory account after the original indebtedness had been paid. Id. at 727-28.
involving real estate, *In re Dorsey Electric Supply Co.* In that case, the United States District Court for the Eastern District of Arkansas refused to apply Arkansas' firmly entrenched relatedness rule to a deed of trust which expressly provided that it secured all other indebtedness, "whether or not the same shall be similar or dissimilar or related or unrelated to the primary indebtedness." Nonetheless, the abolition of the relatedness rule will not always save the careless draftsman. For example, the omission of any time reference from a dragnet provision may exclude subsequently arising debt from its coverage or at least create an ambiguity which raises an issue of fact. Similar problems would arise if a debtor's liability as an endorser or a surety is claimed to be secured under a dragnet clause which does not mention secondary and contingent liabilities.

### E. Debt Acquired by Assignment

Even the most skilled and careful draftsman may not be able to pilot one kind of floating debt, that acquired by assignment, past a lingering vestige of the relatedness rule. A consideration of this point will bring us back to the *Fretz* case.

In *Kimbell Foods*, the Fifth Circuit noted with approval that "in Texas a future advance clause in a mortgage does not secure a subsequent debt from the debtor to a third party acquired by the mortgagee." This point has since been underscored by *Thorp Sales Corp. v. Dolese Brothers Co.*, which dealt with an installment sale agreement covering vehicles and providing that the vehicles secured not only their purchase price but also "all of Buyer's future debts, obligations and liabilities of whatever nature to Seller or Seller's assignee." The same buyer and a different seller entered into a second installment sale agreement covering other vehicles, and

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357. *Id.* at 1175 (emphasis supplied by the court) (footnote omitted). The court noted that the "same class" rule would have applied if the language of the clause had not been so unambiguous. *Id.*
360. For a discussion of *Kimbell Foods*, see notes 344-54 and accompanying text *supra*.
361. 557 F.2d at 495 (citation omitted). *See also First Nat'l Bank v. Rozelle*, 493 F.2d 1196, 1202 n.3 (10th Cir. 1974); *In re White Plumbing & Heating Co.*, 6 U.C.C. Rep. (Callaghan) 467, 470 (E. Tenn. 1969). The *White Plumbing* court held that the "other debt" was secured but emphasized that it had not been "bought up by the bank to become sheltered under its security agreement." *Id.*
363. *Id.* at 198.
both agreements were eventually assigned to the plaintiff. The United States District Court for the Western District of Oklahoma held that the buyer's debt under the second agreement was not secured by the vehicles covered by the first agreement, concluding that the language of the dragnet clause was "unclear and ambiguous."

After citing Gilmore and decisions applying the relatedness rule, the Thorp court asserted:

The Court is convinced by the numerous cases cited by the plaintiff, that it is no longer necessary, as between the original lender and the original debtor, for future advances to be of the same class as the primary obligation. . . . Clauses such as that involved here are valid to include in the security agreement all other debts of whatever class or character created between the original parties. All of these cases involved additional advances of value by the original lender to the original debtor. None of these cases involved an assignee of the original lender purchasing an obligation of the original debtor from a third party.

The court did not hold that no dragnet provision should ever be held to cover debt subsequently acquired by the secured party, but held only that the language of the first agreement under consideration was "not sufficient to enable the plaintiff to purchase the second agreement from . . . [the seller] and have that indebtedness secured by his security interest in" the vehicles covered by the first agreement. It is unresolved whether the court would have reached a different conclusion if the first agreement had expressly covered, for example, "debts of the buyer which the seller or the seller's assignee may hereafter acquire by assignment or otherwise," a paraphrasing of the language used in the security agreement considered in the Fretz case. Although the Fifth Circuit's dictum in Kimbell Foods, quoted above, suggests that such language would not lead it to a different conclusion, that court ignored an opportunity to address the question directly in Fretz.

The Fretz case provides an almost ideal set of facts for a lawyer trying to construct a case which would be most likely to produce a

364. Id. at 196-97.
365. Id.
366. Id. at 199.
367. Id. at 200 (citations omitted).
368. Id.
369. See note 361 and accompanying text supra. The Kimbell Foods court emphasized the fact that the future advances clause in question concerned obligations between the original debtor and creditor. 557 F.2d at 495.
decision that acquired debt can be covered by a dragnet provision. The security agreement was clear and unambiguous, explicitly covered debt which Revlon might acquire by assignment, and even expressed an intention to include debt to Revlon's subsidiaries, the very creditors from which the assigned debt was subsequently acquired by Revlon. Those provisions should have satisfied any court which truly attempted to ascertain the intention of the parties. Nevertheless, although the Fifth Circuit made a passing reference to the concept of floating debt, it did not consider the possible application of that concept to the Fretz case.

F. Policy Considerations

Setting aside questions of interpretation and conscionability, there remains an issue of whether, as a matter of policy, dragnet provisions should be permitted to include debt acquired by assignment. The issue can be identified by assuming the replacement of section 9-204(3) of the Code by a rule limiting the coverage of any security agreement to debt which exists when the security agreement is executed. In other words, a secured party would need to obtain a new security agreement, or an amendment to an existing agreement, each time it extended new credit to the debtor. A secured party would not be prevented from obtaining security for obligations arising from its transactions directly with the debtor. It could simply refuse to enter into a transaction unless the debtor executed the necessary security agreement, which he would be willing to do in order to obtain the additional credit. Under this analysis, the hypothetical rule would cause inconvenience and expense for both parties without producing any benefit for either of them.

The hypothetical rule would interfere in a more significant way with a secured party's ability to obtain security for debt acquired by assignment. In some cases, the debtor may have an interest in substituting one creditor for another in order to obtain some forbearance, and the prospective assignee could then insist on a new security agreement.

370. See 565 F.2d at 368 n.2.
371. Id.
372. Id. at 368.
373. The "reasonable contemplation" of the parties test is controlling in the Fifth Circuit. See text accompanying notes 352 & 353 supra. One commentator has suggested "foreseeability" and "specific intent" tests as a substitute for the relatedness rule. Note, Future Advances Financing Under the Uniform Commercial Code: Curbing the Abuses of the Dragnet Clause, 34 U. PITT. L. REV. 691, 698 (1973). The agreement in Fretz should satisfy even this restrictive test.
374. 565 F.2d at 369.
agreement as a condition to acquiring the debt. With the exception of those cases, a debtor would have no incentive for executing a new security agreement covering acquired debt because the transaction would produce no new benefit to the debtor. In many cases, therefore, the hypothetical rule would serve the interests of debtors by protecting them from the consequences of an agreement that debt subsequently acquired by assignment will be secured.

Nevertheless, an absolute rule that dragnet provisions will not be permitted to catch debt acquired by assignment is not justified because it would be inconsistent with the explicit Code policy of freedom of contract. In appropriate circumstances, however, a court might conclude that a dragnet provision is unconscionable and, therefore, unenforceable to the extent that it covers debt subsequently acquired by assignment. An explicit determination of that kind would be consistent with the policies expressed in the Code.

Another problem is whether the debtor's other creditors should be protected from the consequences of the debtor's agreement that debt subsequently acquired by assignment will be secured. If a secured party is permitted to acquire previously unsecured claims against the debtor and convert them to secured debt under a dragnet provision in an earlier security agreement, the relative rights of other creditors in a distribution of the debtor's assets may be altered. Although that is an appropriate matter for concern, invalidating a dragnet provision is not an appropriate remedy. Instead, the interests of other creditors should be protected by the applicable priority rules and insolvency laws.

G. Priorities

Consider the following hypothetical case. In March, a debtor executed an agreement giving its principal inventory supplier a security interest in the debtor's equipment as collateral for the balance which the debtor then owed to the supplier and for all other indebtedness of the debtor to the supplier which might thereafter arise. The supplier filed appropriate financing statements. In April, the debtor executed an agreement giving a bank a security interest in the same equipment as collateral for a loan, and the bank filed appropriate financing statements. Early in May, an unsecured creditor obtained a judgment lien on the equipment. Until the supplier learned about the lien in June, it continued making weekly shipments of in-

375. U.C.C. § 1-102, Comment 2.
ventory to the debtor without receiving any payments. What are the relative priorities of the supplier, the bank, and the lien creditor?

The 1962 Official Text of the Article 9 of the Code did not deal expressly with the priority of future advances, and the problem has provoked considerable debate.\(^{376}\) Two different methods of analysis have emerged from that debate. One view is that the supplier in the hypothetical case has a single security interest which secures a number of extensions of credit.\(^{377}\) The consequence of that position is that, under the 1962 text of the Code, the supplier has full priority over the bank under the first to file rule of section 9-312(5)(a)\(^{378}\) and over the lien creditor under section 9-301(1)(b).\(^{379}\)

The other approach is that the supplier has a separate security interest for each extension of credit.\(^{380}\) The consequence of this view is that, under the same sections of the 1962 text, the supplier has full priority over the bank\(^{381}\) but has priority over the lien creditor only...

\(^{376}\) E.g., 2 G. Gilmore, supra note 5, § 35.6, at 937-39; 1A Secured Transactions, supra note 96, § 15.09(3), at 1606-08; Cohen, supra note 137 at 11-36; King, Future Advances Under the U.C.C. and the Intervening Judicial Lien Creditor, 74 Com. L.J. 61 (1969); Comment, Priority of Future Advances Lending Under the Uniform Commercial Code, 35 U. Chi. L. Rev. 128 (1967).

\(^{377}\) See 2 G. Gilmore, supra note 5, § 35.6, at 938-39.

\(^{378}\) U.C.C. § 9-312(5)(a) (1962 version). The 1962 version provided that "priority between conflicting security interests in the same collateral shall be determined . . . in the order of filing if both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) and whether it attached before or after filing." Id. Accord, Kimbell Foods, Inc. v. Republic Nat'l Bank, 557 F.2d 491, 497-98, 503-05 (5th Cir. 1977), aff'd sub nom. United States v. Kimbell Foods, Inc., 99 S. Ct. 1448 (1978) (single security interest rule applied under both state and federal law); Associated Business Inv. Corp. v. First Nat'l Bank, 264 Ark. 611, 537 S.W.2d 328, 330 (1977) (subsequent loans had priority over intervening security interests since they were covered by a future advances clause in a preceding mortgage, even though original note had been paid); Thorp Fin. Corp. v. Ken Hodgins & Sons, 73 Mich. App. 428, 436, 251 N.W.2d 614, 618 (1977) (bank which lent money under a future advances clause and incorporated by reference the security agreement into the second loan had priority over an intervening perfected secured transaction made by a finance company); Index Store Fixture Co. v. Farmer's Trust Co., 536 S.W.2d 902, 905-06 (Mo. Ct. App. 1976) (party with first filed security interest had priority over later security interest even though the subsequent transactions between the original creditor and debtor were not pursuant to a future advances clause).

\(^{379}\) U.C.C. § 9-301(1)(b) (1962 version). The 1962 version provided that "an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor without knowledge of the security interest and before it is perfected." Id. See Estate of Cook, 64 Cal. App. 3d 852, 864-67, 135 Cal. Rptr. 96, 102-04 (1976) (applying New York law to hold that future advances under perfected security interest has priority over intervening judgment creditor); Friedlander v. Adelphi Mfg. Co., 5 U.C.C. Rep. (Callaghan) 7, 10 (N.Y. Sup. Ct. 1968) (security interest attaches and is perfected upon the initial advance).

\(^{380}\) See 1A Secured Transactions, supra note 96, § 15.09(3), at 1606-08; Comment, supra note 376, at 137-39.

\(^{381}\) See U.C.C. § 9-312, Example 1 (1962 version). It has been suggested that the first creditor may not have absolute priority unless the advances were obligatory. See 1A Secured Transactions, supra note 96, § 15.09(3), at 1606-08; Marine Midland Bank-E. Nat'l Ass'n v. Conerty Pontiac-Buick, Inc., 77 Misc. 2d 311, 317-18, 352 N.Y.S.2d 953, 961-62 (Sup. Ct. 1974).
with respect to the price of inventory shipped to the debtor before the lien creditor obtained its lien.\textsuperscript{382}

The 1972 Official Text deals with the priority problem directly in section 9-312(7),\textsuperscript{383} which provides:

\begin{quote}
(7) If future advances are made while a security interest is perfected by filing or the taking of possession, the security interest has the same priority for the purposes of subsection (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.\textsuperscript{384}
\end{quote}

Applying this provision, the supplier in the hypothetical case has full priority over the bank regardless of whether the supplier's security interest had been perfected by possession or by filing.\textsuperscript{385}

With respect to lien creditors, section 9-301(4) of the 1972 text\textsuperscript{386} provides:

\begin{quote}
(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.\textsuperscript{387}
\end{quote}

Under this provision, the supplier in the hypothetical case has priority over the lien creditor with respect to the price of inventory shipped to the debtor before the levy was made or within forty-five days thereafter, even if it had learned about the lien immediately after it was obtained.\textsuperscript{388} The supplier would have priority for ship-

\textsuperscript{382}. U.C.C. § 9-301(1)(b) (1962 version). Even under the separate security interest view, the supplier would have priority over the lien creditor if the supplier had been legally obligated to deliver inventory to the debtor after the lien creditor obtained its lien. Marine Midland Bank-E. Nat'l Ass'n v. Conerty Pontiac-Buick, Inc., 77 Misc. 2d 311, 317-18, 352 N.Y.S.2d 953, 961-62 (Sup. Ct. 1974).

\textsuperscript{383}. U.C.C. § 9-312(7).

\textsuperscript{384}. Id.

\textsuperscript{385}. Id. § 9-312(7).

\textsuperscript{386}. Id. § 9-301(4).

\textsuperscript{387}. Id.

\textsuperscript{388}. Id. The text of § 9-301(4) is not as clear as it might be. Standing alone, it could be interpreted as cutting off the priority of a secured party who has knowledge of a lien, even if the 45-day period has not yet expired. Comment 7 to § 9-301, id. § 9-301. Comment 7, however,
ments made after the forty-five day period expired when it had knowledge of the lien only if it were legally obligated to make the shipments pursuant to a commitment given without knowledge of the lien.

Since the 1972 text of Article 9 was not adopted in Texas until 1973, section 9-312(7) of the 1972 text could not have been applied in the Fretz case. Under either view of the 1962 text, however, the first to file rule would have given Revlon full priority over the Bank if the Fifth Circuit had considered the dragnet provision effective with respect to the debt acquired by Revlon from its subsidiaries.

Whether or not the Code would have given Revlon's claim on the acquired debt priority over the bankruptcy trustee in Fretz is a different matter. A bankruptcy trustee is a lien creditor under the Code's definition of that term. If Revlon were viewed as having a single security interest, the 1962 text of the Code would have given its claim priority over lien creditors, including a bankruptcy trustee. To the extent that the single security interest approach reflects a policy designed to promote secured future advances lending for the benefit of debtors, however, Revlon's claim is unappealing because its acquisition of its subsidiaries' claims did not benefit Fretz. If Revlon were viewed as having a separate security interest for the acquired debt, its claim would not have had priority under the 1962 text.

states emphatically that the secured party's priority "is made absolute for 45 days regardless of knowledge of the secured party concerning the judgment lien." Id. In comparison, the contrasting language of U.C.C. § 9-307(3) provides that a buyer who is not a buyer in the ordinary course of business "takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than 45 days after the purchase, whichever first occurs." Id. The 45-day rule is designed to protect the secured party under the similar rule of § 6323(c)(2) and § 6323(d) of the Internal Revenue Code, I.R.C. §§ 6323(c)(2), (d), as amended by the Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125 (codified in scattered sections of 26, 28, 40 U.S.C.). See U.C.C. § 9-301, Comment 7.

90. The Bank could not have changed this result by requiring Fretz to use the procedure provided by § 9-208. See notes 121-37 and accompanying text supra.

91. U.C.C. § 9-301(3).

92. See notes 377-79 and accompanying text supra.

93. See Comment, supra note 376, at 139-44. This commentator finds this argument more compelling in the situation where future advances occur frequently. Id. at 143. Conversely, proponents of the separate security interest view maintain that the single security interest theory restricts the debtor to one source of credit. Id. at 145-46.

94. In fact, Revlon acquired the subsidiaries' claims after Fretz filed its voluntary petition in bankruptcy. 565 F.2d at 366. It is difficult to see the benefit Fretz could have obtained from this assignment. For a discussion of debt acquired by assignment and its relationship to the debtor's interest, see notes 360-74 and accompanying text supra.

95. See U.C.C. § 9-301(1)(b) (1962 version).
If the 1972 text of the Code were applicable, it could be argued that Revlon had priority under section 9-301(4), since it acquired the debt within forty-five days after Fretz filed its petition and the trustee in bankruptcy was appointed. One problem with that argument is that section 9-301(4) limits the secured party's priority to "advances made" within the forty-five day period. That language is narrower than the provision in section 9-204(3), which states that an agreement may secure "future advances or other value." This language raises the question of whether the failure to refer to "other value" in section 9-301(4) has any significance. Another problem is the meaning of "advances." Neither the comments to section 9-301(4) nor the stated reasons for its addition to the 1972 text provide an answer to these questions.

The term advances "does not have a fixed and single meaning." Although it is sometimes used as a synonym for loans, the context may require a broader interpretation. For example, one court has held that advances, as used in a chattel mortgage statute, includes a seller's extension of credit for the purchase price of goods, but another court has held that it does not have that meaning in the context of a factor's lien statute.

In defining a purchase money security interest, section 9-107(b) uses the language "making advances or incurring an obligation." Both that definition and section 9-204(3) indicate that the draftsmen of the Code used the term advances in a somewhat restricted sense and support an argument that, as in section 9-301(4), the term is limited to loans of money.

On the other hand, there is no discernible policy reason for employing such a narrow interpretation in section 9-301(4). If a bank obtains a security interest in a borrower's equipment as collateral for future loans of money to enable the borrower to purchase fuel, section 9-301(4) clearly protects the bank. If a fuel supplier obtains a security interest in the same equipment for future deliveries of oil, the supplier should not be denied similar protection. Protecting both the supplier and the lender serves the policy of promoting future extensions of credit for the benefit of debtors.

396. See 565 F.2d at 368.
397. U.C.C. § 9-301(4).
398. Id. § 9-204(3) (emphasis added).
400. Id.
403. U.C.C. § 9-107(b).
404. Id.
405. See Comment, supra note 376, at 139-44.
That policy, however, does not support a rule which would give a secured party priority over a lien creditor with respect to a claim arising from a future transaction which produces no new benefit for the debtor.\textsuperscript{406} This suggests that an appropriate interpretation of advances in section 9-301(4) is one which includes all direct extensions of credit, whether in the form of loans or otherwise, but not the acquisition of a pre-existing claim.\textsuperscript{407} Under such an interpretation, section 9-301(4) would not have given Revlon priority over the trustee in \textit{Fretz}.

So far as the Code is involved, those were the possibilities in the \textit{Fretz} case. Even if Revlon's claim had priority over the trustee under the Code, however, Revlon still would have had to contend with the Bankruptcy Act.

\textbf{H. Floating Debt in Bankruptcy}

\textit{Fretz}'s trustee might have argued that Revlon's security interest was a voidable preference to the extent that it secured the claims assigned to Revlon by its subsidiaries. Under section 547(b) of the Bankruptcy Reform Act,\textsuperscript{408} a voidable preference is a "transfer" of a debtor's property "to or for the benefit of a creditor . . . for or on account of an antecedent debt"\textsuperscript{409} which is "made while the debtor was insolvent"\textsuperscript{410} and "on or within 90 days before"\textsuperscript{411} the filing by or against the debtor of a petition initiating a bankruptcy proceeding if the effect of the transfer will be to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class.\textsuperscript{412} Under section 101(40)\textsuperscript{413} the creation of a security interest or other lien is a transfer.\textsuperscript{414}

In \textit{Fretz}, the key question would have been whether the transfer occurred within the preference period. Under the preference provisions, a transfer of personal property is deemed to have been per-

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\textsuperscript{406} This is exactly what occurred in \textit{Fretz}. See note 394 and accompanying text \textit{supra}.

\textsuperscript{407} See \textit{Fedders Fin. Corp. v. Chiarelli Bros.}, 221 Pa. Super. Ct. 224, 228, 289 A.2d 169, 171 (1972) (lender provided advances to borrower within U.C.C. § 9-107(b) when it provided new money, as distinguished from pre-existing claim or antecedent debt); U.C.C. § 9-107, Comment 2 (excluding from the definition of a purchase money security interest any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt).

\textsuperscript{408} 11 U.S.C.A. § 547(b) (West Pamphlet 1979).

\textsuperscript{409} Id. § 547(b)(1)-(2).

\textsuperscript{410} Id. § 547(b)(3).

\textsuperscript{411} Id. § 547(b)(4)(A). The period is extended to one year with respect to transferees who are "insiders." Id. § 547(b)(4)(B).

\textsuperscript{412} Id. § 547(b)(5). The test was substantially the same under § 60a of the Bankruptcy Act, 11 U.S.C. § 96(a) (1976).


\textsuperscript{414} Id.
fected and made when it became so far perfected that no creditor on a simple contract can acquire a judicial lien that is superior to the interest of the transferee.\footnote{Id. §§ 547(e)(1)(B), (e)(2). The test was substantially the same under § 60a(2) of the Bankruptcy Act, 11 U.S.C. § 96(a)(2) (1976).} That standard appears to consist of two separate elements: 1) perfection of the transfer; and 2) the priority of the transferee.

With some limited exceptions,\footnote{Id. §§ 9-304(4), (5).} perfection of a Code security interest is accomplished by filing financing statements or by taking possession.\footnote{Id. §§ 9-302, 9-304, 9-305.} In \textit{Fretz}, Revlon’s financing statements had been filed more than four months before the bankruptcy proceeding began.\footnote{565 F.2d at 368.} In addition, however, a security interest is not perfected until it has “attached,” a term used in the Code to describe the point at which property becomes subject to a security interest.\footnote{U.C.C. § 9-303 & Comment 1.} Attachment occurs when three requirements have been met.\footnote{Id. § 9-203(1).} First, there must be a security agreement, which must be in writing unless the collateral is in the possession of the secured party or its agent.\footnote{Id. § 9-203(1)(a).} Second, value must have been given.\footnote{Id. § 9-203(1)(b).} Third, the debtor must have rights in the collateral.\footnote{Id. § 9-203(1)(c).}

In \textit{Fretz}, the first requirement clearly had been met more than four months before bankruptcy when Fretz executed a security agreement with a dragnet provision.\footnote{See 565 F.3d at 367.} While the \textit{Fretz} opinion does not indicate whether any of the collateral was acquired by Fretz within four months before bankruptcy, the floating lien decisions had made that question irrelevant for the purposes of the Bankruptcy Act’s preference provisions.\footnote{See Biggins v. Southwest Bank, 490 F.2d 1304, 1309-10 (9th Cir. 1973) (after acquired property was sufficiently described in financing statement so that subsequent lien creditors, including the bankruptcy trustee, would have notice); DuBay v. Williams, 417 F.2d 1277, 1286-88 (9th Cir. 1969) (secured party filing security agreement covering accounts receivable before four month avoidance period had priority over trustee in bankruptcy who asserted claim for accounts arising during the four month period); Grain Merchants of Ind., Inc. v. Union Bank & Sav. Co., 408 F.2d 209, 213-15 (7th Cir.), \textit{cert. denied}, 396 U.S. 827 (1969) (filing of security agreement covering after acquired property served as record notice and entitled the secured creditor to priority over a subsequent lien creditor).} Those decisions, which held that security interests in after acquired property are not voidable as preferences merely because the debtor’s rights in such property were acquired...
within four months before bankruptcy, have been reversed by section 547(e)(3) of the Bankruptcy Reform Act,\footnote{11 U.S.C.A. § 547(e)(3) (West Pamphlet 1979).} which explicitly provides that for preference purposes "a transfer is not made until the debtor has acquired rights in the property transferred."\footnote{Id.}

The other requirement for attachment remaining to be considered is a determination of when value was given. It is clear that, by extending credit directly to Fretz, Revlon had given some value more than four months before the petition was filed.\footnote{See 565 F.2d at 367-68.} It is necessary to consider whether that was adequate to perfect the security interest as collateral for all of Revlon's claims, including those obtained later by assignment.

The assignments to Revlon by its subsidiaries could be considered as the significant events, and they occurred after the bankruptcy petition was filed.\footnote{Id. at 368.} Any transfer which is not perfected prior to the filing of a bankruptcy petition is deemed to have been made immediately before the petition was filed.\footnote{Bankruptcy Act, § 60a(2), 11 U.S.C. § 96(a)(2) (1976); Bankruptcy Reform Act, 11 U.S.C.A. § 547(e)(2)(c) (West Pamphlet 1979).} Accordingly, if the assignments were treated as the final step in the process of perfection, Revlon's security interest would be voidable. Conversely, if the required value must have been given to the debtor, the date of the assignments to Revlon would be irrelevant, and it would be appropriate to determine when the subsidiaries extended credit to Fretz.

A decision by the Fifth Circuit, \textit{In re King-Porter Co.},\footnote{446 F.2d 722 (5th Cir. 1971).} provides some guidance with respect to this question. In that case, an appliance distributor held a security interest in a dealer's inventory.\footnote{Id. at 723.} A security agreement containing a dragnet provision had been executed on February 14; the distributor had given some value by shipping appliances to the dealer on February 17; and appropriate financing statements had been filed by February 25.\footnote{Id. at 725.} On March 28, a manufacturer shipped 112 air conditioners to the dealer on open account, and on April 15 the distributor acquired that account from

\begin{footnotes}
\footnote{426. 11 U.S.C.A. § 547(e)(3) (West Pamphlet 1979).}
\footnote{427. Id. The impact of that change upon secured parties has been mitigated by the adoption of the improvement of position rule in § 547(c)(5). Id. § 547(c)(5). The rule is used to determine the extent to which a security interest in after acquired inventory or accounts may be avoided. In effect, "[a] creditor with a security interest in a floating mass, such as inventory or accounts receivable, is subject to preference attack to the extent he improves his position during the 90-day period before bankruptcy." S. REP. No. 95-989, 95th Cong., 2d Sess. 88 (1978), reprinted in [1978] U.S. CODE CONG. & AD. NEWS 5787, 5874.}
\footnote{428. See 565 F.2d at 367-68.}
\footnote{429. Id. at 368.}
\footnote{431. 446 F.2d 722 (5th Cir. 1971).}
\footnote{432. Id. at 723.}
\footnote{433. Id.}
\end{footnotes}
the manufacturer when they entered into a distributorship agreement. On May 31, the distributor repossessed 101 of the 112 units.

On June 5, the dealer filed a bankruptcy petition. The distributor sought to reclaim the remaining eleven units, and the trustee counterclaimed for the value of the other 101 units. The bankruptcy judge denied reclamation and granted the counterclaim. The district court affirmed on the grounds that the creation of a security interest in the air conditioners was both a voidable preference and a fraudulent transfer.

The Fifth Circuit reversed, holding that the distributor had given value on February 17 and that its security interest in the air conditioners was perfected shortly after March 28, when the dealer received the units. Moreover, it held that the transfer occurred even earlier. Citing the floating lien cases, the Fifth Circuit stated that, for the purposes of section 60a(2) of the Bankruptcy Act, a transfer “is equated with the act by which priority over later creditors is achieved and not with the event which attaches or perfects the security interest in a specific item of property.” The court therefore maintained that the transfer occurred when the distributor completed its filing on February 25, and the dealer’s debt to the manufacturer was not antecedent to the transfer since it arose after February 25.

The floating lien decisions have been criticized on the ground, among others, that they avoid the Code’s provisions that a security interest cannot attach until the debtor has rights in the collateral and cannot be perfected until it has attached. Nevertheless, in King-

434. Id.
435. Id. at 726.
436. Id.
437. Id. at 725.
438. Id.
439. Id. at 727.
440. Id. at 725.
441. Id. at 727.
442. Id. at 730.
444. 446 F.2d at 730, citing DuBay v. Williams, 417 F.2d 1277, 1287 (9th Cir. 1969).
445. 446 F.2d at 730.
446. Id. at 732. The holding in King-Porter has been described as follows: “A party . . . can convert what would have been a preferential security transfer if made to him into a non-preferential transfer merely by assigning his own claim to another party who has a security interest in assets of the common debtor . . . .” J. White & R. Summers, Uniform Commercial Code § 24-5, at 883 (1972).
447. U.C.C. §§ 9-203(1)(c), 9-303(1). For an example of this criticism, see Countryman, supra note 5, at 275.
Porter, the Fifth Circuit has extended the floating lien decisions by similarly avoiding the Code's provision that a security interest cannot attach until value is given and ignoring the criticism by boldly asserting that bankruptcy law and the Code employ different concepts of perfection.

In a brief criticism of King-Porter, Professor Kennedy concedes that the distributor's security interest in the air conditioners "appears to be sustainable as a security interest for future advances" to the extent that it secured "obligations arising out of credit extensions by the distributor." That concession apparently is based on the floating lien decisions, but Professor Kennedy obviously disagrees with the Fifth Circuit's extension of those decisions. He observes that the dealer's unsecured obligation to pay the manufacturer for the 112 air conditioners arose at least eighteen days before the transaction by which it became a secured debt to the distributor, thereby suggesting not only that the giving of value should be considered relevant for the purpose of bankruptcy law's preference provisions, but also that the significant event for that purpose in King-Porter was the distributor's acquisition of the manufacturer's claim against the dealer. Professor Kennedy concludes that the King-Porter decision "suggests all ingenious way for emasculating the preference policy of the Bankruptcy Act. If a secured party under an agreement that contains a dragnet clause can acquire unsecured claims against the debtor on the eve of bankruptcy, the possibilities of exploitation are patent."

Professor Kennedy's ultimate conclusion must be conceded, but the question is whether there is a basis for distinguishing between the secured party's direct extensions of credit, which should be protected, and its acquisition of unsecured claims during the preference period, which should be denied protection. The King-Porter decision was a logical extension of the floating lien decisions. If one of the Code's conditions of attachment, that the debtor have rights in the collateral, was to be ignored for the purposes of section 60a of the Bankruptcy Act, there was no meaningful analytical basis for insisting on compliance with another of the conditions, that value be given. Moreover, even if the court had not extended the floating lien decisions in King-Porter, the Fifth Circuit should have considered the

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449. See 446 F.2d at 730. A district court has characterized King-Porter as holding that perfection under bankruptcy law is "not synonymous" with perfection under the Code. Owen v. McKesson & Robbins Drug Co., 349 F. Supp. 1327, 1331 (N.D. Fla. 1972).
451. Id.
452. Id.
distributor's security interest for the acquired debt perfected by the value given when the distributor initially extended credit to the dealer. 453

There is, however, another possible basis for distinguishing between direct extensions of credit and acquired claims. The bankruptcy law's preference provisions do not simply provide that a transfer is deemed to have been made when perfected. They require that the transfer be so far perfected that no subsequent lien obtainable by a creditor on a simple contract could become superior to the interest of the transferee. 454 The preceding section of this article considered the relative priorities of a secured party and a lien creditor. 455 As indicated, section 9-301(4) of the 1972 text of the Code clearly gives the secured party priority with respect to credit extended directly to the debtor before or within forty-five days after a lien arises, but that section probably should be interpreted as giving the lien creditor priority to the extent that the security interest covers claims subsequently acquired by the secured party. 456 Under the 1962 text, the result depends on which of two conflicting approaches is adopted. 457 If the Fifth Circuit had considered this question in King-Porter, it could have relied on decisions supporting the single security interest view of the 1962 text, under which the initial extension of credit gives the secured party full priority over a subsequent lien creditor. 458

Although the preference provisions of the Bankruptcy Reform Act purport to provide a trustee with a tool specifically intended to reverse the King-Porter decision, 459 the text appears to fall short of the avowed objective. Under section 547(e)(3), the creation of the security interest in the air conditioners would not be deemed a transfer until the debtor "acquired rights in" the units, 460 which presumably occurred when the units were shipped by the manufacturer on

453. See cases cited note 378 supra. It is possible to argue that in the same manner that the filing of a financing statement secures any advances thereafter made by the creditor, the initial extension of credit also perfects the security interest for the acquired debt.


455. See notes 376-407 and accompanying text supra.

456. See notes 396-407 and accompanying text supra.

457. See notes 376-82 and accompanying text supra.

458. See cases cited note 379 supra.


March 28. 461 Under section 547(b)(2), 462 a transfer made within the preference period is avoidable if it was made for or on account of an antecedent debt "owed by the debtor before such transfer was made." 463 Under that language, the relevant date is not the one on which the distributor acquired the manufacturer's claim, but rather the date on which that claim arose. The claims presumably arose, however, when the units were shipped on March 28. 464 Under this analysis, the debt secured by the transfer was not antecedent.

In any event, section 547 of the Bankruptcy Reform Act would not necessarily provide a basis for avoiding all security interests to the extent that they are claimed to cover previously unsecured debt acquired shortly before bankruptcy by a secured party which holds a security agreement with a dragnet provision. If the debtor had rights in all of the collateral before the preference period began, section 547(e)(3) would not be relevant, 465 and the transfer would be deemed to have been made outside the preference period if all other requirements had been met. In such a case, therefore, it would not matter whether the acquired claim was an antecedent debt which, in the terms of section 547(b)(2), was "owed by the debtor before such transfer was made," or even whether it arose or was acquired during the preference period. 466

In King-Porter, the district court held that the creation of the security interest in the air conditioners was not only a voidable preference but also a fraudulent transfer under section 67d(2) of the Bankruptcy Act. 467 The Fifth Circuit rejected the latter holding in summary fashion, however, stating that the transfer clearly was not made without fair consideration for purposes of section 67d(2) since, as the court had already held for purposes of section 60a, value had been given before the transfer occurred. 468

461. See U.C.C. § 2-401(2)(a).
463. Id.
464. See 466 F.2d at 725.
466. Id. § 547(b)(2).
468. 446 F.2d at 733. While the Fifth Circuit's decision on this point may have been correct, its terse discussion of the issue was inadequate. Its conclusion with respect to § 60a of the Bankruptcy Act should not have controlled its consideration of the issue under § 67d(2) of the Bankruptcy Act. The question of value was relevant under § 60a only in an indirect way since under that section a transfer is deemed to have been made when it is perfected, and the giving of value is a condition to perfection under the Code. See U.C.C. § 9-203(1)(b). The question of value was more directly relevant under § 67d(2) since by its terms that section applies to transfers made without "fair consideration." 11 U.S.C. § 107(d)(2) (1976). A secured party cannot avoid the impact of § 67d(2) merely by showing that some value was given. That value must amount to fair consideration, which, as stated by one court, "requires both 'good faith' and 'fair
Professor Kennedy has pointed out that the decision in *King-Porter* ignored the principle of *Dean*,469 "which condemns a security interest for a contemporaneous advance given to enable the debtor to pay off an unsecured debt on the eve of bankruptcy." 470 In fact, the *King-Porter* court did not even consider section 67d(3) of the Bankruptcy Act, which was a codification of that principle.471

Neither the giving of fair consideration nor the trustee's inability to prove actual fraudulent intent in *King-Porter* would have saved the secured party under section 67d(3) of the Bankruptcy Act.472 The objectionable feature of the transaction subject to that section was the intent to effect a preference as the result of a transfer made within four months before bankruptcy.473 In *King-Porter*, the Fifth Circuit held that, for purposes of the Bankruptcy Act's preference provisions, the transfer occurred when the financing statements were filed,474 and it later held in another case that for purposes of section 67d475 the same rule applied.476 Even under that reasoning, the transfer in *King-Porter* occurred within four months before bankruptcy.477 Moreover, the air conditioners were inventory, and a security interest in inventory should always be deemed a transfer made immediately before bankruptcy for purposes of section 67d.478

It is unlikely that the required intent to perfect a preference existed when the financing statements were filed in *King-Porter*. The acquired debt did not arise until about a month later, and the secured party did not acquire it until more than two weeks after it arose.479 Even if the transfer is deemed to have been made when the financing statements were filed, the date on which the secured party acquired the previously unsecured debt is the relevant time for determining whether the parties had the required intent and knowledge.480

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470. Kennedy, supra note 450, at 770.
473. Id. For a discussion of this section, see notes 175-77 and accompanying text supra.
474. 446 F.2d at 730.
477. The financing statements were filed on February 25, 1969. 446 F.2d at 730. The bankruptcy petition was filed on June 5, 1969. Id. at 726.
478. See notes 187-203 and accompanying text supra.
479. See 446 F.2d at 725.
Applying the foregoing analysis to *Fretz* and assuming that the dragnet provision had been held to cover the claims acquired by Revlon from its subsidiaries, it is unlikely that the Fifth Circuit would have upheld a challenge by the trustee under the preference provisions, because Revlon's financing statement was filed and it had given some value more than four months before *Fretz*’s bankruptcy.\(^{481}\) If section 9-301(4) of the 1972 text of the Code had been applicable, such a challenge probably should have been upheld, however, since, to the extent that the security interest covered the acquired debt, it was not perfected as against a lien creditor on the date of bankruptcy.\(^{482}\)

A challenge under section 67d(2) of the Bankruptcy Act probably would have failed in *Fretz*. Under the reasoning of *King-Porter*, the transfer occurred more than a year before bankruptcy, at least to the extent that the collateral consisted of equipment.\(^{483}\) Even if the transfer were deemed to have been made immediately before bankruptcy to the extent that it consisted of inventory, it is likely that the antecedent debt amounted to a fair consideration.

A challenge under section 67d(3) of the Bankruptcy Act would also probably have failed in *Fretz*. To the extent that the collateral consisted of inventory, the transfer should be deemed to have occurred immediately before bankruptcy. The transaction certainly would have enabled Revlon's affiliates to obtain a greater percentage of their claims than some other creditor of the same class and Revlon obviously intended that result. Section 67d(3) explicitly required, however, that the transferor have the intention of effecting a preference, and it is unlikely that *Fretz* even knew about Revlon's acquisition of its subsidiaries' claims.\(^{484}\)

As noted earlier, the Bankruptcy Reform Act contains no counterpart of section 67d(3) of the Bankruptcy Act, but the principle of *Dean* will have a similar effect in many cases.\(^{485}\) As Professor Kennedy has noted, the result in *King-Porter* is inconsistent with the principle of *Dean*.\(^{486}\) In fact, that principle is free of the technical language of section 67d(3), and it is conceivable that an innovative court might extend it to cover cases such as *King-Porter* and *Fretz*.

\(^{481}\) See 565 F.2d at 367-68. The financing statement was filed on April 5, 1971 and the bankruptcy petition was not filed until August 23, 1972. Id.

\(^{482}\) See notes 396-407 and accompanying text supra.

\(^{483}\) 565 F.2d at 367-68.

\(^{484}\) See id. at 368. *Fretz* had been in bankruptcy approximately a month when Revlon acquired the subsidiaries' claims. Id.

\(^{485}\) See notes 204-13 and accompanying text supra.

\(^{486}\) Kennedy, *supra* note 450, at 770.
Finally, Revlon would have encountered another problem in *Fretz* if it had based its claim on the dragnet provision in the security agreement. As the Fifth Circuit noted, “[p]riority in bankruptcy is determined as of the date of bankruptcy,” and “the policies of the Bankruptcy Act would be greatly disserved” if post-bankruptcy assignments to Revlon by its subsidiaries were allowed to alter the manner in which a distribution to creditors would otherwise be made.487 Without those assignments, Revlon’s dragnet clause would have been ineffective.

IV. CONCLUSIONS

Floating secured parties are not necessarily pirate ships which should be sunk on sight. They sail under the protection of the Code, subject to possible limitation under section 9-301(4) of the 1972 text. Courts outside the Fifth Circuit should reject the *Fretz* decision and be guided instead by *Cushman* and *Industrial Packaging*. If the Fifth Circuit does not itself overrule *Fretz* at the first opportunity, it should at least restrict the decision’s precedential effect to cases in which the secured party does not even nominally hold the secured debt. Floating secured parties who are in fact pirates sailing under false colors can be adequately dealt with under the bankruptcy laws by utilizing the preference and fraudulent transfer provisions of the Bankruptcy Reform Act and the principle of *Dean*.

Similarly, floating debt should not be treated as contraband automatically subject to forfeiture in favor of unsecured creditors, lien creditors, or trustees in bankruptcy. The relatedness rule has no place in the Code’s scheme of commercial law. Draftsmen of dragnet provisions would be well advised to use language specifically including dissimilar and unrelated debt, however, and they must recognize that the principles of unconscionability impose limitations on dragnet provisions used in printed forms and other contracts of adhesion. Secured parties must also recognize that their priority with respect to debt acquired by assignment from other creditors probably will be subject to the rights of lien creditors under section 9-301(4) of the 1972 text of the Code.

487. 565 F.2d at 374. Cf. *In re Apollo Travel, Inc.*, 567 F.2d 841, 844-45 (8th Cir. 1977) (citing the trustee’s “strong arm” powers and holding that dragnet provisions cannot be used to subordinate the trustee’s position as a lien creditor to claims arising after he has taken possession of the assets); United States v. Columbia Erection Corp., 134 F. Supp. 305, 306 (W.D. Mo. 1955) (debtor of bankrupt cannot buy other claims against the bankrupt after adjudication of bankruptcy and then claim protection by virtue of the explicit set-off provision).
The available bankruptcy tools are not adequate for dealing with cases in which dragnet provisions may interfere with a fair distribution to creditors in bankruptcy. Where the secured party relies on assignments made after bankruptcy, the strong arm provision of the Bankruptcy Reform Act may provide the trustee with an adequate weapon. Where section 9-301(4) of the 1972 text of the Code applies, the preference provisions of the Bankruptcy Reform Act should be effective in some cases. An innovative court might extend the principle of *Dean* to deal with a particularly egregious case. There are, however, gaps in this coverage, and the Bankruptcy Reform Act should be amended so as to give a trustee the power to avoid a security interest to the extent that it secures debt which the secured party has acquired by assignment in any case where the creation of a security interest directly in favor of the assignor could have been avoided as a preference. An obvious model is provided by section 553(a) of the Bankruptcy Reform Act, which invalidates a creditor’s setoff to the extent that it is based on a claim transferred to the creditor within the preference period or after commencement of a bankruptcy proceeding.

Finally, the Permanent Editorial Board for the Uniform Commercial Code should reconsider section 9-208, which appears to have been the result of casual conception and drafting. The section’s purposes should be determined more precisely, and its text should then be revised so that its intent is clearly effected. In particular, either the text or the comment thereto should resolve whether and the extent to which section 9-208 is intended to qualify the priority rules of section 9-312. If any qualification is intended, section 9-208 should provide a procedure by which the secured party can identify and measure its impact.

489. Id.