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PRIORITIES UNDER THE UNIFORM COMMERCIAL CODE*

Ray David Henson**

Priorities among conflicting security interests have received considerable discussion in Uniform Commercial Code literature, but the questions raised have often been more interesting than practical. Of course the code does not specifically answer every conceivable theoretical question. However, if the rules of section 9-312 are carefully read—including the extensive cross-references in section 9-312(1)—the usual, ordinary questions can be answered.

Because the priority rules of article nine seem formidable in the abstract, some possible problems are dealt with here in concrete examples. In parts I and II of this article it may be assumed that a series of financing transactions takes place in the sequence in which they are stated. Part III will deal with some miscellaneous, unrelated problems.

A word of caution is perhaps in order. Some code writers have differed in their resolutions of various priority questions. One reason for this is a failure to approach a priority problem by resorting initially to the specific sections enumerated in section 9-312(1) which state the applicable rules in determining

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* The substance of this article will be a chapter in the forthcoming Practice Handbook on Secured Transactions Under the Uniform Commercial Code to be published by the Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association, 101 North Thirty-third Street, Philadelphia, Pennsylvania 19104.

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1 Unless otherwise identified, references are to the 1962 Official Text of the Uniform Commercial Code.

2 Reference to the various subdivisions of §9—312 will be made continuously throughout the article.

3 Uniform Commercial Code §9—312(1):

(1) The rules of priority stated in the following sections shall govern where applicable: Section 4—208 with respect to the security interest of collecting banks in items being collected, accompanying documents and proceeds; Section 9—301 on certain priorities; Section 9—304 on goods covered by documents; Section 9—305 on proceeds and repossessions; Section 9—307 on buyers of goods; Section 9—308 on possessory against non-possessory interests in chattel paper or non-negotiable
priorities between conflicting security interests. Too often section 9-312(5) is the only section consulted despite the code directive that it is applicable only in situations where other rules stated in section 9-312 do not control. Another reason is the understandable desire to settle priority questions the way a writer thinks they should be settled, notwithstanding code provisions to the contrary. One should also remember that the code provides continuous perfection in the circumstances specified in section 9-303(2). Similarly, the practitioner should be familiar with the rules of section 9-306, dealing with the conversion of collateral into proceeds.

Warbuck Corporation (the Company) is the manufacturer of a complete line of clothing for men, women and children.

1. The Company borrows from Bank A using certain stocks which it owns as collateral for the loan.

The type of collateral is an instrument, as defined in section 9-105(1)(g). If the stock certificates are pledged by the Company as collateral, the security agreement may be either oral or in writing since section 9-203(1)(a) dispenses with the written agreement if the collateral is in the possession of the secured party, which is Bank A in this example. Consequently there is no need

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4 Uniform Commercial Code §9—312(5):
(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special-priorities set forth in subsections (5) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows:
(a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under Section 9—204(1) and whether it attached before or after filing;
(b) in the order of perfection unless both are perfected by filing, regardless of which security interest attached first under Section 9—204(1) and, in the case of a filed security interest, whether it attached before or after filing; and
(c) in the order of attachment under Section 9—204(1) so long as neither is perfected.

5 Uniform Commercial Code §9—105(1)(g):
(g) “Instrument” means a negotiable instrument (defined in Section 3—104), or a security (defined in Section 8—102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment;

6 In order for a creditor, such as Bank A in this situation, to acquire a security interest in the collateral of his debtor and secure code protection of this interest, its security interest must attach to the debtor's collateral, and it must be perfected. A security interest cannot attach until there is an agreement that it attach, value is given, and the debtor acquires rights in the collateral. Uniform Commercial Code §9—204. Rules governing the perfection of security interests and the effects of perfection are discussed throughout this article.

7 See Uniform Commercial Code §9—203(1)(a) & comment 3.
PRIORITIES UNDER THE UNIFORM COMMERCIAL CODE

for Bank A to check the filing records before lending against the pledged stock. A security interest in this type of collateral cannot be perfected by filing.8

There is a possibility that the Company purchased these stocks with funds advanced by Bank X under a written security agreement. If so, under section 9-304(4)9 Bank X has, without further action on its part, a temporarily perfected security interest in the stock, good for twenty-one days from the time the interest attaches. Nevertheless, if within the twenty-one-day period the stock is pledged with Bank A, Bank A has priority over Bank X under section 9-309,10 since a bona fide purchaser of a security or a holder in due course of a negotiable instrument takes priority over the holder of an earlier security interest, even though the earlier interest is perfected. The bank as a lender against securities may qualify as a bona fide purchaser under sections 1-201(32) and (33).11 Similarly, if Bank A releases the stock to the Company so that its stock can be sold on the understanding that the proceeds would be used to repay the loan, a bona fide purchaser of the stock thereafter takes free of the security interest of Bank A, which continues for twenty-one days after the stock is released under section 9-304(5).12 Thus, in this latter situation, bank A's interest is good against lien creditors, including a trustee in bankruptcy, or anyone else except one who qualifies as a bona fide purchaser or holder in due course of a negotiable instru-

8 UNIFORM COMMERCIAL CODE §9-304(1):

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5).

To the same effect is §9-309, which states in effect that since filing is ineffective to perfect a security interest in an instrument, it will likewise be ineffective to constitute notice of the security interest to a holder in due course of a negotiable instrument.

9 UNIFORM COMMERCIAL CODE §9-304(4):

(4) A security interest in instruments or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

10 UNIFORM COMMERCIAL CODE §9-309:

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (Section 3-302) or a holder to whom a negotiable document of title has been duly negotiated (Section 7-501) or a bona fide purchaser of a security (Section 8-301) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

11 UNIFORM COMMERCIAL CODE §§1-201(32), (33):

(32) "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.

(33) "Purchaser" means a person who takes by purchase.

As to the rights acquired by a bona fide purchaser of a security, see UNIFORM COMMERCIAL CODE §§8-301.

12 UNIFORM COMMERCIAL CODE §9-304(5):

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange; or

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.
ment. Since the debtor’s disposition of the property is authorized by the secured party, the bank’s security interest continues solely in the proceeds from the sale of the collateral under section 9–306(2).

2. The Company borrows from Bank A using accounts as collateral.

Before entering into this type of financing transaction, it is probable that Bank A would file a financing statement and have the records searched to determine that no prior lender had an interest in the accounts. Under section 9–302 a financing statement must be filed to perfect the bank’s security interest in accounts, unless the transaction falls within the de minimis exception of section 9–301(1)(e). No conflicting prior interest exists in our example, so there is no priority problem at this point.

3. The Company has entered into a contract with the United States Government to supply uniforms for the armed services, and money to be earned under this contract is assigned to Bank B as collateral for a loan.

The kind of collateral Bank B has is contract rights, i.e., rights to payments under a contract which are not yet earned by performance and not evidenced by an instrument or chattel paper. In its financing statement Bank B would

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13 See text of §9–309, note 10 supra.
14 Uniform Commercial Code §9–306(2): (2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.
15 Uniform Commercial Code §9–302:
(1) A financing statement must be filed to perfect all security interests except the following:
   (a) a security in collateral in possession of the secured party under Section 9–305;
   (b) a security interest temporarily perfected in instruments or documents without delivery under Section 9–304 or in proceeds for a 10 day period under Section 9–306;
   (c) a purchase money security interest in farm equipment having a purchase price not in excess of $2500; but filing is required for a fixture under Section 9–313 or for a motor vehicle required to be licensed;
   (d) a purchase money security interest in consumer goods; but filing is required for a fixture under Section 9–313 or for a motor vehicle required to be licensed;
   (e) an assignment of accounts or contract rights which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor;
   (f) a security interest of a collecting bank (Section 4–208) or arising under the Article on Sales (see Section 9–113) or covered in subsection (3) of this section.
   (2) If a secured party assigns a perfected security interest, no filing under this Article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.
16 Uniform Commercial Code §9–106:
"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper. "Contract right" means any right to payment under a contract not yet earned by performance and not
claim an interest in contract rights under the identified contract and in proceeds, since the term "proceeds" includes the account arising when the right to payment is earned under a contract right.\textsuperscript{17} Although filing may not be necessary to perfect Bank B's security interest if the assignment of accounts is insignificant within the meaning of section 9-302(1)(e),\textsuperscript{18} filing is surely the only prudent policy to follow here.

A contract right becomes an account when the right to payment is earned under the contract—presumably with each shipment of goods in our example. Because accounts were used as collateral in the preceding example, there is an apparent conflict between Bank B and Bank A. Business judgment would probably indicate that the banks should enter into a subordination agreement under section 9-316\textsuperscript{19} before a problem arises. In the event of a conflict, however, it seems clear that the code gives Bank B priority over Bank A. The debtor must, of course, have rights in the collateral for the security interest to attach, under section 9-204(1).\textsuperscript{20} Section 9-204(2)\textsuperscript{21} provides that a debtor has no rights in a contract right until the contract is made, nor in an account until it comes into existence. Assuming that a security agreement has been made between the Company and Bank B and that value has been given, the security interest of Bank B has attached in our example before any accounts exist to which Bank A's interest might attach, since the government contract has already been made although no contract rights have yet ripened into accounts. The code provides for the security interest in contract rights to continue in the resulting accounts as proceeds that arise on performance.\textsuperscript{22} This interest is perfected for ten days after the proceeds are received even though not claimed in a filed financing statement. If Bank B had filed a financing statement which covered proceeds as well as the original collateral, or if itperfects its security interest in evidenced by an instrument or chattel paper. "General intangibles" means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments.


\textsuperscript{17} Uniform Commercial Code §9-306(1):
(1) "Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are "cash proceeds". All other proceeds are "non-cash proceeds".

\textsuperscript{18} See text of §9-302(1)(e), note 15 supra.

\textsuperscript{19} Uniform Commercial Code §9-316 provides: "Nothing in this Article prevents subordination by agreement by any person entitled to priority."

\textsuperscript{20} Uniform Commercial Code §9-204(1):
(1) A security interest cannot attach until there is agreement (subsection (3) of Section 1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

The debtor's right in the collateral is one of the three essential elements for a security interest to attach. See note 6 supra.

\textsuperscript{21} Uniform Commercial Code §9-204(2):
(2) For the purposes of this section the debtor has no rights
(a) in crops until they are planted or otherwise become growing crops, in the young of livestock until they are conceived;
(b) in fish until caught, in oil, gas or minerals until they are extracted, in timber until it is cut;
(c) in a contract right until the contract has been made;
(d) in an account until it comes into existence.

\textsuperscript{22} See text of §9-306(1), note 17 supra.
the proceeds within the ten days, its security interest continues to be perfected.23

While it is not a code problem, the Federal Assignment of Claims Act of 1940 should be complied with for the protection of the assignee of contract rights under a contract with the federal government.24 It should also be noted that the code recognizes a problem that has particular relevance to government contracts, although not confined to them. In section 9-318(2) the code provides that insofar as a right to payment under an assigned contract has not become an account, the contract may be modified by the original parties, if the modification is made in good faith and in accordance with reasonable commercial standards and will bind the assignee who acquires corresponding rights under the modified contract. However, the assignment may provide that such a modification is a breach by the assignor.25

4. The Company borrows from Bank A using as collateral 10,000 pieces of costume jewelry intended ultimately to be attached to dresses

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23 The priority rules which govern under §9—312(1) are set forth in Uniform Commercial Code §9—306(3):
(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless
(a) a filed financing statement covering the original collateral also covers proceeds; or
(b) the security interest in the proceeds is perfected before the expiration of the ten day period.

(3) The filing provisions of this Article do not apply to a security interest in property subject to a statute
(a) of the United States which provides for a national registration or filing of all security interests in such property; or
Note: States to select either Alternative A or Alternative B.

Alternative A—
(b) of this state which provides for central filing of, or which requires indication on a certificate of title of, such security interests in such property.

Alternative B—
(b) of this state which provides for central filing of security interests in such property, or in a motor vehicle which is not inventory held for sale for which a certificate of title is required under the statutes of this state if a notation of such a security interest can be indicated by a public official on a certificate or a duplicate thereof.

4 A security interest in property covered by a statute described in subsection (3) can be perfected only by registration or filing under that statute or by indication of the security interest on a certificate of title or a duplicate thereof by a public official.

25 Uniform Commercial Code §9—318(2):
(2) So far as the right to payment under an assigned contract right has not already become an account, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

The Federal Assignment of Claims Act includes §9—318 within its provisions and requires that assignment of claims be filed by the assignee in accordance with the act. See §9—318 & comment 5.
which will be manufactured. The jewelry is delivered to the custody of the bank.

The collateral in this example to which Bank A’s security interest will attach is inventory since the goods involved are raw materials to be used in the Company’s manufacturing process and held for ultimate sale.26 No financing statement need be filed since the collateral is pledged and in the possession of the secured party under sections 9–302(1)(a)27 and 9–305.28 Nevertheless, the records should be checked before a loan is made against a pledge of inventory, since the goods might be—although they are not in this case—subject to a prior security interest.

5. The Company borrows from Bank B using its inventory on hand as collateral.

Here again inventory is the collateral, and a search of the records may not disclose the interest of Bank A in certain items of inventory which were pledged in example 4. However, this inventory will not be on hand as part of the debtor’s property so that Bank B cannot in fact lend in reliance on the debtor’s ownership of the jewelry. Bank B will require that a financing statement be filed and will undoubtedly claim products of the collateral within its security interest, since a manufacturer’s inventory includes work in process and other items, as well as finished goods.29 For business rather than legal reasons this kind of financing may well be handled through a field warehouse.

Under section 9–306(2)30 Bank B has a continuing security interest in the

26 Uniform Commercial Code §9–109:
Goods are
(1) “consumer goods” if they are used or bought for use primarily for personal, family or household purposes;
(2) “equipment” if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;
(3) “farm products” if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory;
(4) “inventory” if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

27 See text of §9–302(1)(a), note 15 supra.

28 Uniform Commercial Code §9–305:
A security interest in letters of credit and advices of credit (subsection (2)(a) of Section 5–116), goods, instruments, negotiable documents or chattel paper may be perfected by the secured party’s taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party’s interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.

29 See text of §9–109(4), note 26 supra.

30 See text of §9–306(2), note 14 supra.
identifiable proceeds arising on the sale of the inventory which is being financed. This interest will continue for ten days after receipt of the proceeds by the debtor, which would not necessarily be within ten days of sale. Bank B's security interest may continue beyond that ten-day period, if its filed financing statement, encompassing the original collateral, also covers identifiable proceeds resulting from its disposition. The specific rules of priority stated in section 9-306 govern transactions falling within that section, so that the general rules of section 9-312, in particular 9-312(5), are not applicable. The application of section 9-306 means that there will be a conflict between the security interest of Bank B and the interest of Bank A in financing accounts under example 2, since accounts will be at least part of the proceeds of the inventory.

Reading sections 9-306(2) and 9-312(1) together, it seems clear that a subsequent security interest in inventory takes priority over an earlier security interest in accounts. The inventory financer, however, may have had no particular interest in the accounts or other proceeds arising on the sale of the inventory, other than to receive periodic payments, if the inventory is being financed on a revolving basis. If the inventory financer has no specific interest in the proceeds, he should be willing to enter into a subordination agreement with the earlier accounts financer. He will be aware of Bank A's interest through a search of the records before any loan was made. The right of creditors to agree on their relative priorities is recognized by section 9-316, although such a subordination agreement does not in itself create a security interest under the code. It is immaterial to third parties how these secured parties regulate their own interests, since in any case these parties will have priority over third parties subsequently acquiring an interest in the collateral. The terms of subordination may be worked out in a simple exchange of letters between the lenders. Section 9-306(4) states the rights of a secured party having a perfected security interest in proceeds in the event of the debtor's insolvency.

31 See text of §9—306(3), note 23 supra.
32 See text of §9—106, note 16 supra.
33 See text of §9—316, note 19 supra.
34 Uniform Commercial Code §9—306(4):
   (4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest
   (a) in identifiable non-cash proceeds;
   (b) in identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;
   (c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and
   (d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is
      (i) subject to any right of set-off; and
      (ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period.

6. The Company buys six new sewing machines from Vocal Machine Company under a conditional sale arrangement.

The collateral to which Vocal Machine Company's security interest will attach fits the category of equipment under section 9-109(2).\textsuperscript{35} Section 9-107 recognizes purchase money security interests of two types: those taken or retained by sellers of collateral to secure the purchase price, and those taken by third parties who give value so as to enable the debtor to acquire the collateral if such value is in fact so used.\textsuperscript{36} Since Vocal Machine, as seller of the equipment, retains a purchase money security interest of the first type, it need not check the filing records to determine whether an earlier financing statement claims this type of collateral. As long as the conditional seller files a financing statement within ten days after the debtor receives the equipment, the seller takes priority over conflicting security interests, if any, under section 9-312(4)\textsuperscript{37} and over transferees in bulk and lien creditors under section 9-301(2).\textsuperscript{38}

On the facts given here, the seller would still be protected against other secured parties if he filed on the eleventh day after the buyer received possession of the goods, or even later, as long as no conflicting financing statement claiming an interest in the goods had been filed so as to bring into operation the first to file rule of section 9-312(5)(a).\textsuperscript{39} The transaction could not be avoided in bankruptcy if bankruptcy did not arise until after four months from the date of filing.

7. The Company buys four more sewing machines. These are purchased from Pfist Company with funds advanced by Bank A.

Once again the security interest is in the equipment of the buyer. Bank A acquires a purchase money security interest of the second type as a party who, by making advances to the Company, gives value so as to enable the debtor to acquire rights in the collateral.\textsuperscript{40} Because of the difficulties in tracing funds, it is normally advisable for a financer, such as Bank A in this case, to make its check payable to the seller or to the seller and the buyer-debtor jointly or to

\footnotesize{\textsuperscript{35} See text of §9—109(2), note 26 supra.}

\footnotesize{\textsuperscript{36} \textit{Uniform Commercial Code} §9—107: A security interest is a "purchase money security interest" to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.}

\footnotesize{\textsuperscript{37} \textit{Uniform Commercial Code} §9—312(4): (4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.}

\footnotesize{\textsuperscript{38} \textit{Uniform Commercial Code} §9—301(2): (2) If the security party files with respect to a purchase money security interest before or within ten days after the collateral comes into possession of the debtor, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.}

\footnotesize{\textsuperscript{39} See text of §9—312(5)(a), note 4 supra.}

\footnotesize{\textsuperscript{40} See text of §9—107(b), note 36 supra.}
pay against documents, so that no question can reasonably arise on the use of the funds.

As long as Bank A files a financing statement before the debtor receives the goods or within ten days thereafter, the bank's interest is protected.\textsuperscript{41} The type of goods involved in this example and those in example 6 should be described as particularly as possible in the financing statement; these goods could be described quite specifically by make and model number. If too broad a description is used, \textit{e.g.}, "equipment," then these secured parties may complicate the debtor's future financing of equipment of other kinds and ultimately have to execute releases of collateral in which they have no interest.\textsuperscript{42}

Consider a variation of the above factual pattern. If Bank A had advanced only forty percent of the purchase price by a check to the seller, and if the Pfist Company had retained a security interest for the balance of the purchase price, and both the bank and Pfist had promptly filed financing statements, there would be conflicting purchase money security interests. Such a conflict is not explicitly resolved by the code. However, since neither interest is entitled to priority, both should rank equally according to their original participation, a result somewhat analogous to that provided for commingled or processed goods under section 9-315(2).\textsuperscript{43}

8. \textit{The Company acquires two new cutting machines of advanced design.}

(a) One is leased from Machine Leasing Corporation under a lease for five years with no option to purchase. Machine Leasing Corporation assigns its interest under the lease to Bank C as security for a loan.

(b) The other machine is leased from Equipment Leasing Corporation under a lease for eight years with a clause in the lease providing that if, at any time, the lessee desires to purchase the machine, eighty percent of the rent then paid will be applied toward the purchase price. The estimated useful life of the machine is ten years.

The machines in both instances are classified as inventory with respect

\textsuperscript{41} See text of §9-312(4), note 37 supra.

\textsuperscript{42} For an account of the formal requisites of a financing statement, see \textsc{Uniform Commercial Code} §9-402.

\textsuperscript{43} \textsc{Uniform Commercial Code} §9-315:

(1) If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass if

(a) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or

(b) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

In a case to which paragraph (b) applies, no separate security interest in that part of the original goods which has been manufactured, processed or assembled into the product may be claimed under Section 9—314.

(2) When under subsection (1) 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.
to the lessors and their financers, but they are equipment in the context of this example.\footnote{44} If the lessors assign the leases (or rents under them) to financers, the leases constitute chattel paper under section 9–105(1)(b)\footnote{45} whether the leases are "straight" leases or disguised conditional sales.

The code does not state definite rules for determining when a lease creates a security interest but according to section 1–201(37) expressly leaves this question for determination in each case. The code states that a mere option to purchase does not of itself make the lease one intended for security. At the other extreme, if the agreement provides that the lessee shall become or has the option to become the owner of the goods for no additional consideration or for a nominal consideration, the lease is one intended for security.\footnote{46}

In example 8(a), where there is no option to purchase either in the lease or in a side agreement there is clearly no security interest and consequently no compliance with article 9 is necessary. The assignment of the lease to Bank C does, however, create a security interest. A financing statement should be filed and the original, executed copy of the lease should be transferred to the bank to prevent the possibility of a subsequent transfer by the lessor to a good faith purchaser who might take priority under section 9–308.\footnote{47} Under that section

\footnote{44} See text of §§9–109(2), (4), note 26 supra.
\footnote{45} \textbf{Uniform Commercial Code} §9–105(1)(b):

(b) "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

The lease here constitutes chattel paper since it is a right which evidences both a monetary obligation and a lease of specific goods.

\footnote{46} \textbf{Uniform Commercial Code} §1–201(37):

"Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2–401) is limited in effect to a reservation of a "security interest". The term also includes any interest of a buyer of accounts, chattel paper, or contract rights which is subject to Article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under Section 2–401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event subject to the provisions on consignment sales (Section 2–326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.


\footnote{47} \textbf{Uniform Commercial Code} §9–308:

A purchaser of chattel paper or a non-negotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under Section 9–304 (permissive filing and temporary perfection). A purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory subject to a security interest (Section 9–306), even though he knows that the specific paper is subject to the security interest.
a purchaser of chattel paper\(^{48}\) who gives new value and takes possession of it in the ordinary course of his business without knowledge that the paper or instrument is subject to a security interest, takes priority over an interest in chattel paper which may be perfected by filing under section 9-304(1).\(^{49}\) If duplicate copies of the lease have been executed and retained by the lessor, the bank should probably insist that they be stamped with a legend stating that they are duplicates and that the lessor’s interest has been assigned to Bank C.

In example 8(b) it is not clear whether there is a security interest on the facts stated. To remove any doubt, the safest procedure is for Equipment to file a financing statement, claiming a security interest in the machine which is now equipment in the hands of the debtor. (Whether filing is desirable for other reasons is a different matter, of course.) The mere existence of an option to purchase does not transform a lease into a secured transaction. However, if eighty percent of the rent would, over the term of the lease, aggregate the purchase price, it is possible that a court would find that a security interest is created.\(^{50}\)

On the other hand, if more than twenty percent of the purchase price would necessarily have to be paid in order to exercise the option—hardly a nominal consideration within section 1-201(37)—the lease would probably be held to be a “straight” lease.\(^{51}\) There is no magic in a twenty percent figure, but it is probable that the rent over the lease term would be in excess of the full purchase price of the goods; this would almost certainly be true if the lessor were being financed, as is likely under this situation. Leasing transactions are still sufficiently unusual in bankruptcy cases that there are undoubtedly some dangers to be encountered if the court happens to be somewhat unsophisticated in this area. In long-term leases there will probably be a charge included in the rent analogous to the time-price differential in consumer installment sales, and this will be so whether the transaction is in fact a straight lease or a conditional sale. Therefore, to be realistic, the test of a security interest in a lease-option to buy arrangement should be the one set out in the code—whether a transfer will be made for nominal consideration or none at all.\(^{52}\) The test should not be simply whether the amount of rent to be applied toward the purchase price can over the full lease term add up to the original cash price of the goods, without

\(^{48}\) Since the lessor has assigned the lease to Bank C in this example, the lease then constitutes chattel paper under §9-105(1)(b). See note 45 supra.

\(^{49}\) **Uniform Commercial Code** §9-304(1):

1. A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party’s taking possession except as provided in subsections (4) and (5).

\(^{50}\) See, e.g., In the Matter of Royer’s Bakery, Inc., 4 CCH INSTALLMENT CREDIT GUIDE ¶ 99274 (E.D. Pa. 1963). Here the court construed an option to purchase in a lease of equipment, where 80% of all prior rentals paid could be applied to the purchase price at any time the option is exercised, as indicia of a lease intended for security.

\(^{51}\) In the Matter of Wheatland Elec. Prods. Co., 237 F. Supp. 820 (W.D. Pa. 1964), the district court held that where the lessee under an option to purchase could apply accrued and paid rentals towards payment of only 75% of the purchase price, the leasing agreement was not one intended for security within the terms of the Uniform Commercial Code. See Burton v. Tatelbaum, 213 A.2d 875 (Md. 1965).

\(^{52}\) See text of §1—201(37), note 46 supra.
giving any consideration to the added costs necessarily involved in "time" transactions.

Whether a lessor’s financer will rely simply on an assignment of the lease or will want a security interest in the leased goods will normally depend on the financer’s evaluation of the credit risks involved. If the lease is a disguised conditional sale and a financing statement covering the goods has been executed, the lessor’s financer may be shown on the statement as an assignee, or a separate assignment may be filed. Neither act, however, is required to protect the financer against creditors of the lessee, since under section 9–302(2) if a secured party assigns a perfected security interest, no further filing is necessary to continue the perfected status of the security interest against creditors of the original debtor. An assignment of record is necessary, however, as far as creditors of the lessor are concerned, if an interest in the goods is material to the financer. If a straight lease is involved and the financer is concerned about a security interest in the goods, then the lessor may be required to execute a financing statement as debtor with the financer as secured party. If the lease contains an unconditional obligation to pay the rentals to the lessor’s assignee and the lessee’s credit rating is high enough, it is probable that the secured party will not require a security interest in the goods, regardless of the security interest versus lease question.


Since "equipment" may include fixtures and it is often unclear whether a particular item should be considered a fixture, both code files and real estate records should be consulted before a loan is made on existing equipment. A search of the code records would disclose the prior interests of Vocal Machine Company in example 6, Bank A in example 7 and probably the interest of Equipment Leasing Corporation in example 8(b). It may not disclose the fact that a cutting machine has been leased from Machine Leasing Corporation in example 8(a), but this situation may be disclosed on a financial statement of the Company. In addition, the security agreement that Bank D will submit to the Company for execution will probably contain a representation about the ownership of any important items of equipment. A false representation would be a default under the agreement, allowing acceleration of the debt.

The financing statement should describe the collateral as specifically as possible with a catchall clause for other equipment then owned or thereafter acquired. A model decision on the description of equipment collateral is National Cash Register Co. v. Firestone & Co., in which the Massachusetts Supreme Court sustained a security interest in after-acquired property, even though the financing statement describing the items of collateral failed to include a reference to the after-acquired property clause set forth in the security arrangement.

53 See text of §9–302(2), note 15 supra.

Since Offices, Inc., retains a purchase money security interest in equipment, its interest is protected if a financing statement is filed before or within ten days after the debtor receives possession of the goods. If the financing statement were filed later than the tenth day, then Bank D in example 9 would take priority over Offices, assuming Bank D claimed an interest in after-acquired equipment. Since both security interests would be perfected by filing, priority would be in the order of filing under section 9-312(5)(a).

11. The Company acquires one thousand bolts of fabric from Rolling Mills, Inc., paid for with funds advanced by Bank E.

Bank B in example 5 has already claimed a security interest in all of the Company’s inventory. In order to prevent the inventory in the present example from falling under Bank B’s earlier security interest, Bank E must establish a purchase money interest, which it may do by paying against documents or by paying Rolling Mills directly. To perfect its security interest under section 9-312(3), Bank E must file a financing statement and give notice to Bank B before the Company receives possession of the goods. The notice must state that Bank E has or expects to acquire a purchase money security interest in fabric to be supplied to the Company. If this kind of financing is to continue between Bank E and the Company, then the notice should so state; if it is not to continue, then the shipment can be described specifically, rather than by type. If these requirements are met, Bank E has priority over Bank B as to the fabric supplied by Rolling Mills.

This may not be the end of the problem, however. Since the Company manufactures clothes, it is quite likely that the fabric will be used in this process.

55 See text of §9—312(4), note 37 supra.
56 Uniform Commercial Code §9—204(3):
   (3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.
57 See text of §9—312(5)(a), note 4 supra.
58 Formerly purchase money security interests were generally limited to such transactions as conditional sales contracts and chattel mortgages. Now a creditor may take a purchase money security interest either by making advances or incurring an obligation so as to enable a debtor to acquire rights in or the use of collateral. See text of §9—107, note 4 supra.
59 Uniform Commercial Code §9—312(3):
   (3) A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if
   (a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and
   (b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and
   (c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.
If dresses are the end product, this shipment of fabric will become only a part of the final result, and the identity of the various financed components will be lost in the process. If such identity is lost or if financing statements covering the original goods also covered the products into which they were processed, the security interests in the products rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the final product.60

One further complication may be added. Assume the costume jewelry pledged to Bank A in example 4 is attached to the dresses in question. Even though the collateral was in its possession, it is improbable that Bank A entered into its financing transaction under a verbal agreement, although it could have done so under section 9-203(1),61 or without filing a financing statement, although one would not be required here under section 9-302(1)(a).62 Whether or not the bank had transferred possession of these ornaments to a bailee (who did not issue a negotiable document for them), if no financing statement had been filed the ornaments could be released to the Company for use in the manufacturing process, and Bank A's security interest would remain perfected without filing for twenty-one days under section 9-304(5)(a).63 After that time, assuming the bank's security interest had not been retired by payment, it would cease to be perfected unless a financing statement had been filed within the twenty-one-day period. If a statement had been filed, perfection would continue and it would date back to the time the security interest was first perfected by taking possession of the ornaments.64 If we assume that there was no filing

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60 Uniform Commercial Code §9-315:
(1) If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass if
   (a) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or
   (b) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

61 Uniform Commercial Code §9-203(1):
(1) Subject to the provisions of Section 4-208 on the security interest of a collecting bank and Section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties unless
   (a) the collateral is in the possession of the secured party; or
   (b) the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.

62 See text of §9-302(1)(a), note 15 supra.
63 See text of §9-304(5)(a), note 12 supra.
64 Uniform Commercial Code §9-303(2):
(2) If a security interest is originally perfected in any way permitted under this Article and is subsequently perfected in some other way under this Article, without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this Article.
and that our problem arose within 21 days after the ornaments were released to the debtor, or that there was a timely filing. Bank $A$ would have priority over a conflicting claim by Bank $B$ if the ornaments are treated as accessions under section 9–314. If a financing statement filed by Bank $A$ covered both ornaments and products, Bank $A$ could not claim the ornaments as accessions under section 9–314, but Bank $A$ would rank equally with Banks $B$ and $E$ in the ratio that the cost of what each contributed bears to the cost of the total product under section 9–315.

II

Herrin Fashions, Inc., (the Store) is a retail department store which owns the property it occupies, subject to a mortgage held by Bank X.

1. The Store borrows from Bank $A$ giving a security interest in its inventory as collateral.

Since this is the first financing transaction in our present series, a search of the records by Bank $A$ will reveal that there are no other financing statements on file. Because the Store is a retail operation, it would be pointless to claim products in the financing statement, as would probably be done if a manufacturer's inventory were being financed. It is likely, however, that proceeds will

65 Uniform Commercial Code §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) and subject to Section 9–315(1).

(2) A security interest which attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole except as stated in subsection (3) but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as part of the whole.

(3) The security interests described in subsections (1) and (2) do not take priority over

(a) a subsequent purchaser for value of any interest in the whole; or

(b) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or

(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the whole at a foreclosure sale other than the holder of a perfected security interest purchasing at his own foreclosure sale is a subsequent purchaser within this section.

(4) When under subsections (1) or (2) and (3) a secured party has an interest in accessions which has priority over the claims of all persons who have interests in the whole, he may on default subject to the provisions of Part 5 remove his collateral from the whole but he must reimburse any encumbrancer or owner of the whole who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

66 See text of §9–315(2), note 60 supra.
be claimed from the disposition of the inventory under authorization of section 9-306.\textsuperscript{67}

2. The Store sells three brands of shoes and decides to add a fourth brand, Variety Shoes, to be supplied on consignment from the manufacturer.

This example poses some difficult questions. Where a buyer may return conforming goods to the seller in the event they are not resold, the transaction is a "sale or return" under section 2-326(1). Such goods are subject to the claims of the buyer's creditors while in the buyer's possession unless the seller complies with the filing provisions of article 9.\textsuperscript{68}

However, a filing in compliance with the rules of article 9 is not quite the end of the problem.

Do we have a security interest here? In the absence of compliance with section 9-312(3), which concerns purchase money security interests in inventory collateral, there is a question as to the seller's right to reclaim the shoes as against Bank A.\textsuperscript{69} Sections 1-201(37)\textsuperscript{70} and 9-102(2)\textsuperscript{71} indicate that article 9 applies

\textsuperscript{67} See text of §9-306(1), note 17 supra.
\textsuperscript{68} There are two other ways for the seller to retain his interest free of claims of the buyer's creditors, but they are inapplicable here, since we are not, by hypothesis, dealing with a seller known to be substantially engaged in selling the goods of others or the laws on sign posting. See UNIFORM COMMERCIAL CODE §2—326:

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

(a) a "sale on approval" if the goods are delivered primarily for use, and

(b) a "sale or return" if the goods are delivered primarily for resale.

(2) Except as provided in subsection (3), goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum". However, this subsection is not applicable if the person making delivery

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

(4) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this Article (Section 2—201) and as contradicting the sale aspect of the contract within the provisions of this Article on parol or extrinsic evidence (Section 2—202).

\textsuperscript{69} See text of §9-312(3), note 59 supra.

\textsuperscript{70} See text of §1-201(37), note 46 supra.

\textsuperscript{71} UNIFORM COMMERCIAL CODE §9—102:

(1) Except as otherwise provided in Section 9—103 on multiple state transactions and in Section 9—104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, docu-
only to consignments which are intended as security. Section 9-113 is not applicable because the Store has possession of the shoes. If the consignment is intended as security, there is a purchase money security interest retained by the seller to secure the purchase price. This means that section 9-312(3) must be followed and notice of this kind of financing must be given to Bank A before the store receives possession of the shoes; otherwise this inventory will fall under the prior security interest of Bank A, under the first-to-file rule of section 9-312(5)(a). A filing within ten days after the store receives possession of the shoes would protect the seller-secured party against lien creditors under section 9-301(2). Although there would be no relation back if the filing were more than ten days after the debtor received the goods, a late filing would be effective from the time it was made, outside of bankruptcy as to liens arising after filing and in bankruptcy if the date of bankruptcy were more than four months after the filing of the financing statement. The best business procedure in this kind of situation is to file and give notice to prior financers before the debtor obtains possession of the goods. If this is not done, there is the problem of determining whether in fact a secured transaction was intended.

Consignments or sale or return transactions are employed for two basic reasons. One is to enable the seller to control the resale price of the products. The other is simply to facilitate business financing for mutual benefit. If the first reason is controlling, it is reasonably certain that no secured transaction is intended by the parties. This does not mean that no filing is required, however. Filing is required for protection against creditors of the consignee, unless there is compliance with an applicable sign posting statute, if any, or unless the consignee is generally known by his creditors to be substantially engaged in selling the goods of others. Even though the consignor's interest in the goods is protected by filing under article 9, the rest of its provisions should not be applicable, and the transaction should be governed by article 2.72

72 Uniform Commercial Code §9-113:

A security interest arising solely under the Article on Sales (Article 2) is subject to the provisions of this Article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods
(a) no security agreement is necessary to make the security interest enforceable; and
(b) no filing is required to perfect the security interest; and
(c) the rights of the secured party on default by the debtor are governed by the Article on Sales (Article 2).

73 See text of §9-107, note 36 supra.
74 See text of §9-312(5)(a), note 4 supra.
75 See text of §9-301(2), note 38 supra.
Where a wholesaler is supplying a retailer with goods on simple sale or return terms, it seems most likely that the wholesaler does intend to reserve a security interest in the unsold goods and that he intends the retailer to sell them on any terms of his choosing subject to a duty to pay for goods sold and to return those remaining unsold. The retailer may, of course, pay for all of the goods consigned to him, but he has the option of returning those which remain in stock on the day of accounting. To protect his interest in the unsold goods, the wholesaler reserves a security interest. In these cases, article 9 should govern in all its terms, once the debtor-consignee has possession of the goods.

3. The Store decides to stock a new line of gas stoves manufactured by Ramona Ranges, to be financed under a floor plan arrangement with Bank B.

Before the code this would have been handled as a trust receipt transaction. To discover any prior security interests it will be necessary for Bank B to search the files before entering into this financing. A search will reveal the prior interests of Bank A and Variety Shoes. While the interest of Variety Shoes is not competitive, being restricted to that brand of shoes, the security interest of Bank A in inventory takes priority over Bank B’s interest under section 9–312(3) unless Bank B files and notifies Bank A that it is going to engage in purchase money financing of Ramona Ranges before the Store gets possession of them.\(^77\) Although Bank A could make such conduct a default under its security agreement with the Store, it cannot monopolize the debtor’s financing to the exclusion of all other possibilities.

4. The Store replaces the furnace in its building, and a new furnace is purchased from Heaters, Inc., under a conditional sale agreement.

The Store’s furnace is equipment, and under the law of most states it is a fixture. Under section 9–313(1), whether a particular item is a fixture is determined by local law, except that certain materials which are incorporated into a building cannot be financed as fixtures under the code.\(^78\)

Assuming that the furnace is a fixture, a financing statement should be filed in the real estate records. This statement should describe the real estate and give the name of the record owner. In this example the record owner and the debtor are the same entity, but this will not always be so. While “any description of personal property or real estate is sufficient whether or not it is specific if it rea-

\(^77\) See text of §9–312(3), note 59 supra.

\(^78\) Uniform Commercial Code §9–313(1):

(1) The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like and no security interest in them exists under this Article unless the structure remains personal property under applicable law. The law of this state other than this Act determines whether and when other goods become fixtures. This Act does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.
reasonably identifies what is described,""9 a description of real estate which does not enable a recording officer to file the financing statement in the proper place does not reasonably identify the property. What kind of description is required varies from place to place; in some areas a legal description is necessary and in others a street address is adequate.80

If a conditional sale contract is executed before the furnace is affixed to the real estate, the events required for attachment under section 9-204(1) will necessarily have occurred,81 and Heaters, Inc., has priority over existing real estate interests. Section 9-313(2) provides that a security interest which has attached to goods before they become fixtures will take priority over all claims of persons who have an interest in the real estate with certain exceptions.82 Local law, however, must be consulted since several states have adopted nonuniform amendments to section 9-313 which have either limited or abolished its effect.83 To give Heaters priority over subsequent purchasers for value of interests in the real estate, subsequent lien creditors and creditors who make subsequent advances under prior recorded encumbrances, attachment alone is not enough and a financing statement must be filed. However, Heater has priority over the earlier real estate mortgagee, Bank X, even without filing if its security interest attaches before affixation, since the mortgagee has made no subsequent advances.84

If the real estate is registered under a Torrens system, it will probably be necessary to present the owner’s duplicate certificate of title to the registrar for a notation of the security interest in order to perfect it, and if the debtor is not the owner the owner’s consent will be required.

5. The Store opens branches in another county of this state and in a neighboring code state and moves part of its inventory to those locations.

79 Uniform Commercial Code §9—110.
80 See, e.g., Yancey Bros. v. Dehco, Inc., 108 Ga. App. 875, 134 S.E.2d 828 (1964), where the court stated that a general description of the property at issue is sufficient where either the location of the property is stated in the instrument or the instrument indicates from whom the property was purchased. The court held that the record description of property will be deemed sufficient if it provides a key to the identity of the property.
81 See text of §9—204(1), note 21 supra.
82 Uniform Commercial Code §§9—313(2), (4):
(2) A security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4).

* * * *

(4) The security interests described in subsections (2) and (3) do not take priority over
(a) a subsequent purchaser for value of any interest in the real estate; or
(b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or
(c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section.
83 California rejects §§9—313 in its entirety, while Ohio has completely rewritten subsections (2) through (5).
84 See text of §§9—313(4), note 82 supra.
If the debtor's state has adopted any of the official filing alternatives in section 9-401(1), no new filing will be required to continue the perfection of the security interest upon change of location of part of the inventory to another county. This is true regardless of which official alternative section 9-401(3) has been adopted and whether dual filing is otherwise required in the particular state, because inventory requires central filing in any event and local filing in addition, if at all, only when the debtor has a place of business in only one county. Therefore, the three inventory financers need not refile in order to preserve their respective priorities.

85 Uniform Commercial Code §9—401(1):

First Alternative Subsection (1)

1. The proper place to file in order to perfect a security interest is as follows:
   a. when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;
   b. in all other cases, in the office of the [Secretary of State].

Second Alternative Subsection (1)

1. The proper place to file in order to perfect a security interest is as follows:
   a. when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the ......... in the county where the debtor's residence or if the debtor is not a resident of this state then in the office of the ......... in the county where the goods are kept, and in addition when the collateral is crops in the office of the ......... in the county where the land on which the crops are growing or to be grown is located;
   b. when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;
   c. in all other cases, in the office of the [Secretary of State].

Third Alternative Subsection (1)

1. The proper place to file in order to perfect a security interest is as follows:
   a. when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the ......... in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the ......... in the county where the goods are kept, and in addition when the collateral is crops in the office of the ......... in the county where the land on which the crops are growing or to be grown is located;
   b. when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;
   c. in all other cases, in the office of the [Secretary of State] and in addition, if the debtor has a place of business in only one county of this state, also in the office of ......... of such county, or, if the debtor has no place of business in this state, but resides in the state, also in the office of ......... of the county in which he resides.

86 Uniform Commercial Code §9—401(3):

3. A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed. Alternative subsection (3)

3(3) A filing which is made in the proper county continues effective for four months after a change to another county of the debtor's residence or place of business or the location of the collateral, whichever controlled the original filing. It becomes ineffective thereafter unless a copy of the financing statement signed by the secured party is filed in the new county within said period. The security interest may also be perfected in the new county after the expiration of the four-month period; in such case perfection dates from the time of perfection in the new county. A change in the use of the collateral does not impair the effectiveness of the original filing.]

87 All three alternatives under §9—401(1) have provisions for centralized filing, while only the third alternative to subsection (1) has the additional requirement of local filing in the event the debtor has his place of business in only one county of the state.
Where part of the inventory is moved to another code state, the security interest in it remains perfected for a four-month period if originally perfected in the state of origin. To continue the perfection beyond that period under section 9-103(3), it is necessary for the inventory financers to file in the other state. A financing statement signed only by the secured party is sufficient under section 9-402(2)(a). Thus, the cooperation of the debtor is not necessary, but if the debtor does not sign the statement, it must state that it is filed to perfect a security interest in collateral which was subject to a security interest in another jurisdiction.

6. The Store sells appliances to consumers on conditional sale contracts and assigns the contracts to Bank C as security for a loan.

The security interests of Bank A in example 1 and Bank B in example 3 are cut off when the financed inventory is sold to buyers in ordinary course of business. Under section 9-302(1)(d) no filing is required to perfect the Store’s purchase money security interest in the appliances which it sells to consumers, assuming they do not become fixtures. Unless the Store files, however, its security interest is cut off if the consumer in turn sells to a good faith purchaser for value who buys for personal, family or household purposes.
The security interest of the banks, although terminated in the appliances, continues in the identifiable proceeds under section 9-306(2). There is an immediate conflict between the banks which financed the inventory and Bank C, which is financing the chattel paper. The interest of Banks A and B terminates ten days after the proceeds are received, unless a filed financing statement expressly claimed them. Even if Banks A and B claimed chattel paper, if it were claimed merely as proceeds of inventory and in fact was not being separately financed, Bank C would take priority over them under section 9-308, assuming it gives new value and takes possession of the paper. Although section 9-308 speaks of a "purchaser" of chattel paper, article 9 applies to both loans against chattel paper and sales of chattel paper under section 9-102(1) (b) and the term "purchaser" includes a secured party. If Bank C does not take possession of the chattel paper so as to perfect its interest under section 9-305, its interest is inferior to the earlier interests of Banks A and B, unless the parties entered into a subordination agreement adjusting their relative priorities.

Some complicated problems can arise when a seller of goods has transferred accounts or chattel paper to a secured party and the goods from which the accounts or chattel paper arose are subsequently returned or repossessed. These problems are resolved in section 9-306(5). If the secured party finances both

93 See text of §9-306(2), note 14 supra.
94 See text of §9-306(3), note 23 supra.
95 See text of §9-308, note 47 supra.
96 UNIFORM COMMERCIAL CODE §9-102(1):
(1) Except as otherwise provided in Section 9-103 on multiple state transactions and in Section 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also to any sale of accounts, contract rights or chattel paper.
97 See text of §§1—203(32), (33), note 11 supra.
98 See text of §9—305, note 28 supra.
99 See text of §9—316, note 19 supra.
100 UNIFORM COMMERCIAL CODE §9—306(5):
(5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:
(a) If the goods were collateral at the time of sale for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.
(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under Section 9—308.
(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).
(d) A security interest of an unpaid transferee asserted under paragraph
inventory and the proceeds arising on its sale, the returned goods would fall back under the original security interest—the security interest would be traced from the original goods into their proceeds into the returned collateral. However, where accounts or chattel paper are transferred to a second secured party, this collateral becomes valueless when the goods are returned or repossessed, and the problems are more difficult.

Where the sale of goods results in accounts, an unpaid transferee has a security interest in the goods as against the transferor. This interest is subordinate to the interest of the unpaid inventory financer, whose security interest reattaches and continues to be perfected. But if the interest of the inventory financer is retired as to these goods when the proceeds of sale are transferred, he has no interest in them, and the interest of the accounts financer in the goods is paramount if it is perfected. Where the sale of goods results in chattel paper, the transferee of the paper who gives new value and takes possession of the paper in the ordinary course of business has priority as to the returned goods over a party who claimed a security interest in them merely as proceeds of the original inventory financing. Returned goods are proceeds of the original proceeds which arose on sale under section 9-306(1). A problem may arise here if bankruptcy intervenes. Section 9-306(5)(d) requires that a security interest in returned goods claimed by an unpaid transferee of accounts or chattel paper must be perfected as to the goods, if it is to have priority over creditors of the transferor (and purchasers of the returned or repossessed goods). If it is perfected, there is no problem, but if it is not perfected, the security interest has priority over the interest of an unpaid inventory financer but is not good against creditors of the debtor, and a trustee in bankruptcy should prevail as to these goods.

7. The Store sells some conditional sale contracts to a finance company.

The code applies to loans against chattel paper and sales of chattel paper, as well as to accounts and contract rights. The only distinction the code makes is that if the transaction was a sale the debtor (assignor) is not liable for a deficiency or entitled to a surplus after default unless the agreement so provides; the contrary is true in the case of a loan.
The safest procedure with respect to chattel paper is to take possession of it, whether the transaction is a sale or a loan. If it is left in the possession of the debtor it should be stamped to show its assignment to the secured party or purchaser. If the paper is neither transferred nor stamped, but a financing statement is filed, a purchaser who gives new value and takes possession of it in the ordinary course of business without actual knowledge that the specific paper is subject to a security interest will take priority over the filed security interest, under the first sentence of section 9-308. Chattel paper in our present economy has many of the attributes of negotiable paper, so that one who takes such paper is in much the same position as one who takes a negotiable instrument. There is no need to search the records for a filed financing statement. As was pointed out in connection with example 6, a purchaser of chattel paper who gives new value and takes possession of the paper in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory, even though he knows the specific paper is subject to a security interest.

Most of the emphasis in parts I and II of this article has been placed on priority questions falling within the cross-references of section 9-312(1) and the purchase money priorities of sections 9-312(3) and (4). There are, of course, general rules which govern priorities not otherwise specifically dealt with, which are set out in section 9-312(5). First, priority is determined in the order of filing, if both interests are perfected by filing irrespective of whether the respective security interests attach to the collateral before or after their filing or whether the other requisites of section 9-204(1) are satisfied. Second, priority is determined in the order of perfection, where both security interests are not perfected by filing. This rule will be applied in the first problem discussed below. Third, priority is determined in the order of attachment, if neither interest is perfected. The last rule is perhaps a necessary catchall, but it is doubtful that it has any practical application, since it is unlikely that a priority question would ever be litigated without one of the secured parties perfecting his interest in some way. If a debtor becomes bankrupt before the secured parties have perfected their interests, a trustee in bankruptcy has priority to collect from the account debtors or obligors must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization from the collections. If the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. But, if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

To the same effect is §9—504(2).

109 See text of §9—308, note 47 supra.
110 See text of §9—312(1), note 3 supra.
111 See text of §9—312(3), note 59 supra and text of §9—312(4), note 37 supra.
112 See text of §9—312(5), note 4 supra.
113 Uniform Commercial Code §9—312(5)(a).
114 Uniform Commercial Code §9—312(5)(b).
115 Uniform Commercial Code §9—312(5)(c).
under section 9–301(1)(b), which concedes the status of a lien creditor to a trustee in bankruptcy over unperfected security interests.116

1. X Company receives some inventory in which Bank A, having duly filed, has a perfected purchase money security interest. This inventory is subsequently placed in a warehouse and either (a) a negotiable receipt or (b) a nonnegotiable receipt is issued.

If a negotiable receipt is duly negotiated to Bank B, as collateral it has priority over Bank A under section 9–309, even though Bank A’s interest was perfected earlier.117 If a nonnegotiable receipt is issued in the name of Bank B as collateral, its security interest is perfected under section 9–304(3),118 but it is subordinate to Bank A’s interest under section 9–312(5)(b),119 which provides that priority is in the order of perfection where both interests are not perfected by filing and other rules are inapplicable.120

Since many inventory financers find it convenient to use nonnegotiable receipts rather than negotiable receipts to assure priority in the event of an earlier filed security interest in the goods, the good faith financer could safely take a negotiable receipt and then have a nonnegotiable receipt issued in its name.

2. A takes a security interest in the equipment in X Store and files a financing statement claiming equipment. B later sells X Store a cash register on conditional sale and files fifteen days after X receives the register.

The first-to-file priority rule is simple enough to apply, although the results may occasionally be surprising. It normally will come into operation where competing loans are made against existing assets, although it is also applicable where a purchase money interest does not qualify for its special priority.121

In the example, B could have received priority as a purchase money secured creditor by filing as to the cash register before or within ten days after X Store received possession.122 B’s failure to do so gives A priority, because the cash register clearly is equipment, and an ordinary security agreement covering all the equipment at designated premises includes after-acquired collateral used as

116 Uniform Commercial Code §9—301(1)(b):
   (1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of
   (b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected.

117 See text of §9—309, note 10 supra.
118 Uniform Commercial Code §9—304(3):
   (3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee’s receipt of notification of the secured party’s interest or by filing as to the goods.

119 See text of §9—312(5)(b), note 4 supra.
121 See text of §9—312(3), note 59 supra and text of §9—312(4), note 37 supra.
122 See text of §9—312(4), note 37 supra.
equipment. If both interests are perfected by filing and the second is not entitled to a purchase money priority, priority is in the order of filing.

3. On June 1, A files a financing statement covering equipment of X Store but the security agreement includes only tables and chairs. On July 1, B files a financing statement covering four cash registers which X Store owns and against which B makes a loan. On August 1, A and X amend their security agreement to give A additional security, including the four cash registers against which B has advanced his loan.

As between A and B, A has priority as to the four cash registers. Both security interests have been perfected by filing, but A filed first, claiming everything that could be classified as the debtor's equipment, even though in fact A had no security interest in the cash registers at that time. A acquired his interest subsequently when the security agreement was amended to cover the registers. At that time his interest became perfected since A had given value and the debtor had rights in the collateral. Section 9--312(5)(a) provides for priority in the order of filing without regard to which interest attached first under section 9--204(1) and whether it attached before or after filing.

If this result seems harsh, B has only himself to blame. A search of the records would have revealed A's prior claim to all of the debtor's equipment. With such a financing statement on file, a prudent lender would not lend against any item properly classified as equipment without requiring the earlier secured party to file a release as to these goods under section 9--406 or entering a subordination agreement under section 9--316. To rely on a statement by A that he does not at that time claim an interest in cash registers is to invite future trouble, although grounds may exist for claiming estoppel under section 1--103.

4. A finances the purchase of a shipment of rugs for X Rug Store by paying against receipt of a negotiable bill of lading covering the rugs. The bill of lading is released to X, who receives possession of the rugs and places them in a show room for sale the following day. The next day B files a financing statement claiming a security interest in

124 See text of §9--204(1), note 20 supra.
125 See text of §9--312(5)(a), note 4 supra.
126 Uniform Commercial Code §9--406:
A secured party of record may by his signed statement release all or a part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. Upon presentation of such a statement to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release shall be $.........

127 Uniform Commercial Code §1--103:
Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.
X's rugs and their proceeds. The following day A files a financing statement claiming a security interest in X's rugs and their proceeds.

A's interest in the rugs becomes perfected by taking possession of the negotiable document under section 9-304(2). A's security interest remains perfected when he releases the document to X so that it could obtain possession of the goods for ultimate sale, and it remains perfected for twenty-one days under section 9-304(5)(a). Since A has filed within the twenty-one-day period, his interest in the rugs continues to be perfected under section 9-303(2). The security interests of A and B were originally perfected by filing, so A has priority over B as to the rugs under section 9-312(5)(b). This is true because section 9-312(6) requires that the rules of section 9-312(5) be interpreted by considering how the security interest was first perfected in cases of continuous perfection.

Several other problems should be considered in this context. What would happen if A had filed twelve days after X received the rugs, but within the twenty-one-day period permitted by section 9-304(5)? This does not involve the question as to whether the rugs are proceeds of the document. They are not. A security interest in goods, in the possession of one who has issued a negotiable document for them, is perfected by taking possession of that document. A security interest perfected by filing during this period is subject to the interest perfected by possession of the document. The collateral is the goods, which are represented by the negotiable document here. The problem is a conflicting claim to proceeds in the event that the rugs are sold after B has filed, but before A has filed. If a rug is sold the day X receives possession of the shipment, and the proceeds of the sale are both cash and a conditional sales contract, A has a continuing interest in the identifiable proceeds—perhaps only the contract here—which would be good for ten days after their receipt. Unless A takes physical possession of the contract (and the cash) within that ten-day period, his claim is subordinate to B's claim, because B has filed a financing statement claiming inventory and proceeds and A at this time, has not. On the eleventh day after the debtor received the proceeds, B's priority would be clear. A would have no claim because of his failure to file. If A filed on the twelfth day, his interest in proceeds received more than ten days before that time would have lapsed. His priority in the

128 Uniform Commercial Code §9—304(2):
(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

129 See text of §9—304(5)(a), note 12 supra.

130 See text of §9—303(2), note 64 supra.

131 Uniform Commercial Code §9—312(6):
(6) For the purpose of the priority rules of the immediately preceding subsection, a continuously perfected security interest shall be treated at all times as if perfected by filing if it was originally so perfected and it shall be treated at all times as if perfected otherwise than by filing if it was originally perfected otherwise than by filing.

132 See text of §9—304(2), note 128 supra.

133 See text of §9—306(3), note 23 supra.

134 See text of §§9—502(2), 9—504(2), note 108 supra.
inventory, however, would continue, just as it would continue in the proceeds of inventory sold in the preceding ten days. A need not give notice to B under section 9-312(3) in these circumstances. Section 9-312(3) is not applicable here, and the priorities are determined by the cross-references in section 9-312(1).

Although article 9 does not expressly state that the purchase money priority in inventory continues in the proceeds, section 9-306(2) provides that an interest in collateral which is disposed of continues in the proceeds, so that there seems to be no reasonable basis for reversing priorities when the inventory is sold. The code’s intention is clear that, whatever the priorities were in the original inventory, they continue in the proceeds. Of course, these priorities will be lost if the proceeds are disposed of to parties who take superior interests under sections 9-308 and 9-309.

5. On January 1, 1963, A leases a farm from B for five years and gives B a security interest in the crops to be grown to assure payment of rent. On March 1, 1965, A and Bank C enter into a security agreement, and Bank C advances funds to enable A to purchase seed for crops to be grown in 1965. The interests of B and Bank C are both properly filed.

When a security interest in crops is given in connection with a lease, land purchase, or improvement transaction, which is evidenced by an appropriate writing, the security interest in crops to be grown during the period of the transaction is not subject to section 9-204(4)(a). This section states that a security interest under an after-acquired property clause cannot attach to crops which become such more than a year after the agreement is executed. Therefore, B’s security interest continues in the 1965 crops. Because B’s interest is a matter of public record, Bank C should be aware of it at the time it enters the financing agreement with A, and B and C may enter into a subordination agreement. If they do not and if their conflicting interests are adjusted on the basis of section 9-312(2), B has priority over C except for obligations due more than six months before the crops become growing crops. As to these stale obligations, C has priority over B, assuming the crops C is financing become growing crops within

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135 See text of §9—306(2), note 14 supra.
136 Uniform Commercial Code §9—204(4)(a):
   (4) No security interest attaches under an after-acquired property clause
       (a) to crops which become such more than one year after the security agreement
       is executed except that a security interest in crops which is given in conjunction
       with a lease or a land purchase or improvement transaction evidenced by a contract,
       mortgage or deed of trust may if so agreed attach to crops to be grown on the land
       concerned during the period of such real estate transaction.
137 Uniform Commercial Code §9—312(2):
   (2) A perfected security interest in crops for new value given to enable the
debtor to produce the crops during the production season and given not more than
three months before the crops become growing crops by planting or otherwise takes
priority over an earlier perfected security interest to the extent that such earlier interest
secures obligations due more than six months before the crops become growing
crops by planting or otherwise, even though the person giving new value had knowledge
of the earlier security interest.
three months after C's advance. This is true even though C knew of B's earlier interest at the time C entered into the agreement with A.

In "pure" crop mortgage situations — where there is no underlying real estate transaction but the parties contemplate continuing financing year after year — it is common for a financing statement to be filed which is good for five years, and for the parties to enter into a new security agreement each year. As long as this procedure is followed, if the debtor enters into a second financing transaction, the first lender has priority under the first-to-file rule of section 9-312(5)(a).

6. On July 1, 1965, A obtains a loan from Bank X and grants a security interest in his automobile to the bank as collateral. This interest is duly perfected by notation on the automobile's certificate of title. Three weeks later A damages his car, and it is taken to Garage G for repairs, which are promptly made. However, A is unable to pay for the repairs, so the garage retains possession of the car. A defaults in the repayment of his loan from Bank X.

As between the bank and the garage, the lien of the garage has priority under section 9-310, unless the statute creating the lien expressly provides otherwise. This is true as long as the lienor retains possession of the goods on which he has a claim for services or materials, and this statutory rule overrides any pre-code decisional law to the contrary.

138 Uniform Commercial Code §§9—403(2), (3):
(2) A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of such sixty day period after a stated maturity date or on the expiration of such five year period, as the case may be, unless a continuation statement is filed prior to the lapse. Upon such lapse the security interest becomes unperfected.

(3) A continuation statement may be filed by the secured party (i) within six months before and sixty days after a stated maturity date of five years or less, and (ii) otherwise within six months prior to the expiration of the five-year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and state that the original statement is still effective. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it.

139 See text of §9—312(5)(a), note 4 supra.
140 Uniform Commercial Code §9—310:
When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.