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INSECURITY FOR SECURED CREDITORS — THE FLOATING LIEN AND SECTION 547 OF THE BANKRUPTCY ACT

ARTHUR J. HARRINGTON*

Any security that will not stand up in case of insolvency of the debtor is only a trap for the unwary creditor. Of all the tests to which a security transaction can be put, bankruptcy is the most exacting. This is as it should be.¹

On October 1, 1979, the Bankruptcy Reform Act of 1978 became effective.² Section 547 of the Act provides the bankruptcy trustee with the power to avoid preferential transfers³ and section 547 contains important changes which should concern the secured party who takes a security interest in after-acquired property of the debtor.

Since the enactment of the original preferential transfer provisions in the Bankruptcy Act of 1898, a constant battle has been waged in the bankruptcy forum between secured and unsecured creditors for rights in after-acquired property of the debtor. Section 547 represents a compromise between these warring factions. This compromise has evolved through numerous changes in the preferential transfer provision of the Bankruptcy Act since the 1898 Act. This article will describe those changes which led to the compromise embodied in section 547 of the Bankruptcy Reform Act of 1978 and point out some of the difficulties arising therefrom.

The enactment of section 547 was also the direct result of certain judicial theories which have evolved since the adoption of the Uniform Commercial Code. Prior to the enactment of section 547, these judicial theories virtually insulated a float-

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3. 11 U.S.C.A. § 547 (1979). Section 547 of the Bankruptcy Reform Act of 1978 is reprinted in the Appendix to this article.
ing lien creditor from attack under the preferential transfer section of the Bankruptcy Act. Section 547 of the Bankruptcy Reform Act will have an important effect in the application of these theories in the future. This article will describe these judicial theories and evaluate their impact on floating liens under section 547. Finally, this article will evaluate a new theory which may be available to the floating lien creditor who is faced with a preferential transfer attack under section 547 by the bankruptcy trustee.

I. SECURITY INTERESTS IN AFTER-ACQUIRED PROPERTY UNDER THE UNIFORM COMMERCIAL CODE

Perhaps no form of collateral has become more important in modern lending than the category loosely defined as "quick" assets of a debtor, such as inventory and accounts receivable. These assets are deemed to be "quick" in the sense that their very nature suggests a rapid turnover in the normal course of doing business. Sales of inventory items generate accounts receivable for the debtor, and payments on the accounts receivable generate funds for new purchases of inventory. The success of this business cycle is dependent upon an unencumbered system for liquidation of these assets.

Prior to 1950, quick assets were not an important source of collateral for the lending industry since traditional lending instruments were too cumbersome when applied to these types of collateral. The business debtor could ill afford to delay a sale of a product out of inventory to a customer until such time as his banker could release a collateral security interest in that product. From the lender's perspective, the administrative expense of protecting a security interest in each piece of new inventory and each new account receivable was prohib-

4. "Although section 9-204 speaks of 'after-acquired collateral' generally and would therefore apply when the collateral is a relatively fixed or long-term asset (such as plant equipment), the section's greatest impact would appear to be upon financing transactions in which the collateral is composed of assets classified as 'current' or 'quick' (such as inventory or receivables)." Kronman, The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act, 124 U. PA. L. Rev. 110, 119 (1975) (footnotes omitted) [hereinafter cited as Kronman].
5. Id. at 119.
6. 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 11.7, at 360 (1965) [hereinafter cited as 1 G. GILMORE].
itive, given the recording and filing requirements of state law.\textsuperscript{7} Traditional modes of financing and collateral instruments were ill-suited to the lender's need for low administrative costs and the debtor's need for liquidity of his inventory and accounts receivable.\textsuperscript{8}

However, the adoption of the Uniform Commercial Code by the states provided a unique financing device to meet the needs of lenders and debtors with respect to these quick assets: the "floating security interest."\textsuperscript{9} The floating lien is normally characterized by a security interest in all of the debtor's inventory and accounts receivable. Two other characteristics, however, make this security interest uniquely tailored to the needs of the lender and the commercial debtor: (1) automatic attachment of the security interest to inventory and accounts receivable acquired and generated by the commercial debtor in the future; and (2) immediate perfection of the lender's security interest upon future acquisitions of inventory and generation of accounts receivable by a previous recordation of the financing statement.\textsuperscript{10}

These rather novel characteristics of the floating lien are made possible by provisions contained in Article 9 of the Uniform Commercial Code.\textsuperscript{11} In particular, section 9-204(1) provides that all obligations detailed in a security agreement may be secured by collateral which is acquired by the debtor subsequent to the date of the agreement.\textsuperscript{12} The drafters of the Uniform Commercial Code expressly approved the character-

\textsuperscript{7} The main disincentive for the use of quick assets as a security device was the Supreme Court's decision in Benedict v. Ratner, 268 U.S. 353 (1925). In Benedict, the Court held fraudulent as a matter of state law transactions where the debtor retained the right to sell collateral freely without prior approval from the lender.

\textsuperscript{8} 1 G. GILMORE, supra note 6, § 2.3, at 27.

\textsuperscript{9} 1 G. GILMORE, supra note 6, § 11.7, at 359-65.

\textsuperscript{10} Skilton, Security Interests in After-Acquired Property Under the Uniform Commercial Code, 74 Wis. L. Rev. 925, 927 (1974).


\textsuperscript{12} U.C.C. § 9-204(1) states as follows: "Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."
istics of immediate attachment and perfection of the floating lien:

Subsections (1) and (3) read together make clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. . . . That is to say: the security interest in after-acquired property is not merely an “equitable” interest; no further action by the secured party—such as the taking of a supplemental agreement covering the new collateral—is required.\(^{13}\)

As important as the floating lien has become in the commercial lending market, it has been a thorn in the side of the bankruptcy trustee. Throughout the history of the Bankruptcy Act, battles have been waged between the commercial lender, secured by future property of the debtor, and the trustee under the preferential transfer provisions of the Bankruptcy Act. The very act against which the creditor attempted to secure himself— the bankruptcy of the debtor— has become a source of insecurity for the creditor and the trustee at different times.

II. Preferential Transfers Under Bankruptcy Law — A Historical Perspective

A primary objective of the Bankruptcy Act is equality of distribution among creditors of the estate.\(^ {14}\) The preferential transfer provisions of the Bankruptcy Act carry this notion of equality among creditors to a period prior to the declaration of bankruptcy. This period has ranged in duration from four months under previous Acts to ninety days under the current Act.\(^ {15}\)

In general, the preferential transfer section of the Act in-

\(^{13}\) See U.C.C. § 9-204, Comment 2 (1957 version). Prior to the enactment of the Uniform Commercial Code, numerous courts which wrestled with the validity of liens covering future property not yet owned by the debtor had condemned them as merely “equitable” interests. A thorough discussion of the historical treatment of liens in future property is provided in Cohen & Gerber, The After-Acquired Property Clause, 87 U. Pa. L. Rev. 635 (1939).


\(^{15}\) The ninety-day period under the current Act is limited to a “non-insider.” If a creditor qualifies as an “insider,” the period is enlarged to one year prior to bankruptcy. See 11 U.S.C.A. § 547(b)(4) (1979).
validates certain transfers of the debtor's property to creditors for debts incurred at a time prior to the transfer.\textsuperscript{16} Prior to the enactment of section 547, there were seven elements of proof required to invalidate a transaction as a preferential transfer.\textsuperscript{17} The most important questions included: (1) Was the transfer made within the four-month time period? and (2) Was the transfer made on account of an antecedent debt?

It is apparent that the concept of a floating lien is vulnerable to attack by the trustee as a preferential transfer. Under the notion of a floating lien, the commercial borrower is agreeing to grant a security interest to the lender in the future property which the borrower may acquire in order to secure the present debt owing to the lender. When the acquisition of the future property by the debtor occurs, along with automatic attachment and perfection of the security interest within the prescribed period prior to bankruptcy,\textsuperscript{18} the trustee is tempted to make the argument that the transaction represents an invalid transfer of property for an antecedent debt within the meaning of the preferential transfer section of the Act. This temptation was nurtured by certain historical developments in the law of preferential transfers.

The crucial consideration for determining whether a floating lien qualifies as a preferential transfer is timing. In other words, the occurrence of the following events determines the time of transfer: (1) the execution of the security agreement; (2) the perfection of the security interest; or (3) the acquisition of the future collateral by the debtor. Prior to the Bankruptcy Reform Act of 1921, various amendments to the bankruptcy law had failed to adequately define the appropriate timing element for security devices which were analogous to the present-day floating lien.

In the original Act of 1898,\textsuperscript{19} the preferential transfer provision merely stated that any preference given within four months before bankruptcy was voidable by the trustee.\textsuperscript{20} The

\begin{itemize}
  \item \textsuperscript{16} 3 W. COLLIER, BANKRUPTCY § 60.02, at 758-59 (14th ed. 1977).
  \item \textsuperscript{17} See note 49 infra.
  \item \textsuperscript{18} See note 15 supra.
  \item \textsuperscript{19} Bankruptcy Act of 1898, ch. 541, § 60, 30 Stat. 544, 562.
  \item \textsuperscript{20} The original text of § 60 of the Bankruptcy Act of 1898 provided as follows:

  Sec. 60. Preferred Creditors. — a. A person shall be deemed to have given a preference if, being insolvent, he has procured or suffered a judgment to be
Act did not make any reference to recording requirements of state laws. The four-month period ran from the time of giving the preference and not from the time of recording a transfer in the public records. Thus, a creditor could obtain a "secret lien" (i.e., an unrecorded agreement for a lien in the debtor's property), wait four months and then record the security agreement in accordance with the recording requirements of state laws on the eve of bankruptcy. This recording gave priority to the creditor and was not subject to preferential attack since transfer of the lien, rather than the recording, occurred more than four months prior to bankruptcy. In this manner,

entered against himself in favor of any person, or made a transfer to [sic] any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class.

b. If a bankrupt shall have given a preference within four months before the filing of a petition, or after the filing of the petition and before the adjudication, and the person receiving it, or to be benefited thereby, or his agent acting therein, shall have had reasonable cause to believe that it was intended thereby to give a preference, it shall be voidable by the trustee, and he may recover the property or its value from such person.

c. If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him.

d. If a debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an attorney and counselor at law, solicitor in equity or proctor in admiralty for services to be rendered, the transaction shall be re-examined by the court on petition of the trustee or any creditor and shall only be held valid to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate.

3 W. Collier, Bankruptcy ¶ 60.05, at 771 n.7 (14th ed. 1977).

21. The defect in the 1898 Act was well documented in Carey v. Donohue, 240 U.S. 430, 435 (1916):

In its original form, § 60 made no reference to record. The four months ran from the time of the giving of the preference, and if this period had elapsed when the bankruptcy proceeding was instituted, there could be no recovery under § 60, whether the transfer had, or had not, been recorded. But a different rule was established for computing the time within which a petition in bankruptcy might be filed. In § 3b, it was provided that the four-month period should not expire "until four months after (1) the date of the recording or registering of the transfer . . . when the act consists in having made a transfer . . . for the purpose of giving a preference . . . if by law such recording or registering is required or permitted, or, if it is not, from the date when the beneficiary takes notorious, exclusive, or continuous possession of the property unless the petitioning creditors have received actual notice of such transfer."
the 1898 Bankruptcy Act actually encouraged the use of secret liens by creditors.22

The 1903 and 1910 Amendments to the Bankruptcy Act,23 and subsequent case law interpreting these amendments,24 proved inadequate to deal with the secret lien problem.25 From the perspective of the trustee, the inadequacies were especially glaring in the case of lenders who had exacted a promise from the debtor to grant a lien in future property26

This distinction between the test of the right to institute bankruptcy proceedings and the test of the right to recover from one who had received a transfer alleged to be a preference lay in the terms of the act and could not rightly be ignored. It was urged that the result was to encourage secret preferential transactions; but the wisdom of the prescribed condition of recovery from the preferred creditor, and the advisability of conforming the provision of § 60 to that of § 3b was a matter of legislative, not judicial, consideration. To secure this conformity, an amendment to § 60 was proposed in Congress in the year 1903, (citations omitted).


22. 3 W. COLLIER, BANKRUPTCY ¶ 60.05, at 772 (14th ed. 1977).

23. The 1903 Amendment added the following provision to section 60a: “Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of recording or registering of the transfer, if by law such recording or registering is required.” Act of Feb. 5, 1903, Pub. L. No. 62, 32 Stat. 797 (emphasis added). The 1910 Amendment to section 60b had no effect on the language in section 60b of the 1903 Amendment. Act of June 25, 1910, Pub. L. No. 294, 36 Stat. 838.


25. As a result of these three Supreme Court decisions, see note 24 supra, a recording was only “required” where failure to record made the transfer voidable by a general creditor. If a recording were not “required,” then the date of transfer was the date of the transfer of the lien and not the date of recording. This very restrictive interpretation of “required” recording had the effect of encouraging the continued use of secret liens. 3 W. COLLIER, BANKRUPTCY, ¶ 60.37[3], at 921-22 (14th ed. 1977).

26. This interest was commonly categorized as an “equitable lien” by the courts:

An equitable lien is neither a jus in re nor a jus ad rem. It is not a property in the thing itself, nor does it constitute a right of action for the thing, but is simply a charge upon it, and, as was remarked by Erle, J., in Brunsdon v. Allard, “the words equitable lien are intensely undefined.”

... 

A contract whereby a contracting party sufficiently indicates an intention to make some particular property or fund which it describes a security for a debt or other obligations creates an equitable lien on the property so indicated. A contract which shows an intention to charge a particular property therein identified with an obligation creates an equitable lien thereon. And if a party by agreement creates a charge or claim in the nature of a lien on property of which he is the owner or in possession, a court of equity will establish and enforce it, not only against the party who stipulated to give it, but also against
under the preferential transfer provisions of the Act. If the promise had been exacted more than four months prior to bankruptcy and a recording occurred on the eve of bankruptcy (a legal lien), the lien would relate back to the date of the enforceable promise and was not voidable under the preferential transfer provision of the Act.\(^2\) In some cases, the same result occurred in lending transactions closely akin to a floating lien.\(^2\)

In 1938, Congress passed amendments to the Bankruptcy Act which were designed to accomplish what previous amendments had failed to achieve — the voidability of all secret liens. However, the result represented overkill from the perspective of the secured creditor. The 1938 Amendment established the bona fide purchaser test for the purpose of determining when a transfer was deemed to have occurred under the preferential transfer provisions of the Act.\(^2\) The test focused the point of inquiry on the time the transaction became

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third persons who are either volunteers, or take with notice. (citations omitted).


28. In a number of cases, the debtor and creditor entered into an agreement under which the debtor retained some right to sell or dispose of all or part of the property subject to a lien and to substitute other property in its place. This practice was declared invalid in some instances under the Bankruptcy Act. See Benedict v. Ratner, 268 U.S. 353 (1925) and City Nat'l Bank v. Zorn, 68 F.2d 566 (5th Cir. 1934). However, other courts insulated such practices from the trustees' attack as personal transfers. In re Robert Jenkins Corp., 17 F.2d 555 (1st Cir.), cert. denied, 273 U.S. 753 (1927).

29. The bona fide purchaser test was embodied in the new language contained in the last sentence of section 60a:

The new test is more comprehensive and accords with the contemplated purpose of striking down secret liens. We provide that the transfer shall be deemed to have been made when it becomes so far perfected that neither a bona fide purchaser nor creditor could thereafter have acquired rights superior to those of the transferee. As thus drafted, it includes a failure to record and any other ground which could be asserted by a bona fide purchaser or a creditor of the transferor, as against the transferee. We have also added a provision which makes the test effective even though the transfer may never have actually become perfected.

known to the public and lost its shroud of secrecy.\(^{30}\)

Under this bona fide purchaser test, the equitable lien security arrangement would likely be voidable. The final lien, if recorded within four months of bankruptcy, could not relate back to the date of the “secret agreement” since a bona fide purchaser’s claim to the collateral would be superior to the secret lien claimant. However, along with the benefits of the voidability of the secret lien, came the voidability of various traditional forms of financing which were not in the category of secret liens. Under the 1938 Amendment, courts struck down as voidable preferential transfers and assignments of accounts receivable.\(^{31}\) Courts also raised the issue of voidability of trust receipt financings\(^{32}\) on the grounds that such traditional security interests were not perfected against a bona fide purchaser prior to bankruptcy.

Congress enacted the 1950 Amendment as a result of a consensus in the lending community that the bona fide purchaser test of the 1938 Act overstepped the goal of voiding the

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31. In Corn Exch. Nat'l Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943), a lender had received an assignment of the debtor's accounts receivable in exchange for a loan. The applicable state law (Pennsylvania) required notification to account receivable debtors in order to perfect against a bona fide purchaser. Since the bank had not notified the accounts receivable debtors, the court held that the trustee had a superior right to the accounts receivable creditor. The assignment was deemed to have been made immediately prior to the date of bankruptcy for failure to meet the bona fide purchaser test of the 1938 Amendments to section 60a.

The Klauder decision was followed and expanded to strike down as preferential account receivable financing even though state law did not require notification to the account receivable debtors. In re Vardaman Shoe Co., 52 F. Supp. 562 (E.D. Mo. 1943).

32. Trust receipts are a lending vehicle which is particularly important at the retail level of consumer goods such as home appliances and automobiles. Under this vehicle, the retail debtor is permitted to sell the consumer product in the ordinary course of his business, and the consumer purchaser takes the product free of the security interest of the lender. By definition, the right of the lender can never be protected against the “bona fide” purchaser within the meaning of the 1938 Amendment. The lender’s interest in the consumer goods was struck down as voidable preferential transfers at the trial level. In re Harvey Distrib. Co., 88 F. Supp. 466 (E.D. Va. 1950). However, this result was reversed apparently on equitable grounds that full value had been given to the debtor by the lender at a time distant from the date of bankruptcy. Coin Machine Acceptance Corp. v. O'Donnell, 192 F.2d 773 (4th Cir. 1951). For an excellent discussion of this issue under the 1938 Amendment to section 60a see 3 W. COLLIER ON BANKRUPTCY ¶ 60.38[1], at 945-46 (14th ed. 1977).
secret lien under the bankruptcy law. In the 1950 Amendment, the "bona fide purchaser" test for transactions involving personal property was replaced with the "lien creditor" test. For purposes of determining whether a particular transfer qualified as a preferential transfer, the point of inquiry was the date that perfection occurred so that "no subsequent lien . . . obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee."

The 1950 Amendments cleared the air of any suggestion that such traditional forms of security lending transactions as trust receipts and assignments of accounts receivable were voidable preferential transfers under the Bankruptcy Act. Under the lien creditor test of the 1950 Amendments, both security transactions were normally beyond the reach of the

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33. The purposes of the 1950 Amendment were summarized in the legislative history as follows:

(a) With respect to section 1 of the bill, dealing with section 60a, its purpose is to clarify the provisions of that section of the Bankruptcy Act; eliminate confusions that have been created by reason of certain court decisions discussed below; and remove the resultant serious doubts that now exist among banks, factors, and other extenders of credit upon the validity of security taken in good faith and for present value. The present language of the act tends to impede and choke the flow of credit, principally to small-business men, and the object of the bill is to free its channels.


34. The bona fide purchaser test was retained for transactions involving real property under section 60a of the Bankruptcy Act.

35. In place of the last sentence of section 60a of the 1938 Amendment, the 1950 Amendment substituted paragraphs (2) through (8). Paragraph (2) embodied the lien creditor test and read as follows:

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

36. See note 32 supra and accompanying text.

37. See note 31 supra and accompanying text.
preferential transfer section of the Act. However, once again the drafter's pen, while succeeding in preserving traditional forms of secured transactions, had called into question the validity of yet another emerging form of security for the lender — the floating lien.

III. JUDICIAL "PREFERENTIAL” TREATMENT OF THE FLOATING LIEN UNDER THE 1950 AMENDMENTS

A. The Theory of the Floating Lien as a Preference Under the "Lien Creditor" Test

A compelling argument has been made by some authorities that the grant of a security interest in after-acquired property of the debtor constituted a preferential transfer under section 60a of the Bankruptcy Act. In order to understand the argument, one must appreciate the interrelationship between Article 9 of the Uniform Commercial Code and the 1950 Amendment to section 60a of the Bankruptcy Act.

Normally, a security interest is created and enforceable as between the debtor and lender by virtue of a written agreement known as a security agreement. However, other steps

38. Under the Uniform Trust Receipts Act, perfection of the lender's interest is obtained by filing a statement of the transaction within 30 days of the delivery of the goods. Proper filing creates an interest superior to intervening or subsequent lien creditors (i.e., the proper filing relates to the date of the delivery of the goods). Thus, if the 1950 Amendments were controlling at the time the trial court decided In re Harvey Distrib. Co., 88 F. Supp. 466 (E.D. Va. 1950), the court would have held the transactions there under consideration not a voidable preferential transfer.

Likewise, the result in Corn Exch. Nat'l Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943) would be reversed. Under Pennsylvania law an assignment of accounts receivable is automatically perfected against a subsequent attachment creditor of the assignor as soon as made. See 3 W. COLLIER, BANKRUPTCY ¶ 60.48, at 1023 (14th ed. 1977). Thus, even though the transaction was not perfected as against bona fide purchasers of the accounts receivable under Pennsylvania law, it was perfected against a subsequent lien creditor at the time it was made and this was not a voidable preference under the 1950 Amendments.


40. In all instances where the lender does not have possession of the collateral, the security interest must be evidenced by a writing:
must be taken to insulate the lender's interest in the collateral from superior claims of third parties such as lien creditors or trustees in bankruptcy.

The lender must perfect his interest in order to maintain a claim superior to the trustee, who is accorded the status of a lien creditor under the 1950 Amendments to section 60a of the Bankruptcy Act. Article 9 of the Uniform Commercial Code contains a number of straightforward sections relating to perfection of a security interest in after-acquired property of the debtor. Two events must occur before a security interest is perfected. First, the security interest must "attach" within the meaning of the Code. Secondly, steps for perfection, such as filing of a financing statement, must take place.

The concept of "attachment" is a novel aspect of the Uniform Commercial Code. Attachment is deemed to have taken place upon occurrence of all of the following: (1) there is an agreement between the parties; (2) the lender gives value to the debtor; and (3) the debtor acquires rights in the collat-

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 third party . . . or [(b)] the debtor has signed a security agreement which contains a description of the collateral . . . .

U.C.C. § 9-203(1). The written agreement known as a security agreement must also contain a description of the collateral that reasonably identifies what is described and must be signed by the debtor. See U.C.C. § 9-203(1)(a).

41. The intent of the drafters of Article 9 in creating a valid security interest in after-acquired property was to reverse the result in Benedict v. Ratner, 268 U.S. 353 (1925). In Benedict, the Court applied state law and invalidated financing agreements which gave the debtor the absolute right to sell existing collateral and replace that sold collateral with newly acquired collateral without the specific approval of the lender prior to each sale. The effect of this decision was to impose a cumbersome system of accounting which required the debtor to make daily payments to the lender of all proceeds received from the sale of old collateral. Upon receipt of the collateral, the lender would immediately remit the proceeds to the debtor in order to maintain the outstanding loan balance. Section 9-205 of the Uniform Commercial Code was enacted for the express purpose of validating the transactions under scrutiny in Benedict. See U.C.C. § 9-205, Comment 1.

42. These requirements for perfection are embodied in U.C.C. § 9-303(1), which provides as follows:

A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in sections 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time it attaches.
erally. Generally, all three prerequisites will be fulfilled at the same time in a secured transaction involving personal property. The exception to this general rule, however, is the security interest in after-acquired property and it is this exception that spawned the attack against floating liens under section 60a of the Bankruptcy Act.

Perfection does not occur until the debtor acquires the property within the meaning of the attachment requirement of Article 9. In the context of a security interest in after-acquired property, this normally occurs well after the debtor has given value, the security agreement has been signed and steps have been taken for perfection by the secured party. Since perfection in after-acquired property normally occurs after the secured party gives value to the debtor, the secured party's claim of a security interest in after-acquired property is open to attack under section 60 of the Bankruptcy Act.

The critical consideration in an analysis of the attributes of a preferential transfer is determining when the transfer is deemed to have occurred. Under the Bankruptcy Act as it existed prior to the 1978 Reform Act, a transfer was defined to include an acquisition of a security interest in collateral.

43. U.C.C. § 9-203(1) defines the prerequisites of attachment as follows:

[A] security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral . . . ; and

(b) value has been given; and

(c) the debtor has rights in the collateral.

44. See note 43 supra and accompanying text.

45. The steps that the secured party is required to take in order to perfect its security interest depend upon the nature and possession of the collateral. If the collateral qualifies as tangible personal property such as goods and negotiable documents and the collateral remains in the possession of the secured party, filing is not required for perfection. See U.C.C. §§ 9-302(1) and 9-305. However, the general rule is that a filing with an appropriate filing office is a necessary step for perfection of collateral which is not in the possession of the secured party such as inventory, equipment and accounts receivable of the debtor.

46. Section 1(30) of the Bankruptcy Act of 1938 defined a "transfer" as follows:

"Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise; . . . .
Under the Uniform Commercial Code, attachment of a security interest in after-acquired property does not take place until the debtor acquires rights in the property. Perfection of a security interest sufficient to defeat rights of third parties in the collateral cannot occur until the security interest attaches, which by definition means that the debtor acquires rights in the property. It is only at this point that the secured party's claim can be perfected to a degree sufficient to defeat the claim of a lien creditor within the meaning of the 1950 Amendment to the Bankruptcy Act. In other words, since perfection sufficient to defeat a lien creditor occurs at the time of acquisition of the property by the debtor under the Code, the transfer is deemed to occur at this time for purpose of preferential transfer analysis under the 1950 Amendment of the Bankruptcy Act.

It should be borne in mind, however, that this is only the first step in the analysis of whether a security interest in after-acquired property qualifies as a preferential transfer under the Bankruptcy Act. The trustee must prove six additional elements in order to invalidate the transaction as a preferential transfer under the Bankruptcy Act. All of these elements must be satisfied as of the date of acquisition of the property by the debtor.

For purposes of illustrating the theory that the security interest in after-acquired property of the debtor is a preferential transfer under the lien creditor test, the following facts should

47. See notes 42-45 supra and accompanying text.
48. See notes 33-38 supra and accompanying text.
49. The trustee must establish all of the following factors under section 60 of the Bankruptcy Act:
   (1) The debtor made a transfer of his property. This element is satisfied in the context of a secured interest in after-acquired property by the definition of transfer contained in section 1(3) of the Act.
   (2) The transfer must be for the benefit of a creditor. There is little doubt that a transfer of a secured interest in after-acquired property is for the benefit of the creditor.
   (3) The transfer must be on account of an antecedent debt.
   (4) The transfer must have been made while the debtor was insolvent.
   (5) The transfer must have been made within four months of bankruptcy.
   (6) The transfer has the effect of permitting the creditor to receive a larger percentage of his debt than any other creditor of the same class.
   (7) The creditor had reasonable cause to believe that the debtor was insolvent at the time of the transfer.
be assumed: On January 1, X executed a security agreement which afforded Y (secured party) a security interest in X's present equipment and any equipment which is acquired by X in the future. On the same date, Y extends $100,000 to X. As of January 1, the value of X's equipment is $100,000 and on the same date Y files a financing statement in the appropriate filing offices. As a result of rapid depreciation, X's original equipment is worth only $50,000 on June 1 of the same year. However, on June 1, X acquires $50,000 worth of additional equipment. At the time X acquired the additional $50,000 worth of equipment on June 1, Y knew X was insolvent. On July 1, of that year, X filed a bankruptcy petition. Y files a secured claim against all of the equipment X owns as of the date of bankruptcy.

With respect to Y's claim for a security interest in X's equipment purchased subsequent to January 1, a strong argument can be made that it was voidable as a preferential transfer under the lien creditor test of the 1950 Amendment. The important issue is whether the claim for $50,000 of X's new equipment arises because of an antecedent debt within the meaning of section 60a. All of the six other factual elements of a preferential transfer are built into the example.\(^5\)

The proponents of preferential transfer treatment for a security interest in after-acquired property of the debtor state that such a transfer is for an antecedent debt within the meaning of section 60 of the Act.\(^6\) It is clear that the transfer of property within the meaning of section 60 occurred at the time X acquired the new equipment on June 1.\(^5\) The debt that X owed to Y came into existence on January 1 — five months before the "transfer" of the property within the meaning of the Bankruptcy Act. Thus, the proponents argue, the transfer must have been "on account of an antecedent debt" within the meaning of section 60a.\(^5\)

50. See note 49 supra.
51. See note 39 supra.
52. See notes 46-48 supra and accompanying text.
53. In this regard, 3 W. Collier, BANKRUPTCY ¶ 60.51A, at 1050.15-16 (14th ed. 1977) states as follows:

If a lender extends credit to a debtor and receives a security interest in the debtor's inventory, on hand and to be acquired, that security interest will attach when each new part of the inventory is acquired. Assuming that some new
The drafters of the Uniform Commercial Code anticipated the preferential transfer treatment of a secured party's claim for a security interest in after-acquired property of the debtor. The Code states that a security interest in such property "shall be deemed to be taken for new value and not as security for an antecedent debt." However, the drafters' intent to protect a secured party's interest in after-acquired property from the "long arm" of the trustee is of little effect under the federal scheme provided under the Bankruptcy Act. While the Act looks to state law in determining when perfection takes place, the question of whether a transfer was antecedent to a debt is a question of federal law.

All of the foregoing adds up to the strong argument made by commentators that under the 1950 Amendments, the security interest in after-acquired property of the debtor qualified as a voidable preferential transfer if acquired within four months of bankruptcy. However, judicial treatment of the secured creditor was much more "preferential" to the secured party's interests than was suggested by the commentators.

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acquisitions occur within four months prior to the filing of a petition initiating a proceeding under the Bankruptcy Act, at a time when the debtor is insolvent and the creditor has reason to believe that the debtor is insolvent, is there a voidable preference? A transfer has occurred during the four-month period. Was it for an antecedent debt? On the face of it, it was. The credit was extended or the loan given when the security agreement was entered into, more than four months before the filing of the petition. At the time the transfer occurred, i.e., when the debtor obtained rights in the inventory, there was a debt already owing to the creditor and the security interest attaching to the new acquisitions was to secure this indebtedness. Therefore, it is obvious that the transfer is for an antecedent debt and all of the elements of a voidable preference are present.

See also note 39 supra.


55. Hogan, Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing, 53 CORNELL L. REV. 553 (1968) [hereinafter cited as Hogan]; Countryman, supra note 39, at 276; Kennedy, The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9, 14 RUTGERS L. REV. 518 (1960) [hereinafter cited as Kennedy].

56. In McKenzie v. Irving Trust Co., 323 U.S. 365, 369-70 (1945), the Court erased all doubt whether federal or state law applied to the resolution of this issue: "What constitutes a transfer and when it is complete within the meaning of § 60a of the Bankruptcy Act is necessarily a federal question, . . . intended to have uniform application throughout the United States." (emphasis added).
B. Judicial Theories Rescue the Floating Lien

In virtually all of the cases which have dealt with the issue under section 60 of the Bankruptcy Act, the courts have upheld the secured party’s claim of a security interest in property acquired by the debtor within four months of bankruptcy against the claim of preferential transfer. The courts have used four theories to support the validity of the secured party’s interest in such property: (1) the entity theory;\(^5^7\) (2) the substitution of collateral theory;\(^5^8\) (3) the “so far perfected” theory of section 60a(2); and (4) the Uniform Commercial Code section 9-108 theory.

1. The Entity Theory

The entity theory has been employed to avoid the preferential treatment of a security interest in after-acquired property when the collateral is inventory or accounts receivable. Under this theory, the debtor’s inventory and accounts receivable are viewed as a single entity or a floating mass and not a combination of individual items each subject to a separate lien.\(^6^0\) Under this theory, the floating mass (which includes present and future items) is the entity to which the secured party’s interest attaches at the time of filing a financing statement. Thus, as long as the financing statement is filed before the four-month period before bankruptcy, the transfer is not subject to preferential transfer treatment, although the debtor

\(^{57}\) There are three exceptions to this general statement. In re Gibson Products of Arizona, 543 F.2d 652 (9th Cir. 1976), the court ruled that a perfected security interest in proceeds which were commingled in the bankrupt’s account was presumptively a preferential transfer. For the same result based upon a different analysis, see Fitzpatrick v. Philco Finance Corp., 491 F.2d 1288 (7th Cir. 1974). See also E. F. Corp. v. Smith, 496 F.2d 826 (10th Cir. 1974) where the court ruled that a transfer did not occur at the time of filing of the financing statement but at the time value was given. Since value was given within the four month period prior to bankruptcy, the court ruled that the floating lien was a preference within the meaning of section 60.

\(^{58}\) This theory has also been referred to as the “res” or “Mississippi River Theory.” See Dubay v. Williams, 417 F.2d 1277, 1287 n.8 (9th Cir. 1969).

\(^{59}\) This theory has also been denoted as the “sophisticated res” theory. See Cogan & Bok, The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture, 69 YALE L.J. 203 (1959).

\(^{60}\) In Rosenberg v. Rudnick, 262 F. Supp. 635, 639 (D. Mass. 1967), the court described the entity theory as follows: “In applying § 60, however, inventory subjected to a security interest should be viewed as a single entity and not as a mere conglomeration of individual items each subject to a separate lien.”
acquires some of the collateral within four months of bankruptcy.61

The entity theory has evoked strong criticism from commentators because it conflicts with the Commercial Code requirement that the debtor acquire the collateral before perfection is complete.62 The theory has also been criticized since its application may permit that which the preferential transfer section of the Bankruptcy Act was designed to prevent — an intentional transfer of property to a favored creditor of the bankrupt.63 Although this criticism has been strong, the theory has been cited with approval by a number of courts in support of their decisions to uphold a secured party's claim to the bankrupt's collateral against attack as a preferential transfer.64

2. Substitution of Collateral Theory

Unlike the entity theory, the substitution theory accepts the notion that the date of transfer for purpose of section 60 analysis is the time the debtor acquires the new collateral. However, the substitution theory validates the transaction by positing that the secured party gives the debtor "new value" at the time of the acquisition of the collateral.65

61. This theory has been employed by at least two courts as the exclusive justification for upholding the validity of the secured party's interest in after-acquired collateral of the debtor. In Rosenberg, the court held that for the purpose of determining the date of the alleged preferential transfer of a security interest in the debtor's inventory, the date of execution of the security agreement is the effective date of transfer rather than the date the debtor acquired rights in the collateral. Although the debtor had reacquired a portion of the inventory within four months of bankruptcy, the court ruled that there was no preference since the security agreement was executed more than four months prior to the filing of the bankruptcy petition. Id. at 638.

See Manchester Nat'l Bank v. Roche, 186 F.2d 827 (1st Cir. 1951), which also applied the entity theory in support of its conclusion that the after-acquired security interest in collateral acquired by the debtor within four months of bankruptcy was not void as a preferential transfer.

62. 65 Mich. L. Rev. 1004, 1007 (1967); see also text accompanying notes 41 & 43 supra.

63. Hogan, note 55 supra at 561.


65. One of the requirements for establishing a preferential transfer is that the transfer must be on account of an antecedent debt. See note 49 supra. If the debtor is given new value at the time of the transfer of a security interest to the secured party,
With respect to quick assets, the theory assumes that the debtor is constantly turning over existing collateral (selling inventory and collecting accounts receivable) and using the proceeds to purchase new collateral. Under the substitution theory, the new value is created by unique characteristics of the floating lien which permit the debtor to sell quick assets covered by a security agreement without prior approval of the lender. A security interest in newly acquired assets is considered to be taken in exchange for the secured party's release of his rights in existing assets. In other words, so the theory goes, the secured party's interest in the new quick assets is substituted for the interest in the released assets.

The substitution theory has been cited by some courts in support of their decision to insulate the secured party's interest in after-acquired property from the trustee's attack under section 60. This theory finds its roots in the notion that a mere substitution of collateral is not a preferential transfer.

The transfer could not be on account of an antecedent debt and a necessary element of a preferential transfer is missing. See Dean v. Davis, 242 U.S. 438 (1917).

66. See notes 4 & 5 supra and accompanying text.

67. In Grain Merchants of Ind., Inc. v. Union Bank & Sav. Co., 408 F.2d 209 (7th Cir. 1969) the court cited the substitution theory as well as the entity theory in support of its decision to validate a secured party's claim in the debtor's accounts receivable acquired within four months of bankruptcy. It should be noted that the court relied on actual evidence of replacement of old accounts receivable with new accounts. The fact that the creditor did not improve his position during the four months prior to bankruptcy seemed to be an important ingredient for the application of the substitution theory in the case:

During the critical period from September 20 when the Bank last extended value until September 30 when Grain Merchants ceased doing business, the debtor's withdrawals appear generally to have been in line with the deposits from new accounts receivable. . . . Our study of this record shows that at the end of the four months preceding bankruptcy, there was an excess of collateral over secured debt, indicating that collateral was regularly transferred in substitution for other collateral without diminishing the bankruptcy assets available for creditors. Here the newly arising accounts receivable may be considered as having been taken in exchange for the release of rights in earlier accounts and for a present consideration. Since the relative positions of the Bank and the debtor were unaltered by the exchanges, the debtor's other creditors cannot be considered harmed by the transactions with the Bank.

Id. at 217. The substitution of collateral theory was also applied to validate a secured party's interest in after-acquired property in In re Portland Newspaper Publishing Co., 271 F. Supp. 395 (D. Ore. 1967), aff'd on other grounds; DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969).

68. Jaquith v. Alden, 189 U.S. 78 (1903); In re Pusey, Maynes, Breish Co., 122 F.2d 606 (3d Cir. 1941); In re Fred Stern & Co., 54 F.2d 478 (2d Cir. 1931); and In re
3. "So Far Perfected" Theory

The so far perfected theory seems to have gained the most popularity with jurists who have upheld the validity of security interests in after-acquired property against attack as a preference. This theory is based upon the so far perfected language contained in section 60a(2).

As in the entity theory, this theory seeks to validate the security interest in after-acquired property by defining the transfer date for purposes of preference analysis as the date when the necessary steps are taken for perfection (usually filing of the financing statement). However, unlike the entity theory, this theory attempts to define "transfer" and "perfection" under federal rather than state law.

The so far perfected theory depends upon the definition of "transfer" provided in section 60a(2) which incorporates the words from which the theory derives its name.


70. See note 45 supra.

71. The distinction between the "entity" and "so far perfected" was articulated by the court in DuBay v. Williams, 417 F.2d 1277, 1287 (9th Cir. 1969) wherein it stated as follows:

Some ingenious theories have been spun to avoid the result to which the trustee's logic leads [entity and substitution of collateral theories]. It is unnecessary for us to resort to any of them to reject the trustee's argument. The unarticulated premise is that Congress left to state law the definition of "transfer" and of "perfection," thereby permitting state law to control the impact of preferences. The premise is flawed. Congress itself defined these concepts leaving only some details to be brushed in by state law.

72. Section 60a(2) of the Bankruptcy Act, 11 U.S.C. § 96(a)(2) (1976) provides the following definition of transfer: "[A] transfer . . . shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon
for the purposes of this section is equated with the act by which priority over later creditors is achieved. Under the theory, one only looks to state law to determine at what point in time the secured party took the steps necessary to prevent a subsequent lien creditor from achieving priority over the secured party's claim in the after-acquired property of the debtor. For purposes of quick assets (inventory and accounts receivable), state law indicates that those steps are taken when a financing statement is filed with the appropriate filing officer. Even though the debtor may acquire the collateral later, the secured party's rights are automatically perfected upon acquisition and cannot be defeated by a lien creditor at the time of acquisition.

The so far perfected theory dictates that "transfer," for purposes of preferential transfer analysis on a floating lien, occurs at the date of filing since a subsequent lien creditor cannot attain priority in after-acquired collateral covered by the security agreement. If the financing statement is filed before such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." (emphasis added).

73. One court has described the conflict between state law and federal law on the issue of preferential transfer analysis for security interest in after-acquired property as stemming from the differing concepts of "perfection" under the Uniform Commercial Code and the Bankruptcy Act:

Perfection under § 60(a)(2) occurs when no subsequent lien creditor can obtain superior rights to those of another secured party or transferee having rights in the property. Perfection under the Code is governed by § 9-204 and § 9-303. Even though perfection of the security interest under the Code may not have been accomplished because the security interest in property had yet to attach, for bankruptcy purposes § 60(a)(2) will treat the secured interest as indefeasible where it cannot be defeated by a subsequent lien creditor. . . . In sum, perfection under state law need not be full perfection, but only perfection so far as is necessary to meet the test of § 60(a)(2).


74. A filing of a financing statement is required when the collateral under consideration is inventory and accounts receivable. See U.C.C. § 9-302.

75. This result is dictated by U.C.C. § 9-301(1)(b) which limits the priority of a lien creditor to "an unperfected security interest" in the same collateral. However, once a financing statement is filed, a security interest immediately attaches and is simultaneously perfected upon the debtor's acquisition of the collateral. See U.C.C. § 9-204(1). Since attachment is immediate, there is simply no intervening time between the debtor's acquisition of the collateral and perfection of the secured party's rights in the goods during which the lien creditor's right can attach to the debtor's inventory and accounts receivable. See Owen v. McKesson and Robbins Drug Co., 349 F. Supp. 1327 (N.D. Fla. 1972).
the four-month period preceding bankruptcy, a secured party’s floating lien will be safe from a section 60 attack under the so far perfected theory. 76

4. Uniform Commercial Code Section 9-108 Theory

The final theory upholding the floating lien against a section 60a attack is based upon section 9-108 of the Uniform Commercial Code. Like the substitution of collateral theory, the section 9-108 theorist argues that the time of transfer for the floating lien is the date the debtor acquires rights in the new collateral. In the event the debtor acquires the rights within the four-month period prior to bankruptcy, this theory saves the floating lien from voidability under section 60 of the Act by relying on the language contained in section 9-108 of the Uniform Commercial Code.

In particular, this theory holds that the transfer was not for an antecedent debt 77 simply because section 9-108 of the Code says it is not. 78 Since a necessary element of a preferential transfer is missing, the floating lien is beyond reproach as a preferential transfer under section 60 of the Act. 79

A few courts have employed the section 9-108 theory in support of their conclusion that the floating lien was beyond

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76. For decisions which have applied the “so far perfected” theory see note 69 supra.

77. A transfer on account of an antecedent debt is one of the seven elements which are necessary for preferential treatment under § 60a. See note 49 supra.

78. U.C.C. § 9-108 provides as follows:
   Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

79. It should be noted that U.C.C. § 9-108 requires that the acquisition of the collateral be “either in the ordinary course of the debtor’s business or as an acquisition which is made under a contract of purchase entered into within a reasonable time after the giving of new value,” and that the secured party give new value at the inception of the transaction. However, it is difficult to conceive of an acquisition of a debtor covered by a floating lien which would not be in the ordinary course of business given the all-inclusive security agreements normally employed in the context of a floating lien. See U.C.C. § 9-108, Comment 1.
attack under section 60a of the Bankruptcy Act. However, a number of commentators have been critical of this theory because the theory attempts to impose a resolution, relying on state law, to an issue which is strictly a federal question - i.e., is the transfer on account of an antecedent debt?

With few exceptions, the worst fears of the commentators, that the 1950 Amendments to section 60a of the Bankruptcy Act would invalidate the floating lien as a financing tool, never came to pass. The secured creditor was fully protected under the four theories even though his secured position improved in relation to other creditors during the four months prior to bankruptcy. Thus, the judicial application of the four theories weighted the scale in favor of secured creditors and left the unsecured creditors urging some modification of the preferential transfer provisions of the Bankruptcy Act.

IV. SECTION 547 — BANKRUPTCY REFORM ACT OF 1978

The enactment of section 547 of the Bankruptcy Reform

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80. In Owen v. McKesson and Robbins Drug Co., 349 F. Supp. 1327 (N.D. Fla. 1972), the court employed the U.C.C. § 9-108 theory as well as the "so far perfected" and entity theories to insulate a floating lien in the debtor's inventory from attack under section 60a of the Act. See also In re White, 283 F. Supp. 208 (S.D. Ohio 1967).

81. See, e.g., Countryman, supra note 39, at 276; Hogan, supra note 55; Kennedy, supra note 55.

82. See note 57 supra.

83. See notes 39-56 supra and accompanying text.

84. The radical change in the respective concerns of the secured and unsecured creditors regarding the preferential treatment of floating liens under the 1950 Amendments to section 60a were outlined in the Report of the Committee on Coordination of the Bankruptcy Act and the Uniform Commercial Code (1970) as follows:

What may be called the politics of the project of revising § 60 have thus come full circle during the past few years. What started out as a rescue mission for secured creditors may end up as a rescue mission for unsecured creditors. It is too early to tell whether spokesmen for unsecured creditors' groups will now support a project which, a few years back, they could have been expected to oppose. No doubt the discussion of this Report in the Conference will throw considerable light on what the answer to the question just posed is to be.

The Committee feels that, despite the political reversal, there is still merit in the proposed legislative solution to the security interest problem. The Ninth Circuit's analysis of the problem in DuBay weights the scales much too heavily on the secured creditor's side, . . . .


Act of 1978 wrought important changes in the preferential transfer law as it existed since the 1950 Amendments to section 60 of the Act. The extent of these changes has been discussed by a number of commentators. The most important change from the perspective of the holder of a floating lien is the "perfection of transfer" doctrine embodied in subsection 547(e).

Subsection 547(e) contains the "timing" provisions concerning when a transfer is deemed to have occurred for purposes of preferential transfer analysis. For purposes of a security interest in after-acquired property of a debtor, a transfer is deemed to occur at the time perfection has occurred which is sufficient to defeat a lien creditor: "A transfer of . . . a property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee."

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86. Among the more significant changes are the following:


(2) The debtor is presumed to be insolvent during the 90 days immediately preceding bankruptcy. 11 U.S.C.A. § 547(f) (1979).

(3) The requirement of proof that the creditor had reasonable cause to believe the debtor was insolvent has been eliminated for the 90 days immediately preceding bankruptcy. However, the requirement is maintained for the period between 90 days and one year before the date of the filing where the creditor is an "insider." 11 U.S.C.A. § 547(b)(4)(B) (1979).

(4) It is possible to declare transfers to "insiders" as preferential even though the transaction occurred between one year and 90 days prior to bankruptcy. 11 U.S.C.A. § 547(b)(4)(B) (1979). An insider is defined to include, but not be limited to, a relative, partner, director, officer or affiliate of the debtor. 11 U.S.C.A. § 101(25) (1979).

(5) New exemptions are provided for the following transactions which would otherwise be preferential transfers under the Act: (a) "cash sales" involving a very short extension of credit 11 U.S.C.A. § 547(c)(1) (1979), (b) payment of debts incurred in the ordinary course of business 11 U.S.C.A. § 547(c)(2) (1979), and (c) a purchase money security interest in property later acquired by the debtor 11 U.S.C.A. § 547(c)(3) (1979).


88. See note 18 supra and accompanying text.

89. The test is embodied in the following relevant provisions of subsection (e), 11 U.S.C.A. § 547 (1979):

(e)(1) For the purpose of this section —

(B) a transfer of a fixture or property other than real property is
At first glance, the perfection of transfer doctrine embodied in subsection 547(e) seems identical in all important respects to the lien creditor test in the 1950 Amendments to section 60 of the Act. However, subsection 547(e) contains an additional limitation on the timing determination of a transfer which was not expressly stated in the lien creditor test of the 1950 Amendment. Under this additional limitation, a transfer cannot be deemed to have occurred for purposes of preferential transfer analysis until the debtor has acquired rights in the property transferred: "For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred."

The limiting language in effect adopts the terminology of the Uniform Commercial Code and makes the term "transfer" virtually synonymous with the term "perfection" as understood under the Uniform Commercial Code. For purposes of determining if a "transfer" of the debtor's property under a floating lien arrangement is for an antecedent debt and acquired within the ninety-day period prior to bankruptcy, the focal point for inquiry is when the debtor acquired the collateral.

This limiting language contained in the perfection of transfer test of section 547(e) could have startling effects on the voidability of the floating lien on collateral acquired by the debtor within the ninety-day period prior to bankruptcy. The voidability effect on such transactions under section 547 perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made -

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days . . . .

90. See notes 33-39 supra and accompanying text.
92. See notes 41-44 supra and accompanying text. Under the Uniform Commercial Code, four requirements are necessary for perfection: there must be a security agreement; value must be given; a financial statement must be filed (if necessary); and the debtor must acquire rights in the collateral. U.C.C. §§ 9-204 and 9-302.
93. This assumes that the secured party who retains the floating lien required that the debtor execute a security agreement, give value and file a financing statement if filing is necessary for perfection. See U.C.C. § 9-302.
can best be demonstrated by a re-examination of the example provided in section III A. of this article. In that example, section 547 would lead one to the conclusion that Y's claim of a security interest in X's equipment acquired on June 1, would be defeated by the trustee as a preferential transfer. The perfection of transfer test would dictate that the transfer occurred at the time X acquired the equipment. Since the transfer occurred within ninety days prior to bankruptcy and the debt was incurred five months prior to the transfer, section 547 would likely condemn the transfer as preferential.

The perfection of transfer test under section 547 calls into question the validity of a floating lien on all collateral acquired by the debtor during the ninety-day period prior to the filing of the bankruptcy petition. However, there are certain safe harbor provisions in section 547 which will serve to validate the traditional floating lien in quick assets for those who meet certain qualifying conditions.

The safe harbor provision is contained in subsection 547(c)(5). This provision is limited to a floating lien in inventory and accounts receivable of the debtor or the proceeds of either. The qualifying condition is contained in the improvement of position formula embodied in this subsection. In

94. This statement is based upon the following assumptions:
(1) The security agreement creating the floating lien was executed prior to the acquisition of the collateral;
(2) Value was given at the time of the execution of the security lien; and,
(3) The secured party does not qualify as an "insider" within the meaning of the Act. See 11 U.S.C.A. § 101(30) (1979). In the event the secured party qualifies as an insider, the 90-day period is extended to one year prior to bankruptcy if the trustee can establish that the secured party had reasonable cause to believe that the debtor was insolvent at the time of the transfer. See 11 U.S.C.A. § 547(b)(4) (1979).
95. The term "inventory" is defined as follows in 11 U.S.C.A. § 547(a)(1) (1979): "Inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease, ....
96. The term "receivable" is defined to include accounts receivable: "' Receivable' means right to payment, whether or not such right has been earned by performance; ...." 11 U.S.C.A. § 547(a)(3) (1979).
97. The "improvement of position" test embodied in subsection 547(c)(5) was derived from the "net result" rule. The net result rule originated in In re Pusey, Maynes, Breish Co., 122 F.2d 606 (3rd Cir. 1941). In Pusey, the court held that a transfer of accounts receivable to the secured creditor made during the four months prior to bankruptcy was not preferential where the accounts transferred were substi-
general, the improvement test states that a floating lien in inventory or receivables which would be avoided under section 547(b) is spared such treatment if the secured party does not improve its position in relation to unsecured creditors on the date of filing for bankruptcy \(t_2\) compared to its relative position ninety days before filing \(t_1\). Improvement is measured by the relative reduction in the spread between the amount of outstanding debt and the value of all collateral subject to a security interest for such debt at \(t_1\) and \(t_2\). If there is no improvement for the floating lien creditor, the safe harbor provision protects the secured creditor from preferential transfer treatment under section 547.

98. There are two exceptions to this general rule. First, in the event the secured party is an insider (see note 86 supra) the position of the secured party at the date of bankruptcy is compared with his position one year before the date of bankruptcy. See 11 U.S.C.A. § 547(c)(5)(A)(ii) (1979).

Secondly, if new value was given by the secured party within 90 days (one year if the secured party is an "insider") of the date of filing the bankruptcy petition, the date new value was given shall be used for comparison purposes rather than the date which represents 90 days before the filing of the petition. See 11 U.S.C.A. § 547(c)(5)(B) (1979).

99. The safe harbor provision of 11 U.S.C.A. § 547(c)(5) (1979) does not provide any guidance for the method to be used for determining the value of the collateral. It would seem logical to assume that a liquidated value should be assessed for collateral involving cases filed under Chapter 7 of the Act (11 U.S.C.A. §§ 701 to 766). A going concern method should be used to determine value of the collateral in cases filed under Chapters 9 (11 U.S.C.A. §§ 901 to 946), 11 (11 U.S.C.A. §§ 1101 to 1174) and 13 (11 U.S.C.A. §§ 1301 to 1330). See 4 W. COLIER, BANKRUPTCY ¶ 547.41, at 547-123 (15th ed. 1979). With respect to the question of valuation, H.R. REP. No. 595, supra note 84, at 6176 states as follows:

The comparison of values at the two measuring points which the Draft requires poses problems of obvious difficulty. A statutory valuation formula would have been helpful. The Committee has considered a number of suggested formulas but has been unable to come up with a satisfactory one. The valuation problem is, therefore, left to the referees and judges.

100. Various combinations of factors respecting value of collateral and debt could result in no improvement within the meaning of the formula. The value of the debtor's collateral subject to the floating lien could increase from \(t_1\) to \(t_2\). However, no improvement in the spread would result if the creditor had extended new value to the debtor in an amount equal to the increase in value of the collateral. It is important to note that the relative spread between \(t_1\) and \(t_2\) is the critical determinant of the improvement test under § 547. Fluctuations in the spread between \(t_1\) and \(t_2\) are
If there is improvement for the floating lien creditor within the meaning of the formula, the creditor can attain the protection of the safe harbor provision for the improvement if he can establish that such improvement was not "to the prejudice of other creditors holding unsecured claims." Although the Act does not define the meaning of this phrase, it is reasonable to assume that lack of prejudice could be established if such improvement simply reflects a seasonal increase in value of the collateral.

In addition, it could be argued that there was no prejudice to other creditors if the creditor could establish that the debtor was not insolvent at the time of the acquisition of the collateral. The creditor would have to establish evidence sufficient to rebut the presumption of insolvency during the ninety-day period prior to bankruptcy. In the event the floating lien creditor fails to establish no prejudice to the unsecured creditors, the amount of the improvement in the creditor's position is void as a preferential transfer.

not relevant to the improvement test under the safe harbor provision.

101. 11 U.S.C.A. § 547(c) (1979) provides in part as follows:
The trustee may not avoid under this section a transfer —

(5) of a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interest for such debt on the later of—

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or
(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; and
(B) the date on which new value was first given under the security agreement creating such security interest; or

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title.

102. If the improvement in position is the result of increase in value due to market or seasonal price fluctuations, which fluctuations are not at the expense of the estate, such improvement is protected by the safe harbor provisions. The following example is provided in 4 W. COLLIER, BANKRUPTCY ¶ 547.41, at 547-123 to 547-124 (15th ed. 1979).

If, for example, the debtor warehoused its inventory of completed Christmas cards in September and filed a petition in December, any increase in the value of the inventory is seasonal and not "to the prejudice" of unsecured creditors except perhaps with respect to the cost of warehousing the collateral.

At first glance, the perfection of transfer test embodied in section 547(e) would seem to sound the death knell for the creditor's security interest in after-acquired property of the debtor when the property is acquired by the debtor within ninety days before bankruptcy. However, as demonstrated earlier, the section contains a legislative safe harbor provision which protects the floating lien covering after-acquired inventory and accounts receivable of the debtor from preferential treatment by the trustee. However, a question remains concerning the validity of the creditor's claim of a security interest in other categories of after-acquired property of the debtor under section 547. Will the four theories developed during the reign of the 1950 amendments to section 60 continue to provide judicially sanctioned safe harbors for such secured creditors under section 547?

V. THE JUDICIAL THEORIES REVISITED

A. The Entity Theory

The entity theory will not provide a safe harbor for the floating lien creditor if no protection is afforded the creditor under section 547 of the Act. If the collateral in question is not a quick asset the entity theory is not appropriate for consideration. The entity theory was particularly appropriate when the collateral involved was composed of numerous units which were designed to turn over rapidly. Given its doctrinal underpinning the entity theory would be of little use to save a creditor with a security interest in after-acquired equipment of the debtor from the trustee's attack under section 547.

104. The presumption of insolvency during this 90-day period is embodied in 11 U.S.C.A. § 547(f) (1979).
105. The following example is provided in H.R. Rep. No. 595, supra note 84, at 6177.

Let it be assumed that a secured party's collateral four months before bankruptcy consists of raw materials have been converted into finished products worth $20,000. (Under Code § 9-315 the security interest in the raw materials carries through to the finished product.) Assuming an initial "deficiency" (the debt secured, let us assume, was at all times $25,000), the $10,000 increase in value is not protected . . . and goes to the trustee.

106. See notes 85-97 supra and accompanying text.
107. See note 4 supra and accompanying text.
108. See Kronman, supra note 4, at 125, n.56.
Regardless of the nature of the collateral, the perfection of transfer test in section 547(e) simply precludes a creditor from arguing that the transfer occurred at the time the security agreement was signed as called for by the entity theory. The perfection of transfer test provides that a transfer cannot take place until such time as the debtor "acquires rights" in the collateral. If the collateral is accounts receivable, the time of acquisition presumably is the date the accounts come into existence.

**B. The Substitution of Collateral Theory**

The substitution of collateral theory applies to collateral which is replaced with new collateral by the debtor within ninety days of bankruptcy. Its rationale is that the secured party agrees to the debtor's liquidation of the existing collateral in return for a security interest in the new collateral. The debtor's free use of the proceeds of the liquidation is viewed as new consideration for the security interest in the new collateral.

Under the substitution theory the date of transfer is the date the debtor acquires rights in the new property. It is consistent with the perfection of transfer test in section 547(e).

109. See notes 97-103 supra and accompanying text. 11 U.S.C.A. § 547(e)(3) (1979) provides as follows: "For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred."

110. 11 U.S.C.A. § 547 (1979) does not define the concept of acquisition of rights as used in subsection 547(e). The drafters intended to incorporate the terminology of the Uniform Commercial Code in the preferential transfer provision. H.R. REP. No. 595, supra note 84, at 6328 reads as follows: "[547(e)] is a substantial modification of present law. It modernizes the preference provisions and brings them more into conformity with commercial practice and the Uniform Commercial Code."

U.C.C. § 9-204(2)(d) (1957 version) states that a debtor acquires rights in accounts at the time they came into existence: "For purposes of this section the debtor has no rights . . . (d) in an account until it comes into existence."

The definition of inventory provided in 11 U.S.C.A. § 547(a)(1) (1979) is broader than that under the Uniform Commercial Code. See U.C.C. § 9-109(4). Under 11 U.S.C.A. § 547(a)(1), inventory is defined to include the following: "inventory means personal property . . . to be furnished under a contract for service . . . ."

In the event the inventory in question resulted from a contract for service, the creditor could argue that the debtor acquired rights in this inventory at the time the contract for service arose rather than the date the goods came into existence as a result of the debtor's service.

111. See note 65 supra.

112. See notes 65-68 supra and accompanying text.

113. See note 66 supra and accompanying text.
However, under the foregoing analysis, the creditor could argue the transfer was not "for or on account of an antecedent debt" within the meaning of section 547.\textsuperscript{114} A new debt is created by the creditor's agreement to release prior collateral in exchange for a security interest in the new collateral acquired by the debtor.\textsuperscript{115} The secured creditor would argue that the full value of the new after-acquired collateral would not be voidable or a preferential transfer under section 547.\textsuperscript{116}

There are at least three problems with the application of this theory in the context of section 547. First, the application of the theory assumes a continual substitution of old collateral for new collateral. As a practical matter, the applicability of the theory would be limited to quick assets such as inventory and accounts receivable.\textsuperscript{117} The creditor would be requested to provide proof that in fact old collateral was being replaced by new collateral in a reasonably contemporaneous fashion.

Secondly, previous application of the theory by the courts would suggest that the theory is subject to a net result test.\textsuperscript{118} In other words, the creditor would likely be required to establish that the value of the new collateral acquired by the debtor did not exceed the value of the old "released" collateral. Such a request is strikingly similar to the improvement test contained in the safe harbor provision of section 547(c)(5) for inventory and accounts receivable.\textsuperscript{119}

\textsuperscript{115} See note 65 supra and accompanying text.
\textsuperscript{116} It is interesting to note that the definition of "new value" provided in 11 U.S.C.A. § 547(a)(2) (1979) includes a release of a security interest in property:

\begin{quote}
(2) "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, but does not include an obligation substituted for an existing obligation; . . . . (emphasis added).
\end{quote}

\textsuperscript{117} See note 4 supra and accompanying text. Of course, if the facts demonstrated that the new collateral was substituted for old collateral, the theory could be applicable. For example, if equipment were involved, the theory could be applied if the old equipment was sold by the debtor (or traded in) and replaced by new equipment.

\textsuperscript{118} See note 67 supra.

\textsuperscript{119} The net result test embodied in the substitution of collateral theory may be more stringent than the improvement test in 11 U.S.C.A. § 547(c)(5) (1979). The latter test merely charts the relative position of the creditor at two points in time (90 days before bankruptcy and the date of bankruptcy). The former test would monitor the increase in value of the security over the 90-day period. It is conceivable that
Finally, the very fact that section 547 contains a safe harbor provision applicable to the floating lien is persuasive evidence that Congress intended this provision to be exclusively applicable for preferential analysis. To the extent that the substitution of collateral theory would protect an improvement of the creditor's security position during the ninety-day period, the theory would produce a result diametrically opposed to the improvement of position test in section 547.120

C. "So Far Perfected" Theory

There is little question that the perfection of transfer test in section 547 sounds the demise of the so far perfected theory as a means for validating a transfer which would otherwise be voidable as a preferential transfer. The so far perfected theory provided life to floating liens under former section 60 by defining the transfer date as that date when the creditor took all steps necessary for perfection.121 This theory held that all steps necessary to defeat the lien creditor were taken at the time the financing statement covering after-acquired property was filed by the secured party.122

there would be no improvement of the secured party's position for purposes of 11 U.S.C.A. § 547 (1979), yet the total value of new collateral had actually increased over the 90-day period.

120. Indeed, the legislative history provides some strong evidence of the drafters' intent to not protect any improvement in position for a floating lien creditor during the 90-day period prior to bankruptcy:

Paragraph (5) [11 U.S.C.A. § 547(c)(5) (1979)] codifies the improvement in position test, and thereby overrules such cases as DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969), and Grain Merchants of Ind., Inc. v. Union Bank and Sav. Co., 408 F.2d 209 (7th Cir. 1969). A creditor with a security interest in a floating mass, such as inventory or accounts receivable, is subject to preference attack to the extent he improves his position during the 90-day period before bankruptcy.


121. See, e.g. DuBay v. Williams, 417 F.2d 1277, 1287-88 (9th Cir. 1969).

122. The intent of the drafters to overrule the "so far perfected" theory as embodied in DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969) is apparent in the Report of the Committee on Coordination of the Bankruptcy Act and the Uniform Commercial Code:

The Draft definition of "perfection" seeks to negative the DuBay reading of present § 60a(2) by making use of the Article 9 distinction referred to. Under the Draft definition a transfer is perfected "when the transferee has acquired an interest in the property which is superior [to the subsequent interests specified in the two branches of the definition.]" Thus there is no perfection until an "interest in the property" has been transferred, which means, to use the
However, the perfection of transfer test under section 547(e) destroys the fiction embodied in the so far perfected theory that a transfer of a security interest in a debtor's collateral can occur before the debtor acquires the property.125 The perfection of transfer test mandates that a transfer cannot occur until the debtor has acquired rights in the collateral.126 In the context of a floating lien, the so far perfected theory could not be utilized to argue that the time of transfer for purpose of preferential analysis is the date of filing of the financing statement.127

D. Uniform Commercial Code Section 9-108 Theory

Section 9-108 of the Uniform Commercial Code attempts to validate a floating lien by eliminating a necessary element of a preferential transfer: antecedency of the debt.128 An antecedent debt is a necessary element of preferential transfer analysis under section 547.129

The same criticisms leveled at the application of section 9-108 under section 60 are applicable in the context of section 547.130 However, it is interesting to note that section 547 does...
not attempt to expressly preempt the application of section 9-108. Indeed, the avowed legislative purpose of section 547 was to bring preferential transfer analysis into harmony with the terminology of the Uniform Commercial Code. The legislative history of the Act suggests that the validity of the application of section 9-108 in the context of preferential transfer analysis is left for judicial determination.

The section 9-108 theorist could take heart in the avowed legislative purpose of section 547. One could argue that the only way to harmonize section 547 with section 9-108 is to decide that all security interests in after-acquired property of the debtor acquired in the ordinary course of the debtor's business shall be deemed to be taken for new value and not for an antecedent debt. Of course such a result would not serve to harmonize the safe harbor provision in section 547(c)(5) with section 9-108 of the Uniform Commercial Code. The safe harbor provision would be unnecessary if Congress intended that section 9-108 would control the issue of the validity of a security interest in after-acquired property under section 547. The very fact that Congress created the safe harbor provision for the floating lien would appear to be strong evidence that Con-

[129] Other problems exist in the current preference section [11 U.S.C. § 109]. They were amply detailed by Prof. Grant Gilmore in his study for the National Bankruptcy Conference of the interaction of section 60 with the Uniform Commercial Code. In short, the adoption of the Uniform Commercial Code radically altered the terminology of secured transactions, and the courts have applied the new terminology to the preference sections, which uses [sic] certain of the same words as the Uniform Commercial Code but in different senses and with different meanings. It is time to bring the two statutes into harmony, and H.R. 8200 does that by adopting the more modern terminology of the Uniform Commercial Code, and providing for specific treatment of transfers governed by the Code. (citations omitted).

H.R. REP. No. 595, supra note 84, at 6139-40.

[130] The Report of the Committee on Coordination of the Bankruptcy Act and the Uniform Commercial Code provides as follows:

In this connection it may be noted that the Draft neither expressly adopts nor expressly rejects the rule of Code § 9-108 under which certain types of after-acquired property interests (principally interests in property acquired "in the ordinary course of the debtor's business") are, as a matter of state law, given "new value" status. The question whether that provision of § 9-108 is valid in federal bankruptcy proceedings is left for judicial determination.

H.R. REP. No. 595, supra note 84, at 6177.
gress did not intend the section 9-108 theory to prevail in preferential transfer analysis.

In the event the floating lien creditor cannot take advantage of the safe harbor provision of section 547(c)(5), it is apparent that the foregoing judicial theories do not provide any degree of "security" against a preferential transfer attack. However, the floating lien creditor may utilize the perfection of transfer test in section 547(e) to remove the transaction from the ninety-day period prior to bankruptcy.

VI. THE CONCEPT OF DEBTOR'S RIGHTS IN THE COLLATERAL

As mentioned previously, the "perfection of transfer" test in section 547(e) differs from the "lien creditor" test in the 1950 amendments to section 60 by the express recognition that a transfer cannot take place until the debtor acquires rights in the property transferred. In other words, in the context of a floating lien, the required elements of preferential transfer are examined as of the date the debtor acquires rights in the collateral and not earlier.131

One of the most critical elements for purposes of the floating lien creditor is whether the transfer of the security interest in after-acquired property of the debtor occurred within the ninety-day period prior to bankruptcy.132 In the event the floating lien creditor can establish that the transfer occurred more than ninety days prior to the date of bankruptcy, the creditor can successfully defeat the trustee's attack under section 547.133 The floating lien creditor's salvation may be born in the concept of "acquisition of rights in the collateral of the debtor" as provided in section 547(e)(3).

131. See note 91 supra and accompanying text.

132. Some of the requisite elements under 11 U.S.C.A. § 547(b) (1979) can be paraphrased as follows:

(1) the transfer was made on account of an antecedent debt;
(2) the transfer was made when the debtor was solvent;
(3) the transfer was made within 90 days before the date of bankruptcy for the non-insider creditor and one year for the insider creditor; and
(4) the transfer enables the creditor to receive more than he should at the date of bankruptcy.

133. Of course, if the creditor were to qualify as an "insider" (see 11 U.S.C.A. § 101(25) (1979)), the period would be enlarged to one year. In this event, the trustee would also be required to prove that the creditor had reasonable cause to believe that the debtor was insolvent at the time of such transfer. See 11 U.S.C.A. § 547(b)(4)(B) (1979).
It is unmistakeable that Congress relied on the concept of "attachment" within the meaning of the Uniform Commercial Code when it chose to define the date of transfer in terms of the date when the debtor acquires rights in the collateral. The floating lien creditor could validate what would otherwise be a preferential transfer of a security interest if he could establish that the debtor acquired rights in the collateral prior to the ninety-day period.\(^{134}\)

The requirement for attachment — that the debtor acquire rights in the collateral — is embodied in section 9-203 of the Uniform Commercial Code.\(^{135}\) The Code does not clearly establish the meaning of the phrase "rights in the collateral."\(^{136}\) It would appear that rights in the collateral should at least include the remedies a buyer would have under Article 2 of the Uniform Commercial Code.\(^{137}\) In addition, other provisions of Article 2 of the Uniform Code should furnish guidelines for determining the time a debtor (buyer) has acquired rights in the collateral.\(^{138}\)

For example, a floating lien creditor could argue that the debtor acquires rights in the collateral\(^{139}\) as early as the date

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\(^{134}\) The trustee must establish the presence of all the five elements described in 11 U.S.C.A. § 547(b) (1979) in order to establish a preferential transfer. The trustee's failure to establish any one element will prove fatal to any attempt to characterize a transfer as preferential within the meaning of 11 U.S.C.A. § 547 (1979).

\(^{135}\) See note 92 supra and accompanying text.

\(^{136}\) It is not surprising that this precise issue has not been litigated in the context of preferential transfer analysis prior to the enactment of section 547. Under the entity and "so far perfected" theories, the courts were virtually unanimous in their opinions that the date of transfer for purpose of preferential analysis was the date of filing of the financing statement rather than the date the debtor acquired rights in the collateral. See notes 76-84 supra and accompanying text.

\(^{137}\) "Rights" are specifically defined in the Code to include remedies. See U.C.C. § 1-201(36). In re Pelletier, 5 U.C.C. REP. SERV. 327 (D. Me. 1968) and Avco Delta Corp. Canada Ltd. v. United States, 459 F.2d 436 (7th Cir. 1972).


\(^{139}\) The concept of "rights in the collateral" is considered in U.C.C. § 9-203(1) which provides as follows:

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 with respect to the collateral and does not attach unless

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a descrip-
the collateral was identified by the seller.\textsuperscript{140} If a contract is made for the sale of goods already existing, the date the contract is made is the date of identification.\textsuperscript{141} Thus, the floating lien creditor could argue that the transfer of the security interest for preferential transfer analysis occurred at the date the collateral was contracted to be bought by the debtor. The concept of rights in collateral is not limited to collateral owned by the debtor.\textsuperscript{142} In addition, the floating lien creditor could argue that the date of transfer of the security interest occurred as of the date the title to goods passed to the debtor from the seller.\textsuperscript{143} Title can pass as early as the date of identification of the goods and as late as delivery of the goods to the buyer.\textsuperscript{144}
It should be noted that there is some authority for the proposition that the debtor cannot acquire rights in the collateral until such time as he acquires possession of the collateral.\textsuperscript{145} However, there is enough uncertainty on the issue to permit the floating lien creditor broad latitude for the argument that the debtor may acquire rights in the collateral earlier than the date the collateral actually comes within the possession of the debtor. In the event the collateral is after-acquired equipment covered by the floating lien, there is a good chance that identification occurs substantially earlier than the date of possession by the debtor.\textsuperscript{146} Thus, there is ample opportunity for the

Insofar as situations are not covered by the other provisions of this Article and matters concerning title become material the following rules apply:

1. Title to goods cannot pass under a contract for sale prior to their identification to the contract (section 2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the Article on Secured Transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

2. Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading
   (a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but
   (b) if the contract requires delivery at destination, title passes on tender there.

3. Unless otherwise explicitly agreed where delivery is to be made without moving the goods,
   (a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or
   (b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

4. A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale".

145. The buyer and the seller can contract for the passage of title. See U.C.C. § 2-401. In In re Bosson, 432 F. Supp. 1013 (D. Conn. 1977) the court construed the date the debtor acquired rights in the collateral as the date title passed from the seller to the buyer (debtor) within the meaning of U.C.C. § 2-401(2).

floating lien creditor to argue that the date of transfer occurred prior to the ninety-day period under the perfection of transfer test in section 547.

VII. CONCLUSION

It is likely that the four judicial theories which were popular during the reign of the 1950 amendments to section 60 will quickly lose their popular appeal under the perfection of transfer test in subsection 547(e) of the Bankruptcy Reform Act of 1978. However, the floating lien creditor may find a source of "security" for an otherwise voidable transfer in the "acquisition of rights" doctrine embodied in the perfection of transfer test. The future should hold some interesting judicial developments under section 547 for the secured creditor with a floating lien on property of the debtor.
Bankruptcy Reform Act of 1978

§ 547. Preferences

(a) In this section—

(1) "inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;

(2) "new value" means money or money’s worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, but does not include an obligation substituted for an existing obligation;

(3) "receivable" means right to payment, whether or not such right has been earned by performance; and

(4) a debt for a tax is incurred on the day when such tax is last payable, including any extension, without penalty.

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—

(i) was an insider; and

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for a new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was—

(A) in payment of a debt incurred in the ordinary course of busi-
ness or financial affairs of the debtor and the transferee;
(B) made not later than 45 days after such debt was incurred;
(C) made in the ordinary course of business or financial affairs of
the debtor and the transferee; and
(D) made according to ordinary business terms;
(3) of a security interest in property acquired by the debtor—
   (A) to the extent such security interest secures new value that
       was—
       (i) given at or after the signing of a security agreement that
           contains a description of such property as collateral;
       (ii) given by or on behalf of the secured party under such
           agreement;
       (iii) given to enable the debtor to acquire such property; and
       (iv) in fact used by the debtor to acquire such property; and
   (B) that is perfected before 10 days after such security interest
       attaches;
(4) to or for the benefit of a creditor, to the extent that, after such trans-
fer, such creditor gave new value to or for the benefit of the debtor—
   (A) not secured by an otherwise unavoidable security interest;
   and
   (B) on account of which new value the debtor did not make an
       otherwise unavoidable transfer to or for the benefit of such creditor;
(5) of a perfected security interest in inventory or a receivable or the
proceeds of either, except to the extent that the aggregate of all such trans-
fers to the transferee caused a reduction, as of the date of the filing of the
petition and to the prejudice of other creditors holding unsecured claims, of
any amount by which the debt secured by such security interest exceeded
the value of all security interest for such debt on the later of—
   (A) (i) with respect to a transfer to which subsection (b)(4)(A) of
       this section applies, 90 days before the date of the filing of the petition;
       or
   (ii) with respect to a transfer to which subsection (b)(4)(B)
       of this section applies, one year before the date of the filing of the peti-
       tion; and
   (B) the date on which new value was first given under the secur-
       ity agreement creating such security interest; or
(6) that is the fixing of a statutory lien that is not avoidable under sec-
   tion 545 of this title.
(d) A trustee may avoid a transfer of property of the debtor transferred
to secure reimbursement of a surety that furnished a bond or other obliga-
tion to dissolve a judicial lien that would have been avoidable by the trustee
under subsection (b) of this section. The liability of such surety under such
bond or obligation shall be discharged to the extent of the value of such
property recovered by the trustee or the amount paid to the trustee.
(e)(1) For the purposes of this section—
(A) a transfer of real property other than fixtures, but including
   the interest of a seller or purchaser under a contract for the sale of real
property, is perfected when a bona fide purchaser of such property
from the debtor against whom applicable law permits such transfer to
be perfected cannot acquire an interest that is superior to the interest
of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; and

(ii) 10 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.