Bulk Sales Under Article 9: Some Easy Cases Made Difficult

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BULK SALES UNDER ARTICLE 9: SOME EASY CASES MADE DIFFICULT

David Gray Carlson*

"[T]he path of the law leads not to the revelation of truth but to the progressive discovery of infinite complexity."

Grant Gilmore**

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* Professor of Law, Benjamin N. Cardozo School of Law, Yeshiva University. Thanks to Jeanne L. Schroeder and Paul Shupack for reading an earlier draft of this article.
Each Article in the Uniform Commercial Code (UCC) has its unique grammar, and, whenever coverage overlaps, translation has proven difficult. Some of the most useful work in commercial law scholarship tries to reconcile the separate grammars in the areas of overlapping coverage. The collision between Article 6 (bulk sales) and Article 9 (security interests in personal property) is the subject of a particularly strong essay by Steven L. Harris,1 who has ex-

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1. Harris, The Interaction of Articles 6 and 9 of the Uniform Commercial Code: A Study in Conveyancing, Priorities, and Code Interpretation, 39 Vand. L. Rev. 179 (1986). Although my comments will often tend to a critical mode, I wish to state that Harris's article is excellent commercial law scholarship indeed. His article is brimming with cleverness and insight. Many times I found myself initially disagreeing with a proposition, only to be won over by Professor Harris's careful argumentation. Countless times Harris's article has saved me from making mistakes in the analysis that is about to proceed.

However, having been invited to join this symposium in order to write on the same subject as Professor Harris, I can't just agree with him on each and every issue, can I? It is incumbent upon me to find some things to disagree with. Accordingly, my essay tends to magnify the tiny areas of disagreement and may give the wrong impression about Harris's
haustively analyzed every problem that might arise in priority disputes between the secured creditors of bulk sellers and bulk buyers\(^2\) (together with their various transferees). Professor Harris's findings on these priority contests are summarized in Figure One:

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work. In an effort to counteract this impression, whenever I have set forth a conceptual idea that was developed first in Harris's article, I have endeavored to give his article credit in the footnotes. Undoubtedly, I have not done this enough. There are very few stones left unturned by Professor Harris's treatment of this subject.

2. One isn't supposed to use the phrase "bulk buyers" under the UCC. One has to say "bulk transferee." U.C.C. § 1-201(9) (1987) ("Buying . . . does not include a transfer in bulk"). The new Article 6 would change this. It refers generally to buyers and sellers. See U.C.C. Article 6 (1988). This new Article 6 fails to amend UCC section 1-201(9), so that buying still does not include a transfer in bulk, even while Article 6 refers to "buyers" in bulk. The new Act also fails to amend the references to "transferee in bulk" that appear in section 9-301(1)(c) and section 9-301(2). In the spirit of the revisions, and because I don't see how it matters much, I will refer to "buyers" or "transferees" in bulk indiscriminately.

Incidentally, some courts have found that the exclusion of bulk transferees from the definition of "buyer" has substantive significance. Thus, where bulk transferees claim to have taken free of inventory security interests under UCC section 9-307(1), courts have said that bulk transferees are not buyers and therefore are not entitled to the protection of section 9-301(1). E.g., Bank of the West v. Commercial Credit Fin. Servs., Inc., 852 F.2d 1162, 1169-70 n.6 (9th Cir. 1988). These courts could also have said that bulk transferees are buyers, but not buyers in the ordinary course of business. Such reasoning also would have disqualified the use of section 9-307(1) by bulk transferees.

I am compelled to admit, however, that there is one substantive difference caused by excluding bulk transferees from the concept of buyer. This difference is felt with regard to the priority of discretionary future advances.

Suppose \(S\) and \(SP_1\) agree that certain collateral will serve as collateral for any discretionary advance \(SP_1\) may choose to give. If \(S\) has sold the collateral to \(B\) (out of the ordinary course of business) and if \(SP_1\) is senior to \(B\), \(SP_1\) may give senior advances—i.e., advances that encumber \(B\)'s newly bought property—until \(SP_1\) learns of the sale. This privilege runs out after forty-five days, however. That is, the privilege has a maximum life of forty-five days. U.C.C. § 9-307(3) (1987).

Suppose, though, that \(B\) is a bulk transferee. According to section 1-201(9), "[b]uying . . . does not include a transfer in bulk." If taken literally, \(SP_1\) does not have the forty-five day privilege described in section 9-307(3). What then is the status of \(SP_1\)'s discretionary future advances?

One answer would take this definition of "buyer" seriously and would play upon the fact that the forty-five day privilege was added in the 1972 amendments to the UCC. Accordingly, one should apply whatever privilege existed before 1972 to bulk transferees. Unfortunately, the status of the future advance prior to 1972 was opaque. One group said that discretionary advances simply expanded the old security interest and did not create a new one. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 35.6 at 937-38 (1965) (asserting that no difference exists between a nondiscretionary future advance and a discretionary one). Another thought each new discretionary advance created a new security interest with a different priority from the ones associated with other advances. 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) (in case of a discretionary future advance, attachment is deferred). One major clue that existed as of
Bulk Sales:

<table>
<thead>
<tr>
<th>Security interest granted by seller:</th>
<th>Complying Buyer</th>
<th>Noncomplying Buyer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perfected</td>
<td>Secured party wins</td>
<td>Secured party wins</td>
</tr>
<tr>
<td>Unperfected</td>
<td>Buyer wins if no knowledge of security interest</td>
<td>Secured party wins whether or not the buyer has knowledge of the earlier security interest</td>
</tr>
</tbody>
</table>

Figure One

1962 appeared in the old fixture priority section. Under the 1962 version of section 9-313(4)(c), discretionary future advances under real estate mortgages had separate priorities. U.C.C. § 9-313(4)(c) (1962). Similarly, the 1962 version of the accession section (still in effect) also applies different priorities to each discretionary future advance. U.C.C. § 9-314(3) (1987). Therefore, if these provisions are evidence of the true pre-1972 rule, and if we apply them to bulk transferees, $SP_1$ may give no future advances after a bulk sale—at least when the purchaser complies with the rules of Article 6. This seems fair. Article 6 compliance implies that $SP_1$ has received full notice and therefore will know not to give any future discretionary advances on the strength of $B$'s collateral. See infra text accompanying notes 55-60. This puts bulk buyers and other buyers on exactly the same footing—both are free of discretionary future advances once the secured party knows the transfer has occurred.

A separate answer simply ignores the definition of “buyer” in section 1-201(9) and applies the rule of section 9-307(3) to bulk transferees. This is justified by the fact that the newly revised version of Article 6 uses the word “bulk buyer,” in spite of section 1-201(9). In addition, the definition of “buying” quoted above appears in a section that commences with the definition “buyer in the ordinary course of business.” It should be possible to argue that the definition of “buyer” that excludes bulk transferees is effective only with regard to the phrase “buyer in the ordinary course of business.” This would allow us to maintain that bulk transferees can be buyers out of the ordinary course of business. On the other hand, this latter point—ignoring section 1-201(9)—must in turn ignore the fact that, in section 9-301(1)(c), buyers out of the ordinary course of business and bulk transferees are treated as mutually exclusive categories.

Bulk transferees are not the only fly in the ointment with regard to discretionary future advances. According to section 9-307(3), only buyers out of the ordinary course of business are subject to the forty-five day rule. Buyers in the ordinary course of business are immune from this privilege—or are subject to the pre-1972 rules, whatever they may be. The drafters of the 1972 amendments thought that this posed no problem because buyers in the ordinary course of business take free of future advances—and free of any perfected security inter-
Figure One represents a legal system that Harris would prefer. Unfortunately, the doctrinal materials are in rebellion in each and every one of the four quadrants presented.  

Let us quickly review this Cartesian domain. In the northwest quadrant, a perfected secured party faces a complying buyer. Professor Harris takes the position that the security interest should survive the bulk sale, a position for which he has strong statutory support. Yet, a recent opinion from the Fifth Circuit states that a buyer who complies with Article 6 takes free of all earlier perfected security interests. In *National Bank of Texas v. West Texas Wholesale Supply Co. (In re McBee)*, a noncomplying buyer took inventory encumbered by perfected security interests. The court held that the perfected security interests had priority over the noncomplying bulk buyer (although only for six months!). The Fifth Circuit's comments about a complying buyer therefore can be contemned as mere dictum. Professor Harris, in his article, spends a great deal of time pulverizing this dictum. Perversely, I will defend *McBee* as better commercial law than Professor Harris would give credit for. I will claim that the *McBee* case protects secured parties adequately well and responds to an unfortunate "double recovery" effect that the "proceeds" provision of Article 9 has.

The southwestern quadrant of Figure One should have been a placid desert. If a complying buyer has no knowledge of an earlier unperfected security interest, then the complying buyer should win. Not so according to the Second Circuit in *Aircraft Trading &
In this case, a debtor sold collateral to a buyer with no knowledge of the unperfected security interest. Later, the secured party did perfect. When the buyer sold to a subsequent buyer, the secured party now had priority.

This case is undeniably bad commercial law. Every commercial law scholar knows of opinions like this, in which judges, unfamiliar with the arcane grammar of commercial law, make a complete incoherent mess of the case before them. It is my belief that commercial law is subject to an implicit paradigm which case law must honor. If case law is within this paradigm, the precedent is honored and subsumed. If bad cases fall outside of the paradigm, then they become alms for oblivion, subject to a grand unspoken conspiracy whereby the precedent is simply forgotten. Indeed, articles like this one are positive dangers in this process, because, by discussing bad cases, it becomes more difficult to pull off the process of forgetting. In other words, if a commercial law opinion is a disaster, for heaven’s sake don’t write a law review article about it! Rather, let the natural process of forgetting take its course. Hence, this Article is built on a certain contradiction, being both dedicated and indifferent to high quality commercial law.

In the northeast quadrant of Figure One, a perfected secured party faces a noncomplying buyer. To put it another way, the hero of Article 9 faces the villain of Article 6. Predictably, the hero loses and the villain wins, at least in the long-term, in that the hero is given a very short statute of limitations. According to the pesky McBee court, the six-month statute of limitations in Article 6 applies to perfected security interests. On the other hand, if the secured party does beat the short statute of limitations, the same case holds that the secured party not only gets the inventory actually transferred in the bulk sale, but a bonus—any inventory the

and receives delivery of the collateral without knowledge of the security interest and before it is perfected.”

noncomplying buyer acquires thereafter.\textsuperscript{12} Or, in other words, the buyer becomes liable on the seller's after-acquired property clause, even though the buyer did not expressly agree to be liable.

The southeast quadrant in Figure One contains the only genuine analytical puzzle. In this quadrant, neither the bulk buyer nor the secured party has fulfilled the obligations imposed by Article 6 and Article 9. Even here, we can be confident that, where the noncomplying buyer knows of the earlier unperfected security interest, the unperfected secured party clearly has priority\textsuperscript{13}—at least for six months.\textsuperscript{14} But if the noncomplying buyer is in good faith in all respects except for complying with the rules of Article 6—that is, if she is a noncomplying buyer without knowledge of the earlier unperfected security interest—the proper priority is difficult to fathom, because neither the unperfected secured party nor the Article 6 noncomplying buyer has done what the law demands. As to this priority puzzle, I will take issue with Professor Harris's solution. He would say that the buyer destroys the unperfected security interest under Article 9,\textsuperscript{15} but Article 6 resuscitates the dead security interest and saves the secured party.\textsuperscript{16} I will attempt to show that this solution is founded upon a contradiction. Instead, if the unperfected secured party is to win out, it must be on a theory Harris explicitly rejects (but implicitly accepts). The theory must be that a bulk buyer who fails to comply with Article 6 is not a bulk buyer at all, within the meaning of Article 9.

These quadrants represent the four categories of possible priority disputes. We now proceed through them, one at a time.

\textsuperscript{12} Id. at 1331.

\textsuperscript{13} See U.C.C. § 9-301(1)(c) (1987). Later, we will see that some authorities insist that bulk transferees who fail to comply with Article 6 are not bulk transferees at all, for the purposes of section 9-301(1)(c). See infra text accompanying notes 267-289. If this principle is followed, then section 9-301(1)(c) cannot establish the priorities. Some other principle must be found. According to this other principle, the bulk transferee always loses to an unperfected secured party, whether knowledgeable or not of the existence of any security interest. This result is dictated by the residual rule in section 9-201, which provides that secured parties always win unless some specific provision of the UCC says otherwise. See U.C.C. § 9-201 (1987). If a would-be bulk transferee cannot use section 9-301(1)(c) because she is not really a bulk transferee by virtue of having failed to comply with Article 6, then no other provision gives her priority either. Accordingly, the unperfected secured party always has priority.

\textsuperscript{14} The short statute of limitations is the dubious conclusion of the McBee court. McBee, 714 F.2d at 1328.

\textsuperscript{15} Harris, supra note 1, at 205.

\textsuperscript{16} Id. at 208.
I. The Perfected Secured Party and the Complying Buyer

In the northwest quadrant of Figure One, a secured party has a perfected security interest in inventory. Thereafter, the debtor sells the inventory to a buyer in a bulk sale. Under Article 9, buyers and any sub-transferees take subject to perfected security interests, unless the secured party authorizes the sale (i.e., waives the security interest). The only chance, then, for showing that bulk sales terminate perfected security interests (when the buyer has complied with the requirements of Article 6) depends on whether secured parties authorize such sales simply by virtue of acquiescing and letting the sale proceed without protest.

Professor Harris thinks this case cannot be made. According to Harris, Article 6 puts only burdens on bulk buyers. If Article 6 were to allow a complying bulk buyer to take free of a perfected security interest, it would be affirmatively rewarding buyer compliance by giving the buyer more than she would have had as a regular buyer.

A. The McBee Case

Harris asserts these views in the course of criticizing Judge Jerre Williams's bacchantic opinion in National Bank of Texas v. West Texas Wholesale Supply Co. (In re McBee). In this case, a noncomplying buyer bought already encumbered inventory from a seller. Subsequently, the buyer granted a security interest in the inventory to her own lender, so that we had the situation presented in Figure Two:

17. U.C.C. § 9-306(2) (1987) ("Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale . . . "). There are exceptions to this rule. Buyers of inventory in the ordinary course of business, buyers of consumer goods (where perfection is not by filing), and any buyer against whom a security interest for a future advance is claimed can each take free of the relevant perfected security interest. U.C.C. § 9-307 (1987). Also, a security interest dies if the secured party waives it. U.C.C. § 9-306(2) (1987). Whether this occurs when a bulk buyer complies with Article 6 is discussed infra in the text accompanying notes 47-64.
19. Harris, supra note 1, at 201.
20. 714 F.2d 1316 (5th Cir. 1983).
In *McBee*, Judge Williams, writing for the Fifth Circuit Court of Appeals, decided that the perfected security interests of SP$_1$ (an inventory lender)$^{21}$ and SP$_2$ (a purchase money lender on inventory)
tory who also claimed after-acquired inventory and accounts receivable) survived the sale and hence both had priority over B.

was no "partnership by estoppel" because evidence did not "preponderate in its favor." In re McBee, 20 Bankr. 361, 363 (Bankr. W.D. Tex. 1982). This holding did not leave Judge Elliott with a theory as to how SP1's security interest might attach to S's inventory.

When the Fifth Circuit reversed and found that SP1 did perfect after all, then a theory was needed as to how S could be bound on an agreement he did not sign. Therefore, some sort of agency-principal relationship must have existed between B and S. Partnership by estoppel seems as good a way to put it as any. See K.N.C. Wholesale, Inc. v. AWMCO, Inc., 56 Cal. App. 3d 315, 319-320, 128 Cal. Rptr. 345, 348 (1976) ("[A] debtor who does not own collateral may nonetheless use the collateral for security, thereby obtaining 'rights in the collateral,' when authorized to do so by the actual owner of the collateral."); Bank of the West v. Commercial Credit Fin. Servs., Inc., 655 F. Supp. 807, 813 (N.D. Cal. 1987), rev'd on other grounds, 852 F.2d 1162 (9th Cir. 1988) (even if bulk seller was never the owner of the assets, it had authority from the real owner to create a security interest in the assets).

In any case, the Fifth Circuit reversed and ruled that SP1 had successfully perfected.

Judge Williams read section 9-402(7) as saying only this: if you file under the name of an individual partnership or corporation, then you need not also list the trade name. Judge Williams did not read this provision as preventing filing under a trade name in lieu of other names. McBee, 714 F.2d at 1321-22. Instead, he thought that you could file under a trade name if not misleading. See 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."). To reach such a conclusion, Judge Williams had to overcome this official comment:

U.C.C. § 9-402 comment 7 (1987). Judge Williams had no problem avoiding this formidable obstacle. He thought "this comment enunciates the general rule that . . . filing under a trade name is insufficient. This principle, however, cannot be applied blindly without reference to the overriding purpose it seeks to serve." McBee, 714 F.2d at 1323. Thus, according to Judge Williams, when trade names are certain, you can file under them. Accord Brushwood v. Citizens Bank of Perry, 642 F.2d 793 (5th Cir. 1981). This was especially true because S and B, in the bulk sale, had signed an agreement that provided that S is to sell "any partnership interest," "Oak Hill Gun Shop," and would have found SP1's financing statement.

22. SP2, a trade creditor, took a purchase money security interest on the inventory supplied, plus a security interest in other existing and after-acquired inventory and accounts receivable. Bankruptcy Judge Elliott ruled (with some justification) that SP1 was unperfected and hence SP2 had priority. See McBee, 20 Bankr. at 363; supra note 21. When SP1 was saved on appeal, an issue might have arisen concerning the comparative priority of SP1 and SP2. To the extent that SP2 could still trace its purchase money collateral, SP2 should have had priority as to these items of collateral. This was simply ignored because, according to Judge Williams, SP2 "does not assert such priority. It concedes that it took its security interest subject to [SP1's] prior interest and should have second priority." McBee, 714 F.2d at 1325 n.9. One hopes that the collateral was adequate to cover the claims of both SP1 and SP2, so that it would be unnecessary to figure out which of the two had priority; or
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and hence over \( SP_3 \)'s security interest as well.\(^{29}\) But in the course of ruling that \( SP_1 \) and \( SP_2 \) had priority, Judge Williams set forth a controversial view of how Article 6 works. According to Williams, if the buyer had complied with the rules of Article 6, then the perfected security interests of \( SP_1 \) and \( SP_2 \) would have been destroyed, and the buyer would have owned the collateral free and clear.\(^{24}\)

Here is the way Judge Williams sees it:

In the absence of a bulk sales law, creditors generally would lose all security interests in collateral once transferred to a new owner; the secured creditor's recourse would lie against the debtor-transferor, including an interest in any proceeds received by the transferor from the bulk sale.\(^{25}\)

This assessment of what the law would look like in the absence of Article 6 is roughly correct as to unsecured creditors,\(^{26}\) but not correct with regard to secured creditors.\(^{27}\) At least when inventory is sold within the ordinary course of business, a perfected security

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23. It actually went further and said that \( SP_1 \)'s security interest covered not only the inventory conveyed by the seller to the buyer but subsequent inventory the buyer acquired after the sale. This aspect of the opinion is criticized by Harris, supra note 1, at 232, and will be more or less defended \textit{infra} in the text accompanying notes 113-22.

24. Initially, the lawyers for \( SP_1 \) and \( SP_2 \) missed the Article 6 issue altogether. Bankruptcy Judge Elliott added it on the basis of allegations by \( SP_1 \) and \( SP_2 \) that they were not notified of the sale. \textit{In re McBee}, 20 Bankr. at 364. Thereafter, McBee became primarily an Article 6 case.

25. \textit{McBee}, 714 F.2d at 1327 (footnotes omitted).

26. General creditors have \textit{in rem} rights against \( B \) under fraudulent conveyance law, so that, even as to them, Judge Williams is misdescribing the significance of bulk sales law (unless he views fraudulent conveyance law as subsumed in bulk sales law).

27. Judge Williams's idea that Article 6 compliance allows a bulk buyer to be senior to prior perfected security interests comes from a misreading of the best-selling commercial treatise by James J. White and Robert Summers, who write, "In the absence of a bulk sales law a transferor's creditors are generally not entitled to levy or the like on assets the transferor has sold to a new owner." \textit{J. WHITE \& R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE} 768 (2d ed. 1980). As Steven Harris shows, White and Summers meant only general creditors in this passage, not secured parties under Article 9. Harris, supra note 1, at 197.
interest will survive the sale.\textsuperscript{28} Be that as it may, Judge Williams explains the effect of Article 6 as follows:

Article 6 of the U.C.C., \textit{as adopted by Texas}, changes the relative position of the parties affected by a bulk sale. \textellipsis{} Article 6 places certain requirements upon the parties to the bulk sale. These requirements serve to notify the transferor's creditors of the intended sale, thus permitting the creditors to protect their security interests \textit{before} the transfer. They also protect the transferee and his subsequent creditors by bringing to light and terminating all prior security claims to the transferred property.

Had Article 6 been complied with, [\(SP_1\) and \(SP_2\)] would have retained no interest in the gun shop in McBee's hands.\textsuperscript{29}

Professor Harris finds this point of view egregiously wrong.\textsuperscript{30} Nevertheless, a little something might be said on behalf of the McBee dictum quoted above.

\textbf{B. Implications of the Strong Version of Article 6}

Texas is among the minority of jurisdictions that has adopted the "strong" version of Article 6. In the strong version, the buyer in bulk has the responsibility to retain the proceeds for the creditors of the seller. Thus, in Texas:

\begin{quote}
Upon every bulk transfer subject to this chapter for which new consideration becomes payable \textellipsis{} it is the duty of the transferee to assure that such consideration is applied so far as necessary to pay those debts of the transferor which are either shown on the list furnished by the transferor (Section 6.104) or filed in writing in the place stated in the notice (Section 6.107) within thirty days after the mailing of such notice.\textsuperscript{31}
\end{quote}

This provision implies that the transferee must keep control of the funds until the creditors are paid. And since these funds are cash proceeds belonging to the perfected secured party, they should be

\begin{itemize}
\item \textsuperscript{28} "Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale \textellipsis{} unless the disposition was authorized by the secured party. \textellipsis{}" U.C.C. § 9-306(2) (1987).
\item \textsuperscript{29} McBee, 714 F.2d at 1327-28 (emphasis added in part).
\item \textsuperscript{30} Harris, \textit{supra} note 1, at 196-201.
\end{itemize}
used to pay down the secured debt, thereby guaranteeing that the security interest is retired. This is what the McBee court may have meant when it thought that Article 6 compliance resulted in the termination of perfected Article 9 security interests.

The McBee view might be defended as asserting the following maxim: a secured party should have a property right to cash proceeds if the security interest has been destroyed in a “free and clear” sale to some transferee. Otherwise, if the sale is made subject to the security interest, the secured party should have no right to cash proceeds.32

Under Article 9, the secured party gets a double entitlement of sorts—a continuing security interest and cash proceeds.33 Suppose collateral is worth $100, and the secured party claims $50. In such a case, a rational buyer with knowledge of the security interest would pay the debtor $50 for her equity. A reasonable person could argue that, if the collateral is still available to the secured party, the secured party should have no claim against the $50 the debtor received. But Article 9 does allow the secured party to have both a continuing security interest (for $50) on the collateral and a right to the $50 cash proceeds a buyer is likely to pay in.34 Thus, before the sale, the secured party had $100 in collateral. After the sale, the secured party has $150 in collateral. Now if the $50 in cash is freely available to the secured party, there is no reason to also allow the secured party to go after the buyer’s property. McBee can be seen as a rebellion against this situation under Article 9. That is, since (the strong version of) Article 6 requires the bulk buyer to hold the cash proceeds for the secured party, the secured party should receive cash proceeds only, and not a surviving security interest.

Several objections to this defense of McBee might be offered. First, the Article 9 idea of giving the secured party a “two-for-one” interest in cash proceeds as well as in the original collateral might be defended because it coerces the debtor and the buyer to seek

33. See Bank of the West v. Commercial Credit Fin. Servs., Inc., 655 F. Supp. 807, 819 n.8 (N.D. Cal. 1987), rev’d on other grounds, 852 F.2d 1162 (9th Cir. 1988).
out the secured party’s authorization of the sale. This gives the
secured party a chance to insist that the cash proceeds be turned
over directly to the secured party, so that the buyer takes free of
the security interest, pays the full unencumbered value of the col-
lateral, and pays off the secured party’s claim to the extent of the
collateral’s value. But, significantly, this is precisely the result that
the McBee dictum produces. That is, the strong version of Article
6 requires that the cash proceeds be turned over to the secured
party directly. Hence, a deep inquiry into proceeds theory of Arti-
cle 9 helps to rehabilitate the vision offered by Judge Williams in
McBee.

A second criticism of the idea that Article 6 compliance de-
strouys perfected security interests—at least where the strong
version of Article 6 is in effect—is that creditors have a pro rata
right to the cash proceeds if they are insufficient to pay all the
creditors. Section 6-106(3) provides, “If the consideration payable
is not enough to pay all of the said debts in full distribution shall
be made pro rata.” 35 This might be taken to imply that a secured
party should share pro rata with the general creditors. If this were
right, then section 6-106(3) poses a serious obstacle to the idea
that a complying bulk transfer terminates perfected security
interests.

Such a reading of section 6-106(3) can be avoided, and many
courts have done so. 36 Article 9 awards cash proceeds to the se-
cured party over the general creditors, so that section 6-106(3)
provides pro rata sharing among general creditors only after the
owner of the cash, the secured party, is paid out to her full entitle-
ment. 37 Details of this theory might work like this. Where only

35. Id. § 6-106(3).
36. E.g., In re Figearo, 79 Bankr. 914, 918 (Bankr. D. Nev. 1987) (a perfected security
interest in the inventory of a business attaches to proceeds recovered by a trustee in bank-
ruptcy as a result of the compromise of fraudulent conveyance litigation); Mid-American
Indus., Inc. v. Ketchie, 767 P.2d 416, 420 (Okla. 1989) (“Article 6 neither impairs a valid
article 9 security interest nor does it affect article 9 remedies. It does not require that se-
cured and unsecured creditors be treated equally.”); Pynor v. Twin City Motor Supply,
ties have priority over general creditors to the Article 6 total purchase price in a bulk
transfer); see also Harris, Practicing Under Existing Bulk Sales Law—And a Look at the
Future of Article 6, 22 U.C.C. L.J. 185, 211 (1990) (“If the goods are subject to a security
interest . . . the transferee who fails to satisfy the debt secured by the . . . security interest
may be liable in conversion to the . . . secured party.”).
37. Figearo, 79 Bankr. at 918.
general creditors exist, no creditor has an *in rem* right against property of the seller before the bulk sale. When collateral is sold, and proceeds are created and held by the buyer for the benefit of the general creditors, each creditor obtains an *in rem* interest (in the cash) simultaneously.\(^\text{38}\) Since the rule of "first in time is first in right" cannot apply to simultaneously created property rights, pro rata sharing is appropriate among the general creditors.\(^\text{39}\) But when a secured party claims the inventory prior to the sale, the secured party has a senior right to cash proceeds under Article 9.\(^\text{40}\) True, the secured party's lien on the cash arises precisely at the same time the property rights of the general creditors arise.\(^\text{41}\) That is, the perfected security interest was *simultaneously created* along with the general creditors' *in rem* rights. Under Article 9, ties between a security interest and a judicial lien go to the secured party.\(^\text{42}\) If the *in rem* rights of general creditors are equated with

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\(^{38}\) For the view that Article 6 bulk sales law creates an *in rem* property interest that resembles an unperfected security interest, see Johnson v. Mid States Screw & Bolt Co., 733 F.2d 1535, 1536 (11th Cir. 1984); *see also* Note, Fraudulent Conveyance Law as a Property Right, 9 CARDOZO L. REV. 843 (1987). The recognition that general creditors have *in rem* rights against the inventory is much superior to the less adequate idea of the transfer being "ineffective" as section 6-110 states. The "ineffectiveness" language leads to strange judicial behavior. In Pastimes Publishing Co. v. Advertising Displays, 6 Ill: App. 3d 414, 286 N.E.2d 19 (1972), a secured party claiming accounts receivable was denied an account that came from a noncomplying bulk sale. The court reasoned that the sale was "ineffective," and so the resulting account did not exist! This fanciful argument would destroy any secured party's claim to proceeds of inventory whenever the inventory is sold in a noncomplying bulk sale. *Pastimes*, 286 N.E.2d at 22.

\(^{39}\) *See* Rome Indus., Inc. v. Intsel Southwest, 683 S.W.2d 777, 780 (Tex. Ct. App. 1984) (general creditor who garnishes the Article 6 fund in the hands of an escrow agent entitled only to pro rata share).


\(^{41}\) That is, when the bulk buyer pays cash, the general creditors obtain an *in rem* property right to the cash at precisely the same moment as the perfected secured party. It may be true that, when the seller owned the inventory, the secured party already had a lien and the general creditors had none. But this does not mean that the secured party had a lien on cash proceeds earlier than the general creditors received their *in rem* right. A security interest on the inventory arises at a different time from the security interest on cash proceeds of the inventory.

\(^{42}\) The theory of the tie between the security interest and the judicial lien goes as follows. According to section 9-201, the secured party always wins unless a specific provision in Article 9 says otherwise. U.C.C. § 9-201 (1987). In case of a tie between perfecting a security interest and the creation of a judicial lien, no provision helps the lien creditor, and so the secured party wins under section 9-201. Section 9-301(1)(b) states, "An unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected." U.C.C. § 9-301(1)(b) (1987) (emphasis added). This provision cannot help the lien creditor in a tie. The lien creditor must have "become a lien
judicial liens,43 or, better still, if the bulk buyer is considered a creditor representative in the nature of an assignee for the benefit of creditors, and hence a lien creditor on behalf of all general creditors,44 then Article 9 priorities dictate that the secured party outranks the general creditors as to the Article 6 fund.45 Under this theory, simultaneity affects the general creditors inter se but not the secured party versus the general creditors. On this view, section 6-106(3) becomes a mini-bankruptcy provision, with secured parties coming first and general creditors sharing the remainder on a pro rata basis.

The newly revised Article 6 obviates any confusion over the obligation to distribute the proceeds “pro rata.” According to new section 6-104(1)(e), the bulk buyer is to distribute the “net contract price in accordance with the undertakings of the buyer in the schedule of distribution.”46 This distribution rule clearly puts perfected secured parties above the general creditors.

43. The in rem rights of general creditors in this situation have been compared to an unperfected security interest. Note, supra note 38, at 847-48, 854-60.

44. See U.C.C. § 9-301(3) (1987) (“A ‘lien creditor’ . . . 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.”); see also Anderson & Clayton Co. v. Earnest, 610 S.W.2d 846, 848 (Tex. Civ. App. 1980) (comparing the bulk buyer to a receiver). Whether the definition of “lien creditor” is expansive or restrictive has divided the commentators. Compare Carlson & Shupack, Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part I, 5 CARDOZO L. REV. 287, 344-46 (1984) [hereinafter Carlson & Shupack, Part I].


46. Id. § 6-104(1)(e) (1988) (emphasis added). Revised section 6-102(1)(k) defines “net contract price” as:

the new consideration the buyer is obligated to pay for the assets less:

(i) the amount of any proceeds of the sale of an asset, to the extent the proceeds are applied in partial or total satisfaction of a debt secured by the asset; and

(ii) the amount of any debt to the extent it is secured by a security interest or lien that is enforceable against the asset before and after it has been sold to a buyer.
C. Bulk Sales as Waiver of the Security Interest

The above view that the secured party should not get a double entitlement—cash and collateral—has yet to be reconciled with the actual language of Article 9, which does admittedly authorize such double entitlements. Professor Harris suggests a theory whereby the McBee dictum can be brought within the terms of Article 9, although, in the end, he criticizes the theory as inadequate. According to Harris's theory, secured parties implicitly authorize the sale of the collateral whenever a buyer complies with the provisions of Article 6, and hence their security interests disappear upon the bulk sale. Harris writes, "The unstated premise for the McBee court's view that a complying buyer in bulk takes free of a perfected security interest may be the court's belief that, by failing to assert its security interest in the face of a bulk sale notice, the secured party 'otherwise' authorizes the sale."  

Harris disagrees with this version of McBee's justification, because a secured party cannot authorize a sale unless the secured party knows of the sale. Yet, Harris thinks, compliance with Article 6 does not guarantee this. For instance, the seller may leave the secured party off the creditor's list, and the bulk buyer need only inform those on the list of the sale and other persons known to hold or assert claims against the transferor. "Thus," Harris concludes, "to the extent that the McBee court's notion that a complying bulk transfer ipso facto terminates a perfected security interest is based on a theory of implied authorization or waiver, the notion is without foundation."  

This implied authorization theory, however, can be rehabilitated from this particular criticism. I think perfected secured parties will always know of a bulk sale, and hence it is possible to

48. Harris, supra note 1, at 199-200.
49. See U.C.C. § 9-306(2) (1987) ("a security interest continues in collateral notwithstanding sale... unless the disposition was authorized by the secured party").
50. Harris, supra note 1, at 199.
51. Id. at 199 n.90.
52. Id. at 200.
53. U.C.C. § 6-107(3) (1987) ("The notice in any case shall be delivered personally or sent... to all persons shown on the list of creditors furnished by the transferor (Section 6-104) and to all other persons who are known to the transferee to hold or assert claims against the transferor.").
54. Harris, supra note 1, at 200.
argue that they authorize the bulk sale by failing to protest it. If the security interest in the seller’s inventory is perfected, a financing statement has necessarily been filed. Therefore, the buyer is always able to find out the identity of the secured party. The buyer is said to have “constructive notice” of the perfected security interest; the whole notion of Article 9 filing is that the buyer is supposed to check the files for previous security interests. From this, it is a short step to the conclusion that, for the purposes of Article 6, the buyer has a duty to look in the files. Such a duty cannot be found in section 1-201(25), which provides: “A person ‘knows’ or has ‘knowledge’ of a fact when he has actual knowledge of it.” But it can be found in section 1-201(27), which states:

[K]nowledge ... received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence.

The argument would be that notice has been brought to the attention of the secured party from the time the buyer should have seen it in the files. Consequently, for a buyer to be declared in compliance, she must have notified all perfected secured parties. Since the premise of the McBee opinion is that the buyer has complied with Article 6, the perfected secured party has already received notice and therefore might plausibly be said to authorize a bulk sale by remaining silent.

56. Id. § 1-201(27) (emphasis added). See also Harris, supra note 36, at 208 (“A court might impute knowledge of creditors to a transferee who affirmatively avoids discovering their existence or might impose liability on the transferee for failing to act in good faith.” (citing U.C.C. § 1-203)).
57. It is probably bad manners to quote another article on a different topic against Professor Harris, but, with regard to lessees, he made an “implied authorization” argument that is similar to the one he rejects with regard to bulk transfers. See Harris, The Rights of Creditors Under Article 2A, 39 ALA. L. REV. 803, 813-15 (1988).

The precise problem that Harris faced in this other article is whether lessees in the ordinary course of a merchant’s business take free of the security interest on inventory (for the duration of the lease). Professor Harris thought that “buyers” was not broad enough to cover “lessees,” but he willingly argued that secured parties impliedly authorize the leasing of inventory, and hence lessees take free of the security interest under section 9-306(2):
When the collateral is the debtor’s equipment, the secured party is most unlikely to authorize the debtor to lease the equipment free of the security interest. However, when the collateral is inventory that the debtor is in the business of leasing, then the
This point is strengthened by, and even dependent upon, the observation that, in Texas, the proceeds are kept on hand by the transferee for the benefit of the secured party, so that the secured party has good reason, in the abstract, to approve of the bulk sale. Furthermore, it cannot be said in such a situation that mere acquiescence prejudices the secured party because the proceeds remain in place for a time after the sale goes through. In jurisdictions where the buyer is authorized to (and actually does) hand over the proceeds directly to the debtor, an argument for implied authorization would seem to be much weaker because a secured party who is merely slow, rather than genuinely acquiescent, may more likely be prejudiced by not responding to the notice of the bulk sale.

One major problem with this view is that the debtor and the buyer have little incentive to maximize the price when the collateral is overencumbered—i.e., when no positive debtor equity exists. If the seller and the buyer have negotiated an unreasonably low price, then it should not be the case that a quiescent secured party should be taken as approving the sale. Yet if the sales price exceeds the amount of the secured claim, or if the negotiated price is

security agreement may explicitly authorize the debtor to hold the goods for lease. Even if the security agreement is silent on that point, a court may infer the secured party's authorization for ordinary course leases from the secured party's conduct, including the fact that the secured party, without objecting, knowingly permitted the debtor to offer the goods for lease.

Id. at 814. This is precisely the argument that can be offered in defense of the McBee dictum. If it works with regard to leases of inventory, it ought to work for sales of inventory out of the ordinary course (provided the buyer holds the proceeds for the secured party).

59. According to section 6-106 comment 3:

The methods by which the buyer may perform the duty stated in the section are various. He may, for instance, by agreement with the seller hold the consideration in his own hands until the debts are ascertained, or deposit it in an account subject to checks bearing his counter-signature, or deposit it in escrow with an independent agency. If the affairs of the seller are so involved that nothing else is practical the buyer will no doubt pay the consideration into the registry of an appropriate court and interplead the seller's creditors.

60. That is, in jurisdictions adopting the weak version of Article 6, buyers are not required to keep proceeds on hand for creditors.
61. It can also be said that the secured party has a full opportunity to object to the terms of the sale in advance and thereby the secured party can be presumed to have authorized the sale. Hence, the danger of a shockingly low sales price does not necessarily work to defeat the theory that a secured party impliedly authorizes a bulk sale once notified of the sale.
reasonable, then the authorization theory raised and criticized by Professor Harris seems not so implausible.

To summarize, according to the face of the language in Article 9, a complying buyer should prevail over a previous perfected security interest only if it is true that the secured party has authorized the bulk sale by acquiescing to it. 62 The case for acquiescence depends upon the secured party remaining silent after having been informed of the bulk sale. This argument should only be allowed in those states with the strong version of Article 6 where the buyer must hold the proceeds for the seller’s creditors. Sound ethical arguments might be made for allowing complying buyers to take free of these security interests in states where the buyer holds the proceeds for the benefit of the secured party. That is, a secured party should have a surviving lien or the cash proceeds, but not both. When a sale is within the ordinary course of business, Article 9 clearly gives the secured party both (unless the secured party waives the lien), 64 but the justice of this double entitlement can be questioned, where the buyer holds the cash proceeds for the secured party to collect. 64

II. THE UNPERFECTED SECURED PARTY AND THE COMPLIING BUYER

The southwest quadrant of Figure One is, or should be, an easy case—the only one a complying buyer might clearly win. If SP1 has not perfected, and if the buyer is a bona fide purchaser,

62. See supra notes 17-18 and accompanying text.
63. See supra note 33 and accompanying text.
64. According to section 6-103(3), “[t]ransfers in settlement or realization of a lien or other security interests” are exempt from the provisions of Article 6. U.C.C. § 6-103(3) (1987). Therefore, if inventory is sold and if all the cash is given to a secured party, then, arguably, no further compliance with Article 6 is required. See Techsonic Indus. v. Barney’s Bassin’ Shop, 621 S.W.2d 332, 334 (Mo. Ct. App. 1981); American Metal Finishers, Inc. v. Palleschi, 55 A.D.2d 499, 501, 391 N.Y.S.2d 170, 172 (1977); but see Hixson v. Pride of Tex. Distrib. Co., 683 S.W.2d 173, 178 (Tex. Ct. App. 1985) (Article 6 does not apply only if the secured party gets all the cash and the security agreement was in default); accord Stone’s Pharmacy v. Pharmacy Accounting Management, Inc., 812 F.2d 1063, 1066-67 (8th Cir. 1987) (Texas law). According to one case, the exemption applies only if the inventory is transferred directly to the secured party in satisfaction of the security interest. Starman v. John Wolfe, Inc., 490 S.W.2d 377, 382 (Mo. Ct. App. 1973). The Starman case has been re-interpreted as one in which a security agreement was not in default, the secured party had no right to foreclose, and not all the cash was given to the secured party, so that Article 6 still applied. Techsonic Indus., 621 S.W.2d at 334.
the buyer should "take free" of the security interest. Of course, if the buyer has knowledge of the unperfected security interest, then the security interest lives on and is fully enforceable and perfectible.65 This result is set forth in section 9-301(1)(c):

[A]n unperfected security interest is subordinate to the rights of

(c) in the case of goods . . . , 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.66

Notice this provision does not quite say that, in case of a bona fide purchaser, the security interest is dead. Rather, it is subordinate to the rights of the buyer. Yet, subordination should be understood to comprehend the termination of the junior security interest.

A. The ATASCO Case

Unfortunately, this notion that subordinated liens are dead was rejected by the Second Circuit in Aircraft Trading & Services, Inc. v. Braniff, Inc. (ATASCO).67 In ATASCO, the court was faced with a priority dispute resembling the one portrayed in Figure Three:

66. Id. (emphasis added).
The case started with ATASCO's sale of a jet engine to the debtor on credit, secured by a purchase money security interest. Before ATASCO perfected, the debtor affixed the engine to an airplane and sold the whole plane (including the engine) to B (Northeastern). B in turn sold the plane to B₂ (Braniff) who sold the plane to B₃ (Condren, an individual). B₃ then leased the plane to B₄ with an option to buy. This lease was not filed with the FAA, as required by federal law. At this point, ATASCO finally filed a financing statement. When B₄ exercised its option to buy, B₄ could have found a financing statement in the federal files pertaining to aircraft and related parts.

Judge Miner, speaking for the Second Circuit, ruled that, SP₁'s security interest was resuscitated as soon as B₃ sold to B₄, so that it could be asserted against the property of B₄. According to Miner:

68. See 49 U.S.C. § 1403 (1982). Although filing must occur pursuant to federal law, the significance of perfection of a security interest is determined entirely under the UCC. ATASCO, 819 F.2d at 1231-32; see generally Philko Aviation, Inc. v. Shacket, 462 U.S. 406 (1983); M. RICE, ASSET FINANCING 251-70 (1989).

69. The consequence of the unrecorded lease is explored infra in the text accompanying notes 97-106.


71. ATASCO, 819 F.2d at 1233.
It is critical to note for the discussion that follows that ATASCO's unperfected security interest, though subordinate, continued to exist. Section 9-301(1) explicitly provides that "an unperfected security interest is subordinate" to the rights of certain buyers and lien creditors. The language of subordination indicates that the secured party's rights live on, although junior to the buyer's rights. Contrast the language of section 9-307—"[a] buyer in the ordinary course . . . takes free of a security interest created by his seller"—which terminates the secured party's interest for all time. Some courts seemingly ignore the subordination language of section 9-301(1) and state that a senior buyer "takes free" of an unperfected security interest, but those cases do not involve subsequent buyers and apparently use the phrases "takes free" and "has priority over" interchangeably.\(^{72}\)

Once the court established that ATASCO's security interest lived on, it necessarily followed that \(B_4\) was not a buyer who took collateral subject to an unperfected security interest. Rather, \(B_4\) took collateral subject to a perfected security interest, and hence section 9-301(1)(c) did not apply to protect \(B_4\).\(^{73}\)

\(^{72}\) Id. (citations omitted and emphasis in original). Judge Miner concluded that section 9-307(1) extinguishes a security interest. That section refers to the buyer in the ordinary course of business "taking free" of security interests on inventory. U.C.C. § 9-307(1) (1987). However, Miner determined that \(B_2\) was not a buyer in the ordinary course, and so the "taking free" language did not apply. ATASCO, 819 F.2d at 1232-33.

\(^{73}\) Because the collateral had been affixed to a plane, which was not collateral, section 9-314, pertaining to accessions, should have applied. See Sigman, The Wild Blue Yonder: Interests in Aircraft Under Our Federal System, 46 S. CAL. L. REV. 316, 370-73 (1973). This was overlooked entirely by the court and by the litigators. As it turns out, the case could have been decided the same way under section 9-314. According to section 9-314(1), "A security interest in goods which attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section 'accessions') over the claims of all persons to the whole except as stated in subsection (3) . . . ." U.C.C. § 9-314(1) (1987) (emphasis added). That is, ATASCO should have won unless something in section 9-314(3) states otherwise. However, section 9-314(3) does state otherwise: "The security interests described in subsection[] (1) . . . do not take priority over (a) a subsequent purchaser for value of any interest in the whole . . . if the subsequent purchase is made . . . without knowledge of the security interest and before it was perfected." U.C.C. § 9-314(3) (1987). The two subsections, read together, establish that \(B\) "takes priority" over ATASCO.

Thus, if the court had analyzed the problem under section 9-314, as it probably should have done, the court still would have faced the question, "What does it mean for a buyer without knowledge to take priority over an unperfected security interest?" This question is simply the obverse of asking, "What does it mean for an unperfected security interest to be subordinate to a buyer without knowledge?" There is no reason to believe that Judge Miner would have come out the other way. See ATASCO, 819 F.2d at 1233 (castigating the Ninth Circuit for "us[ing] the phrases 'takes free' and 'has priority over' interchangeably").
The argument that "subordination" ought to mean killing off an unperfected security interest was specifically rejected by Judge Miner. Though not entirely unimpressed with the argument, he remarked:

We decline . . . to interpret section 9-301(1) in a manner that would give "subordinate" two different meanings in the same sentence depending upon the particular subsection that is relevant to the case at bar—section 9-301(1)(c) (buyers not in the ordinary course of business) or section 9-301(1)(b) (lien creditors). Rather, we are convinced that a plain reading of the statute requires that "subordinate" be given consistent meaning within section 9-301, and that the difference in phrasing between sections 9-301(1) ("is subordinate") and 9-307 ("takes free") is to be given effect, notwithstanding cases that use language of termination interchangeably with language of subordination.

Thus, Miner feared attributing two different meanings to the word "subordinate"—one for buyers and one for secured parties and other lien creditors. Therefore, an absurd result was reached in an attempt to preserve a single denotative sense to the word "subordinate."

B. Death and Subordination

Despite ATASCO, a good argument can be made that subordination means death whether the subsequent taker is a buyer, a secured party, or a lien creditor. If such a result can be shown, then Judge Miner's reading of section 9-301(1)(c) could be proved wrong. That is, it would be true that "takes free of" and "is subordinate to" are one and the same thing.

What Judge Miner could have said, in pursuit of his point of view, is that B4 was not "a subsequent purchaser for value" of the whole "before it was perfected." Hence, B4 would not have been a protected subsequent purchaser. This Dracula aspect of section 9-314(3) was also included in the substantially identical 1962 version of the fixture priority statute. U.C.C. § 9-313 (1962). One of the motivations for the 1972 amendments to section 9-313 was to remove any implication that a senior real estate mortgage could become junior to an Article 9 fixture security interest if the mortgage was assigned. See Carlson, Fixture Priorities, 4 CARDozo L. REV. 381, 403-04 (1983). However, section 9-314 was left untouched (with its anti-shelter implication intact) in 1972 because no one had made a fuss about accessions like they had about fixtures.

74. ATASCO, 819 F.2d at 1233.
75. Id. at 1234.
With buyers and bulk transferees, it is easy to imagine how subordination could mean the death of the security interest. Once a buyer or bulk transferee takes possession of the collateral, the security interest simply dies with the buyer or bulk transferee having clean title to convey to another. But "subordination as death" is equally applicable in the case of subsequent liens. That is, if a second secured party or second judicial lien creditor takes collateral encumbered by an earlier unperfected security interest (and if the party of the second part is senior), then the second lienholder takes free of the earlier unperfected security interest, just the same as the subsequent good faith buyer did.

With regard to second senior lienholders, some explanation is required since most people will claim that the first unperfected security interest continues to exist even after the second security interest or judicial lien attaches. In order to show that subordination means death, even when the senior party holds a competing security interest, let us imagine the simplest conceivable Article 9 priority problem, whereby $SP_1$ and $SP_2$ have both received their security interests from the same debtor. In addition, $SP_1$ has failed to perfect and $SP_2$ is a bona fide purchaser for value who has perfected. Finally, $SP_2$ has repossessed and has held a foreclosure sale, where $B_2$ is the buyer. This priority contest is presented in Figure Four:

![Figure Four](image_url)

It could be said that $SP_2$ takes free of (or has killed off) $SP_1$'s unperfected security interest in the following sense: subject to the complications caused by a perfection rule, a security interest is the right to sell whatever the debtor has at the time of attachment.\footnote{77. See generally Carlson, Simultaneous Attachment, supra note 32, at 508-09; Carlson, Death and Subordination, supra note 32, at 558-63; Dolan, The U.C.C. Framework: Conveyancing Principles and Property Interests, 59 B.U.L. REV. 811 (1979).}

Of course, this basic formula, without more, guarantees that, if $SP_2$ exercises this power of sale, $SP_1$'s security interest lives on. But this formula is altered by Article 9's perfection rule. This perfection rule allows $SP_2$ (if she perfects first) to sell not merely whatever the debtor had at the time of attachment, but to sell free of $SP_1$'s unperfected security interest as well.\footnote{78. "When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto." U.C.C. § 9-504(4) (1987) (emphasis added). The italicized portion of section 9-504(4) establishes the power of a senior secured party to transfer more than what the debtor had at the time her security interest attached.} Meanwhile, if $SP_2$ has not perfected, $SP_2$ may be able to sell less than what the debtor had at the time of attachment, if the debtor conveys a subsequent security interest to a subsequent lender who perfects first.\footnote{79. As the debtor did to $SP_1$ in Figure Four.}

In Figure Four, we can say that $SP_2$ has taken free of $SP_1$'s security interest, when viewed from the perspective of what $SP_2$ can sell to a buyer at a foreclosure sale. To say it another way, $SP_2$ is competent to convey good title to a buyer at the foreclosure sale that is free and clear of $SP_1$'s security interest. In this sense, viewed from the perspective of the title $SP_2$'s buyer can get, $SP_2$ takes free of $SP_1$'s security interest.\footnote{80. Carlson, Simultaneous Attachment, supra note 32, at 513 n.38.} Thus, subordination of a security interest implies death no matter whether the senior party has a lien or the rights of a buyer.

Now pending $SP_2$'s foreclosure sale, the first lien admittedly continues to exist, for some purposes. This is because $SP_2$ did not purport to take an absolute interest in the collateral. Rather, $SP_2$ has left to the debtor an equity interest in the collateral—an equity that has already been conveyed away to $SP_1$. But $SP_1$'s rights to the debtor's equity are fully subject to $SP_2$'s power of sale. In
terms of what $SP_2$ can convey to the buyer in a foreclosure sale, $SP_1$’s lien is already dead. Meanwhile, if we change $SP_2$ into a full buyer, no equity is left to the debtor. If no equity is left to the debtor, then $SP_1$ has no property rights either (because $SP_1$’s rights were strictly parasitic on the existence of a debtor equity). That is, if the debtor sells to an ignorant buyer, the security interest of $SP_1$ is dead for all purposes.

Thus, whether the debtor double-deals the collateral to a subsequent buyer or a subsequent secured party, $SP_1$’s security interest has been terminated—as demonstrated by what happens when the senior transferee transfers to $B_2$ in Figure Four. A subordinated security interest is a dead security interest, and the word “subordination” has but a single meaning for all transferees.

This principle—subsequent but senior transferees take free of the earlier subordinated security interest—is sometimes called the “shelter principle.”

This architectural metaphor is designed to capture the idea that the transferees from a bona fide purchaser are “sheltered” by the bona fide purchaser's status and therefore need not have any such status themselves. Thus, in Figure Four, $B_2$ takes good title from $SP_2$ even though $SP_1$ may have perfected her security interest by the time of the auction because $B_2$ comes within the “shelter” of $SP_2$’s seniority. I have come to view this “shelter” metaphor as unaesthetic, because “shelter” wrongly implies that, outside of the shelter, $SP_1$’s security interest continues to prowl. In fact the wolf is dead. “Shelter” is not needed. It would be better to say that the earlier subordinated security interest has been killed off, so that when the bona fide purchaser transfers the property to another, the dead lien is simply not a factor. It is safe for $B_2$ (in Figure Four) to sleep out under the stars, if she wants to.

Clearly, Judge Miner was wrong to rule that “subordination” in all contexts must mean that the junior security interest continues to exist. The opposite is true. The fixed meaning of subordination should be that the unperfected security interest ceases to exist. Taking free and clear has different details from context to context, but the idea is essentially uniform across all subsequent transfers. Thus, $B_4$, in the ATASCO case, should have


82. Admittedly, I used this phrase routinely in previous articles. See Carlson, Death and Subordination, supra note 32.
bought clean title through the initial buyer, who "took free" of $P_1$'s unperfected security interest. 83

In any case, on a practical level, Judge Miner's reading of the UCC is patently absurd, as the following example will show. Suppose $B$ buys collateral for $100 from the debtor. Unbeknownst to $B$, the collateral is encumbered by $SP_1$'s unperfected security interest for $80. After $B$ buys, $SP_1$ files a financing statement that was adequate to perfect a still-living security interest. According to ATASCO, $B$ is senior but the security interest of $SP_1$ is not dead. Presumably this means that, so long as the collateral is in the possession of $B$, $SP_1$ is unable to repossess. But if $B$ sells to someone else, $SP_1$ will be senior again and able to repossess.

In this case, $B$ has collateral worth $100 to $B$, but if $B$ tries to sell the collateral to anyone else who knows about the security interest, that party will deduct the $80 that $SP_1$ claims and will pay $20. In essence, the rule of ATASCO makes the property of $B$ inalienable (although, in the precise example I used, $B_2$'s equity interest of $20 was itself still valuable). Thus, if $B$, a bona fide purchaser, chooses to sell she is hurt. Subsequent purchasers are not hurt, because they simply reduce the purchase price by the amount of $SP_1$'s claim. Meanwhile, the double-dealing debtor has probably received full price from $B$, who did not know of $SP_1$'s unperfected security interest. And $SP_1$, who forgot to perfect, eventually realizes the full $80 secured claim. Under the rule of ATASCO, only the innocent bona fide purchaser for value is hurt, and absolutely everyone else in the universe is all right and enjoying a good laugh at her predicament. Yet, it is precisely the innocent bona fide purchaser who is supposed to be protected by section 9-301(1)(c). 84

Judge Miner offers some consequentialist reasoning in defense of his decision. He writes:

83. In any case, it must be said that, at the level of language philosophy, Judge Miner's notion that words have fixed meaning is impossible. Since Wittgenstein, most philosophers have thought that words do not have meaning in and of themselves, but only have meaning as supplied by context. Therefore, although Judge Miner thought he was adhering to the one and only meaning of the word "subordination," he was in fact sub rosa switching contexts in order to preserve the illusion that meaning stayed fixed. If meaning is in the context (and not the words), then Judge Miner was guilty of switching meanings around, in the name of fixing the meaning.

The rule appellees urge us to adopt [equating death and subordination] effectively would freeze a secured party's priority status as of the time of the first intervening conveyance: If one failed to file a security interest the day of the sale, the buyer could, by immediately reselling, forever destroy the security interest. While appellees urge that their rule would result in an increment of certainty in such transactions, we believe that such an extreme result would discourage lenders from taking security interests and would thereby inhibit commerce.86

This argument, however, profoundly misunderstands what a perfection rule is. The whole point of a perfection rule is to empower the debtor to double-deal the lender—in order to induce the lender to take the required perfective steps. This is not to say that double-dealing is a good thing in and of itself. Rather, the power to double-deal is the tool which encourages a secured party to perfect her interest. Therefore, asserting a fear of a double-dealing debtor cannot constitute an argument that relieves a secured party of the need to perfect.86 Taken to its extreme, Miner's argument dictates that Article 9 be repealed altogether and replaced with a simple rule of "first in time is first in right."

C. ATASCO and Shelter

Dissatisfaction with the ATASCO holding has prompted the members of the Permanent Editorial Board (PEB) of the UCC to decree a "Proposed New Comment 9 to section 9-301," plus an additional proposed commentary on section 9-301(1).87 Disagreeing with ATASCO's rejection of the shelter doctrine in that case, the proposed commentary states, "The shelter principle should be applied to protect [the sub-buyer]. Otherwise the value of [the buyer's] status, as one taking free of the security interest, is unjus-
tifiably impaired if he cannot confer that status upon his transferee." 88

The PEB then offers its new proposed "official" comment to section 9-301:

There is no conflict between the principle of § 9-301(1) and the "shelter principle," which is applied at several points in the statute, but is most explicitly stated in § 2-403(1): "A purchaser of goods acquires all title which his transferor had. . . ."

Although subsection (1) fails to state the shelter principle expressly, that principle is applicable where a person who had met the conditions for prevailing over an unperfected security interest transfers his right to another person after the security interest is perfected. 89

By this proposed comment, the PEB hopes to overrule ATASCO. However, the comment is subject to a logical flaw.

In ATASCO, the lawyers for $B_4$ argued that under UCC section 2-403, which provides, "A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased," 90 $B_4$ acquired $B$'s immunity from ATASCO's security interest. That is, $B$'s "title" included this immunity, and $B_4$ succeeded to it. 91 Judge Miner disposed of this "novel theory" 92 by noting that, according to section 9-306(2), a security interest continues upon sale of the collateral (unless the secured party consents) "[e]xcept where this Article otherwise provides." 93 An Article 2 provision therefore is not competent to vary the rule of section 9-306(2). 94 Furthermore, section 2-402(3)(a) provides, "Nothing in this Article shall be deemed to impair the rights of creditors of the seller . . . under the provisions of the Article on Secured Transactions (Article 9) . . . ." 95 This provision also disables section 2-403(1) from affecting unperfected security interests.

88. Id.
89. Id.; see also Harrell, Sales-Related Conflicts Between Articles 2 and 9, 22 U.C.C. L.J. 134, 173-74 (1989) (criticizing the ATASCO court for overlooking shelter in section 2-403(1)).
92. Id.
93. Id. at 1235 (quoting U.C.C. § 9-306(2) (1987)).
94. Id.
95. Id. (quoting U.C.C. § 2-402(3)(a) (1987)).
Finally, the very text of section 2-403(1) requires us to know what title the seller has the power to convey, but this question is only settled by reference to section 9-301(1)(c). 96 For these reasons, the PEB's invocation of the shelter provision in section 2-403 is poor theory. It is better to face up to the fact that section 9-301(1)(c) is a murderer. It kills off the security interest altogether—and that Judge Miner (sitting in diversity, mind you, and therefore merely guessing at the content of state law) simply made an error.

D. ATASCO's Application of a Race-Notice Priority Between Unperfected Secured Parties and Lessors

ATASCO involved one other issue which many may find bizarrely decided but which I would like to defend. In Figure Three, recall that B₃ leased the airplane to B₄ at a time when ATASCO had not yet perfected its security interest. This might have raised the issue of whether a lessee takes free of an unperfected security interest—an issue not settled directly by Article 9. 97 Judge Miner evaded this issue and found that ATASCO must win because ATASCO filed before the lessee did. He found authorization for this decision in section 9-312(5)(a), which provides, "Conflicting security interests rank according to priority in time of filing or perfection." 98 Judge Miner thought this rule subordinated the subsequent lessee because the lessee was the second to file. 99

Some will be tempted to criticize Judge Miner for using a section that pertains to competing security interests to solve a priority problem between a security interest and a leasehold interest. I think Judge Miner's reasoning is not so bad. Ordinarily, lessees and buyers do not have to file anything to perfect their interests in

96. Carlson, Death and Subordination, supra note 32, at 550 n.9.
97. Although not directly settled, it is arguable under section 9-301(1)(c) which protects "buyers," not lessees, that lessees are temporary buyers and that the lease is therefore good against the unperfected secured party. Meanwhile, the unperfected security interest would continue to encumber the lessor's reversionary interest in the collateral. "Buyer" is more or less an undefined term under the UCC, so that there is no impediment to such an argument. See U.C.C. § 1-201(9) (1987) ("'Buying' . . . does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt."). For a thorough analysis of whether lessees can come under various Article 9 provisions, see Harris, supra note 57, at 815-16.
99. ATASCO, 819 F.2d at 1236; see 49 U.S.C. app. § 1403(c) (1982).
personal property.100 Federal law changes this with regard to civil aircraft, aircraft engines, propellers, appliances, or spare parts.101 If Congress has decided that buying and leasing should be subject to a perfection rule, then it seems appropriate that section 9-312(5)(a) should apply as a supplement to section 9-301(1)(c). That is, a buyer of an airplane without knowledge of an unperfected security interest in the airplane should take priority over (i.e., take free of) the earlier unperfected security interest, but this result is reversed if the secured party is the first to file.102 Or, to say it another way, federal law, when combined with the UCC, creates a race-notice priority between buyers or lessees and secured parties.103

If buyers and lessees are subjected to a perfection rule, then a race-notice priority is useful to protect the aftermarket for security interests in airplanes. If I may quote myself:

In a race-notice priority, A and B have not perfected. B is a BFP [bona fide purchaser for value]. Between A and B, the first to perfect wins, so that A has the potential to regain priority from a BFP. Thus, A and B are engaged in a race, but only if B was a BFP at the time B gave value. This is done to protect the aftermarket. If A is the first to perfect and wants to sell to X, X could never tell from the record that A was not really the owner or that B (the BFP) was.104

100. One exception is that buyers of accounts and chattel paper are subject to Article 9 filing requirements. U.C.C. § 9-102(1)(b) (1987); but see id. § 9-104(f) (excluding some sales of accounts and chattel paper).
102. See Philko Aviation, Inc. v. Shacket, 462 U.S. 406, 413 (1983) (“Although state law determines priorities, all interests must be federally recorded before they can obtain whatever priority to which they are entitled under state law.”).
103. If I may add a few arcane refinements, federal law requires that notice of leases and liens on engines and planes be filed. 49 U.S.C. app. § 1403(a)(2) (1982). It also requires that notices of purchases of aircraft be filed. Id. § 1403(a)(1). It does not require that outright purchases of aircraft engines be filed. M. Rice, supra note 68, at 253. Therefore, between secured parties and buyers of aircraft, the UCC, combined with federal law, creates a race-notice priority. But as against buyers of airplane engines, combined federal and state law creates only a notice priority—that is, the buyer of an engine takes free of an unperfected security interest in the engine, since such a buyer need not file.
Also, if buyers and lessors who must record are to be treated as if they are secured parties under Article 9, pursuant to Judge Miner’s suggestion, then it follows that those who enter sell-leaseback aircraft deals with aircraft merchants are subject to section 9-307(1). That is, just as section 9-307(1) terminates security interests in airborne inventory, it would also terminate leases in the same inventory.
104. Carlson, supra note 86, at 259-60.
Transposing this analysis to our airplane problem, suppose $A$ is an unperfected secured party and $L$ is a lessee, as in Figure Five:

If $A$ wished to assign her security interest to $X$, and if $X$ searched the record, $L$ would not appear until $L$ filed a record notice of the lease. If $L$ has not filed, $X$ therefore faces a title risk if section 9-312(5)(a) does not govern. But if section 9-312(5)(a) does govern, then $X$ will know that $A$ has good title to the security interest by virtue of having filed first before any subsequent taker. Therefore, $X$ faces less title risk and will accordingly pay a higher price for $A$'s security interest. This greater marketability of the security interest will in turn make secured lending more attractive and might lower the price of secured loans to the debtor. Therefore, if you think that lower interest rates are a good thing, Judge Miner's adaptation of section 9-312(5)(a) is not as implausible as it might appear at first glance.

105. It is often thought that lower interest rates are a good thing. However, they may simply reflect greater costs exported to the public through, for example, limited liability of corporations. Therefore, one must resist proclaiming lower interest rates synonymous with efficiency. See generally Carlson, Postpetition Interest Under the Bankruptcy Code, 43 U. MIAMI L. REV. 577, 615-19 (1989).

106. In the above paragraph, I only wish to suggest that race-notice priorities have a certain rationality to them. I do not wish to be understood as making some sort of law-and-economics efficiency argument. Only a fool would say whether priorities are per se efficient or not. Some of the issues that would have to be resolved to make an efficiency argument include: (a) whether the debtor's business enterprises (or $A$'s or $X$'s) produce externalities, such that lower interest rates and higher productivity will cause more harm than good; (b) whether the benefits to $A$ and $X$ exceed the cost to $B$; and (c) whether making the market for the debtor's goods or services more optimal will make other markets more or less optimal (the second best phenomenon). All of these empirical problems (and more) would
Although the above discussion trespassed beyond the scope of my topic to discuss the rights of an unperfected security interest against buyers generally, everything said about buyers not in bulk translates directly to complying bulk transferees. The thrust of the discussion is that buyers without knowledge—whether complying Article 6 transferees or buyers who need not comply with Article 6—always take free of unperfected security interests. That is, the security interest ceases to exist when a buyer or bulk transferee without knowledge acquires the collateral.

This is especially important for bulk transferees. Bulk transferees purchase inventory in bulk in order to put that inventory into the ordinary course of business. Ordinarily, section 9-307(1) terminates security interests in inventory when a customer buys some items out of inventory. But buyers in the ordinary course of business are not protected unless the seller of the inventory has created the security interest. A bulk transferee has not created the security interest, and so section 9-307(1) cannot help her with unperfected security interests created by the bulk transferor. If the ATASCO case is followed, then the unperfected security interest of \( SP_1 \) springs back to life when the bulk transferee tries to sell some inventory to her customers. This means that \( SP_1 \) can track down the bulk transferee's customers and take back any merchandise that the bulk transferee had acquired, even though the bulk transferee fully complied with the rules in Article 6. Such a rule makes bulk transfers of inventory riskier and therefore increases the exit costs of doing business.

III. THE PERFECTED SECURED PARTY AND THE NONCOMPLYING BUYER

In the northeast quadrant of Figure One is the priority battle between the perfected secured party and the buyer who has not complied with Article 6. How straightforward can a priority battle prevent any conscientious scholar from making an efficiency argument in favor of any given priority system.

be? But here one can find all sorts of startling doctrinal assertions—some of them from the much maligned McBee case. In McBee, Judge Williams determined that noncomplying bulk buyers must contribute after-acquired inventory *not involved in the bulk sale* to the wronged lenders of the seller. Furthermore, Judge Williams also suggests that, under certain circumstances, noncomplying buyers can cut off perfected security interests with a very short (six months) statute of limitations. Finally, Judge Williams decided that SP 2 could never be a bona fide purchaser within the meaning of section 6-110, which provides that bona fide purchasers take free of Article 6 claims of creditors.

The first ruling can be justified, in my opinion, while the second cannot. The third ruling can be criticized as being somewhat overbroad but not totally without merit.

**A. After-Acquired Inventory**

1. **Dissolving the Buyer-Seller Distinction**

   a. McBee.—In McBee, the noncomplying buyer not only bought inventory from the bulk seller but later added inventory from other sources as well. Most judges would have said that the after-acquired property clauses in the security agreements of SP 1 and SP 2 (in Figure Two) could not encumber inventory acquired later by the bulk buyer (which I will call "post-sale inventory") for the simple reason that the bulk buyer never agreed to any after-acquired property clause. On this reasoning, SP 1 and SP 2 (creditors of S) would have priority as to the inventory actually involved in the bulk transfer, and SP 3 (B's creditor) would have any inventory acquired by B after the bulk sale occurred. As to this post-sale inventory, the security interests of SP 1 and SP 2 would not even

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110. McBee, 714 F.2d at 1328-29. Some states lengthen this statute of limitations to a year. E.g., CAL. CoM. CODE § 6111 (West Supp. 1990); GA. CODE ANN. § 11-6-111 (1982).

111. McBee, 714 F.2d at 1330.

Judge Williams writes, "At first glance this argument is appealing: how can a debtor-transferor give his secured creditors an interest in property he no longer owns and, more significantly, in post-transfer property acquired by the transferee which the transferor never owned?" But Judge Williams finds reason to give the post-sale inventory—to which the security interests of \( SP_1 \) and \( SP_2 \) could never have attached—to \( SP_1 \) and \( SP_2 \):

Upon analysis, however, the facial logical persuasiveness and the equitable underpinning of this argument disappears. The transferor gives his creditors a security interest in his property which may, as in the immediate case, cover "after-acquired property." It is Article 6, which provides as a "sanction for non-compliance" that the transferer is ineffective against creditors of the transferor. . . . Clearly, a transferee cannot complain if, by his non-compliance, the transferor's creditors' claims attach to his property as they had prior to sale.

In case this argument went by you too quickly, let us take it step by step. (1) Article 6 imposes sanctions. (2) The sanctions are that the bulk transfer is "ineffective" against the creditors of the transferor. (3) If the transfer is ineffective, that means we must pretend the seller still owns the collateral, and that the seller's creditors have their old rights against the collateral. (4) And yet the buyer now owns the collateral. (5) This contradiction can be resolved by seeing the buyer and seller as the same person. (6) If the seller obtained after-acquired inventory, the security interests of \( SP_1 \) and \( SP_2 \) would attach to it. (7) Since the buyer is the seller, the security interests of \( SP_1 \) and \( SP_2 \) attach to any inventory the buyer might acquire later.

113. Harris, supra note 1, at 231. Attachment requires (a) a security agreement granting a security interest, (b) value given by the creditor, and (c) debtor rights in the collateral. U.C.C. § 9-203(1) (1987). The theory is that the first element of attachment is absent, because the bulk buyer had no security agreement with \( SP_1 \), or \( SP_2 \). But see supra note 21 (showing that in McBee, B did sign a security agreement with \( SP_2 \)).

114. McBee, 714 F.2d at 1328.

115. Judge Williams limited \( SP_1 \) and \( SP_2 \) to the value of the inventory transferred to \( B \) in the bulk sale. Id. at 1319, 1332. This result would adhere if Judge Williams had used the standards for commingled collateral under section 9-315. This matter is discussed infra in the text accompanying notes 234-43.

Even critics of the *McBee* opinion have to admit that this reasoning is innovative—even Hegelian in quality. The immediate appearance is that the seller and buyer are separate persons, but, according to Article 6, the “transfer is ineffective,” and this results in the sublation (*Aufhebung*) or merger of the seller and the buyer into a unified category of being. Since transfers require two persons, this sublation of the buyer-seller distinction is what it means for the transfer to be ineffective. Thus, the obligations of the seller become the obligations of the buyer.

For classical liberals such as Professor Harris, such reasoning is untenable and perhaps even incomprehensible. The buyer and the seller are separate beings, and that’s it! If the transfer is ineffective between buyer and seller, it is not because the buyer-seller distinction has been obliterated. This distinction may be taken as a deconstructible given. Rather, transfer ineffectiveness, as invoked by Article 6, is simply a metaphor to help us imagine legal rules governing the rights of the transferor’s creditors. We are to pretend that the specific inventory in the bulk sale was never transferred. Then we are to imagine what rights the creditors would have against this inventory in such a case. In no sense is the buyer now the seller, and in no way should the seller’s personal contractual obligations be attributed to the buyer.

117. *Id.*


119. Judge Williams cites some cases holding that, when a security agreement provides that the collateral is inventory, both present and after-acquired inventory are deemed to be covered. *McBee*, 714 F.2d at 1331 (citing *In re Nickerson & Nickerson, Inc.*, 329 F. Supp. 93 (D. Neb.)), *aff’d*, 452 F.2d 56 (8th Cir. 1971); *In re Page*, 16 U.C.C. Rep. Serv. (Callaghan) 501, 504 (M.D. Fla. 1974); Borg-Warner Acceptance Corp. v. Wolfe City Nat’l Bank, 544 S.W.2d 947, 950 (Tex. Civ. App. 1976)). These cases would be apt only if one debtor granted inventory-security interests to all the secured parties in the case. They could not apply to the facts in *McBee* unless it can be shown somehow that the seller’s security agreement was binding on the buyer.

120. “Even though the buyer in bulk may continue to do business under the trade name of the seller, at the same location, and using the same assets, the two parties usually are distinct legal persons.” Harris, *supra* note 1, at 231; see Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20, 26-28 (Iowa 1982); Burke, *The Duty to Refile Under Section 9-402(7) of the Revised Article 9*, 35 BUS. LAW. 1063 (1980).

121. They can levy on it, if they have judgments against the seller. U.C.C. § 6-111 comment 2 (1987).
Strangely, on the facts of McBee, the buyer and the seller were, in a sense, one person, or at least they were jointly and sever­ably liable on the seller’s security agreement with SP₁. The security agreement was in fact signed by B, who represented herself as the partner of S. As a result, B was personally bound on the after-acquired property clause in the loan agreement. Therefore, it was proper to give SP₁ priority over SP₃ for the inventory acquired by B after the bulk sale. SP₁’s security interest did attach to this inventory.¹²²

This fact justifies giving post-sale inventory to SP₁. It does not justify giving post-sale inventory to SP₂, who did not obtain B’s signature on its loan agreement. Properly speaking, the Fifth Circuit should have found a way to vindicate SP₁’s seniority to the post-sale inventory while preventing SP₂ from getting this inventory.

One such theory—marshaling of assets—must be ruled out. If inventory can be identified—divided into definite pre-sale and post-sale amounts—then SP₁ would have a senior security interest in both pools of inventory, whereas SP₂ would have a security interest in only one. This is a classic marshaling-of-assets situation, except that SP₃ can make the same argument! That is, SP₁ has a senior security interest in two pools of inventory, while SP₃ is junior to a single pool. One of the rules of marshaling is that it must not cause unfair prejudice to third parties.¹²³ Therefore, SP₂ and SP₃ have identical and conflicting marshaling-of-assets claims which cancel each other out.

If the inventory is perfectly identifiable, another possibility now exists. Recall that SP₂ was a purchase money lender as to part of the inventory.¹²⁴ If this inventory (or its proceeds) could be identified, then SP₂ would be senior as to it over SP₁. If this were true in sufficient magnitude, then the marshaling impasse just described could be avoided. Instead, SP₂ would be senior to at least part of the pre-sale inventory. SP₁ would take the balance of this. To the remainder left to SP₁ we could freely add post-sale inventory without giving any of this collateral to SP₂. SP₃ could then have the residue of post-sale inventory after SP₂ is paid out. If this

¹²². See supra note 21.
¹²⁴. See supra note 21.
line of reasoning had been followed, then Judge Williams's analysis regarding post-sale inventory would have been on the money. He could have given $SP_1$ priority over $SP_3$ without having any post-sale inventory go to $SP_2$.

Of course, whether the inventory was identifiable with this degree of accuracy is not known. If not, then application of the commingling priority in section 9-315 becomes relevant. This subject will be taken up presently.

b. Bulk Transfers Between Corporate Subsidiaries.—McBee is not the only case that dissolves the buyer-seller distinction. Courts have strained to do so especially when one corporate subsidiary transfers a business to another corporate subsidiary. In such cases, the bulk transfer may be completely invisible to the naked eye. The key in such cases is to find a theory whereby the after-acquired property clause executed by the seller will be binding on the buyer. The theories developed to achieve this limited "piercing the corporate veil" have not always been very sound, as the McBee opinion has already demonstrated. A better theory needs to be found.

There has developed a standard string-cite for the proposition that the security agreement of $S$ is binding on $B$. Yet it can be shown that this string-cite is a total bootstrap, if I may mix a few metaphors. The first case to hold $B$ on a security interest she did not sign is said to be Ryan v. Rolland. This case turned only on whether the financing statement covering pre-sale inventory was still good to perfect the security interest in that inventory after the

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125. Certain intra-corporate transfers are exempt from compliance with Article 6:

A transfer to a new business enterprise organized to take over and continue the business, if public notice of the transaction is given and the new enterprise assumes the debts of the transferor and he receives nothing from the transaction except an interest in the new enterprise junior to the claims of creditors[, is not subject to Article 6].

U.C.C. § 6-103(7) (1987) (emphasis added). In the transfers we are dealing with, notice is rarely given and the debts of the seller are not assumed by the buyer. Hence, Article 6 will generally apply.

126. 434 F.2d 353 (10th Cir. 1970); see Towers v. B.J. Holmes Sales Co. (In re West Coast Food Sales, Inc.), 637 F.2d 707 (9th Cir. 1981); Fliegel v. Associates Capital Co., 272 Or. 434, 537 P.2d 1144 (1975).
sale. The court held that it was. There was no dissolution of the buyer-seller distinction there, so far as I can tell.

The second case often cited for holding B to the security agreement of S also fails to establish that point. In Inter Mountain Association of Credit Men v. Villager, Inc., the secured party lent to a corporation in exchange for a security interest in all of the debtor corporation's inventory. Later, the debtor merged with three other related corporations. After the surviving corporation filed for bankruptcy, the court held the surviving corporation liable on the secured party's after-acquired property clause. This part of the case is unexceptional—it is well known that, in a merger, the surviving corporation assumes the liabilities of the previous corporations.

The first case that genuinely held B to S's security agreement (without the aid of a merger) was Fliegel v. Associates Capital Co.

127. Ryan, 434 F.2d at 357.
128. See Burke, supra note 120, at 1089-90.
129. 527 P.2d 664 (Utah 1974).
130. Villager, 527 P.2d at 672.
131. See, e.g., White Motor Credit Corp. v. Euclid Nat'l Bank, 63 Ohio Misc. 7, 409 N.E.2d 1063 (Ct. Common Pleas 1978). The Villager court did innovate, however, in holding that the after-acquired property clause would be limited in scope to the inventory sold in the specific stores that the predecessor corporation owned, even though the surviving corporation now owned many stores, and even though one of the security agreements binding the debtor gave to the secured party "all present and future ... inventory wherever located." Villager, 527 P.2d at 667, 672. The broad language of the security agreement would seem to contradict such a restriction, but a careful reading of the case shows the secured party entered into a different security agreement with the predecessor for each different store of the predecessor. This might lead to the view that the parties intended the after-acquired property clause to cover inventory related to that specific store (and no other). If this is what the predecessor agreed to, it should also be the extent of the surviving corporation obligation.

The case also contains various muddled arguments. For instance, the court is worried whether the secured party has purchase money status. It launches into a lengthy analysis of the metaphysical notion of inventory security interests and adopts the controversial "entity" theory, which was designed to save inventory security interests from vulnerability to voidable preference law. Id. at 668-70 (citing Henson, "Proceeds" Under the Uniform Commercial Code, 65 COLUM. L. REV. 232 (1965)). None of this was necessary in the slightest to the issue at hand—whether the after-acquired property obligation of the predecessor corporation bound the surviving corporation. The court also mentions a clause from the security agreement that any successor would be bound by it. Such contractual language is relevant only if the court is prepared to say that the security agreement created a running covenant on the inventory, such that whoever bought the inventory (in bulk, presumably) was bound on the agreement, whether she agreed or not. Such an innovation is completely unnecessary because the law of corporate merger makes the successor liable on all the predecessor's contracts.
of Delaware, Inc. In this case, S was a partnership bound on a security agreement with an after-acquired property clause on inventory. According to this security agreement, S promised that "[a]ll obligations of [S] shall bind its successors and assigns." Subsequently, S transferred inventory to B, a wholly owned corporation set up to take over the business. B then obtained post-sale inventory (apparently through credit advanced by the secured party). The court simply cited Ryan and Villager (wrongly) for the proposition that a seller's after-acquired property clause is binding on a buyer (at least in an intracorporate setting), and then proceeded to follow these "precedents."

Although the court previously emphasized its reliance on the so-called precedents, it does add this language as if it were an after-thought:

In addition, further support for holding the corporation subject to the defendant's security agreement is provided by the terms of the security agreement itself which provides that "[a]ll obligations of [S] shall bind its successors and assigns." Since it is stipulated that the newly-formed corporation was the "successor" of [S], it became subject to [SP 1's] security [agreement].

This language can be taken to create a kind of equitable servitude on inventory, whereby a bulk buyer becomes bound on the after-acquired property clause of its seller.

The second genuine case in which B became bound on S's agreement (without expressly consenting to it or without a merger) was American Heritage Bank & Trust Co. v. O. & E., Inc. In this case, S granted two security interests on inventory, as to which SP 1 was senior and SP 2 was junior. SP 2 then declared default and sold the business to B, a wholly owned subsidiary of SP 2. B then acquired new inventory and commingled it with the old. SP 1 then declared default and sought to repossess the old and the new inventory. B protested that the after-acquired property clause

132. 272 Or. 434, 537 P.2d 1144 (1975).
133. Fliegel, 537 P.2d at 1148.
134. Id. at 1145 ("It is stipulated that defendant had financed the purchase of all the items which were repossessed.").
between \( SP_1 \) and \( S \) could not affect \( B \)'s post-sale inventory. Citing \textit{Villager} and \textit{Fliegel}, the court held that \( SP_1 \)'s security agreement with \( S \) was binding on \( B \).\footnote{American Heritage, 576 P.2d at 568. The \textit{American Heritage} case is susceptible to a narrower interpretation. In this case, the post-sale inventory was commingled by \( B \) with pre-sale inventory. If commingling means that the property can no longer be identified, then \( SP_1 \) would have a perfected security interest on the whole pursuant to section 9-315(1). The use of section 9-315(1) to establish \( SP_1 \)'s security interest on post-sale inventory is a subject taken up in the next part of this Article. For now, let it suffice that the opinion does not really say that the old and new inventory were indistinguishable, and so this narrower interpretation depends upon this unmentioned fact.} Thus, we see the start of a string-cite that was bootstrapped out of nothing.

Next came \textit{Towers v. B.J. Holmes Sales Co. (In re West Coast Food Sales, Inc.)},\footnote{637 F.2d 707 (9th Cir. 1981).} which involved only one secured party (\( SP \)) who entered into a security agreement with \( S \), doing business as \( B \). The security agreement "contained a 'successors and assigns' clause purporting to bind 'any corporation or other business entity to which the proprietorship's business might be transferred.'"\footnote{West Coast Food Sales, 637 F.2d at 708.} \( S \) then conveyed the business to a new corporate entity, which also bore the name "\( B \)."\footnote{SP filed a financing statement under the trade name \( B \), which was not proper. U.C.C. § 9-402(7) (1987); \textit{but see} National Bank of Tex. v. West Tex. Wholesale Supply Co. (\textit{In re McBee}), 714 F.2d 1316, 1323 (5th Cir. 1983) (holding that filing under trade name is adequate if no one is misled). Later, when \( S \) conveyed all assets to \( B \), the filing error was deemed automatically corrected.}

In the bulk sale, \( B \) assumed all liabilities of \( S \).\footnote{On April 1, 1973, a newly formed entity, West Coast Food Sales, Inc. (the corporation) succeeded to the assets and liabilities of West Coast Sales Company." \textit{West Coast Food Sales}, 637 F.2d at 708.} \( B \) then proceeded to borrow from \( SP \) as if \( S \) still owned the business. \( B \) went bankrupt, and the trustee claimed that \( B \) was not liable on the after-acquired property clause that existed in the agreement between \( SP \) and \( S \). Hence, the trustee argued that \( SP \) had no lien on any post-sale collateral.

The Ninth Circuit (per Judge Ely) held for \( SP \). Judge Ely could have decided that \( SP \)'s security interest was binding on \( B \) because \( B \) assumed \( S \)'s liabilities.\footnote{That is, \( B \) and \( S \) expressly agreed for the benefit of \( SP \) that \( B \) is bound by the security agreement between \( S \) and \( SP \). \textit{See Houchen v. First Nat'l Bank (In re Taylorville Eisner Agency, Inc.), 445 F. Supp. 665 (S.D. Ill. 1977) (where \( B \) assumed all liabilities, post-sale inventory was treated as subject to \( SP \)'s interest).} On the other hand, he could have argued that the clause in \( S \)'s security agreement binding suc-
cessors and assigns to the agreement was binding on B, who took the assets with knowledge of this clause. This would have made the security agreement into an equitable servitude on the property of S, on which B, as a knowledgeable buyer, would have been liable, whether it consented or not. 143 Instead, after intoning the now-standard string-cite of authorities in which the corporate successor was held liable on the predecessor's security agreement, he simply announced that if SP's security agreement does not bind B for post-sale collateral,

a debtor would be able to evade the obligations of a validly executed security agreement by the simple expedient of an alteration in its business structure. We conclude as a matter of law that the security agreement executed by the proprietorship continued to be effective as to the accounts receivable generated by the corporation after the change in entity status. 144

Thus, like the other cases, Judge Ely states no theory for binding B on S's security agreement, except that to rule otherwise would be to sanction an abuse of the corporate form.

Finally, Bank of the West v. Commercial Credit Financial Services, Inc., 145 is a most interesting example of dissolving the buyer-seller distinction. In this case (as shown in Figure Six), B and S were corporate siblings owned by a common parent. Pursuant to a factoring arrangement, S granted a security interest in accounts receivable to SP1. SP2 was B's lender claiming a security interest in after-acquired inventory and accounts. One day the common parent took a beverage business away from S and "sold" it to B. SP1 was unaware of the sale. The same personnel who had worked for S now worked for B. 146 As a result, SP1 continued to collect accounts for B, unaware (at least for a while) that B was a


144. West Coast Food Sales, 637 F.2d at 709.

145. 655 F. Supp. 807 (N.D. Cal. 1987), rev'd, 852 F.2d 1162 (9th Cir. 1988).

146. Even they were confused as to which subsidiary owned the beverage business. Bank of the West v. Commercial Credit Fin. Servs., 852 F.2d 1162, 1169 (9th Cir. 1988).
different entity from S.\textsuperscript{147} In short, even after the bulk sale, $SP_1$ had no way of ascertaining that the sale had even occurred.\textsuperscript{148}

\textsuperscript{147} Id. The opinions are not very clear on the relationship between $SP_1$ and S. According to the appellate opinion:

The factoring agreement provided that [S] would assign its accounts to [$SP_1$]. [$SP_1$] would then collect amounts due from account debtors; three days after collection, [$SP_1$] would remit to [S] the amounts collected, less a 1% commission, and less any prior advances, plus interest. Advances were to be made on accounts which remained uncollected 33 days following assignment. In the factoring agreement, [S] granted $SP_1$ a security interest in its present and after-acquired accounts. In a separate security agreement to secure advances made to [S] pending collection of accounts, [S] also granted [$SP_1$] a security interest in [S]'s present and after-acquired inventory and proceeds.

\textsuperscript{148} Id. at 1165. From the above, it would seem that, if ever S owed $SP_1$ for advances, any given account or piece of inventory was collateral. But $SP_1$'s exposure for the first thirty-three days after an account was signed is unclear. From the above passage, it does not seem as if new value was advanced at the time the account was initially assigned to $SP_1$ for collection.

Judge Schwarzer describes the relationship this way: "The agreement provided that [$SP_1$] would purchase accounts from [S] at a discount from their face value and then collect the sums due from [S]'s customers. After collection, [$SP_1$] would remit to [S] the discounted amount less interest and a commission." \textit{Bank of the West}, 655 F. Supp. at 811. So described, it seems as if $SP_1$ was buying the accounts from [S] on credit and remitting the discounted amount (i.e., the price of the account) to [S] when the account was collected. If this is so, $SP_1$ should not get interest and commissions. On the contrary, it is [S] who should get interest. Alternatively, when Schwarzer said "purchase," he might have meant that $SP_1$ took a security interest in the account in exchange for a loan. In such a case, $SP_1$ might remit all proceeds (less interest on the loan plus a commission), and [S] might pay down principal on the side. That is, $SP_1$ might have foregone its right to set off the amount of the advance to [S] (but retained a right to set off interest and the commission).

Later Judge Schwarzer writes:

From January through September 1984, [$SP_1$] purchased beverage accounts from [S] with a face value of $1,900,000, for which [$SP_1$] paid $1,300,000. . . . [I]nvoices directed account debtors to pay [$SP_1$] . . . . After collecting accounts and remitting proceeds to [S], [$SP_1$] \textit{retained only the amount it originally paid} [S] for the accounts plus $60,000 in interest and commissions. The factoring agreement terminated on October 15, 1984. After that date, [$SP_1$] retained no further collections from account debtors, except to cover one October 31, 1984 interest payment.

\textit{Id.} at 812 (citations omitted and emphasis added). Apparently, $SP_1$ retained (not remitted) the purchase price. This suggests that $SP_1$ advanced cash for the accounts and characterized the advance as the purchase price for the accounts. That is, [S] was a buyer, not a lender. Yet $SP_1$ also obtained interest and commissions above this amount and then returned the balance to [S]. Interest and commissions are inconsistent with $SP_1$ being a buyer. Instead, it sounds as if $SP_1$ was a lender on accounts. As such, $SP_1$ might retain the initial loan (which Judge Schwarzer confusingly calls "the amount if originally paid" \textit{id.}) plus interest and commissions. Any surplus over the amount of $SP_1$'s loan, interest and commissions would be returned to [S].

Factors who buy accounts are treated for historical reasons as if they are secured parties. See 1 G. \textsc{Gilmore}, \textsc{Security Interests in Personal Property} 308 (1965).

\textsuperscript{148} Telephone Interview with Mark R. Reiff, Attorney at Lapidus & Reiff, San Francisco, California (December 20, 1989) (represented $SP_1$ in the litigation).
Within a few months, \( SP_1 \)'s factoring agreement with \( S \) terminated.\(^{149}\) Thereafter, \( SP_2 \), claiming the post-sale accounts as its own collateral, served \( SP_1 \) with a writ of possession requiring \( SP_1 \) to hand over any accounts proceeds it still possessed. In addition, \( SP_2 \) sued \( SP_1 \) for converting its property.\(^{150}\) \( SP_1 \) resisted, claiming it had priority as to the post-sale accounts.

\(^{149}\) This cancellation occurred within four months of the bulk sale. *Bank of the West*, 655 F. Supp. at 816. Therefore, \( SP_1 \)'s financing statement was still good to perfect a security interest in the post-sale collateral, if and only if \( SP_1 \) could show that its security interest attached to such creditor. See U.C.C. § 9-402(7) (1987) (if financing statement becomes seriously misleading, the financing statement is still good to perfect all pre-sale collateral and will continue to perfect post-sale collateral for only four months after the sale).

\(^{150}\) The only property at issue were "accounts generated from the sale of the beverage business's inventory after the transfer of the beverage business from \([S]\) to \([B]\)." *Bank of the West*, 852 F.2d at 1166 (emphasis in original).
At the district court level, Judge Schwarzer avoided deciding whether SP1’s security interest ever attached to the post-sale accounts in question.\footnote{151} Instead, he simply noted that SP2 filed a financing statement (against B) earlier than did SP1 (who filed against S). Applying the “first to file” rule,\footnote{152} Judge Schwarzer awarded priority to SP2. But having done so, Judge Schwarzer then snatched victory from the jaws of SP2. Although Schwarzer is vague on the exact transaction between B and SP1, it appears that SP1 lent funds to B in exchange for a security interest in accounts.\footnote{153} According to Judge Schwarzer, if SP1 had not made this loan, B would have collected the accounts. The proceeds from collection would have been used by B for working capital. SP2 would never have received these proceeds. Therefore, Schwarzer reasoned, SP1’s conversion did not proximately cause SP2’s losses:

The appropriate measure of damages is the loss proximately caused by [SP1’s] conversion. [SP2] is therefore entitled to recover only those sums which were retained by [SP1] and not returned to the beverage business. [SP2] may obtain that portion of the $60,000 in interest and commissions collected by [SP1] for accounts factored after [the bulk sale from S to B].\footnote{154}

Under this formulation, damages excluded the principal amount of the loan and any proceeds remitted to B. It included only the cash proceeds that SP1 still retained by way of commissions and interest, a tiny amount compared with the bulk of the accounts.\footnote{155} Already this was a substantial victory for SP1.

\footnote{151} Judge Schwarzer does discuss the different question of whether SP1’s security interest attached to pre-sale accounts of S. SP2 argued that S never even owned the beverage business in question, so that SP1 did not even receive pre-sale collateral. Although ownership of the beverage business was cloudy, Judge Schwarzer authorized S to use it as collateral. Bank of the West, 655 F. Supp at 813. This finding was unnecessary, since the collateral in dispute was all post-sale collateral. See Bank of the West, 852 F.2d at 1167 (also unnecessarily considering attachment as to pre-sale collateral).
\footnote{152} U.C.C. § 9-312(5) (1987).
\footnote{153} “Here, the funds advanced by [SP1] were used to operate the beverage business and resulted in the creation of new accounts.” Bank of the West, 655 F. Supp. at 819. Whether SP1 was a lender, a buyer, or a debtor is discussed supra in note 147.
\footnote{154} Bank of the West, 655 F. Supp. at 819.
\footnote{155} There is substantial incoherence in Judge Schwarzer’s solution. Judge Schwarzer claims SP2 can have sums retained by SP1 and not remitted to B. Schwarzer characterizes...
SP₂ appealed, but slid backwards into total defeat. Writing for the Ninth Circuit, Judge David Thompson decided that SP₁’s security interest did attach to the post-sale accounts, and that SP₁ had total priority over SP₂.¹⁶⁶ SP₁ was therefore allowed to keep its commissions.

In ruling for SP₁, Judge Thompson zeroed in on the attachment issue. He thought the key issue was “whether [SP₁] has any interest in collateral acquired by [B] after the transfer. At first blush, the answer is no.”¹⁶⁷ But Judge Thompson thought section 9-402(7) demanded a different answer.

In its entirety, and with each sentence separately numbered, section 9-402(7) provides:

[1] A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or names of partners. [2] Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed fi-

these sums as $60,000 in interest and commissions. But if I am right that SP₁ advanced
funds on accounts and repaid itself out of later collections, SP₁ would have retained not
only interest and commissions but the principal amount of its loan. The order that SP₁
surrender retained funds would produce far more than $60,000.

No restatement of this result is free of contradictions either. For example, Schwarzer
might respond to the above critique by saying that he was really trying to isolate proximately caused damages. Damages would exclude amounts that, if B had done the collecting, B would have used in the ordinary course of its business. These amounts correspond to the amount lent by SP₁ to B. But this would be wrong. If B had done the collecting, B would have collected not only what SP₁ lent, but it would have collected the $60,000 in interest and commission expense SP₁ collected and retained. This too would have been used in B’s business, and SP₂ would have sustained no proximately caused damage at all.

If the idea is to give SP₂ $60,000 but to immunize SP₁ from any further liability, Judge
Schwarzer would have to abandon his proximate causation theory and argue simply that
SP₁ is not liable for any sum actually remitted to B. This would guarantee SP₂ the $60,000
in retained interest and commissions, but it would also give SP₂ proceeds equal to the prin-
cipal amount of SP₁’s loan to B—a much larger sum. (The only part of the proceeds
remitted to B would have been the profit—the difference between the amount collected and
SP₁’s total claim on the amount collected). To limit SP₂ to SP₁’s interest and commissions,
Judge Schwarzer might try to argue that SP₁ has a superior right of setoff for the principal
amount of the loan. But if SP₁ could set off principal, why could not it also set off interest
and commissions? If setoff rights are superior, they should be entirely superior of all of
SP₁’s claim. Furthermore, there could be no setoff here because the debts set off are not
mutual. B owes SP₁, on the one hand, and SP₁ owes cash proceeds to SP₂ on the other. No
setoff is possible here. In short, Schwarzer’s theory does not turn on what is remitted to B or
not, nor can it be justified on a theory of proximate causation.

¹⁵⁶. Bank of the West, 852 F.2d at 1174-75.
¹⁵⁷. Id. at 1168 (emphasis in original).
nancing statement becomes seriously misleading, the filing is not
effective to perfect a security interest in collateral acquired by the
debtor more than four months after the change, unless a new appro­
priate financing statement is filed before the expiration of that time.

[3] A filed financing statement remains effective with respect to col­
lateral transferred by the debtor even though the secured party
knows of or consents to the transfer.158

This provision governs financing statements and whether they con­
tinue to perfect a security interest. In particular, the second
sentence says to SP₁, “If the corporate structure changes, so that
people might be misled, you’ve got work to do. You have to get out
and file a new financing statement. Otherwise, your security inter­
est is unperfected on any after-acquired property obtained more
than four months after the change occurs.” That is, the provision
imposes burdens only on SP₁ and promises nothing of benefit.

Judge Thompson, however, turned this provision on its head
and made it into a kind of “piercing the corporate veil” idea. He
reasoned that, instead of placing extra burdens on SP₁, this provi­
sion could bind B on S’s security agreement. His analysis deserves
a careful review.

Judge Thompson starts by worrying whether the second or
third sentence of section 9-402(7) ought to apply. Judge Thompson
noted that the third sentence applies in the case of transferred col­
lateral, but the second sentence (with its four-month grace period
for financing statements) applies in the case of changes in corpo­
rate structure.159 The trouble was that the bulk sale could be
characterized either as a transfer from S to B or as a mere change
in corporate structure. And thus, after playing Hamlet for a while,
Judge Thompson decided to characterize the bulk sale as a change
in corporate structure.160

As I implied earlier, this choice should not have helped SP₁.
At best, the second sentence would have forced SP₁ to file a new
financing statement to perfect security interests in after-acquired
property—a useless endeavor unless SP₁ could show that its secur­
ity interests could attach to post-sale accounts. What SP₁ needed
was an attachment theory, given the fact that B never signed an

159. Bank of the West, 852 F.2d at 1168-70.
160. Id. at 1170.
after-acquired property clause in favor of SP₁.¹⁶¹ For this reason, choosing between the second and third sentence of section 9-402(7) was a waste of time, unless the second sentence supplied an attachment theory.

The theory adopted by Judge Thompson is barely discernible. In his view, the bulk sale of Bank of the West was a form of de facto merger.¹⁶² I have italicized the relevant language so that you don’t miss it:

In summary, we hold that when [S] transferred its assets to [B], this was not a bona fide third party transfer of collateral within the scope of the third sentence of section 9402(7). Rather, [S] simply changed its corporate structure. When the transferor shifts assets to an affiliated company at the behest of their common parent company, and when the transaction has the same effect as a merger of the transferor into the transferee with the transferee as the surviving corporation, we cannot say that this is a simple transfer of collateral. To hold otherwise would permit debtors to decide which sentence of section 9402(7) applies merely by choosing an advantageous formal arrangement for the desired transaction. Thus, applying the second sentence of section 9402(7), we hold that [SP₁’s] security interest continued perfected in [and hence attached to¹⁶³] those assets actually transferred to [B] as well as those assets acquired by [B] during the four months following the . . . transfer. Because the only collateral at issue in this case consists of those accounts factored in the 3½-month period between [the bulk sale] and [the cancellation of the factoring agreement], we need not consider whether the [S-B] transaction rendered [SP₁’s] filed financing statement seriously misleading.¹⁶⁴

¹⁶¹. And even if SP₁ did have an attachment theory, all the post-sale collateral came into existence within four months of the bulk sale. See supra note 149. As a result, SP₁ had an effective financing statement to cover the collateral in dispute, if an attachment theory could be devised.

¹⁶². The de facto merger doctrine was developed to provide shareholder protection in cases when corporate subterfuge might otherwise deny it. Later, it was used in products liability cases, when a seller sold assets to a buyer and promptly dissolved. The idea of the doctrine was to explain why the buyer might be liable on the in personam liability of the seller. See Note, Expanding the Products Liability of Successor Corporations, 27 HASTINGS L.J. 1305, 1316-17 (1976).

¹⁶³. See U.C.C. § 9-303(1) (1987) (“A security interest is perfected when it has attached . . . .”).

¹⁶⁴. Bank of the West, 852 F.2d at 1171 (emphasis added). Judge Thompson also makes much of the West Coast Food Sales case as not permitting S to evade an after-acquired property clause by conveying the business to B. Id. at 1170-71. But this is an incomplete description of that case. As we have seen, there was a perfectly adequate theory to
Although buried in some useless discourse about financing statements, the de facto merger theory genuinely explains how S’s security agreement might be binding on B. Of course, this theory has nothing to do with the effectiveness of anyone’s financing statement. Discussing this matter under section 9-402(7) is therefore misleading.165

There is still the matter of SP₁’s priority over SP₂. It will be recalled that at the district court level Judge Schwarzer applied the “first to file” rule. Judge Thompson reversed on the principle that the “first to file” rule does not apply when two debtors issued separate security interests to competing secured parties.166 According to Thompson, SP₁ had complete priority over SP₂, even though SP₁ was the second to file. As applied to security interests on pre-sale collateral for pre-sale advances, Judge Thompson would have been right to suspend the “first to file” rule. On the other hand, Bank of the West involved entirely post-sale collateral and, probably, post-sale advances. As a result, the court should have developed a more complex priority, as the next section of this Article will show.

c. Priorities When Competing Creditors Have Different Debtors.—With regard to pre-sale property, the basic “first to file or perfect” rule of section 9-312(5) does not necessarily apply when there are two debtors.167 A two-debtor problem resembles the situation portrayed in Figure Seven.

165. For a more recent case declaring a de facto merger (so that B is made liable on S’s security agreement), see Q.T., Inc. v. Thomas Russell & Co., 9 U.C.C. Rep. Serv. (Callaghan) 433, 436 (E.D. Va. 1989).

166. Id. at 1171-73.

167. Judge Thompson has offered a doctrinal justification for the suspension of the “first to file” rule in two-debtor cases. According to section 9-312(1), “The rules of priority stated in other sections of this Part . . . shall govern where applicable.” U.C.C. § 9-312(1) (1987). One such rule is section 9-306(2), which provides: “Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party . . . .” Id. § 9-306(2). The theory is that section 9-306(2) varies the “first to file” rule by providing that the second debtor takes subject to the security interest of SP₁, and that SP₂ is likewise limited. Bank of the West, 852 F.2d at 1174. This theory is compromised, however, by the language of section 9-306(2): “[e]xcept where this Article otherwise provides . . . .” U.C.C. § 9-306(2) (1987) (emphasis added). This language in section 9-306(2) refers us right back to the “first to file” language, and so we are at an impasse.
In Figure Seven, $SP_1$ perfects a security interest and, after that, the debtor sells the collateral out of the ordinary course of business to $B$. $B$ takes subject to $SP_1$'s already perfected security interest, and $SP_2$ ($B$'s lender who has a right to after-acquired property) is automatically junior, even if $SP_2$ was the first to file.

When $SP_2$ is the first to file, it must be true that $SP_1$ prevails. If not, a debtor could easily disencumber her assets by selling them to a buyer with a venerable after-acquired lender. Meanwhile, no amount of research in the files could protect $SP_1$ from this risk.\(^{168}\)

In contrast, where a single debtor grants security interests to both $SP_1$ and $SP_2$, the "first to file or perfect" rule allows $SP_1$ to do the research necessary to protect herself. Although $SP_1$ is "first in time" in a property transfer sense, $SP_1$ could search the records

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\(^{168}\) Steven Harris adds this rationale for the rule: "$SP_2$ had no interest in the goods and could not possibly have been disadvantaged by a secret security interest in favor of $SP_1$," Harris, supra note 1, at 223. While this is true much of the time, it is not so universal as Harris suggests. One justification for pre-attachment filing is so that a secured party can know that she will always be senior with regard to any specific types of collateral. The suspension of the "first to file or perfect" rule might defeat that expectation and therefore prejudice $SP_2$. 

to see that $SP_2$ has already filed and accordingly has priority.\footnote{Id. at 224.}

This is shown in Figure Eight:

In Figure Eight, if $SP_1$ checks the filing records under the debtor’s name, she will find $SP_2$’s financing statement and can react accordingly. Not so when there are sequential debtors, as in Figure Seven.\footnote{The “first to file or perfect” rule does apply in some two-debtor cases, however. Specifically, it occurs when the first debtor sells to the second before $SP_1$ perfects. The buyer must have knowledge of the unperfected security interest. See infra text accompanying notes 267-74. Alternatively, the buyer might have no knowledge but be subordinated for having violated the rules of Article 6. Harris, supra note 1, at 203-11; see infra text accompanying notes 268-78.}

These ideas have been well developed in the work of Barkley Clark,\footnote{B. CLARK, THE LAW OF SECURED TRANSACTIONS § 3.8[4] (1980).} Steven Harris,\footnote{Harris, supra note 1, at 224-26.} and others. But Judge Thompson was nevertheless wrong to apply these thoughts to post-sale property in light of his theory that $B$ and $S$ had entered into a de facto merger.

\textit{i. De Facto Mergers, Post-Merger Property, and Future Advances.—In Bank of the West,}\footnote{852 F.2d 1162 (9th Cir. 1988).} Judge Thompson needed an
attachment theory—a theory to explain why a security agreement signed by S and $SP_1$ would be binding on B, so that post-sale property acquired by B would be encumbered by $SP_1$'s security interest. His solution was to declare the existence of a de facto merger between S and B. On top of this, Judge Thompson suspended the “first to file” rule and gave $SP_1$ priority, even though $SP_2$ had filed years before $SP_1$.

If this case had involved pre-sale collateral and pre-sale advances, this solution would have been unassailable. A merger should be treated just like a sale, with regard to pre-merger property. That is, the “first to file” rule should be suspended, and each secured party should be protected for the pre-merger collateral each separately claims.

But this solution seems inappropriate for post-sale or post-merger collateral. In such a case, each party attaches and perfects a security interest in the collateral at precisely the same time. It was arbitrary for Judge Thompson to favor the second to file over the first to file, with regard to post-merger collateral. Yet it would have been just as arbitrary to favor the first to file. In the case of a merger, neither side could have protected itself by searching the records of possible merger partners.

A better solution is for the two competing secured parties to share pro rata by analogy to the commingling statute. This pari passu rule would displace the “first to file” rule, but it would be consistent with the principle of “first in time is first in right.” That is, these security interests both attached and perfected at the same time. There is no strong reason to subordinate one party to another, and so pro rata sharing seems appropriate.

Pari passu priority is justified because each party obtained perfected security

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174. There is a certain economy of word play here, because while the collateral remains discrete and identifiable, the debtors commingle themselves.

175. One problem caused by pro rata priorities is that, in a foreclosure sale, neither security interest is senior to the other, and so it is impossible for one to foreclose the other. See U.C.C. § 9-504(4) (1987) (foreclosure discharges the security interest from being enforced, plus “any security interest or lien subordinate thereto”). This creates a “reverse prisoner's dilemma,” where the first secured party to proceed loses value to the secured party who does nothing. Suppose, for example, that $SP_1$ and $SP_2$ each claims $1,000, and the post-merger collateral is worth $1,500. Suppose further that they are awarded an equal priority. $SP_1$ elects to foreclose. A buyer would obtain the collateral subject to the other unforeclosed lien and so would pay $500. Later, $SP_2$ can foreclose at her leisure and take the full $1,000. Thus, $SP_1$ was the first to proceed and therefore received only $500. Yet this was precisely what $SP_1$ would have received if it had been completely junior. Each secured
interests simultaneously, and the "first to file" rule has been sus­
pended in double-debtor cases.

This pari passu suggestion for post-merger collateral can only
apply to pre-merger advances or pre-merger commitments to lend
by SP\textsubscript{1}. If, after the merger, SP\textsubscript{1} voluntarily advances funds to B
(with knowledge of the merger), then, in effect, a single debtor (B)
will have granted security interests to two secured parties. Accord­
ingly, the "first to file" rule applies once again, and SP\textsubscript{2} wins
completely, having been the first to file.\textsuperscript{176}

In Bank of the West, the opinions do not specify when the
advances were given. It appears likely, however, that SP\textsubscript{1} made ad­
vances only after an account came into existence. If these were
discretionary advances (not pursuant to a pre-merger commit­
ment), then Judge Thompson should have applied the "first to
file" rule after all.\textsuperscript{177} But there remains this consideration: SP\textsubscript{1} did
not even know the merger had taken place. SP\textsubscript{1} thought it was
making advances to S on collateral owned by S.

It might be possible to apply the rule of section 9-307(3). Ac­
cording to this section:

A buyer other than a buyer in ordinary course of business . . . takes
free of a security interest to the extent that it secures future ad­
vances made after the secured party acquires knowledge of the
purchase, or more than 45 days after the purchase, whichever first
occurs, unless made pursuant to a commitment entered into without

party, then, has an incentive to do nothing. The second best option is to cooperate and
foreclose together. Carlson, Simultaneous Attachment, supra note 32, at 520-525.

If these security interests are foreclosed in bankruptcy, the reverse prisoner’s dilemma
can be avoided because the bankruptcy trustee can sell free of liens and simply divide the

176. Accord White Motor Credit Corp. v. Euclid Nat’l Bank, 63 Ohio Misc. 7, 409
N.E.2d 1063 (Ct. Common Pleas 1978) (“first to file” rule applied as between
SP\textsubscript{1}, whose security agreement was with S, and SP\textsubscript{2}, whose security agreement was with the post-merger
entity).

177. If it were not for the merger theory, we would have to add that advances to B are
not secured by any collateral, unless a written security agreement exists. See U.C.C. § 9­
203(1)(a) (1987) (“a security interest . . . does not attach unless . . . the collateral is in the
possession of the secured party pursuant to agreement, or the debtor has signed a security
agreement”). Unless B is bound on S’s agreement (by virtue of having merged with S), then
SP\textsubscript{1} must produce a security agreement that B has signed. It is often said, however, that
reliance by a promissee takes a contract out of the statute of frauds. Here, SP\textsubscript{1} would have
relied on B’s promise by advancing funds, thereby making a written agreement unnecessary.
knowledge of the purchase and before the expiration of the 45 day period.\footnote{178}

Under section 9-307(3), any advances made pursuant to a pre-sale commitment to lend are senior to a buyer’s interest in the collateral actually bought. In addition, $SP_1$ (if without knowledge of the sale) had a forty-five day privilege to make discretionary senior advances to $S$ (not $B$). If discretionary advances (to $S$) are made within this period, they are treated like pre-sale advances. After that, all discretionary advances by $SP_1$ are junior to the buyer’s interest in the collateral actually bought.

The de facto merger theory of Judge Thompson threatens the use of this provision because the advances were not to $S$ but to a merged $S-B$. In other words, $S$ has ceased to exist, and has been replaced by a sublated new entity. But since this new entity preserves the attributes of $S$,\footnote{179} perhaps we can say that advances to the $S-B$ combination are legally the same as advances to $S$. As such, any committed advances and any discretionary advances made within forty-five days of the merger by an ignorant $SP_1$ are entitled to some kind of priority.\footnote{180}

But recall that the collateral in question was post-merger collateral. As to this collateral (obtained by $S-B$), the “first-to-file” rule is suspended. Instead, we substitute a “first-to-perfect” rule. Whoever between $SP_1$ and $SP_2$ was the first to perfect should have priority. If they are tied, they should share pro rata priority.

In \textit{Bank of the West}, it is hard to tell whether $SP_1$ had committed to make advances (prior to the merger), or whether it had discretion to advance every time an account was tendered to $SP_1$\footnote{181}. If $SP_1$ was committed to advance funds on proffered ac-

\footnotesize
\begin{itemize}
\item \footnote{178} U.C.C. § 9-307(3) (1987).
\item \footnote{179} According to Hegel (our leading philosopher of mergers and acquisitions):
\begin{quote}
What is sublated [i.e., merged] is not . . . reduced to nothing . . . it is a non-being . . . which had its origin in a being. It still has, therefore, \textit{in itself} the \textit{determinateness from which it originates}. “To sublate” has a twofold meaning in the language: on the one hand it means to preserve, to maintain, and equally it also means to cause to cease, to put an end to.
\end{quote}
\item \footnote{180} In other words, we are equating mergers and sales for the purpose of applying section 9-307(3).
\item \footnote{181} Judge Thompson writes: “Advances \textit{were to be made} on accounts which remained uncollected 33 days following assignments.” \textit{Bank of the West}, 852 F.2d at 1165 (emphasis added). Judge Schwarzer writes: “The agreement provided that [SP$_1$] \textit{would purchase accounts from [S] . . . .}” \textit{Bank of the West}, 655 F. Supp at 811. He also hints that the
counts, then all of its advances should have been treated as pre-merger advances. If such was the case, $SP_1$ and $SP_2$ perfected security interests in post-merger accounts at the same time. Since the "first to file" rule is suspended, $SP_1$ and $SP_2$ should share the collateral pro rata.

If, on the other hand, $SP_1$ had discretion to lend or not, all discretionary advances for the first forty-five days must be treated as pre-merger advances, to the extent that $SP_1$ had no knowledge of the merger. These initial protected advances should generate for $SP_1$ a pro rata share of post-merger property. After the privilege in section 9-307(3) lapses, $SP_1$'s discretionary advances to $B$ should be subordinated to $SP_2$'s claims. Now a common debtor has created the security interests of both $SP_1$ and $SP_2$. Hence, the "first to file" rule is reinstated. Under this rule, $SP_2$ is senior to $SP_1$. Thus, if all advances are discretionary, the post-merger advances falling under section 9-307(3) will be entitled to a pro rata priority, and all others will be junior.

ii. Other Attachment Theories.—De facto merger is not the only attachment theory that Judge Thompson could have adopted to show how $SP_1$ might claim post-merger property, but none of the other possibilities succeeds in producing a better priority for $SP_1$. For instance, McBee established the principle that noncomplying bulk transferees are personally liable on the security agreements of $S$. This theory—based upon a strange notion that "ineffective transfers" mean that the buyer and the seller are merged as the same person—has already been criticized. Possibly, this theory is the same one which prevailed in the Bank of the West appeal. In any case, at best it supports pro rata sharing between $SP_1$ and $SP_2$.

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182. U.C.C. § 9-307(3) (1987). There is no finding on this question in the reported opinions, but $SP_1$ did claim to be a holder in due course of checks received from account debtors. Such a claim would involve the assertion that $SP_1$ knew nothing of the merger.


184. Id.

185. Judge Schwarzer ruled that Article 6 did not apply because $SP_1$ claimed "accounts," and Article 6 covers only "inventory" (plus auxiliary equipment). Bank of the West, 655 F. Supp. at 816; see also U.C.C. § 6-102(1),(2) (1987). This holding is correct, insofar as it applied to $SP_1$'s claims to the accounts, but it should be remembered that $S$
A second theory is that, after the sale, B simply assigned accounts to SP₁—one at a time. That is, even if S's security agreement did not cover these accounts, B's agents independently assigned the accounts to SP₁. This theory has a flaw, however. According to UCC section 9-203(1)(a), B must sign the security agreement. In Bank of the West, only S signed. Some method must be found to satisfy this signature requirement. Even if this impediment could be overcome, this attachment theory subordinates SP₁ to SP₂ because SP₂ clearly has priority under the "first to file" rule. ¹⁸⁶ Whereas, before, Judge Thompson could claim (wrongly in my view) that the "first to file" rule is suspended in double-debtor cases, now it must be admitted that SP₁ and SP₂ have the same debtor, B, so that the "first to file" rule would clearly apply.

A third theory might be that B implicitly consented to liability on S's security agreement. If so, then SP₁'s security interest attached to post-sale inventory by virtue of the after-acquired property clause in S's security agreement. This theory requires some evidence of B's consent, and just as important, some way must be found to evade the requirement that B sign the security agreement. ¹⁸⁷ Even if this is possible, SP₁ and SP₂ would have had a single debtor, so that the "first-to-file" rule applies to subordinate SP₁.

A fourth theory might hold that, even if B did not consent implicitly, B is stuck with S's security agreement because the business assets were encumbered by an equitable servitude making the possessor of business assets liable on the obligations of the seller.

also transferred inventory, and SP₁ had a perfected security interest in that inventory. Whereas Article 6 would not permit SP₁ to claim a property interest against accounts, SP₁ might have been a creditor of S. (This is uncertain, see supra note 147). As such, SP₁ would have had rights against the inventory that S transferred to B.

A second idea of Schwarzer was that SP₂ seemed to be a bona fide purchaser for value of inventory and equipment by virtue of its after-acquired property clause in the security agreement with B. Bank of the West, 655 F. Supp. at 816. (No evidence was presented on what SP₂ knew of the bulk sale). Such a status would cut off SP₂ from any claim on inventory. U.C.C. § 6-110 (1987). However, it would have no effect on SP₁’s claims to accounts, which Judge Schwarzer thought unaffected by Article 6.

On appeal, Judge Thompson seemed to assume that Article 6 did apply. Bank of the West, 852 F.2d at 1170 n.6. As a result, B could not claim to have cut off SP₁’s security interest under section 9-307(1) at the time of the bulk sale.

¹⁸⁷ Id. § 9-201(1)(a).
Such a theory is fanciful, but recall this is a California case. In California, equitable servitudes spring up in the darnedest places. Thus, in Ray v. Alad Corp., also a case involving intracorporate transfers, B never agreed to assume the products liability of S. When a person was injured after the bulk sale, he sued B and won, because the obligation to pay for such torts ‘ran’ with the factory. It is not so great an extension to apply this principle to security agreements. Such a theory does not supply SP1 with priority in Bank of the West, however. If B became bound on the servitude when it ‘bought’ the beverage business, then, B has agreed to encumber its after-acquired property for the first time. Since both SP1 and SP2 have a common debtor, the ‘first-to-file’ rule of section 9-312(5) applies, which subordinates SP1 to SP2.

One theory that would not work to establish attachment of SP1’s security interest on B’s post-merger property is that S made a fraudulent conveyance to B thereby reviving the after-acquired property clause against B. Fraudulent conveyance law gives in rem rights in B’s property. SP1 needs a theory that establishes B’s in personam obligation on the security agreement of S. In any case, SP2 would have been a bona fide purchaser for value who takes free of any in rem right created by fraudulent conveyance law. Nor is it clear that fraudulent conveyance law could encumber post-merger property.

188. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977); For comparsion of Ray v. Alad to equitable servitudes, see Carlson, Successor Liability in Bankruptcy: Some Unifying Themes of Intertemporal Creditor Priorities Created by Running Covenants, Products Liability, and Toxic Waste Cleanup, 50 LAW & CONTEMP. PROBS. 119 (1987). For a history of this development in the law of products liability, see Note, supra note 162.


190. One commentator thinks that the entire line of cases analyzed in the text is a category mistake: “A few courts have regarded the transfer of items of inventory as somehow tantamount to a transfer of the category, such that items later acquired by the transferee independent of the transferor debtor have been held to fall within the inventory clause of the original security agreement.” Knippenberg, Debtor Name Changes and Collateral Transfer Under 9-402(7): Drafting From the Outside-In, 52 Mo. L. REV. 57, 107-08 (1987) (footnote omitted).

191. See Note, supra note 38.

192. This is what Judge Schwarzer ruled. Bank of the West v. Commerical Credit Fin. Servs., 655 F. Supp. 807, 816 (N.D. Cal. 1987), rev’d on other grounds, 852 F.2d 1162 (9th Cir. 1988).
iii. How Bank of the West Should Have Been Decided.—Since the reasoning in Bank of the West has sustained heavy damage, it might be useful to describe how I think the case should have been decided by the Ninth Circuit Court of Appeals.

First, $SP_1$’s case depends entirely on whether it can prove a theory of attachment. Special emphasis should be put on the fact that $SP_1$ acted honestly in thinking that it had advanced funds to $S$ pursuant to its factoring agreement, instead of advancing funds to $B$, with whom it had no agreement. Judge Thompson’s de facto merger theory does provide an attachment theory that provides $SP_1$ with something better than a totally subordinated position.

Accordingly, I would agree that $B$ and $S$ are to be treated as merged. This ruling has nothing to do with section 9-402(7), however, which simply governs the effectiveness of $SP_1$’s financing statement. Instead, the de facto merger doctrine would be adapted from California’s free-wheeling tort law.

Having ruled that $SP_1$’s security interest attached to the post-sale accounts of $B$, I would then reverse and remand the case on the strength of a theory that Judge Schwarzer completely rejected. The best theory for $SP_1$ is that it was a holder in due course of checks from the account debtors and therefore took free of $SP_2$’s senior security interest.

Invariably, when $SP_1$ obtained payment of an account, the account debtor wrote $SP_1$ a check, or the account debtor wrote $B$ a check which was negotiated over to $SP_1$. These checks were proceeds of the accounts. Accordingly, $SP_2$ had a valid security interest in these checks, but if $SP_1$ took the checks as a holder in due course, it took free of $SP_2$’s security interest. This is a risk that receivables lenders face routinely. According to Professor Paul Shupack:

> When a secured lender relies on priority rights to after-acquired intangibles, her expectations may be defeated by making those rights tangible and then having the tangible version of those rights acquired by a good faith purchaser. If, for example, a lender relies on a pool of continuously renewing accounts receivable, a debtor could defeat the creditor’s interest by having his customers embody their obligations in negotiable instruments. The debtor could then sell

193. Id. at 812.
194. U.C.C. § 3-305(1) (1987) (“To the extent that a holder is a holder in due course he takes the instrument free from (1) all claims to it on the part of any person . . . .”).
these instruments to a person who qualifies as a holder in due course, leaving the original secured creditor without assets she legiti-

mately expected to be available to her.\textsuperscript{195}

Judge Schwarzer rejected this theory on inadequate grounds. He thought that $SP_2$ was not claiming an interest in the checks them-

selves. Instead, $SP_2$ was claiming accounts. Accordingly, it was the assignment of accounts by $B$ to $SP_1$ that was the act of conversion. Therefore, a later liquidation of the accounts into checks was irrelevant, and so was the claim that $SP_1$ was a holder in due course of those checks. This argument is founded on an erroneous premise. The sale of accounts cannot be an act of conversion. Article 9 specifically authorizes the transfer of debtor equity in collateral.\textsuperscript{196} In light of this authorization, it takes a greater interference with $SP_2$'s rights to constitute the act of conversion.\textsuperscript{197}

Because the assignment of accounts cannot have been the act of conversion, and because $SP_2$'s security interest continued to encum-

ber the accounts after the assignment, $SP_2$ did indeed claim a property right to the checks themselves. These checks were proceeds of the accounts. If $SP_1$ were a holder in due course,\textsuperscript{198} then $SP_1$ would take free of property claims of third parties, such as $SP_2$.\textsuperscript{199}

The worst result in commercial law is when ordinary account debtors are made to pay twice. There is no danger of that here. According to section 9-318(3), "The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due . . . has been assigned . . . ."\textsuperscript{200} This provision would allow the account debtor to pay $SP_1$ until $SP_2$ notified the account debtor of its senior security interest. Although $SP_1$ is not the assignor, $SP_1$ took by assignment everything the assignor ($B$)

\textsuperscript{195.} Shupack, Defending Purchase Money Security Interests Under Article 9 of the UCC From Professor Buckley, 22 Ind. L. Rev. 777, 788 (1989).

\textsuperscript{196.} U.C.C. § 9-311 (1987).

\textsuperscript{197.} See Nickles, Enforcing Article 9 Security Interests Against Subordinate Buyers of Collateral, 50 Geo. Wash. L. Rev. 511, 526 (1982).

\textsuperscript{198.} Because Judge Schwarzer thought it impossible for $SP_1$ to be a holder in due course, he declined to find whether $SP_1$ was without notice. Bank of the West, 655 F. Supp. at 820 n.9.

\textsuperscript{199.} U.C.C. § 3-305(1) (1987); see id. § 9-309 ("Nothing in this Article limits the rights of a holder in due course . . . [and] [f]iling under this Article does not constitute notice of the security interest to such holders or purchasers.").

\textsuperscript{200.} Id. § 9-318(3).
had, including the power in section 9-318(3) to double-deal senior assignees by demanding payment from account debtors before they hear of the senior assignment.\footnote{201} Hence, the account debtors were authorized to pay $SP_1$. Furthermore, as a holder in due course, $SP_1$ has no liability for receiving this payment.

Bank of the West therefore should have been remanded to determine the extent to which $SP_1$ was a holder in due course of each check it received. For every such check, $SP_2$'s conversion claim is defeated.\footnote{202}

\footnote{201. Compare supra note 170 (describing how junior buyers inherit the debtor's power to double-deal senior unperfected secured parties).

202. I have implied in the text that $SP_1$ needs an attachment theory in order to be a holder in due course. Behind this claim lies some difficult and tenuous analysis. Suppose the de facto merger theory is rejected. The other theories, see supra text accompanying notes 183-92, fail to establish that $B$ signed a security agreement in favor of $SP_1$, as required by section 9-203(1)(a) ("a security interest is not enforceable against the debtor or third parties . . . unless . . . the debtor has signed a security agreement.") (emphasis added). Without a security agreement signed by $B$, $SP_1$ is neither a purchaser of accounts nor the owner of an unperfected security interest. See U.C.C. § 9-102(1) (1987) ("this Article applies . . . (b) to any sale of accounts"). As a result, $SP_1$ never took a security interest in any account. Or, to say it another way, $B$ never sold or otherwise transferred any accounts to $SP_1$. Yet $SP_1$ is the holder of checks made out to it by $B$'s account debtors.

Putting these two legal conclusions together, it appears that $SP_1$ has not given value and is not a holder in due course. U.C.C. § 3-302(1)(a) (1987). Instead, $SP_1$ has made an unsecured loan to $B$, but this loan is utterly unconnected to its receipt of the check. That is, $SP_1$ is, at best, a collection agent for $B$, and a lender to $B$, but collection and the unsecured loan must be unrelated and unconnected, if we are to give effect to the premise that no effective assignment of accounts by $B$ to $SP_1$ took place for lack of $B$'s signature on a security agreement. "Value," for the purposes of being a holder in due course, is defined in section 3-303: If $SP_1$ has an attachment theory, it is easy to find that $SP_1$ took the checks for value. Section 3-303 says that value exists when $SP_1$ has a security interest in the instrument. Given attachment of a security interest in accounts, $SP_1$ would have a security interest in the checks because the checks are proceeds of the accounts that $SP_1$, by hypothesis, would own. But if there is no attachment theory, the only language in this definition that could be relevant to $SP_1$ is section 3-303(b), which provides that "[a] holder takes the instrument for value . . . (b) when he takes the instrument in payment of or as security for an antecedent claim against any person . . . ." This language, though, cannot describe $SP_1$ unless one also adds an attachment theory. The checks from the account debtors are in payment of an antecedent claim owned by $B$, but section 3-303(b) seems to require that $SP_1$ own the antecedent claim which is paid. Otherwise, collecting agents would routinely be holders in due course, which is not the case. J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 622-27 (3d ed. 1988).

In the absence of an attachment theory, $SP_1$ has one remaining argument: Article 9 (with its signature requirement) does not even cover this transaction. According to section 9-104(f), Article 9 does not apply to a sale of accounts . . . as part of a sale of the business out of which they arose, or an assignment of accounts . . . which is for the purpose of collection only, or a transfer of a right to payment under a contract to an assignee who is also to do the perform-
In case $SP_1$ is not a holder in due course, further consideration of the priorities is necessary. The next point I would make is that the case should have been remanded for a determination of whether any of $SP_1$’s claim comes from advances or commitments made before the merger. There is a good chance that all of its claim is pursuant to a pre-merger commitment to lend. Even if the advances were discretionary, it is still possible that some of the advances pre-date the merger.

Let us suppose that some or all of the claims are pre-merger claims. The first thing that needs to be done is to investigate $SP_1$’s claim to inventory. If any pre-merger inventory still existed at the time of $SP_2$’s lawsuit, this should have been awarded to $SP_1$ on the strength of pre-merger advances, even though $SP_2$ filed first.\footnote{This is because the “first to file” rule is suspended in two-debtor cases. Instead, we apply the “first to perfect” rule. As to old inventory, $SP_1$ clearly perfected first to the extent $SP_1$ gave pre-merger advances under the contract or a transfer of a single account to an assignee in whole or partial satisfaction of a preexisting indebtedness.}

We have said that $SP_1$ is a mere collection agent, in the absence of an attachment theory, and section 9-104(f) does exempt collection agents from Article 9. $SP_1$ might hope that it can take a common-law assignment for the purpose of collection, and then, as an unsecured creditor of $B$, $SP_1$ might retain the collection by way of setoff against the unsecured loan it has made to $B$. If the common law of assignments applies, the statute of frauds might require a writing, but not $B$’s signature. In 

Bank of the West, there was a writing; it was the security agreement between $S$ and $SP_1$. If Article 9 does not apply, then $SP_1$ could claim to be the owner of accounts under the common-law doctrine of assignment.

If so, then $SP_1$ is a holder who takes “the instrument in payment of . . . an antecedent claim against any person.” U.C.C. § 3-303(b) (1987). That is, $SP_1$ has taken the account debtors’ checks in order to create a setoff against $B$. See U.C.C. § 9-104(i) (1987) (setoffs not covered by Article 9). But this doesn’t quite work. Section 3-303(b) requires the checks to be in payment of $B$’s obligation to $SP_1$. Here, $SP_1$ is collecting checks for $B$, but they do not “pay” $SP_1$’s claim against $B$. Instead, the manifestation of a later setoff is the payment. Hence, the use of section 9-104(f) does not show that $SP_1$ took the checks for value.

Nor can $SP_1$ claim that it took assignments of accounts in satisfaction of an antecedent claim by $SP_1$ against $B$. The facts of \textit{Bank of the West} probably are that, first, the account came into existence, and then it was assigned to $SP_1$ in exchange for an advance. Also, it is unlikely that the assignment is in satisfaction of antecedent debt. Rather, it appears that the accounts are security for $B$’s obligation to pay back loans.

If I am right, $SP_1$ needs an attachment theory to be a holder in due course of the checks received from the account debtors of $B$. A de facto merger is a convenient theory because it explains how $B$ signed a security agreement. Under this theory, $B$ becomes $S$. Since $S$ signed the security agreement, $B$ signed it too (through merger theory). By this means the requirements of section 9-203(1)(a) would be met.

\footnote{Judge Thompson recognized this in his opinion. \textit{Bank of the West v. Commercial Credit Fin. Servs.}, 852 F.2d 1162, 1168 (9th Cir. 1988).}
value. Now this inventory is not at issue in the lawsuit by SP\textsubscript{2} for conversion of accounts. Nevertheless, this determination must be made in anticipation of the point that SP\textsubscript{1} must be given a chance to trace pre-merger inventory and pre-merger accounts into post-merger accounts. If this can be done, SP\textsubscript{1} obtains complete priority for any traceable amounts.

A different priority exists for post-merger accounts that cannot be traced to SP\textsubscript{1}'s pre-merger collateral. If SP\textsubscript{1} had any pre-merger claims or if it had made post-merger advances pursuant to a pre-merger commitment to lend, SP\textsubscript{1} and SP\textsubscript{2} must share the leftover disputed collateral on a pro rata basis.\textsuperscript{204} Since SP\textsubscript{1} has retained $60,000 in interest and commissions plus the principal amounts of any loans, SP\textsubscript{1} could conceivably have some conversion liability to SP\textsubscript{2} on this proposition, although it will depend on how successful SP\textsubscript{1} was in showing itself to be a holder in due course of checks or in tracing inventory into accounts and how large the claim of each secured party is.

Finally, if SP\textsubscript{1} gave discretionary advances after the merger, these advances are treated like pre-merger advances to the extent they can be brought under section 9-307(3). Thus, on remand, it could be necessary to determine when SP\textsubscript{1} became knowledgeable of the sale of the beverage business to B. If SP\textsubscript{1} remained ignorant of the sale for more than forty-five days, then any discretionary advances forty-five days after the de facto merger are to be treated as pre-merger advances.\textsuperscript{205} That is, these advances will generate for SP\textsubscript{1} a pro rata share of post-merger collateral. If SP\textsubscript{1} obtained this knowledge earlier than forty-five days, then only advances made prior to gaining this knowledge will be treated as pre-merger advances. Any advances failing to come under the section 9-307(3) umbrella will not enjoy pro rata priority with SP\textsubscript{2}'s claims and instead will be entirely subordinated.

\textsuperscript{204} See supra text accompanying notes 174-75.

\textsuperscript{205} Of course, if SP\textsubscript{1} had no knowledge of the merger for forty-five days, it was probably a holder in due course of checks from the account debtors, and so would have a better priority than merely pari passu, as the use of section 9-307(3) would provide. See supra text accompanying notes 193-202.
2. Proceeds and Commingling Theory in McBee

For those who scorn the above fancy theories for dissolving the seller into the buyer, there are two more pedigreed theories for establishing that $SP_1$ gets a security interest in inventory acquired by $B$. First, if $B$ took encumbered inventory and sold it, and then took the cash proceeds and bought new inventory (a plausible result), then the new inventory would be proceeds of the old inventory. As such, the new inventory would belong to $SP_1$. Second, if the old inventory were commingled with new inventory in such a way that neither the new nor the old inventory could be identified, then $SP_1$ might be awarded a security interest under UCC section 9-315, which pertains to security interests in commingled goods.

These theories—particularly commingling—do not explain the McBee case unless there are additional facts beyond those disclosed in the published opinion. Neither Judge Williams of the Fifth Circuit nor Bankruptcy Judge Elliott mentions whether the proceeds of old inventory went to buy new inventory, or whether inventory was commingled. Indeed, the inventory (guns and weapons) is likely to be highly identifiable and hence it is unlikely that McBee was a secret commingling case.

a. The Priority of $SP_3$ (as Junior to $SP_1$ and $SP_2$).—Just in case McBee was a secret commingling case, Professor Harris offers us an interpretation of section 9-315(2), which provides:

When under subsection (1) [of Section 9-315] more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

According to Harris, where $SP_1$ and $SP_2$ have security interests in inventory sold by $S$ to $B$, and where $B$ commingles the inventory with other property as to which $SP_1$ and $SP_2$ have no claim, and where, subsequent to commingling, $B$ then grants a security interest to $SP_3$, then section 9-315(2) does not apply to make all these interests equal.

206. Harris, supra note 1, at 231-33.
207. Id. at 233-36.
208. As Professor Harris recognizes. Id. at 236.
secured parties equal in priority. Instead, $SP_1$ and $SP_2$ have priority over $SP_3$. The exact order of events is crucial:

1. $SP_1$ and $SP_2$ attach and perfect;
2. $S$ transfers inventory to $B$;
3. $B$ commingles collateral and noncollateral;
4. $B$ issues a junior security interest to $SP_3$.

If we switch the order around just a little:

1. $SP_1$ and $SP_2$ attach and perfect;
2. $S$ transfers inventory to $B$;
3. $B$ issues a junior security interest to $SP_3$ (on post-sale inventory);
4. $B$ commingles the collateral of $SP_1$ and $SP_2$ with the collateral of $SP_3$;

then section 9-315(2) applies and all secured parties are equal in priority. Pari passu priority follows because, now, each secured party has a perfected security interest in uncommingled inventory and has now contributed collateral to the whole. Before, $SP_3$ had not contributed its own collateral into the common pool, but simply took a junior security interest on the entire pool. Given the former temporal order that actually existed in the McBee case,

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210. Harris states:

To avoid dealing with subsection (2) altogether, one can argue that [$SP_3$]'s security interest did not attach to the mass by virtue of commingling "under subsection (1)," but rather by virtue of its security agreement under sections 9-201 and 9-203(1). Under this approach, section 9-315(2) by its terms does not apply, and one must look elsewhere, to equitable principles, to resolve the priority dispute. When the buyer does not sell any of the commingled inventory, those principles award priority to $SP_1$ in an amount equal to the value of the collateral transferred.

Harris, supra note 1, at 235-36 (footnotes omitted and emphasis added). I will dispute the correctness of the italicized assumption later on. See also Carlson & Shupack, Part II, supra note 44, at 864 ("Although the matter is considered here for the first time, we suggest that a judicial lien attaching to the whole after the moment of commingling is, of course, always junior. The only security interests that survive to encumber the whole are security interests perfected before commingling. As such, they prevail under the "first in time" rule of section 9-301.").

211. This temporal order would have occurred as a matter of course if $SP_3$ had an after-acquired property claim on inventory at the time the bulk seller transferred inventory to $B$. In such a case, $SP_3$ would have a senior security on all inventory except that inventory transferred in the bulk sale. For a case involving just these facts, see In re San Juan Packers, Inc., 696 F.2d 707 (9th Cir. 1983) (ruling the parties to be pari passu under section 9-315(2)).

212. Though we are just pretending that the case involved commingling.
agree with Harris that $SP_3$ is junior, not *pari passu* with $SP_1$ and $SP_2$, but Harris does not tell us who has priority between $SP_1$ and $SP_2$. This subpriority issue is worth exploring.

b. The Priority of $SP_1$ and $SP_2$ Inter Se—Before commingling, $SP_1$ was senior to $SP_2$, but after commingling, section 9-315(2), if read literally, equals $SP_1$ and $SP_2$. That is, $SP_1$ has lost its priority vis-a-vis $SP_2$.

This should not be the rule. Instead, we should recognize that section 9-315(2) contains an unacknowledged assumption—that where two nonpurchase money security interests encumber a component added to the common mass, with one senior to the other, their priority vis-a-vis each other is not affected by the pro rata rule of section 9-315(2). Instead, the portion that $SP_1$ and $SP_2$ claim should be given to them jointly, with $SP_1$ having priority over $SP_2$ for this amount.

As a matter of fact, $SP_2$ was a purchase money lender and so should have had priority over $SP_1$. But purchase money status requires that the purchase money collateral still be identifiable. $SP_2$ must be able to point to the exact inventory that is purchase money inventory, or to inventory or other property that is proceeds of the purchase money inventory. If $SP_2$ cannot do so, then an

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213. This may be because, in his article, $SP_1$ and $SP_2$ are collapsed for expositional purposes into a single entity. That is, my $SP_1$ and $SP_2$ equals Harris's $SP_1$, whereas $SP_3$ does not exist in Harris's article.

214. For example, suppose $SP_1$ and $SP_2$ both claim $10,000 in inventory. This amount is added to $5,000 of inventory as to which $SP_3$ already had a pre-colliding perfected security interest. On these facts, $SP_3$ is *pari passu* with the combined unit of $SP_1$ and $SP_2$. $SP_1$ and $SP_2$ are jointly entitled to $10,000 under the ratio described in section 9-315(2), but $SP_1$ would have seniority to $SP_2$ for the entire amount.


216. This tracing requirement can be shown to exist as a normal incident of property law. Suppose $SP_1$ claims inventory items A, B, and C, and any after-acquired inventory. Suppose $SP_2$ lends purchase money so that items D and E are acquired. Assume also that $SP_2$ has obtained a superpriority by complying with section 9-312(3). Now suppose that the debtor commingled the group together, so that it is impossible to tell which item is which. $SP_2$ has no security interest on items A, B, and C (or, if it claimed nonpurchase money inventory in addition to purchase money collateral, it is junior to these items). $SP_2$ must repossess only its collateral. If $SP_2$ grabs any old piece of inventory, regardless of whether it has a lien on it, then $SP_2$ may be grabbing property of another. This is not allowed. $SP_2$ can repossess only the items in which $SP_2$ has a security interest. Hence, $SP_2$ must be able to identify its collateral in order to repossess it. *Cf*. Raleigh Indus. of America, Inc. v. Tassone, 74 Cal. App. 3d 692; 141 Cal. Rptr. 641 (1977).
act of commingling must have occurred. That is, both $SP_1$ and $SP_2$ claimed perfected security interests in separate items of inventory that subsequently found their way into a commingled mass. Because this occurred, $SP_1$ and $SP_2$ should have shared a pro rata priority under section 9-315(2). When the bulk sale to $B$ occurred, followed by a hypothetical second commingling, the second commingling invoked pro rata priority for a second time. Under this scenario, $SP_1$ and $SP_2$ should have shared a pro rata priority with $SP_3$.

David Frisch, who has written the leading article on commingling, disagrees.\(^\text{217}\) He claims that $SP_1$ and $SP_2$ can never be *pari passu* under section 9-315(2).\(^\text{218}\) Instead, $SP_2$ is either senior or junior to $SP_1$, depending on whether $SP_2$ perfected in time to preserve her superpriority. He has two arguments for this position; one is linguistic, based on the language of Article 9, while the other emphasizes the potential for abuse if a *pari passu* priority were the rule. Neither argument is convincing.

The linguistic argument is that section 9-315(2) requires each competing secured creditor to obtain a lien on the whole through section 9-315(1).\(^\text{219}\) That is, each secured party must have a lien on the whole solely because its collateral was commingled with noncollateral.\(^\text{220}\) In *McBee*,\(^\text{221}\) for example, $SP_1$ obtained its lien on the whole (of the seller's inventory) through an after-acquired property clause, rather than solely through section 9-315(2).\(^\text{222}\) Under Frisch's view, $SP_1$ and $SP_2$ would never be *pari passu* under section 9-315(2).

and $E$ did not create a security interest in other inventory). The *Tassone* case should be read with care. It involved California's nonuniform (and since amended) Article 6, which required nonpurchase money secured parties to notify general creditors as if the second party were a bulk buyer.


\(^{218}\) *Id.* at 48-52.

\(^{219}\) *Id.* at 49.

\(^{220}\) *Id.*

\(^{221}\) Recall that we are assuming that the seller commingled $SP_2$'s purchase money inventory with $SP_1$'s nonpurchase money inventory. The reported opinions do not say whether this really occurred.

\(^{222}\) This commingling was presumed to have been accomplished by the seller; the bulk sale to $B$ has not yet occurred. Note that the reported opinions say nothing about the seller's commingling or $B$'s commingling. One suspects, however, that if one commingled, both did, since their business practices were probably identical.
The argument that $SP_1$ must have obtained a lien on the whole through commingling only is not convincing based on the language of section 9-315(2). $SP_1$ can claim a lien through commingling under section 9-315(1) and through the after-acquired property clause. Nothing in section 9-315(2) prevents an after-acquired property clause from overlapping with security interests through section 9-315(1).

As a second argument, Professor Frisch observes that if $SP_2$ has failed to send the advance letter to $SP_1$ required by section 9-312(3)\textsuperscript{223} and, subsequently, if $SP_2$ is subordinated to $SP_1$, then $SP_2$ can recoup part of this lost priority by becoming pari passu under section 9-315(2).\textsuperscript{224} This partial recoupment is seen as subverting the requirement that letters be sent to after-acquired property lenders in inventory cases. Hence, to prevent such abuses, whatever priorities are established under the ordinary purchase money rules should be continued in spite of commingling.

This second point is a good one. Section 9-315(2) should not have the effect of mitigating perfection mistakes. If $SP_1$ is senior because $SP_2$ failed to send the letter required by section 9-312(3), then $SP_2$ should not benefit from loss of identity of the purchase money collateral. From this admittedly good point, Professor Frisch concludes that a purchase money lender should continue to have priority, even in spite of commingling and loss of collateral identity.\textsuperscript{225}

This is fine if $SP_2$ fails to send the letter. But suppose $SP_2$ has sent the required letter and is senior to $SP_1$ prior to commingling. After commingling, $SP_2$ can no longer identify its collateral. Suppose further that Frisch is correct and section 9-315(2) does not apply. If pari passu priorities are forbidden, we must either abandon the tracing rule and give $SP_2$ her superpriority anyway, or we must apply the "first to file" rule.

Frisch favors abandoning the tracing requirement.\textsuperscript{226} Yet, tracing is what makes Article 9 a "first in time is first in right" property regime. Without tracing, a purchase money lender has an

\textsuperscript{223} U.C.C. § 9-312(3)(b) (1987) (requiring purchase money secured party to give notification in writing to the holder of the conflicting security interest).

\textsuperscript{224} Frisch, supra note 217, at 51.

\textsuperscript{225} Id.

\textsuperscript{226} Id. at 48 ("A mass is apportionable and it is therefore possible to recognize a [purchase money secured party's] superior right of disposition . . . ").
effective floating lien on inventory. In effect, the abandonment of tracing renders Article 9 a regime of "last in time is first in right."

Admiralty presents a lien system based in part on a rule of "last in time is first in right." The rule is no threat at all to secured financing if we can be sure that every new loan added an equivalent new value to the estate. But since we cannot be sure that purchase money loans are rational in this way, the abandonment of tracing and the establishment of a "last in time" priority shifts the risk from the purchase money lender to the after-acquired property lender.

If we are resolved to hang onto tracing because it is fundamental to the rule of "first in time is first in right," then a purchase money lender loses the superpriority if the collateral cannot be identified. If, per Frisch, section 9-315(2) cannot apply, then the purchase money lender goes from superpriority to complete juniority, just because the debtor commingled. Frisch's rule which is based on the results of hypothetical misconduct by $SP_2$, now punishes $SP_2$ in spite of her good behavior of sending the letter required by section 9-312(3)(a).

227. I am assuming that such a floating lien can be contained to inventory and that it would not float around the debtor's entire estate. This limitation is rather arbitrary. If we no longer care which items the purchase money lender grabs, why should the scope of floatation be limited to inventory, or even personal property?


229. Two often cited commentators have emotionally predicted that "[u]nless this elementary condition [of tracing] is satisfied, no creditor will ever agree to lend on a secured basis." Jackson & Kronman, Secured Financing and Priorities Among Creditors, 88 YALE L.J. 1143, 1177 (1979). Such a statement is overwrought; collateral is constantly invaded by all sorts of legal and nonlegal factors, and yet, secured lending continues to exist. The statement nevertheless does capture a partial truth: if the purchase money priority is enforced without strict attention to tracing, the property rights of the after-acquired property lender are compromised.

230. See Frisch, supra note 217, at 48.

231. See id. at 48-51. Frisch, of course, would favor $SP_2$ by abandoning the tracing rule. The point made in the text is that if we keep tracing and still insist that pro rata sharing is inappropriate, then $SP_2$ is rendered junior by any act of commingling.

232. Ironically, while Frisch favors the survival of the purchase money status in case of commingling (even though the purchase money collateral can no longer be located), he disfavors it in accession cases, where the purchase money collateral can be identified. See id. at 58-59. I think he has it precisely backwards!

One feature of an accession (a part added to the whole) is that a secured party claiming the part may elect her priority under the accessions statute (section 9-314) or under the commingling statute (section 9-315). See U.C.C. § 9-315 comment 3 (1987). If the secured party claiming the part elects to have a security interest in the whole under section 9-315,
The rule I advocate avoids the unfortunate side effect that Professor Frisch has identified and therefore constitutes the better medicine. First, if \( SP_2 \) has perfected a purchase money security interest, and if the debtor has commingled the purchase money inventory, then \( SP_2 \) is demoted for failure to identify the collateral, but only to \textit{pari passu}—not total juniority. Second, if \( SP_2 \) has not established priority over \( SP_1 \), then she is totally subordinated under section 9-315(2).

An example of this is as follows: Assume that \( SP_1 \) is an after-acquired property lender who has advanced \$150 and who claims \$100 of existing inventory. \( SP_2 \) is a purchase money lender who claims \$80 of identifiable inventory and who lent \$60. Before commingling, \( SP_1 \) has a junior security interest to the \$80 in inventory (that is, a claim on the \$20 in equity). \( SP_2 \) has no claim on the other nonpurchase money collateral (or, if the security interest so provides, a claim that is junior to \( SP_1 \)'s security interest).

Now suppose that the debtor commingles and also that the total inventory has shrunk from \$180 to \$120 in value. That is, losses have occurred that must be allocated between \( SP_1 \) and \( SP_2 \). If \( SP_2 \) perfected by sending \( SP_1 \) the proper letter under section 9-312(3), then \( SP_1 \) is \textit{pari passu} with the combined \( SP_2-SP_1 \) unit of purchase money inventory. Thus, \( SP_1 \) is entitled to a pro rata share of the remaining inventory according to this formula:

\[
\text{This formula is based on section 9-315(2), which provides that } SP_1 \text{ and } SP_2 \text{ are to } \text{"rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass." U.C.C. § 9-315(2) (1987).}
\]
\[
\frac{100}{100 + 80} \times 120 = $66.66
\]

The combined \( SP_2 - SP_1 \) unit (representing the purchase money contribution to the commingled pool) gets this share:

\[
\frac{80}{100 + 80} \times 120 = $53.33
\]

Of this combined share, \( SP_2 \) is totally senior to \( SP_1 \), so that \( SP_2 \) (who lent $60) takes it all.

Now suppose that \( SP_2 \) had not perfected according to section 9-312(3). Now \( SP_2 \) is junior as to the combined \( SP_2 - SP_1 \) unit of $53.33. Hence, \( SP_1 \) (on these numbers) would take its own $66.66 share and would take what it needs ($33.33) from the combined \( SP_2 - SP_1 \) share of $53.33. \( SP_2 \) is junior and gets only the leftovers of $20.00. In this way, if \( SP_2 \) has not sent the letter that section 9-312(3) requires, \( SP_2 \) is totally junior to \( SP_1 \), whether commingling occurs or not. But if \( SP_2 \) has sent the fateful letter, \( SP_2 \) does not fall all the way to juniority if tracing is impossible due to commingling. Instead, \( SP_2 \) becomes pari passu with \( SP_1 \).

c. Expansion and Shrinkage of Inventory.—Professor Harris has added another unstated assumption to the mechanics of section 9-315(2)'s unusual priority: if \( SP_1 \) and \( SP_2 \) are undersecured, they may not use commingling as an excuse to improve their position.\(^{234}\) That is, if the inventory encumbered by the liens of \( SP_1 \) and \( SP_2 \) equals $10,000 in value, then $10,000 is the most they can receive, no matter what.\(^{235}\) If the mass of commingled inventory expands, the excess constitutes debtor equity. In the context of the McBee case, this debtor equity was given to \( SP_3 \), so that \( SP_3 \) was the sole beneficiary of inventory expansion.\(^{236}\)

\(^{234}\) See Harris, supra note 1, at 234-35.

\(^{235}\) David Frisch locates this limitation idea in the origins of section 9-315(1)(b) in the equity doctrine of tracing, where improvement of position was never allowed. See Frisch, supra note 217, at 41-45.

\(^{236}\) Judge Williams similarly limited \( SP_1 \) and \( SP_2 \) to a maximum entitlement—the amount of pre-sale inventory commingled in the mass (suggesting that perhaps McBee was
Although not stated in section 9-315, this innovation makes sense. But I disagree with Harris's view that the security interest of $SP_1$ and $SP_2$ might shrink from the $10,000 limit if the mass decreases in value (through sale to customers). Recall that Harris and I agree that $SP_1$ and $SP_2$ have priority to the mass over $SP_3$, with the proviso that $SP_1$ and $SP_2$ be limited to the amount of the

an unacknowledged commingling case). See National Bank of Tex. v. West Tex. Wholesale Supply Co. (In re McBee), 714 F.2d 1316, 1331 (5th Cir. 1983). ("While $[SP_1]$ and $[SP_2]'s$ priority is limited to the overall value of the inventory transferred in bulk to $[B]$, it is not limited to the actual inventory remaining and traceable to the bulk sale." (footnotes omitted and emphasis in original)). Judge Williams attempts to justify this limitation based upon comparison to voidable preference law:

The trustee in bankruptcy is not a party to this proceeding. We note, however, that under the Bankruptcy Act an after-acquired property interest in collateral to the extent of the value of the collateral at a set pre-bankruptcy date may only be valid against the trustee. 11 U.S.C. § 547. Thus, under the Act, a secured creditor—even without an intervening bulk sale—might not be able to enforce his "floating" lien for the greater value of inventory at the time of bankruptcy. Without deciding whether the result we reach is required by this section of the Bankruptcy Act, we note its consistency with the result we reach under the U.C.C.

Id. at 1331 n.20 (citation omitted). Roughly translated, Judge Williams seems to be saying that occasionally a secured party claims inventory in the bankrupt estate but is limited by Bankruptcy Code section 547(c)(5) to a maximum amount of inventory to prevent an improvement of position by that secured party. $SP_1$ and $SP_2$ should be similarly limited, so they do not improve their position at the expense of $SP_3$.

237. David Frisch disagrees. He fears that the limited secured party will foreclose and have a poor incentive to obtain a good price. That is, if the secured party is limited to the value of the contributed collateral and yet forecloses on the whole, the secured party will simply stop marketing the whole once her own security interest is satisfied; but if that secured party had a higher entitlement, she would also have a better incentive. See Frisch, supra note 217, at 40. This ignores the fact that many of these cases will be litigated in bankruptcy where the trustee will have the incentive to maximize the price, and making irrelevant the secured party's lack of an incentive.

Frisch also points out that the limitation view requires a judicial valuation, which is painful, whereas the nonlimitation view simply gives the secured party collateral up to the fixed amount of her claim. See id. This also ignores the fact that, in bankruptcy, valuation may be necessary anyway, unless an immediate sale is planned, but otherwise, one has to admit that the necessity of valuations is unfortunate.

Finally, Frisch notes that the secured party's right to proceeds is not limited by the amount of the collateral contributed by the secured party. See id. at 40-41. That is, under a proceeds theory, the secured party can improve her position. By analogy, the secured party should be able to improve her position in commingling cases. It is true that a secured party can improve her position through proceeds, but proceeds must be identifiable, whereas, by definition, commingled assets are not identifiable. See id. at 42. Consequently, in commingling cases, the secured party wants to get other people's property, whereas in proceeds theory, the secured party simply wants to collect the identifiable fruits of its own identifiable collateral. These differences weaken, or at least complicate, the aesthetics of Frisch's analogy.
inventory sold to $B$ ($\$10,000$, in Harris's hypothetical numbers). If the mass expands, $SP_3$ benefits, but if the mass shrinks, then $SP_3$ ought to lose out first before $SP_1$ and $SP_2$ suffer, just like any subordinate creditor would. Shrinkage should come out of the debtor equity first and out of the junior creditor's entitlement before the senior creditors are affected. This follows from the fact that security interests routinely work this way, and nothing in section 9-315 changes this result.\textsuperscript{238}

In contrast, Harris believes that, as the mass shrinks, the percentage share that $SP_1$ and $SP_2$ hold should shrink as well.\textsuperscript{239} I believe there is no basis for this. According to Harris, shrinkage occurs if section 9-315(2) applies to the case,\textsuperscript{240} but the whole premise of the discussion is that section 9-315 does not apply when $SP_3$'s security interest attaches after commingling.

After the inventory shrinks, Harris pumps new inventory into his hypothetical example and commingles it with old inventory. Prior to commingling, the new-but-uncommingled inventory has been encumbered only by $SP_3$'s security interest, by virtue of its after-acquired property clause.\textsuperscript{241} The security interests of $SP_1$ and $SP_2$ do not attach to this inventory, \textit{ex hypothesi}. Now section 9-315(2) does apply, because both $SP_3$, on the one hand, and $SP_1$-$SP_2$-$SP_3$ are contributing collateral to a commingled pool. As to this newly constituted pool of inventory, $SP_3$ shares equally with $SP_1$-$SP_2$-$SP_3$. In other words, as to past inventory $SP_1$ and $SP_2$, as a unit, are senior to $SP_3$, but as to the new inventory added to the group, $SP_3$ is \textit{pari passu} with the combined share of $SP_1$, $SP_2$, and $SP_3$. That is, part of $SP_3$'s claim is junior to $SP_1$ and $SP_2$, and part of the claim will be \textit{pari passu}. In any case, there is no reason to apply section 9-315(2) until $SP_3$ contributes inventory that $SP_1$ and $SP_2$ cannot get. Professor Harris provides the following numerical example:

\textsuperscript{238} At least in the specific circumstance under consideration, this occurs where $SP_1$ and $SP_2$ had perfected security interests before commingling, and $SP_3$ took a perfected security interest in inventory after commingling. It is the post-commingling perfection that kept $SP_3$ from being pro rata with its competitors.

\textsuperscript{239} See Harris, supra note 1, at 236-37.

\textsuperscript{240} See id.

\textsuperscript{241} I am assuming that $B$ is not bound on the after-acquired property agreement between $S$, $SP_1$, and $SP_2$. If $B$ and $S$ are deemed merged, then $SP_1$ and $SP_2$ are \textit{pari passu} with regard to the new-but-uncommingled inventory. See supra text accompanying notes 173-206.
Assume that $B$ owns $15,000 of commingled inventory, of which $[SP_1]$’s share is $10,000 and $[SP_3]$’s is $5000. If $B$ sells $6000 of the inventory, then $SP_1$ and $[SP_3]$ will share in the remaining $9000 as they did in the $15,000; that is, $SP_1$ will receive two-thirds ($6000) and $[SP_3]$ will receive one-third ($3000).

I take issue with the last sentence. I think that, on Harris’s numbers, $SP_1$ has $9000 of inventory, and $SP_3$ has none. Harris continues:

As $B$ acquires new inventory and commingles it, $[SP_3]$’s share will increase. Suppose that $11,000 of new collateral is added to the $9000 remaining. Because $SP_1$’s interest attaches to the goods when they are already encumbered by $[SP_3]$’s security interest, the extent of $[SP_3]$’s share of the mass should be increased by the $11,000 of newly added value.

Here is how we differ. I would say that $SP_1$ and $SP_2$ get 9/20, or $9,000, and $SP_3$ gets 11/20, or $11,000. Harris gives $SP_1$ and $SP_2$ less than I would ($6,000) because he has already knocked down $SP_1$ and $SP_2$ from $9000 (incorrectly in my view).

From this point forward, the ratios of $SP_1$ and $SP_2$, on the one hand, and $SP_3$, on the other, are preserved. This is because section 9-315 really does apply from now on; $SP_3$ has contributed collateral to the commingled mass after $SP_3$ perfected a security interest in collateral to which $SP_1$ and $SP_2$ had no claim. Before, $SP_3$ took a security interest only after commingling had already occurred. Thus, an unstated premise of section 9-315(2) is that each pro rata security interest must have attached to uncommingled property before commingling.

B. A Short Statute of Limitations

Besides awarding post-sale inventory to the seller’s secured parties, McBee has a second interesting aspect. According to Judge Williams, if the perfected security interests of $SP_1$ and $SP_2$ survive the bulk sale because $B$ did not comply with the provisions of Arti-

242. Harris, supra note 1, at 236-37.
243. Id. at 237. The last remark that $SP_3$ is senior because $SP_1$’s security interest attached (and was perfected) first may seem a little confusing. All Harris is doing here is attempting to reconcile section 9-315(2) with the “first in time is first in right” rule. Harris means to apply section 9-315(2) in order that the parties share pro rata.
244. “Thus $[SP_3]$ will be entitled to 70% (14/20), and $SP_1$ to 30% (6/20).” Id.
In defending the view that $SP_1$ and $SP_2$ should have the inventory acquired by the buyer after the bulk sale, Judge Williams sought to calm $SP_3$ with the following observation:

We find further support for our conclusion in the statutory pattern. The transferor's creditor is not saved harmless forever in a non-complying bulk transfer. Article 6 limits the period in which a transferor's creditor may assert a security interest to six months after the non-complying bulk transfer, unless there has been concealment of the transfer. This limitations period evidences a policy that at some point a diligent creditor should realize that a transfer has occurred absent concealment of that fact and despite his lack of notice. If the prior creditor does not exercise such diligence, his security interest in the transferred property is lost. This time limitation was met in this case by [$SP_1$ and $SP_3$]. The time limitation supports our conclusion that Article 6 is a reasonable and balanced provision in preserving the security interests of the transferor's creditors effective against the transferee.\textsuperscript{246}

Thus, according to Judge Williams, a perfected security interest survives a noncomplying bulk transfer, but not for long! Unless the transfer has been concealed, the security interests are dead within six months, unless the secured parties bring an "action under this Article."\textsuperscript{247}

In ruling that the secured parties had only six months to assert their perfected security interests, Judge Williams may have imagined that he was doing the secured parties a favor. According to Judge Williams, Article 9 provided only four months, compared to six months under Article 6.\textsuperscript{248} Since the secured parties asserted their claims in the fifth month, they could be thankful that the Article 6 rules applied. According to Judge Williams:

We agree with the bankruptcy court that the four-month period for refiling upon a name change of the debtor under [section 9-402(7)] does not apply here. If this general Article 9 provision applied, it would in effect reduce the specific provision in Article 6 from six to

\textsuperscript{245} National Bank of Tex. v. West Tex. Wholesale Supply Co. (In re McBee), 714 F.2d 1316, 1328 (5th Cir. 1983).

\textsuperscript{246} Id. at 1328-29 (footnote omitted) (citing \textit{Tex. Bus. & Com. Code Ann.} § 6.111 (Vernon 1968)).

\textsuperscript{247} \textit{U.C.C.} § 6-111 (1987).

\textsuperscript{248} McBee, 714 F.2d at 1329 n.19.
four months. Where, as here, a specific section of the Code applies to a particular situation, the specific provision should govern. Thus, the six-month period in Article 6 relating to non-complying bulk sales, was correctly applied by the bankruptcy court. 249

The bankruptcy court refused to apply the four-month rule of section 9-402(7) 250 because no one changed her name. 251 Instead, the collateral was transferred from one person to another. It is possible to read the above passage from the appellate opinion as implying that the four-month rule did apply, except that the narrow Article 6 rule trumps the more general Article 9 rule.

If this is what Judge Williams meant, his view does not comport with the text of section 9-402(7). This by-now-all-too-familiar section provides:

Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer. 252

Judge Williams may have misread section 9-402(7) for two reasons. First, this section does not apply when property is transferred from one debtor to another—only when a single debtor changes her name while retaining the collateral. This is the import of the last sentence of the above-quoted passage. 253 Second, even if section 9-402(7) did apply, it is no statute of limitations, as Judge Williams supposes. Instead, under section 9-402(7), old collateral remains encumbered by a perfected security interest. If collateral is acquired more than four months after the name change, section 9-402(7) provides that the financing statement is no longer compe-

249. Id. (citation omitted).
253. See id. § 9-402 comment 8. In Bank of the West v. Commercial Credit Fin. Servs., Inc., 852 F.2d 1162, 1170 (9th Cir. 1988), Judge Thompson thought the second sentence of section 9-402(7) might apply when buyer and seller are corporate subsidiaries owned by the same parent. But this ruling was totally unnecessary to his analysis. See supra text accompanying notes 161-64.
tent to perfect the security interest that attaches thereto.264 Hence, in McBee, even if section 9-402(7) applied, any inventory acquired by the debtor or the noncomplying buyer on or before a date four months after the bulk sale would be encumbered by a perfected security interest subject to no statute of limitations at all. Any inventory acquired four months after the bulk sale, would be encumbered by unperfected security interests as to which no statute of limitations applies.

Article 9, then, contains no relevant statute of limitations. At best, it provides for occasional lapsed perfection.285 Therefore, Judge Williams wasn’t handing out any favors when he applied the six-month statute of limitations in section 6-111.

Judge Williams’s reading of section 6-111 is easily avoided. According to section 6-111, “No action under this Article shall be brought nor levy made more than six months after the date on which the transferee took possession of the goods unless the transferee has been concealed.”286 Thus, the six-month statute of limitations applies only to actions under Article 6. If a secured party has a surviving security interest against inventory sold to a noncomplying bulk buyer, the secured party has an action under Article 9, not Article 6. Hence, the statute of limitations of Article 6 does not apply.

C. Subsequent Bona Fide Purchasers for Value

According to section 6-110:

When the title of a transferee to property is subject to a defect by reason of his non-compliance with the requirements of this Article, then:

(1) a purchaser of any of such property from such transferee who pays no value or who takes with notice of such non-compliance takes subject to such defect, but

254. See Knippenberg, supra note 190, at 77-78. For an effective attack on section 9-402(7), see Westbrook, Glitch: Section 9-402(7) and the U.C.C. Revision Process, 52 Geo. Wash. L. Rev. 408 (1984).

255. A perfected security interest becomes unperfected after five years, unless a continuation statement is timely filed. U.C.C. § 9-403(2) (1987). Furthermore, tangible collateral removed from the states becomes unperfected after four months. Id. § 9-103(d)(i). These are not statutes of limitations since the security interest lives on in an unperfected state.

256. Id. § 6-111 (emphasis added).
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(2) a purchaser for value in good faith and without such notice takes free of such defect.257

In the *McBee* case, the noncomplying transferee in bulk conveyed a security interest to *SP* 3. *SP* 3 argued that it should take free of security interests by virtue of section 6-110.258 The *McBee* court reasoned that, since *SP* 1 and *SP* 2 had already filed a financing statement, *SP* 3 automatically had notice.259 Steven Harris argues260 that the *McBee* court egregiously ignored the general definition of "notice" provided in section 1-201(26): "A person 'receives' a notice or notification when (a) it comes to his attention; or (b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications."261 But Harris overlooks section 1-201(27), which provides:

Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence.262

Section 1-201(27) indicates that knowledge is received when, through the use of due diligence, it should have been received. And knowledge "should have been received" if *SP* 3 had taken the trouble to check out the UCC records. If *SP* 3 had knowledge under this standard, surely it had notice within the meaning of section 6-110. These observations vindicate Judge Williams against Professor Harris's criticism.263

257. *Id.* § 6-110.
259. *Id.*
260. Harris, *supra* note 1, at 226.
262. *Id.* § 1-201(27). See *supra* text accompanying notes 55-57.
263. One prominent case does emphasize that Article 6 imposes no duty of inquiry on *SP* 3 with regard to general creditors. Adrian Tabin Corp. v. Climax Boutique, Inc., 34 N.Y.2d 210, 313 N.E.2d 66, 356 N.Y.S.2d 606 (1974). This is undoubtedly correct with regard to general creditors, but we are concerned with whether *SP* 3 can be a good faith purchaser for value under section 6-110 who takes free of perfected security interests. The whole purpose of perfecting a security interest should be to defeat subsequent purchasers for value, and even purchasers under section 6-110 should likewise be defeated.
To supplement his reasoning, Judge Williams also ruled that $SP_3$ could not be a "purchaser" within the meaning of section 6-110. This ignores the definition of "purchase" which provides, "Purchase includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property." This particular rationale is neither satisfactory nor necessary to Judge Williams's result. If the McBee interpretation of section 6-110—secured parties are not purchasers—is followed, then unfortunate consequences result. Suppose that $SP_1$ and $SP_2$ had failed to perfect. $SP_3$ took a security interest from the bulk transferee without knowledge of $SP_1$ and $SP_2$. Under the McBee interpretation of section 6-110, $SP_3$ would still be junior because she is not a "purchaser" and hence does not take free of the bulk transferee's failure to comply with Article 6. This should not be the rule. Instead, section 9-312(5)(a) should supply the rule, and $SP_3$ should win as a good faith purchaser who was the first to file a financing statement under Article 9.

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264. McBee, 714 F.2d at 1330.

265. U.C.C. § 1-201(32) (1987). For a case holding a secured party is a purchaser under section 6-110, see Mayfield Dairy Farms, Inc. v. McKenney, 612 S.W.2d 154 (Tenn. 1981).

266. There is a possible implication in section 6-110 that an unperfected $SP_3$ is a purchaser for value entitled to priority. Professor Harris would still apply the "first-to-file" rule, with the proviso that $SP_3$ must always have no notice or knowledge of the earlier Article 6 defect. That is, $SP_3$ cannot have priority over $SP_1$ or $SP_2$ until $SP_3$ files a financing statement before $SP_1$ or $SP_2$. But even if $SP_3$ accomplishes this, $SP_3$ loses if she knew of the Article 6 defect.

Thus, if $SP_3$ (who has filed first) knows of the unperfected security interest but not of the Article 6 defect, then it appears that Harris would give priority to $SP_3$ on the theory that section 6-110 is not to the contrary and because Article 9 creates a race priority. Harris, supra note 1, at 241 n.239 ("Even if $[SP_1]$ still will prevail if $[SP_3]$ is the first to file.").

Some have argued that Article 9 is not the brute race priority it is usually taken to be. Carlson, supra note 86, at 260-68; Nickles, Rethinking Some U.C.C. Article 9 Problems—Subrogation; Equitable Liens; Actual Knowledge; Waiver of Security Interests; Secured Party Liability for Conversion Under Part 5, 34 ARK. L. REV. 89 (1980); see U.C.C. § 9-401(2) (1987) (if $SP_1$ has filed in the wrong office, knowledgeable $SP_2$ is junior to $SP_1$). Except for this disagreement, Harris's reason for keeping Article 9 priorities in general (where $B$ is a noncomplying bulk transferee) is sound: otherwise $SP_3$, if unperfected, would beat out general creditors of the first debtor who have Article 6 remedies. Yet Article 9 makes clear that judicial lien creditors should have priority over unperfected secured parties. Id. § 9-301(1)(b).
IV. THE UNPERFECTED SECURED PARTY AND THE NONCOMPLYING BUYER

The only quadrant of Figure One that should be difficult is the southeasterly one—where both the secured party and the buyer fail to do their duty under their respective articles. Now if the non-complying buyer knows of the unperfected security interest, the priority solution is not hard. The buyer absolutely depends on being a buyer or transferee in bulk without knowledge under section 9-301(1)(c). If the buyer cannot qualify for priority here, the buyer’s position is hopeless, whether or not she has complied with Article 6.

But if the buyer is without knowledge within the meaning of section 9-301(1)(c), the solution to the priority problem is imponderable. On the one hand, the buyer has not complied with Article 6 by sending notice to the creditors of the bulk sale. On the other hand, the secured party has not perfected. The dilemma can be stated this way. Article 6 makes the buyer the villain, and Article 9 makes the unperfected secured party the villain, yet in this pri-

267. The two statutory schemes have a different perspective on who the villains and victims are. Under Article 6, the bulk transferee is the villain who is burdened with the duty of notifying preexisting victims (the seller’s creditors) of the bulk sale. Under Article 9, the secured party is the villain who must notify subsequent victims (buyers and creditors).

Commercial law never permits generalizations quite so elegant as this, and so I must qualify the above by exceptions. First, it must be said that Article 9 imposes a perfection duty on purchase money lenders with regard to parties who are coeval, not subsequent. Thus, to preserve priority against after-acquired lenders, a purchase money secured party must perfect within a ten-day grace period, in some cases. U.C.C. §§ 9-301(2), 9-312(4) (1987). See generally Carlson, Simultaneous Attachment, supra note 32, at 516-17.

Second, a secured party requires perfection against not merely a coeval party but a later party who files and perfects before the purchase money lender does. If the collateral is not inventory, purchase money security interest status allows a “first in time” purchase money secured party to perfect second and still take priority. For example, suppose a secured party has established an unperfected purchase money security interest on equipment, and the debtor subsequently grants a security interest to a lender. This second security interest is not an after-acquired property interest; it is an ordinary security interest that is second in time. The purchase money security interest can still have priority if the purchase money security interest lender files within the grace period provided. This grace period commences when the debtor receives the collateral and terminates ten days later. U.C.C. § 9-312(4) (1987). In many states, this grace period has been extended to 20 days. See, e.g., Ala. Code §§ 7-9-301(2), 7-9-312(4) (1984); Cal. Comm. Code § 9312(4) (1990); N.Y.U.C.C. §§ 9-301(2), 9-312(4) (McKinney Supp. 1990).

In such a case, the purchase money security interest is first in time, but its purchase money status allows it to defeat a lien which is not simultaneously created. Yet this subsequent lienor cannot possibly benefit from the perfecting act because this perfection is
ority battle each party is both villain and victim together. Here, two scoundrels face off for the priority’s puck when both should be in the penalty box. Hence, we are condemned to pick the lesser of two evils.\textsuperscript{268}

\textbf{A. The Frydlewicz Case}

If the noncomplying buyer has no knowledge, she might win if she is still a “buyer” or “transferee in bulk” within the meaning of section 9-301(1)(c), in spite of the noncompliance. The one and only case on this question, \textit{National Bank of Royal Oak v. Frydlewicz},\textsuperscript{269} was decided the other way. In Frydlewicz, the unperfected secured party won because a noncomplying bulk transferee is no bulk transferee (or other buyer)\textsuperscript{270} at all. Hence, section 9-301(1)(c) could not be used to destroy or subordinate the unperfected security interest.\textsuperscript{271}

Such arguing must be recognized for what it is: conclusions smuggled into the analysis in the form of argument. The question is: What is a transferee in bulk? The argument just presented (“a subsequent, not advance, notice. That is, the second creditor has already advanced funds by the time the purchase money lender has perfected."

This anomaly does not work for inventory, since no grace period is provided for such collateral. U.C.C. § 9-312(3) (1987). On the other hand, if the “second in time” lien is a judicial lien (or a bulk sale), then a grace period is provided for all kinds of collateral. \textit{Id.} § 9-301(2).

\textsuperscript{268} Or, as Professor Harris would have it, with his law-and-economics search for the “least cost avoider,” we must search for the most efficient victim. \textit{See infra} text accompanying notes 290-309.


\textsuperscript{270} Once again, section 9-301(1)(c) provides that an unperfected security interest is subordinate to “a person who is not a secured party and who is a transferee in bulk or other buyer not 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.” U.C.C. § 9-301(1)(c) (1987).

\textsuperscript{271} The court in Frydlewicz states:

\begin{quote}
Normally, as a transferee in bulk, National would be entitled to priority over plaintiff’s unperfected security interest . . . pursuant to UCC § 9-301(1)(c) . . . . However, National failed to satisfy the requirements necessary under the bulk transfer provisions of UCC art. 6 to assert a claim of priority as a transferee in bulk.
\end{quote}

The trial court found National to be a transferee in bulk and, therefore, to be subordinate to plaintiff’s rights in the disputed merchandise. \textit{Frydlewicz}, 241 N.W.2d at 473. I read this passage to mean that National was a noncomplying bulk transferee under Article 6 and hence not a bulk transferee under section 9-301(1)(c).
noncomplying transferee in bulk is no transferee in bulk at all") seems infected by the preconceived notion that a noncomplying transferee should not prevail. Hence, rather than depending on the words “transferee in bulk” for an objective and uncontroversial meaning, it might be better simply to look for policy reasons in lieu of inherent content in the words “transferee in bulk.”

But such a retreat to policy may also disappoint. For example, one might argue that favoring the secured party would encourage the bulk transferee to comply. But one would have to concede that, to some degree, favoring the secured party would discourage the secured party from complying with Article 9. Thus, we are faced with an imponderable cost-benefit speculation for which no data exist.

B. Resurrection of the Security Interest

Steven Harris criticizes the reasoning of Frydlewicz, but likes the result. The new rationale he proposes, however, is self-contradictory. According to Harris:

Article 6 penalizes the noncomplying buyer by making the transfer “ineffective” against creditors of the seller.... A fair reading of the word “ineffective” as it applies to secured creditors should yield an analogous result: the secured creditor may disregard the transfer and treat the goods as still belonging to the transferor. That is, upon default the secured party may “foreclose or otherwise enforce the security interest by any available judicial procedure.”

272. More precisely, the court held that the buyer was not a “transferee in bulk” within the meaning of section 9-301(1)(c) because noncomplying transferees were not transferees at all. Id. 241 N.W.2d at 473. This leads Professor Harris to wonder whether the buyer should still win because, even though not a “transferee in bulk,” it was still an “other buyer not in the ordinary course of business.” Harris, supra note 1, at 205. But see U.C.C. § 1-201(9) (1987) (“Buying... does not include a transfer in bulk...”). This is not a good point. The court easily could have extended its reasoning to say that any transferee or buyer who is required to comply with Article 6 and does not is neither a transferee nor a buyer.


274. Lack of data rarely deters an experienced law-and-economics scholar, and it is to Professor Harris’s great credit that he largely avoids any definitive conclusions based on the intuited costs and benefits of secured parties and bulk buyers in the abstract. Comments on Harris’s analysis can be found infra in the text accompanying notes 290-309.

To put it another way, one of the remedies under Article 6 is supposed to be the assertion of an Article 9 security interest (provided, of course, that the creditor had one in the first place).  

The paradox here is that, according to Harris, the noncomplying bulk transferee is a bulk transferee for the purpose of section 9-301(1)(c), so that the security interest that $SP_1$ wants to assert has been killed off. That is, the noncomplying buyer had no knowledge of the earlier unperfected security interest and so took free of it under section 9-301(1)(c). $SP_1$'s security interest is therefore dead and gone. If so, how can $SP_1$ assert a security interest under Article 6?  

In fact, Harris's view that secured parties have security interests under Article 6 is involved in a contradiction. This view depends upon the noncomplying transferee in bulk not being a buyer or transferee in bulk under section 9-301(1)(c), the very view Harris criticizes. Only if the noncomplying buyer fails to kill off the competing security interest under section 9-301(1)(c) can there still be a security interest for Article 6 to deal with. For this reason, his doctrinal argument does not seem to work.  

Since Harris's article was published, the Permanent Editorial Board of the UCC has promulgated a new Article 6. Under the revised version of Article 6, creditors of the noncomplying buyer no longer have any in rem claims against the buyer's property. Instead, they have only in personam rights against the buyer personally and only for proximately caused damage, which, to boot, is automatically subject to limitation. Furthermore, the noncomplying buyer is excused if her failure was in good faith.

276. This notion of resurrection tempts Harris to take the position that a short six-month statute of limitations does apply to security interests that were unperfected at the time of the bulk sale, although Harris is tentative on this subject. See id. at 219 n.167.  

277. To use Harris's own words against him: "The rights of unsecured and secured creditors inter se are set forth clearly in Article 9. Nothing in Article 6 justifies adjusting them." Id. at 211.  

278. One point can be made in favor of the Frydlewicz reasoning: the transfer in bulk is "ineffective," according to Article 6, so that it can be said no transfer took place for the purposes of section 9-301(1)(c).  


280. The damage limitation is actually fairly generous and may even exceed what is available under the in rem system of the original Article 6. According to new section 6-107(4), the cumulative liability of the noncomplying buyer is twice the net contract price, minus any amount actually paid to the seller or the seller's creditors. See id. § 6-107(4).  

281. Id. § 6-107(3).
This change from property concepts in the style of fraudulent conveyance law is a blow to general creditors. Before, they could use a judgment against the seller and levy the property of the buyer. Now, they will have to start a separate in personam action against the seller. Procedurally, this could take a much longer time. In addition, the creditors lose the “class action” quality that bankruptcy law provides, in case the seller files for bankruptcy. If the creditors had in rem rights against the buyer, the trustee would be subrogated to these rights and would be able to recover the entire bulk transfer, even if the aggregated claims of creditors identified by the bankruptcy trustee are less than the value of the bulk transfer. If the general creditors have no in rem rights (i.e., no power to avoid the bulk transfer), then the bankruptcy trustee has no ability to attack the bulk transfer at all under Article 6.

Meanwhile, this reform also deprives Professor Harris of his argument. Harris needed statements from Article 6 which made the bulk transfer “ineffective” against the seller’s creditors, if the buyer did not comply with notice requirements. Under the new version, noncomplying bulk transfers are fully effective against creditors, who, in compensation, get in personam rights. This throws Harris back to the disdained reasoning of the Frydlewicz case, which held that noncomplying buyers are not buyers at all under Article 9. Ironically, under the new Act, the “good result” of Frydlewicz depends utterly on the essentializing argument (“who

283. “The trustee may avoid any transfer of an interest of the debtor in property ... that is voidable under applicable law by a creditor holding an unsecured claim [against the debtor].” 11 U.S.C. § 544(b) (1979).
284. Moore v. Bay, 284 U.S. 4 (1931). Moore v. Bay is legislated into the Bankruptcy Code in section 550(a), which provides “[T]o the extent that a transfer is avoided ... , the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property ... .” 11 U.S.C. § 550(a) (1979). See In re Figearo, 79 Bankr. 914 (Bankr. D. Nev. 1987).
285. The ability of a general creditor to “avoid” a transfer to the noncomplying buyer constitutes an in rem right in the buyer’s assets. See Note, supra note 38, at 850.
286. On the other hand, under the new revisions, any creditor who does feel motivated to pursue the bulk buyer can do so without fear of bankruptcy’s automatic stay. Those first in time, however, will shut out the slower footed creditors who were better off with Moore v. Bay.
287. Professor Harris was, in fact, the person who pointed this out to me. In his words, he feels “mooted out” by the new Article 6, for which he himself was the Reporter.
289. Harris, supra note 1, at 207-08.
is or is not a transferee in bulk or a buyer”) that Harris expressly disfavored (but implicitly relied on).

C. A Resort to Law-and-Economics

The priority between two scoundrels—the noncomplying buyer and the unperfected secured party—is undetermined by UCC statutory language. Hence, Professor Harris has succumbed to the temptation of turning to law-and-economics as a possible answer for solving this priority dispute. The idea is to find the efficient solution to the priority conundrum. Happily, the Harris article, so very strong in almost all respects, is also much better than average in its economic analysis. Harris’s conclusion is that the data are inconclusive enough to hazard an intelligent position on what is efficient. This should always be the answer in law-and-economics. Anyone who ever comes up with any different answer simply has a deficient imagination about dreaming up potential costs. The costs are endless, and ignoring them is completely arbitrary and destructive of the premises of the science. To quote Arthur Alan Leff, anyone who hazards a guess without knowing the quantity of each and every cost is “a booby.”

With this warning, let me say a few words about efficiency as a normative program. Efficiency, in the welfare sense, is a form of utilitarianism. Efficiency analysis hopes to maximize something. The usual choices are utility or wealth. The only difference between these two maximands is the deontological assumption about what people are entitled to. If you are an egalitarian, you would choose a common form of utilitarianism, which starts from a baseline wherein every human being is equally entitled to happiness. A competing form of utilitarianism is wealth maximization, where people are assumed to be unequal. They are entitled to whatever happiness their pre-existing wealth can buy. That is, the rich are disproportionately entitled to happiness compared to the poor. This disgraceful elitism is the only difference between wealth maximization and egalitarian utilitarianism. If wealth were

290. Id. at 216.
292. There are actually infinite utilitarianisms, as many as there are imaginable entitlement baselines. See Note, Judge Posner’s Wealth Maximization Principle: Another
redistributed so that everyone was equal, there would be no difference whatsoever between these methods. Furthermore, ordinary utilitarianism demands that wealth be redistributed. This follows from the declining utility people obtain from increments of wealth. Wealth maximization, however, succeeds in disabling income redistribution as a normative program because wealth cannot be increased solely by shifting it around. There is no declining utility for wealth when wealth is the numeraire by which utility is measured. Therefore, not only are the rich favored, but the existing distributions of wealth are perpetuated by making wealth the numeraire by which human preference is measured.\textsuperscript{293}

However it is measured, utilitarianism seeks to maximize human satisfactions. But let us step back for a moment and consider what Harris implies by using law-and-economics on a microscopically insignificant priority problem such as the noncomplying buyer against the unperfected secured party.\textsuperscript{294} Could the proper priority between unperfected secured parties and noncomplying bulk buyers possibly have a visible impact upon happiness in the United States? Most people in the United States are unaware that bulk sales law even exists. How likely is it that the answer to this priority problem will impact on the national welfare?\textsuperscript{295} Even if the priority question affected the price of credit and hence the cost of production—a fact that must be proven and

\textit{Form of Utilitarianism?}, 10 CARDOZO L. REV. 815, 818 (1989). In fact, most people don’t even acknowledge what the baselines are. Many utilitarians claim that everyone has an equal entitlement to happiness, or entitlements according to wealth, but they often end up privileging Americans over foreigners, European cultures over third world cultures, human beings over animals, etc.

293. \textit{Id.} at 842-44.

294. Harris does not specify whether wealth in some other form of utility is being maximized. But given his emphasis on cost reduction as per se desirable, I will assume that wealth is being maximized in his discussion.

295. A somewhat different ploy would magnify tiny priority disputes into important efficiency issues by emphasizing the ethical preferences of nonparticipants in the market transactions. To illustrate, let us take Article 9’s alleged race priority. Suppose \( D \) grants \( SP_1 \) a security interest. \( SP_1 \) forgets to perfect, but nobody is misled because \( D \) lists the security interest in her financial reports. \( D \) then grants a security interest to \( SP_2 \) who perfects promptly. The usual view is that \( SP_2 \) is senior in spite of \( SP_2 \)’s knowledge. See \textit{Special Project, The Priority Rules of Article Nine}, 62 CORNELL L. REV. 834, 849 (1977).

The ethics of awarding priority to \( SP_2 \) are unsavory. The dubious ethics become in themselves enormous efficiency concerns if (1) you assume perfect knowledge of the situation among the public; and (2) no transaction costs in making their preferences known. If every American (reconstituted through the assumption of perfect knowledge) would vote a few pennies toward an ethical commercial law, these “external preferences” would swamp
not assumed—there is still the intractable point that limited liability of corporations (and bankruptcy discharges) are specifically designed to export costs to the unwitting public. If productive costs rise for marginal business enterprises, the increased cost may actually reduce externalities and therefore increase efficiency. In short, the connection between this tiny little priority problem and human happiness is so extravagantly tenuous that one may wonder whether indulging in law-and-economics is not a total waste of time.296

So far, nothing I have said is inconsistent with Professor Harris's analysis. He too finds no answers in law-and-economics, and all I have done so far is to suggest that this could have been predicted well in advance simply by the fact that the legal issue in question is utterly trivial in the scheme of things.297 There are, however, certain things that I would like to say about Harris's methodology. These points are harmless error, however, because

any utilities registered by the parties involved in actual commercial transactions. See generally Carlson, supra note 86, at 223-30.

Notice that this move makes ethical content—not the trivial commercial transaction itself—the focus of wealth maximization. Incidentally, it is precisely this strategy that drives Frank Michelman's celebrated efficiency analysis of fifth amendment compensation. Michelman, Property, Utility and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165, 1214-15 (1967) (dealing with "demoralization costs").

None of this analysis applies here, unless you think that the priority battle between noncomplying bulk buyers and unperfected secured parties implicates some ethical principle that the public actually holds. I do not perceive this to be the case in the priority dispute at hand—the unperfected secured party versus the noncomplying bulk buyer.

296. In earlier days, I considered a priority problem that did not exceed Harris's problem in significance—the priority between judicial lien creditors who have served executions but who have not enjoyed a sheriff's levy versus the unperfected secured party. I too tried to figure out what was efficient. Carlson & Shupack, Part I, supra note 42, at 306-09. Therefore, the above comments are directed at myself more than anyone else. Law-and-economics was just what you were expected to do in legal scholarship in the early 1980's. The last thing law-and-economics asks of itself—the last thing it can bear!—is to examine its own premises. Here I hope to make up for an earlier uncritical perspective.

297. Paradoxically, wealth maximization works better as the policy questions become more trivial and unimportant. If the policy question is monumental in scope, then the wealth at stake becomes a large percentage of the voting power of the preference holders. If this occurs, it triggers the "wealth effect" indeterminacy, where wealth maximization solutions turn entirely on who is considered initially to own the entitlement in question. See generally Carlson, Reforming the Efficiency Criterion: Comments on Some Recent Suggestions, 8 Caro. L. Rev. 39, 52 (1986). Wealth effects imply that law-and-economics becomes more and more valid the more trivial its policy concerns become. Accordingly, law-and-economics reaches its ultimate validity when it refuses to make any policy recommendations at all.
Professor Harris reaches the right result—that law-and-economics is a big dud on this question of priority between noncomplying buyers and unperfected secured parties.

Harris writes:

One common approach to problems of risk allocation is to impose the risk of loss on the party who can prevent or insure against the loss at less cost. This allocation usually has two effects. First, it minimizes the resources spent on loss avoidance, thereby freeing those resources for alternative uses. Second, because some losses are likely to exceed one party's cost of avoidance but be less than the other party's cost, allocating the loss to the efficient cost avoider is likely to reduce the total number of losses.\(^{298}\)

This passage invokes the concept of the "least cost avoider." This phrase is rhetorically more clever than most law-and-economics tropes because it evades the issue of hidden external costs and benefits and subsumes complete knowledge of these things into the phrase "least cost." That is, if you really could know who is the least cost avoider (and this cannot be known) then, by definition, it is efficient to assign costs to this person. Or, to say it another way, "least cost avoider" is simply a truism and has no more content than to say "do what is efficient."

It is important to note that, if wealth is to be maximized, cost reduction has an efficiency consequence if and only if the costs imposed are marginal costs of production. If a cost is simply a one-shot affair—a wealth transfer from one person to another—it has no efficiency consequences.\(^{299}\) For this reason, when Harris writes that total resources spent on loss avoidance might be conserved by the proper priority rule,\(^{300}\) he overlooks the fact that one person's loss is another's gain. As such, conservation of resources is a misnomer; wealth transfers by themselves neither decrease nor increase wealth. Instead, the cost reduction must be felt in each and every unit of future production. If the cost is marginal with respect to future production, then a higher marginal cost (coupled with a downward sloping demand curve) will produce genuine deadweight losses in the market in question. But even a showing of marginality

\(\text{298. }\) Harris, supra note 1, at 211 (footnotes omitted).
 \(\text{300. }\) Harris, supra note 1, at 211.
does not prove that least cost avoidance is per se efficient. A deadweight loss in one market may eliminate deadweight loss in another market, and hence maintenance of the deadweight loss is desirable. A "non-optimal" risk allocation might serve as a kind of Pigouvian tax on producers who export costs to the public. 301

Yet another problem with least cost avoider analysis is that the cost cannot be marginal unless the risk is noticeable, or unless the risk proximately causes its prevention. 302 For example, if a bulk buyer already has powerful incentives to comply with Article 6, a small reform in priorities between noncomplying buyers and unperfected secured parties may have no effect on the behavior of bulk buyers. If so, a change in the allocation of risk would make no difference whatsoever. Or, to say it another way, not every legal change induces human behavior to change. If the legal reform is too trivial to waste time on, there are rational economic reasons for not changing your behavior. 303

These problems—unacknowledged external costs and benefits and public indifference to the legal change in question—are the grounds I assert to support the proposition that the priority between noncomplying buyers and unperfected secured parties has no efficiency consequences. Professor Harris's approach is differ-

301. A Pigouvian tax is one in which a producer is taxed by the amount of external costs exported to the public. As a result of the tax, the producer's incentives to invest are returned to optimal efficiency.

302. Harris admirably recognizes this point, but only in part. He maintains that only unperfected secured parties have so many incentives to perfect that another marginal incentive will make no difference. Harris, supra note 1, at 220. On the other hand, he thinks that noncomplying buyers really will be encouraged to comply because a cheap alternative—holding the sales price in escrow until the short six-month statute of limitations is past—cannot work for an unperfected security interest, which is subject to a much longer statute of limitations. Id. at 218-19. As a result of this asymmetry, a cheap alternative to complying with Article 6 is eliminated and so there will be more Article 6 compliance.

303. This principle might be called "rational apathy." (I have borrowed this delightful phrase from a talk given by Melvin Eisenberg on efficiency and corporate law.) The response here, I suppose, is that if it makes no difference, why not go ahead and make the change? Perhaps, at the margin, there is a case so close to the line as to whether the bulk buyer should comply or not with Article 6 that even the slightest change in law will produce a slight change in behavior. See Carlson & Shupack, Part I, supra note 42, at 306-09 (cited here with disapproval). At such a margin, however, the stakes are very small indeed, and extremely marginal cases may not be worth the bother of scholarly activity worrying about it. Also, the existence of the marginal cases is a pure article of faith. It could easily be true that the marginal case has never arisen and will never arise—that the existing incentives will overwhelm the new reformist incentives in every case.
ent. He undertakes to list all the costs and benefits he can think of. Here is a list of his findings:

Costs to Secured Party: Harris lists a series of costs to the unperfected secured party, many of them alternatives to higher costs elsewhere. These items therefore significantly overlap:

1. The cost of perfecting a security interest, including the cost of filing and the cost of ascertaining the debtor’s correct name and address.

2. The cost of monitoring the debtor to discover changes in name or location of collateral. This cost is necessary to keep the security interest perfected.

3. As an alternative to the costs of perfection, the secured party can monitor the debtor to see if any bulk sales are planned. If this monitoring reveals an impending bulk sale, the secured party can destroy the buyer’s seniority under UCC section 9-301(1)(c) by telling the buyer about the unperfected security interest.

4. As an alternative to perfecting the security interest or to monitoring the debtor to see if bulk sales are contemplated, the secured party could simply raise the price of the loan in order to compensate for the risk of loss absorbed.

Costs to the Complying Buyer: Harris also lists costs to the bulk buyer and treats these costs as if the buyer bears them. It should be emphasized, however, that any such cost, if anticipated, decreases the buyer’s demand for another’s inventory. That is, the buyer reduces the price she is willing to pay, and the seller bears all these costs. Therefore, the following list combines the cost borne by the buyer and seller, on the theory that ultimately, the seller bears all of the cost. Here is a list of those costs:

1. Determining that Article 6 applies.
2. Preparing and distributing the required notice.

304. Harris, supra note 1, at 212-15.
305. One thing that Harris leaves out is the cost of learning the law, so that the secured party knows enough to file at all. For most secured parties, this cost has already been capitalized through legal education. For a new entrant into business, this cost might be quite high.
306. Harris, supra note 1, at 214-15.
3. The cost of tipping one's hand that one is buying inventory. These costs include competitive losses from the lack of surprise.

4. As an alternative to complying with Article 6, the buyer could search specifically for unrecorded security interests. If the seller refuses to disclose, or the buyer does not trust the seller, this cost could be high.

5. The loss by the seller of creditor goodwill, once it is learned that a bulk sale of inventory is contemplated.

6. In those states where the buyer must retain the proceeds for the benefit of creditors, ascertaining who the creditors are and how much they deserve is a cost.

7. As an alternative to complying with Article 6, the bulk buyer could keep the sales price in escrow until the six-month statute of limitations runs out.\textsuperscript{307}

This seems like a pretty good list of the costs that would arise in a universe that included only the buyer and the unperfected secured party. It leaves out, however, the effect of prices in other markets if the price in a specific market is raised or lowered (second-best phenomena). It also is not clear that these costs are marginal costs. In particular, one must wonder whether bulk sale costs are typically recurring costs of a retail business, such that inventory acquisition is routinely affected by them. If the costs are one-shot costs imposed upon a seller, then bearing high costs of this sort may be too unpredictable to be included in a (short-term) marginal cost curve. Such costs are typically incurred only when a business shuts down. They are exit costs and may in fact have been capitalized (or ignored) at the beginning of the life of the enterprise.

In any case, even on the basis of the disclosed list, Harris has the sense to proclaim, "it is difficult to determine which class of parties is able to avoid the loss at less cost."\textsuperscript{308} This is law-and-economics brought to its most brilliant possible manifestation.\textsuperscript{309}

\textsuperscript{307} This would not seem to help out against an unperfected security interest, which is subject to no statute of limitations whatsoever. Hence, this may not be an effective observation. Harris sees that the escrow option is not really viable against an unperfected secured party who is senior to the noncomplying buyer. Id. at 218-19.

\textsuperscript{308} Id. at 216.

\textsuperscript{309} After reaching this admirable conclusion, Harris regrettably backslides into some confusion. He goes on to note that some losses are inevitable and that these losses should be imposed on the party that would lose the least. Id. at 217. Now the problem with this asser-
V. Conclusion

One would think that the priority between buyers (in bulk or otherwise) and secured parties would be clear and straightforward. Nothing is further from the case. In fact, the deep theory of priority turns out not to be very well worked out at all. I have tried to illuminate a few of the tricks and difficulties. Most of these were brilliantly explored earlier by Professor Harris. If I have gone at least a little beyond his work, I feel as if I have accomplished something—proving once and for all that there is no such thing as an easy case in commercial law. Even the simple cases are founded on dark and misunderstood premises that come to the surface when two ignorant armies of law—here, bulk sales and Article 9 security interests—clash by night.

tion is that one person's loss is another person's gain. Thus, if the secured party loses, the noncomplying buyer gains, and vice versa. Harris would like to claim that these amounts are not symmetrical. Id. I do not think he has shown this.

For asymmetry, Harris relies on the fact that the noncomplying buyer will lose the retail or wholesale value of the inventory, while the secured party would gain only the liquidation value. Id. at 218. This overlooks the point that the secured party sells to somebody who then gets the wholesale or retail value. Thus, if we followed Harris's advice and imposed a loss on the secured party, this would also impose a loss on the secured party's buyer as well. These two losses should precisely equal the gain of retail or wholesale value of the noncomplying buyer. Because Harris has forgotten that the secured party gets liquidation value by selling the inventory to someone who resells (just like the noncomplying buyer) he is able to produce the illusion of asymmetry. If there is asymmetry, it has to be based on the premise that the secured party is less likely to channel the inventory to an eventual highest valuing user than is the noncomplying buyer. But since, in either case, the goods will move in roughly the same kind of distribution channels, such asymmetry is unlikely to be demonstrable.

After incorrectly locating the smaller loss on the secured party, Harris then backslides again, by suggesting that the size of the loss will affect compliance with the UCC. That is, if the loss is imposed on the secured party, it is more likely that the secured party will comply with Article 9 filing requirements. And if the loss is imposed on the noncomplying buyer, that buyer will more likely comply with the provisions of Article 6. This violates Harris's own premise of loss allocation—that these losses are the ones that are too expensive to prevent. But if they can be prevented by complying with the rules of the UCC, then they are not unpreventable losses. Therefore, Harris contradicts his own presuppositions.