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# SOME "PROCEEDS" AND PRIORITY PROBLEMS UNDER REVISED ARTICLE 9

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> In one way the generality is not and cannot be news to anyone that every day has its yesterday and every day has its tomorrow; and yet, in another way, this can be a sort of news. There was the first occasion on which this generality was presented to us, and very surprising it was—despite the fact that on every day since infancy we had thought about its particular yesterday and its particular tomorrow. There is, anyhow at the start, an important sort of unfamiliarity about such generalizations of the totally familiar.**

*Preliminary Draft No. 2 of the Review Committee for Article 9*[1] proposes a rather significant number of changes in the form of Article 9, although important practical changes in substance, as distinguished from theory, are rather few in number. This general observation applies to the changes in section 9-306 dealing expressly with proceeds.

## I

The least important change in Article 9 as a practical matter, but the one which is bound to excite the most comment from some elements of the bankruptcy bar, is the provision that makes the security interest in proceeds automatic.[2] As everyone with any practical experience

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** RYLE, DILEMMAS 30 (1954).

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2. The security interest in proceeds has always been automatic for ten days *after*

knows, security agreements routinely provide for a security interest in proceeds even though it is highly unlikely that the collateral will be sold and even though it would be a default if it were. Financing statements contain boxes to check if a security interest in proceeds is intended and, aside from inadvertent clerical omissions, this box is always checked unless the form comes with a printed check in the box. Proceeds are always claimed, absent error, in accounts and inventory financing, and all third parties are aware of this, both as a practical matter and constructively or actually because of filed financing statements. In other words, the revised Code is simply recognizing as a matter of law what everyone recognizes as a fact of life.

This provision in no sense creates a statutory lien within the Bankruptcy Act.[3] Statutory liens arise apart from contract.[4] In this case

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*receipt* of the proceeds following a disposition of the collateral by the debtor. The requirement of a filed financing statement covering proceeds applied only beyond the ten-day period. *See* 1962 Code §§ 9-306(2), (3). With modifications, this requirement is continued in revised section 9-306(3). Section 9-203(1), which specified that a security interest was not enforceable against the debtor or third parties unless the debtor had signed a security agreement describing the collateral, had a sentence stating that the word "proceeds" was sufficient to cover proceeds of any "character." This presumably could only have applied to the period following ten days after the receipt of the proceeds. While it has usually been assumed that section 9-203(1)(b) required a reference to proceeds in the security agreement if proceeds were to be claimed, if this provision is read carefully, the assumption may be debatable. In no event is such a reference necessary under revised section 9-203(3). The confusion resulting from the relationship between "agreement" as used in sections 9-203(1) and 9-204(1) has led to a consolidation of these provisions in revised section 9-203(1) so that it is now unmistakably clear that the agreement necessary for attachment is a written security agreement, except for pledges. The form of the financing statement specified in section 9-402(3) has been changed in several respects, and revised section 9-402(3) eliminates any reference to proceeds. The revision of § 9-203(3) approved by the Review Committee was changed by the Permanent Editorial Board and the provision now reads: "Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by Section 9-306." This emphasizes the consensual element in the security. The change was approved by the American Law Institute on May 20, 1971.

3. The Bankruptcy Act's definition of "statutory lien" says that it is "a lien arising solely by force of statute upon specified circumstances or conditions, but *shall not include any lien* provided by or *dependent upon an agreement to give security*, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by statute." Bankruptcy Act, § 1(29a), 11 U.S.C. § 1(29a) (1964) (emphasis added). While this definition seems clearly on its face not to apply to the 1962 or revised proceeds provisions, a suggestion that the revised Code does create a statutory lien is contained in Countryman, *Code Security Interests in Bankruptcy*, 75 Com. L. J. 269, 272 (1970).

4. *See generally* V. Countryman, Cases and Materials on Debtor and Creditor 458-70 (1964); Kennedy, *Statutory Liens in Bankruptcy*, 39 Minn. L. Rev. 697 (1955).

the statute recognizes and states that if the parties by contract create a security interest in designated collateral, that security interest extends to the identifiable proceeds of the collateral if it is disposed of.[5] This is simply a specific statutory recognition of pre-Code common law[6] and statutory law.[7] The Code provision is in accord with the understanding that everyone has in these cases: if third parties have no claim to the collateral, they know they have no claim to its proceeds. Absent bankruptcy and the hope of a windfall, third party, non-reliance creditors are perfectly aware of this.

## II

The revised Code eliminates apparent inconsistencies in the 1962 Code between or among section 9-203(1)(b) which appears to require a claim to proceeds in the security agreement for the interest to be good against the debtor, section 9-402(3) which appears to require a claim on the financing statement for the interest to be good against the third parties, and section 9-306(2) which provides for an automatic continuance of the interest into identifiable proceeds when the collateral is disposed of. Surely no one has ever questioned the right of a secured party to claim the proceeds of collateral wrongfully disposed of, as against non-reliance creditors; and in the case of inventory or accounts financing the secured party's right to proceeds as such has never been questioned, only the means by which that right is recognized and enforced. To say that a secured party never has any right to proceeds arising on the disposition of any collateral would be going a bit far, even for some bankruptcy specialists, although that might be a logical conclusion to some of their premises.

Since the term "proceeds" includes whatever is received when collateral is disposed of, it has always been theoretically possible to claim a security interest in a Chagall acquired with the proceeds arising from the wrongful sale of a dealer's financed stock of automobiles. No such far-fetched example appears to have arisen outside the classroom. This will not be possible under the revised Code where the security interest in the proceeds must have been capable of perfection by a filing in the

5. 1962 Code §§ 9-306(2), (3); Revised Code §§ 9-306(2), (3).

6. *See, e.g.*, Hamilton Nat'l Bank v. McCallum, 58 F.2d 912 (6th Cir. 1932), *cert. denied*, 287 U.S. 619 (1932); *In re* James, Inc., 30 F.2d 555 (2d Cir. 1929).

7. *See, e.g.*, Taylor v. Quittner, 218 F.2d 549 (9th Cir. 1954); Commerce Union Bank v. Alexander, 44 Tenn. App. 104, 312 S.W.2d 611 (1957); Annot., 36 A.L.R. 1379 (1925).

same office where the original financing statement was filed.[8] Of course, if an important instance of this kind should arise, it is theoretically still possible for the secured party to learn of the disposition and file an appropriate financing statement concerning the proceeds within ten days after their receipt.[9] A further refinement is that if the proceeds are acquired with cash proceeds, as they almost certainly will be in a commercial context, the description of the collateral on the financing statement must indicate the types of property constituting the proceeds.[10] If a bank is financing a merchant's "inventory," either in general or of a specific, described kind, this clearly accords with the intent of the parties. Should a merchant sell his financed inventory and purchase a Renoir, there are other ways of reaching it if an innocent third party purchaser has not already acquired it by the time the secured party wakes up.

There is no restriction, nor has there been, on tracing the security interest into identifiable proceeds within ten days after their receipt by the debtor, but the special problem dealt with arises beyond that time. The revised Code does not purport to continue the security interest in all conceivable proceeds merely because a filed financing statement makes a claim to proceeds in general. It will no longer be possible to claim a proceeds security interest in instruments alone (other than checks) beyond ten days after their receipt because they are not "cash proceeds" and it is not possible to perfect an interest in instruments as such by filing.[11] Possession can be taken, of course. If the proceeds are chattel paper (of which the secured party does not take possession) or acounts,

8. Revised Code § 9-306(3)(a). A dealer's stock of automobiles would be "inventory" under section 9-109. While most theoretical examples of the type in the text assume that the expensive painting bought with the proceeds of inventory would be "consumer goods," it is not impossible that such a painting would turn out arguably to be "equipment" in an era when many businesses of various kinds indulge in art displays, perhaps to improve the public image of the business or perhaps to gratify a whim of a principal in the business. If the painting turned out to be equipment, the security interest would be perfected by a filing in the same office in which the inventory financing statement was filed. In any case the security interest in the painting as identifiable proceeds would be good for ten days if the painting were traded for cars, which is unlikely, and if the painting was acquired with cash proceeds then the collateral described in the financing statement must have indicated this type of property, or else the security interest in the painting as proceeds must have been perfected before the end of the ten-day period after the cash proceeds were received. *See* Revised Code § 9-306(a), (c). Neither situation is likely to occur.

9. Revised Code § 9-306(3)(c); 1962 Code § 9-306(3)(b).

10. Revised Code § 9-306(3)(c). *See* note 8 *supra*.

11. 1962 Code § 9-304(1). But note the specific recognition of a "proceeds" interest in instruments under revised section 9-304(1), which specifically includes sections 9-306(2), (3).

a filing will be required in the appropriate jurisdiction,[12] rather than being automatically perfected by a claim to proceeds in the original financing statement.[13] This eliminates the potentially troublesome problem under the 1962 Code where a sale by a branch store located in Indiana might have given an Indiana inventory secured party a perfected security interest in an account recorded in Chicago in the debtor's head office. The interplay between sections 9-306(3) and 9-103(1) was not clear here.

It must be emphasized that the changes in Article 9 affecting proceeds are not, as a practical matter, significant. Both the 1962 Code and the revised Code provide for a security interest to continue in "identifiable proceeds including collections received by the debtor." [14] The 1962 Code gave a continuing security interest beyond the ten-day period when the filed financing statement expressly covered proceeds or when there was an appropriate filing within that period.[15] The revised version continues the possibility of perfecting a security interest in any kind of proceeds within the ten-day period but eliminates the continuation into proceeds of *any* kind because of an original filing as to collateral and proceeds in favor of restricting the continuing automatic interest in two ways: one, the interest continues in identifiable cash proceeds of the original collateral where there is a filed financing statement, which as a practical matter is not likely to be an important situation because identifiable cash proceeds are not likely to remain on hand very long;[16] and, two, where the proceeds are collateral in which the security interest could have been perfected by filing in the the same office where the original financing statement was filed, which is rather limited to trade-in cases, or if the proceeds are acquired with cash proceeds the originally described collateral must also indicate the types of collateral which the proceeds constitute.[17] This permits financing inventory or accounts on a continuing basis.

The new "proviso" to section 9-306(3) is quite significant for it states that except as otherwise provided, "a security interest in proceeds can

12. *Compare* Revised Code § 9-103(6) *with* 1962 Code § 9-103(1). There is no specific conflict of laws rule covering chattel paper in section 9-103. In the *Final Report* of the Review Committee approved by the American Law Institute on May 20, 1971, Revised Code § 9-103 was extensively rearranged for clarity.

13. *Compare* 1962 Code § 306(3)(a) *with* Revised Code § 9-306(3)(a).

14. 1962 Code § 9-306(2); Revised Code § 9-306(2).

15. 1962 Code § 9-306(3).

16. Revised Code § 9-306(3)(b).

17. *Id.* § 9-306(3)(a).

be perfected only by the methods or under the circumstances permitted . . . for original collateral of the same type." Note that the provision refers to "type," not "item or type." A reference to "item or type" appears both in the 1962 Code in section 9-312(3)(c) and in the revised Code in section 9-312(3)(d) in connection with inventory financing priorities, and the reference to "item" will normally be meaningless since inventory will usually be described simply by type, but within the provisions of section 9-306 "type" is clearly broader than "item." Be that as it may, it will be necessary for the secured party to take possession of instruments if the security interest in them is to continue beyond the ten-day period, and if trade-ins are not likely to be of the same type as the original collateral, policing will be of even more value than would often be the case.

Without serious question, the proceeds provisions of the Code are of routine, primary importance only in accounts or inventory financing. (These provisions are also of importance when a debtor is dishonest or when any collateral is destroyed and insurance proceeds are payable, but these are exceptional situations.) It is vital that this kind of financing be given a firm base for operation, and the Code is designed for this purpose.

The revised Code may make a change in a problem arising from a typical consumer transaction. Under the 1962 Code, if, for example, a consumer buys a refrigerator on time and no financing statement is filed, the seller (and his assignee) may have a perfected purchase money security interest in the refrigerator and, if it is sold, in its proceeds, but that interest would not extend beyond ten days and into a new refrigerator bought with the proceeds arising from the sale of the old one, unless a financing statement claiming proceeds had been filed.[18] If a financing statement has been filed and the refrigerator is traded in on a new one which is sold on a conditional sale contract, in the event of default the resolution of the priority conflict—admittedly a minor one—is not clear.

18. *See* 1962 Code §§ 9-302(1), 9-306(3); Revised Code §§ 9-302(1)(d), 9-306(3). Both the 1962 Code and the revised version require a filed financing statement to claim proceeds of collateral beyond ten days after their receipt. The only difference in this case is that the financing statement under the revised version need not state that proceeds are covered; in both versions a security interest in proceeds can be perfected by a filing within the ten-day period, and only the secured party need sign the financing statement. 1962 Code § 9-402(2)(b); Revised Code § 9-402(2)(b). No financing statement is required to perfect a purchase money security interest in most consumer goods, but in the absence of filing certain purchasers will take free of the security interest. 1962 Code §§ 9-302(1)(d), 9-307(2); Revised Code §§ 9-302(1)(d), 9-307(2).

It is obvious that the new conditional seller has a purchase money security interest, but it is not clear whether the first seller also has such an interest in the second refrigerator.

The Code has never explicitly resolved the priority between a conditional seller and a purchase money financer who provides the balance of the purchase price of consumer goods, at least if neither interest is filed. It has been generally thought that these financers ranked equally, in proportion to their financial interests, since neither was entitled to priority.

The revised Code now provides that a purchase money security interest, in collateral other than inventory, has priority over a conflicting security interest in that collateral *or its proceeds*, if the purchase money security interest is perfected when the debtor gets possession of the collateral, as is true in the case of purchase money security interests in consumer goods, or within ten days thereafter.[19] It is not obvious how or whether this provision applies to our problem. The first seller, who filed, has a purchase money security interest and it carries through into the proceeds and is entitled to priority over "a conflicting security interest." But the second security interest is also a purchase money security interest in our example. If this case is not resolved by section 9-312(4), and probably it is not, then priority is determined by "priority in time of filing or perfection" [20] and "a date of filing . . . as to collateral is also a date of filing . . . as to proceeds," [21] which appears to give priority to the first financer. There may be nothing wrong with this result as a practical matter, but it is arguably a change from the 1962 Code. If this result can be reached in the case of consumer goods, it can also be reached in appropriate cases involving equipment. In other words, the revised Code seems to enact a priority for collateral other than inventory, in purchase money situations, which could have been implied from the 1962 Code, although some would not have done so and vehemently would not have done so in the case of inventory.

Some changes have been made in section 9-306(4) which restrict the secured party's interest in proceeds in the event of insolvency. The changes are technical rather than substantive. The enforceability of section 9-306(4) under the 1962 Code has not been open to serious question.[22]

19. Revised Code § 9-312(4).
20. *Id.* § 9-312(5)(a).
21. *Id.* § 9-312(6).
22. *See, e.g.,* Howarth v. Universal C. I. T. Credit Corp., 203 F. Supp. 279 (W.D.

III

It is a rare security agreement that does not require the debtor to carry casualty insurance when the collateral is goods; the omission is almost certain to be a mistake, for a lender looks to insurance proceeds as a substitute for the collateral if the goods are destroyed. Anyone who has ever bought a home subject to a mortgage is well aware of this. Everyone knows of the common understanding except the few courts which have been confronted by cases involving proceeds of casualty insurance payable by reason of damage to or destruction of the collateral.[23]

While it should have been clear that insurance proceeds were proceeds of collateral, this was not plainly spelled out by section 9-306(1) of the 1962 Code and the application of section 9-306(2) was even less clear. These provisions have now been revised to make clear what ought to have been clear in the first place. A sentence has been added in revised section 9-306(1) stating: "Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement." While a secured party will normally stipulate that casualty insurance be carried, he may inadvertently fail to be certain that he is named loss payee, and if a second secured party is named loss payee on the policy, whatever is received by that party will not be proceeds available to the first secured party. This is true, without regard to what the Code says, as a matter of insurance law. If the proceeds are payable to the debtor, then they clearly are subject to the security interest in the original collateral,[24] even though the secured party was not named loss payee.

Pa. 1962); *In re Morris*, 8 UCC REP. SERV. 593 (W.D. Okla. 1970) (in bankruptcy); *In re* JCM Cooperative, Inc., 8 UCC REP. SERV. 247 (W.D. Mich. 1970) (in bankruptcy); *In re* Gibson, 6 UCC REP. SERV. 1193 (W.D. Okla. 1969) (in bankruptcy); *In re* C. E. Pontz & Son, Inc. 2 UCC REP. SERV. 1120 (E.D. Pa.) (in bankruptcy), *aff'd*, 7 UCC REP. SERV. 1131 (E.D. Pa. 1965); Farnum v. C. J. Merrill, Inc., 264 A.2d 150 (Me. 1970); Girard Trust Corn Exch. Bank v. Warren Lepley Ford, Inc. (No. 3), 25 Pa. D. & C.2d 395, 1 UCC REP. SERV. 531 (C.P., Phil. County 1958) (involving the predecessor of the present section 9-306(4)(d)).

23. Most of the cases are discussed in Henson, *Insurance Proceeds as "Proceeds" Under Article 9*, 18 CATHOLIC U. L. REV. 453 (1969).

24. That is, insurance proceeds are "received" when the collateral is "disposed of." 1962 Code § 9-306(1), (2). Insurance proceeds will ordinarily materialize in the form of a draft in which a security interest can be perfected only by possession, under section 9-304(1), except in the case of proceeds, and a claim to proceeds in a financing statement is necessary to continue the security interest in the proceeds beyond ten days after their receipt unless possession is taken (1962 Code § 9-306(3)). It will become

## IV

*D* Department Store finances its inventory with *S* Bank. The security agreement dated January 4, 1971, gives *S* a security interest in traded-in goods, conditional sale contracts, cash, and any other "proceeds" received on the sale of new inventory. An appropriate financing statement is filed. A loan of $1,000,000 is made. On February 1, *R* Refrigerator Co. enters into an arrangement with *D* to supply refrigerators on a purchase money basis for sale by *D*, a financing statement is filed, and *R* sends a notice to *S* that this kind of purchase money financing is going to be engaged in with respect to *R* refrigerators before any refrigerators are supplied. In addition to *R* refrigerators, *D* also sells, *X*, *Y*, and *Z* brands of refrigerators.

In a surprising flurry of activity, *D* sold its entire inventory of refrigerators immediately prior to getting into financial difficulty on June 30, 1971. On this date, *D* had on hand a number of checks representing refrigerators sold for cash, checks representing down-payments on refrigerators sold on conditional sale along with the conditional sale contracts, some traded-in refrigerators, cash representing down-payments deposited in a special "refrigerator" account, and cash commingled in other deposit accounts and not specifically identified.

Assuming that the priority competition is solely between *S* and *R*, who wins?

A perfected purchase money security interest in the refrigerators, which *R*'s interest would be, has priority over the bank's interest under revised section 9-312(3) because there was an appropriate filing and *S* Bank was duly notified in writing before the inventory was supplied, but this priority extends only to the refrigerators supplied by *R* and to identifiable cash proceeds received on or before delivery of the inventory to a buyer.

Revised section 9-306(2) continues the earlier provision that a security interest continues in identifiable proceeds—it cannot continue in inventory after sale.[25] Revised section 9-306(3) provides that this interest continues even beyond ten days after the debtor receives the proceeds

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imperative for the secured party to be named loss payee as a practical matter under revised section 9-306(3). Otherwise (1) the secured party must get physical possession of the draft within ten days after the debtor receives it, or (2) the draft must be retained as such or deposited in a special account, or (3) the draft must be transformed into the same type of property as the original collateral within the ten-day period. *See* Revised Code § 9-306(3).

25. 1962 Code § 9-307(1); Revised Code § 9-307(1).

if a security interest in the proceeds could have been perfected by a filing in the office where the original financing statement was filed, and, although not applicable here, the description of the original collateral indicates the type of property constituting proceeds where it is acquired with cash proceeds.

As to priority, the new rules do not give the purchase money inventory financer (*R*) priority in the traded-in refrigerators. This priority conflict between *R* and *S* is determined in the order of filing under revised section 9-312(5)(a) because *R*'s purchase money security interest is not covered in this aspect by revised section 9-312(3), and consequently the first inventory financer to file—here, *S*—has priority. *R* would have priority over *S* as to checks on hand representing proceeds of cash sales of *R*'s refrigerators or down payments on them, and in traceable cash in the "refrigerator" account, assuming that these "cash" proceeds are identifiable.[26] *R* would be subordinate to *S* as to conditional sale contracts, even those involving *R*'s refrigerators,[27] and, assuming insolvency, it would also be subordinate as to commingled funds in deposit accounts.[28] *R*'s security interest would continue to be perfected in these accounts on insolvency, but *R* is not entitled to priority over *S*.

## V

*S* Bank takes a security interest in the accounts arising from the sale of *D* Store's inventory. Subsequently *T* Bank agrees to finance *D*'s inventory and its proceeds. The proceeds may include cash, accounts, traded-in goods, and chattel paper.

Under the 1962 Code there was an academic disagreement about

26. Revised Code § 9-312(3): "A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and in identifiable cash proceeds received on or before delivery of the inventory to a buyer . . . ." "Money, checks, deposit accounts, and the like are 'cash proceeds.'" Revised Code § 9-306(1).

27. The conditional sale contracts would not be "cash proceeds." *See* note 26 *supra*. Not coming under the special priority rule of revised section 9-312(3), priority is determined by revised section 9-312(5)(a), and revised section 9-312(6) provides: "For the purposes of subsection (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds." *See also* Revised Code § 9-306(2), (3).

28. *See* Revised Code § 9-306(4)(d) stating a rule of perfection in insolvency. The applicable priority rule is revised section 9-312(5)(a). "Deposit account" is a new term, and in revised section 9-105(e) it is defined to mean "a checking, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization."

whether *S* or *T* had priority in the accounts generated from the sale of inventory after *T* entered the picture.[29] Under the revised Code, the intention is that *S* should have priority as to the accounts even though they arise from inventory financed by *T*.[30] (This makes it more advisable than ever that *T* police the proceeds arising on the sale of financed inventory.) Since there is no means by which purchase money financing of accounts arising from retail sales can be accomplished, the special rules on purchase money priorities of revised section 9-312(3) and (4) are inapplicable, and these conflicts are resolved by revised section 9-312(5) which gives priority to the first to file as to the collateral in which the conflict arises, or the accounts here. (Had the inventory and accounts financer filed ahead of the accounts financer here, the first to file would have priority in the accounts, since the date of filing as to collateral is also the date of filing as to proceeds.)[31] *T* would have priority vis-à-vis *S* as to the other identifiable proceeds.[32]

## VI

*D* Department Store sells a refrigerator to *C*, a consumer, on conditional sale in State *Y*. No financing statement is filed. Two months later *C* moves to State *X*, and no financing statement is filed in *X*. Then *C* grants a security interest in the goods to *J*, and a financing statement is filed. Seven months later *C* defaults in payments under the conditional sale contract. Can *D* enforce its security interest in State *X* as against *J*?

The 1962 Code was less than explicit on this problem; alternatively, it did not cover this problem at all. The apparently applicable sentence in section 9-103(3) said:

> If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest

29. *Compare* Henson, *Priorities Under the Uniform Commercial Code*, 41 NOTRE DAME LAW. 425, 431-32 (1966), *with* Kripke, *Suggestions for Clarifying Article 9: Intangibles, Proceeds, and Priorities*, 41 N.Y.U. L. REV. 687, 726 (1966), *and* Henson, *Countersuggestions Regarding Article 9: A Reply to Professor Kripke*, 42 N.Y.U. L. REV. 74, 75-77 (1967). *See generally* Moye, *Priorities of Inventory and Accounts Financers Under Article 9 of the Uniform Commercial Code*, 23 BUS. LAW. 1013 (1968).

30. *See* REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, PRELIMINARY DRAFT No. 2, 29-32 (1970) in 25 BUS. LAW. 1067, 1092-94 (E33-E38) (1970).

31. Revised Code § 9-312(6).

32. If *S* is financing only accounts, presumably *S* could not claim a security interest—only *T* could—in the other proceeds arising on the sale of inventory.

> attached and before being brought into this state, the security interest continues perfected in this state for four months and also thereafter if within the four month period it is perfected in this state.

This sentence suggests that affirmative action is required to perfect *D*'s security interest in State *X*, although section 9-302(1)(d) requires no affirmative action at any time for a purchase money financer to perfect a security interest in consumer goods.[33] It could reasonably be argued, of course, that the purchase money security interest was indeed perfected in the second state since there was never a time when it was unperfected in either state, and this would be the clearly correct result. It is made indisputably certain in Revised Article 9.[34] Perhaps some of the difficulty with the conflict of laws rules in the 1962 Code (and earlier versions) arose because of the uncertainty about the adoption of the Code throughout the states. This is no longer a problem. The rules can now be stated with all-encompassing language, and earlier ambiguities can be removed in favor of clearer, more definite language. In this area, as in others, experience has value.

## VII

While it was clear under section 9-306(1) that checks were proceeds and that a proceeds security interest in them could be perfected by filing, section 9-304(1) provided that a security interest in instruments (other than instruments which were part of chattel paper) could be perfected only by taking possession of them, aside from specific exceptions for temporary perfection. This conflict is resolved in revised section 9-304(1) which excepts instruments from the possessory requirement when they are proceeds and recognizes that a security interest in them can be perfected by filing when they are claimed as proceeds. By definition, the term "instrument" includes a negotiable instrument, a security, and any other writing evidencing a right to the payment of money (other than a security agreement or lease) if it is of a type

33. Filing is required for a fixture or for a motor vehicle required to be licensed. 1962 Code § 9-302(1)(d). This provision has been revised to make the exceptions: "for a motor vehicle required to be *registered*; and *fixture filing* is required for priority over conflicting interests in fixtures to the extent provided in Section 9-313." Revised Code § 9-302(1)(d) (emphasis added). But in the absence of filing, a consumer buyer from a consumer seller can take free of such a perfected purchase money security interest if the requirements of section 9-307(2) are met.

34. Revised Code § 9-103(3).

which is transferred by delivery with any necessary indorsement or assignment in the ordinary course of business.[35]

Section 9-308 has always had an enigmatic aspect. The first sentence reads:

> A purchaser of chattel paper or a non-negotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knoweldge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under Section 9-304 (permissive filing and temporary perfection).

While "permissive filing" is applicable to chattel paper, the "temporary perfection" provisions of section 9-304 are not. While the provisions of section 9-304 are, in terms, applicable to non-negotiable instruments, since the word "instrument" is used, in the context of the section probably only negotiable instruments or securities are intended to be covered.[36] Revised section 9-308 in the first sentence drops "non-negotiable" and now covers purchasers of chattel paper and instruments.

The second sentence of section 9-308 gives priority to a purchaser of chattel paper (who gives new value and takes possession of the paper in the ordinary course of business) over a security interest claimed merely as proceeds of financed inventory, even though the purchaser knows of the inventory financer's security interest. One effect of this is to allow the purchaser to take a negotiable instrument free of prior claims if he buys it as part of chattel paper, when he could not have taken a negotiable instrument alone free of the inventory financer's claim under section 9-309 for he could not have been a holder in due

35. 1962 Code § 9-105(g); Revised Code § 9-105(i).

36. Comment 4 to 1962 Code § 9-304 states: "Subsections (4) and (5) follow the Uniform Trust Receipts Act in giving perfected status to security interests in instruments and documents . . ." in specified instances. Section 8 of the Uniform Trust Receipts Act, which is probably the target of the reference, applied to goods, documents and instruments, but "instrument" was defined to include (a) negotiable instruments as defined in the NIL, (b) stock certificates, bonds, and debentures, and (c) certain kinds of interim, deposit, or participation certificates, etc. Uniform Trust Receipts Act, § 1. Some instruments, such as registered obligations which would not have been negotiable under the NIL are made negotiable under section 8-105(1), and were apparently covered by the definition of "instrument" in section 1 of the Uniform Trust Receipts Act. But the third class of obligations covered by section 9-105(g) and revised section 9-105(i)—*i.e.*, non-negotiable paper within the scope of current Code definitions—was not included.

course because of his knowledge of the earlier interest.[37] The second sentence of revised section 9-308 reads:

> A purchaser of chattel paper *or an instrument* who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest *therein* [in chattel paper] which is claimed merely as proceeds of *prior collateral* [inventory subject to a security interest] (Section 9-306), even though he knows that the specific *chattel* paper *or instrument* is subject to the security interest.

While the revision undoubtedly removes an anomaly, the use of the word "instrument" may create problems in time. Since the term "purchaser" includes the holder of a security interest,[38] some accounts financers may be benefited by extending the benefits of the purchaser beyond chattel paper claimed merely as proceeds of inventory to chattel paper and instruments claimed merely as proceeds of "prior collateral." The ramifications of the changes have not yet crystallized.

## VIII

The elimination of the term "contract right" [39] should produce some interesting problems. In the 1962 Code a contract right is "any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." [40] Because the 1962 Code's definition of "account" is narrower than the ordinary usage of "account receivable," there apparently were instances where secured parties mistakenly claimed an interest in contract rights and accounts (rather than merely proceeds) when the claim should have been to general intangibles rather than accounts. Many contract rights would not turn into accounts on performance of the contract because account is defined in the 1962 Code as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper." [41] To this definition the revised Code will add: "whether or not it has been earned by performance."

Insofar as the security interest arises out of a contract relating to goods or services, the elimination of "contract right" is advantageous.

37. 1962 Code § 3-302(1)(c); Final Report § 9-103(1)(d).
38. *Id.* § 1-201(31), (32).
39. Revised Code § 9-106.
40. 1962 Code § 9-106.
41. *Id.*

As redefined, "account" will cover the right to payment before and when it is earned.

Potential problems may come to light when the unearned rights to payment relate to things other than goods or services. An agreement under which a patent is licensed with payments to be earned in the future will present some difficulty under the definition of general intangibles which, as revised, says that the term means "any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money." [42] For anyone who finds the term "things in action" devoid of meaning and who cannot readily associate the term "personal property" with a right to payment which has not been earned and which may never be earned—that is, when we speak of personal property we normally think of something which has a present existence—it will be challenging to call this collateral a general intangible prior to the time it is earned.[43]

In contests between sureties and financing banks arising out of construction contracts, the revised definitions would, at least superficially, seem to reinforce the surety's reliance on common law subrogation rights rather than filing.[44] In fact, whether the bank should file, and

42. Revised Code § 9-106.

43. Since Article 9 applies, subject to specific exceptions, "to any transaction (regardless of its form) which is intended to create a security interest in personal property" (1962 Code § 9-102(1)(a)), any such transaction has to fit somewhere. It was conceptually simpler to fit appropriate unearned contractual rights to payment into "contract right" than it will be to say that some of these rights are general intangibles as that term is defined.

44. In general, the practice apparently has been for banks to file financing statements when they were financing construction contracts, while sureties did not file but relied on subrogation rights. In most cases sureties have been wise to do so. *Compare* United States v. G. P. Fleetwood & Co., 165 F. Supp. 723 (W.D. Pa. 1958) *with* Jacobs v. Northeastern Corp., 416 Pa. 417, 206 A.2d 49 (1965) *and* National Shawmut Bank of Boston v. New Amsterdam Cas. Co., 411 F.2d 843 (1st Cir. 1969) *and* Aetna Cas. & Sur. Co. v. Perrotta, 62 Misc. 2d 252, 308 N.Y.S. 2d 613 (Sup. Ct. 1970). *But see* Maryland Cas. Co. v. Mullett, 295 F. Supp. 875 (W.D. Pa. 1969); National Sur. Corp. v. State Nat'l Bank of Frankfort, 454 S.W.2d 354 (Ky. 1970). It was questionable whether a surety had a "right to payment *under a contract* not yet earned by performance," as section 9-106 requires for a contract right. (Emphasis added). If there was such a contract right, then it was arguably excluded from Article 9 as "a transfer of a contract right to an assignee who is also to do the performance under the contract." 1962 Code § 9-104(f). Yet the conflict was just not the kind that Article 9 was designed to cover. Presumably no one will argue that a surety's right to payment, in the event of performance, arises from a contract for goods sold or leased or services rendered, as an account must. Nor can a surety's rights be easily fit into the definition of general intangibles. In a definitive opinion written by Mr. Justice (formerly Profes-

if so as to what, is less than immediately obvious.[45]

sor) Braucher, the Supreme Judicial Court of Massachusetts has now held that "[F]iling under the Code is unnecessary to preserve the priority of a surety's right of subrogation over the rights of a construction contractor's trustee in bankruptcy. " Canter v. Schlager, 8 UCC Rep. Serv. 932, 935 (Mass. 1971).

45. Or, as Sir Walter Scott put it, "We build statues of snow and weep when they melt." Quoted in Auden, Book Review, THE NEW YORKER, Feb. 20, 1971, at 117