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cumstances which clearly exclude this general rule. Once this paragraph is
applied, the result should be, in the event of simultaneous death, inclusion
of the owner’s interest in his estate at a zero valuation.

Donald L. Sweatt

Floating Lien Upheld Against Trustee

In September 1965 Grain Merchants gave to Union Bank a security in-
terest in all its accounts receivable “now or hereafter received by or belong-
ing to . . . [Grain Merchants] . . . .” It was duly and timely filed as re-
quired by section 9-302 of the Uniform Commercial Code. Pursuant to
the security agreement, Grain Merchants executed promissory notes in
favor of Union Bank on the twentieth of each month, the note of the pre-
vious month being cancelled by the succeeding one. The last such note, ex-
ecuted on September 20, 1966, in the amount of $100,000 cancelled a pre-
vious note dated August 20, 1966. On September 30, 1966, Grain Mer-
chants ceased doing business, and on October 27, 1966, filed its petition in
bankruptcy. Beginning September 30, Union Bank collected from Grain
Merchants’ accounts receivable a total of $127,641.43. Of this amount,
$52,441.49 represented accounts receivable which came into existence after
September 20, 1966, the last date on which new consideration was ad-
vanced to Grain Merchants by Union Bank.

The referee in bankruptcy held that the transfer of a security interest
in the accounts receivable took place at the time the individual accounts
came into existence. Therefore, those accounts coming into existence after
September 20 were transferred “for or on account of an antecedent debt”
(the antecedent debt being the September 20 note). Finding that the trans-
fer of the accounts arising after September 20 effectively gave Union
Bank a greater percentage of its debt than was given to other creditors
of the same class, the referee held the transfers to be voidable preferences
as defined in section 60(a)(1) of the Bankruptcy Act. Accordingly, he
ordered Union Bank to turn over the $52,441.49 to the trustee. The dis-
trict court reversed the referee’s turnover order, holding that the transfer
“should be considered to have taken place when Union Bank filed its
financing statement.” It adopted the view that accounts receivable, pres-

1 Grain Merchants of Ind., Inc. v. Union Bank & Sav. Co., 408 F.2d 209, 210 (7th Cir. 1969).
2 Ind. Ann. Stat. tit. 19, § 19-9-302 (1964) [hereinafter citation will be made to the UNI-
FORM COMMERCIAL CODE].
4 Id.;
   A preference is a transfer . . . of any of the property of a debtor to or for the
   benefit of a creditor for or on account of an antecedent debt, made or suffered by
   such debtor while insolvent and within four months before the filing by or against
   him of the petition initiating a proceeding under this title, the effect of which
   transfer will be to enable such creditor to obtain a greater percentage of his debt
   than some other creditor of the same class.
6 Id. at 602.
ent and future, transfer as an “entity”—not individually as separate and distinct units. *Held, affirmed:* Under section 60 of the Bankruptcy Act, an entity of accounts receivable may be transferred when a security agreement is filed; moreover, the “substitution of collateral” doctrine, which permits the secured creditor to substitute one account for another if the assets of the bankrupt are not thereby diminished, is applicable to a security interest reaching future accounts receivable. *Grain Merchants of Indiana, Inc. v. Union Bank & Savings Co.,* 408 F.2d 209 (7th Cir. 1969).

I. THE BANKRUPTCY ACT AND THE UNIFORM COMMERCIAL CODE

The primary purpose of the Bankruptcy Act is to secure an equitable and ratable distribution of the bankrupt’s unencumbered assets among his unsecured creditors. The trustee in bankruptcy takes the bankrupt’s assets subject to all valid liens and encumbrances conferred by state law. The trustee, however, can avoid certain transfers which are classified as preferences. The law of preferences basically seeks to prevent two distinct evils. The first is the “eleventh hour” security arrangement under which one creditor achieves an advantage over others. The second is the employment of secret or “equitable” security devices which prevent the general creditors from discovering—until it is too late for them to protect themselves—that the debtor’s assets are totally tied up and have been for some time. The Act does not, however, seek to invalidate all secured transactions. It recognizes and intends to give effect to legitimate security arrangements created in accordance with state law.

A transfer is deemed to have been made, within the meaning of section 60 of the Bankruptcy Act, when it becomes “so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract would become superior to the rights of the transferee . . . .” However, “perfection” as required by section 60(a)(2) is a matter of state law10 and is governed by article 9 of the Uniform Commercial Code. Article 9 authorizes security devices such as the floating lien, long accepted in the business finance world, but not generally accepted by the bankruptcy courts. A principle purpose of the article is to make such commercially acceptable security arrangements valid against

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8 Id. See also Matthews v. James Talcott, Inc., 345 F.2d 374 (7th Cir. 1965).
9 Bankruptcy Act § 1(30), 11 U.S.C. § 1(30) (1964) defines “transfer” as including “the sale and every other mode . . . of disposing of or parting with property or with an interest therein . . . [such as] a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise . . . .” See note 4 supra.
10 Uniform Commercial Code § 9-301(2). A purchase money security arrangement takes precedence over a creditor’s lien.
11 In 1910 Bankruptcy Act § 60, 11 U.S.C. § 60 (1964) was amended to its present form. In recommending passage of the amendment, the House Committee on the Judiciary stated, “The present [1938] language of the act tends to impede and choke the flow of credit, principally to small-businessmen, and the object of this bill is to free its channels.” H.R. REP. No. 1293, 81st Cong., 1st Sess. 3 (1949); 2 U.S. CODE CONG. & AD. NEWS 1985 (1950).
13 See note 8 supra, and accompanying text.
14 The Uniform Commercial Code has been adopted by all states except Louisiana and has been adopted by Congress for the District of Columbia and the Virgin Islands.
the trustee in bankruptcy.\textsuperscript{15} Under article 9, a security interest attaches when there is agreement that it attach, value is given, and the debtor has rights in the collateral.\textsuperscript{16} A security agreement which has attached is perfected by the filing of a financing statement.\textsuperscript{17} However, if the required steps for perfection (i.e., filing) are taken before the security interest attaches, it is perfected at the time when it attaches.\textsuperscript{18} While a debtor has no rights in an account receivable until it comes into existence,\textsuperscript{19} "a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement."\textsuperscript{20} This possibility is limited, however, to situations where the debtor acquires his rights in the collateral "in the ordinary course of his business."\textsuperscript{21} The security interest in such after-acquired property is "deemed to be taken for new value and not as security for an antecedent debt."\textsuperscript{22}

### II. Judicial Acceptance of the Floating Lien in Bankruptcy Cases

The Code-authorized "floating lien" has previously been upheld against the trustee in bankruptcy through adoption of the "entity" theory\textsuperscript{23} and the "substitution of collateral" doctrine.\textsuperscript{24} The Massachusetts case of Rosenberg v. Rudnick\textsuperscript{25} was apparently the first to reach federal district court in this area since the adoption of the Uniform Commercial Code. There the bankrupt had given to his creditor, well in advance of the four-month period, a security interest in present and future inventories. In holding that inventory should be viewed as a single entity and that the transfer of the security interest in it took place at the date of execution of the security agreement, the court emphasized that the security transaction involved was outside the intent of the Bankruptcy Act.\textsuperscript{26} This decision seems to rest pri-

\textsuperscript{15}Uniform Commercial Code § 9-108, Comment 1.
\textsuperscript{16}Id. § 9-204(1).
\textsuperscript{17}Id. § 9-302(1). Section 9-304 sets out the procedure for filing a financing statement.
\textsuperscript{18}Id. § 9-303(1).
\textsuperscript{19}Id. § 9-204(2)(d).
\textsuperscript{20}Id. § 9-204(3).
\textsuperscript{21}Id. § 9-108.
\textsuperscript{22}Id.
\textsuperscript{23}The entity theory was first advanced in Manchester Nat'l Bank v. Roche, 186 F.2d 827, 831 (1st Cir. 1951):
By analogy it might be possible to treat a merchant's accounts receivable as a unit presently and continuously in existence, the component elements of which . . . may be constantly changing, without affecting the identity of the res; so that a general assignment by way of security of accounts receivable present and future might be deemed to create in praesenti a lien upon this enduring unit . . . which lien would persist as a floating charge upon such res, however much its component elements might change from time to time . . . ."
\textsuperscript{24}In the leading case on the substitution doctrine, new collateral was given to the creditor before other collateral held was released. The effect was to create an excess of collateral over debt which was withdrawable by the debtor. In re Pusey, Maynes, Breish Co., 122 F.2d 606 (3d Cir. 1941). See also 3 W. Collier, Bankruptcy § 60.20 (14th ed. 1968).
\textsuperscript{26}The transaction here was not one of those which the provisions of Section 60 were designed to avoid. There was nothing here in the nature of a secret lien. There was no attempt by one
marily on the Code provisions regulating attachment and perfection\(^7\) and on the "so far perfected" requirement of section 60(a)(2)\(^8\) of the Bankruptcy Act. However, the court cited section 9-108 as establishing the intent of the Code, and because of the Code's widespread adoption, reasoned that this "intent" should be followed in interpreting the provisions as to attachment and perfection.\(^9\)

In the widely discussed Portland Newspaper case,\(^10\) the Rosenberg court's conclusion that inventory should be viewed as an entity deemed to have been transferred at the time of execution of the security agreement was followed and applied to a security interest in a stock of accounts receivable. Repeating the belief that the Code does not allow the evils section 60 seeks to prevent,\(^11\) the Portland court observed that there could be no preference here because the accounts in question were mere substitutions for released collateral and the bankrupt's estate was in no way diminished by the substitutions.\(^12\) In a third case,\(^13\) an Ohio district court cited the Rosenberg and Portland decisions in reversing the referee in bankruptcy and upholding the validity of a floating lien on inventories and proceeds.

### III. Grain Merchants of Indiana, Inc. v. Union Bank & Savings Co.

Handing down the first court of appeals decision on this particular problem since enactment of the Uniform Commercial Code, the court in Grain Merchants chose not to follow the reasoning of the courts in Rosenberg, Portland, and White. Instead of citing section 9-108 as establishing the "intent" of the Code, the court in Grain Merchants relied on construction of section 60 of the Bankruptcy Act. It found the "so far perfected" requirement of section 60(a)(2) to establish the "intent" of the Act, and determined that Union Bank's security interest became "so far perfected" at the time of recording the financing statement. Although section 9-108 of the Code could have produced a similar result, it was not found to be controlling. The court of appeals alternatively approved three different theories supporting its decision: first, the transaction is deemed to have taken place at the time of filing; second, an entity of accounts receivable may be transferred at that time; and third, the substitution of collateral doctrine is applicable to these facts.

As observed above, section 60 of the Bankruptcy Act does not require absolute perfection. And the time at which a transfer becomes "so far perfected" is to be determined by state law.\(^14\) Reading sections 9-301(1)(d) to creditor to outtrace others at the last moment before bankruptcy. Defendant here bargained for and acquired his security interest at the time he made his loan." Id. at 639.

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\(^7\) Uniform Commercial Code §§ 9-204, 9-303.


\(^9\) 262 F. Supp. 635, 639.


\(^11\) Id. at 401.

\(^12\) Id. The estate of the bankrupt actually increased during the four months preceding bankruptcy.


\(^14\) See text accompanying notes 12-14 supra.
and 9-204(3) of the Uniform Commercial Code together, the court con-
ccluded that "a secured creditor who had filed a financing statement on
after-acquired property is entitled to priority" over subsequent liens ob-
tainable on a simple contract. Such priority is created at the time of filing.
Therefore, the time of filing is the time at which the transfer is deemed to
have been made under section 60 of the Bankruptcy Act. Since this trans-
fer was made in advance of the four-month period preceding bank-
ruptcy, no voidable preference resulted.

The court of appeals approved as an alternative holding the district
court's conclusion that the transfer was not on account of an antecedent
debt. In so doing it approved the "entity" theory of accounts receivable
and inventory as adopted by the district courts in the cases discussed above.
Union Bank's interest was interpreted to be in the entity of accounts re-
ceivable. This interest transferred in September 1965 with the filing of the
security agreement, although the debt had not yet been created.

Although denominated alternative holdings by the court of appeals,
these conclusions (first, that the transfer took place before the four-month
period, and second, that the transfer was not on account of an antecedent
debt) would seem to be mutually dependent in this fact situation. They
must necessarily follow each other. Either conclusion can be reached only
by considering the time of transfer as the time of filing, which is both
before the four-month period preceding bankruptcy and before the ad-
advance of credit to Grain Merchants.

The court of appeals cited a third reason, not mentioned in the district
court's opinion, in support of the result reached. Under the substitution of
collateral doctrine, collateral can be transferred as security in exchange for
other collateral which was held as security, regardless of the time of such
transfer, so long as it does not bring about a diminution of the bankrupt's
estate. The facts of this case show that there was no diminution of Grain
Merchant's assets in favor of Union Bank during the four-month period
preceding bankruptcy.

IV. Conclusion

The result reached in this case is supported by law, precedent, and rea-
son. There is no violence done to the wording or the intent of the Bank-
ruptcy Act in interpreting it so as to permit use of the security transactions
established by the Uniform Commercial Code. Indeed, under the substi-
tution theory this particular kind of security transaction would seem to be
valid as against a trustee in bankruptcy without the provisions of the
Code. Such flexible security arrangements are extremely useful—if not
absolutely necessary—for modern business financing. However, to consider
the instant problems as being resolved would indeed be dangerous. Ap-
parently only four district courts and only one court of appeals have dealt
with these issues since the adoption of the Uniform Commercial Code. It
cannot be said with certainty that the Supreme Court or the other circuits

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85 408 F.2d at 213.