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THE FLOATING LIEN CONTROVERSY IN THE COURTS: JUDICIAL RESPONSE TO THE PREFERENCE PROBLEM

HENRY S. HEALY*

INTRODUCTION

During the past ten years the validity of the "floating lien" in bankruptcy proceedings has been one of the foremost issues in discussions of Article 9 of the Uniform Commercial Code. The question has generated a large volume of material in law reviews and treatises, and has been discussed in this Review on several prior occasions. Until very recently, however, the problem has received no judicial scrutiny. It is the purpose of this article to examine four recent cases in which this controversial issue has been decided. The volume and quality of the literature provides an excellent opportunity to measure the impact of the commentators on the judicial process.

* B.S., College of the Holy Cross, 1960; LL.B., Boston College Law School, 1963; Member of the Massachusetts Bar.

1 U.C.C. § 9-204, Comment 3.

2 All references are to the 1962 Official Text.


I. BACKGROUND

A. The Problem

Sections 60(a) and (b) of the Bankruptcy Act\(^6\) give a trustee in bankruptcy the power to avoid a transfer of the debtor's property to a creditor if: (1) the transfer was made for or on account of an antecedent debt; (2) the debtor was insolvent at the time of the transfer; (3) the creditor had reasonable cause to believe that the debtor was insolvent; (4) the transfer would enable the creditor to obtain a greater share of his claim than another creditor of the same class; and (5) the transfer occurred within four months of the filing of the petition initiating the debtor's bankruptcy. It is the application of this language to "floating" liens created under the Uniform Commercial Code which gives rise to the problems discussed in this article.

Article 9 of the Code permits a creditor to obtain a security interest in collateral which the debtor may acquire in the future, as well as collateral in which the debtor has present rights.\(^7\) This floating lien is of particular importance where the collateral is in a shifting form. A good example of this type of collateral is the inventory of a retail business, which in the ordinary course is regularly being sold to customers and replaced by new shipments. Another is accounts receivable, which are regularly being collected by the debtor and replaced by new accounts. Once perfected, the floating lien insulates the interest of the secured

\(^{6}\) 11 U.S.C. § 96(a),(b) (1964). The pertinent language of section 60 reads as follows:

(a) (1) A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(b) For the purposes of subdivisions (a) and (b) of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. . . . [If any transfer . . . is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this title, it shall be deemed to have been made immediately before the filing of the petition.

(b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent.

\(^{7}\) "A security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement." U.C.C. § 9-204(3); see also U.C.C. § 9-204, Comment 3.
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party in the debtor’s future collateral against claims of ordinary judgment creditors of the debtor.  

The controversy between the bankruptcy trustee and the creditor protected by a floating lien centers around two questions, or perhaps one question viewed from two different angles. First, for the purposes of Section 60 of the Bankruptcy Act, when is an interest in the debtor’s after-acquired collateral “transferred” to the holder of a floating lien? Second, is such a “transfer” of after-acquired collateral a transfer for an “antecedent debt” as to collateral acquired by the debtor within four months of the filing of a bankruptcy petition? Answers to these questions are discovered through an examination of additional provisions of the Code and the Bankruptcy Act.

Section 60(a)(2) of the Bankruptcy Act fixes the date on which a transfer of the debtor’s property is deemed to occur:

[A] transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.° (Emphasis added.)

A holder of a perfected security interest under the Uniform Commercial Code has priority over ordinary lien creditors. To be perfected, however, the security interest must “attach” to the collateral. Under section 9-204(1) a security interest does not “attach” until (1) there is a written agreement that it attach, (2) an advance or payment is made pursuant to the agreement and (3) the debtor obtains rights in the collateral described in the agreement. In the case of inventory and accounts a security interest, once it attaches, becomes perfected when a financing statement describing the parties and the collateral is filed with the appropriate office. If filing takes place before the security interest attaches it becomes perfected at the time when it attaches.°

8 U.C.C. § 9-301(1)(b).
10 U.C.C. § 9-301(1)(b). Section 9-301(3) defines a “lien creditor” as “a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.”
11 U.C.C. § 9-302(1).
12 U.C.C. § 9-303(1), U.C.C. § 9-204 states in part:

(1) A security interest cannot attach until there is agreement (subsection (3) of section 1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.
From the foregoing statutory pattern the shape of the problem begins to become apparent. An example will further demonstrate the point. Secured Party and Debtor are parties to a written security agreement covering inventory. A financing statement is on file and cash has been advanced to Debtor pursuant to the agreement. Debtor has an existing inventory. At this time, and at all subsequent times, Secured Party knows that Debtor is insolvent. Six months later a petition in bankruptcy is filed to adjudicate Debtor as bankrupt. In the four-month period prior to the filing of the petition Debtor has had a considerable turnover of inventory, including receipt of a number of new shipments. The problem is whether trustee or secured creditor is entitled to the new inventory received during this four-month period.

In the hypothetical, at least at first glance, all the elements of a voidable preference are present. The Debtor's granting of a security interest in the new shipments of inventory was a "transfer" of its property to a creditor who at all times knew Debtor to be insolvent. Under Section 60(a)(2) of the Bankruptcy Act, quoted above, the date of the transfer is the date on which it became perfected under state law.\textsuperscript{13} Under section 9-204(1), the security interest did not attach to the new shipments (and apparently did not become perfected as to such shipments) until the Debtor obtained rights in them. This transfer, apparently occurring at the time when the Debtor obtained rights in the collateral, took place within the four-month period, and was on account of an antecedent debt—the cash advanced to Debtor pursuant to the security agreement. If, in the hypothetical, the collateral were accounts receivable, the transfer of future accounts would also seem to be for an antecedent debt because of section 9-204(2)(d), which states that a debtor has no rights "in an account until it comes into existence." When these Code sections are compared with the elements of a preference, it appears that the trustee has a formidable case.

Section 9-108 of the Code attempts to remedy this problem by a

\begin{quote}
(2) For the purposes of this section the debtor has no rights
\begin{itemize}
\item[(c)] in a contract right until the contract has been made;
\item[(d)] in an account until it comes into existence.
\end{itemize}
\end{quote}

Once a security interest in inventory or accounts receivable has "attached" it becomes perfected if a financing statement describing the collateral has been filed. If no statement is on file prior to the time that the security interest attaches, it becomes perfected upon filing. U.C.C. §§ 9-302, -303. Filing is not required to perfect an assignment of accounts receivable which "does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts \ldots\ of the assignor.\ldots\) U.C.C. § 9-302(1)(e).

\textsuperscript{13} McKenzie v. Irving Trust Co., 323 U.S. 365, 370 (1945); Matthews v. James Jalcott, Inc., 345 F.2d 374, 378 (7th Cir. 1965); see 3 W. Collier, supra note 3, § 60.39[2], at 957.
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determination that the transfer of an interest in after-acquired property is for "new value" and not for an "antecedent debt":

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

It is established, however, that the only element of a preference which is a matter of state law is the date on which the transfer becomes perfected. The definition of an "antecedent debt," being a matter of federal law, raises a serious problem: is the definition embodied in section 9-108 an impermissible conflict with federal law? To determine whether the approach of section 9-108 can be squared with the intent of Congress, it is first necessary to examine the legislative history of the preference concept. Consideration of the legislative history is also helpful for understanding and evaluating the theories which have been advanced to justify the validity of the floating lien against the preference challenge.

B. The Development of the Preference Provisions of the Bankruptcy Act

The preference language of the 1898 Act was essentially identical with the present section 60(a)(1) and the first sentence of section 60(b). The 1898 Act dealt with transfers to a creditor made by an insolvent debtor within four months prior to bankruptcy. If the transfer was made on account of an antecedent debt, and the creditor was aware of debtor's insolvency, the transfer was characterized as a voidable preference. A number of cases decided under the 1898 Act permitted creditors, who had entered into agreements with debtors prior to the four-month period, to escape the preference pitfall even

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16 Act of July 1, 1898, ch. 541, § 60 a, b, 30 Stat. 562.
though they did not take all steps necessary to perfect their liens until shortly before bankruptcy. Such cases were based on the idea that the pre-existing security agreement gave the creditor an "equitable lien," which the courts considered sufficient to complete a transfer at the date of the agreement rather than the date when final steps for perfection were taken. The perfection shortly before bankruptcy was held to relate back to the date of the original agreement. 17 Sexton v. Kessler 18 was the leading case reaching this result. There, the debtor agreed to hold certain securities for the benefit of a creditor. This agreement was made more than four months prior to the debtor's bankruptcy. The securities were not delivered to the creditor, however, until two weeks before bankruptcy. The Supreme Court of the United States held that an equitable lien, valid against the preference challenge, was created by the agreement regardless of the failure to perfect the security until shortly before bankruptcy.

Cases such as Sexton v. Kessler 19 led to considerable agitation for an amendment to the Bankruptcy Act which would eliminate this type of "equitable lien." In 1938 the Chandler Act provided such an amendment by adding a clause to section 60(a) stating that for purposes of that section a transfer shall be "deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein . . . . ." 20 (Emphasis added.)


18 225 U.S. 90 (1912). Mr. Justice Holmes stated:

[T]here can be no doubt . . . that before the bankruptcy the . . . [creditor] had an equitable right at least to possession if it wanted it. While the phrase equitable lien may not carry the reasoning further or do much more than express the opinion of the court that the facts give a priority to the party said to have it, we are of the opinion that the agreement created such a lien at least, or in other words, that there is no rule of local or general law that takes from the transaction the effect it was intended to produce. . . . When the . . . [creditor] took the securities it only exercised a right that had been created long before the bankruptcy and in good faith.

19 Cases cited note 16 supra; see articles collected in 3 W. Collier, supra note 3, ¶ 60.37, at 940 nn.81-83. Professor McLaughlin stated that "[t]he equitable lien is a dangerous and elusive enemy of the law of preference. As applied to some bankruptcy cases it seems as well named as the Holy Roman Empire, for it is neither equitable nor a lien." McLaughlin, Amendment of the Bankruptcy Act, 40 Harv. L. Rev. 341, 389 (1927).

20 Act of June 22, 1938 ch. 575, § 60a, 52 Stat. 869. The House Report states, "[t]he new test is more comprehensive and accords with the contemplated purpose of striking down secret liens. . . . As thus drafted, it includes a failure to record and any other ground which could be asserted by a bona fide purchaser or a creditor of the transferor, as against the transferee." H.R. No. 1409, 75th Cong., 1st Sess. 30 (1937);
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The legislative history of the Chandler Act gives strong support to the conclusion that the language quoted was aimed at the elimination of "secret" liens of the sort involved in Sexton v. Kessler. The draftsmen were, however, a little too thorough. Professor Gilmore described the result as "the classical example of overkill." The use of a "bona-fide purchaser" test resulted in decisions such as Corn Exch. Nat'l Bank & Trust Co. v. Klauder, which rigorously adhered to the literal wording of the clause just quoted. Klauder involved an assignment of accounts receivable by Quaker City Company to a bank. The arrangement was of the revolving credit type and the bank did not give notice to the persons who were obligated to Quaker City on the accounts. Pennsylvania law provided that between two assignees of the same account receivable, the first to notify the account debtor of the assignment would prevail. The United States Supreme Court ruled that the "bona-fide purchaser" language of section 60, as amended in 1938, applied to postpone the "transfer" of accounts to the bank until account debtors were notified. Since no such notification was given to any account debtors under the financing arrangement being used by the parties, Quaker City's trustee in bankruptcy became entitled to all the company's outstanding accounts receivable. The effect of this decision was to invalidate most non-notification accounts receivable financing. It also raised serious questions about inventory financing, where customers always acquire goods free of existing security interests.

In 1950 the "bona-fide purchaser" test was dropped, and the present sections 60(a)(2) through (8) were adopted, establishing the "lien creditor" test. Under the "lien creditor" test, as discussed pre-

See also Analysis of H.R. 12889, 74th Cong., 2d Sess. 188 (1936), quoted in 3 W. Collier, supra note 3, ¶ 60.38, at 942-43.

21 2 G. Gilmore, supra note 3, at 1302:
[The unpremeditated destruction resulted from the facts that in all inventory financing buyers take free of the security interest and that, in so-called English rule states, the assignee of a chose in action who did not notify the obligor of his assignment could lose to a later assignee. [Footnotes omitted.] Thus such arrangements could never be perfected against potential "bona fide purchasers" and consequently could always be avoided as preferences. . . .

22 318 U.S. 434 (1943). Mr. Justice Jackson noted that the decision was undoubtedly the result of a literal reading of the Act, and that such a construction could lead to harsh results. Id. at 436-37. See also In re Varaman Shoe Co., 52 F. Supp. 562, 563 (E.D. Mo. 1943); 3 W. Collier, supra note 3, at ¶ 60.38.


24 The House Report noted:
In Sexton v. Kessler (1912) 225 U.S. 90, the Supreme Court, under the language of the Bankruptcy Act prior to the 1938 amendment, recognized as valid a pledge of stocks and bonds consummated within the 4-month period, at a time when the pledgor was insolvent, because a promise to make a pledge had been made before the commencement of the 4-month period. This result was reached on the doctrine of "relation back."

Similarly, in Carey v. Donohue (1916) 240 U.S. 430, the Supreme Court recognized as valid an unrecorded deed to real estate, on the ground that the
viously, a transfer is deemed to take place at the time it becomes so far perfected under state law that no ordinary lien creditor of the debtor could obtain rights superior to those of the transferee.

A consideration of the legislative history of the preference provisions of the Bankruptcy Act points to two conclusions. First, the tests of section 60(a)(2) are aimed at "secret" liens, of the type involved in Sexton v. Kessler. Second, Congress intended to protect security interests, which are protected under state law against judgment creditors of the debtor.

II. THEORIES ADVANCED TO SUPPORT THE POSITION OF THE SECURED CREDITOR

A number of theories have been advanced to support the position that security interests in after-acquired property can survive the preference challenge. The following is a summary of the various suggestions made by writers in the field.

applicable State statute did not make such a deed invalid as against judgment creditors. The Carey case accordingly became known as the "pocket lien" case.

In 1938 the Bankruptcy Act was amended to obviate the effect of these cases, which were regarded with disfavor by the great majority. But, in so doing, the authors of the amendment went further than was necessary, and it brought about results which they did not anticipate. The amendment placed the trustee in the position of an artificial potential bona fide purchaser, and, by so doing, unintentionally invalidated many types of liens acquired in good faith and for value, in normal and accepted business and financial relationships.

The matter was first brought to a focus in 1943, in the case of Corn Exchange National Bank & Trust Company v. Klauder (318 U.S. 434, 63 Sup. Ct. 679, 87 L. Ed. 884), in which the Supreme Court, because of the new language, felt constrained to strike down an assignment of accounts receivable taken by a bank long prior to the beginning of the 4-month period and for value because it had failed to comply with the requirement of notifying the account debtors, which, under the applicable State law, was necessary in order to cut off the rights of a possible second assignee. And this, despite the fact that no second assignee was involved in the case at all.

The resultant confusion has cast grave doubt upon the validity of normal business security... H.R. Rep. 1293, 81st Cong., 1st Sess. 4-5 (1949).

The committee pointed out that the objections of the bill were, inter alia:

(A) To retain unimpaired the basic object of the 1938 amendment, which eliminated the "relation back" doctrine of Sexton v. Kessler, and the "pocket lien" doctrine of Carey v. Donohue referred to above;

(B) To eliminate the evil of allowing a trustee in bankruptcy to take the position of a potential and artificial bona fide purchaser, and to restore him to the position of a lien creditor, in harmony with his functions under the Bankruptcy Act...

Id. at 6.
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A. The "Entity" Theory

The "entity" theory considers the present and future inventory or accounts of the debtor as a mass, independent of the individual items or accounts which combine to make up that mass. Proponents of this view consider that the transfer of this "entity" or "mass" of collateral takes place at the time the perfected security interest attaches to the initial components of the mass. The time at which the security interest attaches to later components is immaterial for purposes of determining the existence of a voidable preference. This theory has its roots in the statement by Chief Judge Magruder in Manchester Nat'l Bank v. Roche:

[I]n other words, the res which is the subject of the lien . . . is the merchandise or stock in trade, conceived of as a unit presently and continuously in existence—a "floating mass" the component elements of which may be constantly changing without affecting the identity of the res.

Support for the theory can also be found in the fact that the businessman probably considers stock in trade or accounts receivable as a continuing, independent entity, separate from its individual components.

The reply of the trustee to the entity theory is that (1) the carefully drafted provisions of, and Official Comments to the Uniform Commercial Code disclose no trace of this concept, and that (2) the terms of section 9-108 demonstrate that a very different method of resolving this problem was in the minds of the draftsmen of the Code.

B. The "Lien Creditor" Theory

The "lien creditor" theory is based on the proposition that once a security agreement is executed, a financing statement is filed, and

25 See, e.g., Coogan & Bok, supra note 3, at 1396-98; Freidman, supra note 3, at 215-16; Henson, supra note 3, at 248-49. Professor Gilmore has suggested that earnings of the debtor under future contracts may be presently existing "general intangibles."
27 186 F.2d 827 (1st Cir. 1951).
28 Id. at 831.
29 As early as 1906 Professor Williston stated: "[T]o the mind of the layman a stock in trade has a continuous existence as an entity irrespective of the articles which compose it." Williston, Transfers of After-Acquired Personal Property, 19 Harv. L. Rev. 857, 861 (1906).
30 See, e.g., Gordon, supra note 3, at 53-56; 3 W. Collier, supra note 3, § 60.51A, at 1050.14 -1050.15; King, supra note 3, at 1123-24.
31 See Friedman, supra note 3, at 219-220; King, supra note 3, at 1124. The language of § 9-108, it is suggested, indicates that the draftsmen believed that security interests in after-acquired property did not become fully perfected until the debtor obtained rights in the individual items of such property. The Code seeks to avoid the preference problem by stating that the transfer of an interest in these after-acquired items shall not be deemed to be for an "antecedent debt."
funds are advanced under the agreement, no levying creditor under state law can obtain priority over the interest of the secured party in the after-acquired property. Such an interest, it is argued, meets the test of section 60(a)(2) which fixes the date of a “transfer” at the point where it becomes so far perfected under state law that no ordinary judgment creditor’s lien on the property could become superior to that of the transferee.31

The trustee, in reply, maintains that the time of the perfection of a transfer is a matter of state law, and that the Code provides explicitly that a security interest is not perfected until the debtor acquires rights in the collateral.32

C. The Substitution of Collateral Theory

The “substitution of collateral” theory is based on a premise long recognized under section 60. Often a creditor will permit a debtor to substitute new collateral of equivalent value for that being held under a security agreement. It is established that such a substitution, made within four months of bankruptcy, does not constitute a voidable preference, except to the extent that the new collateral is worth more than the old. Of course, the theory will not be applied unless the substitution of the new collateral precedes, or is simultaneous with, the release of the old.33 In the context of the hypothetical used previously, the proponents of this theory would say that shipments of inventory received or receivables arising during four months prior to bankruptcy would be considered as “substituted” for those previously sold or collected. The transfer “substituting” new for old collateral would not be preferential, so long as the values are approximately equivalent. The proponents seek to avoid the necessity of simultaneous release and substitution by relying on Section 9-205 of the Code, which eliminates the requirement that the secured party must police his collateral.34 They suggest that the requirement of simultaneous release and substitution would be a re-imposition of this “policing” duty, and would be inconsistent with section 9-205.

The trustee’s position is that the requirement of simultaneous release and transfer is a matter of settled bankruptcy law, and that state law is immaterial.35 The trustee would limit use of the “substitution of collateral” theory to instances of actual one-for-one substitution, as under a revolving credit arrangement.

31 See, e.g., King, supra note 3, at 1132-33.
32 Krause, Kripke and Seligson, supra note 3, at 289-90.
34 See U.C.C. § 9-205, Comments 1-3.
35 Gordon, supra note 3, at 63.
III. THE CASES

The first case to come to grips with the floating lien problem was *Rosenberg v. Rudnick*,\(^{36}\) decided by the United States District Court for the District of Massachusetts. By a security agreement executed on April 30, 1962 in connection with a loan, the debtor (Boyle Sundries, Inc.) gave Rudnick a security interest in all its equipment, machinery, fixtures, inventory and accounts receivable, "'together with all additions thereto and all property now or hereafter substituted therefor or otherwise acquired in the ordinary course of business.'"\(^{37}\) Financing statements covering this collateral were filed. On November 9, 1962, an involuntary petition in bankruptcy was filed against the debtor, and adjudication followed on December 12, 1962. The debtor's trustee claimed the items of inventory acquired by the debtor during the four months preceding bankruptcy, and brought a proceeding to set aside the security interest of Rudnick in these items as a voidable preference.

Relying on Sections 9-303 and 9-204(1) and (2)(d) of the Code, the trustee argued that Rudnick's lien under the security agreement attached separately to each item of inventory as it was acquired by the debtor.\(^{38}\) The secured party relied on the "entity" theory, the "lien creditor" theory and the provisions of Section 9-108 of the Code.

Judge Ford first dealt with the "lien creditor" argument, responding to the trustee's contentions that perfection under state law was necessary to meet the test of section 60(a)(2), and that Rudnick's interest in the debtor's future inventory could not be perfected until the debtor obtained rights in the inventory. He stated:

> The specific test of § 60(a)(2) is one of when under state law the security interest, however described, becomes one which cannot be defeated by a subsequent lien obtainable in proceedings on a simple contract action. Perfection under state law need not be full perfection but only perfection *so far as is necessary to meet the test of § 60(a)(2).* While the Massachusetts law may not regard a security interest in after-acquired inventory as fully perfected until it attaches to items as they are acquired by the debtor, nevertheless § 9-204(3) recognizes that a lien in such inventory items can be validly created by a security agreement. Such a lien, after proper compliance with the filing provisions, is superior to a subsequently acquired contract creditor's lien or other claims of third parties except the rights of buyers in the ordinary

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\(^{37}\) Id. at 636.

\(^{38}\) Id. at 638.
course of business under § 9-307(1) and holders of perfected purchase money security interests under § 9-312(3).³⁹

Judge Ford did not rely solely on the "lien creditor" theory. He noted that Section 9-108 of the Code presents "a different approach to the problem" by determining that even though the security interest attaches separately to each item of collateral, the collateral is deemed to be taken for "new value" rather than for an "antecedent debt." He pointed out that no definition of "antecedent debt" has been formulated under Section 60 of the Bankruptcy Act, and determined that, while the question is one of federal rather than state law, "the definition of § 9-108 should be regarded as generally accepted and in accord with current business practice and understanding and hence applied in bankruptcy."³⁴⁰

The "entity" theory was also accepted by the court. Judge Ford cited the statement by Chief Judge Magruder in Manchester Nat'l Bank v. Roche and concluded that "[t]he security interest is in the entity as a whole, not in its individual components, and the transfer of property occurs when this interest in the inventory as an entity is created."³⁴¹

In summary, the court emphasized that the transaction involved was not a "secret" lien of the type that the provisions of section 60 were designed to avoid. "No supplier who sold merchandise on credit to [the debtor] can justifiably claim he relied on the appearance of [debtor's] inventory."³⁴² Compliance with the Code's filing requirements eliminated any possibility of "secret" liens.

The Rosenberg opinion gave strong support to the contentions of the secured creditor when In re Portland Newspaper Publishing Co.³⁴³ was decided by the District Court for the District of Oregon. This was a petition to review a referee's decision disallowing, as preferences, certain claims of a secured party. The decision of the referee, which has been widely discussed, rejected the "entity" theory and ruled that Section 9-108 of the Code conflicted with the Bankruptcy Act and could not be applied.³⁴⁴ The facts, in brief were as follows. The creditor, Rose City Development Company, made loans to the debtor, a company formed by striking unions to publish a daily newspaper in Portland, Oregon. To secure these loans the debtor gave Rose City a

³⁹ Id.
⁴⁰ Id. at 639.
⁴¹ Id. "In applying § 60, however, inventory subjected to a security interest should be viewed as a single entity and not as a mere conglomeration of individual items each subject to a separate lien." Id.
⁴² Id.
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security interest in all of its accounts receivable "now existing or hereafter arising." A financing statement describing the collateral was filed. Ten months later, following a petition in bankruptcy, the debtor was declared bankrupt. The referee accepted the trustee's contention that the security interest of Rose City was a voidable preference to the extent that it covered accounts receivable which came into existence within the four months prior to bankruptcy. The opinion of Chief Judge Solomon, following the analysis of Rosenberg v. Rudnick, reached the opposite result. The court relied on the "entity" theory and the "substitution of collateral" theory, noting that "the bankrupt's estate will not be diminished because the creditor is only receiving a substitution of security. There is no preference when new accounts are substituted for released old ones." Chief Judge Solomon also agreed with Judge Ford's conclusion that the phrase "antecedent debt" in section 60, while a matter of federal law, should be interpreted in a manner consistent with Section 9-108 of the Code, which reflects a national consensus about good business practice. Again agreeing with Judge Ford, the court concluded that the transaction under review bears no similarity to the "secret" liens at which section 60 is aimed.

The same result was reached by the District Court for the Southern District of Ohio in the case of In re White, involving a security interest in inventory. In a cryptic opinion citing Rosenberg and Portland the court reversed a referee's decision denying the secured party's petition for reclamation.

The final case in this series is In re Grain Merchants of Ind., Inc., decided by the District Court for the Northern District of Indiana. Here, the court reached the same conclusion, but by a somewhat different route. In this case the Union Bank made loans to Grain Merchants, secured in part by a security agreement covering "accounts receivable then belonging to Grain Merchants or thereafter received by or belonging to Grain Merchants." Appropriate financing statements were filed. On October 27, 1966, Grain Merchants filed a voluntary petition in bankruptcy. Its trustee claimed that all accounts receivable of Grain Merchants which came into existence within four months prior to bankruptcy were transferred to the bank during this period, and, therefore, were voidable preferences. The referee accepted this argument and ordered the bank to turn over to the trustee the proceeds of accounts receivable arising during the four months in

45 Id. at 71,140.
46 271 F. Supp. at 401.
47 Id. at 400.
48 Id. at 401.
51 Id. at 599.
question. Judge Eschbach set aside the order of the referee, relying on the "entity" theory as a matter of federal law, and found that a consideration of the effect of Section 9-108 of the Code was unnecessary. The decision is based primarily on an analysis of the legislative history of section 60 which led the Judge to conclude that the various amendments to section 60 were intended to eliminate only "secret" liens, and should not be applied to void a security interest accompanied by public notice made prior to the preference period.

An unfortunate aspect of the opinion is the statement that the transfer of all accounts receivable took place at the time when the bank filed its financing statement, which was "well in advance of the bank's extension of credit to Grain Merchants." Section 9-303(1) states that if filing takes place "before the security interest attaches, it is perfected at the time when it attaches." As discussed previously, a security interest cannot become perfected until it has attached and a security interest cannot attach, under section 9-204(1), until "value is given and the debtor has rights in the collateral." Even if the debtor can be considered to have rights in the mass or "entity" of his present and future accounts and inventory, a security interest cannot attach to this mass or entity of collateral until value is given by the secured party. The court's conclusion, therefore, as to the time of the transfer is probably mistaken. The date of perfection and transfer would appear to be the date on which the bank "gave value." To this extent at least, the method of perfection is a matter of state law and the date of filing would not meet the standards of perfection required for a transfer under section 60(a)(2).

IV. Reflections on the Cases

The main theme running through the cases is a determination that the floating lien is not the type of interest at which the various amendments of section 60 were aimed. In taking this approach, rather than a mechanical word-by-word comparison of the various sections of the Bankruptcy Act and the Code, the decisions avoid the kind of overly literal statutory construction exemplified by decisions such as Klauder, which made necessary the 1950 amendments to section 60. Professor Gilmore has suggested that the present version of section 60
"does not mesh with Article 9 of the Code a great deal better than the 1938 revision meshed with pre-Code security law."

Once it is established that the Code's floating lien is not the type of security device at which section 60 is aimed, the "entity," "lien creditor" and "substitution of collateral" theories are used to cement over the apparent contradictions between the language of the Bankruptcy Act and the Code on the one hand and the intent of the Congress on the other. The way in which Section 9-108 of the Code is used is curious. It is not considered as binding federal court interpretations of the term "antecedent debt," as used in the Bankruptcy Act; rather it serves as the source in which the federal courts find the "current business practice and understanding" on which the federal definition is to be based. Such a conclusion about the federal definition of "antecedent debt" removes the last obstacle to validation of the floating lien in bankruptcy.

This analysis seems appropriate, in view of the unfortunate results of a more literal analysis in cases like Klauder. It is to be hoped that federal appellate courts will take the same view and spare the bar and business community the necessity of further revisions of section 60.

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60 2 G. Gilmore, supra note 3, at 1303.