Judicial Lien Priorities under Article 9 of the Uniform Commercial Code: Part I

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JUDICIAL LIEN PRIORITIES UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE: PART I

DAVID GRAY CARLSON* AND PAUL M. SHUPACK**

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Part II of this Article will appear in 5 Cardozo L. Rev. (forthcoming Summer 1984).
INTRODUCTION

It was a truth universally acknowledged throughout the nineteenth and much of the twentieth centuries that secret hypothecations on personal property were voidable by creditors. Of course, the Uniform Commercial Code (UCC)\(^1\) has changed all this. One of Article 9's most important innovations was to protect secret hypothecations from general creditors. Unperfection of a security interest endangers the secured creditor today only when the general creditor has himself become a secured creditor by obtaining a nonconsensual lien in conjunction with a money judgment.

The modern battle for debtor assets between secured and unsecured creditors is actually a battle for priority among secured creditors only.\(^2\) This observation is no less true in bankruptcy proceedings, where the trustee is deemed to have obtained a judicial lien on the debtor's property as of the day the bankruptcy petition is filed.\(^3\) Thus endowed with powers of a hypothetical lien creditor, the trustee competes for priority with Article 9 secured parties for debtor assets.\(^4\)

Bankruptcy law requires courts to explore the priorities of judicial liens, but priority problems in this context are easily solved.

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1 Unless otherwise indicated, all citations to the UCC shall be to the 1978 version.
2 For the justifications behind this change, see infra text accompanying notes 135-39.
4 Id. § 550.
Bankruptcy courts need only determine whether a secured party has succeeded in perfecting before bankruptcy day, a task so simple that the academic community apparently has been lulled into thinking that all priority problems between judicial liens and security interests can be disposed of just as easily. On the contrary, many priority issues are quite complex and misunderstood.

This Article explores the state law priority between judicial liens and consensual liens created under Article 9. Needless to say, judicial liens are not created by the UCC. However, its provisions—most notably section 9-301—establish rules of priority between judicial liens and security interests.


See U.C.C. § 9-104(h) (“[t]his Article does not apply . . . to a right presented by a judgment”).

The text of section 9-301 is as follows:

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under Section 9-312;
(b) a person who becomes a lien creditor before the security interest is perfected;
(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;
(d) in the case of accounts and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A “lien creditor” means 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.
We will first attempt to define exactly what judicial liens are and when they first arise, a task that is more difficult than it sounds. Thereafter, we will examine the priorities between judicial liens and security interests under section 9-301. When nonuniform state lien law is accounted for, the meaning of section 9-301 becomes unclear and certainty of result disappears. We will offer a preferred meaning of the language in section 9-301 that is consistent with both the UCC policy of uniformity and the competing policies occasionally found in nonuniform state law.

Finally, we will examine specific priority problems concerning purchase money priority, after-acquired property and future advances.®

I. JUDICIAL LIENS

A. The Judicial Lien as Property Interest

A “judicial lien” is an interest in property of the debtor that the law gives to a creditor either to secure a judgment or, in some narrow circumstances, in anticipation that a judgment will be procured.® The

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

® Problems pertaining to creditor representatives, fixtures, crops, minerals and accessions will be addressed in Part II of this Article to appear in 5 Cardozo L. Rev. (forthcoming Summer 1984).

® Cf. 11 U.S.C. § 101(27) (1982) (“ ‘judicial lien’ means lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding”); id. § 101(28) (“ ‘lien’ means charge against or interest in property to secure payment of a debt or performance of an obligation”). We shall use the term “judgment lien” to signify liens that arise solely by virtue of docketing a judgment. “Equity lien” shall refer to a lien arising from the type of supplemental proceeding that has replaced the old creditor’s bill in equity. See infra text accompanying notes 34–37. Other liens will be described in terms of their origin, e.g., an execution lien arising from service of the execution upon the sheriff. “Judicial lien” is a term that will include all of the above, as well as prejudgment attachment liens on the debtor’s property.

Dispossession of the debtor pursuant to the enforcement of a prejudgment judicial lien is restricted by the due process clause of the fourteenth amendment to the Constitution. Fuentes v. Shevin, 407 U.S. 67 (1972). Postjudgment seizures pursuant to judicial liens are usually thought not to require any further notice or hearing to protect the debtor’s interest because the judgment itself represented the debtor’s day in court. Endicott Johnson Corp. v. Encyclopedia Press, Inc., 266 U.S. 285, 288 (1924). But see Finberg v. Sullivan, 634 F.2d 50, 59–63 (3d Cir. 1980) (postjudgment seizure of bank account might constitute seizure of property exempt from the satisfaction of the judgment, and hence the debtor must be accorded further due process rights); Deary v. Guardian Loan Co., 534 F. Supp. 1178, 1185–87 (S.D.N.Y. 1982) (same).
property rights of a judicial lien creditor are limited to seizure and sale of the encumbered property by a court officer acting on behalf of the creditor.10

One important aspect of any property right is that, generally speaking, a person’s property may not be given away without his consent. This basic attribute of property is, of course, riddled with exceptions.11 Creation of the judicial lien itself is an involuntary transfer of the debtor’s property to the creditor. But this general aspect of property is the paramount feature of the lien. Once the creditor has his lien, the debtor loses the ability to transfer the encumbered property to a third party.12 The property, to the extent of the lien, has already been taken from the debtor.13 By creating a property interest in the creditor (and depriving the debtor of property) a lien serves effectively as a restraint on the debtor’s power of alienation.

Nevertheless, in the interest of commerce, the general rule has been eroded by a series of statutory exceptions. Originally, at common law, a judgment creditor was given his lien immediately upon obtain-

Although a creditor may be able to establish a judicial lien before judgment, he nevertheless may not receive proceeds from the sale pursuant to his “ownership rights” until he is a judgment creditor. See, e.g., N.Y. Civ. Prac. Law § 6218(a) (McKinney 1980) (sheriff to hold attached property “to answer any judgment that may be obtained against the defendant”).

10 Cf. U.C.C. § 9-505(2) (the secured party who has repossessed collateral may retain the collateral in satisfaction of the debt; however, if the debtor objects to such retention, the secured party must reduce the collateral to cash proceeds).

11 For example, property interests can be terminated without consent of the owner by one with apparent authority to terminate them.

12 Cf. 31 U.S.C. § 191 (1976) (creating federal priority in nonbankruptcy liquidation proceedings). This provision “creates no lien in favor of the United States, so the fiduciary administering the insolvent’s estate is free . . . to sell and pass clear title to property.” Plumb, Federal Liens and Priorities—The Agenda for the Next Decade (pt. 1), 77 Yale L.J. 228, 234 (1967) (footnote omitted).

13 It has become fashionable to complain that the term “lien” is vague and more appropriately divisible into two component parts: the creditor’s rights against other lien creditors (priority issues); and the creditor’s rights against the debtor and the debtor’s transferees. See 6 J. Weinstein, H. Korn & A. Miller, New York Civil Practice ¶ 5202.02 (1982); Distler & Schubin, supra note 5, at 459-63. The attempt to divide the lien into separate parts ultimately fails to account for the fact that subsequent judicial liens, which are consigned to the realm of “priorities,” are also subsequent transfers made—albeit involuntarily—by the debtor, and that subsequent non-lien transferees may be entitled to some priority, however low, in the distribution of proceeds. In comparison, analysts of Article 9 have never felt compelled to reject the use of the term “security interest” as inadequate to describe the dual legal implications of holding such an interest.

We believe that the judicial lien can be understood as an interest in property. The interest is accorded integrity against certain subsequent transfers to third parties—including involuntary transfers such as subsequent judicial liens—and is not accorded integrity against other subsequent transfers. This simple concept is embodied in the definitions of the Bankruptcy Code. See 11 U.S.C. § 101 (1982); see also Ward, supra note 5, at 226 (“Though . . . the word ‘lien’ lacks exact definition, it generally marks the time at which the initiating creditor is afforded a measure
ing a money judgment against the debtor. In fact, the common law indulged in the fiction that the lien related back to the first day of the judicial term in which the judgment was entered. After the lien arose, the debtor could not convey any personal property that was encumbered by the judicial lien because the property was no longer his to give. The fact that the debtor's purported transferee was a bona fide purchaser for value was of no consequence. Naturally, this rule made commerce difficult since no purchaser could be confident that his title to goods would withstand the claims of some judgment creditor of the seller, whose existence he had no simple means of ascertaining.

To reduce the commercial disruption caused by the judicial lien, the original Statute of Frauds, passed in 1676, made an important reform. Henceforth, the judicial lien was deemed to arise only upon the delivery of a writ of fieri facias (what we would now call a writ of execution) to the sheriff. This writ commanded the sheriff to seize (or “levy”) the property of the judgment debtor. Prior to the delivery of the writ, the debtor retained the power to convey his personal property to a transferee, subject to the limitations of fraudulent conveyance law. This reform, although an improvement, by no means removed all impediments to commerce. Delivery of the writ to the sheriff was not an event easily ascertainable by customers of the judgment debtor. Absent visiting the sheriff's office to investigate whether writs had been delivered, no one could be absolutely sure whether the debtor had good title to convey.

In the United States, limitation of the judicial lien in the interest of commerce continued, but it varied widely from state to state. Some jurisdictions adopted the rule that generally a lien arises upon delivery of the writ of execution, but that good faith purchasers for value (and no one else) could nevertheless take the debtor's personal property, at
any time prior to the levy by the sheriff, free from the judicial lien. The rationale for this legislative reform is that delivery of the writ, being secret, gives the good faith purchaser no adequate chance to protect himself from the lien. After the levy, however, the good faith purchaser can protect himself by ascertaining whether the debtor still has possession of the personal property he is purporting to convey. If he does not have possession, the purchaser is on notice that the property may already have been levied. The policy of protecting good faith purchasers therefore ends with the levy. In any case, since commerce depends on the good faith purchaser and not upon the gratuitous transferee or bad faith purchaser, the latter parties usually remain unprotected from the lien at all times.

A different and very common type of legislative reform simply delays attachment of the judicial lien to the time of the levy. Service of the writ, in these jurisdictions, has no lien significance. Subject to fraudulent conveyance law, judgment debtors remain completely free

\[\text{footnotes}
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to transfer unlevied property to any transferee, whether gratuitously or for fair consideration.

Three states, still grant lien significance to the judgment itself. Georgia makes entry of judgment, without more, an event of lien significance, although good faith purchasers are sometimes protected until the judgment is docketed in the debtor's home county. Alabama and Mississippi simply delay the judgment lien until it is docketed, so that all predocketing transferees are protected.

One particularly distinctive execution lien is that of Tennessee. The lien arises as of the date of teste on the execution, and the date of teste for all courts of record (i.e., all except the smallest local courts) is deemed to be the first day of the judicial term. Bona fide purchasers receive postlien protection only for the period, if any, that the lien predates the entry of judgment. This model is therefore quite close to

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25 Id. §§ 39-701, -702. Under these statutes, protection ceases when the judgment is recorded on the "execution docket" of the debtor's home county. Where the forum court is not the defendant's home county, the docketing seems to relate back to the date of entry, provided docketing occurs within 30 days. Id. § 39-702. This rule provides no protection to bona fide purchasers after entry of the judgment if the judgment creditor complies with the grace period. But see Reynolds Banking Co. v. I.F. Peebles & Co., 142 Ga. 615, 83 S.E. 229 (1914) (no docketing necessary if the judgment creditor levies within the grace period). Where the defendant resides in the forum county, docketing does not relate back to entry. Bona fide purchasers are protected, in such a case, until docketing. Ga. Code Ann. § 39-701.
29 In Tennessee, purchasers of real estate receive protection until the judgment is docketed, but purchasers of personalty are specifically excluded from such protection. Note, supra note 28, at 65-66. The rules for personality stem from section 26-1-109. Tenn. Code Ann. § 26-1-109 (1980) ("Courts executions are tested of the first day of the term next before the date of issuance, except that general sessions court executions are tested of the day of issuance."). By case law, the execution lien defeats bona fide purchasers as of the day of teste, which can be considerably before the date on which the execution was issued or delivered to the sheriff. John Weis, Inc. v. Reed, 22 Tenn. App. 90, 118 S.W.2d 677 (1938). When the execution is issued in the same year in which the judgment was entered, the execution lien still arises the first day of the judicial term, although by case law, bona fide purchasers are protected from the lien before the date of judgment. Berry v. Clements, 28 Tenn. (9 Hum.) 312 (1848), rev'd on other grounds, 52 U.S. (11 How.) 398 (1850). The rule in Tennessee therefore may be summarized as follows: The execution lien destroys the debtor's right to alienate personality as of the date of teste, which is the first day of the judicial term in which the execution was issued, except that bona fide purchasers are protected from the lien up until the judgment is entered. This rule applies only to executions from courts that are not general sessions courts or courts in continuous term. Executions from these latter courts are tested on the day of issuance. Tenn. Code Ann. § 26-1-109.
the common law rule that existed prior to the passage of the Statute of Frauds.

Three states now permit the creation of liens by means of filing what amounts to an Article 9 financing statement: New Hampshire, Vermont and California.

At the same time that legislators struggled with the execution lien significance of delivering the writ of execution, equitable methods of enforcing money judgments were being developed because of certain perceived defects in the common law. For instance, it was formerly thought that the sheriff could levy only personal property that he could seize and carry away with him. Intangibles could not be physically seized and therefore were not reachable by the writ of execution or its accompanying lien. The equity courts therefore permitted the

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30 N.H. Rev. Stat. Ann. § 511:23 (1983). New Hampshire's ancient statute curiously provides that only the sheriff may make the filing. The filing is to be made in the appropriate Article 9 filing office within 48 hours after the sheriff "takes possession" of the items in question. Obviously, the statute contemplates some manner of constructive possession because the whole point of the statute is to leave the debtor in possession. Nevertheless, manifestation of the sheriff's possession is essential; the filing itself does not create the lien. Scott v. Manchester Print Works, 44 N.H. 507 (1863).

Not all types of property may be encumbered by filing—only livestock and "articles which, by reason of their size, situation, fluidity, explosive or inflammable qualities, including motor vehicles... are incapable of being conveniently taken into actual possession." N.H. Rev. Stat. Ann. § 511:23. Meanwhile, any person who diminishes the value of the encumbered property is guilty of a misdemeanor. Id. § 511:25.

The above provisions apparently apply only to prejudgment attachments. As for executions, the sheriff apparently must levy goods by taking possession. In fact, he must keep them for "four days at least," even if they are fluid, explosive, inflammable, etc. Id. § 528:2 (1974). On the other hand, if the goods are subject to a security interest, the sheriff may levy "in the same manner that [such goods] may be attached." Id. § 528:8. There appear to be no judicial opinions that sort out these confusing statutes.

32 Cal. Civ. Proc. Code §§ 607.510–530 (West Supp. 1983). The creation of this new lien is part of a massive overhaul of California debtor-creditor law and applies to judgments entered after June 30, 1983. See 1983 Cal. Stat. 1364. The lien encumbers only limited types of property, i.e., not consumer goods, negotiable instruments, registered vehicles or vessels, or retail merchandise worth less than $500 per item. The lien does not displace other, more traditional methods of creating judicial liens. See Cal. Civ. Proc. Code § 697.520. The filing may be made by the judgment creditor's attorney or, if he has no attorney, by the judgment creditor himself. Id. § 697.550.

33 In determining what property is subject to execution liens, we have only to consider the purpose in aid of which such liens have been created by law. The purpose was to prevent the defendant from alienating such property as the plaintiff was entitled to take in satisfaction of his writ. Therefore, as a general rule, all property subject to execution is subject to an execution lien. On the other hand, it must be true that no property not subject to execution can be subject to execution lien, for it would be idle to declare the existence of a lien, and at the same time maintain that no proceedings can be had for its enforcement.
Judgment creditor to reach intangible property by filing a creditor’s bill in equity.34 By this procedure, a creditor with no adequate remedy at law35 could reach the debtor’s intangible assets. The equity courts would assess the validity of those debts and, if actually owed to the debtor, would declare that the debts must be paid, when due, to the judgment creditor of the debtor. The creditor’s bill has often been replaced legislatively with supplemental proceedings, occasionally called proceedings in aid of execution.36 Other states have taken the simple and practical step of eliminating the disability of the sheriff with regard to intangibles by extending the execution lien to cover all of the debtor’s property, including intangibles.37

In jurisdictions where the sheriff cannot levy upon the debtor’s intangibles, only the creditor’s bill or the modern supplemental proceeding can supply a lien in favor of the judgment creditor. The exact time that an equity lien arises varies greatly. In some states, filing of the bill by the judgment creditor gives the court jurisdiction over the equitable assets, thereby depriving the debtor from conveying those assets to a third party.38 In other states, the lien is said to arise only when the court issues the ultimate equitable order39 or when the garnishee is served with process.40 In any case, there comes a point in time when the equitable proceeding gives rise to a lien that, in some jurisdictions, is separate from the judgment or execution lien.41 These liens are generally good against any transferee, although New York

1 A. Freeman, supra note 15, § 197, at 569–70; see also In re Smith, 17 Bankr. 541, 545 (Bankr. M.D. Ga. 1982) (judicial lien cannot extend to property that is not part of the debtor’s estate); Levine v. Pascal, 94 Ill. App. 2d 43, 52–59, 236 N.E.2d 425, 429–32 (1968) (constructing the beneficial interest of a land trust as an intangible and, therefore, inappropriate for a writ of execution); 3 R. Clark, The Law of Receivers § 667.1(b), at 1201 (3d ed. 1959) (judgment creditor cannot issue legal execution against equitable interests).

34 E.g., Freedman’s Sav. & Trust Co. v. Earle, 110 U.S. 710 (1884) (interpreting Maryland law).


36 See S. Riesenfeld, Creditors’ Remedies and Debtors’ Protection 283–86 (3d ed. 1979).

37 E.g., N.Y. Civ. Prac. Law § 5232(a) (McKinney 1978).

38 E.g., Freedman’s Sav. & Trust Co. v. Earle, 110 U.S. 710, 716 (1884); 3 R. Clark, supra note 33, § 667.1(a), at 1200; cf. Penn Gen. Casualty Co. v. Pennsylvania, 294 U.S. 189 (1935) (filing an application for an equity receivership divests the debtor of his property and brings it within the power of the court).


41 See generally Annot., 92 A.L.R. 1435, 1437–40 (1934) (discussing the timing of liens in various states).
gives unique postlien protection to transferees who give fair consideration without knowledge of the equity lien.42

B. When Does a Lien Attach to the Debtor’s Property?

A principal purpose of our inquiry is to explore the meaning of section 9-301 and its concept of “a person who becomes a lien creditor before the security interest is perfected.”43 This statutory language requires us to identify the exact time at which a judicial lien first attaches to the debtor’s personal property. In light of the principal utility of the lien, i.e., to prevent the debtor from alienating his property prior to its seizure, we generally will define that moment as the time when the debtor’s ability to transfer property to some third party transferee is first defeated. Thus, in all states except Georgia,44 no judicial lien arises upon entry of judgment because no restriction on transfer is thereby created. In some states a lien arises when the judgment is docketed or the execution is delivered, while in others the lien arises only when the sheriff levies.45 The continuing power of the debtor, after any one of these events, to transfer personal property to a good faith purchaser for value does not disprove the existence of a lien. We require only that some transferee be subject to the lien. For example, under New York’s prejudgment attachment statute the plaintiff must obtain an attachment order from the court and must then serve it upon the sheriff.46 The sheriff then must levy under the order.47 After the order of attachment is served and before the levy, the defendant may still transfer property free of the lien to good faith, and even bad faith, purchasers for value. He may even transfer his property to good faith gratuitous transferees. He may not, however, convey property to bad faith gratuitous transferees.48 New York’s prelevy attachment procedure may well produce America’s weakest lien, but it is a lien nevertheless; at least some class of transferees—those who gave no fair consideration and had knowledge of the or-

43 See U.C.C. § 9-301(1)(b).
44 See supra text accompanying notes 24–25.
45 By our definition, teste is always the time when an execution lien arises in Tennessee. See supra note 29. A Tennessee garnishment lien, however, does not arise until the garnishee is served with process. In re Robby’s Pancake House, 24 Bankr. 989, 998 (Bankr. E.D. Tenn. 1982); Note, supra note 28, at 73.
47 Id. §§ 6214–6215.
48 Id. § 6203.
der—take the property subject to the lien. Vast numbers of other transferees are protected from the lien, but this extensive protection does not negate the existence of the lien; such protection merely whittles away the utility of the lien to the plaintiff.\[49\]

Having defined the point of attachment for liens in such a fashion, we hasten to add that different statutory schemes may redefine that point in order to require at least some degree of perfection against third parties. For example, the bankruptcy courts do not recognize the existence of a lien on personal property until it is so far perfected that no subsequent hypothetical lien creditor can gain priority over the judicial lien under scrutiny.\[50\] Under the "property theory" definition described earlier, a lien might exist and yet be accorded no validity in bankruptcy for lack of adequate perfection.\[51\]

The UCC contains its own definition of a lien creditor, which the drafters presumably supposed would be of assistance in assessing priorities between competing security interests and judicial liens. It is to

\[49\] It may help at this point to distinguish fraudulent conveyance law, which, for many states, is set forth in the Uniform Fraudulent Conveyance Act (UFCA). The distinction between the disabilities placed on the debtor by judicial liens and those placed on the debtor by the UFCA manifests itself in the quality of title that the debtor's transferee is able to acquire. In a case where the debtor has transferred property encumbered by a judicial lien (and assuming no lien statute provides protection for subsequent transferees), the transferee can take only the equity that the debtor still possesses, i.e., the debtor's equity in the property after the lien. The lien itself remains a property right of the judgment creditor. As to the portion of the personal property covered by the lien, it is frequently said that the transferee has void title.

A fraudulent conveyance, loosely speaking, is one made gratuitously by a debtor in anticipation of insolvency or with the intent to defraud creditors. See UFCA §§ 4-7, 7A U.L.A. 205, 227, 240, 242 (1978). The conveyance is good against the world except the defrauded creditors. Hence, until the defrauded creditors make a move to establish a lien on the conveyed property the transferee has some title but it is less than perfect. The state of his title is frequently called voidable.

Whether a transferee has void or voidable title becomes relevant when a transferee attempts to convey the property in question to a good faith purchaser for value. If the property is conveyed while title is voidable, the defect in title is cured, and the good faith purchaser takes perfect title. Id. § 9, 7A U.L.A. 304. But if the transferee has void title (to the extent of the lien), he can convey nothing to the second transferee. On the distinction between void and voidable title generally, see Dolan, The U.C.C. Framework: Conveyancing Principles and Property Interests, 59 B.U.L. Rev. 811, 813-16 (1979); Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954); Weinberg, Sales Law, Economics, and the Negotiability of Goods, 9 J. Legal Stud. 569 (1980) [hereinafter cited as Weinberg, Sales Law]; Weinberg, Markets Overt, Voidable Titles, and Feeless Agents: Judges and Efficiency in the Antebellum Doctrine of Good Faith Purchase, 56 Tul. L. Rev. 1 (1981); see also Flemming v. Thompson, 343 A.2d 599 (Del. 1975) (a transferee of property encumbered by a judicial lien has voidable—not void—title). This case is critized in Murray, supra note 5, at 491.


\[51\] In Indiana, a lien arises when the sheriff is served with the execution, but, where executions are delivered to different enforcement officers, the first execution to be levied upon
this definition that we now turn. As we shall see, the UCC definition differs from the general "property theory" definition we have just offered. The exact point at which a lien is deemed to come into existence for the purposes of the UCC is far from clear.52 Nevertheless, the priority system in section 9-301 cannot work unless this point in time is identified. We will offer a new method for determining when judicial liens arise, a definition that will apply only for the purpose of assessing their priority against UCC security interests.

II. PRIORITIES BETWEEN SECURED PARTIES AND LIEN CREDITORS

A. "Becoming a Lien Creditor"

Section 9-201 of the UCC makes a security agreement "effective according to its terms between the parties . . . and against creditors."53 The statutory force given a security agreement is severely limited, however, by the section's opening words: "Except as otherwise provided by this Act . . . ." One of the most important UCC provisions to fall under the "otherwise provided" clause is section 9-301. This section was designed as a catalogue of those creditors with rights superior to unperfected secured parties.54 Among the creditors who take priority over unperfected secured parties are "lien creditors."55

In governing the priorities between judicial lien creditors and secured parties, section 9-301 encourages a race between the two. The

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52 See Mellinkoff, The Language of the Uniform Commercial Code, 77 Yale L.J. 185, 196-97 (1967). Professor Mellinkoff singles out the UCC definition of lien creditor as a particularly unfortunate piece of draftsmanship.

53 U.C.C. § 9-201 (emphasis added).

54 The nature of section 9-301 as a catalogue of rights potentially superior to an unperfected security interest is further developed later in this Article. See infra text accompanying notes 130-39.

55 U.C.C. § 9-301(1)(b).
winner is the party who crosses the finish line before the other. Section 9-301, however, establishes a different finish line for each of the parties. Perfection, a point that the UCC clearly defines, is the finish line for the secured party. The lien creditor's finish line is described by the words of section 9-301(1)(b):

Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

   (b) a person who becomes a lien creditor before the security interest is perfected . . . .56

The converse proposition is stated in the first clause of section 9-301(4):

A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest . . . .

Both these statements of the simple rule require determination of the exact time at which a judgment creditor first “becomes a lien creditor.”

Subsection (2) of section 9-301 deals with the special case of purchase money security interests. This subsection uses slightly different language to describe the lien creditor’s finish line:

If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, he takes priority over the rights . . . of a lien creditor which arise between the time the security interest attaches and the time of filing.

Here the question is, exactly when did the judicial lien “arise”?

Despite the difference in language, all three subsections ask questions that require the same answer. Until one can say when a person “becomes a lien creditor” or when the “rights” of a lien creditor “arise,” these provisions of the UCC cannot be applied.

The answer begins with the definition of lien creditor contained in section 9-301(3):

56 The 1962 version of this section provided: “Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor without knowledge of the security interest and before it is perfected.” Under this provision, a lien creditor who would otherwise be senior would be subordinated by virtue of his knowledge at the time he became a lien creditor. E.g., Central Nat’l Bank v. Wonderland Realty Corp., 38 Mich. App. 76, 195 N.W.2d 768 (1972); see Credit Bureau v. Moninger, 204 Neb. 679, 284 N.W.2d 855 (1979) (where a person became a lien creditor at the time of levy, the levying sheriff’s knowledge is not imputed to the lien creditor).
A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for the 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.

To say that a lien creditor is one who "acquired a lien . . . by attachment, levy or the like" does not establish when a person becomes a lien creditor, a point in time that must be established to make clear the priorities between lien creditors and secured parties. This determination is particularly vulnerable to confusion in states such as New York and Indiana, which accord some lien significance to events that take place before the levy, e.g., delivery of the execution to the sheriff. The drafting history of section 9-301(3) adds to the confusion. Even in early drafts of the section, a lien creditor was defined as a "creditor who has acquired a lien . . . by attachment, levy or the like." However, the section went on to provide:

A creditor who secured the issuance of process which within a reasonable time result in attachment, levy or the like is a lien creditor from the time of issuance of process.

In 1956, this language was omitted "because it involved varying local procedural rules." It can be seen that the words "attachment, levy or the like," when originally used, had no timing significance. It was the omitted sentence quoted above that established the exact time at which a lien first arose. When the drafters dropped these words, they left absolutely no timing mechanism for judicial liens; timing was a matter to be left entirely to the various nonuniform state lien statutes. The point at which a lien arises under section 9-301(3) is the question to which we now turn.

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57 U.C.C. § 9-301(3) (1952).
58 Id. § 9-301(4).
59 1 G. Gilmore, Security Interests in Personal Property § 16.6, at 496 (1965) (quoting the 1956 Recommendations of the Editorial Board). Professor Gilmore thought that this was "a good reason . . . for keeping it in." Id.
60 In contrast, both the early drafts and the current version of section 9-301(3) define exactly when the lien rights first arise for general assignees, bankruptcy trustees and receivers. See R. Henson, Secured Transactions Under the Uniform Commercial Code § 7-1, at 238 (2d ed. 1979).
61 See id. at 236–37; cf. Jackson & Peters, Quest for Uncertainty: A Proposal for Flexible Resolution of Inherent Conflicts Between Article 2 and Article 9 of the Uniform Commercial Code, 87 Yale L.J. 907, 938–39 (1978) (noting, in the context of section 2-702, the difficulty in drawing "inferences from language that, like the Cheshire cat, is no longer there").
1. The Current Thinking

A person becomes a lien creditor under section 9-301(3) by “attachment, levy or the like.” It is tempting to conclude that some common element of “attachment” and “levy” must exist, which in turn becomes the standard for defining the vague term “the like.”

One commentator posits that the common element is notice to the world. Not every lien, therefore, makes a person a lien creditor for the purposes of section 9-301. Rather, only those liens that provide notice should be accorded status against unperfected security interests.

While notice to the world is an important consideration, we disagree with the proposition that notice alone is adequate to define the point in time at which a lien arises for UCC purposes. First, the terms “attachment” and “levy” are not necessarily the equivalent of acts constituting notice. In California, attachment does not inevitably refer to an act that dispossesses the debtor (and serves to give notice in most ordinary cases). “Attachment” is just as likely to refer to an “order of attachment,” not the levy thereunder. In Wisconsin, attachment is synonymous with the writ of execution in other states. The order of attachment without a levy, of course, provides small opportunity for notice to other potential creditors.

Second, in some states, not even a levy under an execution or writ of attachment necessarily requires an act that would convey notice to potential creditors. A Kentucky sheriff, for example, may levy property of the debtor by appointing the debtor as his bailee. In New York, a sheriff can levy merely by serving an order of attachment upon the debtor. In Nebraska, a sheriff can levy by holding onto the property and announcing to those within earshot that the item is levied. By these sorts of levies, creditors would not easily be put on notice.
notice that a lien has arisen. Granted, a levy *tends* to be more notorious than other possibilities, such as delivery of an execution, but this is not inevitably so.

Third, priority of judicial liens is not necessarily based solely on notice. Between judgment creditors, the prize usually goes to the diligent, not the notorious.\(^6\) We have already seen that the drafters intended to defer to local lien law.\(^7\) Establishing a rule based upon notice defeats this intent wherever local lien law is based on a policy of diligence.

Finally, the suggestion that notice determines when a lien arises fails to account for liens arising from equitable orders, such as the appointment of a receiver. In New York, a lien arises against third parties when an order appointing the receiver is "secured"\(^8\) and "filed."\(^9\) These events are not calculated to give notice to the world. It is also quite significant that, in according a receiver the status of a lien creditor, the UCC *specifically* provides that an equity receiver's lien rights against unperfected security interests arise at the moment he is appointed.\(^10\) The appointment, without more, has little to do with effective notice to the world. We therefore submit that more is involved in section 9-301(3) than a directive to find the point at which a lien achieves some undefined degree of notoriety.

Instead, we propose to explore some very basic concepts of liens and the economics of commercial law in order to find the optimal definition for "becoming a lien creditor." Such a definition might lead to different results from state to state because legislation creating judicial liens is quite diverse. It should be possible, however, to reduce the methodology for finding a result to a single formula that could be used in every state.\(^11\) To derive this formula, we will consider two factors of overriding importance: (1) whether statutory conflict between nonuniform lien law and the UCC can be eliminated; and (2) whether the formula adequately minimizes what has been called a

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\(^6\) J. Weinstein, H. Korn & A. Miller, supra note 13, ¶ 5202.02, at 52-30.
\(^7\) See supra text accompanying notes 57-61.
\(^8\) N.Y. Civ. Prac. Law § 5202(b) (McKinney 1978) (lien arises as to judicial lien creditors when an order is "secured").
\(^9\) Id. § 5234(c) (priority over competing judicial lien creditors depends upon when the order is "filed" by the clerk).
\(^10\) U.C.C. § 9-301(3).
\(^11\) Such a uniform test would comport with UCC section 1-102, which states: "Underlying purposes and policies of this Act are . . . to simplify, clarify and modernize the law governing commercial transactions [and] . . . to make uniform the law among the various jurisdictions."
postlien transfeeree’s “innocent purchaser risk,” a transaction cost upon secured lending that may be economically unjustifiable. Each of these concepts requires some preliminary explanation.

2. Statutory Harmonization

Harmonization of apparently conflicting statutes is a basic tenet of statutory interpretation. In the context of judicial liens and security interests, the failure to harmonize conflicting provisions will result in discrimination between postlien transfers, depending on whether Article 9 governs the transfer.

For example, in New Jersey, an execution lien on tangible property arises when the execution is first delivered to the sheriff. Thereafter, until a levy of property occurs, a judgment debtor may transfer his property free of the lien to any good faith purchaser for value. The creation of a security interest could be such a postlien transfer and hence (assuming the requisite good faith) would be protected from the execution lien. If, however, the holder of an execution lien “became a lien creditor” on delivery of the execution to the sheriff, then the UCC would subordinate the security interest to the execution lien. If the UCC priority is enforced in spite of nonuniform lien law—perhaps on the grounds that the “narrow” UCC should govern over “general” lien law—then an inexplicable discrimination is created between the judgment debtor’s postlien transfers for fair consideration that are not security interests and postlien transfers that are security interests. In

76 Id. § 2A:17-14.
78 This seems to be Professor Ward’s solution to the problem. See Ward, supra note 5, at 245. If there is a true statutory conflict (which we do not concede), section 1-104 and section 10-103 support his position. On the other hand, consider New York’s nonuniform lien law, which can be found in its Civil Practice Law and Rules. The New York law states: “The consolidated laws [which includes New York’s UCC] shall not be construed to amend, repeal or otherwise affect any provision of the . . . civil practice law and rules . . . .” N.Y. Gen. Constr. Law § 101 (McKinney Supp. 1983–1984). In New York, there is no basis for choosing one statutory scheme over another.
79 This precise situation was put before the court in Friedlander v. Adelphi Mfg. Co., 5 U.C.C. Rep. Serv. (Callaghan) 7 (N.Y. Sup. Ct. 1968). The court upheld the security interest and therefore avoided statutory conflict between section 9-301(3) and section 5202(a)(1) of the New York Civil Practice Law, but only by illegitimate means. In that case, a discretionary future advance was made after the execution was delivered and before the levy. The court seemed to believe that the lien creditor obtained its lien when the execution was delivered to the sheriff, but that the discretionary future advance gave rise to a perfected security interest that related back to
short, choosing the UCC over the nonuniform statute rewards the
general unsecured creditor who has obtained a judicial lien and pun­
ishes the secured party who, with equal good faith, obtains a security
interest.

This discrimination between transfers does not bear rational
analysis and is economically dysfunctional. It is irrational because
there is no material distinction between an absolute sale or transfer in
satisfaction of preexisting debt, on the one hand, and a transfer that
leaves the debtor with possessory rights until default (i.e., a security
interest), on the other. Both are transfers that, if not fraudulent
against creditors, remove the assets from the estate of the debtor and
from the reach of the creditors. It is dysfunctional because it discour­
ages rehabilitation of debtors, thereby burdening the very lien credi­
tor whose seniority is supposedly being vindicated by the UCC. Sup­
pose our New Jersey debtor, after an execution has been delivered but
before a levy, pays a creditor by giving him his typewriter, or suppose
he simply sells it to raise cash. New Jersey protects both transactions
because both are for fair consideration. The UCC is not applicable
because the outright transfers are not security interests. Both transfers—
the buyer and the preferred creditor—take the typewriter free of the
execution lien. Now suppose the same debtor hypothecates the
same typewriter to collateralize a loan. If the execution creditor is
considered a UCC lien creditor under section 9-301(3), then the security
interest is subordinated to the execution lien by section 9-301(1)(b).
This security interest benefits the lien creditor—the very person whom
we are trying to protect—much more than does a transfer for anteced­
ent debt. The preference of the unsecured creditor, perfectly permis­
sible under New Jersey law, simply depleted the debtor's estate to the
prejudice of the lien creditor. The straight sale was more favorable; at
least the debtor received value in return, which the sheriff could levy
on behalf of the lien creditor.® The hypothecation, however, allowed
the debtor to keep the typewriter pending default. If the typewriter is
an income producing asset (e.g., the debtor is a writer), the lien
creditor is much better off under the hypothecation where the debtor
can retain the typewriter and can produce future income from it. The
"debtor-in-possession" concept is a major tool in rehabilitating

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a time prior to delivery of the writ. This view of future advances is criticized later in this Article.
See infra text accompanying notes 253–94.

® Of course, in order to levy the cash received from the sale, the sheriff must find it, which is
by no means a certain prospect. See Coogan, supra note 5, at 1032–33.
debtors. The irrational discrimination created by the conflict between nonuniform law and the UCC discourages rehabilitation (through secured lending) and favors liquidation of assets that might otherwise produce income for the debtor. 81

In choosing a universal test for deciding when a person “becomes a lien creditor” under section 9-301, the existence vel non of statutory conflict and resulting irrational discrimination will be important. Obviously, in light of this principle, choosing delivery of the execution would be a mistake in New Jersey.

3. Defining Lien Creditor Status for Optimal Welfare Effects

Our analysis here is not intended to prove anything about any particular case, but, rather, will demonstrate the general economic effects of competing interpretations of section 9-301(3) where all other variables are held constant. In many cases (perhaps in a vast majority of cases), the priority rules between lien creditors and secured parties will be such a remote consideration at the time a lender undertakes to make an advance that a change in the rules would not affect the assessment of transaction costs the lender must make in pricing his loan. Nevertheless, our proposed test for priorities will have beneficial effects in some jurisdictions and will have negative effects in very few cases.

We start with the premise that credit is a basic raw material in the goods and services we use. Increased cost of credit will increase the price, and reduce the quantity, of goods and services. As a result, society will suffer the “deadweight loss” that results whenever the marginal cost of production increases. 82


82 Credit is a marginal cost of production regardless of whether the producer of goods or services needs to borrow in order to produce. For those who do not have the cash on hand to produce goods or services, no production at the margin can occur until the funds are borrowed to finance production. Obviously, an increase in the cost of money will increase the marginal cost of production. For those with cash on hand, higher interest rates will make marginal production comparatively less attractive. When the producer can make more by lending than by producing, he also will stop producing. Opportunity cost therefore is always an element in analyzing marginal cost; if the expected price of the marginal product does not equal at least the marginal cost (including the opportunity cost), production ceases. See Weston, Some Economic Fundamentals for an Analysis of Bankruptcy, Law & Contemp. Probs., Autumn 1977, at 47, 49.

“Deadweight loss” is a concept that refers to the absolute loss of aggregate societal wealth when marginal costs increase across the board. The deadweight loss occurs not only when the
Risk is a significant element of the cost of lending. When the lender undertakes increased risk that the loan will not be repaid, he is undertaking an extra cost for which he will demand a higher interest rate by way of compensation. Alternatively, he could lower the risk by incurring investigative or insurance costs. Even so, these increased costs raise the price of the loan to the borrower. Whether risk, investigative costs or insurance costs are chosen depends on which of the costs is perceived to be smallest.

Innocent purchaser risk, as applied to secured lending, is the risk that a secured lender's right to realize his claim upon collateral will fail because of some defect existing in the debtor's title to the collateral. The theoretical possibility of prior secret liens constitutes such a risk. This risk generates a cost that is quantifiable as the amount of the secret lien (plus the cost of defending against the lien in court) multiplied by the probability that the loss will occur. If the secured lender undertakes a title search, he will reduce the risk by reducing the probability that secret liens exist. Alternatively, by purchasing insurance against failure of title, the secured lender reduces
his personal loss from any secret lien. No matter what option is ultimately chosen, innocent purchaser risk generates transaction costs that ultimately increase the price of the loan. This will be true whether the security interest is in exchange for new value or is in satisfaction of antecedent debt.

Elimination of the innocent purchaser risk caused by secret liens (for example, by legislating that good faith purchasers for value take free of liens) will not inevitably lower the marginal cost of lending. If we eliminate secret liens in this way, we may raise the cost of general credit by making such credit more risky. The risk that a general creditor faces, of course, is that the loan will not be repaid. To the extent that we make debt collection procedures more difficult, we increase that risk. A good compromise may exist, however, between the secured creditor and the general creditor in the form of perfection requirements imposed upon judicial liens. For instance, if we require, as part of debt enforcement procedure, that a notorious event happen before a judicial lien is recognized against bona fide purchasers, we might lower the investigative costs, effectively replacing the secured creditor's innocent purchaser risk. This savings might well exceed any increase in the nonpayment risk or enforcement costs to the general creditor. Obviously, we must consider which set of rules imposes the

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90 The higher price of the loan could be in the form of higher interest or more collateral. Each will eventually compensate the lender for bearing the innocent purchaser risk.

91 The Permanent Editorial Board recognized this principle when it abolished the automatically perfected purchase money security interest in farm equipment having a purchase price not in excess of $2,500. See U.C.C. § 9-302(1)(c) (1962). According to the Reasons for 1972 Change, the rule was abolished because its effect “was to make farmers' equipment unavailable to them as collateral for loans from some lenders.” Id. § 9-302 (1972) reasons for 1972 change.

92 The fact that innocent purchaser risk will affect the cost of secured lending when the security interest is exchanged directly for new value should be apparent. That it will do the same in the case of antecedent debt may be somewhat less clear, although equally true. We may presume that when a general creditor obtains a security interest, he does so as a quid pro quo for the promise not to accelerate his debt or the like. See, e.g., Allegaert v. Chemical Bank, 657 F.2d 495, 500 (2d Cir. 1980). When the general creditor therefore undertakes a decision to accelerate or to accept security in lieu thereof, innocent purchaser risk will affect his decision on how much collateral must be taken to justify extending the loan.

93 We have assumed that the secured party is a good faith purchaser. If a secured party knows a lien is outstanding, there are no risks and no investigative costs that constitute transaction costs. The secured party simply buys or not, depending on the legal rules that protect him and on whether he thinks he will be caught. Therefore, if we require the secured party to be a good faith purchaser, we can protect the general creditors (thereby lowering their risk and hence their costs) without raising the cost of secured lending. See Weinberg, Sales Law, supra note 49, at 585. Of course, costs would be generated when the losing creditors attack the bona fides of subsequent secured parties.

94 See In re Komfo Prods. Corp., 247 F. Supp. 229, 234 (E.D. Pa. 1965) (“The purpose of . . . recording requirements generally, is obviously to protect subsequent creditors who might not have extended credit had they known of an existing security interest.”).
least aggregate costs on all the actors.\(^4\) This choice of rules will depend upon a balance of harms and benefits caused to secured versus general creditors.\(^5\) In the next section, we will analyze each of the various interpretations of section 9-301 to determine which test is the most efficient in this sense.

4. Choosing Among the Various Tests for Determining When a Person Becomes a Lien Creditor

The most natural inclination is to assume that a lien arises for UCC purposes as soon as it arises for any purpose.\(^6\) Earlier we defined that point as the time when at least some restraint on the debtor’s power to alienate has arisen.

This choice as the point at which a person “becomes a lien creditor,” however, will create statutory conflict in those states that have chosen to protect bona fide purchasers from otherwise effective liens. We have already seen that, under nonuniform law, New Jersey and several other states protect bona fide purchasers after a lien arises. This conflict is ample cause to search for a better definition of the UCC lien creditor.

Such an interpretation of section 9-301(3) also has a poor effect on innocent purchaser risk, depending on whether a state has legislated wisely in formulating its nonuniform lien law. Those states that require a notorious act before a lien arises will have favorable results under this reading of section 9-301(3). Michigan is such a state, with an execution lien having no effect until the comparatively notorious levy occurs.\(^7\) Other states, however, have declared that liens arise upon fairly obscure events, such as delivery of the execution by the judgment creditor.\(^8\) These states pose unduly high innocent purchaser

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\(^4\) See Jackson & Kronman, Secured Financing and Priorities Among Creditors, 88 Yale L.J. 1143, 1151–52 (1979); cf. Weinberg, Sales Law, supra note 49, at 583 (“An efficient rule places risk on the class of persons that can prevent it with the smallest efficient expenditure of resources.”).

\(^5\) When a debtor grants a security interest to one of his creditors, he increases the riskiness of other creditors’ claims by reducing their expected value in bankruptcy. It is a fair assumption, however, that these other creditors will be aware of this risk and will insist on a premium for lending on an unsecured basis . . . .

\(^6\) This theory, which comports with plain English, is the definition most discounted by Professor Mellinkoff, supra note 52, at 197.


\(^8\) The most extreme example is Tennessee, which gives lien significance to the first day of the judicial term even if a judgment had not been entered against the debtor at that time. Tenn. Code Ann. § 26-1-109 (1980); see supra note 28 and accompanying text & note 45.
risk on all subsequent transferees. Such a theory of interpreting section 9-301(3) will therefore impose that risk on their secured parties as well. Of course, mere economic analysis is not reason enough to ignore the clearly expressed intent of the legislature. When the legislature has decided that delivery of the execution has lien significance, that policy should not be defeated by fanciful interpretations of section 9-301(3). But let us not lose sight of the fact that many states have specifically chosen to reduce innocent purchaser risk by protecting bona fide purchasers from execution liens. If we interpret the UCC in a way that denies bona fide purchaser protection to secured parties, we are placing a unique disability on secured parties in derogation of state lien policy favoring their protection.

Section 9-301 should be read to give secured parties the protection that nonuniform state law gives to bona fide purchasers. A theory based upon mere creation of the lien under nonuniform law does not adequately do the job.

Another possibility is that a judgment creditor "becomes a lien creditor" under section 9-301 when the judgment creditor's lien becomes so far perfected that no subsequent hypothetical lien creditor could obtain a superior judicial lien. This test is borrowed from the bankruptcy strong-arm and preference statutes and therefore has the advantage of familiarity.

While in some states the test seems to produce positive results, in other states it fails to harmonize the statutes or to reduce investigative costs. In New York, the test as applied to property capable of delivery seems adequate because the execution lien would be delayed to the time of levy (a reasonably public act).

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99 11 U.S.C. § 547(e)(1)(B). Under this section, the hypothetical lien creditor test is used to determine when the transfer was actually made. Once that time is set by section 547(e)(1)(B), it is still necessary to determine whether the transfer, as of that time, is voidable under section 547(b).
100 There is also some poetic value here; the drafters of the UCC adopted the term "perfection" from section 60 of the Bankruptcy Act of 1898, ch. 541, § 60, 30 Stat. 544, 562, which promulgated the hypothetical lien creditor test as a method of destroying secret liens. See U.C.C. § 9-301 comment 1. Therefore, adoption of the hypothetical lien creditor test would supply a common denominator between security interests and judicial liens. Each would be tested according to the time at which it became perfected for the purpose of the preference statute. The first to perfect for bankruptcy purposes would win the priority contest under UCC section 9-301.
101 Even after the execution is delivered in New York, a subsequent hypothetical lien creditor could gain priority over the first execution creditor if he serves a subsequent execution on a different enforcement officer and that officer is the first to levy the property in question. N.Y. Civ. Prac. Law § 5234(b) (McKinney 1978).
is protected from the execution lien after the levy of property capable of delivery; hence, there would be no conflict between the statutory schemes. But the test fails when the property is not capable of delivery or when a lien creditor proceeds by equitable means to enforce his judgment. New York protects bona fide purchasers even after the levy of property not capable of delivery; likewise, bona fide purchasers are protected from liens that arise from equitable proceedings. In both cases, the hypothetical lien creditor test discriminates irrationally against good faith secured parties.

New Jersey is another state where the hypothetical lien creditor test fails. There, a hypothetical lien creditor can defeat an execution creditor as to tangible property once the writ is delivered to the sheriff. Delivery of the writ gives no notice, which makes investigative costs for subsequent secured parties quite high. Also, bona fide purchasers are protected from the execution lien until the sheriff levies. Therefore, during the time between delivery of the writ and levy by the sheriff, irrational discrimination between secured parties and other good faith purchasers is created. Secured parties in Georgia also suffer from irrational discrimination and high innocent purchaser risk under a hypothetical lien creditor test. Under Georgia law, no hypothetical lien creditor can gain priority over a lien creditor whose judgment already has been entered. After entry of judgment, some bona fide purchasers are protected until the judgment is docketed,

But see In re Cosmopolitan Aviation Corp., 34 Bankr. 592 (Bankr. E.D.N.Y. 1983) (holding that the New York execution lien establishes itself against a hypothetical lien creditor as soon as the execution is delivered to the sheriff). This aspect of the case is criticized supra in note 51. It also should be noted that the court interprets New York law as creating a levy lien separate and distinct from—and in substitution of—the execution lien. We think this characterization is unduly complicated and does not account for priorities between execution creditors who serve the levy sheriff. See N.Y. Civ. Prac. Law § 5234(b) (establishing “first-in-time” rule between such creditors). The “levy lien” in New York can be better viewed as a more perfect incarnation of the execution lien, just as a security interest after a financing statement is filed is a more perfect incarnation of the security interest that preceded the filing.

104 Id.
105 Id. § 5202(b).
106 Walton v. Hillier, 128 N.J.L. 119, 24 A.2d 219 (1942); Woodward v. Lishman, 80 N.J.L. 586, 78 A. 701 (1911). Equitable turnover orders and receiverships are merely in aid of execution and presumably depend on that writ for priority. See, e.g., N.J. Rev. Stat. § 2A:17-65 (West 1952). As to intangibles, New Jersey accords no lien significance to delivery of the execution. Instead, the lien arises only when the garnishee is served with the writ of execution by the sheriff. Id. § 2A:17-51.
which guarantees statutory disharmony. In addition, creation of a lien upon mere entry of judgment has the worst possible effect on innocent purchaser risk, since entered judgments are not even indexed alphabetically.

The hypothetical lien creditor test may therefore be rejected as a national uniform test for interpreting section 9-301 of the UCC.

In our judgment, a person "becomes a lien creditor" for UCC purposes the moment his lien is established against bona fide purchasers. The bona fide purchaser test is used in the Bankruptcy Code to test real estate transactions, which generally must be recorded under state law. If Congress had used a hypothetical lien creditor test for this purpose (as it did to test transfers of personal property), many unrecorded secret conveyances of land would be upheld, since judgment creditors are frequently not protected under many recording statutes.

Likewise, since many states protect bona fide purchasers from certain judicial liens, the test is appropriate for our purposes. Under a bona fide purchaser test, statutory conflict between the UCC and state lien law would be eliminated. Using our New Jersey example, if a person does not become a lien creditor under section 9-301(1)(b) until he has established a lien good against a bona fide purchaser, a security interest could be created after delivery of the execution and prior to the levy without being subordinated to the execution lien. Of course, nonuniform law would require good faith with regard to the security interest, but (assuming that good faith is present) the debtor's ability to create a security interest will be exactly equivalent to his power to transfer property to other bona fide purchasers free of the pre levy execution lien.

In addition, the test would produce lower innocent purchaser risk than some of the other tests. In the states that give lien significance to the delivery of the execution—as New Jersey does—while

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109 See supra notes 24-25 and accompanying text.
110 Judgments are usually not alphabetized until docketing. E.g., Mo. R. Civ. P. 74.59-60.
112 See, e.g., In re Destro, 675 F.2d 1037 (9th Cir. 1982); 4B Collier on Bankruptcy ¶ 70.80[1], at 898-900 (J. Moore 14th ed. 1978); see supra text accompanying notes 65-68.
114 It should be emphasized that we are not arguing for the repeal or amendment of existing lien law. That law would continue to govern where the UCC does not. For example, prior to the levy a bad faith secured party would be subordinated under nonuniform law, e.g., id., while after the levy, he would be subordinated under section 9-301(1)(b) of the UCC. The point of our test is that we have eliminated the overlap between the two statutes, consigning the effect of each to different periods of time.
protecting bona fide purchasers thereafter, the crucial point under section 9-301(3) is the levy, generally a more notorious event than delivery of the writ and, hence, more economically beneficial with regard to the cost of credit. In states like Michigan, where only the levy has lien significance, the bona fide purchaser test continues to capture the economic benefits that the legislature intended when it deferred the execution lien to the time of the levy. Likewise, Alabama and Mississippi, which recognize judgment liens, continue to enjoy the benefits of their systems. While these states enjoy satisfactory results under some of the other tests, a bona fide purchaser test preserves them while providing additional good results in states that follow the New Jersey pattern.

The test is not a panacea for all the problems created by state lien law, however. At best, it captures the economic efficiencies already present in state lien law. If states have made poor choices in establishing liens based on nonnotorious events, our test does not and should not provide a better position for UCC secured parties than that accorded to other bona fide purchasers. Indiana, for example, recognizes an execution lien upon delivery of the writ to the sheriff, granting no protection to bona fide purchasers. Our test would establish delivery as the point at which a person becomes a lien creditor for Indiana is an example of a state that refuses to protect any purchaser after the execution is delivered. See J.W. Dann Mfg. Co. v. Parkhurst, 125 Ind. 317, 25 N.E. 347 (1890). But see In re Sieler, 29 Bankr. 33 (Bankr. N.D. Ind. 1983) (using UCC section 9-307 to defeat tax liens on inventory sold in the ordinary course of business). Curiously, the hypothetical lien creditor test would defer UCC lien significance of the execution until the sheriff levies. See Ind. Code §§ 34-1 to -9 (1976) (where executions served on different enforcement officers, first to be levied has priority). The levy would be a better lien perfection requirement from the standpoint of innocent purchaser risk, but the hypothetical lien creditor test would guarantee that UCC secured parties are afforded more protection than other postlien transferees. The bona fide purchaser test, then, even in Indiana, best promotes state policy, dubious though that policy may be.

Even more peculiar than Indiana's lien law is Tennessee's seldom litigated execution lien on personal property. Tennessee approaches the common law model as it existed prior to the Statute of Frauds, Act for Prevention of Fraud & Perjuries, 1676, 3 Car. 11, ch. 3, § 13. See supra text accompanying notes 14–15. The Tennessee judgment debtor is prevented from transferring his personal property to bona fide purchasers after the date of teste on the writ of execution or after the entry of judgment, whichever is later. See supra notes 28–29 and accompanying text & note 45. Under our bona fide purchaser test, statutory conflict is again eliminated. After the later of these two dates, a debtor would not be able to transfer to a bona fide purchaser either a security interest or an absolute interest. Innocent purchaser risk, however, would be quite high. This stems from Tennessee's poor choice of lien law. Ironically, a hypothetical lien creditor test would defer creation of the lien for UCC purposes until the sheriff's levy, Note, supra note 28, at 71–72, which would produce much better economic results, but only at the cost of statutory discord. The UCC should not be read to relieve secured parties of the disabilities that all other parties in commerce must suffer under state law.

115 Indiana is an example of a state that refuses to protect any purchaser after the execution is delivered. See J.W. Dann Mfg. Co. v. Parkhurst, 125 Ind. 317, 25 N.E. 347 (1890). But see In re Sieler, 29 Bankr. 33 (Bankr. N.D. Ind. 1983) (using UCC section 9-307 to defeat tax liens on inventory sold in the ordinary course of business). Curiously, the hypothetical lien creditor test would defer UCC lien significance of the execution until the sheriff levies. See Ind. Code §§ 34-1 to -9 (1976) (where executions served on different enforcement officers, first to be levied has priority). The levy would be a better lien perfection requirement from the standpoint of innocent purchaser risk, but the hypothetical lien creditor test would guarantee that UCC secured parties are afforded more protection than other postlien transferees. The bona fide purchaser test, then, even in Indiana, best promotes state policy, dubious though that policy may be.
UCC purposes. This point in time has poor innocent purchaser risk consequences, but it must be remembered that all good faith purchasers are similarly disadvantaged. If no good faith purchase is protected from the postdelivery execution lien as a matter of state law, it is hardly appropriate that a UCC definition be devised to defeat this policy. Our task cannot venture beyond harmonizing UCC policy with state lien policy.

The bona fide purchaser test has a weakness with regard to equity liens, which often arise when a person holding property of the debtor is served with process or when the court has issued an equitable order against such a person. Neither of these events is calculated to give notice, so that innocent purchaser risk exists when bona fide purchasers are not protected from an equity lien. Our only defense is that our suggested test is at least as good as the other possibilities. In addition, many states require a judgment creditor to exhaust his legal remedy of execution before resorting to equitable remedies. When a debtor has possession of property that is capable of delivery, secured parties may safely infer under our test that no lien creditor has exhausted his remedies and, therefore, that no equity lien encumbers the property. Some reduction of risk is achieved, and there is no better method available for assessing equity liens against security interests.

New York is a particularly difficult state in which to apply a bona fide purchaser test under section 9-301(3). Certain judicial liens are never good against bona fide purchasers in New York. For example, bona fide purchasers are always protected against attachment liens (on property the sheriff has not taken into custody), execution liens (on property not capable of delivery) and equity liens (on any kind of property whatsoever). Under our bona fide purchaser test, these liens would never have status against a UCC security interest, a situation which may at first glance seem anomalous.

Take, for example, a judgment creditor who secures an appointment of a receiver to sell a piece of heavy equipment belonging to the debtor. The debtor maintains his power to transfer this machinery to a good faith purchaser, regardless of the receiver's actions. Of course, the more that the receiver exercises dominion and control over the

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116 See supra text accompanying notes 33-37.
117 See 3 R. Clark, supra note 33, § 667.1(d).
119 Id. § 5202(a)(2) (McKinney 1980).
120 Id. § 5202(b).
equipment, the less likely it is that any transferee of the debtor could qualify as a "transferee without knowledge." In any case, although the statute does not say so, it must be assumed that bona fide purchaser protection ends when the receiver (or sheriff under a turnover order) sells the property of the debtor. Such a sale forecloses the debtor's interest in the encumbered property, leaving him with nothing left to sell to a bona fide purchaser. However, on the eve of sale, the receiver may be defeated if the debtor can locate a good faith purchaser willing to buy the property. This statutory scheme makes for questionable policy, but is one from which subsequent secured parties deserve as much benefit as any other good faith purchaser.

Even in New York, with its peculiar protection of bona fide purchasers, our proposed test satisfies our two criteria reasonably well. The test eliminates discrimination between secured parties and other subsequent transferees for value. Since equity liens and execution liens on nondeliverable property can never have priority under the UCC, each class of subsequent transferees will remain equally unaffected, provided the requisite good faith is present. Additionally, secured parties face no innocent purchaser risk from such liens. The test is therefore successful even in New York, perhaps the most difficult state in which to reconcile the UCC with nonuniform lien law.

5. Unperfected Security Interests that Antedate the Judicial Lien

In proposing a bona fide purchaser test, we have focused on security interests created after an event giving rise to a judicial lien. But what about the unperfected security interest created before any judicial lien conceivably could have arisen? The priorities in section 9-301 have the dual purpose of preventing the postlien creation of new security interests and penalizing prelien failure to perfect preexisting security interests.

Actually, the bona fide purchaser test for judicial liens would reduce the cost of secured lending in this case too. No secured party purposely fails to perfect, unless his intent is fraudulent. When a secured party first undertakes to make a secured loan, he prices his loan according to the probability that prior judicial liens will be enforced against him. Failure to perfect comes about by accident.


122 E.g., In re McClain, 447 F.2d 241 (10th Cir. 1971) (security interest in truck that debtor indicated he would use in business but which was actually used as consumer goods should have
and thus is not factored into the price of the loan. In contrast, if the definition of lien creditor makes the existence of secret senior liens more probable, then that secured loan, unperfected though it may be, becomes more expensive than is merited.

Likewise, protection of the unperfected secured party for a longer time (due to the lien perfection rule that we have proposed) has no adverse effect on the cost of general credit beyond lien perfection costs already imposed. As far as the hazard to general creditors when security interests can remain unperfected for a longer time, this risk is subsumed in the "risk of debtor misbehavior" that all general creditors face anyway. This is the risk that the debtor will prefer other creditors over the unsecured lender. The secret preference given to the unperfected secured party is exactly that kind of risk. The failure of the preferred creditor to perfect would seem to have no actuarial significance as the benefits to general creditors from such a failure are entirely random.

With regard to previously created unperfected security interests, no statutory conflict between the UCC and nonuniform law can ever exist. State lien law is silent on the debtor's power to make prelien conveyances. Meanwhile, the UCC subordinates the previously created unperfected security interest to the lien. Between these two ideas there is no conflict. The bona fide purchaser test, however, inevitably delays the effect of the lien and gives the unperfected secured party additional time to perfect.

We find no unfairness in this result. Prior to the UCC and its predecessor recording statutes, the rule was that a judicial lien attached only to the debtor's equity interest in property. Even if the debtor had given a secret interest to another, the lien was subject to that secret interest. The rule has changed only to the extent that it is changed by the UCC. If the UCC recognizes only liens that are perfected against bona fide purchasers, then the common law rule remains unaffected up to that point. We find nothing unjust or illogical about this solution, and we note the beneficial economic effects that a bona fide purchaser test would have when secured parties assess the risk of lending at the inception of the loan.

been filed in the county of the debtor's residence, not the county where his business was located), cert. denied, 405 U.S. 918 (1972).

122 See Jackson & Kronman, supra note 94, at 1149-51.


124 See County Nat'l Bank v. Inter-County Farmers Coop. Ass'n, 65 Misc. 2d 446, 448, 317 N.Y.S.2d 790, 792-93 (Sup. Ct. 1970) ("[w]here unaffected by recording statutes, an assignee in good faith for value of an existing fund . . . is entitled to priority over a creditor of the assignor").
6. Summary

The confusion created by section 9-301 concerning the relationship between judicial liens and security interests seems to stem from the sections having been drafted without accounting for the mechanics of debt enforcement. Because section 9-301(3) does not determine when a judicial lien arises, it simply does not answer the question that it poses.

We have offered a bona fide purchaser test to remove the statutory conflict. The test has favorable consequences on the price of secured lending, which probably outweigh any negative effects on the cost of unsecured lending. A bona fide purchaser test is consistent with the language of section 9-301(3). Indeed, the test is little more than the decision that, when nonuniform lien law protects bona fide purchasers, such law should override any perceived ambiguities in section 9-301(3) and should protect bona fide secured parties as well. The test, then, is the most logical and efficient way to resolve conflicts that otherwise would arise between the UCC and provisions of nonuniform state lien law.

B. The Person Who Becomes a Lien Creditor Before His Rival Secured Party Has Perfected

Section 9-301 is the principal section that governs priorities between judicial liens and security interests, but this is not all it does. Section 9-301 was originally an attempt to catalogue all the interests that could take priority over an unperfected security interest. Thus,

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126 Coogan leveled a similar accusation against the drafters of the Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125 (codified in scattered sections of 26 U.S.C.), which protects security interests from tax liens only to the extent that the security interests are protected from "judgment liens" by state law (i.e., the UCC). See Coogan, The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code, 81 Harv. L. Rev. 1369, 1389 (1968) ("the language was changed by Treasury draftsmen who understandably knew more tax law than lien law").

127 In fact, section 9-301(1)(b) nowhere states explicitly that subsequently created security interests are subordinate to prior judicial liens. Only previously created unperfected security interests are mentioned. This lacuna is almost certainly an accident, however. See infra text accompanying note 140.

128 Cf. Baker v. Hull, 250 N.Y. 484, 166 N.E. 175 (1929). In this case, the New York Court of Appeals considered the validity of a conditional sale interest perfected between delivery of the writ to the sheriff and his levy of the property. Under its common law, New York did not recognize a lien at all against a debtor's goods previously encumbered by a conditional sale interest. Cf. U.C.C. § 9-311 comment 2 ("the debtor's interest in the collateral remains subject to claims of creditors who take appropriate action"). The conditional sales act in New York, however, stated that unperfected conditional sale interests were void against creditors who had liens by "attachment or levy." The lien creditor argued that since the New York lien generally
senior secured parties, bulk transferees, buyers out of the ordinary course of business, buyers in the ordinary course of business arose when the execution was delivered, the security interest was void from that time forward. The New York court, however, ruled that the conditional sales act established a different rule when judicial liens came up against conditional sales. Even though liens in general dated from the delivery of the execution, liens as against conditional sales dated from the levy. This case proves that specific legislation pertaining to security interests might have the effect of varying the life of the lien. We note that New York's conditional sales act required that a judicial lien arise only by "attachment or levy." Section 9-301(3) of the UCC allows liens by "attachment, levy or the like" and is purposefully ambiguous as to when those liens might arise. See supra text accompanying notes 56-61. Therefore, it is possible to argue that the UCC might establish independent standards for perfection of liens.

U.C.C. § 9-301(1)(a). Today, "persons entitled to priority under Section 9-312," id., are merely mentioned as among the parties who are senior to unperfected secured parties. Section 9-312 tells us that all perfected secured parties and any unperfected secured party that is prior in time have seniority. In the early drafts, however, section 9-301(1)(a) had independent force. In 1952, the subsection bore the number 9-301(1)(b) and provided that unperfected security interests were subordinated to "a subsequent secured party who becomes such without knowledge of the earlier security interest and perfects his security interest before the earlier security interest is perfected." Later, the drafters of the UCC decided that Article 9 should be a strict race statute, at least between secured parties. Today, with some important exceptions, e.g., id. § 9-401(2) (financing statements filed in the wrong place are effective against parties with actual knowledge of the contents of the statements), the knowledge of a secured party is irrelevant to his status as against other secured parties. 2 G. Gilmore, supra note 59, § 34.2, at 898–902; Felsenfeld, Knowledge as a Factor in Determining Priorities Under the Uniform Commercial Code, 42 N.Y.U. L. Rev. 246 (1967).

U.C.C. § 9-301(1)(c), (2). A bulk transfer is "any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory ... of an enterprise." Id. § 6-102(1). Debtors who see no hope of paying creditors are often tempted to sell their inventory in bulk and disappear with the proceeds, leaving the creditors with no remedy. Article 6 requires that a purchaser in a bulk sale at least notify the creditors that the sale is occurring. Id. § 6-105. An optional provision also provides that the proceeds of the sale be applied to satisfy creditors. Id. § 6-106. It is thought that notice at least allows creditors to defend themselves with appropriate legal measures. Id. § 6-101 comments 3 & 4; see Rapson, U.C.C. Article 6: Should It Be Revised or "Deep Sixed"?, 38 Bus. Law. 1753 (1983).

Section 9-301(1)(c) provides that an unperfected security interest is subordinated to a bulk transfer if the transferee is without knowledge of the security interest when he receives possession of the collateral. At first blush, it may seem that the point need not have been mentioned, since section 9-301(1)(c) states that all buyers out of the ordinary course of business similarly take free of unperfected security interests, assuming the requisite ignorance. However, section 1-201(9), which defines the term "buying," excludes "a transfer in bulk."

Section 9-301(2) states that the 10-day grace period granted purchase money security interests applies against bulk transferees, allowing late filing by the secured party. For a discussion of this grace period as applied to judicial lien creditors, see infra text accompanying notes 168–82.

U.C.C. § 9-301(1)(c). Note that buyers who are secured parties are excluded from the rules in this subsection. Buyers in the ordinary course of business also are not covered by section 9-301(1)(c), but section 9-307(1) says that they take free of all security interests, perfected and unperfected, provided they are created by the seller. Nothing in the UCC protects a buyer in the ordinary course of business from unperfected security interests that are not created by the seller.
who buy farm goods, transferes of intangibles, assignees for the
benefit of creditors, bankruptcy trustees and equity receivers are all
mentioned in section 9-301. The 1972 addition of section 9-301(4),
which governs the priority between future advances made pursuant to perfected security interests and judicial liens, does not fit within the
original purpose of the section, in that it does not affect unperfected
security interests at all.

One party deliberately excluded from the section 9-301 catalogue
is the unsecured creditor who has not yet obtained a judicial lien,
and therein lies a tale. Under pre-UCC chattel mortgage statutes,
unperfected security interests were frequently void against general
creditors who made advances without knowledge of the unrecorded
interest. This status against general creditors created enormous
bankruptcy risks, because the bankruptcy trustee could subrogate
himself to the rights of any creditor under section 70(e) of the 1898
Act. If an actual general creditor existed in the gap between attach­
ment and perfection of a chattel mortgage, the chattel mortgage was
likewise void against the trustee. Moreover, the chattel mortgage was
not just void to the extent of the creditor's claim. Thanks to Moore v.

The protection of buyers in the ordinary course of business who buy farm goods is
necessitated by their exclusion from the protection given to all other buyers in the ordinary
course of business under section 9-307(1). Buyers of farm goods take subject to security interests
in general, but section 9-301(1)(c) makes clear that they have rights senior to those of an
unperfected secured party if the buyer is ignorant of the unperfected security interest at the
appropriate time. See generally R. Henson, supra note 60, § 5-5, at 139-46 (agricultural
collateral).

U.C.C. § 9-301(1)(d). This subsection refers to "transferees" and not "buyers," as does
section 9-301(1)(c). The distinction in terms is of little consequence. The reason "buyers" are
covered in a separate section is because the property they "buy"—goods, instruments, etc.—are
all tangible property capable of delivery. In order to prevail, "buyers" must be ignorant of an
unperfected security interest both at the time they gave "value" and at the time they received
delivery of the property. Transferees of intangibles, however, cannot receive delivery of any­
thing. Therefore, section 9-301(1)(d) provides that the ignorance of transferees of accounts and
intangibles must exist only at the time value is given.

These last three concepts are discussed in Part II of this Article to appear in 5 Cardozo L.

E.g., Commercial Credit Corp. v. National Credit Corp., 251 Ark. 702, 705-06, 473
S.W.2d 881, 883-84 (1971) (creditors without liens have no status against unperfected security interests).

E.g., N.Y. Lien Law § 230 (repealed 1964).

Bankruptcy Act of 1898, ch. 541, § 70(e), 30 Stat. 544, 566. Today, this subrogation power
can be found in section 544(b) of the Bankruptcy Code, 11 U.S.C. § 544(b) (1982), which more
clearly specifies that it is unsecured creditors to whom the trustee is subrogated.

This was less clear under section 70(e). Respectable opinion had it that under section 70(e)
the trustee could subrogate himself to a lien creditor. 2 G. Gilmore, supra note 59, § 45.3.2, at
1293-94; Coogan, Security Interests in Fixtures Under the Uniform Commercial Code, 75 Harv.
L. Rev. 1319, 1338-39 (1962). But see Carlson, Fixture Priorities, 4 Cardozo L. Rev. 381, 408
n.106 (1983).
it was totally void. When added to the extreme technicality of the recording requirements under pre-UCC law, the power of general creditors against unrecorded chattel mortgages posed unacceptable risks to secured lenders. Section 9-301 was drafted with Moore v. Bay in mind; general creditors therefore have no status against unperfected security interests.  

With regard to priorities between lien creditors and secured parties, we have seen that section 9-301 establishes a race between the creditor and the secured party. The creditor must first "become a lien creditor" to win. The secured party must "perfect" in order to gain victory. Once courts have determined when each of these events occurs, they are in a position to consider the priority contests that can arise between secured parties and lien creditors.

1. The Contest Under the 1972 UCC

The exact words of section 9-301(1)(b) do not provide complete treatment of judicial lien priorities. The problem comes from the fact that these words govern only the contest between the unperfected security interest and the judicial lien. When the lien arises at a time after the unperfected security interest has been created, the language fits exactly, and the judicial lien is senior. Nowhere does section 9-301 explicitly say that subsequently created security interests are also junior to earlier judicial liens.

It is unthinkable that the drafters of section 9-301(1)(b) intended to give priority to perfected security interests that are created after a judicial lien arises. We therefore proceed on the basis that persons who become lien creditors before the security interest is perfected are superior not only to preexisting security interests that are untimely perfected, but also to subsequently created security interests (regardless of when they are perfected).

2. Subordination of Lien Creditors with Knowledge

Under the 1962 version of the UCC, otherwise senior lien creditors were subordinated if they had knowledge of the unperfected

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139 Hogan, Bankruptcy Reform and Delayed Filing Under the U.C.C., 35 Ark. L. Rev. 35, 36-41 (1981). Nevertheless, loose philosophizing about the purpose of perfection is not uncommon. E.g., In re Komfo Prods., Inc., 247 F. Supp. 229, 234 (E.D. Pa. 1965) ("The purpose of the filing requirements of the UCC, like recording requirements generally, is obviously to protect subsequent creditors who might not have extended credit had they known of an existing security interest."); Baird, supra note 124, passim.
140 Ward, supra note 5, at 234-64.
security interest at the time they became lien creditors. The 1972 amendments removed knowledge as a general impediment to judicial lien seniority, but the 1962 version of the UCC is still the law in a handful of states. In these states, a lien creditor's knowledge remains a dangerous commodity.

The knowledge requirement that appeared in the 1962 version of the UCC was added in an era when the drafters still contemplated a "notice" recording statute. Thus, until 1956, even subsequent secured parties with knowledge of a prior unperfected security interest were junior. In 1956, the drafters decided that, as between secured parties, priority should be decided solely by a race to perfect. Knowledge, however, continued to be relevant for lien creditors and all other parties listed in section 9-301(1) as potentially superior to an unperfected security interest.

The 1972 amendments were designed in part to make the UCC more nearly a "race" statute. The Permanent Editorial Board was impressed with the fact that a general creditor's knowledge at the time the lien arose might be quite irrelevant in numerous cases. For instance, the lien creditor may have been a tort victim and may never have voluntarily extended credit to a debtor at all. Even the protection of standard trade creditors is more soundly based on the moment credit is extended than on the moment a lien arises. These considerations led to the 1972 amendments to section 9-301.

It would be a mistake, however, to conclude that knowledge has ceased to be a threat to a lien creditor's seniority. One provision that makes a lien creditor's knowledge relevant is section 9-401(2). This...
provision covers the common situation of filing in the wrong office or filing in only one office when dual filing is required. If the filing is in good faith, it is "effective . . . against any person who has knowledge of the contents of such financing statement."

This provision is ambiguous on at least two counts. First, the 1972 amendments were supposed to make a lien creditor's knowledge irrelevant. On this basis, one Georgia court was willing to state that the legislative history required the conclusion that "any person" does not include lien creditors. Yet, the plain meaning of the words "any person" would seem to include them. "Any person" also appears to include secured parties. The final 1956 draft altered the rule that knowledge on the part of secured parties subordinated them to prior unperfected secured parties. The Georgia court's reasoning about legislative history might exempt secured parties from section 9-401(2) as well, which certainly is against the weight of the case law. It must therefore be concluded that, despite any ambiguity caused by legislative history, "any person" means "any lien creditor," "any subsequent secured party,"—indeed "any person." To this rule, we would add one exception.

Section 9-401(2)'s use of "any person" may involve an unacceptable consequence with regard to assignees for the benefit of creditors, bankruptcy trustees and equity receivers who, under section 9-301(3), are given the power and status of lien creditors against unperfected security interests. In the 1962 version of the UCC, when knowledge still subordinated lien creditors to unperfected security interests, section 9-301(3) contained the following helpful language:

Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest.

This language was deleted by the 1972 amendments because it appeared to the Permanent Editorial Board that knowledge of the lien

146 United States v. Waterford No. 2 Office Center, 154 Ga. App. 9, 267 S.E.2d 264 (1979), aff'd, 246 Ga. 475, 271 S.E.2d 790 (1980). The lower court drew the conclusion described in the text, but the Georgia Supreme Court affirmed solely on the grounds that knowledge of the contents of the financing statement was not present in the case. The supreme court therefore reserved the question whether "any person" under section 9-401(2) could include a lien creditor.

147 2 C. Gilmore, supra note 59, § 34.2, at 898-902; see supra note 129.

148 E.g., First Nat'l Bank & Trust v. First Nat'l Bank, 552 F.2d 524 (10th Cir. 1978); In re Enark Indus., Inc., 86 Misc. 2d 985, 383 N.Y.S.2d 796 (Sup. Ct. 1976); see Sequoia Mach., Inc. v. Jarrett, 410 F.2d 1116 (9th Cir. 1969).

creditors was no longer to be significant in determining priorities. The argument may well arise, however, that even a general assignee or equity receiver with knowledge of the contents of the secured party’s financing statement falls within the category of “any person” and therefore takes subject to the otherwise unperfected security interest.\(^{150}\) Here, legislative history militates more strongly against subordinating these creditor representatives than it does against subordinating specific lien creditors. The unique knowledge rule for creditor representatives was designed to make the representative more powerful than any single lien creditor who might have knowledge and to guarantee that otherwise competent persons would not be disqualified from appointment as assignees or receivers simply by the accident of what they knew. The only reason for removing the above quoted sentence from section 9-301(3) was the supposition that knowledge of lien creditors would never again be relevant. Although the Permanent Editorial Board was overly optimistic, courts should not punish the creditor representative because of what he knows. Therefore, “any person” should be read to mean “any person except a general assignee, bankruptcy trustee or receiver in equity.”\(^{151}\)

A second ambiguity is more troublesome. When does a person have “knowledge of the contents” of a financing statement?\(^{152}\) The courts\(^{153}\) and commentators\(^{154}\) agree that knowledge of the security interest under the 1962 version of section 9-301(1)(b) is not the same as

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\(^{150}\) The argument has already been made with regard to bankruptcy trustees, and the courts have not always rejected it out of hand. E.g., Sequoia Mach., Inc. v. Jarrett, 410 F.2d 1116, 1119 (9th Cir. 1969) (“the secured party would, under § 9401(2), have to prove that either the trustee in bankruptcy or perhaps all the unsecured creditors had actual knowledge of the contents of the financing statement”). The bankruptcy trustee, however, has, by virtue of federal law, the power of a hypothetical lien creditor without knowledge under state law. As a matter of federal supremacy, nothing under state law could effectively deny a bankruptcy trustee such powers. In re Coed Shop, Inc., 435 F. Supp. 472 (N.D. Fla. 1977), aff’d, 567 F.2d 1367 (5th Cir. 1978). But a bankruptcy trustee is still “any person”; federal supremacy prevents section 9-401(2) from having any effect against bankruptcy trustees.

By analogy, UCC security interests have priority against the federal government’s tax lien only to the extent that Congress cares to give priority. Therefore, knowledge on the part of the Internal Revenue Service is also irrelevant to the status of the federal lien under section 9-401(2).


See R. Henson, supra note 60, § 7-1, at 242.


knowledge of the contents of the financing statement under section 9-401(2). This may not be different from saying, however, that section 9-401(2) applies only when there is an improper filing or when filing occurred only in one office in a dual filing state. Once this is established, the difference between section 9-401(2) and the 1962 version of section 9-301(1)(b) becomes rather inconsequential. The latest judicial trend indicates that the knowledge of the facts in a financing statement is sufficient; the person who would otherwise be senior need not actually visit the filing office to view the statement.\textsuperscript{155} Since a financing statement must include the names and addresses of the debtor and lender and a reference to the collateral,\textsuperscript{156} a lien creditor will be subordinated by virtue of knowing these facts. Under the 1962 version of section 9-301(1)(b), a lien creditor was subordinated if he knew generally that a security interest on specific collateral existed. Knowledge of the names of the lender and borrower and their addresses was not necessary. These differences end up being highly formalistic and indefensible. Why should a lien creditor be senior if he does not know the address of the secured lender, but junior if he knows it? Nevertheless, this seems to be the meaning of the case law.\textsuperscript{157}

Section 9-401(2), therefore, reintroduces lien creditor knowledge in one important category of cases. Roughly speaking, we may divide unperfected security interests into three categories. First, the secured


\textsuperscript{156} A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral.

U.C.C. § 9-402(1).

\textsuperscript{157} Cases have held that financing statements without the debtor’s address, e.g., \textit{In re} Smith, 205 F. Supp. 27, 28–29 (E.D. Pa. 1962), or without the secured party’s address, e.g., Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366, 369–70 (1967), are not effective to perfect the security interest therein described. These cases might be used to bolster the rather absurd reading of the case law suggested in the text, i.e., if the addresses are so important that their absence prevents perfection, then it is imperative that a person who may be subordinated under section 9-401(2) must have knowledge of the addresses. Cf. U.C.C. § 9-402(8) (“A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.”).

A further difficulty is that “knowledge,” as used in section 9-401(2), is defined as “actual knowledge” and not mere “reason to know.” id. §§ 1-201(25), 9-401 comment 5. Carried to its extreme, section 9-401(2) would not apply to a lien creditor without actual knowledge of the secured party’s address, even where the address could be obtained from the telephone book.
party files in the wrong place. Second, the secured party does not realize that he holds a security interest that needs to be perfected, as where he has leased a chattel to the borrower, only to find that it is a security interest, not a lease.\(^{158}\) And third, the secured party is merely negligent or indifferent and does not file at all. As to the first category, the UCC still contains a knowledge requirement.

Whatever knowledge may subordinate an otherwise senior lien creditor under section 9-401(2), knowledge of the old-fashioned 1962 sort is damaging to a lien creditor who attempts to levy property that includes an “accession” covered by a security interest.\(^{159}\) Under section 9-314 an unperfected secured party with an interest in an accession can defeat a lien creditor with knowledge of a prior unperfected security interest. This provision is directly contrary to the spirit of section 9-301(1)(b) and was probably overlooked by the drafters of the 1972 amendments simply because section 9-314 has always been an obscure and unlitigated provision.

C. The Secured Party Who Perfects Before His Rival Becomes a Lien Creditor

Whatever ambiguities may exist with regard to unperfected security interests and subsequent judicial liens, the outcome of the contest between a perfected security interest and a subsequent lien could not be clearer. The perfected secured party wins. This is true by the negative implication of section 9-301(1)(b)\(^ {160}\) and by the affirmative statement of the first clause of section 9-301(4). For this reason, the UCC becomes a rather simple tool for the assessment of security interests by a bankruptcy trustee, who is a lien creditor without knowledge on the day the petition for bankruptcy is filed.\(^ {161}\) If a security interest is still unperfected as of that day, the trustee may avoid it.\(^ {162}\) In addition, under the preference statute, a security interest is deemed made on the day it establishes itself against a hypothetical lien creditor\(^ {163}\) (i.e., the day it is perfected\(^ {164}\)) or, if perfection

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\(^{155}\) The UCC definition of “security interest” contains a lengthy test for distinguishing between true leases and disguised security interests. See U.C.C. § 1-201(37).

\(^{158}\) Accessions are discussed in Part II of this Article to appear in 5 Cardozo L. Rev. (forthcoming Summer 1984).


\(^{161}\) The only exception to this simple proposition pertains to unperfected purchase money security interests that attach within 10 days of bankruptcy. Id. § 546(b); see Breitowitz, Article 9 Security Interests as Voidable Preferences (pt. 1), 3 Cardozo L. Rev. 357, 397–98, 408 (1982).


\(^{163}\) Id. § 547(e)(1)(B).
occurs within ten days of attachment, on the day the security interest attaches.\textsuperscript{165} Except for an abstruse difficulty with regard to purchase money security interests,\textsuperscript{166} section 9-301(1)(b) is easy to apply under the preference statute. No subsequent hypothetical lien creditor can possibly defeat a secured party after the security interest is perfected.\textsuperscript{167}

D. Lien Creditors and Purchase Money Security Interests

1. The Nature of the Grace Period

Even under the terms of section 9-301, a lien creditor may still lose to a subsequently perfected security interest that has purchase money status. Under section 9-301(2), the unperfected secured party can still prevail if he “files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral.”\textsuperscript{168}

One might think that purchase money lenders should be grateful for the grace period in section 9-301(2), but in fact it constitutes a disadvantage. In the past, purchase money security interests always were good against earlier interests in after-acquired property.\textsuperscript{169} Section 9-301(2), therefore, constitutes a limitation on purchase money priority, not an extension.\textsuperscript{170} Nevertheless, the grace period is better

\textsuperscript{165} Id. § 547(e)(2)(A).

\textsuperscript{166} The nature of this difficulty is that “perfection” is defined in section 547(e)(1)(B) to be the point when lien creditors can no longer obtain priority. During the grace period of section 9-301(2), it is not yet clear that a lien creditor can get priority. Hence, perfection might be the start of the grace period whenever the filing is during the grace period. The better view is that perfection occurs when the filing occurs. Breitowitz, supra note 162, at 397–408; see infra text accompanying notes 184–88. Contra In re Burnette, 14 Bankr. 795 (Bankr. E.D. Tenn. 1981).

\textsuperscript{167} Assuming, of course, no retroactive lapse in perfection. See U.C.C. § 9-403(2).

\textsuperscript{168} A purchase money security interest is carefully defined in UCC section 9-107 to require that the credit extended was actually used to purchase the collateral in question. The seller of the item can reserve for himself such a security interest to secure the purchase price, in which case the security interest is what used to be called a “conditional sale.” Alternatively, a third party can lend to the debtor on the understanding that the money be used to buy specific property, in which case the advance is called an “enabling loan.” See R. Henson, supra note 60, § 3-11, at 43–44; see also Breitowitz, supra note 162, at 416–29 (discussing the special treatment afforded enabling loans and the rationale for such treatment). To be afforded purchase money status, the lender must be able to trace his loan to the collateral that the loan enabled the debtor to purchase. For an economic defense of this tracing requirement, see Jackson & Kronman, supra note 94, at 1175–78.

\textsuperscript{169} Holt v. Henley, 232 U.S. 637 (1914); Robinson v. Wright, 90 Colo. 417, 9 P.2d 618 (1932).

\textsuperscript{170} The Florida Supreme Court refused to believe that the UCC had changed the law as Justice Holmes described it in Holt v. Henley, 232 U.S. 637 (1914). See International Harvester
than a straight "first-in-time" rule, which purchase money secured parties face with regard to buyers out of the ordinary course of business. The grace period seems to have been based on the practical idea that buyers of goods on credit want to take home the goods they have bought. It is therefore designed simply to let the buyer have his goods immediately without rendering the seller's security interest instantly vulnerable to the buyer's lien creditors, who might be lurking on the buyer's doorstep waiting for his buying spree to end.

There are several curiosities worth exploring in section 9-301(2). First, the ten-day grace period that exists against lien creditors is not parallel to the ten-day grace period under section 9-312, which governs priorities between secured parties, or the grace period under section 9-313, which governs fixtures. Under section 9-312, the ten-day period applies only to noninventory purchase money security interests. As for inventory, section 9-312(3) requires not only that the purchase money security interest be filed in advance of the debtor's receipt of delivery, but also that competing secured parties with after-acquired property interests in the inventory be notified in advance of the delivery of inventory. If the purchase money lender fails to meet these requirements, he does not receive the preferred purchase money priority; his inventory interest is judged as of the day it is perfected by filing, in which case he must of necessity lose to the previously filed after-acquired property interests.

No similar requirement for inventory interests exists in section 9-301(2). As a result, the inventory purchase money lender who files a day after the inventory is delivered to the debtor may find himself losing to previously filed after-acquired property interests in inventory. However, he still beats the party who "became a lien creditor" between the time his security interest attached and the time he filed.


171 U.C.C. § 9-301(1)(c). A bulk purchaser of all the debtor's assets, however, is treated like a lien creditor, and as to him there is a 10-day grace period. Id. § 9-301(2).

172 See 1 G. Gilmore, supra note 59, § 16.6, at 498. Priority without filing survived into the UCC when the collateral was a fixture and the after-acquired property clause was in a real estate mortgage. U.C.C. § 9-313(2) (1962). The 1972 amendments now impose a filing requirement upon prior real estate parties. Priority without perfection is still possible in accession cases, however. Id. § 9-313(4)(a) (1972).

173 See Breitowitz, Security Interests as Voidable Preferences: The Floating Lien (pt. 2), 4 Cardozo L. Rev. 1, 6 & n.15, 7 & n.16 (1982). This, of course, creates a circular priority. For California's attempt to legislate around this problem, see infra note 252.
The grace period under section 9-301(2) does not apply when the purchase money collateral is fixtures. This conclusion is not absolutely clear from the statutes, but is supported by the explicit inconsistent provisions of section 9-313 and the drafting history of the 1972 amendments to that section. Under section 9-313(4)(a), a prior "encumbrancer" wins, unless, within ten days from the time the goods become affixed to the real estate, a "fixture filing" is made by the purchase money lender. Thus, while a grace period similar to that of section 9-301(2) is provided, it starts running at a different point (from affixation to real estate).

The ten-day grace period in section 9-301(2) is also not parallel to the grace period in the preference statute. In section 9-301(2), the purchase money secured party must file within ten days of the time the debtor receives possession of the collateral. Under section 547(c)(3), on the other hand, the secured party must file within ten days of attachment. These two points in time need not be the same. For instance, where the goods are shipped from the seller to the buyer, the debtor may have rights in the collateral as soon as the seller identifies the goods to the sales contract.

174 2 C. Gilmore, supra note 59, § 30.6, at 827; Shanker, An Integrated Financing System for Purchase Money Collateral: A Proposed Solution to the Fixture Problem under Section 9-313 of the Uniform Commercial Code, 73 Yale L.J. 788, 799-800 (1964).

175 Professor Kripke is primarily responsible for the language of the 1972 amendments to section 9-313. See Henson, Fixtures: A Commentary on the Officially Proposed Changes in Article 9, 52 Marq. L. Rev. 179, 181 n.11 (1968). Professor Kripke reports that a grace period against subsequent purchasers and lien creditors was considered by the drafters but was howled down by the real estate bar. See Kripke, The Review Committee's Proposals to Amend the Fixture Provisions of the Uniform Commercial Code, 25 Bus. Law. 301, 308 (1969).

176 An "encumbrance" is defined to include judicial liens on real estate. U.C.C. § 9-105(g).

177 A fixture filing has more rigorous requirements than ordinary filings. Compare id. § 9-402(1)-(3) (formal requirements of financing statements) with id. § 9-402(5) (additional requirements for fixture filings).

178 For an examination of the intricacies of the fixtures grace period, see Carlson, supra note 137, at 409-10. The filing requirements are also different, since section 9-313(4)(a) requires a fixture filing period. See U.C.C. § 9-401(1)(a) (filling in local real estate records); id. § 9-402(5) (format of fixture filing different). If the collateral is readily removable office equipment or replacements of consumer appliances, a regular UCC filing will beat the prior encumbrances; but, strictly speaking, purchase money status is not required, id. § 9-313(4)(c), and no grace period exists. Perfection must occur prior to affixation, in such a case, for a regular filing to beat a prior lien creditor. Id. A somewhat novel interpretation—that all priorities against lien creditors should be tested under section 9-313(4)(d)—will be offered later. See Part II of this Article to appear in 5 Cardozo L. Rev. (forthcoming Summer 1984).

179 "The trustee may not avoid under this section a transfer . . . of a [purchase money] security interest in property acquired by the debtor . . . that is perfected before 10 days after such security interest attaches . . . ." 11 U.S.C. § 547(c)(3)(B) (1982).

180 U.C.C. §§ 2-105(2)-(4), 9-501(1).
section 547(c)(3) begins to run. But the grace period under section 9-301(2) starts to run only when the debtor receives possession of the collateral.\(^{181}\)

The effect of these nonparallel provisions is that secured parties are advised to ignore the liberal grace period in section 9-301(2) and to conform with the narrower grace period in section 547(c)(3). Otherwise, the secured party runs a severe risk that his purchase money security interest will be a voidable preference.\(^{182}\) The liberal grace period of section 9-301(2) will continue to protect him, however, in contests with lien creditors under state law.

2. How Long Can The Grace Period Last?

If a sheriff intercepts goods before the debtor receives them,\(^{183}\) the secured party is afforded an indefinite grace period, under section 9-301(2), within which to file in order to establish seniority over the lien creditor for whom the sheriff acts. In this unusual case, the sheriff would have done better to levy the goods only after the debtor technically “received” them, so that the UCC grace period could start running.

Under these circumstances, is it possible for the grace period under section 9-301(2) to last in perpetuity? Execution sales and bankruptcy may each provide deadlines for filing.

   a. Sheriffs’ Sales. Sheriffs’ sales generally foreclose junior security interests.\(^{184}\) Unperfected purchase money security interests are of

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\(^{181}\) See Breitowitz, supra note 162, at 394–99. Contra In re South Atl. Packers Ass’n, 30 Bankr. 836, 840–42 (Bankr. D.S.C. 1983). In this case, the court equated debtor possession with attachment. The debtor had received delivery of the collateral piecemeal between April 1 and September 25. The secured party filed on September 28. This was held to be a timely filing under section 547(c)(3).

\(^{182}\) Unless perfection occurs within the narrow grace period of section 547(c)(3)(B), the time of the transfer will be deemed to occur on the date of perfection. The transfer would then be on account of antecedent debt. If, in addition, the debtor is insolvent and perfection is within 90 days before bankruptcy (or one year for insiders who had reason to know of the insolvency), the security interest would be a voidable preference. See 11 U.S.C. § 547(b) (1982).

\(^{183}\) See Joint Holdings & Trading Co. v. First Union Nat’l Bank, 50 Cal. App. 3d 159, 123 Cal. Rptr. 519 (1975). In Joint Holdings, the sheriff levied goods in transit, but the security interest had no purchase money status.

\(^{184}\) One serious impediment exists in this assumption. Section 9-201 provides that only UCC provisions can destroy security interests, yet nothing in the UCC states specifically that foreclosure provisions in nonuniform lien law have such destructive force. At least some courts have found that sheriff’s sales do not foreclose junior security interests. In re Dennis Mitchell Indus., Inc., 280 F. Supp. 433 (E.D. Pa. 1968) (bankruptcy trustee’s sale), rev’d on other grounds, 419 F.2d 349 (3d Cir. 1969); Tabers v. Jackson Purchase Prod. Credit Ass’n, 649 S.W.2d 202 (Ky. App. 1983); Bloom v. Hilty, 427 Pa. 463, 234 A.2d 860 (1967). If these courts are right, lien
doubtful priority, however, when they are still within the grace period. If these security interests are senior, then the sale itself will not foreclose them in most states. The doubtful priority of these interests may, of course, be ignored where the sale itself can foreclose the security interests regardless of their priority. If the buyer at the sheriff's sale qualifies for protection under section 9-301(1)(c) or (d)—that is, he is without knowledge of the unperfected security interest—the buyer will "take free" of the security interest, since no grace period exists as to buyers. But section 9-301(1)(c) does not aid a buyer who has knowledge of the security interest. In this event, it is necessary to determine whether the judicial lien independently has the effect of foreclosing the unperfected security interest. That question turns on whether the security interest is truly junior while the grace period continues. At least one court has held that the security interest is not junior and hence not foreclosable without a boost from the buyer's protection under section 9-301(1)(c).

Professor Breitowitz has written on this subject in the context of federal preference law and has concluded that the lien creditor is senior during the grace period. At the state law level, this implies that the sheriff's sale ought to foreclose the purchase money security interest. Professor Breitowitz's argument is based on the structure of the preference statute—there is a provision that would have no meaning unless the lien creditor were genuinely senior during the grace period. The trouble with this analysis is that the preference statute priorities under Article 9 mean precious little. For the argument that nonuniform lien foreclosure provisions do destroy junior security interests in spite of section 9-201, see Carlson, supra note 121.

185 Carlson, supra note 121. In Delaware, however, sheriff's sales foreclose senior security interests. Maryland Nat'l Bank v. Porter-Way Harvester Mfg. Co., 300 A.2d 8, 12 (Del. 1972). The question of whether a judicial lien is senior or junior during the life of the grace period need not be addressed in determining the foreclosure effect of a Delaware sheriff's sale.

186 There is a line of cases holding that protection for bona fide purchasers, e.g., U.C.C. § 9-301(1)(c), is never available to buyers at sheriffs' sales. See infra text accompanying notes 222-30 for a discussion of these cases. Also, establishment of a buyer's seniority over an unperfected secured party is not necessarily the same as the buyer's taking free of the security interest. Sections 9-301(1)(c) states that the secured party has a junior interest, not that he has no interest. This aspect of section 9-301(1)(c) is discussed in Carlson, supra note 121.

187 For example, the buyer's protection under section 9-301(1)(c) would not apply where the secured party shows up at the auction to advertise his unperfected interest.


189 Breitowitz, supra note 162, at 394-99.

190 The grace period issue for preference law is strictly one of timing the transfer of the security interest. Timing is necessary to determine whether the transfer was within 90 days of bankruptcy and whether the transfer was in satisfaction of antecedent debt. See 11 U.S.C. § 547(b)(2)(4)(A) (1982). Under section 547(e)(2), the security interest is deemed transferred when
itself refers to state law to determine when the lien creditor is senior. In writing the provision to which Professor Breitowitz refers, Congress was indeed taking a position as to what it thought section 9-301(2) meant. But the congressional interpretation is certainly not dispositive on this state law issue. In fact, given the dominant intent of referring to state law for lien priorities, the congressional interpretation of section 9-301(2) may not even be dispositive of federal law if state law really differs from what Congress believed it to be.

Viewed from the perspective of state policy—and putting aside for the moment the effects on preference law that an interpretation of section 9-301(2) might have—there is no compelling reason why the lien creditor should win. The lien creditor generally is not considered a “reliance” creditor who depends upon the state of the record. In addition, the secured party is not technically guilty of any misconduct; even though the security interest is unrecorded, the grace period for filing continues. Furthermore, we are assuming a buyer with knowledge of the facts, so that no good faith purchaser is involved here.

Nevertheless, we ultimately agree with Professor Breitowitz’s point that a decision favoring the secured party would interfere with the priorities assumed by the preference statute. It is legitimate for a state court to choose an interpretation that facilitates the mechanics of federal law. Certainly there are many precedents for rewriting or

it attaches or, if perfection is more than 10 days after attachment, when it is perfected. Perfection (with regard to personal property and fixtures) is defined as the time when a judicial lien creditor can no longer obtain seniority pursuant to state law. Id. § 547(e)(1)(B).

The status of the unperfected security interest during the grace period is important for preference purposes. If a lien creditor is not senior during the grace period of section 9-301(2), then “perfection” must occur at the start of the grace period. In cases where the grace period stretches out because the debtor has never received possession of the purchase money collateral, unrecorded purchase money security interests would not be avoidable as preferences, since they would usually be deemed contemporaneous exchanges for value (i.e., not transfers on antecedent debt).

Professor Breitowitz makes the point that if section 9-301(2) is read in this way, section 547(e)(2)(C)(ii) would be rendered useless. This subsection provides a 10-day grace period after the commencement of bankruptcy. Professor Breitowitz demonstrates that this grace period can refer only to purchase money security interests, since the trustee’s strong-arm power under section 544(a) destroys all other unperfected security interests. Breitowitz, supra note 162, at 397. If, however, purchase money secured parties are senior to lien creditors before filing and during the grace period of section 9-301(2), there would be no need for the special post-bankruptcy grace period in section 547(e)(2)(C)(ii). Therefore, Congress must have assumed that lien creditors during the grace period are senior as a matter of state law.


developing state rules in light of dependent federal rules. In addition, the unperfected security interest is foreclosable anyway by section 9-301(1)(c) or (d), whenever the buyer at the sheriff’s sale lacks knowledge. Providing for independent foreclosure power in the lien—by deeming it truly senior—simply plugs an anomalous loophole in the law that cannot be justified. For these reasons, we favor the conclusion that the sheriff’s sale terminates the unperfected purchase money security interest even if the grace period of section 9-301(2) has not ended.

If the sheriff levies on goods that are in interstate commerce, interesting choice of law questions must be answered before the length of the grace period can be assessed. A special UCC provision governs such choice of law questions. As Joint Holdings & Trading Co. v. First Union National Bank demonstrates, the application of this provision is not always easy. In Joint Holdings, a California sheriff attached property in transit to North Carolina. The secured party did not have purchase money status and was therefore not entitled to a grace period. But the secured party had already made a North Carolina filing and therefore would have been senior to the judicial lien if section 9-103 dictated a choice of North Carolina law on the question of perfection. The California court, however, decided that, according to the 1962 version of section 9-103(3), North Carolina law did not

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104 The purchase money lender will also be unable to retrieve superpriority as to the cash proceeds that the sheriff holds for the lien creditor. If the security interest is a “conditional sale” within the meaning of section 9-107, the secured party cannot claim purchase money status because the security interest in the cash proceeds was not taken “to secure all or part of its price.” If the security interest secures an enabling loan within the meaning of section 9-107(b), purchase money status as to cash cannot be obtained because the advance under that section must be given for the purpose of obtaining the collateral. Breitowitz, supra note 173, at 147. By the time the sheriff’s sale is over, the cash in question no longer belongs to the original debtor. Rather, it belongs to the lien creditor who never took any security interest and certainly not for the “purpose” described in section 9-107. Cf. Nickles, Rights and Remedies Between U.C.C. Article 9 Secured Parties with Conflicting Security Interests in Goods, 68 Iowa L. Rev. 217, 245–49 (1983) (arguing that proceeds from a foreclosure sale are not proceeds within the meaning of section 9-306(2) because they are not received by the debtor).

This labored analysis is rendered necessary because section 9-306 is silent as to the status of purchase money security interests in proceeds. Cf. U.C.C. § 9-312(3) (inventory purchase money lenders specifically given superpriority as to cash proceeds, but only as against other secured parties).

105 U.C.C. § 9-103(1)(c).

apply; the same result that apparently would be achieved under the notorious "last event" test of the present version of section 9-103(1)(b).

If, however, the North Carolina secured party had purchase money status, North Carolina law clearly would have governed under the curious grace period in section 9-103(1)(c), added by the 1972 amendments. Under that section—in cases where the debtor and secured party contemplate the goods ending up in North Carolina—North Carolina law would have applied for thirty days after the

The court reasoned that the security interest, which was created by a North Carolina agreement, attached while the goods were in Taiwan or perhaps American Samoa. Id. at 165, 123 Gal. Rptr. at 523. The court read the 1962 version of section 9-103(3) (“If personal property . . . is already subject to a security interest when it is brought into this state, [its] validity . . . is to be determined by the law . . . of the jurisdiction where the property was when the security interest attached.”) to mean that Taiwan or American Samoa law applied. Id. Without looking further, the court simply assumed that the law of those jurisdictions would have required local perfection. It therefore awarded priority to the California attachment lien creditor.

This joint understanding requirement (“[i]f the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security
debtor received possession of the goods. Accordingly, where the debtor never received possession, North Carolina would have remained the appropriate place to file forever. Furthermore, the grace period under North Carolina's section 9-301(2) would last in perpetuity, subject to the implicit deadlines of a sheriff's sale and bankruptcy.

b. Bankruptcy. Whatever effect sheriff's sales have on the grace period, bankruptcy also terminates the grace period in section 9-301(2). Under section 547(e)(2)(C)(ii) the purchase money secured party must file no later than ten days from the filing of the petition to gain seniority. The rationale for this conclusion is a bit complicated and therefore its explication is relegated to a footnote.201

c. Attachment After Receipt of the Collateral. A levy before the debtor receives possession of the collateral is not the only means by which the grace period in section 9-301(2) can last a good deal longer than the ten days mentioned therein. The Ninth Circuit has concluded that, where the debtor does not agree upon the terms of a conditional sales agreement, the ten days could start to run long after the time the debtor receives the collateral. Although decided in the context of section 9-312(4), the court's reasoning is directly applicable to the grace period in section 9-301(2).

interest attaches that the goods will be kept in another jurisdiction," U.C.C. § 9-103(1)(c)) raises yet more ambiguities, as where one party has an intent that does not comport with the mutual understanding. See In re Dennis Mitchell Indus., Inc., 419 F.2d 349 (3d Cir. 1969) (parties agreed upon a Pennsylvania situs, but debtor took the goods to a plant in New Jersey). This requirement is contrary to the suggestion made by Professors Baird and Jackson that choice of law, as it applies to third parties, should not be determined by private agreement between parties to a security agreement. D. Baird & T. Jackson, supra note 84, at 269.

201 The trustee's power as a hypothetical lien creditor, 11 U.S.C. § 544(a)(1) (1982), is of no avail here, since section 546(b) permits postbankruptcy perfection as a means of establishing priority over a hypothetical lien when state law grants a grace period. Therefore, at least in terms of section 544(a), the filing of a petition in bankruptcy is not in itself the deadline for perfection. Under the preference statute, however, the security interest must logically be a voidable preference if filing does not occur within 10 days after the bankruptcy petition is filed. Section 547(e)(2)(C)(i) provides that if the secured party has not perfected by the day of bankruptcy, the security interest is deemed transferred immediately before bankruptcy. If the secured party's advance was made before that day, the purchase money security interest is considered a transfer on antecedent debt and hence voidable. But see id. § 547(b)(3) (voidability requires that the debtor be insolvent at the time of transfer). The crucial exception to this principle is that if bankruptcy falls within the 10-day grace period between attachment and perfection, the secured party may still perfect after bankruptcy and within the grace period. Id. § 547(e)(2)(C)(ii). Therefore, since the grace period must end within 10 days of attachment (and since the security interest has attached—the debtor simply has not received possession yet), the deadline for filing logically must be no later than 10 days after bankruptcy. See also id. § 551 (trustee is subrogated to voided liens and may assert their seniority against unavoidable junior liens).
In *Brodie Hotel Supply, Inc. v. United States*, the seller allowed the buyer to take possession of restaurant equipment while the parties continued to negotiate the price and other terms of the credit sale and security agreement. The buyer received the property in July, but the property was not "sold"—in the sense of shifting title—until November, when the bill of sale was transferred and the security agreement was signed. In the interim, the buyer had granted another security interest in the equipment to a local bank, which perfected it and assigned it to the Small Business Administration (SBA). The purchase money lender did not file until late November, within ten days of attachment but many months after the debtor received possession of the equipment. The SBA financing statement had been filed at least two weeks before the competing security interest was perfected.

The Ninth Circuit found that the purchase money security interest was senior, thanks to the grace period in section 9-312(4). The holding is based upon an extremely clever linguistic trick. The court reasoned that, whereas the buyer received the equipment in July, the equipment was not "received by the debtor" until the buyer became an Article 9 debtor in November, when the security agreement was signed. Since the collateral was not "received by the debtor" until November, only then did the grace period commence. The purchase money secured party therefore did file within the ten-day grace period (although five months after the inchoate debtor received possession) and consequently prevailed over the SBA security interest.

This result could be read as establishing that the substantially identical grace periods in sections 9-301(2) and 9-312(4) commence either when the buyer receives possession or when the security interest attaches, whichever occurs later. Such a reading would be unfortunate, however, in that it extends the grace period for inordinate amounts of time. We prefer a somewhat narrower interpretation. The Ninth Circuit assumed (somewhat casually) that the buyer and seller had concluded no sales contract until the security agreement was

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202 431 F.2d 1316 (9th Cir. 1970).
203 Id. at 1318-19.
204 This linguistic gimmick was expressly rejected in North Platte State Bank v. Production Credit Ass'n, 189 Neb. 44, 52-53, 200 N.W.2d 1, 6 (1972).
205 Purchase money priority generally serves to overcome the after-acquired property clause of an earlier filed security interest. 2 G. Gilmore, supra note 59, § 29.1, at 777. *Brodie Hotel Supply* presents a rare circumstance where purchase money priority defeated an earlier security interest that did not rely on an after-acquired property clause.
206 There is some indication in the *Brodie Hotel Supply* opinion that the court thought attachment to be the earliest point at which a buyer could become a debtor. In describing the seller's argument, the court states:
signed. Until then, the buyer held the equipment as a lessee, a bailee or, perhaps, a consignee on approval. Under these facts, the buyer had no appreciable interest in the collateral to give the SBA. The buyer obtained commercially important rights in the collateral only when the consignment or bailment ripened into a sale. When the sales contract was formed, the buyer became a debtor, and the grace period started to run.

This reading of the opinion avoids a rule that the grace period never starts to run before attachment. It is possible for buyers and

Brodie contended that although Lyon received possession of the restaurant equipment over five months before Brodie's financing statement was filed, Lyon did not become a "debtor," and the equipment did not become "collateral" until November 12, 1964, when Lyon received the bill of sale and executed Brodie's chattel mortgage. Accordingly, Brodie contended, it was not until November 12, that "the debtor . . . receive[d] possession of the collateral" within the meaning of the statute.

431 F.2d at 1318 (emphasis added). It is not clear here whether the conclusion of the sales agreement or the security agreement governs whether Lyon is a "debtor." Later, the court remarks: "It was not until November 12, 1964, that Lyon purchased the equipment and became obligated to pay the purchase price. Until that obligation came into being, Lyon was not Brodie's debtor with power to mortgage the restaurant equipment . . . ." Id. (emphasis added). This language could be read to mean that no person is a "debtor" within the meaning of section 9-105(1)(d) until he has rights in the collateral, or perhaps until he has signed a security agreement. Both of these items are elements of attachment. U.C.C. § 9-203(1). The court also states:

Although Lyon might have been liable for the reasonable rental of the equipment or for its return to Brodie, he did not owe performance of an "obligation secured" [within the meaning of section 9-105(1)(d)] by the collateral in question until November 12, 1964, and therefore was not a "debtor" for purposes of [section 9-312(4)].

431 F.2d at 1319. Here the court assumes not merely that there need be an obligation, but an "obligation secured." An obligation cannot be secured until attachment.

Throughout the summer of 1964, Brodie and Lyon negotiated over the price and terms under which Lyon was to purchase the equipment." 431 F.2d at 1317. "It was not until November 12, 1964, that Lyon purchased the equipment . . . ." Id. at 1318.

The court is ambiguous as to whether it thought a lease or a bailment had been created. Id. at 1319 ("Although Lyon might have been liable for the reasonable rental of the equipment or for its return").

On the paper-thin difference between bailments and sales, see In re Sitkin Smelting & Ref., Inc., 639 F.2d 1213 (5th Cir. 1981); In re Medomak Canning Co., 25 U.C.C. Rep. Serv. (Callaghan) 437 (Bankr. D. Me. 1977), aff'd, 588 F.2d. 818 (1st Cir. 1978); NYTCO Servs., Inc. v. Wilson, 351 So. 2d 875 ( Ala. 1977).

See U.C.C. § 2-326(1)(b). While the goods are so held, the creditors of the buyer cannot reach the goods. Id. § 2-326(2). Perhaps this section means that a buyer cannot transfer a security interest in consigned goods, so that the SBA would have been defeated in the Brodie Hotel Supply case. But a consignment exists only until the goods are accepted by the buyer. Acceptance is narrowly defined in section 2-606 to mean that the goods conform to the contract. It is less than clear that a buyer could hold goods on consignment on sale or return while the sales agreement is negotiated, where the goods are in fact physically acceptable to the buyer.

Presumably, the debtor could convey his interest as bailee or consignee to the SBA, and these possessory rights would be good against the purchase money lender. But such ephemeral rights are hardly worth having. The purchase money lender would retain whatever power it had to terminate the debtor's possession over an objection posed by the SBA.
sellers to form a sales contract even before the price or other terms are agreed upon. For instance, under an open term contract, the buyer is obligated to perform his side of the bargain according to whatever terms the court determines to be reasonable. If a buyer and seller form a sales contract prior to attachment, the buyer becomes a "debtor" within the meaning of section 9-105(1)(d) at a point earlier than attachment. Thus, the proper reading of Brodie Hotel Supply is that the grace periods in section 9-301(2) and section 9-312(4) start to run either when the debtor receives possession of the collateral or when the buyer of the goods first becomes a debtor, whichever is later.

Brodie Hotel Supply has been widely criticized, and the Supreme Court of Nebraska has specifically declined to follow it, holding instead that the grace period always starts to run when the buyer of goods receives possession. But given the Ninth Circuit's gloss on the grace period in section 9-312(4) (and in the substantially identical section 9-301(2)), the court would have been presented with a curious

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211 U.C.C. § 2-305 (open price term); id. §§ 2-308 to -310 (other open terms).
212 The UCC defines "debtor," in pertinent part, as "the person who owes payment . . . of the obligation secured." Id. § 9-105(1)(d). We read these words to mean that a person who owes a debt that is later secured is a debtor nunc pro tunc before the security is given. Accord North Platte State Bank v. Production Credit Ass'n, 189 Neb. 44, 52-53, 200 N.W.2d 1, 6 (1972). The drafters, writing with the perspective that Article 9 comes into play only after the security is given, were slightly careless in their use of tenses in section 9-105(1)(d). The Ninth Circuit, however, may have taken the view that a person is not an Article 9 debtor until an Article 9 security agreement exists. 431 F.2d at 1319 ("he did not owe performance of an 'obligation secured' by the collateral" until the date of attachment). The only consequence of the Ninth Circuit's apparent refusal to relate back debtor status to the formation of the debt is an extended grace period under sections 9-301(2) and 9-312(5).
213 This narrow reading depends upon the somewhat dubious conclusion that a bailee or consignee with no title to collateral is not a debtor until he is given title. That is, a person can be a debtor only when the sales contract is formed. Before that point, the buyer is a bailee or a consignee. Either status, of course, suggests an obligation to the seller, and the best view is that the buyer became a debtor the minute he "received possession" of the collateral. But such a view is obviously inconsistent with the Ninth Circuit's holding. We attempt in the text to interpret what the Ninth Circuit actually ruled.
214 See, e.g., Kennedy, Secured Transactions, 27 Bus. Law. 755, 768 (1972); Note, Uniform Commercial Code—Protection for the Purchase Money Secured Party Under Section 9-312, 49 N.C.L. Rev. 849 (1971). The Brodie Hotel Supply case is also discussed in Baird & Jackson, Possession and Ownership: An Examination of the Scope of Article 9, 35 Stan. L. Rev. 175, 198-201 (1983). Professors Baird and Jackson do not attempt to work out the complexities of the case, but merely view it as evidence of the evils of excluding chattel leases from the coverage of Article 9. In fact, bringing chattel leases under Article 9 coverage does not solve the ostensible ownership problems posed by the Brodie Hotel Supply opinion. Buyers could still hold goods on consignment or as bailiffs. Instead, a more conservative view of the grace periods is needed, whereby the 10 days start to run whenever the buyer-debtor physically receives possession of the collateral. See infra note 215.
215 North Platte State Bank v. Production Credit Ass'n, 189 Neb. 44, 54, 200 N.W.2d 1, 7 (1972). According to the court: "By their nature grace periods must have a fixed time limit, or
anomaly indeed if the SBA had held a judicial lien instead of a security interest. Section 9-301(2) requires that, for the grace period to apply, the judicial lien must arise after attachment of the security interest. Preattachment judicial liens are simply not covered by section 9-301(2), meaning that section 9-301(1)(b) makes the preattachment lien senior. Thus, if the SBA had been a lien creditor before the security interest attached (that is, before the security agreement was signed), the SBA might have been senior to the purchase money lender. Section 9-301(2) would have been to no avail.

_Brodie Hotel Supply_, then, presents two important considerations for judicial lien priorities. First, if the parties have not yet reached a sales agreement, _Brodie_ may extend the start of the grace period indefinitely beyond receipt of possession. Second, when the purchase money lender transfers the collateral to the debtor before the security agreement is signed, liens may nevertheless attach to the debtor’s property before the security interest attaches. In such a case, the judicial lien will be senior under section 9-301(1)(b) because the grace period in section 9-301(2) does not apply against pre-security agreement judicial liens.


Read literally, only purchase money security interests perfected by filing obtain the advantage of the ten-day grace period in section 9-301(2). The negative implication of this section is that the automa-

they become meaningless. We cannot extend judicially another grace period over the Code grace period. We cannot pile flexibility upon flexibility.” Id. The court’s refusal to extend the grace period until the buyer also became a debtor was only an alternative holding. In _North Platte_, the buyer had intended to pay for some cattle with a check. The check bounced, and the seller became the unsecured creditor of the buyer. The buyer then borrowed, using the cattle as collateral, to pay off the seller. The enabling lender was held not to have a purchase money security interest because the secured loan did not “enable” the debtor to obtain rights in the collateral. Rather, it was the general credit extended by the seller that permitted this. See U.C.C. § 9-107.

_In Brodie Hotel Supply_, the seller itself was extending credit. Although, in that case, the purchase money security interest had all the earmarks of a transfer by the buyer on account of antecedent debt, nothing in section 9-107 requires a contemporaneous exchange for value between the seller extending credit and the buyer. _In re Cerasoli_, 27 Bankr. 51 (Bankr. M.D. Pa. 1983); Breitowitz, supra note 173, app. § V, at 146-47; see U.C.C. § 9-107 comment 2 (discussing the requirement of present consideration only in terms of nonsellers). Contra _In re Brooks_, 29 U.C.C. Rep. Serv. (Callaghan) 660 (Bankr. D. Me. 1980) (even where enabling loan truly enabled debtor to obtain collateral, security agreement must be reasonably contemporaneous with extension of credit). Under the _Cerasoli_ holding, the buyer in _Brodie Hotel Supply_ could still grant a purchase money security interest months after the debt for goods arose.
cally perfected purchase money security interest in consumer goods is not perfected at all against lien creditors, unless there is a timely filing. In light of the obvious bankruptcy implications, such a reading of section 9-301(2) would all but repeal the special automatic perfection accorded to purchase money security interests in consumer goods.

Professor Henson has pointed out that there is an escape from such a reading. By its title, section 9-301 proclaims itself to govern: "Persons Who Take Priority Over Unperfected Security Interests . . . ." Also, from section 9-301(1), we learn that the holder of an unperfected security interest loses to a whole host of favored parties "[e]xcept as otherwise provided in subsection (2)." Therefore, whatever is said in section 9-301(2) about purchase money security interests is said only about unperfected interests. The purchase money security interest in consumer goods is automatically perfected and therefore always beats a judicial lien.

This argument loses some of its rhetorical force under the 1972 amendments. The amendments left section 9-301's title intact, but added subsection (4), which deals with perfected security interests. Section 9-301(4), however, is itself direct authority for the proposition that the automatically perfected purchase money security interest in consumer goods defeats subsequent liens. The first clause of that section provides: "A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest . . . to the extent that it secures advances made before he becomes a lien creditor . . . ." A creditor whose lien attaches to purchase money collateral loses under this clause, even though the secured party has not filed. This direct and affirmative statement should override any

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216 U.C.C. § 9-302(1)(d). This provision does not cover purchase money security interests in consumer motor vehicles that are required to be registered under non-UCC procedures. Also, fixture filings are necessary against certain (but not all) real estate claimants. Id; see id. § 9-313(4)(a)-(b); see also Carlson, supra note 137, at 407–18 (discussing the priority of security interests perfected by fixture filing). Under the 1962 UCC, a fixture filing was always necessary to beat any real estate claimant. U.C.C. § 9-301(1)(d) (1962); see Carlson, supra note 137, at 403. The 1962 UCC also provided for a self-perfecting purchase money security interest in farm equipment having a purchase price of less than $2,500. U.C.C. § 9-302(1)(c) (1962). This exception was eliminated in 1972 because lenders refused to take qualifying farm equipment as collateral because of the risk of prior secret liens. See id. § 9-302 (1972) reasons for 1972 change.


218 R. Henson, supra note 60, § 7-1, at 243–44.

219 See U.C.C. § 1-109 ("Section captions are parts of this Act.").
dubious negative inference emanating from section 9-301(2). In any case, there has been no recent hint that bankruptcy trustees (who are hypothetical lien creditors as of the day of bankruptcy) have ever succeeded in avoiding unfiled but perfected purchase money security interests in consumer goods.\(^{220}\)

Even if unfiled purchase money security interests in consumer goods can be senior to judicial liens, another section may be thought to reverse this priority. According to section 9-307(2), any person who, for his own personal use, buys encumbered consumer goods without knowledge of an unfiled purchase money security interest takes the goods free of the security interest.\(^{221}\) Suppose consumer goods encumbered by an unfiled purchase money security interest are levied upon on behalf of a lien creditor. Based on what has been said about section 9-301(2), the lien is junior in priority to the automatically perfected security interest. In addition, at the sheriff's sale, no buyer could be protected from the unfiled interest by section 9-301(1)(c) because that section protects good faith buyers from unperfected interests. It may be possible, however, that section 9-307(2) protects the buyer at the sheriff's sale. The buyer, of course, would have to buy for his own personal use. If he qualifies in this regard, can he take the goods free of the unfiled purchase money security interest?\(^2\)

This question was put before the Supreme Judicial Court of Massachusetts in National Shawmut Bank v. Vera,\(^{222}\) which ruled that the buyer at a sheriff's sale could never be protected by section 9-307(2) from unfiled purchase money security interests. The court's reasoning, however, was extremely unfortunate. The court noted that the term "buyer," as used in section 9-307(2), is not defined by the UCC. "Purchase" is defined, however, in section 1-201(32), as a voluntary transaction. In a sheriff's sale, the debtor has been involuntarily divested of the consumer goods. The buyer at a sheriff's sale therefore is not engaging in a "voluntary" transaction and cannot be a UCC "purchaser," the term that the court equates with "buyer."

The reason that the court's logic is unfortunate is that, if followed, buyers at sheriff's sales can never claim protection under the

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220 It should be noted that In re Moore, 7 U.C.C. Rep. Serv. (Callaghan) 578 (Bankr. D. Me. 1969), drew the negative inference from section 9-301(2) long before the 1972 amendments were drafted and therefore is distinguishable on that score.

221 Section 9-307(2) provides:

In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

various provisions of the UCC that protect bona fide purchasers, such as section 9-301(1)(c) or (d). These sections might otherwise make the rights of buyers at sheriff's sales senior to the rights of unperfected secured parties. Of course, enforcement of a senior judicial lien would foreclose a junior unperfected security interest, rendering the state of the buyer's knowledge irrelevant. But the unperfected security interest may be unforeclosable because it is senior. For example, the lien creditor might have knowledge under the 1962 versions of sections 9-301(1)(b) or 9-313(4)(b) or under the current versions of sections 9-401(2) or 9-314(3). The Vera case means that the buyer at the sheriff's sale who is ignorant of the unperfected security interest must inevitably be junior to the unforeclosed, unperfected security interest. As a result, junior lien creditors who choose not to inform the buyers at the sheriff's auction of unperfected senior security interests of which they have knowledge will benefit from bids which outstrip the true value of the collateral to the buyer. This loss, however, is more appropriately visited upon the unperfected secured party than upon the innocent buyer.

Besides section 9-301(1)(c) and (d), there are other provisions in the UCC which might be of use to buyers at sheriffs' sales. In Mazer v. Williams Brothers, a buyer was denied the protection of section 8-405(3) on the authority of Vera. As the dissent in Mazer properly

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222 Even if section 9-301(1)(c) or (d) applies to sheriff's sales, the innocent buyer does not so clearly take free of the unperfected security interest of which he has no knowledge. He only takes a senior position. Cf. U.C.C. § 9-307(1)-(2) (qualifying buyers take free of qualifying perfected security interests). For the view that a security interest "subordinated" to the rights of a senior buyer must be read as dead and nonexistent, see Carlson, supra note 121.

223 See Carlson, supra note 121.

224 As between the purchaser and the secured party, it is ordinarily less costly for the secured party to perfect than it is for the purchaser to discover the secret lien. Economic efficiency demands that the loss fall upon the most efficient risk avoider. See generally Phillips, The Commercial Culpability Scale, 92 Yale L.J. 228 (1982) (presenting a hierarchical set of rules for allocating loss based upon culpability).

The secured party should not be without remedy against the deceitful lien creditor. He should be able to bring a conversion action against the lien creditor who interfered with his property rights. On potential conversion actions arising out of sheriffs' sales, see Justice, supra note 5, at 441-42 (1975); Nickles, Enforcing Article 9 Security Interests Against Subordinate Buyers of Collateral, 50 Geo. Wash. L. Rev. 511 (1982).


226 Section 8-405(3) governs the rights of all the possible parties if an owner loses securities and then obtains replacements from the issuer. The owner is entitled to the replacements, but he must post a bond to protect the issuer from liability. U.C.C. § 8-405(2). Meanwhile, a bona fide purchaser of the lost or stolen securities is entitled to have his purchase registered or its equivalent by the issuer. The issuer can reimburse itself from the bond posted by the person who originally lost the securities. Id. § 8-405(3). In this way, the loss is visited upon the person who originally lost the securities. Id. § 8-405 comment 3.

227 In Mazer, the sheriff levied stock certificates and sold them to a buyer at a sheriff's sale. The judgment debtor thereafter told the issuer that the shares were lost. The issuer issued
pointed out, denial of bona fide purchase rights to buyers at sheriffs' sales merely succeeds in rendering the enforcement of money judgments more difficult.\footnote{229}

The reasoning in \textit{Vera} is also questionable on its face. The buyer certainly buys and the sheriff certainly sells voluntarily. Nothing in the UCC definition of "purchaser"—assuming this definition is even relevant to "buyers" under section 9-307(2)—requires that the debtor, whose goods have been taken away from him, be endowed with the element of voluntariness. A "buyer" at a sheriff's sale is every bit the voluntary agent in need of protection given to buyers against unperfected security interests.\footnote{230}

The court, however, was obviously concerned that unfiled purchase money security interests would become worthless if they did not survive the sheriff's sale. To this we add our own concern that, as applied to a sheriff's sale, section 9-307(2) does not quite work. The buyer must intend to use the goods for his own personal use; hence, buyers at sheriffs' sales who are dealers and who want to use the goods for inventory or for business purposes would not be protected. Thus, even if one thought that unfiled purchase money security interests in consumer goods should be susceptible to levy and sale free of the interest, section 9-307(2) seems a clumsy tool by which to accomplish this.

A much stronger rationale exists for protecting an unfiled purchase money security interest in consumer goods from sheriffs' sales.

\footnote{229} 461 Pa. at 595–96, 337 A.2d at 563–64 (Manderino, J., dissenting).

\footnote{230} This, real estate recording statutes are typically extended to protect buyers at execution sales. See Pugh v. Highley, 152 Ind. 252, 53 N.E. 171 (1899).
In *Everett National Bank v. Deschuiteneer*, the Supreme Court of New Hampshire ruled that section 9-307(2) applied only when a consumer seller sold directly to a consumer buyer. According to the facts, second hand goods were sold to a consumer by a seller whose capacity—as consumer seller or retail dealer—was unclear. The *Everett* court held that if the seller had not been holding the goods as a consumer, section 9-307(2) could not apply to destroy the unfiled purchase money security interest. This same analysis could have been used by the *Vera* court. The debtor whose goods had been levied was effectively divested of his interest in the goods. The sale was conducted by the sheriff who acted for the lien creditor. The sheriff's sale therefore was not a consumer-to-consumer transaction, as the *Deschuiteneer* court required but, rather, was a lien creditor-to-consumer transaction. Since the lien creditor instigated the sheriff's sale, it is clear that he entered the transaction in a voluntary capacity. If the *Vera* court had used this rationale, buyers at sheriffs' sales could still be voluntary “purchaser-buyers” who are entitled to section 9-301(1)(c) or (d) protection against unperfected security interests. It also should be emphasized strongly that real estate recording statutes, by their terms, universally protect bona fide purchasers. Courts have never had any difficulty finding that bona fide purchaser protection under those acts covers the buyer at a sheriff's sale. The same rule should apply under the UCC.

E. Contests in which the Secured Party Has an After-Acquired Property Interest

Variations on the basic theme arise when we deal with a security agreement that has reserved an interest in after-acquired property. Historically, courts struggled with and resisted the concept that a secured party might encumber property not yet acquired by the debtor. The history of the concept and its embodiment in the UCC, thereby permitting inventory and accounts receivable financing, need not be repeated here. For our purposes, we will note that even

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231 109 N.H. 112, 244 A.2d 196 (1968).
234 For a discussion of after-acquired property, see 1 G. Gilmore, supra note 59, ch. 5.
though the UCC upholds most after-acquired property interests, it still defines perfection as the point in time at which a filing has occurred and the debtor has obtained rights in the collateral. While the act of filing can be performed at any time, filing does not constitute perfection until the debtor has rights in the collateral.

In sorting out priorities between competing secured parties, section 9-312(5) makes clear that the first party to perfect or file takes priority. Thus, for a secured party to establish priority over subsequent security interests, mere filing is sufficient, even though the debtor has no rights in the collateral at that time. The only type of subsequent security interest that can beat the filed security interest in the after-acquired property is the purchase money variety.

Priorities between security interests in after-acquired property and judicial liens are not so easily worked out because, unlike section 9-312(5), section 9-301 has no rule equivalent to "first to perfect or file." Instead the contest is decided by the race between the secured party to perfect (not file) and the judgment creditor to "become a lien creditor." Thus, the earliest time the secured party can win the race under section 9-301 is when the debtor has obtained rights in the collateral.

Fortunately for the secured party, the lien creditor is in much the same position. Under many lien statutes, it is possible for a lien to capture after-acquired property, but the lien does not attach until the property is acquired. In Tennessee, for example, an execution lien good against bona fide purchasers arises as of the date of teste. The date of teste is deemed to be the first day of the judicial term of the court issuing the execution. Property acquired by the judgment debtor thereafter becomes subject to the lien. The case of *In re Darwin* presents a convenient set of facts. In that case, the date of teste on the lien creditor's execution was before the commencement of the preference period. The personal property claimed by the lien

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235 See U.C.C. § 9-204(1).
236 Compare id. § 9-303(1) ("A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken.") with id. § 9-203(1)(c) (attachment is not possible until the "debtor has rights in the collateral").
237 See id. § 9-402(1) ("A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.").
238 See id. §§ 9-301(2), 9-312(3)-(4).
240 Id.; see supra notes 28-29.
241 117 F. 407 (6th Cir. 1902).
242 Technically speaking, the trustee was not trying to avoid the judicial lien under the old preference statute, Bankruptcy Act of 1898, ch. 541, § 60. 30 Stat. 544, 562, but under an analogous provision pertaining only to judicial liens, id. § 67(f), 30 Stat. at 565.
creditor was first acquired within the preference period. The court ruled that the transfer occurred only when the lien attached to the property, and that this could occur only when the debtor obtained rights in it. Since attachment was within the preference period, the transfer was a voidable preference, in spite of its venerable date of testa.243

We therefore proceed to examine the possibilities for resolving priorities where the secured party has an interest in the after-acquired property. If the secured party has filed a financing statement in advance of the debtor obtaining rights in the collateral, the time of perfection will be the time the debtor obtained rights in the collateral. Likewise, when a creditor has acquired a judicial lien with an after-acquired property dragnet,244 the earliest he can “become a lien creditor” with regard to the after-acquired property is also when the debtor first obtained rights in the collateral. In short, the lien arises at the exact same moment that the security interest attaches. Who wins?

Although courts245 and commentators246 occasionally miss the point, the rule in such cases of simultaneity is that a tie goes to the secured party. This result is dictated by the language of section 9-301(1): “[A]n unperfected security interest is subordinate to the rights of . . . (b) a person who becomes a lien creditor before the security interest is perfected . . . .” The key word in this section is “before.” If the lien creditor’s rights arise at the same instant that the security interest is perfected, the lien creditor loses because his rights must arise before the perfection of the security interest.247 This fortuitous

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243 The rule that judicial liens attach only when the debtor obtains rights in the collateral is more commonly dealt with in the context of real estate that is acquired by the debtor when a judgment has been docketed against him in the local county. See, e.g., Hulbert v. Hulbert, 216 N.Y. 430, 111 N.E. 70 (1916); Zink v. James River Nat’l Bank, 58 N.D. 1, 224 N.W. 901 (1929).

244 Outside of Tennessee, the dragnet effect with regard to after-acquired property will exist whenever the judgment or delivery of the writ of execution to the sheriff establishes the lien. See, e.g., Robinson v. Wright, 90 Colo. 417, 9 P.2d 618 (1932) (execution lien created when sheriff receives writ). Many states, however, provide that no lien arises from an execution until the sheriff actually levies. E.g., Mich. Comp. Laws Ann. § 600.6012 (West 1968). If the sheriff may levy only by seizing the property, the lien is ineffective with regard to after-acquired property; the sheriff must, therefore, return and releve in order to establish the lien on the newly acquired property. See Plumb, Federal Liens and Priorities—Agenda for the Next Decade (pt. 2), 77 Yale L.J. 605, 664 (1968).


246 See, e.g., Coogan, supra note 5, at 1016 (“No priority rules in the Code or CPLR specifically govern this situation.”); Plumb, supra note 244, at 665 n.362 (parties share pro rata in cases of simultaneous attachment); Note, Nonconsensual Liens Under Article 9, 76 Yale L.J. 1649, 1667 (1967) (same).

247 D. Baird & T. Jackson, supra note 84, at 371–72. Coogan later assumed this was true without making the linguistic argument. Coogan, supra note 126, at 1404. Professor Breitowitz
use of the word “before” prevents pro rata sharing between simultaneous security interests and liens, which the court in *Southern Rock, Inc. v. B & B Auto Supply* erroneously required.

Having shown that a tie goes to the secured party, we also emphasize that the order in which the competing parties levied or filed is completely irrelevant under the UCC. Thus, there may be an outstanding “liken significant act” already in place by the time the secured party files the financing statement. Nevertheless, the two interests attach at the same point, and the secured party must therefore win. This follows because the creditor does not “become a lien creditor” with respect to the after-acquired property until the debtor acquired it, and because the secured party does not “perfect”—within the technical meaning of that word—until that same point in time.

**F. Future Advances**

1. In General

One of the innovations of the UCC was its wholesale approval of the concept that a security agreement can cover advances that the

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develops this point somewhat better, although he finds room for ambiguity. Breitowitz, supra note 173, at 7 n.16.

248 *711 F.2d 683, 688–89 (5th Cir. 1983).* The *Southern Rock* case involved tax lien priorities. As against receivables, inventory, etc., tax liens have the priority of a hypothetical judicial lien. 26 U.S.C. § 6323(c)(1)(B) (1982). Presented with a tie, the court looked to the UCC and erroneously concluded that the proceeds from the receivables should be divided equally between the IRS (as hypothetical lien creditor) and the secured party.

249 There is a situation in which the secured party will lose. Suppose X has given a security interest in after-acquired property to SP. If X then acquires property encumbered by a judicial lien, SP will not have priority as to that property. The judgment creditor who established the lien “became a lien creditor” before SP perfected a security interest in that property. Of course, this hypothetical set of facts does not really concern simultaneous attachment.

250 See Breitowitz, supra note 173, at 7 n.16.

251 That is, perfection cannot occur before attachment has occurred. U.C.C. § 9-303(1).

252 California is the only state where the temporal order of events before the debtor acquires property is significant. In the course of creating a new lien on the basis of filing notice of a judgment in the Article 9 filing system, see supra note 32, California adopted a “first to file” rule with regard to after-acquired property between lien creditors and secured parties. Cal. Civ. Proc. Code § 697.590(b) (West Supp. 1983). This same provision preserves the superpriority of purchase money secured parties, provided they file within 10 days of the debtor receiving possession of the collateral.

California has also enacted the following ill-considered modification of the rule:

If a perfected purchase money security interest in inventory has priority over a judgment lien on after-acquired inventory pursuant to subdivision (b) and a conflicting security interest has priority over the purchase money security interest in the same inventory pursuant to [UCC section 9-312(3)], the conflicting security interest
lender might make to the borrower in the future. We must, however, distinguish between future advances made pursuant to a binding commitment to extend credit and future advances made entirely at the discretion of the lender. Section 9-203(1)(b) provides that attachment (and hence perfection) cannot occur until the secured party gives value. Attachment and perfection with regard to a nondiscretionary advance can be as early as the date on which the binding commitment to lend is made. Attachment and perfection with regard to a discretionary future advance, however, can be no earlier than the date on which the advance is made, at least under the 1972 UCC.

When the competing claimants are both secured parties who have filed, priority is decided upon the basis of the first to perfect or file. Under such a rule, it is irrelevant whether the advance is

also has priority over the judgment lien on after-acquired inventory notwithstanding that the conflicting security interest would not otherwise have priority over the judgment lien. Id. § 697.590(c).

Obviously, the drafters of this statute were attempting to solve the failure of the UCC to coordinate grace periods under section 9-301(2) and section 9-312(3). Under the latter section, purchase money lenders who finance inventory are given no grace period and are required to notify after-acquired property lenders in advance of the debtor's receipt of the inventory. See supra text accompanying note 173. The above quoted statute is an attempt to prevent a circular priority from arising.

Unfortunately, the statute has the effect of allowing the debtor to defeat judicial lien priority over an inventory lender by simply entering into a new purchase money transaction in some small amount. The debtor's ability to do this certainly weakens the after-acquired property effect of California's new liens.

253 See U.C.C. § 9-204 comment 5. Courts have required, however, that the debtor specifically agreed to collateralization of future advances; future advance clauses are to be strictly construed in this regard. See Labovitz, The Erosion of the Future Advancements Clause Under Section 9-204 of the Uniform Commercial Code, 88 Com. L.J. 533, 534-35 (1983).

254 See U.C.C. § 9-303(1).

255 The commentators were divided as to whether the optional advance related back to attachment of the original security interest or gave rise to a new and separate security interest as of the date the future advance was made. Compare 2 G. Gilmore, supra note 59, § 35.6, at 937-38 (no difference between a nondiscretionary future advance and a discretionary future advance, provided earlier value was given) with Coogan, supra note 5, at 1028-31 (in the case of a nondiscretionary future advance, attachment is deferred) and Coogan & Gordon, The Effect of the Uniform Commercial Code Upon Receivables Financing—Some Answers and Some Unresolved Problems, 76 Harv. L. Rev. 1529, 1549-51 (1963)(same). See also Plumb, supra note 244, at 659-62 (finding the UCC to be ambiguous).

These commentators missed a major clue in the 1962 UCC that definitively decides the matter in favor of Coogan and Gordon and against Gilmore. In section 9-314(3)(c), which has remained intact since 1962, future advances are assumed to give rise to a separate and junior security interest on accessions only when the advance is actually made. This suggests that discretionary future advances generally attach only at the time of the advance. A similar point can be made with regard to advances under real estate mortgages under the 1962 version of section 9-313(4)(c). See Carlson, supra note 137, at 390-92; Kripke, Fixtures Under the Uniform Commercial Code, 64 Colum. L. Rev. 44, 71-72 (1964).

256 U.C.C. § 9-312(5).
discretionary or nondiscretionary; a filing protects the lender in either case. But when one of the claimants is a judicial lien creditor under section 9-301(1)(b), the secured party must perfect (not file) to win. Here, it makes a great deal of difference whether the future advance is discretionary or nondiscretionary. Where an advance is made after a lien arises but pursuant to a commitment made before the lien arose, the security interest connected with the advance is perfected before, and therefore is senior to, the lien. Before section 9-301(4) was added by the 1972 amendments, the status of the same security interest without the binding commitment to lend, had been the subject of a substantial debate. Even then, the better view was that each new discretionary advance gave rise to a separate security interest, which became perfected only at the time the advance was made.

Section 9-301(4) now grants limited protection to discretionary advances made under a security agreement. The first requisite of this protection, however, is that there be a perfected security agreement in existence at the moment a person becomes a lien creditor. Presumably, no protection is afforded where a financing statement has been filed before the lien arises but no advance or binding commitment has yet been made. In the absence of a binding commitment, at least some money must have been lent before the lien arises—the ritual one dollar will do—for the protection of section 9-301(4) to apply. It is not clear that this requirement was intended. Perhaps a justification can be found in discouraging secured parties who have given no value from filing financing statements to defeat lien creditors. Such a justifi-

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257 An exception to the statement in the text exists when a senior pledgee (who has not filed) makes a future advance. His security interest for the discretionary advance is perfected only when the advance is made, allowing the competing secured party who has previously filed to prevail over the future advance.


259 One of the very few published cases to consider the status of discretionary future advances followed Professor Gilmore’s view. Friedlander v. Adelphi Mfg. Co., 5 U.C.C. Rep. Serv. (Callaghan) 7 (N.Y. Sup. Ct. 1968). In that case, a security interest was perfected before an execution was delivered to the sheriff. After delivery (but before levy) a discretionary future advance was made. The court held that a discretionary future advance relates back to perfection of the earlier security interest. The court stated: “There is no provision in the Uniform Commercial Code tending to negative the one security interest approach . . . .” Id. at 9. Contra Coogan, supra note 5, at 1030. Of course, section 9-301(4), added in 1972, “negative[s] the one security interest approach” once and for all.

For a case under the 1962 UCC that awards a separate priority to postlien value, see In re Apollo Travel, Inc., 567 F.2d 841 (8th Cir. 1977), discussed infra note 297.

256 Breitowitz, supra note 173, at 8 n.19.
cation fails, however, if the same transaction can be achieved by the present advance of a single dollar.\(^{261}\)

If a "perfected" security interest exists at the exact moment a person becomes a lien creditor, there are three situations in which section 9-301(4) protects discretionary future advances made by a secured party. First, future advances are always protected for a forty-five day period after a person becomes a lien creditor. Second, the section protects advances made even beyond the forty-five day period if the secured party makes the advance without knowledge of the lien. This is important protection indeed. A lender with knowledge will certainly cease advancing funds, if he can,\(^{262}\) and a lender without knowledge will be protected if he manages to maintain his ignorance.\(^{263}\) Third, the secured party is protected if he enters into a commitment to make future advances, provided the commitment is made without knowledge of the lien. This provision does not limit its protection to commitments made before the lien arises. The commitment can be made even after the lien has arisen, provided the commitment is made without knowledge.

The reason section 9-301(4) was added in 1972 is fairly arcane. The Permanent Editorial Board had no high regard for the section. In its view, "[t]he importance of the rule . . . may not be great."\(^{264}\) Nevertheless, the Board felt compelled to act by the Federal Tax Lien Act of 1966.\(^{265}\) In that Act, Congress decided, for the first time, to protect future advances under prior security interests from tax liens. In granting this protection, Congress required that the future advance be protected against hypothetical lien creditors under applicable state

\(^{261}\) In comparison, the Federal Tax Lien Act requires only a written security agreement, not a perfected security interest, prior to the tax lien. 26 U.S.C. § 6323(c)(1)(A), (d)(1) (1982). The Act also requires that the security agreement be perfected against hypothetical lien creditors. Id. § 6323(c)(1)(B), (d)(2). Since section 9-301(4) denies protection to future advances unless the ritual one dollar is given, a future advance under a mere prelien security agreement (without the ritual dollar) nevertheless loses to the tax lien.

\(^{262}\) "[N]o lender in his right mind is going to make a further advance if he is really free not to do so." Coogan, supra note 126, at 1396. If the debtor files for bankruptcy, section 365(e)(2) of the Bankruptcy Code excuses the loan commitment regardless of whether there is contractual language allowing the lender to escape. 11 U.S.C. § 365(e)(2) (1982).

\(^{263}\) The Review Committee had recommended that in all cases a secured party's ability to give senior advances end at 45 days, but the Permanent Editorial Board thought it important to continue the ignorant secured party's priority until the secured party actually obtains knowledge of the lien. Review Committee, supra note 145, para. E-44 n.7, reprinted in 3 U.L.A. at 34 n.7.

\(^{264}\) U.C.C. § 9-301 comment 7. One suspects the influence of Coogan, supra note 5, at 1033, in the Editorial Board's view that this question is not important.

law. At the time, however, the UCC gave discretionary future advances no clear protection from judicial lien creditors. Since the perfection requirement in the Internal Revenue Code threatened to obliterate the protection that Congress otherwise intended to give future advances, section 9-301(4) was introduced.

One problem that section 9-301(4) poses is that a secured party can subvert a sheriff's sale by giving so much in future advances that the debtor's equity shrinks to nothing. No buyer would purchase the items for sale unless the debtor maintained at least some equity after the senior security interest. The drafters of the 1972 amendments to the UCC fully recognized this problem:

It seems unfair to make it possible for a debtor and secured party with knowledge of the judgment lien to squeeze out a judgment creditor who has successfully levied on a valuable equity subject to a security interest, by permitting later enlargement of the security interest by an additional advance, unless that advance was committed in advance without such knowledge.

But after making this observation, the drafters nevertheless provided the collusive secured party a period of forty-five days in which to make senior future advances. Forty-five days gives a secured party ample time to subvert a sheriff's sale. Even the risk of future advances should be enough to depress prices at sheriff's sales. The future advance enhances the debtor's estate, but, of course, this money must be found by the sheriff to be of any consolation to the lien creditor. Fortunately, another provision in the UCC reduces the harm done by the forty-five day privilege to make senior future advances. Under section 9-307(3), also added in 1972, a buyer is protected from

267 U.C.C. § 9-312 (1972) reasons for 1972 change; see also Review Committee, supra note 145, para. E-44, reprinted in 3 U.L.A. at 34 ("There should be a limit on the power of a debtor and secured party to squeeze out a judgment creditor who has successfully levied on a valuable equity subject to a security interest, through later enlargement of the security interest by an additional advance, unless that advance was committed in advance."); Coogan, supra note 126, at 1398-99 (noting the potential for unfairness).
268 Of course, any mischevious intent on the part of the secured party may make the transaction a fraudulent conveyance. See Suffolk County Fed. Sav. & Loan Ass'n v. Geiger, 57 Misc. 2d 184, 186–87, 291 N.Y.S.2d 982, 985–86 (Sup. Ct. 1968). But reliance on fraudulent conveyance law to remedy legislative drafting problems may be inadequate. See Unif. Fraudulent Conveyance Act § 9, 7A U.L.A. 304 (1978) (secured party's interest immune if he is a good faith purchaser for value).
269 The effect of potential secret liens on the cost of lending is discussed supra text accompanying notes 82–95.
270 Professor Gilmore emphasized the first part of the sentence but showed no appreciation for the latter part when he discussed these matters. See 2 G. Gilmore, supra note 59, § 356, at 939.
future advances that are made any time after the secured party has knowledge of the sale. Thus, if the buyer at the sheriff's sale promptly makes certain the secured party has knowledge of his purchase, he takes the collateral subject only to the security interest representing the old advances. Any new discretionary advances would not further encumber the collateral. This effectively cuts down on the forty-five day window in section 9-301(4), provided the secured party has knowledge of the sale. Of course, the salutary effects of section 9-307(3) apply only if the reader rejects the logic of National Shawmut Bank v. Vera, which held that section 9-307 never applies to buyers at sheriffs' sales.

Section 9-307(3) cuts down the forty-five day privilege in section 9-301(4) only when a sheriff's sale is in fact contemplated. When the sheriff levies cash proceeds, or a bank account containing proceeds, there is no need for a sale, and section 9-307(3) is of no use. In such a case, the garnished bank apparently may insist that the lien creditor wait until every possibility of senior future advances has been eliminated. Where the senior secured party has made an extensive commitment to lend (with no deadlines), this wait can be perpetual.

It can be seen, then, that the forty-five day privilege to make advances under section 9-301(4) can cause some mischief. Fortunately, it was not repeated in section 9-307(3), so that discretionary future advances good against purchasers of the collateral can never be made by secured parties with knowledge of the sale (or by ignorant secured parties forty-five days after the sale).

One may fairly ask why purchasers and lien creditors are treated so differently. Why must lien creditors be subject to forty-five days of absolute vulnerability when buyers are not similarly vulnerable? Apparently, the Review Committee believed such extensive protection of future advances from lien creditors was necessary to protect future advances from prior tax liens. But the Committee went too far. Under the Federal Tax Lien Act of 1966, discretionary future advances may be made after a tax lien is perfected, provided the advance is made without knowledge and within forty-five days. Knowledge of the tax lien immediately ends the power of a secured party to make further discretionary advances. But no protection is given to the fu-

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271 See supra text accompanying notes 222-33.
ture advance unless applicable state law would protect the advance from antecedent lien creditors. Although the drafters of the 1972 amendments insulated all future advances made within forty-five days after the lien, they could have narrowed the protection so that the advance also had to be made in ignorance of the antecedent lien.

The Review Committee must have feared that the courts would charge any secured party making a discretionary future advance with knowledge of the hypothetical lien created by the Federal Tax Lien Act. If such knowledge is presupposed, then the extensive protection in section 9-301(4) is necessary to protect the advance against the tax lien. But we see no reason why a flesh and blood secured party should be charged with knowledge of a fictional and nonexistent judicial lien. Congress intended only that secured parties should receive no priority against tax liens of which they were ignorant, unless they also had a parallel immunity against judicial liens. This intent does not require an absolute immunity against judicial liens. Parallel immunity would have sufficed. This more limited version of section 9-301(4) would have prevented the possibility that collusive secured parties might destroy sheriffs' sales.

2. Interest Payments and Enforcement Expenses: Are They Future Advances?

Future advances are not hard to understand for those who never venture beyond the priorities among Article 9 security interests. The priority rule under section 9-312(5) is that the first to perfect or file takes priority with regard to both future and past advances. We have already seen that between secured parties and lien creditors, secured parties must be the first to perfect in order to be senior. Filing is irrelevant unless it succeeds in perfecting a security interest, i.e., the debtor already has rights in the collateral and the lender has already given value. As to this latter point, we must determine exactly when

\[\text{Id. § 6323(d)(2). The exact wording of section 6323(d)(2) requires that the future advance be "protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation." (emphasis added). In most states, a judgment does not give rise to a lien on personal property that would have priority over a subsequent security interest. See supra text accompanying notes 16-37. Commentators, however, have assumed that the tax lien statute refers to judicial liens in general, acquired by service of execution, levy, garnishment or whatever procedural step that has lien significance under state law. See R. Henson, supra note 60, at 178; Coogan, supra note 126, at 1388-89; Flumb, supra note 244, at 659-70.}

\[\text{Subsections (c) and (d) [of section 6323] subject the [future] advance to the hypothetical judgment creditor test, but nowhere tell us whether the future advance is charged with knowledge of that hypothetical judgment lien." Coogan, supra note 126, at 1401.}\]
value is given in order to determine when that part of the security interest has attached and hence perfected.

One issue that has never been fully explored is the extent to which the growth in the debtor's obligation to the secured party must be considered future advances for the purpose of sections 9-301(4) or 9-307(3). For example, the size of the secured obligation will continue to grow because interest continues to accrue. Similarly, the senior secured party might incur attorneys' fees that the debtor is contractually obligated to pay. Do these increases in the secured debt give rise to separate security interests with priorities different from that of the initial advance? If so, both lien creditors and buyers can expect that a time will come when the security interest is subject to a ceiling amount beyond which it cannot go, even if interest charges continue to accrue or the creditor's attorneys continue to generate legal fees.  

There is a dearth of precise definitional help from the drafters of the UCC. But hints emerge from various provisions, suggesting that a distinctions between advances and other parts of the secured obligation should be drawn.

"Value" is defined in section 1-201(44)(d) to include anything given by a secured party that could constitute "consideration sufficient to support a simple contract." Interest and collateral preservation costs incurred by a pledgee could easily fall within into this definition. Whereas "value" is a defined term, "advance" and "future advances" are not defined.

277 Mr. Coogan used section 9-204(3)—formerly numbered as section 9-204(5)—to argue that discretionary future advances had priorities different from those accorded to old advances, a matter supposedly left in doubt prior to the 1972 amendments. Coogan, supra note 5, at 1030; see supra note 275. If this is true, then section 9-204(3) also proves that interest and collateral preservation costs ("other future value") have a different priority from that accorded to old advances. The suggestion that they also have a different priority from future advances is not made by Mr. Coogan.

278 U.C.C. § 9-207(2) ("Unless otherwise agreed, when collateral is in the secured party's possession (a) reasonable expenses (including the cost of any insurance and payment of taxes or other charges) incurred in the custody, preservation, use or operation of the collateral are chargeable to the debtor and are secured by the collateral," (emphasis added)).

279 Interest is a charge for the use of money, and collateral preservation inheres to the benefit of the debtor. In each case, the secured party has conferred value on the debtor. The cost of collection is potentially chargeable to the debtor, see id. § 9-504(1)(a), and also qualifies as "value" in that such costs constitute "consideration sufficient to support a simple contract" within the meaning of section 1-201(44)(d). In re United Merchants & Mfrs., Inc., 674 F.2d 134, 136-40 (2d Cir. 1982).

Professor Gilmore wondered whether section 9-504(1) could be read to distinguish between secured debt and collection costs, since that section treats them in separate subsections—collection costs receive first priority in distributions and secured debt comes second. 2 G. Gilmore, supra note 59, § 42.2, at 1132-33. In the end, he concludes, "[t]he possible inference from § 9-504(1) that post-default expenses should not be regarded as included in the secured obligation or that the debtor should not be personally liable for them should be disregarded." Id. at 1133.
ture advance” are not. An advance does connote, however, an affirmative transfer of funds to the debtor. The accrual of interest, collateral preservation expenses and collection costs could not be considered “advances” under this reasoning. Such a distinction between advances and other types of value is strongly supported by section 9-204(3), which provides:

Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment . . . .

This section makes the point that a security agreement can cover obligations already owing and obligations not yet owed. For our purposes, it is worth noting that the drafters thought that not all future obligations were future advances; some future obligations were “other value.” Section 9-204(3), therefore, is consistent with the view that interest and collateral preservation charges are future “value” but are not future “advances.”

Two very recent cases lend support to these distinctions. The first, In re Iowa Premium Service Co., supports the view that

We would add that section 1-201(44)(a) includes these costs as “value” and, hence, part of the “attached” security interest under section 9-203(1). Therefore, we tend to view these costs as “value,” but not as “advances.”

Strong evidence that interest and collateral preservation costs are not “advances” is found in California’s short-lived nonuniform enactment of section 9-312(7), 1963 Cal. Stat. 819 (repealed 1965), reprinted in Coogan, supra note 5, at 1021. This provision stated that the secured party took priority not only as to the principal amount of the loan (i.e., advances) but also “as to advances and expenditures made by the secured party for the protection, maintenance, preservation or repair of the collateral. Accrued interest has the same priority as the advance or expenditure to which it relates.” Id. Coogan, a bitter critic of California’s nonuniform provision, took the view that this language applied specifically to the priority between judicial liens and accrued interest under otherwise senior security interests. Coogan, supra note 5, at 1027 (“[b]y process of elimination it would seem that the principal (and perhaps the only) situation in which 9-312(7) has room to act is that in which a future advance is preceded by another creditor’s intervening lien”). California took Mr. Coogan’s comments to heart and repealed the nonuniform provision soon after his article appeared. See Note, Priority of Future Advances Lending Under the Uniform Commercial Code, 35 U. Chi. L. Rev. 128, 134 n.22 (1967). Nevertheless, for our purposes, it is revealing that California passed specific legislation on the priority of interest and collateral preservation costs, since it felt that the UCC legislation on “future advances,” standing alone, was inadequate.

Section 9-108 is to the same effect. It states: “Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value . . . his security interest . . . shall be deemed to be taken for new value . . . .” U.C.C. § 9-108 (emphasis added).

695 F.2d 1109 (8th Cir. 1982) (en banc).
interest (and other nonadvance future value) has a different priority from the principal amount of a loan. In this case, a creditor had lent funds on a demand note and was entitled to receive monthly interest payments from the bankrupt debtor. Three of these payments had been made during the ninety-day preference period and therefore seemed to be voidable. The creditor argued, however, that interest accrued daily and that the interest payments were in the ordinary course of business within forty-five days of a debt’s being incurred. As such, the payments were protected from avoidance by section 547(c)(2). Although the original panel associated the interest with the earlier advance, the Eighth Circuit agreed en banc with the creditor and viewed the interest debt as distinct from, and accruing later than, the original principal debt. The court’s analysis was very similar to ours here.

In the second case, *Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc.*[^676] the Court of Appeals for the Second Circuit was called upon to decide whether only “future advances” were covered by section 9-301(4) or whether all types of future value could sneak within the confines of that protective statute. This case implicates almost our entire discussion of future advances and judicial liens and therefore merits discussion in a separate section of the Article.[^266]

For our present purposes, we need only say that in the *Dick Warner* case, a lien had attached to a general intangible of the debtor,[^289] which a competing secured party claimed as collateral. The secured party asserted the right to seniority over the lien creditor as to the debtor’s surplus in case future advances were made or future collection costs were incurred. The Second Circuit remanded without reaching the issue, but suggested that the district court should consider whether all parts of future secured debt could be considered “advances” or whether some parts—particularly attorneys’ fees—had to be considered “other value” as we have used the term.[^280]

[^676]: 676 F.2d 1220 (8th Cir. 1982).
[^266]: *Iowa Premium Services* is an important case because it implies that any payment made in the ordinary course of the business or financial affairs of the debtor and creditor is a preference only to the extent that the payment cannot be characterized as payment on interest accruing within the past 45 days. Usually, the presumption is that partial payments on debt are first applied to interest due and thereafter to the principal amount outstanding. See *Federal Consumer Creditor Protection Act*, 15 U.S.C. § 1606(a)(1)(A) (1982).
[^287]: 700 F.2d 858 (2d Cir. 1983), rev’d 538 F. Supp. 1049 (D. Conn. 1982).
[^289]: See infra text accompanying notes 306–37.
[^286]: The nature of the collateral in this case is somewhat unclear. See infra note 310.
[^280]: See 700 F.2d at 863–64, 863 n.5. In remanding on the question of whether attorneys’ fees arising after a lien can come within section 9-301(4), the Second Circuit cites two opinions that
In summary, our argument concerning judicial liens and their status against future advances, starts with the proposition that a security interest cannot attach or perfect before the value is given. The portions of a security interest that represent interest, collateral preservation expense and collection costs cannot attach or perfect until they actually accrue. Furthermore, these costs are not future advances. When a judicial lien arises, the part of a security interest that attaches and perfects prior in time is senior, and the part that perfects subsequently is junior, except that the subsequently perfected portion constituting "future advances" is subject to the additional protection of section 9-301(4).

What we have just said may strike some as surprising and, perhaps, alarming. Actually, it is more the former than the latter.

We start with the bankruptcy trustee. Here, a specific section of the Bankruptcy Code protects the secured party in all respects. Section 506(b) provides:

supposedly take opposing positions. See 700 F.2d at 858, citing In re Appollo Travel, Inc., 567 F.2d 841 (8th Cir. 1977) (disallowing attorneys' fees); In re Continental Vending Mach. Corp., 543 F.2d 966, 993-94 (2d Cir. 1976) (allowing priority for such fees). In those cases, the issue considered was whether all future value had a different priority from that of the initial advance (the unitary theory) or whether each new extension of value gave rise to a new security interest. See supra text accompanying notes 255-59. Every state that has adopted section 9-301(4) has obviously opted for the latter position. These opinions, however, were decided in jurisdictions where section 9-301(4) was not yet enacted. See infra note 297. As a result, they do not address the issue of whether attorneys' fees are "advances" within the meaning of section 9-301(4).

As to the Dick Warner case, the district court has ruled on remand that attorneys' fees are protected by section 9-301(4), contrary to what we have said. See No. 80-500, slip op. (D. Conn. Sept. 28, 1983).

291 U.C.C. §§ 9-203(1)(b), -303(1).
292 That is, they represent "other value" and not future advances, within the meaning of section 9-204(3).
293 This is true by virtue of the first clause of section 9-301(4) ("[a] person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances [and other value] made before he becomes a lien creditor"). We have added the words "and other value," a reference to the distinction between advances and value in section 9-204(3), on the assumption that all parts of the prelien security interest have seniority, not just the part that came from prelien "advances." The bracketed words are not present in section 9-301(4) but are supplied by the negative inference in section 9-301(1) ("an unperfected security interest is subordinate to the rights of . . . (b) a person who becomes a lien creditor before the security interest is perfected").
294 See 2 G. Gilmore, supra note 59, § 42.6, at 1139-40. This comes from the negative implication of section 9-301(4). If the postlien portion of a security interest is senior only when derived from narrowly defined future advances (those made within 45 days, etc.), the portion of postlien security interest derived from other sources (i.e., nonqualifying future advances and all "other value," such as accrued interest) must be junior.
295 Although he did not focus on the matter, Professor Gilmore confounded future "advances" and future "other value." See id. § 42.6. Of course, in 1965, section 9-301(4) did not yet exist to distinguish between future advances and future "other value."
To the extent that an allowed secured claim is secured by property the value of which, after [the trustee's expenses in preserving or disposing of the collateral], is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided under the agreement under which such claim arose.\textsuperscript{196}

The very existence of this provision is evidence that our analysis is correct. Absent this protection, the portion of the security interest representing postbankruptcy interest and other charges could not survive the trustee's status as hypothetical lien creditor as of the day of bankruptcy.\textsuperscript{297}

Our analysis creates some disadvantage to secured parties with regard to the tax lien statute. Section 6323(d) of the Internal Revenue Code\textsuperscript{298} protects future advances if made by the secured party without knowledge and within forty-five days of the time when the tax liens are filed. But our analysis shows that interest, collateral preservation expenses and postdefault collection expenses are not future advances. Those expenses are covered under section 6323(e), which grants protection only "to the extent that, under local law, any such item has the same priority as the lien or security interest to which it relates."\textsuperscript{299} Since we have shown that these expenses do not have the same priority against judicial lien creditors that the underlying security interest has, these expenses have no priority against a tax lien. The security interest, therefore, becomes frozen in size against the tax lien from the moment the tax lien is properly filed, unless the increase in size comes

\textsuperscript{196} 11 U.S.C. § 506(b) (1982).

\textsuperscript{297} \textit{In re Apollo Travel, Inc.}, 567 F.2d 841, 844 (8th Cir. 1977). This case was decided under the 1962 UCC, which was unclear on whether discretionary future advances (or other future value) had a priority different from that accorded to the original advance. See supra note 255. The Eighth Circuit agreed with the view that postlien value should be accorded a junior priority. Since the trustee's lien creditor status destroys junior security interests, the decision completely precluded the collection of attorneys' fees out of the collateral. To the opposite effect is \textit{In re Continental Vending Mach. Corp.}, 543 F.2d 986, 993-95 (2d Cir. 1976). This decision was also decided under the 1962 UCC. The court recognized that the attorneys' fee question should be decided under state law and went on to assume that the claim for attorneys' fees had the same priority as the original advance. In so ruling, the Second Circuit was in accord with the scant New York authority on the question. See Friedlander v. Adelphi Mfg. Co., 5 U.C.C. Rep. Serv. (Callaghan) 7 (N.Y. Sup. Ct. 1968), discussed supra note 259.

\textsuperscript{298} 26 U.S.C. § 6323(d) (1982).

\textsuperscript{299} Id. § 6323(e). The fact that Congress protected future advances in subsection (d) and interest and collection costs in subsection (e) is strong additional evidence that the two concepts are distinct.
from future advances given without knowledge and within forty-five
days.\footnote{Coogan is uncharacteristically opaque on the effect of section 6323(e) upon interest and collection costs. He writes, "If . . . section 9-504(1)(a) does not allow inclusion of attorney's fees on a parity with the principal secured obligation, subsection (e) does not give these charges protection against an earlier filed tax lien." Coogan, supra note 126, at 1395-96. While he begs the question, we have demonstrated that the priority accorded to these charges is not on a parity with the prelien security interest.}

At first glance, our analysis would seem to interfere with the orderly application of the UCC's default procedure. If interest cannot be included as part of a senior security interest when a judicial lien arises, distribution of proceeds ostensibly becomes hopelessly entangled. For example, a security interest may be senior in toto against a junior security interest but senior against a judicial lien only with regard to the prelien portion of the security interest. A circular priority might seem to loom, with the senior secured party wholly senior to the junior secured party, who is fractionally senior to the lien creditor, who is in turn fractionally senior to the senior secured party. The problem is illusory, however. Under section 9-504(4), when the senior secured party disposes of the collateral the junior lien creditor is foreclosed by the sale; and under section 9-504(1), the junior lien creditor has no right to distribution of proceeds. The end result is that the junior lien creditor is deprived of his lien and denied his priority; the circular priority problem is therefore nonexistent.\footnote{On the omission of the lien creditor from the default procedure of Article 9, see Carlson, supra note 121.}

When the sheriff sells on the joint behalf of a secured party and a lien creditor, the suggested priority vis-a-vis lien creditors does provide some complexity, in part because, while the security interest is constantly growing in size, so is the judgment, which is ordinarily accorded statutory interest.\footnote{The solution in the text, although dictated by section 9-504(1), cannot be defended on policy grounds. Clearly, the best solution for accrued interest is to recognize that the interest claims of all the claimants arise simultaneously. Therefore, after the priority amounts of each secured claim is satisfied, the claimants should share the surplus on a pro rata basis if the surplus is less than the aggregate of all simultaneously arising interest claims.}

Nonuniform lien law, however, has no analogue to section 9-203(1)(b), which defers attachment until value is given. Accordingly, judgment interest should be accorded the same priority as the initial lien upon which the judgment creditor relies. Postlien interest on a senior security interest should be accorded a status junior to that of the lien because of section 9-203(1)(b) and

\footnote{E.g., N.Y. Civ. Prac. Law §§ 5003-5004 (McKinney 1978).}
because accrual of interest does not have the priority of "future advances."\(^3\)

To summarize, a junior priority for postlien interest and collateral preservation expenses does not have drastic effects. Nor should it appear unusual that our analysis splits most security interests into two parts when a judicial lien appears. Section 9-301(4), after all, presupposes a cleaving of an otherwise unitary security interest, as does section 6323(d) of the Internal Revenue Code.\(^4\) All we have done here is to add some detail to the nature of the cleavage.\(^5\)

3. The *Dick Warner* Case and the Scope of Section 9-301(4)

All of the above issues pertaining to future advances and judicial liens have been implicated in the exceptionally interesting case of *Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc.*\(^6\) The case was remanded by the Second Circuit for a determination of the exact scope of section 9-301(4). The district court, on remand, has adopted an extremely broad definition of "advance," contrary to the arguments we have made.\(^7\)

The written opinions to date give only a sketchy outline of the facts. It seems that Aetna Business Credit, Inc. (Aetna), a major inventory and accounts receivable financer, undertook to finance a thinly capitalized new company, Best Banana Co., Inc. (Best Banana), which hoped to import bananas purchased from foreign producers. The imports typically were conducted under letters of credit issued by domestic banks and financed by Aetna. Aetna was to have

\(^3\) Although this is dictated by the statutes as currently written, the better solution is for pro rata sharing among simultaneously arising accrued interest claims. See supra note 301.

\(^4\) See also U.C.C.\S 9-313(4)(c) (1962) (future advances under real estate mortgage are separate from priority accorded to earlier advances); id. \S 9-314(4)(c) (future advances under security agreement, where accession is involved, have separate priority from earlier advances).

\(^5\) Purchase money priority also might be subject to the rules we have suggested. According to section 9-107: "A security interest is a 'purchase money security interest' to the extent that it is (a) taken or retained by the seller . . . to secure . . . its price . . . ." Id. \S 9-107 (emphasis added). The emphasized language implies that, to the extent the security interest represents accrued interest, it is not entitled to purchase money status. Similar analysis can be made for the enabling loan. Purchase money status exists only to the extent that the secured party gives value "by making advances or incurring an obligation." Accrued interest constitutes neither of these.

Hence, interest on purchase money debt should be treated like any other postlien interest—junior to the lien even when other portions of the debt are senior.

\(^6\) 700 F.2d 858 (2d Cir. 1983), rev'g 538 F. Supp. 1049 (D. Conn. 1982).

\(^7\) See No. 80-500, slip op. at 8–9 (D. Conn. Sept. 28, 1983).
discretion concerning whether to finance any given letter of credit.\footnote{538 F. Supp. at 1051. Of course, if Aetna had used its discretion and made a prelien commitment to lend, the analysis would change considerably. In a case such as Dick Warner, prelien commitments give rise to prelien perfected security interests. See infra text accompanying note 314.} The collateral for the loans included inventory, accounts receivable and the proceeds of both.

January 11, 1980, is the key date in this case. On that day, Dick Warner Handling Corp. (Dick Warner), a judgment creditor of Best Banana, served a writ of garnishment on Aetna. The exact status of the mutual obligations of Aetna and Best Banana on that day therefore requires careful examination.

Aetna was entitled to collect on the accounts owing to Best Banana from its domestic customers and to use cash proceeds to reduce Best Banana’s debt.\footnote{309 “[T]he secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in reduction of the secured obligation . . . .” U.C.C. § 9-207(2)(c).} Under this agreement, if Aetna were to collect a surplus, it could retain the funds as security for future obligations. It is worth noting that Aetna seems to have commingled excess cash proceeds with its own funds, so that Aetna simply owed Best Banana a general debt.\footnote{310 The opinions suggest that none of the parties focused on this point, and there is no clear description of exactly what Aetna did with the excess proceeds. We will assume that Aetna used the cash and simply kept an account on its books in favor of Best Banana. Cf. Associated Poultry, Inc. v. Wake Farmers Coop., Inc., 17 N.C. App. 722, 195 S.E.2d 325 (1973) (cash proceeds, upon commingling, become general claim against commingler).}

As of January 11, 1980, Aetna had collected almost $400,000 in cash proceeds of Best Banana’s accounts and had applied most of this money to offset Best Banana’s indebtedness. After this setoff was made, Aetna owed Best Banana approximately $45,000, and it was this sum that Dick Warner hoped to garnish. Aetna, on the other hand, hoped to retain this sum for future setoffs. In particular, Aetna already had decided to fund a letter of credit in excess of $1,000,000 on behalf of Best Banana. The bank issuing the letter of credit previously had dishonored the tender of documents by the letter of credit’s Ecuadorian beneficiary, and litigation eventually ensued. In this as yet unresolved litigation, Aetna has incurred legal fees chargeable to Best Banana. Aetna may incur additional legal expenses and may be forced to assume liability on the letter of credit. The $45,000 surplus was to serve as security for these actual and contingent liabilities.

The district court initially reasoned that the $45,000 surplus was subject to diminution by Aetna’s collection costs and attorneys’ fees.
Because this was so, the court ruled that Aetna's debt to Best Banana was contingent on such expenses not being incurred. Since contingent debts may not be garnished under Connecticut law, the court thought that Dick Warner had failed to establish a lien at all. 311

The Second Circuit reversed on this point, ruling that Aetna's obligation to return the $45,000 surplus was subject to defeasance only by conditions subsequent, i.e., subsequent advances or subsequent collection costs. In Connecticut, debts subject to conditions subsequent can be garnished, even though debts subject to conditions precedent can not. Hence, the Second Circuit held that the judicial lien attached to the surplus. 312 In finding that conditions subsequent existed, the court quite properly saw itself as vindicating the policy of section 9-311, which permits lien creditors to obtain a debtor's surplus in collateral despite language in a security agreement to the contrary. 313 The case was remanded to the district court to determine whether section 9-301(4) gave Aetna priority over the lien creditor for its collection costs and attorneys' fees incurred after the lien attached.

In determining the ways in which section 9-301(4) might protect Aetna, it is important to note that since Aetna made a prelien commitment to lend, its security interest in the $45,000 surplus relates back to

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311 538 F. Supp. at 1053. The court also indulged in a long digression on the significance of section 9-201, which establishes the superiority of a security interest over third party rights absent a specific UCC provision to the contrary. Id. at 1052-53. The court commented that the future advance clause of the security agreement must be honored against creditors, but it is difficult to see how this is so. Section 9-301(4) stands for the proposition that at least some future advances are junior to intervening liens, and section 9-311 specifically contemplates that lien creditors be able to reach debtor surplus in collateral. If the court's view of section 9-201 were accepted, no property could ever be levied where it was possible for a future advance or other future value to come within the security interest.

312 700 F.2d at 862-63.

313 Under Article 9, Aetna would have to surrender any debtor surplus to a lien creditor. U.C.C. § 9-311. "Surplus," of course, is the part of collateral value that is unnecessary to satisfy Aetna's senior indebtedness. Section 9-301(4) indicates that certain unprotected future advances and all other future value give rise to junior security interests. Aetna's attempt to retain the collateral against Dick Warner to secure junior debt therefore would be ineffective. This was essentially the rationale of the Second Circuit's opinion in Dick Warner. See 700 F.2d. at 863 n.4 ("Section 9-311 explicitly limits the power of a secured party to contract around intervening lien creditors.").

In contrast, anti-assignment clauses have been upheld under Connecticut's common law. Lewin & Sons, Inc. v. Herman, 143 Conn. 146, 149, 120 A.2d 423, 425 (1956). Since garnishment is an involuntary assignment of the judgment debtor's chose in action, a scheme to defeat garnishments should be good against a lien creditor as well.

One of the purposes of anti-assignment clauses is to preserve the account debtor's rights of setoff. 1 G. Gilmore, supra note 59, § 7.6, at 214. Although it was not done explicitly, Aetna effectively barred assignments by postponing any of its obligation to repay until such time as the possibility of future setoffs has disappeared.
the time of the commitment. Because Aetna decided to fund the Ecuadorian letter of credit prior to the attachment of the lien, the amount of the potential liability constitutes a senior security interest. The possibility that the commitment may never be enforced in no way alters the fact that the commitment itself is "value" under section 1-201(44)(a). Seniority of this security interest over the judicial lien is established both by the negative implication of section 9-301(1)(b) and by the affirmative statement of section 9-301(4). 314

Furthermore, any prelien collection costs, attorneys' fees or prelien interest would become part of the prelien secured debt and would likewise have priority under the negative implication of section 9-301(1)(b). 315 Any possibility of claims to prelien attorneys' fees, however, was eliminated as of January 11, 1980, when Aetna exercised its right to reduce the secured debt by retention of cash proceeds. 316 As to future collection costs (including attorneys' fees) or interest accruing after January 11, 1980, these claims give rise to postlien security interests that are not protected by section 9-301(4). A security interest associated with these postlien expenses would, in our view, be junior under section 9-301(1)(b). 317

Section 9-301(4) might have provided protection if Aetna had made discretionary advances or postlien commitments to lend without knowledge of the lien, or if Aetna had made discretionary advances within forty-five days of January 11, 1980, regardless of knowledge. Since Aetna made no such advances or commitments, this branch of section 9-301(4) can be ignored.

Because Aetna's commitment to fund the Ecuadorian letter of credit clearly preexisted the creation of Dick Warner's judicial lien, Dick Warner may not use what otherwise would have been a powerful argument. As we said earlier, section 9-301(4) conditions all of its protection on the fact that a person "becomes a lien creditor while a security interest is perfected." U.C.C. § 9-301(4). If no value had been outstanding on January 11, 1980, section 9-301(4) would have given no protection to Aetna. This points up the danger to lenders who extend revolving

314 "A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made . . . pursuant to a commitment entered into without knowledge of the lien." U.C.C. § 9-301(4).

315 Here, the affirmative statement in section 9-301(4) would not apply since it refers only to advances, not attorneys' fees or collection costs.

316 "As of January 11, 1980, Best Banana had no outstanding obligations to Aetna." 700 F.2d at 860.

317 On remand, the district court has taken a contrary position on this point. See No. 80-500, slip op. (D. Conn. Sept. 28, 1983).

318 U.C.C. § 9-301(4) (emphasis added); see supra text accompanying notes 256-61.
credit if they allow the secured debt to be fully repaid. If a lien were to intervene during the time that no value was outstanding, it would be senior to any future discretionary advance, even if extended without knowledge of the lien.\footnote{319}

The Second Circuit opinion raised a difficult question on the scope of section 9-301(4). It suggested that section 9-301(4) should not protect Aetna with regard to its commitment on the Ecuadorian letter of credit. Offered merely as a suggestion and not as a declaration of the law, Judge Newman of the Second Circuit had this to say:

Arguably, section 9-301(4) covers only transactions in which the secured party advances new assets to the debtor and does not allow the secured party to increase its secured interest by assuming liabilities of the debtor, even if bound to assume the liabilities by a prior commitment. The rationale of such a theory would be that the secured party does not injure unsecured creditors when the secured party advances an asset because the debtor’s assets increase by the same amount that the security interest increases following the advance. However, when the secured party assumes an unsecured liability of the debtor, the debtor's assets remain the same after the advance, although those assets remaining unsecured and available to unsecured creditors decrease. We need not and do not now assess this or any alternative theory of section 9-301(4).\footnote{320}

Here, the Second Circuit implicitly addresses the troubling issues raised in the case of \textit{In re E.A. Fretz Co.}\footnote{321} In Fretz, the security

\footnote{319} This principle might be referred to as "lapsed attachment." UCC scholars are reasonably familiar with the concept of "lapsed perfection" and its controversial effect on priorities. See Breitowitz, supra note 101, at 404; Carlson, supra note 132, at 418-19. In light of the "first to perfect or file" rule in section 9-312, lapsed attachment has significance only with regard to lien creditor priorities (and pledges under section 9-312(5)(a)).

For those who think it unjust that a lender extending revolving credit should be vulnerable to intervening lien creditors whenever no secured debt exists, an argument is available for the proposition that attachment never lapses. Section 9-203(1)(b) requires only that "value has been given" before attachment exists. Nowhere does it say that attachment lapses when value is returned by the debtor. Under the presumption of section 9-201, the security interest therefore continues, even though no secured debt exists.

While this argument can be made, one must concede that its validity is metaphysically difficult. A security interest is "an interest in personal property or fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(37) (emphasis added). If no obligation exists, it is hard to see how the security interest can survive. Furthermore, such an argument creates a phantom zone in which all security interests that have ever been paid off live on in ghostly form. Nevertheless, the linguistic argument that attachment never lapses would prevent a lien creditor from breaking up a revolving credit arrangement since section 9-301(4) would always be available to protect discretionary advances made in ignorance of the lien.

\footnote{320} 700 F.2d at 863 n.5.

\footnote{321} 565 F.2d 366 (5th Cir. 1978).
agreement authorized the secured party to buy up general claims against the debtor and to bring the assumed debt under the security umbrella. The economic effect of such an arrangement is quite unacceptable. Under this scheme, on the eve of bankruptcy, general creditors can sell their claims to an unsecured creditor for more than they would receive in bankruptcy. The secured party, in turn, will seek to assert the face value of the claim as part of its secured claim. Such an arbitrage between secured and unsecured creditors is clearly preferential. On this basis, the Fifth Circuit ruled that Article 9 does not countenance the bringing of assumed debt under the security interest in the guise of a future advance.

The Fretz decision seems correct, but the facts of that case should be distinguished from the facts of Dick Warner. Aetna had no similar authority to buy up general claims. Rather, it simply agreed to finance specific letters of credit proposed by the debtor. Without Aetna’s promise to the bank to pay the letter of credit obligation, the bank would not have agreed to extend general credit at all.

The fact that Aetna remitted funds directly to the bank that extended general credit to Best Banana does not make the case analogous to Fretz. The distinction lies in the debtor’s power to decide whether a future advance should be made. In Fretz, the debtor was forced to give up equity in collateral whenever the secured party elected to buy up a general claim from a third party. But in Dick Warner, the debtor had the power to determine when the future

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323 The decision was reached in a priority contest between two secured parties: Revlon and Republic. Revlon, the secured party with the power to bring assumed debt under the security interest, filed first and hence was senior. Revlon took assignments of general claims against the debtor from its own subsidiaries a few days after the petition in bankruptcy had been filed. The court held that Revlon could not claim any security for the assigned debt. Republic, of course, benefited from the elimination of part of Revlon’s senior claim.

It should be noted that federal grounds existed to avoid Revlon’s security interest for the assumed debt. The court could have declared the security interest a fraudulent conveyance in that the security interest was for the purpose of allowing the assignors to obtain a preference. See Dean v. Davis, 242 U.S. 438 (1917). In addition, the postbankruptcy security interests arising from the assigned claims were postbankruptcy transfers of debtor property and hence avoidable by the trustee. Bankruptcy Act of 1898, ch. 541, § 70(d), 30 Stat. 544, 566. This latter view depends upon whether Texas, which then was governed by the 1962 version of the UCC, followed the Coogan view as opposed to the Gilmore view, on whether future advances related back to the original advance. See supra text accompanying notes 255–59. If the Fifth Circuit had used federal law to invalidate Revlon’s security interest for the assumed debt, Republic would not have been the beneficiary. Instead, the sums would have been recovered by the trustee for the benefit of the estate. Act of July 7, 1952, Pub. L. No. 82-456, ch. 579, § 67(d)(6), 66 Stat. 420, 429. Preservation of voided liens for the benefit of the estate permits the trustee to assert the priority that is accorded to the defeated creditor under state law.
advance would be made and when equity in collateral would be given up. This policy of keeping the debtor from surrendering power to creditors well in advance of the true moment of decision has other antecedents in Article 9. For example, the debtor may give only limited after-acquired property interests in consumer goods and may not agree to strict foreclosure until after default. Fretz can be seen as providing an analogous rule with regard to future advances.

It therefore will be unfortunate if the Second Circuit does not draw a distinction between Fretz and Dick Warner on the basis of the debtor’s continuing power over the increase in the size of the security interest.

“"No security interest attaches under an after-acquired property clause to consumer goods other than accessions (Section 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value." U.C.C. § 9-204(2).

Although we have attempted to distinguish Fretz from Dick Warner on the basis of the debtor’s control over the decision whether the advance should be made, we have by no means settled the voidable preference problems that Fretz raises. Where the advance does not travel through the debtor, courts have held that sums received by the assignor from the assignee cannot be recovered by the debtor’s trustee. In addition, security taken by the assignee from the debtor is not a voidable preference because it is a contemporaneous exchange of values and not a transfer on antecedent debt. See Dean v. Davis, 242 U.S. 438, 443 (1917). Instead, the trustee must rely on less satisfactory fraudulent conveyance theory, i.e., the secured party was participating in a conspiracy to prefer a creditor in light of an obviously impending bankruptcy. Id. at 445. These preference issues are as difficult as they are venerable. For our purposes, it is important merely to preserve accounts receivable financing from an overbroad reading of Fretz.

The Second Circuit’s suggested reading of section 9-301(4) risks a replay of the Twist Cap controversy, this time within the confines of Article 9. See In re Twist Cap, Inc., 1 Bankr. 284 (Bankr. M.D. Fla. 1979). In that case, a bankruptcy court ruled that the automatic stay in bankruptcy enjoined a bank from honoring its letter of credit when the beneficiary presented the appropriate documents. The bankruptcy court reasoned that if the beneficiary exercised its rights under the letter of credit, the bank, which held a security interest securing its obligations under the letter, would be able to collect its security from the debtor’s estate, thereby prejudicing general creditors.

The injunction drastically changed the position of the beneficiaries under the letters of credit. They had sold their goods on credit, assuming that, in economic effect, the bank had guaranteed that credit risk. The injunction transferred to the beneficiaries a credit risk they had not bargained for. The letter of credit transactions placed the risk of the debtor’s insolvency on the bank. The injunction transferred that risk to the beneficiary of the letter of credit.


In Dick Warner, once Aetna committed itself on the Ecuadorian letter of credit, it in effect, played the same role as did the bank in Twist Cap. Aetna has agreed with both the creditor and the debtor that if the debtor does not pay the creditor, Aetna will make the creditor whole and look to its security interest for reimbursement. A ruling that Aetna cannot bring assumed debt under a security agreement would duplicate the result in Twist Cap except that the ultimate loser would be the equivalent of the bank, not the equivalent of the beneficiary. (Even though Aetna merely guaranteed the bank’s letter of credit, it can easily be seen that Aetna’s inability to
The district court, on remand, has rejected much of the above analysis. It has asserted that no valid economic distinction exists between future advances and future value of other sorts,\(^{328}\) and it has held that Aetna is entitled to protection for attorneys’ fees generated after the lien attached to the $45,000 surplus.\(^{329}\) We believe, however, that there are several differences, economic and otherwise, to justify a distinction between advances and other value. First, as we have pointed out, the distinction is based on the plain meaning of section 9-301(4) and other parts of Article 9.\(^{330}\) Second, as the Second Circuit pointed out, future advances replenish the estate of the debtor, while accrued interest and attorneys’ fees do not.\(^{331}\) The distinction could therefore be viewed as a compromise between the needs of general creditors (who, by acquiring liens, hope to protect themselves from diminution of the debtor’s estate) and the needs of secured parties (who wish to give future advances without having to undertake new investigations of the debtor’s situation). Future accrued interest and even future attorneys’ fees do not demand the same type of investment decision required by future advances and therefore are not deserving of the same degree of protection.\(^{332}\) Third, the debtor has control over

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\(^{328}\) No. 80-500, slip op. at 8 (“It would make no economic sense to distinguish between payments made under a liability and payments made to avoid incurring that liability.”).

\(^{329}\) Id. at 8-9.

\(^{330}\) See supra text accompanying notes 279-83.

\(^{331}\) 700 F.2d. at 863-64. One exception to this reasoning concerns expenses that preserve the value of the collateral. Since such expenses presumably do not diminish the estate, they should receive greater protection from lien creditors. Lien creditors should not be able to foist postlien preservation costs upon the secured party, just as secured parties should not be able to foist accrued interest and the cost of their own attorneys upon the lien creditor. Unfortunately, the statutory apparatus for drawing such a distinction does not exist. Of course, where the sheriff must seize the property to create the lien, there will ordinarily be no postlien preservation costs by the secured party. In any case, prelien preservation expenses are certainly protected, and postlien expenses can be expected to be minimal.

\(^{332}\) The court characterized Aetna’s attorneys’ fees as “necessary and nondiscretionary on its part.” No. 80-500, slip op. at 8. They are undoubtedly well spent, since Aetna can avoid a loss of $1,000,000 if the Ecuadorian letter of credit against which it is defending can be broken. But whether Aetna will make this investment is not affected by the interpretation of section 9-301(4) so much as by the amount of loss that can be avoided by investment in litigation.
whether to receive future advances, whereas it has no control over whether the secured party incurs litigation expenses. Our analysis of *Fretz* shows that growth in the secured obligation that is beyond the debtor’s control is generally less worthy of protection than are future advances, which the debtor can elect to receive or not. Fourth, the district court is not equating attorneys’ fees with future advances at all, since discretionary future advances that are made after forty-five days and after acquisition of knowledge of the lien are never afforded seniority. Rather, the court is equating Aetna’s decision to defend itself with its prelien commitment to lend. Attorneys’ fees and commitments do not deserve the same level of protection. Commitments to lend deserve protection because they represent investment decisions that are based on the absence of outstanding liens. The secured party should be able to make the advance on a senior basis even if a lien intervenes. Otherwise, his earlier investigation will have been meaningless, and commitments will become promises too dangerous to make. Protection of commitments helps to preserve a useful benefit to debtors. Postlien attorneys’ fees and accrued interest are creditor benefits that, if senior, lien creditors will pay for. Whereas a case can be made for protecting an investment commitment—commitments enhance the debtor’s estate—attorneys’ fees and interest merely deplete the estate and therefore do not merit protection.

For the above reasons, it is inaccurate to view the distinction between future advances and other future value as irrational or erroneous.

Dick Warner contains one last puzzle and warning for a secured creditor with a revolving loan arrangement. Aetna’s security arrangements raise the question whether Aetna had a perfected security interest in its collateral. The property in which Aetna claims a security interest is its own debt due to Best Banana. Section 9-306(3) provides that, once a filing covers original collateral, a security interest in identifiable cash proceeds is perfected continuously. Certainly Aetna made such a filing. The trouble is that the proceeds—Aetna’s obligation to Best Banana—may not technically be cash proceeds. Cash proceeds are defined in section 9-306(1) as “[m]oney, checks, deposit

Nevertheless, any disadvantage to secured parties will result in some theoretical increase in the cost of secured credit (which, of course, will be offset to some degree by the decrease in the cost of unsecured credit). Nevertheless, Aetna’s decision on how much to invest will undoubtedly be more efficient if Aetna is not subsidized by virtue of the competing lien creditor’s being squeezed out through Aetna’s senior expenditures.

333 See supra text accompanying notes 321-26.
accounts, and the like." Aetna may be able to prove the money is still "identifiable" by use of equitable tracing rules. But if tracing is impossible, it is hard to see how Aetna's personal obligation to return the surplus falls within the category of cash proceeds. If not, Aetna must rely on some other perfecting alternative under section 9-306(3). For example, if Aetna included general intangibles in its security agreement and its original financing statement, then it would have a perfected security interest in its own debt to Best Banana. Without a perfected claim to this somewhat unusual general intangible, the security interest is unperfected, and the judicial lien is senior.

4. Some Concluding Remarks on Obligatory and Discretionary Future Advances

Section 9-311 allows lien creditors to reach the debtor's equity in collateral, a practice that would not necessarily have been allowed prior to the adoption of the UCC. But while section 9-311 makes the

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333 “Deposit account” is defined in section 9-105(1)(e) as a “demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit.” The obvious flavor of this definition is that the debt must be owed by a chartered lending institution. Of course, the ambiguous words “or the like” in section 9-306(1)—and similar words in the definition of “deposit account”—give some license to expand the definition of cash collateral to include the secured party's general obligation to retain any surplus.

334 See Citicorp (USA), Inc. v. Davidson Lumber Co., 718 F.2d 1030 (11th Cir. 1983). In this case, the debtor used identifiable cash proceeds to purchase a certificate of deposit. The certificate of deposit was held not to be “cash proceeds” within the definition of section 9-306(1). Hence, the secured party had an unperfected security interest in the certificate of deposit that was avoidable in the debtor's bankruptcy.

335 See U.C.C. § 9-306(3)(a). Aetna's obligation to repay the surplus is not an “account” of Best Banana. See id. § 9-106 (“[a]ccount means any right to payment for goods sold or leased or for services rendered”). Hence, the fact that the financing statement lists accounts as part of the collateral is of no assistance to Aetna. Aetna's obligation to repay the surplus seems to be a "general intangible." See id.; D. Baird & T. Jackson, supra note 84, at 678 (“From the perspective of Article 9, each [side in a set off situation] holds a general intangible that represents the debt owed by the other.”). Aetna has a continuously perfected security interest in its own obligation to pay Best Banana only if the financing statement mentions "intangibles" as part of the collateral.

Even if the financing statement does not cover general intangibles, it is still possible that Dick Warner's lien attached to the intangible during the 10 days the security interest was perfected. If so, the court might have to determine whether lapsed perfection has a retrospective effect (in which case Dick Warner wins) or only a prospective effect. Compare U.C.C. § 9-103(1)(b)(i) (lapse after interstate removal of collateral is prospective only as to lien creditors) with id. § 9-403(2) (lapse after five years is entirely retrospective). Section 9-306 is silent on the issue. In light of the bankruptcy implications, i.e., the trustee's hypothetical lien creditor status on the day of bankruptcy, the better view is prospective lapse only.

336 See Carlson, supra note 121.
debtor's equity in collateral available to lien creditors, section 9-301 gives secured parties the power to diminish that same equity by making advances after these liens arise. This is the case for forty-five days even where the secured party with full discretion not to lend has been notified of the lien and therefore can protect himself simply by not advancing funds. Section 9-307(3) provides some help where a buyer at a sheriff's sale is involved. No discretionary future advance is allowed after the secured party is notified of the sale. But this section is of no help where intangibles are garnished (so that there is no sale) or where, prior to the sale, there has been a commitment to lend.

The secured party who has given a commitment obviously needs protection. But the reasons for seniority for these security interests are only as strong as the secured party's commitment. The definition of "commitment" is quite loosely written. According to section 9-105(k):

An advance is made "pursuant to commitment" if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation . . . .

This provision allows a secured party to extend a commitment with one hand and, by means of a broad default clause, to deny the advance if it is ever requested. For example, he can stipulate that default occurs when the secured party deems himself insecure.\(^339\) In such a case, he can refuse to honor his commitment, if necessary, but can play "dog in the manger" to the lien creditor so long as the debtor refrains from asking for an advance.\(^340\) Thus, the lien creditor can be nearly as ill-treated by obligatory advances as by discretionary advances; he is prevented from reaching the debtor's equity in property by virtue of a loan that has not been and may never be advanced.

The future advance rules of Article 9, then, conflict to some degree with the policy of section 9-311. Under the current UCC, a perfected secured party with a discretionary power to lend can, for forty-five days, destroy the debtor's equity that section 9-311 makes unavailable to lien creditors. A perfected secured party with an unexercised binding commitment to lend can insulate collateral indefi-

\(^339\) This depends on whether the words "not within his control" in section 9-105(k) apply to "subsequent event of default" as well as "other event." If not, the accrual of a lien on the collateral can clearly be an event of default and is all that is necessary here to confound lien creditors.

nately from claims by lien creditors. We believe the conflict between section 9-311 and section 9-301(4) should be resolved by amendments to the UCC that vindicate the policy of section 9-311. We see no reason why a perfected secured party with knowledge of a lien who has discretion not to make advances deserves any protection from the lien creditor. The forty-five day window that now exists should be abolished.

The perfected secured party whose commitment is significantly under his own control presents a more difficult problem. The problem here is to distinguish between real commitments and essentially voluntary advances and to do so in a way that does not turn every case into an issue of fact. We would suggest that existing security agreements contain language that will, in most cases, solve the problem. The existence of the lien is itself a common event of default. The difficulty is, that under many security agreements, the existence of an event of default does not necessarily create a default. Only a declaration by a secured party can do that. Our proposal is that once an event of default has occurred, the secured party who knows of the lien cannot thereafter choose to ignore the event of default. We propose that the UCC be amended so that as between the lien creditor and the knowledgeable secured party, the lien creditor takes priority over the secured party with respect to advances made after the secured party knows of the lien and after an event of default under the security agreement has occurred. In addition, an event of default that is based on the secured party's own state of mind as to the investment risk should be deemed to have occurred whenever a judicial lien has attached to the collateral, so that secured parties with knowledge of the lien cannot use the existence of a pseudo-commitment on behalf of the debtor to keep away lien creditors.341

341 Our proposals could be instituted by substituting the following for the existing text of section 9-301(4):

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances and other value made before he becomes a lien creditor or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien, except that a lien creditor has priority over advances made pursuant to a commitment to lend (Section 9-105(k)) whenever the advance is made after the secured party has knowledge of the lien and after an event of default has occurred. For the purposes of this subsection, when an event of default is totally dependent upon the secured party's good faith belief that the prospect of payment or performance is impaired, it is deemed to have occurred whenever a person has become a lien creditor with regard to the collateral.

Part II of this Article will appear in 5 Cardozo L. Rev. (forthcoming Summer 1984)