Priority Problems in Receivables Financing: The German Experience and the Uniform Commercial Code Compared

Peter L. Murray
PRIORITY PROBLEMS IN RECEIVABLES FINANCING: THE GERMAN EXPERIENCE AND THE UNIFORM COMMERCIAL CODE COMPARED

PETER L. MURRAY*

The Federal Republic of Germany is one of the few nations of Western Europe which has developed a system of secured financing which contemplates the everyday use of inventory and accounts receivable as collateral in commercial financing transactions. Moreover, this system, which has been in development since 1900 when the German Civil Code (Bürgerliches Gesetzbuch) became effective, in many respects parallels the system of commercial financing provided by Article 9 of the Uniform Commercial Code. In particular, the two systems are similar in that they both provide for assignment of accounts receivable by debtors to creditors through both direct contracts of assignment and as proceeds of the sale of inventory collateral.

A difficult problem of conflicts between creditors secured with accounts receivable has arisen under the German system. The conflict in its classic form arises between a creditor who lends money to a debtor and accepts an assignment of present and future accounts receivable as security for the loan, and a goods supplier who claims the same accounts as proceeds of a permitted resale of inventory in which the supplier had a purchase money security interest. Under

* A.B., Harvard University, 1964; LL.B., M.C.L., Harvard Law School, 1967; Member of the Maine and Massachusetts Bars; Associate, Pierce, Atwood, Scribner, Allen & McKusick, Portland, Maine.

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2 Throughout this article citations to the German Civil Code (Bürgerliches Gesetzbuch) [BGB] will be to the Palandt edition no. 23 (C.H. Beck 1964).

3 See Kollisionen zwischen der dinglichen Sicherung von Lieferantenkredit und Bankkredit, Tägung für Rechtsvergleichung; Fachgruppe für Zivilrechtsvergleichung, Vienna 1963, which discusses the possibilities for such conflicts of various types in Germany, France, and the United States.

355
Article 9 of the Uniform Commercial Code, a similar conflict is possible. An examination of the German experience with this problem, and the attempts of German jurists and scholars to resolve it, will be helpful in clarifying the legal elements of the American situation, and will aid legislative and judicial attempts to resolve the conflict.

I. THE LEGAL CONCEPTS USED IN INVENTORY AND RECEIVABLES FINANCING IN GERMANY

In Germany, the three chief forms of non-possessory commercial financing arrangements applicable to receivables are: (1) extended reservation of ownership (Verlängerte Eigentumsvorbehalt), (2) security transfer (Sicherungsübereignung), and (3) global assignment (Globalzession or Globalvorausabtretung). These arrangements are all based on combinations of provisions in the German Civil Code.

A. Extended Reservation of Ownership

Reservation of ownership (Eigentumsvorbehalt) is based on Section 455 of the Civil Code and on the general Code provisions dealing with the transfer of ownership in personal property. Accord-

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4 P. Coogan, W. Hogan & D. Vagts, Secured Transactions under the Uniform Commercial Code ch. 16 (1967); G. Gilmore, Security Interests in Personal Property § 29.4 (1965); B. Sievers, supra note 1, at 1.

5 The German terms have been translated fairly literally, thereby communicating their legal significance under German law without being labeled with a roughly parallel American term freighted with special connotations from the American experience. Since the philosophy of the German Code is not quite the same as the philosophy of the American system of mixed common and statute law, the German terms do not lend themselves easily to translation into the American legal idiom. Important German terms have been noted parenthetically beside the translations. Undoubtedly the very precise reader will wish to refer to the original German sources cited.

6 The German Civil Code was passed by the Reichstag in 1896 and became effective on January 1, 1900. The Code purported by its terms to furnish a complete self-contained system of private law. With few revisions, the Code continues to be the framework for the German civil law today.

7 BGB § 455 provides:

If a seller has reserved the ownership of a movable thing until payment of the purchase price, it shall be presumed that transfer of ownership will occur on the condition of full payment of the purchase price and that the seller is entitled to recission of the contract if the buyer defaults in payment.

Reservation of ownership in personal property may be accomplished by the mere oral notification of the buyer by the seller, that ownership will be reserved. However, if the buyer is so notified after the sales contract has been executed, he may refuse to accept the goods or to pay for them. If he does accept the goods, he is bound by the reservation of ownership. See K. Haegele, Eigentumsvorbehalt und Sicherungsübereignung 14 (1951) [hereinafter cited as Haegele], which discusses formation of reservation of ownership by the seller at various stages of a purchase transaction; Judgment of April 9, 1929 (Reichsgericht), in 58 Juristische Wochenschrift 2164 (1929), where reservation of ownership printed on the back of an invoice was held valid when the debtor accepted the goods. The basis for reservation of ownership through unilateral action by the seller is BGB § 929, which prescribes agreement and transfer of possession as prerequisites for the transfer of ownership in personal property. Without the express or implied agreement of the seller, ownership will not pass to the purchaser despite a transfer of possession. Ex-
RECEIVABLES FINANCING

...ing to section 455, ownership in personal property may be retained by the seller after delivery of the property to the buyer until such time as the parties may agree upon for the passing of title. The interest retained by the seller is actually ownership (Eigentum), but he may be divested of this ownership by the sale and delivery of the property by the possessor to a good faith purchaser. There is no necessity to file or give public notice in order to make the rights of the owner of the property superior to other creditors of the debtor-purchaser, secured or unsecured, including the trustee in bankruptcy. The property covered by reservation of ownership is not the property of the

press notification of reservation of ownership is usually necessary to counteract the agreement presumed in most commercial transactions. Once ownership has been transferred by delivery and agreement, it cannot be retroactively reserved by agreement or otherwise. For additional discussion of the basic foundation and characteristics of reservation of ownership, see P. Hofmann, Der verlängerte Eigentumsvorbehalt als Mittel der Kreditsicherung des Warenlieferanten (Mainz 1960) (doctoral dissertation) [hereinafter cited as Hofmann]; 3 E. Geseler, W. Hefermehl, W. Hildebrandt & G. Schröder, Kommentar zum Handelsgesetzbuch § 368 app. (3rd ed. 1956) [hereinafter cited as Geseler], which shows that although reservation of ownership is expressly sanctioned in BGB § 455 with regard to payment of the purchase price, the concept proceeds from the basic prescriptions of BGB § 929, and a transfer of ownership may be predicated on conditions other than payment of the purchase price. Judgment of April 15, 1964 (Bundesgericht), in 17 Neue Juristische Wochenschrift 1788 (1964), discusses formation of reservation of ownership in general business conditions (allgemeine Geschäftsbedingungen) printed on business forms.

Under BGB § 932, a good faith purchaser (gutglaubiger Erwerber) of personal property in the actual possession of his transferor will get good title to the property regardless of the title of his transferor, provided that the transferee takes immediate possession of the property upon purchase. This doctrine of good faith purchaser is one of the cornerstones of the German law of personal property.

Ownership of the seller is also divested by manufacture of the goods into a new product by the debtor under BGB § 950. However it has been held and it is generally accepted that the parties can agree in advance that the interest of the seller-creditor will continue in the manufactured product. Whether this interest in the product is actually a separate security transfer subject to the requirements of a security transfer, or merely a permitted contractual modification of the reservation of ownership has been vigorously debated and was the subject of a recent Bundesgericht decision. See Flume, Der verlängerte and erweiterte Eigentumsvorbehalt, 3 Neue Juristische Wochenschrift 841, 843 (1950), where the author contended that an interest in manufactured products may be contractually modified; BGB § 950 n.1 (Palandt 23rd ed. 1964); Jacusial, Der Eigentumsvorbehalt 25 (1932), where it was contended that BGB § 950 cannot be modified by reservation of ownership, since it was enacted for the protection of workers and unsecured creditors. This can be compared with Judgment of March 20, 1964 (Oberlandesgericht Neustadt), in 17 Neue Juristische Wochenschrift 1802 (1964), which seems to take a middle ground, holding that BGB § 950 does not preclude an arrangement whereby reservation of ownership can continue in manufactured goods, but that the section cannot be waived by a mere contract, and which held as valid a purchase contract whereby the debtor was to manufacture extended reservation of ownership collateral as agent for the supplier-creditor.

Reservation of ownership will continue in goods which have been commingled. The reservation of ownership creditor will have joint ownership of the commingled goods in proportion to the value of his collateral compared to the value of the other components of the total. BGB §§ 947, 948. See Judgment of Sept. 21, 1950 (Landesgericht Braunschweig), in 4 Monatschrift für Deutsches Recht 735, 740 (1950), which was concerned with jam and jam containers.

357
debtor-purchaser until the conditions contained in the reservation of ownership agreement are fulfilled. Upon fulfillment, ownership of the collateral passes to the debtor-purchaser.

The condition on which ownership passes under a reservation of ownership arrangement usually is the payment of the purchase price of the collateral by the debtor-purchaser. However, in many cases the passing of ownership may be conditioned on the performance of other, more specific acts by the use of one of the expansion forms (Erweiterungsformen). Among these are: Kontokorrentvorbehalt, under which ownership of collateral does not pass to the vendee until all outstanding obligations of the vendee to the vendor have been paid in full; Konzernvorbehalt, under which ownership remains in the vendor until the vendee's obligations to other named creditors are paid; and weitergeleitete Eigentumsvorbehalt, under which the vendee pledges to resell the collateral so that his purchaser will take subject to the reservation of ownership of the original supplier-creditor.

B. The Security Transfer

The security transfer (Sicherungstibereignung) is a transfer of ownership of property already in the possession of the debtor, to secure an obligation not generally arising from the purchase of the collateral.

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9 This means that there are no specific legal protections for debtors under extended reservation of ownership, and arrangements to protect the debtor upon default must be incorporated into the contract of reservation of ownership. Of course any arrangement which is so one-sided as to shock the conscience might be struck down under BGB § 138, which invalidates transactions offending good morals (die guten Sitten).

This arrangement is to be contrasted with the German pledge law (Pfandrecht), which regulates possessory security interests, and which contains stringent procedural safeguards to protect the debtor on default and otherwise. See BGB § 1200 et seq.

The right of the debtor-purchaser under an agreement of reservation of ownership is one of expectancy of ownership (Anwartschaftsrecht auf das Eigentum). The nature of this right of expectancy and whether it in turn can be sold, pledged, and so on is an interesting problem. See, e.g., Judgment of May 21, 1953, 10 Entscheidungen des Bundesgerichts in Zivilsachen [BGHZ] 69, where a right of expectancy was determined to be not effective against all persons.

10 Agreements of reservation of ownership usually either provide that ownership will pass to the debtor automatically upon fulfillment by the debtor of the prescribed condition, or that the creditor will convey the property to the debtor upon fulfillment. See BGB § 929. Reservation of ownership may only be employed by a creditor who is also a supplier of the collateral.

11 More detailed explanations of each of these and other less common forms involving reservation of ownership will be found in Gessler, supra note 7, 1613; 1 R. Serick, Eigentumsvorbehalt und Sicherungsübertragung § 5, at 79-84 (1963); Hoffman, supra note 7, 47-58. See also Judgment of June 15, 1964 (Bundesgericht), in 4 Neue Juristische Wochenschrift 1788 (1964).

12 It is to be emphasized that ownership and not a limited security interest is being transferred, see note 5 supra. The security transfer is utilized both for loans made for the purpose of purchasing inventory collateral and for loans for other business purposes of the debtor.
This form of security interest is often used to secure money loans with inventory collateral.  

The security transfer is not specifically provided for in the Civil Code, and in fact the Code places burdens upon such transfers. To transfer ownership in personal property under the Code, there must be agreement between the parties that ownership is being transferred (Einigung), and there must be a physical transfer of the possession of the transferred object (Übergabe). Agreement alone, without the accompanying change of possession, usually will not cause a change in ownership. This requirement of change of possession in order to transfer ownership of personal property would seem to be a serious impediment to creating non-possessory security interests. Moreover, the sections of the Civil Code providing for pledge, that is, possessory security interests, contain strict requirements that the collateral in fact be transferred to the possession of the creditor in order for the pledge to be effective. Of course, the requirement of change of possession for transfer of ownership or pledge reflects the general policy in favor of public notice (Publizitätsprinzip), and against secret liens and secret rights of ownership in property ostensibly owned by its possessor.

The commercial and economic need for some kind of effective security interest in inventory produced the security transfer, despite the Code policy favoring publicity of transfers and security interests. According to sections 929 and 930, ownership in personal property may be transferred by agreement that title should pass coupled with transfer of either immediate possession (unmittelbare Besitz) or mediate possession (mittelbare Besitz). Mediate possession occurs

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14 But see BGB § 929 which provides an exception for ownership interests in unregistered ships, which may be transferred by agreement alone.

15 BGB § 1205 provides:

For use of the pledge law it is necessary that the owner transfer possession of the thing to the creditor and that both are in agreement that the pledge law shall apply. If the creditor is in possession of the thing, agreement of application of the pledge law is sufficient.


16 For a discussion of the extreme abhorrence by the German business community of any publicity of credit arrangements, see H. Westermann, Interessenkollisionen und ihre richterlich Wertung bei den Sicherungsrechten an Fahrnis und Forderungen 1-5 (1954) [hereinafter cited as Westermann].

17 Gessler, supra note 7, 1624; M. Unterreiner, supra note 13, at 15.

18 BGB § 929 provides:

For the transfer of ownership in a movable thing it is necessary that the owner physically transfer the thing to the possession of the transferee and that both
where actual possession of the property is lodged in a trustee, bailee or custodian to be surrendered to the mediate possessor on demand.\textsuperscript{19} The Code was interpreted by lawyers and judges as meaning that ownership could be transferred by agreement, accompanied by a further agreement that the transferor would retain possession of the property as custodian for the transferee.\textsuperscript{20} Thus, in the case of inventory financing under a security transfer, the debtor would agree to a transfer to the creditor of ownership in described inventory, and the parties also would separately agree that the debtor would hold the goods for the creditor as custodian, or in a similar legal relationship. Of course, the agreement would provide that the debtor-custodian would be free to manufacture and sell the creditor's property in the ordinary course of business, and that ownership would revert to the debtor upon payment of his obligations to the creditor.\textsuperscript{21}

It should be emphasized that the security transfer also does not require any form of public notice or filing.\textsuperscript{22} The only requirement is agreement among the parties to a transfer of ownership and a transfer of mediate possession through a custodial arrangement. It is thus a secret lien of the very type condemned by the publicity principle underlying the Code provisions on pledge transactions. While this is also

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agree that ownership shall be transferred. If the transferee is already in possession of the thing, agreement of transfer of ownership is sufficient.
\end{quote}

\textit{BGB} § 930 provides:

\begin{quote}
If the owner is in possession of the thing, the physical transfer of possession can be replaced by a legal relationship between the owner and the transferee through which the transferee gets mediate possession of the thing.
\end{quote}

\textit{BGB} § 868 defines mediate possession as follows:

\begin{quote}
If one possesses a thing as usufructuary, pledgee, lessee, tenant, custodian or under a similar arrangement by the power of which he is entitled to or entrusted with possession with respect to another person, so is the other person also possessor (mediate possession).
\end{quote}

However the relationship required under \textit{BGB} § 930 need not be one of those mentioned in \textit{BGB} § 868. Any legal relationship which defines a right of possession in a person other than the owner will create mediate possession in the owner. See Gessler, supra note 7, 1626.

\textsuperscript{20} In the decision of March 11, 1904, the Reichsgericht recognized a security transfer of a crane and equipment to a creditor, and upheld it against an attempted distraint and execution by another creditor. Judgment of March 11, 1904, 57 RGZ 175. See also Judgment of Dec. 5, 1905, 62 RGZ 126, where a security transfer of consumer goods and furnishings was upheld against a judgment creditor who attacked the transfer as a secret pledge.

\textsuperscript{21} See 2 R. Serick, Eigentumsvorbehalt und Sicherungsübertragung §§ 18, 19 (1965), for a discussion of clauses regulating the duties of both parties to a security transfer. There are a few exceptions to this rule. Non-possessory security interests in registered ships, shipyards, and telegraph cables must be registered in appropriate public registers. H. Vollmer, Der verlängerte Eigentumsvorbehalt 108 (Frankfurt 1962) (doctoral dissertation) [hereinafter cited as Vollmer]. In addition, under the Farm Credit Law (Pachtkreditgesetz), Law of Aug. 5, 1951, [1951] Bundesgesetzblatt [BGBl.] 494, farmers may give a non-possessory security interest in their entire operations, including land, equipment and inventory, to farm credit institutions. These interests must be entered in an official record at the local court.
true of the reservation of ownership, such reservation is specifically sanctioned in section 455. However, the security transfer, as well as the reservation of ownership, has become so common commercially in Germany that any creditor of minimum sophistication will not assume that his debtor actually owns all of the goods in his possession, but will expect that some or all of the debtor's apparent property is subject to the rights of secured creditors.23

The creation of a valid security interest by security transfer is subject to a fairly stringent requirement that the collateral covered be specifically defined. Unless the collateral is very clearly described, so that both parties know exactly what is being transferred, and so that a court or third party may ascertain what is covered from the terms of the agreement, the transfer lacks the specificity necessary for an agreement under sections 929 and 930, and the purported transfer is void.24 Security transfers of collateral described as "five tons of flour" or "10,000 DM [Deutsch Mark] worth of iron and steel" are not valid, since the particular five tons of flour or the particular batch of steel worth 10,000 DM is not clearly specified.25 Moreover, agreements which attempt to create a security interest through a security transfer in collateral to be designated later by the debtor, and which is not

23 Apparently, printed clauses of reservation of ownership are to be found on virtually every invoice in modern Germany. In many industries goods are delivered under reservation of ownership unless it is specifically agreed otherwise, see Vollmer, supra note 22, 18; Hofmann, supra note 7, 33-36. Cf. Judgment of Feb. 27, 1931, 132 RGZ 183.

The mere fact that a security transfer was secret would not make it unconscionable as a fraud on unsecured creditors.

24 See Haegele, supra note 7, 68. When the security transfer is utilized to create security interests in equipment such as machines, definiteness is achieved by a careful description of the items covered. However, when a creditor seeks to create a valid interest in a part of the debtor's inventory, the problems of definiteness become more acute. See Judgment of Dec. 10, 1931, (Reichsgericht) In 51 Juristische Wochenschrift 1197, 1199 (1932), which held that there must be special marks on transferred goods sufficient to insure definiteness; Judgment of Feb. 27, 1931, 132 RGZ 183, which held that there can be no reference to books of accounts or such general statements indicating a security transfer of "drugs" and "specialties." See also Mezger, Wann sind Sicherungsübereignungen wirksam?, 23 Konkurs-, Treuhand-, und Schiedsgerichtswesen 129 (1962).

The security transfer creditor does not have the advantage of the reservation of ownership creditor who usually already has had possession of the collateral and delivered it to the debtor subject to his interest. The problem of definiteness for the supplier-creditor generally does not arise until his collateral is sold to create accounts receivable.

25 Judgment of June 13, 1956, 21 BGHZ 52. In that case the court stated: "It lies in the nature of the arrangement that only individually defined things and not portions of a whole described merely by quantity or value may be transferred." Id. at 55. In the Judgment of Nov. 7, 1921, 103 RGZ 151, the court held that an attempted transfer under §§ 929, 930 of 50 cases of sardines out of a larger quantity owned by the transferor was void since there was no description of which 50 cases were transferred. In the Judgment of March 4, 1930, 127 RGZ 337, the court alternatively held that a transfer of 15,000 kg. of tobacco and 10,000,000 cigarettes was ineffectual for indefiniteness when the transferor held much more of each commodity. In the Judgment of May 21, 1912 (Reichsgericht), in 41 Juristische Wochenschrift 797 (1912), the court held that a transfer of 50,000 tiles out of a total of some 700,000 was void since the 50,000 purported to be transferred were insufficiently described.
otherwise sufficiently described, do not become valid until the collateral is in fact so designated, because of the lack of an agreement until that time. However, security transfers of all of a particular type of collateral that the debtor has or may acquire are sufficiently definite, since it is possible to ascertain at the time of the contract, and at any time thereafter, exactly what is covered by the transfer. Security transfers of after-acquired property are permitted so long as the collateral is so defined that it can be determined at its acquisition by the debtor whether it will be subject to the security transfer, without recourse to any source of definition other than the original agreement.

In order to satisfy the requirement of definiteness, while retaining maximum commercial flexibility for the debtor, the security transfer of the changing contents of warehouses (Sicherungsübereignung von Warenlagern mit wechselnden Bestand), has come into common use. Under this form, the debtor assigns the contents of a particular warehouse or storeroom to the creditor in a security transfer, and the contents of the warehouse at all times defines the interest of the creditor.

If no formal designation is made by the debtor, the security transfer is not valid. See Haegele, supra note 7, 70.

R. Serick, supra note 21, at 155, 156.

Haegele, supra note 7, 65, which states that the interest is still valid but very difficult to prove.

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Where goods under reservation of ownership are brought into a transferred warehouse, and where they are commingled with goods already there, the security transfer may fail for indefiniteness. Judgment of March 9, 1926, 113 RGZ 57, which held a security transfer of sacks of flour void. But see Judgment of Feb. 27, 1931, 132 RGZ 188.
RECEIVABLES FINANCING

The reservation of ownership and security transfer provide adequate security for inventory financers during the time that the inventory collateral is still in the possession of the debtor. However, with resale by the debtor to a third party, the interest of the creditor in the goods disappears. Section 455 does not provide a substituted collateral for the sold inventory; however, financers have availed themselves of Section 398 of the Civil Code to "extend" their inventory arrangements to accounts arising from the sale of inventory collateral. In so doing they have created the concept of extended reservation of ownership (verlängerte Eigentumsvorbehalt), and the extended security transfer. Under the terms of an agreement of extended reservation of ownership, a simple reservation of ownership is coupled with an assignment of accounts under section 398. A security transfer may be similarly extended.

C. Global Assignment

Section 398, which provides the legal basis both for direct security assignments of accounts (Globalzession), and for assignments of accounts as proceeds for the sale of inventory collateral (verlängerte Eigentumsvorbehalt), is a general provision permitting free assignability of money claims. It provides: "A claim may be transferred by the creditor by a contract with a third party to this third party. With the execution of the contract the new creditor assumes the position of the former creditor." The language of the section is general and encompasses assignment of all types of legal claims (Forderungen), liquidated or unliquidated, those which have matured through past performance of the assignor as well as those subject to future per-
The types of claims which are most often assigned in commercial financing are accounts receivable and contract rights. The question arose early in the history of the Civil Code whether section 398 validated the present assignment of claims to arise in the future. In 1903 the Reichsgericht, the German Supreme Court, held that present assignments of future claims are valid. The court found that these assignments were valid under pre-Civil Code German law, and also were recognized by the “common law” (Gemeines Recht). Since the Code did not expressly sanction or forbid assignments of future accounts, the court reasoned that the Reichstag, the German Legislature, did not intend to change the prior law in this respect, for had it so intended, it would have expressed itself unambiguously.

The Reichsgericht further noted that assignment of future accounts was necessary for a strong system of commercial financing. The importance of section 398, according to the Reichsgericht, is its recognition of assignments of accounts generally, and its fixing of the time of the assignment as the time the contract of assignment is executed, whether or not the accounts assigned have arisen.

permitted resale of inventory collateral. Judgment of April 30, 1959, 30 BGHZ 149; Westermann, supra note 16, 13 et seq. See BGB § 398. The Civil Code also provided for the pledge of claims under §§ 1280-90. Pledges of claims under these sections are restricted to accounts or claims presently in existence. Moreover, in order for a pledge of claims to be effective, the obligor on the claim must be notified. For these reasons, the pledge law, with its protections for the debtor is unacceptable as applied to receivable financing, and the direct assignment section is employed in its stead.

33 See Roth, Zur Quantitätsfrage bei Sicherungen durch Zessionen, 15 Die Wirtschaftsprüfung 312, 343 (1962), for a detailed discussion of economic and business problems of receivables financing, including methods of determining the security of receivables collateral and of realizing on assigned accounts in case of default.

34 The pre-World War II Reichsgericht and post-war Bundesgericht are the courts of last resort for ordinary civil matters under the German judicial system. Actions are commenced in the Landesgericht (regional court) and an appeal with a trial de novo of facts and law may be had to the Oberlandesgericht (superior regional court). Review of the decision of the Oberlandesgericht by the Reichsgericht or now Bundesgericht is limited to revision. On revision the court may only consider and rectify errors of law of the lower courts. The findings of fact of the superior regional court will not be questioned. The Bundesgericht sits in 5 judge senates (Senaten) whose decision is that of the court. Whenever one senate wishes to overrule the decision of another senate, discussion and ruling must be by the entire court.

35 Judgment of Sept. 29, 1903, 55 RGZ 334. In that case the debtor in April, 1900, assigned to plaintiff proceeds due under a contemplated building contract between the debtor and the defendant. The building contract was not executed until June 1, 1900. Defendant refused to pay plaintiff on the ground that the April assignment was ineffective to convey an interest in a future claim.

36 Judgment of Sept. 29, 1903, 55 RGZ 334, 335. There are two types of direct security assignments under BGB § 398. The global or general assignment (Globalzession, Globalvorausabtretung) purports to presently assign present and future accounts, and is effective as of the time it is executed. The blanket assignment or special assignment (Manteizession) provides for accounts to be designated from time to time by the debtor. Such an assignment is valid as to any particular account only as of the time that the
Since this decision, the courts have viewed the question of the validity of present assignments of future accounts as settled. Although there still exists a vociferous minority who insist that section 398 does not and cannot validate present assignments of future accounts, the great majority of the commentators join with the courts in recognizing the validity of present assignments of future accounts under section 398, and, in practice, present assignment of future accounts is provided for in almost every commercial financing agreement involving inventory or receivables which is executed in Germany today.

A valid assignment of accounts receivable or contract rights under section 398 requires only agreement between the assignor and the assignee. With the execution of the agreement, the assignee steps into the legal shoes of the assignor. All defenses and setoffs of the account debtor which would be good against the assignor are good against the assignee. Payment to the assignor discharges the obligation designation is made, regardless of the time of the original agreement. H. Scholtz, Das Recht der Kreditsicherung 363-73 (3rd ed. 1965) [hereinafter cited as Scholtz].

See K. Hahnzog, Die Rechhtstellung des Zessionars künftiger Forderungen (1962), for a detailed discussion of various problems of assignments of all sorts of claims to secure indebtedness, and for other purposes, from the viewpoint of the creditor-assignee; B. Sievers, supra note 1, at 29-31.

In Eccius, Zur Frage der Abtretung künftiger Forderungen, 9 Deutsche Juristenzeitung 54 (1904), the author argues against present assignment of future claims. In Fischer, Der verlängerter Eigentumsvorbehalt in der Krise, 12 Neue Juristische Wochen- schrift 366 (1959), the author contends that assignment of future accounts have no legal foundation and should not be permitted. Doubts are raised concerning the assignment of accounts in von Caemmerer, Verlängerte Eigentumsvorbehalt und Bundesgerichtshof, 8 Juristenzeitung 97 (1953); Westermann, supra note 15; Mückenburger, Der verlängerte Eigentumsvorbehalt in der Krise, 11 Neue Juristische Wochen- schrift 1253 (1958).


See B. Sievers, supra note 1, at 35, and Scholtz, supra note 37, 369, 370, for a discussion of terms and requirements for security assignment of present and future accounts.

Claims which by their nature may be only discharged to the original obligee may not be assigned, nor may claims which are rendered non-assignable by agreement of the obligor and the obligee. BGB § 399. See Judgment of Oct. 14, 1963, 40 BGHZ 156, where a contract between the debtor-assignor and the Ministry of Works forbade assignment of any part of it without consent of the Ministry. The debtor concluded an agreement of extended reservation of ownership for materials to be used in fulfilling the contract. Pursuant to this reservation of ownership, amounts due under the contract were assigned to the supplier-creditor. The Ministry of Works was not notified of the assignment at the time, nor did it then give permission. The debtor later asked and received permission to assign the proceeds of the contract to a bank to secure a money loan. Upon hearing of this assignment, the supplier-creditor notified the Ministry of the prior extended reservation of ownership, and the Ministry purported to retroactively ratify the prior assignment to the supplier. Upon the insolvency of the debtor, the Bundesgericht held that the retroactive permission was not effective to validate the extended reservation of ownership assignment, and gave judgment for the bank.
of the account debtor, unless he is notified in writing that the account has been assigned to the assignee.\(^4^4\) No filing or public notice is required for the assignment to be valid against third parties claiming through the assignor.

II. THE REQUIREMENT OF DEFINITENESS IN THE CREATION OF A SECURITY INTEREST

In order for an assignment of accounts under section 398 to be effective, the accounts assigned must be described in the agreement of assignment with a fairly high degree of definiteness (Bestimmtheit) or definability (Bestimmbarkeit).\(^4^5\) Just as it is impossible to create a valid security transfer of 10,000 DM worth of inventory collateral, it is impossible to assign “accounts to the value of 10,000 DM” under section 398.\(^4^6\) Without a clear description of the accounts assigned, the agreement necessary for an effective assignment under section 398 is lacking.

The problem of definiteness is particularly acute when it arises in connection with the assignment of accounts pursuant to an agreement of extended reservation of ownership or an extended security transfer.\(^4^8\) Nearly all agreements of extended reservation of ownership are contained in the printed order-confirmation forms of the seller-creditor as general conditions of delivery (allgemeine Lieferungsbedingungen), and are therefore couched in very general terms.\(^4^9\) Such assignments

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\(^4^4\) BGB § 407. However, the account debtor cannot be required to pay the assignee unless the notification is in writing signed by the assignor. BGB § 410.

\(^4^5\) See B. Sievers, supra note 1, at 35-41. In Flume, Der verlängerte und erweiterte Eigentumsvorbehalt, 3 Neue Juristische Wochenschrift 841 (1950), the author argues for a less stringent requirement of definiteness.

\(^4^6\) Beeser, Abtretung des Bruchteils einer Mehrheit wechselnder Forderungen, 156 Archiv für die Civilistische Praxis 414, 415, 416 (1957). See Judgment of Feb. 27, 1920, 98 RGZ 200, where assignment of 20,500 DM worth of accounts without describing how the amount was to be divided among the several accounts of the debtor-transferor was held void. However, the assignment of a part of a single account otherwise sufficiently defined is perfectly valid. Beeser, supra note 45, at 416, 418.

\(^4^7\) B. Sievers, supra note 1, at 37.

\(^4^8\) Accounts which are designated by the name, initial or geographic location of the account debtor are sufficiently defined. Even those who are inclined to doubt the validity of present assignments of future accounts concede this. Westermann, supra note 16, 21; von Caemmerer, supra note 39, at 99.

The problem of definiteness has been discussed at length by almost all of the commentators and textwriters, as well as by the courts. See Flume, supra note 45; Erman, Verlängerte Eigentumsvorbehalt und Globalzession, 14 Betriebsberater 1109 (1959); Fischer, supra note 39; von Caemmerer, supra note 39.

\(^4^9\) Such clauses provide, for example:

Our deliveries remain our property until payment of our entire balance due, regardless from what transaction, even when the purchase price for certain items has been paid. By running account the reservation of ownership shall be valid as security for our balance due. Manufacture occurs for us, without binding us in any way. If the goods are mixed with or attached to other ob-
usually cover accounts which arise from the permitted resale of inventory collateral. Defining how much of the resulting account is assigned is particularly difficult when the value of the inventory collateral resold is small relative to the size of the account, or when the inventory collateral is sold together with other property not subject to extended reservation of ownership or security transfer.  

A. The Pre-War Standards of Definiteness

During the economic depression of the 1930s, when faced with an increasing flood of attacks on the definiteness of assignments of accounts pursuant to extended reservations of ownership, the Reichsgericht took the position that, to be effective, an assignment of accounts under section 398 had to provide, as of the time of execution of the agreement, absolute definiteness as to what would be assigned under any conceivable circumstances. The court further ruled that the contract was to be read within its four corners, and that the circumstances of the parties were not to be considered in determining whether there

...
could be circumstances under which the assignment agreement was not absolutely clear as to the accounts assigned. \(^{52}\)

In a 1935 decision, the Reichsgericht was faced with the interpretation of a general condition of delivery which provided that, "in case of further sale of the wares delivered by us or after manufacture of said wares, the account receivable is transferred to us as of the time it arises to the extent of our unpaid balance." \(^{53}\) The court ruled that as a legal document (Urkunde) the conditions of delivery were to be construed on revision, and that they did not provide the necessary definiteness for an assignment of accounts under section 398. The court posed the question of what account would be assigned to the supplier-creditor to the extent of the unpaid balance in the event the wares were sold to several customers, or how much of each account would be so assigned. Being unable to answer this question from the four corners of the agreement, the Reichsgericht found the assignment void. \(^{54}\)

In 1937 the Reichsgericht again ruled against the assignment of accounts as proceeds from the sale of inventory collateral. \(^{55}\) In this case the general conditions of delivery authorized the debtor-purchaser either to manufacture the wares or to sell them in ordinary business transactions. However, these conditions also provided that the full amount of all accounts arising out of this sale or manufacture, including the profit and other value, are assigned to the supplier to secure the

\(^{52}\) Judgment of April 8, 1932, 136 RGZ 100.

\(^{53}\) Judgment of Oct. 18, 1935, 149 RGZ 96. In this case the plaintiff supplier, on March 7, 9, and 12, 1931, had delivered tin, pipe, and other items to the debtor, a boiler-maker. On its order-confirmation form was an extended reservation of ownership. The debtor previously had concluded a contract with a factory for the construction and installation of certain steamboilers. Under the contract, payments were to be made as the work progressed. The debtor used the plaintiff’s materials in fulfilling the contract. On June 17, 1931, the debtor assigned part of the amount still due on the boiler contract to the defendant bank. Upon the insolvency of the debtor, the amount due the debtor on the contract was paid into a special fund by the obligor. The plaintiff claimed an amount equal to its unpaid balance from the fund on the grounds of its prior extended reservation of ownership. The defendant claimed that the extended reservation of ownership was void for indefiniteness.

\(^{54}\) The defendant’s claim was satisfied out of the proceeds of the special fund, and the excess was turned over to the trustee in bankruptcy for the benefit of the unsecured creditors.

\(^{55}\) Judgment of April 6, 1937, 155 RGZ 26. In that case the debtor, a tiling concern, was awarded a defense contract to tile certain barracks in January, 1936. It ordered flagstones from the defendant and other materials from various other suppliers, all such orders being under extended reservation of ownership printed on the order-confirmation forms. These materials were used in the defense contract. In early April, 1936, the proprietor of the debtor died and the plaintiff was appointed administrator of the estate. In May, bankruptcy was commenced against the debtor and the plaintiff was appointed trustee. On April 7, the defendant notified plaintiff of its extended reservation of ownership. Payments by the defense department made thereafter were placed in a special fund. The plaintiff sued for a declaratory judgment that the extended reservation of ownership was void, and that the estate of the bankrupt was entitled to the proceeds of the special fund.
RECEIVABLES FINANCING

purchase price of the collateral. The Court reaffirmed its 1935 decision, holding that this assignment could encompass accounts arising from work performed by the debtor in which the collateral was only incidentally used, and in which the value of the collateral used represented a very small portion of the account purportedly assigned. It further found that it was not definite how much, if any, of these accounts would be assigned under the general conditions, and thus that the agreement was void. The court noted that if the general conditions were interpreted as encompassing all accounts in which any of the collateral was involved, either incidentally or otherwise, the assignment would be invalid, because of the possibility of unconscionability. That is, such an assignment would work an economic fettering of the debtor (Knebelung) by tying up his economic assets to an extent disproportionate to the amount advanced.\(^{56}\)

Even though such assignments had been printed on the back of virtually every order-confirmation form in Germany,\(^ {57}\) these decisions of the Reichsgericht all but eliminated assignment of accounts pursuant to extended reservation of ownership in general conditions of delivery. They also adversely affected assignments pursuant to extended security transfers, which were also stated in general terms and tied to resale of the inventory collateral. These decisions were vigorously attacked by commentators and the spokesmen for the supplier-creditors and inventory financers.\(^ {58}\) It should be noted, however, that the decisions did not affect the validity of direct assignments of accounts pursuant to a

\(^{56}\) For a discussion of unconscionability such as that resulting from a fettering of the debtor or fraud on other creditors, see Vollmer, supra note 22, 66-104. An assignment of accounts which is by its terms effective only if the debtor defaults in payments on the underlying obligation is void because of its repugnance to the principle of equality of creditors in bankruptcy. Judgment of Oct. 21, 1932, 138 RGZ 89. Judgment of Dec. 16, 1957 (Bundesgericht), in 11 Neue Juristische Wochenschrift 458 (1958), held that an extended reservation of ownership which assigned accounts unconditionally to the creditor, but which recited that he would not collect them unless the debtor defaulted, was valid. See Hofmann, supra note 7, 156, 157.

\(^{57}\) See Flume, supra note 45, at 846; Hofmann, supra note 7, 136-38. In 1938 the National Industrial Committee (Reichsguppe Industrie) circulated a written recommendation among its members, including all significant elements of the commercial community, urging that they cease including the extended or expanded reservation of ownership in their general conditions of delivery. The Committee strongly recommended restriction of the general conditions to simple reservation of ownership, so that the tremendous confusion and complication which arose from the decisions of the Reichsgericht could be avoided. Grundsätze der Reichsguppe Industrie über die Anwendung des Eigentumsvorbehalt, 100 Deutsche Justiz 619 (1938). See also Schwister, Zu der Grund-sätzen der Reichsguppe Industrie über die Anwendung des Eigentumsvorbehalt, 67 Juristische Wochenschrift 1857 (1938).

\(^{58}\) Strong criticism of the Reichsgericht's doctrine of definiteness came from Flume, supra note 45; Lange, Lage und Zukunft der Sicherungübertragung, 3 Neue Juristische Wochenschrift 565 (1950); Müller, Der verlängerte Eigentumsvorbehalt, 5 Zeitschrift der Akademie für Deutsches Recht 502 (1938). The Reichsgericht's approach, however, found support in von Caemmerer, supra note 39, and Westermann, supra note 16.
general assignment, since such assignments usually arise through special contracts between the creditor-assignee and the debtor-assignor, and the accounts assigned are defined according to the account debtor rather than through the transaction out of which they arise. Therefore, the decisions tended to favor the bank-dominated receivables financing industry while crippling the inventory financing industry.\(^59\)

**B. The Post-War Standards of Definiteness**

During the post-war German economic recovery and boom, there was tremendous pressure on the Bundesgericht to abandon the extremely strict attitude of the pre-war court as to the definiteness requirement for valid assignments of accounts as proceeds in general conditions of delivery.\(^59\) Because cash and credit were generally in short supply, sellers were practically compelled to give credit in order to keep their customers. At the same time, opportunities for receivables financing had far outstripped the resources available, and banks simply did not have the funds to advance to borrowers.\(^61\)

In 1952 the Bundesgericht yielded to this pressure and overruled the earlier decisions.\(^62\) While the court affirmed the rule that the validity of the assignment was to be tested within the four corners of the agreement, without regard to the present circumstances, it also ruled that it was not necessary for the assignment to be definite under all conceivable circumstances, but that it should be definite under those

\(^59\) Westermann, Referat before the 41st Deutsche Juristentag, 41 Deutsche Juristentag Verhandlungen F3 to F5 (Berlin 1955).

\(^60\) See von Caemmerer, supra note 39; Lange, supra note 58; Flume, supra note 45.

\(^61\) See Janberg, Finanzierung durch Lieferantenkredit oder Bankkredit?, 11 Der Betrieb 1425 (1958), for a discussion of the advantages and disadvantages to the borrower of supplier-credit and bank-credit.

\(^62\) Judgment of Oct. 25, 1952, 7 BGHZ 365. In that case the defendant, a plumbing materials supplier, delivered 17,000 DM worth of supplies to the debtor, a plumbing contractor between May, 1949 and January, 1950. These deliveries were under general conditions of delivery including extended reservation of ownership. The reservation of ownership covered "accounts arising from the sale of the goods, including all ancillary rights." The debtor was installing plumbing in 3 houses of a third party at a contract price of 24,000 DM, and he employed about 13,000 DM worth of the defendant's materials in fulfilling this contract. By December, 1949, the third party had paid the debtor some 14,400 DM of the 24,000 DM to be due as work progressed on the contract. On December 8, 1949, the debtor assigned 1000 DM of the amount remaining due on the contract to the plaintiff. The debtor finished his work under the plumbing contract and then became insolvent. The third party placed the remaining 9,600 DM in a special fund for whomever should finally be entitled to it.

The plaintiff sued for a declaratory judgment that its claim to satisfaction from the 9,600 DM was superior to that of the defendant, on the ground that the defendant's prior assignment under general conditions incorporating extended reservation of ownership was void for indefiniteness. The trial court and the superior court found for the plaintiff. The decision of the superior court is the Judgment of Jan. 18, 1952, (Oberlandesgericht Celle), in 5 Neue Juristische Wochenschrift 306 (1952).
circumstances which the parties could have reasonably had in mind at the execution of the agreement. In this connection, the nature of the business carried on by the debtor, and the question whether the creditor knew of the purpose to which the collateral would be put were to be considered in determining the circumstances under which the assignment would have to be definite. The court thus held that if the assignment, under the circumstances foreseeable as of the time of assignment, would provide sufficient definiteness as to the accounts to be assigned, it would not be void for indefiniteness.

This assignment, like that voided in the 1937 decision, encompassed all of the accounts arising from the sale or manufacture of the collateral.\footnote{Judgment of April 6, 1937, 155 RGZ 26.} The court brushed aside the unconscionability argument by concluding that under the circumstances obtaining at the time of the assignment, it was not likely that such an assignment would result in a fettering of the debtor, especially since the agreement contained a clause to the effect that if the accounts assigned exceeded the unpaid balance of the debt by 25 percent, the creditor-assignee could reassign accounts to the debtor-assignor to bring the excess down to 25 percent.\footnote{7 BGHZ 365, 369.}

This decision produced a tremendous increase in inventory financing in Germany, and a universal blossoming of general conditions incorporating extended reservation of ownership on order-confirmation forms of German suppliers on all levels.\footnote{See Westermann, supra note 59, at F3 to F6; Schmitz-Beuting, Zur Kollision von Sicherungsvor-aus-abtretungen an Geld und Warenkreditgeber, 17 Konkurs-, Treuhand-, und Schiedgerichtswesen 88 (1956).} However, the Bundesgericht had not given blanket approval to all future assignments of accounts in general conditions of delivery. This was illustrated in two decisions announced on December 16, 1957 in which the Bundesgericht held one such assignment valid and struck down another as too indefinite.

In the first case,\footnote{Judgment of Dec. 16, 1957, 26 BGHZ 178. In October and November 1953, plaintiff steel supplier delivered some 20,000 DM worth of structural iron to the debtor, a building contractor, for use in the construction of two houses. These deliveries were covered by an expanded and extended reservation of ownership entered into prior to September 1, 1953, pursuant to general conditions of delivery. The debtor secured contracts to build the two houses on September 29, and November 5, 1953. The debtor had concluded a blanket assignment of accounts (Mantelzession) with the defendant on February 15, 1952 under a revolving credit arrangement, and on September 29, 1953, he notified the other party to the house building contract to make progress payments to the defendant bank. Payments were so made and credited to the loan account of the debtor. Upon the insolvency of the debtor, the plaintiff sued under BGB § 816 (unjust enrichment) for amounts paid the defendant under the assignment. The action was dismissed in the trial and appeals courts.} the Bundesgericht found that, according to the
terms of the general conditions of delivery of structural iron from a supplier to a contractor, the entire amount due on performance of the assignor's building contract would be assigned to the supplier. The Bundesgericht struck down the assignment, stating that it was inconceivable that a 200,000 DM contract right could be assigned to cover a 20,000 DM claim, and that the general conditions did not provide for any definite lesser portion of the contract right to be assigned.

In the second case,\textsuperscript{67} the court sustained the assignment of accounts arising from the manufacture and sale of coats from cloth supplied under extended reservation of ownership by the supplier-assignee. Here the accounts were not disproportionately larger than the purchase price of the cloth, and the general conditions included a covenant by the creditor-assighee to release accounts assigned in excess of 125 percent of his unpaid balance.

Although conflicts between receivables financers on the one hand and inventory financers claiming assignments of accounts through extension clauses in general conditions of delivery of the inventory collateral, or through agreements of security transfer of inventory collateral, on the other hand, had been common since the inception of the Civil Code, the new permissive attitude of the Bundesgericht toward assignments of accounts in general conditions of delivery, and the consequent proliferation of these assignments, greatly increased the frequency of these conflicts. As a result there have been many recent suggestions by both jurists and commentators for providing mechanisms to resolve these conflicts.\textsuperscript{68}

\textsuperscript{67} Judgment of Dec. 16, 1957, 26 BGHZ 185. There, the plaintiff cloth supplier delivered to the debtor coat manufacturer some 15.5 meters of heavy coat cloth in March, 1955 under general conditions of delivery including extended reservation of ownership. The assignment stated: "The buyer assigns herewith the accounts receivable from a resale of the collateral to the seller, even if the goods are manufactured." The debtor made 12 ladies coats from the cloth, which were sold together with other merchandise to 3 different customers in July, 1955. At that time the debtor assigned the 3 accounts to the defendant bank to secure a loan. The customers paid directly to the bank, which credited the payments to the debtor's account. Upon insolvency of the debtor, the plaintiff sued the defendant bank for amounts paid by the account debtors.

See also Judgment of July 7, 1953 (Oberlandesgericht Köln), in 8 Betriebsberater 898 (1953), which held that an assignment of an account to full face value in general conditions of delivery was void for indefiniteness even though the account was itemized and easily divisible according to the goods sold.

\textsuperscript{68} Dempewolf, Verlängerte Eigentumsvorbehalt und Globalzession, 13 Monatschrift für Deutsches Recht 801 (1959), which shows that the permissive attitude of the Bundesgericht toward assignments under extended reservation of ownership in general conditions has multiplied conflicts among inventory and receivables financers. See also Flume, supra note 40; Serick, supra note 40; Heidland, Eigentumsvorbehalt bei Finanzierungs Käufen, 23 Konkurs-, Treuhand- und Schiedgerichtswesen 13 (1952), which shows the complicated nature of the problems of conflicts between extended reservation of ownership and other security interests in multilevel financial transactions.
III. CONFLICTING SECURITY INTERESTS
UNDER THE GERMAN CIVIL CODE

The classic case of conflict among the interests of secured creditors in accounts receivable assigned by a common debtor arises between a bank which has advanced money in return for a general assignment of present and future accounts (usually designated by the names or locations of the account debtors), and an inventory financer who has delivered goods subject to extended reservation of ownership covering accounts arising from the sale of inventory collateral. When the debtor sells inventory collateral to any of the account debtors described in the general assignment, there occurs a purported assignment to both creditors. For this reason, the conflict is often referred to as a conflict between goods-credit or supplier-credit (Warenkredit or Lieferantenkredit) on the one hand, and money-credit or bank-credit (Geldkredit or Bankkredit) on the other.°°

However, this is not the only situation when two secured parties might claim the same accounts as validly assigned collateral for their advances. For instance, two supplier-creditors might each claim the total amount of accounts arising out of the sale of a product containing collateral of both creditors. The debtor might fraudulently assign the same accounts to more than one receivables financer to secure advances. An inventory financer under a security transfer might conflict with a supplier-creditor for accounts arising from the sale of goods from a warehouse with changing contents. Thus the possibilities for conflict are numerous.°°

Professor Rolf Serick draws a distinction between two types of conflict.°°° The multiple assignment of security interests in the same collateral through fraud or negligence, according to Professor Serick, poses few problems. However, the conflict arising from the unexpected coincidence of two separate assignments, that is, the classic case of the receivables financer versus the inventory financer, is more complex, as is the case where the collateral of more than one inventory financer are combined, or processed and then sold, resulting in a single account from the sale of the collateral of the secured parties. In these latter situations it is difficult to find legal or policy considerations which entitle

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°°° See Serick, Kollisionen zwischen der dinglichen Sicherung von Lieferantenkredit und Bankkredit, Tagung für Rechtsvergleichung; Fachgruppe fur Zivilrechtsvergleichung, Vienna 1963.

Id; Serick, supra note 40.
either party to priority in the assigned accounts. Moreover, since there are no public notice requirements for creating any of these interests in accounts, conflicts of both types are more likely to occur than in a jurisdiction requiring some sort of filing or notice.

It is questionable whether Professor Serick's distinction between types of conflict is as clearcut as he maintains. For instance, when a debtor assigns to a receivables financer accounts which he knows will arise from the sale of goods under extended reservation of ownership, or when a debtor buys goods under extended reservation of ownership which he knows he will sell to account debtors whose accounts have already been assigned to a bank, the situation is substantively more similar to the first type of conflict, involving fraud or negligence, although in form it is closer to the latter type of conflict. Where two suppliers of component parts each claim accounts arising from the sale of the manufactured product, it is unclear how much of the conflict is due to coincidence, and how much is due to an actual double assignment of the same accounts. The difference seems to be more of degree than of type, with the fraudulent double assignment and the classic case of conflicting good-faith security interests occupying the two extremes of a more or less continuous spectrum of transactions possessing the characteristics of both coincidence and double assignment.\textsuperscript{72}

\section{A. The Priority Principle as a Means of Resolving Conflicts}

Since the Civil Code became effective in 1900, the fundamental principle for resolving conflicting claims under section 398 assignments has been the priority principle (Präventionsprinzip, Prioritätssprinzip),\textsuperscript{73} according to which the first assignee under a valid assignment has precedence in the collateral over later assignees. The term "Priorität" in German means literally "priority in time." The priority doctrine is based on the terms of section 398, under which the assignee steps into the shoes of the assignor with respect to all accounts validly assigned, present and future, and the assignor consequently loses his rights in the claim or account.\textsuperscript{74} The doctrine of good faith purchaser...
(gutgläubiger Erwerber), which plays such an important part in the German law of personal property, has no application to transfers of claims and accounts under section 398. 75

According to the terms of section 398, the time of the assignment for the purpose of applying the priority principle is the time of the agreement of assignment between the assignor and the assignee, whether or not the accounts to be assigned are in existence. 76 In the case of inventory financing, this agreement usually occurs when the debtor-assignor accepts goods under general conditions of delivery which include extended reservation of ownership, or upon the signing of an agreement of extended security transfer. 77 A subsequent assignment is not void, but rather subject to the first assignment. If there is any collateral left after satisfaction of the claim of the prior assignee, the second assignee's claim is valid as to the remainder covered by his assignment. 78

The priority principle makes no distinction between the origins or types of assignments under section 398. 79 If a supplier through an agreement of extended reservation of ownership gets a valid assignment of an account arising from the sale of his inventory collateral, this assignment is good against the later assignment of the account to a receivables financer, regardless of when the goods are sold and the account arises. 80 The same is true of the inventory financer whose assignment covers accounts arising from the sale of manufactured inventory collateral. The earliest assignee prevails over other component supplier-assignees whose collateral was combined and sold to produce the accounts. 81

Serick, supra note 40, where it is shown that an assigned future account will go directly to the assignee when it arises.

75 BGB § 404 provides that a transferee takes a claim subject to any and all legal infirmities existing at the time of transfer. See Serick, supra note 40.

76 Judgment of Sept. 29, 1903, 55 RGZ 334; Schmitz-Beuting, supra note 65, at 89. However, if the account arises after the opening of bankruptcy proceedings, an assignment prior to bankruptcy is ineffective against the trustee. Judgment of Jan. 5, 1955 (Bundesgericht), in 8 Neue Juristische Wochenschrift 544 (1955); Konkursordnung [KO] § 15 (Jaeger 8th ed. 1958).

On the other hand, if goods subject to extended reservation of ownership or extended security transfer are sold after bankruptcy proceedings are opened, the creditor is entitled to the resulting account. KO § 46; Serick, supra note 40. For a basic hornbook on German bankruptcy practice, see K. Haegele, Konkurs-Vergleich Gläubigeranfechtung (2d ed. 1963).

77 Scholtz, supra note 37, 363.

78 BGB § 185. This section allows a stranger (Nichtberechtigte) to make legal dispositions, and then ratify them by later acquiring the disposed of rights. It is most similar to the doctrine of estoppel by deed in American real property law.

79 Compare the Judgment of Dec. 16, 1957, 26 BGHZ 185, which allowed a prior extended reservation of ownership, with that of June 9, 1960, 32 BGHZ 367, which allowed a prior general assignment.


81 Serick, supra note 40, at 150.
The apologists for the priority principle maintain that it produces a definite system for determining which secured creditor will have precedence in receivables collateral in case of conflict. However, this is only true after the fact; that is, the priority principle is only effective to sort out the interests of the receivables assignees after the debtor has become insolvent, and while they are fighting over his commercial assets. Without some complementary system of notice or filing, the priority principle does not enable creditors to know in advance the strength of their security against other claimants in cases where the debtor has more than one secured financer. Where the debtor assigns accounts arising from the manufacture and sale of the inventory collateral of several secured suppliers, it is often a matter of chance whose collateral was first shipped to the debtor, and who, consequently, will have the first claim to the proceeds of the combined inventory collateral.

B. Attempts to Mitigate the Harshness of the Priority Principle

1. Joint Ownership in Accounts

The fact that strict application of the priority principle to the interests of all secured inventory and receivables financiers creates unsatisfactory results generally has been recognized in the German legal and commercial communities. In order to mitigate the harshness of the doctrine in the case of conflicting claims by inventory suppliers in manufactured goods, German inventory suppliers have modified their general conditions of delivery to provide for joint reservation of ownership of processed goods. Until recently, however, supplier-financers were unable to provide for corresponding joint ownership of accounts arising from the sale of these manufactured goods because of the risk that such a clause would invalidate the whole assignment for indefiniteness. Of course, when the agreement provided for assignment of the full account arising from the sale of manufactured goods to the supplier of merely one component, the assignee ran the risk that his interest might be struck down as unconscionable because it could en-

82 Serick, supra note 40, and Dempewolf, supra note 68, attacked Flume's thesis and defended the priority principle. See also Wendt, Eigentumsvorbehalt bei Finanzierungen, 10 Monatschrift für Deutsches Recht 336 (1956).
83 Flume, supra note 45; Flume, supra note 40; Hees, Verlängerte Eigentumsvorbehalt und Globalzession, 9 Monatschrift für Deutsches Recht 525 (1955); Erman, supra note 48.
84 One such condition provides: "If the collateral is processed with other goods not the property of the seller, the seller obtains joint ownership in the new thing in ratio of the value of the collateral to the other processed components." Reprinted and construed in Lindenmaier-Mühling, No. 9 (Ga.) to BGB § 157 (1963).
85 See Hofmann, supra note 7, 158-62.
RECEIVABLES FINANCING

compass an account many times the size of the claim secured and would result in an economic fettering of the debtor.  

The possibility of joint ownership in accounts arising from the sale of inventory collateral was judicially recognized in a 1963 decision of the Bundesgericht.  

In that case the plaintiff, a cloth goods supplier, delivered cloth to the debtor, a fabricator of women's coats, according to the seller's general conditions of delivery which included the following clauses of extended reservation of ownership:

The accounts receivable of the buyer from the resale of the collateral are assigned as of this time to the seller, regardless of whether the collateral is resold before or after manufacture or to one or several purchasers. The assigned accounts serve as security for the seller only to the amount of the value of the collateral resold to that time. In case the collateral is resold together with other goods not belonging to the seller, whether manufactured or not, the assignment of accounts will be valid only to the amount of the value of the collateral which . . . is the object of this purchase contract.

On January 27, 1960, the debtor assigned a number of accounts to the defendant bank through a blanket assignment (Mantelzession), and the account debtors were notified of the assignment in August, 1960. The account debtors paid directly to the defendant. The plaintiff claimed a portion of the assigned accounts which arose from the resale of coats containing its inventory collateral on the basis of its prior extended reservation of ownership. The defendant maintained that the assignment through extended reservation of ownership was void for indefiniteness. It was stipulated that the value of the collateral comprised 50 percent of the face amount of the disputed accounts.

Although the trial court found for the plaintiff, the intermediate appeals court reversed, holding that the plaintiff's assignment was void because of the ambiguity of the term "value of the collateral" (Wert der Verbehaltswaren) which defined the extent of the plaintiff's purported assignment. The Bundesgericht, however, construed the general conditions of delivery on revision and found the term "value of the collateral" to be an absolute measure of the amount of the accounts assigned. The intermediate court of appeals had interpreted the phrase

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87 Judgment of Oct. 23, 1963 (Bundesgericht), in Lindenmaier-Möhring, No. 9 (Ga) to BGB § 157 (1963). But see Judgment of Feb. 12, 1959 (Bundesgericht), in Lindenmaier-Möhring, No. 8 to BGB § 398 (1959), where an extended reservation of ownership assignment of contract claims to the value of the delivered goods was held void for indefiniteness.
as establishing a fractional part of the accounts to be assigned, and hence as being too vague to be valid. The Bundesgericht decided that the "value of the collateral" was to be determined by the price paid for the collateral by the debtor according to the purchase contract, rather than by the proportionate part of the resale price attributable to the collateral, or the market value of the collateral at the time of manufacture or resale. The Bundesgericht thus upheld the prior assignment of the supplier to the extent of the purchase price of the resold collateral.

This case was indeed significant because, for the first time, an assignment of accounts in general conditions of delivery had avoided both the Scylla of indefiniteness and the Charybdis of unconscionability purely by skillful drafting, and without regard to the conditions pertaining between the debtor and creditor at the time of the assignment. Thus, a way was opened to supplier-financers to insure the validity of their assignments to the extent of the price of the collateral sold, even if the assignments were printed on order-confirmation forms or invoices as general conditions of delivery. Moreover, several supplier-creditors could hold valid interests in the same accounts to the extent of the prices of their collateral. The old problem of the harsh effects of priority among supplier-creditors was greatly mitigated. The decision did not directly change the priority principle or solve the classic conflict between inventory financers and receivables financers. It did allow supplier-creditors to create a valid assignment of accounts, limited to the extent of the price of their collateral, so that additional valid interests of both receivables and inventory financers in the accounts collateral could also be created.

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89 See Scholtz, supra note 37, 282, 283.
90 Of course their interests to the value of their collateral would be ranked by priority, but presumably there would be enough in the account to satisfy several such creditors. See Mückenberger, supra note 39, at 1756, which suggests such a partial assignment as a solution to the problems of priority among inventory financers.
91 One commentator has suggested that this decision might lead to a solution of the classic conflict. Riesenfeld, Book Review, 54 Calif. L. Rev. 1854, 1856 (1966). Certainly, if the supplier-creditors would make it a practice to so limit their extended reservation of ownership, the conflict would be mitigated. But without complementary voluntary action by money-lender assignees, the conflict would still exist. But see assignment clause reprinted in note 48 supra.
92 The decision of Oct. 23, 1963, was reaffirmed by the Bundesgericht in its decision of April 24, 1968. In that case also, the supplier-creditor sought to create an extended reservation of ownership of accounts receivable to the extent of the value of the inventory collateral sold. The court found that the supplier's interest was sufficiently definite to be valid to the extent of the wholesale price of the collateral, although it refused to recognize any interest in the accounts for trucking services rendered by the supplier-creditor. Judgment of April 24, 1968 (Bundesgericht), in 21 Neue Juristische Wochenschrift 1516 (1968).
RECEIVABLES FINANCING

2. Judicial Application of the Principle of Unconscionability

Another disadvantage of the classic priority principle is that, strictly applied, the receivables financer will usually win over the long term. That is, shortly after a receivables financer gets a global assignment of accounts, the wares ordered and delivered prior to his assignment will be manufactured, sold, and paid for, and the debtor then will be using inventory ordered and acquired after the general assignment of accounts receivable. Any assignments of accounts through extended reservation of ownership or security transfer with respect to this later-acquired inventory will be subject to the earlier assignment to the receivables financer. This result has been attacked vigorously by some commentators. In the extreme case, a receivables financer could effectively tie up accounts which the debtor needed for assignment to supplier-creditors under extended reservation of ownership in order to secure inventory to carry on his business.

The Bundesgericht was faced with the extreme case in a celebrated and violently criticized decision in 1959. The court seized upon the often-utilized unconscionability clause of the Civil Code, Section 138, to invalidate an assignment of accounts to a receivables financer where both the debtor and the assignee knew that the debtor would be required to assign the same accounts to inventory suppliers in order to obtain material to continue business operations.

In that decision the debtor, a leather goods manufacturer, executed on October 15, 1952, a general assignment of present and future accounts to the plaintiff bank, a receivables financer, in return for a revolving line of credit. Thereafter, the debtor purchased a quantity of leather and other raw materials for its business from various suppliers, most of which purchases were under extended reservation of ownership. On September 7, 1954, the debtor went into bankruptcy. The plaintiff then brought suit against the defendant, bankruptcy trustee for the debtor, for 8,306 DM which had been collected by the defendant from an account allegedly assigned to the plaintiff. In the trial court the plaintiff succeeded in establishing the validity and the priority of his assignment, and this finding was upheld by the intermediate court of appeals. On revision the Bundesgericht first reasoned that the assignment of October 15, 1952, was a global assignment, and thus encompassed future accounts as of the time of its execution. The

93 Flume, supra note 40. But Serick contends that the supplier-creditor, through the use of appropriate expansion and extension forms, can remain on equal terms in this respect with the bank assignee. Serick, supra note 40. See also Dempewolf, supra note 68, who maintains that the receivables financer has no real advantage.

94 Judgment of April 30, 1959, 30 BGHZ 149.

95 BGB § 138(1) provides: "A legally operative expression of human will [Rechts-geschäft] which offends good morals [die guten Sitten] is void."

379
court further concluded that the assignment was not void for indefinite-
ness or because it resulted in an economic fettering of the debtor. The
Bundesgericht then reaffirmed its commitment to the priority principle
in determining disputes of this type. At this point, though, the Bundes-
gericht broke with precedent and found the assignment of accounts
void under section 138 of the Code, because it committed the debtor
to a breach of contract and fraud with respect to the supplier-creditors
from whom he would have to secure the goods to continue operations
and to pay back the loan which was the subject of the receivables
assignment to the plaintiff. It noted that in the present case both the
debtor and the bank must have known that many of the accounts as-
signed to the bank also would have to be assigned under extended
reservation of ownership of inventory to suppliers in order for the
debtor to purchase raw materials.

The Bundesgericht did not totally invalidate the assignment, but
remanded the case to the trial court for a redetermination, in accord-
ance with its new pronouncement, of (1) whether the plaintiff and the
debtor had, in fact, intended that the general assignment would cover
accounts to be assigned to suppliers and would take priority over the
interests of the suppliers, and (2) whether, even if the assignment
violated section 138, it might be at least partially valid under section
139.

Since the 1959 decision was limited to the specific facts of the
case, it left open many questions of extreme importance to receivables
financers and inventory financers alike. However, it did create tremen-
dous confusion among bankers and receivables financers. It was not
clear how far the Bundesgericht had gone, or would go, toward in-
validating general assignments of accounts which conflict with interests
created under extended reservation of ownership in inventory. More-
over, it was not clear from the decision whether any sort of actual or
imputed knowledge of probable conflict between prior receivables as-
signments and extended reservation of ownership assignments would be
necessary to make the prior assignment void. Although the Bundes-

97 BGB § 139 provides: "If any part of the transaction is void, the whole transac-
tion is void, unless it is to be presumed that it would equally have been entered into if
the void part had been omitted."

98 See, e.g., Blomeyer, Commentary on decision of April 30, 1959 in 14 Juristen-
zietung 600 (1959), where it is contended that the decision effectively destroys security
interests through assignments of accounts directly; Dempewolf, supra note 68, where it is
contended that the decision destroyed global assignment.
RECEIVABLES FINANCING

gericht had nominally affirmed the priority principle in the 1959 decision, to the bankers the decision greatly decreased the certainty which they had formerly enjoyed as to the priority of their receivables interests. Within weeks of the decision, textbook writers and commentators were violently debating its merits and demerits. On the other hand, lawyers drafting general assignments of accounts took special care to add new clauses to minimize the adverse impact of the new doctrine of the Bundesgericht.

The worst fears of the banking community were somewhat allayed by the February 2, 1960 decision of the Bundesgericht. There, the debtor was a potato dealer which had secured a contract to deliver a large quantity of potatoes to a third party at a given price. It was found by the trial court that before October 24, 1955, the debtor had given an assignment of its rights to payment under the contract to the plaintiff bank which had advanced money to the debtor for the express purpose of financing the purchase and handling of the potatoes for the assigned contract. On October 24, 1955, the debtor purchased potatoes from the defendant supplier, subject to a printed extended reservation of ownership on the back of the supplier's order-confirmation form. The potatoes so purchased were used to fulfill the contract, payment for which had been earlier assigned to the plaintiff bank. The Bundesgericht affirmed the priority principle as applied to present assignments of future accounts, and found that the assignment to the

99 Flume, supra note 40, praises and criticizes various parts of the decision; Dempewolf, supra note 68 attacks Flume and argues that the April 30 decision should be limited to its facts; Erman, supra note 48, criticizes the decision; Serick, supra note 40, proposes limiting the decision to only the extreme cases; BGB § 398 No. 9 Rietschel, Lindenmaier-Möhring, (annot. to Judgment of April 30, 1959), also criticized the decision, noting that many important questions were left open; Neubeck, Globalzession und verlängerter Eigentumsvorbehalt, 12 Neue Juristische Wochenschrift 1954 (1959), agreed with the decision on the facts; Wünschel, Globalzession und verlängerter Eigentumsvorbehalt, 12 Neue Juristische Wochenschrift 1953 (1959); Nebelung, Globalzession und verlängerter Eigentumsvorbehalt, 13 Neue Juristische Wochenschrift 510 (1960), attacked the decision and rejected the thesis that as a general rule these types of transfers are invalid under BGB § 138.

100 See, e.g., the contract terms of the Bremen Landes-Bank, reprinted in B. Sievers, supra note 1, at 20. The following clause was added to cope with the decision of April 30, 1959.

6) The debtor warrants that he is entitled to exercise unfettered dominion over the accounts transferred to the bank, and especially that the accounts are not assigned to one of his suppliers on the grounds of his conditions of delivery (extended reservation of ownership). In the exceptional case that the accounts assigned to the bank may be justly claimed by a supplier of the debtor on the grounds of extended reservation of ownership, the assignment shall only be effective with the extinction of the extended reservation of ownership. The bank is entitled to extinguish the extended reservation of ownership through performance to the supplier.

plaintiff was valid, even though the account was later assigned to the defendant under extended reservation of ownership to secure payment of the purchase price of the resold collateral.

The court distinguished the 1959 decision by pointing out that in the present transaction the loan secured by the assignment was made specifically for the financing of the purchase of the potatoes, and that the bank therefore could not have had the unconscionable intent necessary to void the transaction under section 138 since it expected that there would be no assignment under extended reservation of ownership because the debtor was to pay for the potatoes in cash. The court further ruled that the debtor’s subsequent default in utilizing the loan proceeds in a manner other than that intended by the parties at the time of the loan agreement and assignment should not be charged to the lender-assignee unless the lender knew, or should have known, that the debtor would not be likely to utilize the proceeds as promised in the loan agreement. The Bundesgericht therefore found for the plaintiff as the prior assignee.

The decision of February 2, 1960, clarified somewhat the question of the degree of knowledge required on the part of the receivables assignee in order to invalidate a prior general assignment because of unconscionable infringement of a later foreseeable assignment under extended reservation of ownership. However, this decision, like the one in 1959, was an extreme case, and there remained a large grey area in which the receivables financer could not be certain whether his prior assignment would be valid.

The 1959 decision was especially hard on the receivables financer because a prior general assignment which was found to be unconscionable under section 138 was not merely subordinated to the later extended reservation of ownership assignment, but was struck down entirely. Thus, even in cases where there would have been sufficient accounts available to satisfy most or all of the receivables assignee’s claim if he were a secured creditor subordinate to the supplier-assignee, the receivables assignee was thrown into the limbo of the unsecured creditor.

On June 9, 1960, the Bundesgericht again upheld, on the grounds of no unconscionability, a prior assignment of accounts against attack by a later extended reservation of ownership assignee. On February 7, 1953, the debtor, a butcher shop, executed a blanket assignment of

\[\text{Footnote:} 102 \text{ of course the prior creditor cannot realize more on its security than its advances and financing charges. The excess would go back to the debtor and, through him, under BGB §§ 185, 398, to the subordinate creditor-assignee, without being subject to the claim of the trustee in bankruptcy.} \]

\[\text{Footnote:} 103 \text{ Judgment of June 9, 1960, 32 BGHZ 361 (1960).} \]

382
accounts agreement with the defendant bank. According to the arrange-
ment, the debtor promised to assign accounts up to a specified amount
by periodically sending lists of the assigned accounts to the defendant.
The proprietor of the shop died on January 24, 1955, leaving the busi-
tess to his widow who sought to carry it on. The manager of the
debtor-shop signed two lists of accounts and sent them to the defend-
ant on February 7, 1955. The lists contained the names of several
customers of the butcher shop and stated that present and future
accounts arising from the sale of meat products to these customers
were, as of that time, assigned to the defendant. In addition, the debtor
was to send to the bank from time to time a list of the balances due
on each of the assigned accounts. However, the debtor was to collect
the assigned accounts subject to the option of the bank to notify the
debtor's customers and collect the accounts itself.

On March 10, 1955, the debtor contracted with the plaintiff, a
meat wholesaler, for quantities of beef and pork. The plaintiff's printed
contract form contained a clause of extended reservation of ownership
encompassing accounts arising from the sale of the collateral. Several
shipments of meat were made under this contract, and much of the
meat was resold by the debtor. The butcher shop experienced diffi-
culty in making payments on the loan, and the defendant exercised its
option to notify the account debtors and collect the accounts itself.
The customers paid the defendant some 4,132 DM which the plaintiff
then claimed on the basis of his assignment under extended reservation
of ownership. The trial and appeals courts found for the defendant
bank because of the priority of its assignment.

On revision, the plaintiff argued that the assignment to the de-
fendant was void under section 138, relying on the 1959 decision. The
Bundesgericht, affirming the priority principle, found that the assign-
ment was not unconscionable in the present case, because there was
no showing that the debtor could only obtain meat on extended reserva-
tion of ownership, nor was there proof that the defendant was aware
that the debtor would have to buy under extended reservation of own-
ership in order to secure inventory to carry on his business. Since, in
fact, there were only four accounts which fell within the terms of both
assignments, it seemed to the Bundesgericht unlikely that the defend-
ant had either known or had cause to know that his assignment would
force the debtor to breach contracts with future suppliers. The Bun-
desgericht therefore affirmed in favor of the defendant bank.

The June 9, 1960 decision, like the 1959 decision, did not draw
any clear lines to guide receivables financers in creating interests. It
did, however, indicate that mere coincidence with a later-created
supplier interest would not always invalidate a prior receivables interest.\textsuperscript{104}

The position of the receivables financers was again weakened by an April 24, 1968 decision of the Bundesgericht.\textsuperscript{105} In that case the debtor was a building contractor and the plaintiff was a supplier of building materials and a contract trucker. The defendant bank had executed with the debtor a global assignment of accounts on May 9, 1962. According to the terms of the contract of assignment, the debtor assigned all of his present and future accounts to the bank to cover present and future cash advances. The printed terms and conditions on the reverse side of the finance contract form contained a number of provisions drafted to avoid the effect of the 1959 decision. According to these terms, the debtor covenanted that it was not necessary for him to procure inventory under extended reservation of ownership, that if he did so obtain his inventory he would apply the bank loan proceeds first to payment for goods supplied under extended reservation of ownership, and that if he did buy goods under extended reservation of ownership, he would promptly notify the bank. The plaintiff claimed, under extended reservation of ownership arising from printed conditions on its acknowledgment and invoice forms, 16,000 DM for transportation services and 17,000 DM for materials furnished to the debtor.

The Bundesgericht on revision distinguished the two intervening cases\textsuperscript{106} and, following its decision of April 30, 1959, declared that the global assignment of accounts to the defendant bank was void for unconscionability. In reaching this result, the court first observed that in the building industry it was a trade usage for contractors to obtain materials only under extended reservation of ownership. By reason of this trade usage, knowledge on the part of the bank of the need of the debtor to purchase goods under extended reservation of ownership was, in effect, presumed. The bank's efforts to avoid a finding of unconscionability by printing covenants on its contract form were ineffective. As the court observed, the debtor never paid heed to the terms, and they had absolutely no effect on the actual practice or conduct between the parties.

The court emphasized the fact that all of the debtor's accounts were assigned to the bank, and thus distinguished the decision of June 9, 1960, where only a portion of the debtor's accounts were assigned to the receivables financier. The court also specifically referred to and

\textsuperscript{104} See B. Sievers, supra note 1, at 65, 66.
\textsuperscript{105} 21 Neue Juristische Wochenschrift 1516 (1968).
RECEIVABLES FINANCING

distinguished the decision of February 2, 1960, on the basis that there a single transaction was involved, and the money advanced by the receivables financer was, in fact, intended for the purchase of the items to be sold. However, where the financing was of a continuing business enterprise, and where the purchase of goods under extended reservation of ownership was a trade usage, the bank must have known that by taking an assignment of all of the debtor's accounts it would be requiring the debtor to commit a fraud upon its supplier-creditors.

The April 24, 1968 decision aroused a violent reaction in the receivables financing industry. A foremost commentator advanced the view that this decision essentially eliminated receivables financing as it was then practiced in Germany. Nonetheless, the Bundesgericht affirmed its position in a subsequent decision involving the same debtor. In its decision of November 6, 1968, the Bundesgericht noted that its April decision had received both praise and criticism, but on facts identical to those in the earlier case the court adhered to its position and voided the prior receivables assignment.

The German courts have firmly adhered to the priority principle so far as determining the relative priorities of valid interests in accounts receivable. However, while paying lip-service to the priority principle, the courts as a practical matter have substantially modified it by applying the doctrine of unconscionability to receivables financing. As of the present time, it is not clear whether a receivables financer can safely take a true global assignment of accounts in any industry where there is a trade usage of purchasing under extended reservation of ownership. Perhaps a system of very closely policing the debtor's operations and supervising the disbursement of money would alleviate this serious problem. Mere printing of covenants and conditions in contract forms apparently will not.
3. Suggestions for Resolving Conflicts

The textbook writers and commentators are not unanimous by any means in supporting the view taken by the courts. Several other judicial resolutions of conflicts among assignees of accounts have been proposed by various scholars and practitioners.\(^1\) One "solution" which has been advanced by a few commentators, is either to refuse to recognize assignments of future accounts altogether, or to restrict such assignments to specific contracts in which the accounts to be assigned are named or described in an extremely exact manner, so as to be precisely ascertainable at the time of the assignment.\(^1\) The proposal to eliminate assignments has found very little favor with the legal community because of the great degree of dependence by the business community on present assignments of future accounts.\(^1\) The latter alternative, the elements of which seem to have been embodied in the celebrated Reichsgericht cases which voided assignments of accounts in general conditions of delivery, would virtually abolish any sort of assignment of accounts tied to the collateral sold to create the accounts to be assigned.\(^1\)

One of the most controversial proposals for judicial resolution of the supplier-financer versus receivables-financer conflict was suggested by Professor Flume, who proposed that the extended reservation of ownership always take precedence over a direct assignment in accounts arising from the sale of inventory collateral, to the extent of the resale value of the collateral.\(^1\) Where the collateral is resold in substantially the same condition as when it was delivered to the debtor, the supplier-creditor would take the entire account, despite a prior assignment to a receivables financer. Where the collateral has been manufactured so that the account arising from its resale is greater than its resale value alone, the supplier-creditor would get precedence to the extent of the resale value of the collateral if it were sold alone, and the balance of the account would go to the assignee, receivables or inventory (extended), holding the prior assignment. Where several extended reservation of ownership creditors claim the same account as arising from the sale of their collateral, such as with components of a manufactured product, they would each get an amount equal to the resale value of their collateral if sold alone in unmanufactured form, regard-

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\(^1\) See Serick, supra note 40, and B. Sievers supra note 1, for brief discussions of the several proposals.

\(^1\) Fischer, supra note 39; von Caemmerer, supra note 39; Westermann, supra note 16.

\(^1\) See Flume, supra note 40, where it is contended that reservation of ownership and assignments of accounts have become legal institutions in Germany, and can only be abolished or drastically changed by the legislature; the courts may define and limit the extent of these institutions, but they may not undercut their basic elements.

\(^1\) See in this connection, Westermann, supra note 59, at F3 to F80.

\(^1\) Flume, supra note 45; Flume, supra note 96; Flume, supra note 40.
RECEIVABLES FINANCING

less of priority. Where the total amount of the account is not greater than or equal to the total claims of the secured suppliers, the account would be pro-rated among them according to the respective resale values of each creditor’s resold collateral, regardless of priority.

Professor Flume bases his proposal on the thesis that in the case of goods transferred under reservation of ownership, the creditor is not obligated to allow the debtor to resell the goods. Therefore, if he does allow the debtor to resell the goods, he ought to be assured of priority in the resulting account to the extent of the resale value of the collateral which he has released. Since the debtor is not authorized to sell the collateral unless the account will be validly assigned to a reservation of ownership creditor, any sale where the account is not so assigned is a breach of the contract of extended reservation of ownership, and under certain conditions might be fraudulent.

The execution of an assignment by the debtor to a receivables financer, which by its terms encompasses accounts which will arise from the sale of the collateral of supplier or inventory financers, would thus be void by virtue of section 138, and also because the debtor did not have authority to sell the collateral unless the resulting account would belong to the inventory financer to the extent of the resale value of the collateral sold. Professor Flume admits that there is little justification for giving the supplier-creditor an absolute priority in accounts arising from the sale of manufactured or processed collateral for a greater amount than the resale value of his collateral. Precedence to the full amount of such accounts might very likely result in an economic fettering of the debtor, and hence might be void under section 138.

This proposal, which favors the inventory financer to a great extent, gives the prior receivables financer only the balance of accounts from the sale of extended reservation of ownership collateral over and above the resale price of the collateral, and the later receivables financer nothing. The Bundesgericht seemed to be inclined toward Pro-

117 See Flume, supra note 45. But see Dempewolf, supra note 68; Serick, supra note 40. Flume’s thesis would seem to find some support in the Judgment of May 23, 1958, 27 BGHZ 306. In that case the debtor received goods under extended reservation of ownership. The court held that he was not authorized to use them to fulfill a contract which was by its terms non-assignable, without the permission of the other party. The supplier-creditor could get special satisfaction in bankruptcy. But see Judgment of Oct. 14, 1963, 40 BGHZ 156. Frequently a sort of right of subrogation (Surrogation) is brought in to justify a special priority for the inventory financer in accounts arising from the sale of inventory collateral. See Rühl, Eigentumsvorbehalt und Abzahlungsgeschäft 42 (1930).

118 Flume, supra note 40, at 920.

119 However, Flume takes an almost inconsistent position with respect to amounts already collected from account debtors by a bank-assignee. Flume argues that the bank should have precedence in these amounts. Since the debtor under the power of collection (Einziehungsermächtigung) could have collected the accounts himself, and paid off the bank loan with the amounts collected, the bank should not be forced to give up amounts it collected itself to a prior extended reservation of ownership assignee. Flume, supra
Professor Flume's view in its 1959 decision when it made a significant exception to the priority principle by finding a prior assignment of accounts void as unconscionable when the debtor was compelled to purchase his raw materials under extended reservation of ownership.\(^{120}\) Professor Flume's position apparently also influenced the 1963 decision where the Bundesgericht recognized the validity of an extended reservation of ownership assignment of account to the "value of the collateral," although the court placed the value of the collateral at the price paid by the debtor, and not at its resale price.\(^{121}\)

Professor Flume's thesis has been attacked by other scholars and commentators, and, although it appeals particularly to supplier-creditors in cases of the classic conflict between assignees accounts, it also has severe weaknesses.\(^{122}\) One of the most vigorous critics of the pro-

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\(^{120}\) Judgement of April 30, 1959, 30 BGHZ 149. However, in a subsequent decision the Bundesgericht failed to go any further toward adoption of Flume's proposals, and apparently retreated slightly from its position in the decision of April 30, 1959. See Judgement of June 9, 1960, 32 BGHZ 351; Judgment of Feb. 2, 1960 (Bundesgericht), in 13 Neue Juristische Wochenschrift 1003 (1960). The only judicial acceptance of Flume's built-in priority for supplier-financers is dictum in the Judgment of Jan. 18, 1952 (Oberlandesgericht Celle), in 5 Neue Juristische Wochenschrift 306 (1952), see note 61 supra for the facts. The Oberlandesgericht held (although reversed by the Bundesgericht) that the assignment was void for indefiniteness, citing the decisions by the Reichsgericht. However, in dictum the court noted that even if the assignment to the supplier-creditor were valid, it would only come ahead of the contract right assignee's claim to the resale value of the supplier's collateral utilized in the contract. The court cited Flume, supra note 45. Although the dictum purported to be applying the Flume theory, it is not clear whether it did so correctly.


\(^{122}\) Those rejecting Flume's thesis are: Serick, supra note 40; Westermann, supra note 16; Schlegelberger-Hefermahl, Handelsgesetzbuch (HGB) § 368 app.; von Caem-
RECEIVABLES FINANCING

Proposal is that of Doctor Gunter Dempewolf,128 who attacked the argument regarding unconscionability under section 138 which was partially adopted by the Bundesgericht in the decision of April 30, 1959. Doctor Dempewolf does not agree that sales by the debtor are only authorized if the account will be validly assigned to the supplier-creditor to the extent of the resale price of the collateral, and that a debtor would be guilty of fraud or breach of contract against his supplier-creditors by concluding a prior assignment of accounts receivable to a bank. He maintains that since the bank has the prior assignment, the later assignment pursuant to extended reservation of ownership to a supplier-creditor, to which Professor Flume's thesis gives precedence, might be a fraud on the bank. Doctor Dempewolf contends that only in extreme cases, for example perhaps that of the 1959 decision, can the bank's interest be invalidated by later occurrences when there was no prior interest at the time of the receivables assignment. He maintains that the moneylender does not have to lend to the debtor, and if he does so, he should be able to expect that his assignment will be good to the extent that it precedes other assignments. The conflict is not created by the prior receivables assignment but by the later agreement of extended reservation of ownership. The supplier-creditor, as well as the receivables financer should be compelled to cope with the existence of prior interests in the accounts of its debtors, and the priority principle should apply equally to both types of interest. Doctor Dempewolf concludes that the priority principle is the only fair and impartial way to resolve conflicts among assignees of accounts, regardless of the origins of their assignments.

Another adherent of the priority principle is Professor Serick.124

128 Merer, supra note 39; Dempewolf, supra note 68; Capeller, supra note 69; Rietschel, supra note 99.

Those supporting Flume are Gast, Zusammentreffen von verlängertem Eigentumsvorbehalten und Globalzession, 11 Der Betrieb 1235 (1958); Falkenstein, Das Problem der Doppelfristigkeit, 12 Der Betrieb 1245 (1959), Hees, supra note 83.


125 Dempewolf, Zur Konkurrenz von verlängerten Eigentumsvorbehalten und Globalzession, 9 Neue Juristische Wochenschrift 851 (1956); Dempewolf, Prioritätsprinzip auch bei Konkurrenz zwischen verlängerten Eigentumsvorbehalten und Globalzession, 10 Neue Juristische Wochenschrift 858 (1957); Dempewolf, Zusammentreffen von verlängertem Eigentumsvorbehalten und Globalzession, 12 Der Betrieb 654 (1959); Verlängerter Eigentumsvorbehalt und Globalzession, 13 Monatschrift für Deutsche Recht 801 (1959); Verlängerter Eigentumsvorbehalt, Globalzession, und Wechselrecht, 12 Der Betrieb 1160 (1959).

He properly points out that Professor Flume's thesis does not hold up for all conflicts between inventory and receivables financers, but only applies to the classic case of extended reservation of ownership versus general assignment of accounts. For instance, Professor Flume's proposals do not furnish a satisfactory ideological basis for a solution to a conflict between an assignee under a security transfer and an assignee under a general assignment, where both assignees are banks. According to the mechanics of the thesis, the security transferee would have priority to the amount of the resale value of the collateral, even though it, like the receivables financer, is a moneylender, and even though the resale price of the collateral may have no close relationship to the amount of its advances. Professor Serick contends that a conflict between a security transferee and a supplier-creditor for an account arising from the sale of a product of their manufactured collateral would seemingly be avoided by giving each creditor equal precedence in the account to the extent of the resale value of his collateral, even though the bank's interest, had it loaned on the receivables directly rather than on the inventory, would have been subordinated to that of the supplier-creditor. Although Professor Serick does not disagree with the 1959 decision on its facts, he would limit its application to cases where the receivables financer knew or must have known that despite his advances, the debtor would have nevertheless purchased his inventory under extended reservation of ownership.  

Professor Serick also readily admits the possibility that an assignment of accounts may be unconscionable and void, regardless of whether the debtor must assign the accounts to secure inventory, if the assignment operates to so completely limit the debtor that he is a mere tool of the creditor, or if the assignment is of such scope that the entire worth of the debtor's business is assigned, to the detriment of unsecured creditors. Nevertheless, he maintains that the priority principle should remain the governing influence for assignments of accounts in all forms. He also urges that assignments be made more public so that present and potential inventory and receivables financers are able to cooperate in arranging for subordination or modifica-

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125 Serick, supra note 40. See also Judgment of May 25, 1960, 32 BGHZ 351; Judgment of Feb. 2, 1960 (Bundesgericht), in 13 Neue Juristische Wochenschrift 1003 (1960). Serick draws support for his conclusion from the Judgment of Jan. 15, 1957 (Bundesgericht), in 10 Neue Juristische Wochenschrift 587 (1957), where a creditor took his debtor's wares as purchaser in discharge of a money obligation knowing that the wares were not paid for and that the debtor was in financial difficulties. The transaction was rescinded as unconscionable and the offending creditor was required to pay damages to the supplier of the goods, an extended reservation of ownership creditor.  

126 For a discussion of several of the ways in which an assignment of accounts may be invalid as unconscionable, see B. Sievers, supra note 1, at 45-59.
RECEIVABLES FINANCING

tion of their interests so as to avoid the more harsh effects of the priority doctrine.

Professor Harry Westermann contends that conflict between assignees is mainly due to the indefinite and automatic nature of assignments under extended reservation of ownership.\(^7\) He condemns assignments of future accounts through printed extended reservation of ownership clauses in general conditions of delivery. According to his view, the Reichsgericht, in its decisions restricting extended reservation of ownership in general conditions of delivery, came the closest to grasping the nature of the problem and creating a rational solution. Professor Westermann would only recognize the validity of assignments of future accounts which either described the account by the name of the debtor, or by some other indication which would make it clear at the time of assignment exactly which accounts would be assigned. He would not allow assignments arising from printed clauses in general conditions of delivery, and all assignments would have to be made through a special contract with the debtor. Although such a restriction on the assignment of future accounts applies the priority principle as it was conceptually intended, and would remove many conflicts attributable to the shotgun approach of the supplier-creditor and inventory financer, there is no evidence that the courts have adopted this view.

Professor Walter Erman has proposed dividing accounts purportedly assigned to more than one creditor among the assignees in proportion to their economic “stake” in the assigned accounts. This proposal was first suggested in reaction to the 1959 decision, and has received a great deal of attention among commentators, although the Bundesgericht has expressly refrained from embracing it.\(^2\) Professor Erman criticizes Professor Flume’s thesis that the supplier-creditor, in selling goods under extended reservation of ownership, gives authority to the debtor to resell the inventory only under the condition that the resulting account would be assigned to the supplier-creditor ahead of all other assignees. He points out that such a condition imposed by the supplier-creditor might well be unconscionable, since it would virtually paralyze the debtor in securing additional credit to carry on his busi-

\(^{127}\) Westermann, Referat before the 41st Deutsche Juristentag, 41 Deutsche Juristentag Abhandlungen F3 (1955).


See the comments by Serick, supra note 40; Hofmann, supra note 7, 170; B. Sievers, supra note 1, at 82–87. Braunbehrens, Verlängerter Eigentumsvorbehalt und Globalzession, 15 Betriebsberater 156 (1960), contends that Erman’s proposals should be the basis of a legislative resolution of the problem. The Bundesgericht rejected Erman’s proposal as a general rule in the Judgment of May 25, 1960, 32 BGHZ 351.
ness. Moreover, Professor Flume’s thesis ignores the economic realities of the situation, namely, that the bank or money lender has made an equal economic contribution to the debtor and deserves equal security. Professor Erman maintains that the priority principle is far preferable to the result advocated by Professor Flume or that reached by the Bundesgericht in its 1959 decision, in that the priority principle treats both supplier and bank creditor approximately equally, in accordance with their similar economic contributions.

Professor Erman has outlined a new principle to resolve conflicts among multiple assignees of receivables—the division principle (Teilungsprinzip). This new scheme departs from the priority principle in resolving conflicting rights in receivables, and is based on economic and common-sense arguments rather than existing legal theories. Whenever a single account is assigned to two or more assignees, whether through extended reservation of ownership, general assignment or otherwise, each assignee who could show that his advances had created value in the disputed account would be entitled, at a minimum, to the amount of his advance reflected in the account, regardless of priority. In the case of a supplier-creditor, this value would be the cost of the inventory collateral sold to create the account. In the case of a receivables financer, determining the value of the contribution would be more difficult. Value in the account attributable to advances made by unsecured creditors or the capital contribution of the debtor would go to the debtor’s trustee in bankruptcy. Where a creditor could not show that his advances contributed value to the account, he would not be entitled to share under the division principle. If a dispute arose between a creditor who could show that he had value in the collateral and one who could not, the dispute would be resolved according to the priority principle. However, once the account was given to any one assignee with value in the collateral, all such assignees would be entitled to share, even though some of them otherwise might have been barred by the intervening claim of a non-participating assignee.

Professor Erman suggests that his scheme be judicially adopted as a rule of construction of assignments of accounts, whether by extended reservation of ownership or by general assignment, and regardless of the terms of the assignment. Under his plan the courts would interpret assignments as only encompassing the minimal amount representing the contribution of the assignee, whenever more than one such assignment might be found for a single account. Alternatively, he proposes that secured parties write appropriate terms into their agreements or general conditions of delivery to achieve the result desired.
This latter suggestion has apparently received support in the Bundesgericht's 1963 decision.\footnote{For commentaries on the Judgment of Oct. 23, 1963, see Lindenmaier-Mähring No. 9 (Ga) to BGB § 157; 17 Neue Juristische Wochenschrift 149 (1964).}

A recent proposal closely paralleling Professor Erman's was advanced by Professor Josef Esser,\footnote{Esser, Globalzession und verlängerter Eigentumsvorbehalt, 23 Juristezeitung 281 (1968). See also Annot., 23 Juristenzeitung 529 (1968).} who maintains that the priority principle as applied to conflicts between secured financers is basically unsound. Noting the heavy preponderance of supplier credit relative to bank credit, Professor Esser suggests that the effect of the priority principle of favoring the receivables financer in the long run is contrary to public policy, and that the only long-term solution is to "vertically" divide up accounts receivable. According to his proposal, by the appropriate drafting of the instruments of assignment, an inventory financer could restrict his right to accounts receivable arising from the sale of its collateral to the wholesale price of the goods which the accounts replace. The banks would then be entitled to that portion of the accounts in excess of the wholesale price of the inventory goods sold, that is, the profit and any increased value of the goods due to manufacturing and processing. There would be no priority principle, and accounts would be divided without regard to the time of assignment.

The proposals of Professors Erman and Esser have aroused criticism, both on the basis of their lack of present legal foundation and their impracticality.\footnote{B. Sievers, supra note 1, at 82, 83; Serick, supra note 40, at 146; Zillas, Globalzession und verlängerter Eigentumsvorbehalt-Eine Stellungnahme zum Teilungsprinzip, 15 Betriebsberater 612, 615 (1960); Heidland, Verlängerter und erweiterte Eigentumsvorbehalt in Insolvenzverfahren, 21 Konkurs-, Treuhand-, und Schiedgerichtswesen 17, 21 (1960), where it is contended that the division principle would be unworkable in bankruptcy proceedings. Erman points to BGB § 947, which deals with joint ownership in commingled personal property, to show that his proposals are not alien to the German legal system.} They do, however, recognize what is not recognized by Professor Flume's proposal, namely, the basic economic equivalence of supplier and money credit.

IV. SUMMARY OF THE PRESENT STATE OF THE GERMAN LAW

A fair reading of the recent decisions of the Bundesgericht demonstrates the court's basic recognition of the priority principle. Disputes between holders of valid assignments of accounts will be resolved according to priority in time, regardless of the sources of the assignments. The first assignee will be entitled to satisfaction of his claim out of the assigned accounts, and the second assignee will be entitled to the excess to the extent of his claim, and so on. The priority principle is sharply qualified in the case of the receivables financer by the possibility that his assignment will be found to be unconscionable.
under section 138 if it appears that he caused accounts to be assigned to him which he knew, or should have known, would have to be assigned by the debtor under extended reservation of ownership in order for the debtor to obtain inventory to carry on his business. The supplier-creditor who receives an assignment through printed conditions is still subject to some requirement of definiteness in the account assigned, although the conditions obtaining at the time of the assignment can be taken into account to determine whether the assignment is valid. Of course, the supplier-creditor who causes accounts to be assigned to an amount much greater than the indebtedness to be secured also runs the risk of having his assignment struck down as an unconscionable fettering of the debtor under section 138. The same risk exists for the receivables financer.

Although the 1963 decision has enhanced the possibility that supplier-creditors may avoid both the problems of indefiniteness found in earlier partial assignments of accounts under extended reservation of ownership, and the fettering problem often inherent in demanding the full account arising from the sale of the inventory by creating an assignment of proceeds accounts to the extent of the contract price of the collateral sold, it is still not possible for a secured receivables or inventory financer to know with certainty at the time of his assignment that his assignment will have precedence in the assigned accounts. This uncertainty is at least partially due to the lack of public notice required to create valid assignments either under reservation of ownership, security transfer, or other general assignments. Moreover, although the priority principle has been judicially modified to more adequately cope with conflicts among secured receivables assignees, the modifications, which generally involve the complete invalidation of infringing interests, have also produced harsh results. Thus it certainly cannot be said that the German legal community has produced a “solution” to the problem of multiple assignments of accounts receivable.

V. PROPOSALS FOR LEGISLATIVE ACTION IN RECEIVABLES FINANCING

Proposals for legislative remedies for conflicts involving receivables assignments and inventory financing have been frequent since the deficiencies of both the Civil Code system of assignment and the priority principle became apparent early in this century. The first significant attempt at reform was embodied in a legislative proposal in 1925 by a group of legislators, and reproposed in substantially the same form by the Central Association of Large Businesses in the following year.¹³² The proposal was merely to transform the security transfer into a filed mortgage (Registerpfandrecht). No purported security transfer would

¹³² See Vollmer, supra note 22, 106-09.
be valid until filed in a public register. The proposal did not affect the reservation of ownership of the suppliers, or the general assignment of accounts of the receivables financiers, but was aimed mainly at eliminating the "secret lien" character of the security transfer which many felt was a judicially-created parasite on the German civil law. 

Opposition to the bill was almost universal among lenders and borrowers alike. The borrowers feared publicity of their credit relationships, and the lenders were opposed to the provision favoring the debtor which would restrict the power of the lender to repossess and dispose of the collateral upon default. Because of this united opposition, the bill was not passed. An alternate proposal to require debtors to note in their business books the existence of adverse interests in their inventory also failed to muster sufficient support to reach the floor of the Reichstag.

In 1937 Heinrich Lehmann's proposal for thoroughgoing reform of the extended reservation of ownership, the security transfer, and assignments of accounts was debated in legal circles. Lehmann's aim was twofold, first, to publicize security interests, and second, to make them more definite and reduce the tendency toward excessive security caused by the uncertainty of account assignments, particularly under extended reservation of ownership and security transfer. Accordingly, he proposed that the security transfer be replaced by a filed mortgage system, and that the reservation of ownership require a writing signed by the debtor for its validity. Assignment of future accounts under extended reservation of ownership, general assignment, or otherwise would require a special written contract signed by the parties. All interests in the chattels and accounts of the debtor would have to be noted in a "security book" to be maintained by the debtor for inspection by lenders and suppliers. Although Lehmann's proposal had a great deal of merit, opposition in the industrial and financial community was overwhelming and the proposal did not become law.

The most recent proposal for legislative reform in the area of inventory and receivables financing is that of Dr. Karl Munzel. In 1951 he proposed that rights of the security transferee and the supplier under extended reservation of ownership to special satisfaction (Aussonderungsrecht, Absonderungsrecht) in bankruptcy be abolished.

135 See Rühl, supra note 117. In Bernstein, Die Nachteile des Registerpfandrechts, 31 Juristenzeitung 737 (1926), and in Sattler, Sicherungsübereignungen von Sachge- samtheiten, 56 Juristische Wochenschrift 2453, 2454 (1927), opposition is expressed to the filed chattel mortgage system.

134 See Lange, Lage und Zukunft der Sicherungsübertragung, 3 Neue Juristische Wochenschrift 565 (1950).

155 H. Lehmann, Reform der Kreditsicherung an Fahrnis und Forderungen (1937).

Moreover, he proposed that collateral under reservation of ownership and security transfer be available for levy and attachment by unsecured judgment creditors. His proposal would leave the secured creditor with little more than a right of repossession upon default prior to bankruptcy or levy. It would also effectively abolish the priority principle among inventory creditors in bankruptcy, since all creditors would be treated alike, regardless of the time or type of any security interest. Munzel's proposal did not expressly treat assignments of accounts, although it is not difficult to apply his inventory proposals to assignments under either extended reservation of ownership or a direct assignment. These proposals, although provoking some scholarly comment, have not received any legislative notice, probably because of the continued opposition of powerful financer groups.

VI. A COMPARISON OF GERMAN PRIORITY PROBLEMS WITH THOSE OF THE UNIFORM COMMERCIAL CODE

Although the Uniform Commercial Code attempts to resolve conflicts among American receivables financers which are similar to those experienced under the German Civil Code, the Code provisions do not provide for many potential conflicts. These issues have not been fully considered by either the commentators or courts which have interpreted the Code, and thus there is little American authority for future judicial resolution of these problems. A comparison of the German experience with the Uniform Commercial Code will help provide such authority, but only if such a comparison takes into account the differences and similarities of the legal systems and business practices of the two countries.

While the German Civil Code has been in existence for about seventy years and is regarded by German lawyers and jurists as being the basic source of law for German legal transactions and realtionships, the Uniform Commercial Code is of relatively recent vintage and is

137 For a view opposing that of Münzel, see Klee, Eigentumsvorbehalt und Sicherungstübereignung, 5 Monatschrift für Deutsches Recht 455 (1951). For a good discussion of various proposals for legislative reform of extended reservation of ownership and security transfer, see 41 Deutsche Juristentag-Abhandlungen F1 to F80 (1955), which recommends that there be no change at present without a careful study of the economics of the situation and of similar arrangements under foreign law.

138 At least 3 reasons have been advanced why these and similar conflicts have not come before the courts: (a) financers frequently are aware of possible conflicts and shape their practices so as to avoid them; (b) different industries adopt particular financing devices; (c) even after a conflict has arisen, the secured creditors settle out of court to avoid the expenditure of money and effort on litigation. Coogan, Article 9 of the Uniform Commercial Code: Priorities among Secured Creditors and the "Floating Lien," 72 Harv. L. Rev. 838, 856 (1959). Mr. Coogan's article is recommended to the reader as a comprehensive study of the American Code Problems. See also Note, The Priority Conflict Between a Purchase Money Security Interest and a Prior Security Interest in Future Accounts Receivable, 22 Vand. L. Rev. 1157 (1969).
still regarded as a state statute in derogation of the common law and therefore is to be construed strictly.139 While a German court would feel at liberty to broadly construe the Civil Code and draw therefrom appropriate doctrine to meet changing legal and economic conditions, the American courts so far have tended to construe the Uniform Commercial Code relatively strictly, falling back upon the common law as a source of law from which any novel doctrines are to be extracted.140

There are also significant differences in business practices which should be taken into account. In Germany there is wide use of secured credit in the ordinary sales of materials through reservation of ownership and extended reservation of ownership. This is in contrast to the American practice whereby substantially all sales are made on an open account. The great bulk of everyday business inventory sales in Germany is controlled by reservation of ownership printed on invoices or acknowledgment forms. Undoubtedly one of the reasons for this is the relative ease by which a security interest can be created in inventory collateral and its proceeds; the German law does not require publicity, filing or anything other than an express or implied agreement between the parties for the creation of a security interest in inventory or receivables.

While noting the differences between the two economic and legal systems, it is also necessary to emphasize their common features. Under both systems the inventory financers can obtain a security interest in the account resulting from the sale of inventory, and the receivables financers can create a security interest in the account of the debtor. Thus, under both systems the possibility exists that receivables financers and inventory financers can claim the same accounts receivable through two different types of assignment. Moreover, under both systems where different secured components are processed by the debtor to make a new product and then sold, conflicts may arise between more than one inventory financer and the receivables financer. While the Uniform Commercial Code has attempted to provide a mechanism for resolving some such conflicts, the ensuing discussion illustrates the relevancy of the German experience in discovering and suggesting resolutions for other possible conflicts.

Although the Code is the result of the painstaking efforts of distinguished lawyers and jurists over the span of many years, and is generally highly successful in providing a uniform and reasonably

139 Although there is a recent trend to construe the Uniform Commercial Code in a manner similar to that of the European codes, even where accepted this approach to the Code as a source of law falls far short of the manner in which the European courts deal with the Civil Codes. See generally Franklin, On the Legal Method of the Uniform Commercial Code, 16 Law & Contemp. Prob. 330 (1951).

140 U.C.C. § 1-103. All references to the Uniform Commercial Code are to the 1962 Official Text.
rational set of rules for the guidance of debtors and creditors in their affairs, it does have limitations, particularly in its treatment of security interests in receivables. A brief inspection of the provisions of Article 9 with respect to receivables financing will highlight some accomplishments of the Code and focus attention on its inadequacies.

Under Article 9 a non-possessor security interest in personal property is created by written agreement between the debtor and the secured party. This interest “attaches” to the collateral when there is agreement that it should attach and when the debtor acquires rights in the collateral. The security interest arising from such agreement establishes a legal relation between the parties thereto and certain assignees, and more importantly establishes the priority of the holder of the interest as against general creditors and lien creditors of the debtor, such as the trustee in bankruptcy. In order for a security interest to be valid against this group of creditors, it is necessary that it be “perfected,” usually by filing a “financing statement” describing the collateral in an appropriate public office. However, filing is not the only means of perfecting the security interest. Secured interests in certain types of collateral may be perfected by possession of the collateral, and Article 9 in addition contains a few special provisions by virtue of which a security interest may be regarded as perfected even though there has been no filing and no possession.

Under the Code, a security interest in both accounts receivable and inventory is created when the debtor signs a security agreement in which the collateral is duly identified. Such a security interest is perfected by the execution and filing of a financing statement in which the collateral is described as either accounts or inventory.

The Code provides for a continuation of an inventory security interest to cover proceeds of a permitted sale of the inventory.

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141 For a detailed treatment of Article 9, see P. Coogan, W. Hogan, D. Vagts, Secured Transactions under the Uniform Commercial Code (1967); G. Gilmore, Security Interests in Personal Property (1965).

142 U.C.C. § 9-203 sets out the requisites for the creation of an enforceable security interest. U.C.C. § 9-204(1) provides that a security interest attaches as soon as an agreement is reached, value is given and the debtor acquires rights in the collateral. U.C.C. § 9-204(3) provides that a security agreement may cover after-acquired property while § 9-204(5) provides that a security agreement may include future advances.

143 U.C.C. § 9-301.
144 U.C.C. § 9-302(1).
145 U.C.C. § 9-305.
146 U.C.C. § 9-306(3) provides that proceeds from collateral of a perfected security interest remain perfected for 10 days after receipt of the proceeds from the debtor. U.C.C. § 9-304(5) provides that a security interest in goods covered by documents possessed by the creditor is perfected for 21 days after the goods are released for processing.

147 U.C.C. § 9-203(1); U.C.C. § 9-106 defines the term “accounts.”
149 U.C.C. § 9-402 sets out the formal requisites of a financing statement.
150 U.C.C. § 9-306(2).
the inventory was perfected, the proceeds are automatically perfected for 10 days. This security interest in the proceeds will not remain perfected beyond the tenth day, however, unless the secured party (1) either has perfected the proceeds by filing within the original 10-day period, or (2) had stated on the original financing statement filed as to the inventory that the collateral includes "proceeds." Since these proceeds may be accounts receivable, that security interest conflicts with that of the receivables financer.

Article 9 creates a system of priorities among conflicting valid and perfected security interests in the same collateral. Section 9-312(5) provides:

In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows:

(a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) or whether it attached before or after filing;

(b) in the order of perfection unless both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) and, in the case of a filed security interest, whether it attached before or after filing; and

(c) in the order of attachment under Section 9-204(1) so long as neither is perfected.

Thus, the basic test under the Uniform Commercial Code, as under the German Civil Code, is priority in time, although application of this concept to Uniform Commercial Code transactions is somewhat complicated by the requirement of perfection. Moreover, the provisions requiring perfection by public filing under the Code stand in sharp contrast to the complete absence of any kind of public notice under the German law, so that many of the problems which have plagued the German courts because of the secrecy of the competing security interests do not arise regarding financing under the Uniform Commercial Code.

Under the Uniform Commercial Code conflicts among inventory financers or between inventory financers and receivables financers holding interests in the same accounts may remain unresolved or be-

151 U.C.C. § 9-306(2).
come resolved in an unsatisfactory manner. One example of such a result is where a financer files a very broad financing statement covering all of a debtor's inventory equipment and accounts. Typically, this statement is filed while the debtor is negotiating an arrangement under which he consolidates his debt by the financer advancing sufficient capital to release the debtor from his present creditors. Then, before any security agreement is reached and before the financer is committed to make advances, the debtor receives a loan from one of his creditors and signs a security agreement for a specific piece of equipment. Agreement on the first financing arrangement is later reached between the debtor and the financer. On the debtor's insolvency the financer has priority in all the equipment since, by filing first, his security agreement has priority over the specific interest in spite of the fact that the security agreement on the specific item of equipment was first to be perfected.153

Another example of a possible undesirable result is where an inventory financer holds a security interest in inventory and proceeds perfected by filing, and a receivables financer has a security interest in accounts also perfected by filing. If the debtor sells an item of inventory which gives rise to an account, both creditors have a claim to the resulting receivables.154 Although section 9-312 would grant priority to the creditor who was first to file, since both interests were perfected by filing,155 the German experience shows that under certain circumstances application of a "first in time—first in right" rule is open to serious question.156 If the application of the first to file rule were in favor of an inventory financer, problems may result if the value of the resulting account was higher than that of the original collateral. Accounts resulting from the sale of inventory collateral are assumed to be merely substitutes for the inventory sold.157 In fact, however, accounts result-

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153 This is one example of the first to file rule not protecting the party who has made the initial advances. The financer of the equipment could have protected himself by filing a statement terminating the financing statement as provided by § 9-404(1), by negotiating a subordination agreement with the total financer as provided by § 9-316, by requiring that the broad financing statement be written so as to exclude this particular piece of equipment, or by perfecting his interest in the equipment in some way other than by filing, so as to exempt himself from the first to file rule and to require application of the first to perfect rule of § 9-312(5)(b). Coogan, supra note 138, at 857-60.

154 In order for the receivables financer to have an interest in this account the security agreement would have to cover after-acquired accounts. U.C.C. § 9-204(3). The inventory financer's claim to the account is based on the fact that the account represents proceeds of the permitted sale of the inventory. U.C.C. § 9-306(2).

155 U.C.C. § 9-312(5)(a).

156 See, e.g., the discussion at pp. 374-76 supra, which demonstrates that the application of the first in time priority principle of the German law enables a receivables financer to fetter all of the debtor's accounts, including those which have been created by the sale of secured inventory.

157 P. Coogan, W. Hogan & D. Vagts, supra note 141, § 7.02.
RECEIVABLES FINANCING

ing from the sale or other disposition of inventory collateral often have a face value far higher than the value of the inventory collateral sold, and generally include contributions by the debtor or other secured parties in addition to the value of the inventory collateral sold. This is particularly true when inventory collateral is used in fulfilling a contract where much labor and other material is employed. Thus, the use of collateral in fulfilling a building contract may give rise to a security agreement in the proceeds or account arising from the contract, and this account will be much greater than the value of the collateral.158

Another problem which is not clearly resolved by the Code is whether section 9-306 gives an inventory financer a security interest in the resulting account in excess of the value of the inventory collateral disposed of.159 This question would arise where the value of the inventory did not cover the total debt secured by it. In that case the inventory financer would look to the total value of the account and claim the total value as proceeds. This will be particularly important where there is also an accounts receivable financer who has filed after the inventory financer. The receivables financer will claim that the proceeds are substitution for the inventory, and as such the priority should not exceed the value of the inventory,160 while the inventory financer will argue that, just as a financing statement creates a security interest in collateral as to the entire value needed to cover the obligation, the continuation of this interest requires that the account also cover as fully as possible the obligation it secures.

Under the German system, techniques have arisen where the account resulting from the sale of inventory collateral will jointly secure the interests of the inventory and the receivables financer.161 It is uncertain whether such a result is possible under the priority rules of the Uniform Commercial Code. One example of a situation where the same collateral may be split to cover two security interests is where a creditor makes advances on an item of personal property and files a

158 U.C.C. § 9-313(1) provides that no security interest exists in building materials such as bricks and lumber after they are incorporated into a building. The Code, however, is silent as to whether the account or contract under which a structure is built can be subject to a security interest which covered the building materials prior to their incorporation into the structure. U.C.C. § 9-306(2) is broad enough to include disposition by incorporation of the collateral, but since the security interest is destroyed on incorporation there is no secured collateral which can give rise to an account. There is little authority on this point and the question remains open.

159 Although this problem has been the subject of litigation under the German Civil Code, see p. 377 supra, neither commentators nor jurists have considered this issue under the U.C.C. The commentators apparently assume that the entire account arising from the sale of the inventory collateral is proceeds and is covered by the inventory, regardless of the relationship of the value of the inventory to that of the account. See, e.g., G. Gilmore, supra note 141, § 27.4.

160 P. Coogan, W. Hogan & D. Vagts, supra note 141, § 7.02.

161 See p. 377 supra.
BOSTON COLLEGE INDUSTRIAL AND COMMERCIAL LAW REVIEW

financing statement covering the item. Although he is under no obligation to do so, this creditor then anticipates a second advance to be made on the same collateral in the future. Later, a second creditor advances money on the same property after taking possession of the property as a pledge. The first creditor, unaware of the pledge, then advances additional money, believing that the second loan is secured by the property pursuant to the filed statement. The value of the collateral turns out to be less than the total of the three loans. Since perfection is not by filing under section 9-312(5)(b), the priority is determined by who was first to perfect. But a more basic issue is whether there are three separate security interests, or whether the first creditor has one security interest for the total of the value given. In this situation, allowing separable security interests in collateral seems sensible, for otherwise a creditor filing and making a small advance could tie up property and have it secure subsequent advances that he is not obligated to make. This seems to be a situation where a creditor could monopolize a debtor’s credit line as to all future transactions. This problem illustrates the desirability of the German solution whereby the unconscionability doctrine was applied to prevent a creditor from fettering a debtor’s assets.102

102 See Coogan, supra note 138, at 867-68.

This question suggests two further questions not directly concerning priorities among receivable financers. First, is the disposition of collateral by the debtor and the appearance of an account in excess of the value of the collateral in favor of a secured party a voidable preference under § 60 of the Bankruptcy Act, 11 U.S.C. § 96 (1964)? Certainly the elements of a preference can be found in such a situation if the goods are disposed of and the account arises within 4 months of bankruptcy. Presumably there would be a transfer at the time the account arises, since under § 9-204(1) the security interest cannot attach to an account until the debtor has rights in the collateral. But see Grain Merchants, Inc. v. Union Bank & Sav. Co., 408 F.2d 209 (7th Cir. 1969); Dubay v. Williams, 417 F.2d 1277 (9th Cir. 1969). In both cases the accounts receivable which arose within 4 months of bankruptcy were held valid and nonpreferential against the trustee where the original assignment had been executed and perfected prior to the 4-month period. In so holding, both courts adopted a theory whereby the security interest is deemed to attach to the changing mass of the debtor’s accounts receivable rather than to each individual account as it comes into existence. The courts thus rejected, for the purpose of § 60 of the Bankruptcy Act, § 9-204(2)(d) which provides that a security interest cannot attach to an account until it comes into existence.

While this theory has obvious appeal in the case of a flowing stream of accounts receivable collateral, there is some question as to whether or not it has equal appeal in the case of transformation of inventory collateral into substantially higher amounts of receivables collateral. In the latter case, it would seem that there would be greater opportunity for the trustee to argue that there was a transfer, especially to the extent of the increased value of the accounts over the value of the inventory. If the secured party does not make a new advance on the disposition of the inventory collateral, the excess of the accounts over the value of the inventory collateral sold would seem to be preferential.

The second question is whether the interest of an inventory financer in proceeds will prevail over the Federal tax lien provided by 26 U.S.C. § 6323 (Supp. II, 1967). The doctrine of “inchoate and general lien” has lost most of its meaning to commercial financers since the enactment of § 6323(a). However, even under the new law it is not
Problems of priority in accounts under section 9-312 become more complex if the inventory financer has perfected his interest otherwise than by filing. For example, a creditor may initially perfect an interest in documents covering the inventory collateral by taking possession of the documents. The creditor then may release the collateral to the debtor for processing or manufacturing. If the inventory is manufactured and sold within 21 days of the release of the collateral, and an account arises, the interest of the inventory financer will continue in the account for an additional 10 days without any filing. If the account is also claimed during this 10-day interval by a receivables financer under a security interest perfected by filing, apparently the priority of the interests depends upon which creditor perfected first. The security interest in the documents held in possession is perfected when it attaches. The security interest in the accounts is perfected when it attaches or when it is filed, whichever is completed last. A security interest in an account usually attaches when the account arises. Thus, in this case, the security interests of both parties in the account were perfected at the same time. Of course, the inventory creditor will insist that he is entitled to priority because of the continuity of his interest in the assets of the debtor. The receivables financer might reply that section 9-204 does not permit any rights in an account until it comes into existence, so that his interest is at least equal with that of the inventory financer. The clear whether the sale of inventory collateral giving rise to an account in excess of the value of the goods sold will be regarded as a mere continuation of the security interest of the creditor if the sale occurs after the 45-day period, or whether upon a sale during the 45-day period the secured party will be regarded as having parted with “money or money’s worth” to the total face value of such an account. See P. Coogan, W. Hogan & D. Vagts, supra note 141, § 1201, at 1252 (Supp. 1967).

103 U.C.C. § 9-304(2), (3), (5).
105 U.C.C. § 9-312(5)(b). The first to file rule of subsection (5)(a) only applies if both security interests were perfected by filing.
107 U.C.C. §§ 9-204(1), (2)(d) provide that a security interest cannot attach until the debtor has rights in the collateral and the debtor has no rights until the account arises.
108 Thus it may be argued that since the account is proceeds of a perfected security interest, and since the perfection is continuous under § 9-303(2), the time of perfection was when the interest in the documents was perfected. Thus the inventory financer’s interest was perfected before that of the receivables financer.
109 U.C.C. § 9-204 only applies to 2 of the 3 classes of collateral which are otherwise loosely known as “receivables.” They are accounts, contract rights, and general intangibles. There is no mention of when the debtor can have rights in a “general intangible” or when a security interest may attach to a general intangible. One might be tempted to argue that a security interest can be created in the debtor’s rights to payment under future contracts and accounts. Such a right would be neither a contract right, which requires a contract, nor an account, since performance has not occurred. This right would be a present right. It would seem then that the security interest would attach to this right as soon as the agreement was signed and the secured party gave
receivables creditor might also argue that equitably he should come ahead of the inventory financer, because his interest in the accounts was on public notice, while that of the inventory financer was a more secret interest, existing as a result of the overly permissive provision of Article 9.

Another variant of the conflict problem exists where the inventory creditor, having perfected his interest in inventory as above, and having released the inventory for manufacture, files as to the inventory but not as to proceeds. The inventory is then sold, and within 10 days the inventory financer files a financing statement covering proceeds. Upon the subsequent insolvency of the debtor, the inventory financer and a receivables financer with a security interest filed prior to the initial agreement of the inventory financer each claim priority in the accounts purportedly assigned to both creditors. The inventory financer would argue that the interest in the goods was perfected when released, and this perfection occurred by a means other than filing. Since the original perfection of one of the interests was not by filing, the first interest that was perfected takes priority. Since the goods were perfected prior to the creation of the account, the inventory financer would argue that his interest was continuous and the filing as to the inventory and then as to the proceeds only preserved his perfected interest rather than create it. Since the receivables financer’s interest was perfected when the account arose, under this reasoning the inventory financer would have priority. The receivables financer, on the other hand, would argue that the interest of the inventory financer in the account was perfected as of the expiration of the 10-day period following sale by the filing during that period, notwithstanding that

value. Of course, through time this right would become a contract right and accounts in which the initial security interest would continue as a security interest in proceeds under U.C.C., § 9-306. It can be argued that perfection would be continuous under U.C.C. § 9-303, and that the interest is perfected at the time it originally attached to the general intangible and a financing statement was filed, rather than when the account arose.

This theory is similar to the entity theory of accounts that was recently adopted by several of the circuit courts of appeal. In Grain Merchants, Inc. v. Union Bank & Sav. Co., 408 F.2d 209, 216 (7th Cir. 1969), the court stated:

[The creditor’s security interest was in the entity of the accounts receivable as a whole, and not in the individual components, so that the transfer of property occurred here when the interest in the accounts receivable as an entity was created and the financing statements duly filed.

See also Dubay v. Williams, 417 F.2d 1277 (9th Cir. 1969).

170 U.C.C. § 9-306(3) (b).

171 U.C.C. § 9-312(5) (b). The security interest in the documents was perfected by possession.

172 Under § 9-303(2) the interest is deemed to have been continuously perfected.

Under § 9-312(6), for the purpose of the priority rule, the collateral is considered to have been perfected by possession.

173 U.C.C. § 9-204(1), (2) (d).
the original interest of the inventory financer in the inventory collateral was perfected otherwise than by filing, so that they both were perfected by filing and the first to file rule would apply.\textsuperscript{174} He might further point out that the account is not merely a substitute for the inventory, but rather contains a variety of economic elements and probably exceeds the value of what was given up in sale.\textsuperscript{170} This problem and others are probably due to an apparent inconsistency between the notion of continuity of perfection and the notion that no security interest may attach to an account until it comes into existence. As with the German experience, the future judicial resolution of these problems will probably be based on an analysis of the economic needs of the business community as well as legal concepts.\textsuperscript{178}

Article 9 provides that security interests of goods financers continue in collateral which has been manufactured or mixed.\textsuperscript{177} The Code is silent here as to what excess in value of the product is encompassed by the original security interest in the component inventory. The Code does provide that when inventory collateral of more than one financer is incorporated in a manufactured product, so that more than one interest attaches to the product, the interests do not rank by priority in perfection but "according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass."\textsuperscript{171} This subsection raises more problems than it solves. First, the term "cost of the total product or mass" is not defined. It is not clear whether it refers to the value of the manufactured product or to the cost of the components. If it refers to the value of the product, it is unclear whether "cost of the goods" refers to their value at the time of incorporation or to the price paid or to be paid for them by the debtor. If the cost of the mass is greater than the total of the costs of the component collateral, the increment in value presumably would be pro-rated among the secured parties.

The problems arising from the incorporation of collateral into products are compounded when manufactured goods subject to more

\textsuperscript{174} U.C.C. § 9-312(5)(a).
\textsuperscript{175} Such an argument is contrary to the Code provisions establishing continuity of a security interest. See U.C.C. §§ 9-312(6), 9-303(2), 9-306.
\textsuperscript{176} The needs and practices of the business community were recognized in two recent cases: Grain Merchants, Inc. v. Union Bank & Sav. Co., 408 F.2d 209 (7th Cir. 1969), and DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969). In Grain Merchants the court recognized the principle that "good business practices should be good business law." 408 F.2d at 216. In DuBay the court recognized the need to make commercial law "conform to the legitimate needs of commerce, rather than to the common law lawyer's wish for conceptual nicety." 417 F.2d at 1289. Such reasoning is similar to the process of the Bundesgericht in relaxing the standards of definiteness in order to allow a greater use of inventory financing. See p. 370 supra.
\textsuperscript{177} U.C.C. § 9-315. See G. Gilmore, supra note 141, § 31.4.
\textsuperscript{178} U.C.C. § 9-315(2). See G. Gilmore, supra note 141, § 31.5.
than one security interest are disposed of by the debtor, giving rise to an account. The first question to be answered is whether all component secured parties have a proportionate interest in the account, or whether the disposition of the inventory collateral removes applicability of the rule by which secured parties get a ratio of the product and places the priority of the various secured inventory creditors claiming proceeds in the order of perfection or filing. Moreover, if a receivables financer intervenes in priority between two inventory financers jointly claiming an account as proceeds from the sale of a product manufactured from the collateral of both, it is unclear whether the receivables financer will come ahead of the later-perfecting inventory financer as to the later inventory financer's part of the account, or whether an earlier inventory financer gets the entire account because of an intervening receivables financer.

Although under Article 9 there is the possibility that an early-filing secured party can tie up the secured credit of a debtor, so far there has been no tendency on the part of American courts to invalidate security interests of such creditors on the ground of unconscionability. This is perhaps a result of the fact that the possibility of fettering the debtor's assets is less under the American system than under the German system. Other creditors can still perfect security interests in the debtor's assets regardless of the prior filing, and the debtor can remove the prior filing if there are no advances outstanding. Moreover, the publicity of financing arrangements under Article 9 makes the possibility of fraud, found by the German courts to be inherent in the German system, unlikely.

The Code gives special priority to purchase money security interests in inventory under certain conditions. However, it does not expressly extend this priority to accounts arising from the sale of the

179 U.C.C. § 9-315(2).
180 The Code provision dealing with unconscionability, § 2-302, is located within Article 2 which deals with sales transactions. Thus courts have been reluctant to apply § 2-302 to security transactions (Article 9). See, e.g., Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P. 474 (1968). There is some authority for applying at least the policy behind § 2-302, if not the section itself, to transactions outside of the scope of Article 2. Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967). See Comment, Unconscionable Security Agreements: Application to Section 2-302 to Article 9, 11 B.C. Ind. & Com. L. Rev. 128 (1969).
181 See note 153 supra for the various means by which a debtor may remove his assets from a prior financing statement. See also P. Coogan, W. Hogan & D. Vagts, supra note 141, § 7.05(3).
182 U.C.C. § 9-312(3) provides that a purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor gets the collateral, and if the supplier-creditor of the collateral in which the purchase money security interest is claimed has notified all secured parties who are known and who had filed as to that collateral prior to delivering the collateral to the debtor. See P. Coogan, W. Hogan, & D. Vagts, supra note 141, § 706.
RECEIVABLES FINANCING

purchase money inventory collateral. In a case where a purchase money inventory financer has priority in his collateral over an earlier inventory financer, it is unclear whether his security interest in proceeds will have priority over that of an earlier receivables financer. It is also unclear whether the purchase money priority will continue ahead of the interest of another inventory financer with a security agreement covering proceeds of the sale of manufactured inventory. Since the section of the Code favoring purchase money security interests is found among the Code provisions establishing priorities of perfected interests, and those Code sections establishing a continuity of security interests are perfection sections, reason would indicate that under the former section the purchase money financer has priority only in the inventory collateral, so that priority in the resulting accounts will be determined according to the usual rules.

Although the Code is especially favorable to the purchase money inventory financer, probably this section should not aid him after the sale of his collateral. The Code provisions relative to purchase money security interests are based on the notion that a purchase money financer deserves special protection because he is making an additional contribution from his own property to the assets of the debtor. However, this notion ignores the economic fact that all creditors who make advances to the debtor in return for security interests, whether the advances are used to purchase additional inventory col-

183 U.C.C. § 9-312(3).
184 The question whether the priority of the purchase money security interest carries over into proceeds from inventory remains unresolved. There appears to be no case law on the subject and the commentators are in disagreement. Section 9-312(3) gives the purchase money financer priority over conflicting security interests in the "same collateral." Thus, the question is whether proceeds are within the phrase "same collateral." Mr. Coogan contends that the purchase money financer is favored only so long as the collateral remains in the form of goods. Once the goods change form he is on a parity with the non-favored party. P. Coogan, W. Hogan & D. Vagts, supra note 141, § 15.11[3][e]. See also Coogan, supra note 138, at 861 n. 87.

Dean Gilmore contends that the favored position of the purchase money financer should carry over to proceeds. The expectation of the purchase money financer is basically that he will be paid first. Since the debtor is in the business of selling the goods, the favored position is illusory if his priority does not carry over to the account. Furthermore, the general philosophy of Article 9 is that once priorities are established, they are not reversed. See U.C.C. §§ 9-306(3), 9-312(6). Thus, there is little difficulty in construing the term "inventory collateral" as "inventory collateral including proceeds." Gilmore, the Purchase Money Priority, 76 Harv. L. Rev. 1333, 1383-84 (1963); G. Gilmore, supra note 141, § 29.4. See also Henson, "Proceeds" under the Uniform Commercial Code, 65 Colo. L. Rev. 232, 239-42 (1965).

186 Dean Gilmore suggests this as a possible approach. G. Gilmore, supra note 141, § 29.4, at 795.
187 Perhaps also it is a vestige of the old notion that "title" to the goods remains in the seller so that other security interests could not validly attach on conditional sale. U.C.C. § 9-312, Comment 3. See G. Gilmore, supra note 141, § 28.4, at 745.
lateral or to pay the wages of workmen so that the goods may be man-
ufactured and sold, are making a real contribution to the estate of the
debtor, and that all of these creditors deserve equal treatment. Pos-
sibly, the purchase money priority is based on the further notion that
the goods delivered under a purchase money security interest are only
delivered conditional upon receiving a prior interest in them. This rea-
soning, which echoes the position espoused by Professor Flume,188 is
fallacious. There is actually no more reason for such a condition to be
implied in the delivery of purchase money collateral than in the fur-
nishing of any other advance.

The purchase money priority of section 9-312(3) should not be
extended to accounts arising from the sale of purchase money inventory
collateral because this would not be in accord with the notice system of
Article 9. Unless the purchase money priority is limited to the purchase
money financer's interest in the inventory, section 9-312 is open to the
same objections as the German priority principle, namely, that it pro-
vides an ex post facto determination of creditors' rights, but does not
afford a standard by which secured parties can gauge their interests
in advance.189

CONCLUSION

Both the American and the German systems of secured financing
of receivables and inventory give rise to disputes among secured cred-
itors over accounts assigned directly and as proceeds of the sale of
inventory collateral. Although the Uniform Commercial Code is about
50 years more recent than the German Civil Code, it has also failed to
furnish a practical and satisfactory general rule to resolve these
cases.190 Over the six decades during which the German Civil Code has
been in effect, various judicial methods of dealing with this problem
have been proposed and tried. None of them has been completely suc-
cessful. The Uniform Commercial Code however, does not, according
to its terms, provide such a resolution, and so far the courts have not
tended to step in and develop one.

188 See p. 386 supra.
189 As under the German system it is expected that particular financers will make
a strong bid for resolution of conflicts between inventory and receivables financers in
favor of the group they represent. Riesenfeld, Kollision zwischen der dinglichen
Sicherung von Lieferantenkredit und Bankkredit, Tägung für Rechtsvergleichung; Fach-
gruppe für Zivilrechtsvergleichung, Vienna 1963, at 41-63. See also Rabel, Deutsches und
amerikanisches Recht, 16 Rabel's Zeitschrift für Auslandisches und Internationales
190 See Rabel, supra note 189, at 353-56, which briefly compares the German
and American law of secured transactions and challenges for reform, and Rumler-Detzel,
Die Forderung als Kreditsicherungsmittel in Recht der U.S.A. 127-44 (Koln 1960)
(doctoral dissertation), for a critical look at the U.C.C. provisions governing receivables
financing through the eyes of a German commentator.
RECEIVABLES FINANCING

As of the present time, at least two distinguished groups of lawyers, law professors and judges are striving to provide answers to some of the questions here discussed. A special committee of the National Bankruptcy Conference has been working with Dean Gilmore and Mr. Coogan, distinguished commentators on Article 9, to draft proposed provisions of Section 60 of the Bankruptcy Act to deal with, among other things, the problem of accounts claimed as proceeds of inventory of only a fraction of their value. In addition, the American Law Institute and the Commissioners for Uniform State Laws have formed a Joint Review Committee for Article 9 which is expected to release proposed revisions to Article 9 dealing with certain other priority problems within the very near future. It is to be expected that this committee will report legislative proposals to resolve various deficiencies of section 9-312, including the purchase money priority problem. In considering alteration and reform of Article 9 to eliminate problems and ambiguities in establishing priorities, reference to the German experience in secured financing provides insights into the strengths and weaknesses of our own system, and suggests directions for improvement.