ARTICLE 9 SECURITY INTERESTS AS VOIDABLE PREFERENCES: PART II

THE FLOATING LIEN

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V. After-Acquired Property and the Floating Lien

A. After-Acquired Property and State Law

One of the most important developments in commercial financing over the past thirty years has been the widespread growth of borrowing on so-called "current assets," i.e., accounts receivable and inventory.\(^1\) This is an especially valuable source of capital for smaller businesses that may not have adequate capital assets.\(^2\) The peculiar nature of such a security interest lies in the fact that the underlying property subject to the interest is constantly changing. Inventory is sold (and indeed is sold free of security interests created by the seller to "buyer[s] in the ordinary course of business")\(^3\) and replaced by new items; old accounts receivable are liquidated and new accounts receivable arise. Because the security interest shifts from item to item, such interests are commonly termed "floating liens."\(^4\) Historically, the use

\(^{1}\) In the case of accounts receivable financing, such financing may either take the form of a secured loan with recourse against the assignor or "factoring"—the outright sale of accounts receivable with no recourse against the debtor. According to a 1974 study of the National Commercial Finance Conference, Inc., the total volume of accounts receivable assigned to member organizations for the year 1972 (both factoring and nonfactoring variety) was almost $40 billion, an eight-fold growth since the end of World War II. See generally Reisman, What the Commercial Lawyer Should Know About Commercial Finance and Factoring, 79 Com. L.J. 146 (1974). I have found no comparable figures for inventory financing. Article 9 treats the sale of accounts receivable and the creation of a security interest in accounts receivable in an identical manner. U.C.C. § 9-102(1) (1972).

\(^{2}\) Reisman, supra note 1, at 146, 153-56.


\(^{4}\) It is important to distinguish between the replacement or substitution of collateral—denoted by the term "floating lien"—and additions to collateral. Not every security agreement containing an after-acquired property clause involves a floating lien in the sense used here. For example, in the case of inventory financing, although the debtor was invariably authorized to sell the collateral and, under section 9-307(1), buyers in the ordinary course of business take free of even a perfected security interest, the secured party could still assert a claim against the proceeds of the sale under section 9-306. The secured party could require immediate remittance, segregation in a separate bank account, or any other method to insure that the proceeds were not dissipated. Indeed, under Benedict v. Ratner, 268 U.S. 353 (1925), the secured party was compelled to take such steps. If, in addition to a claim against proceeds, the security agreement also reaches after-acquired property, one after-acquired item of collateral is not being substituted for another, rather the secured party is simply improving his position by taking additional collateral.

In the case of accounts receivable, the substitution of new collateral for old will occur where, under the terms of the security agreement, the debtor has the unfettered right to liquidate old accounts receivable without applying the proceeds to the satisfaction of the debt. This will commonly be the case where: (1) the assignment of accounts receivable was for security, rather than an outright sale; and (2) was on a non-notification basis. See infra note 6. Where the account debtor was notified to make payments directly to the secured party, the subsequent acquisition of new accounts receivable is again not in substitution of the old but is simply additional collateral.
of such financing posed two basic problems. First, there was the conceptual notion that one cannot transfer what one does not yet own. Consequently, some courts took the position that a security agreement could not cover property that the debtor acquired subsequent to its execution and that a supplementary agreement was necessary. Since accounts receivable and inventory are constantly shifting, such a procedure would have been so cumbersome as to make inventory and accounts receivable financing impractical.

Second, in the standard case of inventory and non-notification accounts receivable financing, the debtor was generally under no obligation to apply the proceeds of sale or liquidation to the preexisting debt, or to deposit the money in a separate account. In Benedict v. Ratner, the Supreme Court, interpreting New York law, held that such arrangements were void as a matter of law against other creditors since the unfettered control of the debtor over the collateral was

The significance of this distinction lies in the fact that at least one of the theories used to sustain the true "floating lien" in bankruptcy—"relaxed substitution"—could not have protected such an arrangement. See infra text accompanying note 45.

5 This was the rule in Massachusetts and some of the other New England states. See, e.g., In re Robert Jenkins Corp., 17 F.2d 555 (1st Cir. 1927); Burrell v. Whitcomb, 100 Me. 286, 61 A. 678 (1905); Davis v. Smith-Springfield Body Corp., 250 Mass. 278, 145 N.E. 434 (1924). Even under the rule requiring supplementary agreements, however, the original agreement did operate to create an "equitable mortgage" on the after-acquired property that was enforceable between the immediate parties. See Cohen & Gerber, The After-Acquired Property Clause, 87 U. Pa. L. Rev. 635, 639 nn.20-22 (1939). This article remains a useful summary of pre-UCC law. The authors also note that characterizing the interest arising from a security agreement containing an after-acquired property clause as an "equitable mortgage" was somewhat of a misnomer. At least in Massachusetts, such interests were actually inferior to a normal equitable interest, since even a lien creditor could prevail over the former though only a bona fide purchaser could cut off the latter. Id. at 639.

6 268 U.S. 353 (1925). The case involved the assignment of accounts receivable where the debtor was free to collect the accounts and use the proceeds in his discretion. Ratner, the secured creditor, did have the right to require periodic remittance and, in the 10 days prior to bankruptcy exercised that right, collecting over $11,000 out of the total outstanding debt of $90,000. Ratner filed a claim for the balance claiming a valid security interest. The trustee, claiming the security interest was void, cross-petitioned for recovery of a preferential transfer. The district court and the Second Circuit upheld Ratner's claim. In re Hub Carpet Co., 282 F. 12 (2d Cir. 1922), rev'd, 268 U.S. 353 (1925). However, the court of appeals appeared to concede that a chattel mortgage on stock in trade would be invalid under New York law but felt that the rule had no applicability to accounts receivable. Id. at 14-15. A unanimous Supreme Court reversed.

The earliest forms of accounts receivable financing—construction loans and factoring in the textile industry—typically involved notice to the account debtor directing that payments be made to the assignee or factor. Generally, this was a nonrecourse assignment. Benedict had no effect on these types of arrangements. By the late 1920's, non-notification accounts receivable financing began to emerge. Indeed, Benedict itself is one of the earliest cases dealing with the problem; the earlier cases dealt with inventory, rather than accounts receivable. Benedict had the potential of severely limiting a valuable means of raising capital, but the ingenuity of lenders managed to surmount its obstacles. See I C. Gilmore, Security Interests in Personal Property § 8.1 (1st ed. 1965).
deemed inconsistent with the creation of a security interest. The result of Benedict was to require debtors either to apply payments towards the debt as they were received (which would, in effect, convert all inventory and accounts receivable transactions into self-liquidating loans) or to use the funds solely for replacement of collateral. Although Benedict purported to be only an interpretation of New York law, state courts across the country quickly considered it an authoritative directive from the highest court of the land, often with little or no discussion of the issues involved. 7 Undoubtedly, part of the courts’ hostility toward after-acquired property clauses was derived from a belief that such a device simply covered too much and was prejudicial to the unsecured trade creditor who supplied the very inventory the security interest covered. 8 Yet, as noted in the comments to Uniform Commercial Code (UCC) section 9-205, Benedict did not abolish such financing but merely made it needlessly more expensive by imposing costly policing requirements. 9

Article 9 of the UCC sets up a system that greatly facilitates the use of current asset financing. 10 Section 9-204 clearly states that, with the single exclusion for consumer goods acquired by the debtor more than ten days after receiving value, a security agreement may cover after-acquired property without the need to take any supplemental action. Section 9-205 repeals Benedict by providing that a security agreement is not invalid against creditors by reason of the debtor’s liberty to dispose of collateral and use the proceeds. 11 Since filing a financing statement is the only way to perfect a security interest in accounts receivable 12 (which will generally be the only method of perfection available for inventory which remains in the possession of

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7 See cases cited id. § 8.5, at 271 n.23.
8 See U.C.C. § 9-204 comment 2 (1972). “The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future . . . .” Id.
9 Indeed, although post-Benedict courts would require remittance, after collecting the funds the creditor could simply release them to give the debtor working capital. G. Gilmore, supra note 6, § 8.3, at 260.
10 U.C.C. § 9-204 (1972).
12 U.C.C. § 9-302(1) (1972) provides that a “financing statement must be filed to perfect all security interests” except for certain exclusions. Section 9-302(1)(a) excludes security interests in collateral “in possession of the secured party” under section 9-305. Section 9-305, however, does not include accounts receivable among the species of property for which possession is an available means of perfection. Section 9-302(1)(e) also provides that no filing is necessary for accounts receivable if the assignment “does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor.” Cf. U.C.C. § 9-104(f) (1972) (a transfer of a single account receivable in satisfaction of a pre-existing debt is
the debtor), creditors can be put on notice despite the debtor's ostensible ownership of the collateral. Not only does the UCC validate security interests in "floating collateral" but its perfection and priority rules make them virtually invulnerable. Under the basic priority rule of Article 9, a secured party who files a financing statement covering collateral to be acquired by the debtor in the future will generally have priority over any Article 9 secured party who subsequently files or perfects. Moreover, execution of a security agreement and the filing of a financing totally excluded from Article 9). In any event, the following discussion assumes that a "significant part"—however defined—of the filing is therefore necessary.


14 Admittedly, Article 9's notice filing system is not fully responsive to the plight of general creditors who, as a result of the debtor's unfettered control over the collateral, extend credit in the belief that the assets are unencumbered. Section 9-301 only protects the creditors who obtain liens prior to perfection; it does nothing for one who acquires no lien and simply extends credit.

15 U.C.C. § 9-312(5)(a)(1972). The "first-to-file" rule confers priority even where the "second-to-file" was actually the first to perfect. For example, A, a secured party, files a financing statement on February 1. B, also a secured party, files a month later and immediately makes an advance. A then extends credit. Although A's interest does not attach until an advance is made and hence could not be perfected until that point, A prevails by virtue of his earlier filing, whether or not B was aware of A's interest at the time he made his advance. See id. § 9-312 comment 5. This is to be distinguished from section 9-301, concerning priority over lien creditors, which requires the security interest not merely to be filed but perfected.

The principal exception to the "first-to-file" rule involves a subsequently acquired purchase money security interest retained by the seller of the collateral or by a third party who financed its acquisition. Under section 9-312(4), a subsequent purchase money security interest in collateral other than inventory will prevail over an earlier filed nonpurchase money security interest if the purchase money security interest is perfected at the time the debtor received possession of the collateral or within 10 days thereafter. The holder of the purchase money security interest will generally perfect by filing a financing statement, although if the collateral is consumer goods, perfection will be automatic. See U.C.C. § 9-302(1)(d) (1972). Note, however, that where the subsequently acquired collateral is "consumer goods," the rights of the first nonpurchase money secured party to claim the collateral as after-acquired property are limited by section 9-204(2) which provides that "[n]o security interest attaches under an after-acquired property clause to consumer goods . . . when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value."

If the subsequent interest is a purchase money security interest in inventory, the requirements for prevailing over an earlier filed nonpurchase money security interest are somewhat more rigorous. The purchase money security interest must be perfected at the time the debtor receives possession of the collateral and the holder must notify the first secured party. U.C.C. § 9-312(3) (1972). Moreover, even where the perfection and notice requirements are met, priority is limited to the inventory itself or the cash proceeds received from its sale. If, for example, the inventory is sold on credit and generates an account receivable, the normal "first-to-file" rule applies, and the nonpurchase money interest in accounts receivable prevails. Under section 9-312(4), however, the priority of a purchase money security interest in noninventory collateral extends to all proceeds. Cf. infra note 116.
statement prior to the debtor’s acquisition of the property eliminates any gaps between attachment and perfection, and effectively immunizes the interest from attack by lien creditors and most third-party purchasers. The relative simplicity of the financing state-

16 See U.C.C. § 9-303(1) (1972) ("[A] security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken . . . . If such steps are taken before the security interest attaches, it is perfected at the time when it attaches."). Thus, a financing statement may be filed prior to the debtor’s acquisition of collateral or the secured party’s extension of value. This is implicit in the “first-to-file” rule as well. See id. § 9-312 comment 5; see also supra note 15 (“first-to-file” rule confers priority even where the second interest was actually the first to perfect).

Once a security interest is perfected through the filing of a financing statement, all parties who then buy the collateral from the debtor, other than buyers in the ordinary course of business under section 9-307(1), take title subject to that interest. See U.C.C. §§ 9-201, -306(2) (1972); Cf. id. § 9-307(2) (consumer buyer may prevail over automatic perfection). Since the debtor’s first opportunity to sell the collateral will be upon his acquiring rights in it and, as soon as he acquires these rights, the security interest attaches and is immediately perfected, advance filing forecloses the possibility of a buyer not in the ordinary course of business from obtaining priority.

With regard to subsequent lien creditors, the issue is somewhat more complicated. Under section 9–301(1) (b), only “a person who becomes a lien creditor before the security interest is perfected” prevails over the holder of an Article 9 interest, the implication being that a creditor who acquired his lien after the security interest was perfected would be subordinated. The issue that section 9–301(1) (b) does not clearly address is what are the priorities when perfection of the security interest and the judicial lien arise simultaneously.

Many states date execution liens only from the time a levy is made by the sheriff. E.g., Flemming v. Thompson, 343 A.2d 599 (Del. 1975); Alaska Stat. § 09.35.110 (1973); Cal. Civ. Proc. Code § 688 (West 1980); Wis. Stat. Ann. § 272.19 (West 1977). See generally S. Riesenfeld, Creditor's Remedies and Debtor's Protections 154–57 (3d ed. 1979). In those jurisdictions, advance filing insures that the security interest is perfected before the judicial lien could arise since no levy could take place until the debtor acquires the property and, as soon as that occurs, the security interest immediately attaches and is perfected.

However, in those few jurisdictions that recognize judgment liens on personal property, Ala. Code § 7–9–310 (Supp. 1982); Ga. Code Ann. § 110–507 (1973 & Supp. 1982); Miss. Code Ann. § 11–7–191 (1972), and in the larger number that date execution liens from the time the writ of execution is delivered to the sheriff, e.g., Ark. Stat. Ann. § 30–116 (1979); Colo. Rev. Stat. § 13–52–111 (1973); Ind. Code Ann. § 34–1–34–9 (Burns 1973); Ky. Rev. Stat. § 426.120 (1972); Century Pipe & Supply Co. v. Empire Factors Corp., 19 Ill. App. 2d 165, 153 N.E.2d 298 (1958), it is entirely possible that, even with an advance filing, the judicial lien and perfection of the security interest will arise at the same time. Assume, for example, that Secured Party lent money and filed a financing statement in January; Judgment Creditor delivered a writ of execution to the sheriff in February; and on March 1, Debtor acquires the collateral. It is clear that neither interest existed prior to March 1. Both came into existence at the same moment. Who has priority in the collateral? Section 9–301 simply fails to address the problem.

Suffice it to say that two approaches are possible. One could argue that, since the basic priority rule of section 9–301(1) (b) is a modified “first-in-time” rule (with the caveat that the secured party must be first in time in terms of perfection, not merely attachment), that policy would dictate that where the interests arise simultaneously, they share pro rata. An alternative line of argument would focus on section 9–201 which states that, except as otherwise provided in the UCC, “a security agreement is effective . . . against creditors.” Section 9–301(b) is the only exception and that protects only creditors who acquire their lien before perfection. A lien creditor not protected by section 9–301(1) (b) would then be subject to section 9–201 and would be subordinated.
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In short, if a secured party files a financing statement prior to the debtor's acquisition of the collateral, he is guaranteed priority over subsequent lien creditors in those states which do not recognize judgment liens on personal property and which date execution liens from the time of levy. In all other jurisdictions, advance filing does guarantee that the secured party will not be subordinated to a subsequent lien creditor, but whether the secured party will have priority or share pro rata is uncertain. This issue becomes especially important in the discussion of the sufficient perfection theory of DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969). See infra notes 39-41 and accompanying text.

A final point: Even without an advance filing, the secured party with an agreement containing an after-acquired property clause will still prevail over a subsequent lien creditor where the secured party made an enabling loan within the meaning of section 9-107(b), and where he perfected the interest within 10 days of the debtor's getting possession of the collateral. U.C.C. § 9-301(2) (1972). Unlike the analogous provision in section 9-312(4), the 10 day grace period applies both to inventory and noninventory collateral. Cf. supra note 15 (section 9-312(4) only applies to noninventory collateral). However, under section 9-301(2), the priority of a purchase money lender over a gap lien creditor is limited to where the purchase money security interest attached prior to the lien. Since it is possible in some jurisdictions for the purchase money security interest to attach simultaneously with the judicial lien, the same issue raised in connection with section 9-301(1) (b) exists under section 9-301(2), i.e., where both interests attached simultaneously, would the holder of the purchase money security interest have 10 days to perfect and attain priority?

18 Id. § 9-306. Under the 1972 version of Article 9, there is no need to claim proceeds in the security agreement or in the financing statement. See id. § 9-203(3), 402(3). Under section 9-306, the security interest in proceeds is deemed continuously perfected without supplementary action if the security interest in the original collateral was perfected and if the proceeds are either identifiable cash proceeds or a type of collateral which could have been perfected by filing in the same office where the financing statement on the original collateral was filed. Otherwise, the secured party must reperfect within 10 days after receipt of the proceeds. If he does reperfect before the expiration of those 10 days, the interest is deemed continuously perfected. If more than 10 days elapse, the interest in proceeds is deemed perfected only prospectively.
19 The 1962 Official Text of Article 9 contained no provisions dealing with the issue of whether the priority of a perfected security interest over buyers and lien creditors extended to advances made subsequent to the judicial lien or purchase. Commentators were divided on the issue. See R. Henson, Handbook on Secured Transactions Under the Uniform Commercial Code § 5-13, at 99 (2d ed. 1979); Coogan, Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the “Floating Lien,” 72 Harv. L. Rev. 838, 866-68 (1969). Section 9-301(4) currently provides that creditors who acquire their judicial lien after the security interest was perfected are subject not only to prior advances, but to those made within 45 days after the judicial lien or without knowledge of the lien, even if more than 45 days later. Section 9-301 also provides that even advances made more than 45 days after the judicial lien arose and with knowledge of that lien will still be protected, as long as the advance was made pursuant to a loan commitment entered into without knowledge. Since section 9-301(4) applies only where the security interest was perfected prior to the creation of the judicial lien, and perfection could not occur until some value was given, the priority for future advances would exist only where at least one advance or binding commitment for such advance was made before the judicial lien arose. See U.C.C. § 9-203(1)(2) (1972).
B. The Conflict With the Bankruptcy Act of 1898

1. The Source of the Conflict

A codification of state law cannot supersede the provisions of the Bankruptcy Act of 1898 (1898 Act).\textsuperscript{20} Benedict v. Ratner\textsuperscript{21} was an interpretation of state law and as such could be overruled by subsequent state legislation. But abolition of Benedict v. Ratner left other problems not amenable to state solution. It will be recalled that, prior to the 1950 amendments to the 1898 Act, section 60 deemed transfers of personality to be made only when the rights of the transferee could prevail over those of a bona fide purchaser.\textsuperscript{22} In the well known

Section 9–307(3) is somewhat more limited. Buyers not in the ordinary course of business are subject to future advances only if made within 45 days of the purchase and without knowledge, unless the advance is made pursuant to a commitment entered into without knowledge before the expiration of the 45 day period. (Of course, a buyer in the ordinary course of business takes free of all advances—past and future—made under security agreements created by the seller. Id. §–307(1).) Although section 9–307(3) does not explicitly require the security interest to be perfected, a buyer not subject to preexisting advances can certainly not be subject to future ones. Accordingly, section 9–307(3) protects future advances from buyers not in the ordinary course of business only if: (1) the necessary perfection step—e.g. filing—took place before the purchase; or (2) the buyer bought the collateral with knowledge of an unperfected security interest and was therefore unprotected by section 9–301(1) (c) or (d). In both cases, some value in the form of an advance or commitment had to be extended before the purchase since, without such value, the security interest would not yet have attached and could not bind subsequent purchasers, even those having notice that a financing statement was filed. (The special “first-to-file” rule of section 9–312(5) is limited to priority conflicts between two Article 9 claimants. See supra note 14.)

That a purchaser takes subject to future advances under section 9–307(3) only if an advance or commitment of any amount was made before a purchase rests on the obvious notion that a purchaser cannot be bound by a security interest that was not in existence at the time of his purchase. It may also be inferred from the language of section 9–301(1) (c) which provides that a buyer not in the ordinary course of business takes free of an unperfected security interest (and this includes a fortiori a security interest which has not attached since there can be no perfection before attachment, U.C.C. § 9–303(1) (1972)) if he takes possession without knowledge of that interest. A purchaser can never have knowledge of a security interest if none is yet in existence. Consequently, irrespective of his knowledge regarding a filing, the purchaser prior to attachment is always protected under section 9–301(1) (c) and hence not subject to section 9–307(3).

Finally, section 9–312(7) provides that the “first-to-file” rule confers priority over a subsequent Article 9 interest even with regard to future advances. Given the fact that the rule of section 9–312(5) never depended on an advance being made in the first place, section 9–312(7) may appear superfluous. Its intent, however, may have been to overrule cases such as Coin–O–Matic Serv. Co. v. Rhode Island Hosp. Trust Co., 3 U.C.C. Rep. Serv. 1112 (R.I. Super. Ct. 1966), which held that a financing statement could not cover a future advance which was not in the contemplation of the parties at the time of the filing. Section 9–312(7) is also necessary where the initial perfection was by possession, rather than filing. In that case, priority under section 9–312(5) does depend on being the first to perfect which in turn necessitates the giving of value, thereby triggering the problems of future advance.

\textsuperscript{20} ch. 541, 30 Stat. 544.

\textsuperscript{21} 268 U.S. 353 (1925); see supra note 6.

\textsuperscript{22} See Breitowitz, Article 9 Security Interests as Voidable Preferences, 3 Cardozo L. Rev. 357, 372–73 & nn.55–56 (1982).
Klauder case, the Supreme Court struck down as preferential an assignment of accounts receivable made more than four months before bankruptcy for new value on the grounds that, under state law, a second assignee could defeat the first assignment for failure to give notice to the account debtor. Applying the bona fide purchaser test to convert a contemporaneous exchange into a transfer on account of an antecedent debt, the Court discounted the fact that the assignment was not secret, was duly noted on the books of the principal debtor, was arranged by a creditors' committee, and would hardly have been a fraud on a second assignee. After Klauder it became apparent that, in many states, non-notification financing could not survive bankruptcy. The Klauder holding, as well as the analogous problem in the area of inventory financing, was the primary impetus for the 1950 amendments to section 60 which required only perfection against lien creditors rather than bona fide purchasers—a standard that inventory and accounts receivable financing could meet. However, the effect

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24 The Klauder case was based on Pennsylvania law which followed the so-called English rule that a second assignee, who notifies the account debtor first, can prevail over an earlier assignee. Since such notice was not given, the transfer was not perfected against a bona fide purchaser and thereby became a preference. See Countryman, The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act, 16 Law & Contemp. Probs. 76, 79–80 (1951).
25 Klauder, of course, had no effect on financing arrangements where the assignee would notify the account debtor to pay monies as they became due, which at the time, was the prevailing practice in the construction industry. But for many industries, notably retail businesses, non-notification financing was the only acceptable method of borrowing. See G. Gilmore, supra note 6, § 8.6, at 271–74 (1965).
26 Moreover, even in cases of non-notification financing, Klauder had direct application only in states following the English rule. Under the New York rule of “first-in-time, first-in-right,” a second assignee could never prevail over an earlier one; thus, even the bona fide purchaser test could have been easily met. Massachusetts and several other states had yet a third rule. Generally, a first assignee would prevail unless the second assignee obtained a judgment, payment, surrender of a tangible writing, or a novation (i.e., the second assignee assumed the status of the assignor). This so-called “Four Horsemen” rule was adopted by the First Restatement of Contracts. Restatement (First) of the Law of Contracts § 173 (1932). It was unclear after Klauder whether the hypothetical ability of a second assignee to prevail by taking the supplementary action specified in the Four Horsemen rule would have deemed the assignment unperfected under section 60 and hence preferential. At least one court answered the question in the affirmative. See In re Vardaman Shoe Co., 52 F. Supp. 562 (E.D. Mo. 1943). Since the Four Horsemen rule gave priority to second assignees who took the necessary steps even where the first assignee gave notice to the account debtor, the Vardaman holding would have destroyed the possibility of even notification financing (let alone non-notification filing) in the states subscribing to that rule. See Countryman, supra note 24, at 80–82.
28 Actually, by the time Congress amended the Bankruptcy Act in 1950, the Klauder problem had been largely resolved on the state level. By August 1949, most states had enacted accounts receivable statutes of various sorts. Fifteen states passed validation statutes codifying the New York rule; another 15 had statutes permitting a first assignee to perfect his assignment...
of those amendments was merely to protect from invalidation security interests in collateral acquired by the debtor before the preference period, but which were deemed preferences only by virtue of the bona fide purchaser test formerly contained in section 60. The amendments did nothing to protect transfers of inventory and accounts receivable that had arisen within the four month period. Herein lies what was once regarded as the sharpest conflict between the UCC and the 1898 Act—the validity of revolving credit arrangements on accounts receivable and inventory acquired by the debtor while insolvent within four months before bankruptcy. Despite the fears (or hopes) of numerous commentators, the conflict became moot with secured creditors emerging victorious. Section 547(c)(5) of the Bankruptcy Reform Act of 1978 (BRA) is designed both to enshrine that victory and limit the excesses that some courts would have permitted.

To restate the problem in its historical context: Section 60 of the 1898 Act invalidated transfers of the “property of the debtor” for an antecedent debt, made within four months before bankruptcy, if the debtor was insolvent and the creditor had reasonable cause to believe this fact. “Transfer” was defined in section 1(30) to include the “fixing [of] a lien” or, in other words, the creation of a security interest. The

against a subsequent assignee by filing notice in a central or local office; and a third and smaller group merely required notation of the assignment on the books of the principal debtor. States adhering to the New York common law rule had no reason to make any change and accordingly did not. See Countryman, supra note 24, at 81–82. Essentially, then, while state legislation was making it possible for assignments of accounts receivable to meet the bona fide purchaser test, Congress was lowering the standard by substituting the lien creditor test. Obviously, both steps were not necessary. The fact that neither side appreciated what the other one was attempting to do has been aptly described as “ships passing in the night.” Accounts receivable statutes were short-lived. They were soon superseded by the UCC, which is a notice filing statute. Once a proper financing statement is filed, the assignment will generally be effective against bona fide purchasers. See U.C.C. §§ 9-201 – 306(2) (1972). Thus, under Article 9 as well, assignments could have passed muster even under the old bona fide purchaser test.

In any case, while Congress may have been acting in response to Klauder in view of the changes in state law the principal need for the 1950 amendments was the validation of inventory financing and not the protection of assignments of accounts receivable.

The law review literature on the subject, both before and after the cases, is exhaustive. See, e.g., Countryman, Code Security Interests in Bankruptcy, 75 Com. L.J. 269 (1970); Hogan, Games Lawyers Play With the Bankruptcy Preference Challenge to Accounts and Inventory Financing, 53 Cornell L. Rev. 553 (1968); Kronman, The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act, 124 U. Pa. L. Rev. 110 (1975); Skilton, Security Interests in After-Acquired Property Under the Uniform Commercial Code, 1974 Wis. L. Rev. 925. See also articles cited in DuBay v. Williams, 417 F.2d 1277, 1280 n.2 (9th Cir. 1969).

determination of when a security interest was created or came into existence was dependent on state law, though the effect of section 60(a)(2) was to provide that even after a transfer occurred under state law, it would be delayed until it was perfected against a lien creditor. Since, under section 9-203 of the UCC, a security interest is not enforceable against the debtor or third parties unless, among other things, the debtor has rights in the collateral, no transfer could possibly occur before that time. Moreover, even if state law were not controlling, logic would dictate that there cannot be a current transfer of property that the debtor does not yet own. Accordingly, if a secured party took an assignment of accounts receivable or inventory, his interest in each unit presumably could not arise until rights in each account receivable or inventory item were actually acquired by the debtor. Only then could such rights be transferred to the secured party. If the accounts receivable arose within four months, the transfer should have been a preference although the underlying security agreement was executed well in advance of the preference period. The drafters of Article 9 sought to prevent trustee avoidance of these transfers through the adoption of section 9-108, which basically provides that, as long as new value was given pursuant to a security agreement, any subsequent transfers will be deemed to be taken for new value, not for antecedent debt, if the debtor's acquisition was made in the ordinary course of business. Commentators properly castigated section 9-108, and many predicted the floating lien would fail. A series of federal court decisions in the late 1960's, however, indicated that, without actually relying on section 9-108, such interests would nevertheless survive.

2. The Judicial Response

The story has been told many times; only its highlights need be sketched here. The earliest case to consider the problem was Rosenberg v. Rudnick which involved acquisitions of inventory

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29 Subject to the provisions of section 60(a)(7). See Breitowitz, supra note 22, at 388–89.
30 Section 9–108 also protected acquisitions pursuant to enabling loans. Id. at 416–29.
31 “Here is the most flagrant disregard of the Supremacy Clause of the Constitution to be found in the Code.” Countryman, supra note 27, at 276. It should be noted that none of the literature defending the validity of section 9–108 is responsive to this point. It is often said that, as a matter of policy, acquisitions in the ordinary course of business not resulting from manipulative conduct should be protected. See Hogan, supra note 27, at 565–75; Kronman, supra note 27, at 162–64. But these arguments need to be addressed by Congress or perhaps the courts. The issue is not one which state law can properly resolve. See Breitowitz, supra note 22, at 418 n.165.
32 See articles cited supra note 27.
within the preference period pursuant to an agreement entered into more than four months before bankruptcy. In upholding the transfer, the district court relied in part on what has become known as the "entity theory," because accounts receivable and inventory are regarded as a single mass, although their individual components change. Consequently, although a debtor cannot effect a transfer until he has rights in the collateral, the collateral is not the individual unit but the entire changing mass of accounts receivable or inventory items. Thus, as long as the "res" was transferred prior to the preference period, no further transfer was deemed to have taken place within the preference period merely because different accounts receivable or inventory items were substituted. Note that, unlike section 9-108 which moved the new value forward to the actual time of transfer, the entity theory moved the time of transfer back. Whatever the merits of the theory, it is inconsistent with the language of section 9-108 which assumes that the transfer takes place upon the debtor’s acquisition of the individual unit. In any event, it was unclear whether the entity theory was limited to inventory and accounts receivable or applied to any after-acquired property. The language of the cases, however, strongly suggests the former.

A second theory, termed the "Abracadabra Theory" by Professor Countryman, involved a novel interpretation of section 60(a)(2). That section provided that transfers of personal property were not deemed made until protected against a subsequent lien creditor. As

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34 Id. at 639. It has been pointed out that the theory was apparently derived from the dictum of Judge Magruder in an opinion construing the New Hampshire Factor’s Lien Act. Manchester Nat'l Bank v. Roche, 186 F.2d 827, 831 (1st Cir. 1951). See Hogan, supra note 27, at 559-60. In the academic world, the most enthusiastic supporter of the "entity theory" appears to be Professor Henson. "[A]dmitting that we cannot step twice into the same stage of a river does not require a corresponding admission that we cannot step twice into the Mississippi River . . . ; for obviously we can." Henson, "Proceeds" Under the Uniform Commercial Code, 65 Colum. L. Rev. 232, 233 (1965).

35 See Breitowitz, supra note 22, at 418-28.

36 The entity theory was also inconsistent with the language of the 1962 version of U.C.C. § 9-204(2) (d) which provided that "a security interest cannot attach . . . in an account until it comes into existence." Hogan, supra note 27, at 555; Skilton, supra note 27, at 971.

This inconsistency is of some importance since the entity theory was originally proposed as a theory of state, not federal, law. See supra note 34. There was nothing in the 1898 Act itself that suggested that all accounts receivable or inventory items were to be regarded as components of a single mass; if under state law, they are clearly not so regarded, the theory loses much of its justification.


38 Countryman, supra note 27, at 277 & n.52. He points out that this theory originated in a 1959 law review article, Friedman, The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under the Code, 108 U. Pa L. Rev. 194 (1959).
interpreted by the Ninth Circuit in *DuBay v. Williams*, section 60(a)(2) provided an independent federal definition of when a transfer was deemed made. Although under state law no security interest can exist until the debtor has rights in the collateral, if at an earlier point in time the possibility of a lien creditor of the debtor obtaining superior rights over the transferee was already foreclosed, the transfer was deemed made at that earlier point. The court reasoned that as soon as a creditor extended value pursuant to a written security agreement and filed a financing statement, there was no chance that a subsequent lien creditor could ever achieve priority. This was so because creditors of the debtor could not proceed against the property until the debtor acquired it. As soon as he did, the prior Article 9 interest attached. As soon as it attached, it became automatically perfected by virtue of the prior filing, leaving no “gap” between the attachment and the perfection of the security interest during which the creditor could obtain a lien, and under section 9-301, only the gap lien creditor is protected. Since the possibility of lien creditor priority was effectively eliminated by the extension of value, execution of agreement, and the filing of a financing statement, the transfer was, for the purposes of section 60(a)(2), deemed made at the later of those three events. The state law concept of attachment, dependent upon the debtor obtaining present rights in the collateral, was simply irrele-

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39 417 F.2d 1277 (9th Cir. 1969). This case involved “the short and turbulent life of the *Portland Reporter.*” Id. at 1281. Many members of a printers’ union had lost their jobs as a result of a strike. To provide their members with employment, the union organized and published a rival newspaper, the *Portland Reporter.* Id. The union also formed the Rose City Development Corporation which made loans to the *Portland Reporter* secured by existing and after-acquired accounts receivable. Id. Four years later, the *Portland Reporter* was put into bankruptcy. Id. Rose City Development Corporation had filed a financing statement well before the preference period, but the accounts receivable that it was claiming as collateral had arisen during the preference period. Both the district court and the court of appeals, however, upheld Rose City Development Corporation’s claim with the court of appeals relying primarily on its theory of sufficient perfection. Id. at 1285-89. The situation was complicated by the presence of other creditors and subordination agreements, but these agreements were found to be voidable. Id. at 1281-85.

40 As noted earlier, the fact that a secured party has extended value and filed a financing statement does not necessarily guarantee that a subsequent lien creditor will be defeated. This will indeed be the case in a “levy” state, but in jurisdictions which recognize judgment liens on personal property or date execution liens from the time the writ is delivered to the sheriff, it is entirely possible to have a situation where the judicial lien and perfection of the security interest arise simultaneously. See supra note 15. However, even if the parties in such a case would share pro rata—and it is possible that the secured party would have priority anyway—this would not have affected the *DuBay* analysis. Section 60(a) (2) did not deem a transfer made as of the time it would be superior to a subsequent lien creditor; rather a transfer was deemed made as of the time that the subsequent lien creditor could no longer obtain superior rights to it. There is comparable language in section 547(e) of the BRA.
vant. Like the entity theory, the time of transfer was artificially moved back.

The *DuBay* case was undoubtedly correct in its assertion that perfection under section 60(a)(2) need not have been identical with the concept of perfection under Article 9. Indeed, the federal use of the term long predated the drafting of the UCC. Although under section 9-303(1) of the UCC a security interest cannot be perfected until it attaches and under section 9-203(1)(c) it cannot attach until the debtor has rights in the collateral, Article 9 definitions are not controlling in construing similar terms in federal legislation. The term “perfection” in section 60(a)(2) is given no internal definition other than the achievement of priority over subsequent lien creditors. The arguments against *DuBay* based on its alleged misreading of the term “perfection” are, therefore, unconvincing.\(^4\) Nevertheless, the history of section 60(a)(2), if not the language, clearly demonstrated that it was intended to postdate transfers that were already deemed made under state law but were secret;\(^5\) section 60(a)(2) never purported to recognize transfers that, under state law, did not yet exist. Utilization of section 60(a)(2) to deem a transfer made before it was deemed made under state law simply stood history on its head. The court’s willingness to adopt a construction of section 60(a)(2) so obviously at variance with the plain meaning of the provision, its legislative history, and the basic policy of section 60 as a whole, can be explained only in terms of its desire to achieve a specific result: the validation of security interests in after-acquired property in the event of bankruptcy.\(^6\) While the court’s motives may have been laudable, and

\(^4\) See 3 Collier on Bankruptcy ¶ 60.37, at 916-40 (J. Moore 4th ed. 1977); Breitowitz, supra note 22, at 378-79.

\(^5\) Besides its failure to properly consider the historical background of section 60(a)(2), the *DuBay* analysis raised a number of other difficulties. The court ignored the fact that section 60(a) (2) of the 1898 Act was not the only definition of “transfer.” Section 1(30) of the 1898 Act defined “transfer” as including the “fixing of a lien,” the existence of which apparently depended on state law, with no reference to priority over lien creditors. Thus, section 60 required both a “transfer”—i.e., the state recognition of a security interest effective between the parties—and an interest sufficiently perfected so that a subsequent lien creditor could not attain priority. There is no indication that section 60(a)(2) superseded the definition in section 1(30); it merely imposed an additional element. Moreover, it was clear from the language of section 60 itself that the term “transfer” did have a meaning independent of the concept of perfection. Section 60(a)(7) provided that perfection within 21 days, under certain circumstances, would deem the transfer
while there were certainly important economic and social reasons which supported its holding, its analysis opened the door for large-scale creditor overreaching and abuse in a way that the other theories did not.  

A third theory was known as the relaxed substitution theory. It was well established under prior law that substitution of collateral made as of the time of the transfer rather than the time of its perfection. But if “transfer” were defined exclusively in terms of “perfection,” the statement simply had no meaning. See Bankruptcy Act of 1898 § 60(a) (8), 11 U.S.C. § 96(a) (8) (1976). This clearly indicated that the section 1(30) definition, which appeared to incorporate state law notions of attachment, remained operative under section 60 as well.

Second, even assuming that a transfer was deemed made as soon as it was perfected, the term “perfection” suggested that the inability of a lien creditor to prevail had to derive from the superior property right of the transferee. Yet the inability of a creditor to acquire a lien prior to the debtor’s acquisition of the collateral had nothing to do with the existence of an earlier Article 9 interest. Indeed, even if the secured party had not filed a financing statement, another creditor could not levy simply because the debtor did not own the property. Where the disability of a creditor to obtain a lien is for reasons totally unrelated to the presence of a prior transfer, it does not appear to be accurate to speak of that prior transfer as currently effective against lien creditors. The earliest moment in time when a creditor may no longer obtain a superior lien as a result of the previously perfected Article 9 security interest is only upon the debtor’s acquisition of the collateral, and accordingly, even under a perfection test, it is only then that the transfer can be deemed made.

Third, section 60(a) (2) provided that a transfer was deemed made at the time “no subsequent lien . . . obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.” The statute did not require perfection only as against creditors of the debtor-transferor but as against all creditors. At best, however, the filing of a financing statement merely insured that there would be no “perfection gap” that would allow a creditor of the debtor to obtain a superior lien. Assume, however, that the secured party extended value and filed a financing statement covering the debtor’s after-acquired inventory on January 15. The debtor will receive a shipment of inventory from his supplier on January 20. Between January 15 and 20, if a creditor of the supplier would have levied on the inventory, the debtor’s subsequent acquisition of the inventory would have been subject to that judicial lien, and the Article 9 security interest would have attached only to the debtor’s equity. Thus, even under section 60(a)(2), the property is insulated from attack by any lien creditor only upon the debtor’s acquisition of the property.

Finally, insofar as the DuBay analysis would have permitted a secured party to greatly improve his position during the preference period, it was contrary to the basic policy of section 60 to prevent such improvement. The fact that the security interest in the accounts receivable was not secret should not obscure the fact that the transfer clearly did have preferential effect, contrary to the notion of distributive equality. See Breitowitz, supra note 22, at 377–78. The DuBay holding may thus be another instance of substituting “notoriety” for “equality” as the primary focus of the preference law and is illustrative of the pitfalls in having a single statutory mechanism attempt to redress two very different evils. Id. at 378 n.64.

44 The specific abuse which DuBay would have permitted was the ability of a creditor who was totally unsecured as of the start of the preference period to improve his position through manipulative or coercive conduct. See infra text accompanying notes 72–74 & 95.

45 Unlike the entity or sufficient perfection theories, the formulation based on relaxed substitution protected the floating lien only in its pristine form, i.e., where the secured party released his claim on old collateral as it was liquidated and looked solely to the later acquisitions for satisfaction of the debt. Where the security agreement covered after-acquired property but
within the preference period was not a voidable preference, either on the ground that the new security taken was not on account of antecedent debt but rather was for the new value that was contemporaneously released, or that the transfer, not depleting the estate, lacked preferential effect.\footnote{46} The validity of such a substitution was traditionally subject to two limitations: (1) the substituted security could not be of greater value than what was released to the debtor—to the extent that there was an excess, the creditor was being preferred; and (2) the substitution must be contemporaneous.\footnote{47} Otherwise, the released collateral simply gave rise to a claim which, vis-à-vis the security later transferred, was an antecedent debt.\footnote{48}

Applying these principles to accounts receivable and inventory financing, if a creditor wanted a valid security interest in collateral acquired during the preference period, the traditional test required that he hold the proceeds of liquidated accounts receivable or inventory items until new accounts receivable had arisen or new inventory was received.\footnote{49} The new collateral could not exceed the value of the old collateral released. As a corollary, if at any point within the preference period, the new accounts or inventory items were not as valuable as collateral or proceeds that were previously released, the

did not purport to release security interests in collateral that was liquidated, e.g., the secured party required remittance or segregation of proceeds of inventory that was sold or accounts receivable that were collected, the newly-acquired collateral is not in substitution or replacement of the old and would therefore not be covered by a substitution theory. See supra note 4.


\footnote{47} Stewart v. Platt, 101 U.S. at 743-44. Actually, the substitution did not have to be contemporaneous with the acquisition of new collateral, if the new collateral was acquired by the debtor prior to the release of the old collateral, since even a subsequent release of collateral undid whatever preferential effect the acquisition of new collateral produced. See Bankruptcy Act of 1898 § 80(c), 11 U.S.C. § 96(c) (1976); 11 U.S.C. § 547(c)(4) (Supp. IV 1980). Put differently, if at no time during the preference period did the lender give up the secured status it occupied prior to the preference period (whether that status was fully secured or partially secured), it was entitled to assert that secured status in bankruptcy. See Breitowitz, supra note 22, at 411 n.147.

\footnote{48} Presumably, the same cases which allowed some delay between the loan and the transfer would have permitted similar delays between the release of old collateral and the substitution of new. See Countryman, supra note 27, at 273 n.24. It is possible that such substantially contemporaneous substitution was effective only if, at the time new value was given or the old collateral was released, the substitution was expected to take place. Compare Dean v. Davis, 242 U.S. 438 (1917) (substantial contemporaneity test) with National City Bank v. Hotchkiss, 231 U.S. 50 (1913) (delay of several hours resulted in invalidation). This is clearly true under current law. See 11 U.S.C. § 547(c)(1) (Supp. IV 1980); Breitowitz, supra note 22, at 410-16.

\footnote{49} Alternatively, the debtor could simply have deferred the collection and liquidation of old accounts receivable until new accounts receivable of an equivalent value had arisen. This may be more difficult in the case of inventory which is sold on a day-to-day basis.
lower figure would be the baseline for determining the validity of subsequent acquisitions. Assume, for example, that on January 1, a secured party took and perfected an assignment of the debtor’s accounts receivable worth $100,000. On March 1, the proceeds of the accounts receivable were released to the debtor and new accounts receivable totaling only $50,000 which had previously arisen were substituted. On June 1, the proceeds were again released in exchange for new accounts receivable totaling $100,000. On June 10, the debtor filed for bankruptcy relief. The value of the collateral that was released contemporaneously with the creditor’s acquisition of these final accounts receivable was only $50,000—accordingly, the creditor was only entitled to $50,000 of the new collateral. The release of $100,000 of accounts receivable in March would not support a claim against the $100,000 of accounts receivable in June because the earlier release was not contemporaneous with the new acquisition. In short, under the traditional substitution doctrine a creditor would have been entitled only to the lowest value of collateral at any point within the preference period.\textsuperscript{50}

In the normal revolving credit arrangement, however, the debtor is free to liquidate accounts receivable and use the proceeds even before new accounts receivable of equivalent value arise. Thus, there was a potentially serious timing problem in that the substitution of new accounts receivable were not substantially contemporaneous with the release or collection of old ones. In addressing this problem, the Seventh Circuit in \textit{Grain Merchants of Indiana, Inc. v. Union Bank \\& Savings Co.},\textsuperscript{51} simply stated that imposing a requirement of strict timing, insofar as it would require the secured party to exercise control over the accounts receivable or proceeds until new accounts receivable had arisen, would be inconsistent with UCC section 9-205, which repealed \textit{Benedict v. Ratner}.\textsuperscript{52}

\textsuperscript{50} But cf. infra note 93 (entity theory and section 9-108).
\textsuperscript{51} 408 F.2d 209 (7th Cir.), cert. denied sub nom. France v. Union Bank \\& Sav. Co., 396 U.S. 827 (1969). This was the principal case which expounded the theory of relaxed substitution.
\textsuperscript{52} See id. at 216. The court’s assertion that strict timing would be equivalent to reviving \textit{Benedict v. Ratner} was not quite accurate. \textit{Benedict} required remittance and application of the proceeds to the satisfaction of the debt (or at least to the replacement of collateral). Strict substitution would merely require the matching of the liquidation of old accounts receivable with the creation of new ones. See supra note 49. The court may have meant, however, that as a practical matter, the economic cost of both types of policing would have been virtually identical. The policing requirements would raise the cost of secured credit and, in a sense, defeat Article 9’s policy of facilitating secured transactions. As noted in the text, the court fails to address the critical issue of how the enactment of section 9-205 and its repeal of \textit{Benedict v. Ratner} could in any way affect federal law.
The difficulty with the reasoning in *Grain Merchants* lies in the fact that section 9-205 merely protects the initial security interest from being void as fraudulent for lack of policing by the secured party. It does not, indeed cannot, address the problem of whether the property acquired within the preference period pursuant to that security agreement is preferential. If the debtor has unfettered discretion to liquidate that collateral before an equivalent value has arisen, there is little reason to treat the release of collateral any differently from any other antecedent debt, as to which subsequent acquisitions and transfers of collateral are preferential. While the statutory justification of the theory may thus be tenuous, it did avoid some of the potential for creditor abuse that *DuBay* could have engendered\(^5\) and, as I will attempt to show later,\(^5\) was in fact the basis for section 547(c)(5) of the BRA.

It is noteworthy that none of the above-mentioned cases upholding the floating lien ever relied on section 9-108 of the UCC, although a number of decisions made reference to it.\(^5\) The fact that courts felt constrained to devise alternative theories to uphold transactions

Interestingly enough, the court in *Grain Merchants* relied on a number of other theories as well. It noted the entity theory and the sufficient perfection theory of *DuBay* and, for good measure, it even mentioned the Gilmore Committee draft which, at that point, had not yet been submitted to Congress. 408 F.2d at 214-18. The court also made reference to section 9-108 of the UCC, although it stated that it was unnecessary to decide whether section 9-108 must fall before the superior command of section 60(a)(2) of the 1898 Act. Id. at 218. Finally, the court alluded to an argument advanced by the Permanent Editorial Board of the UCC that the new accounts receivable were proceeds of a perfected security interest in inventory but maintained that the failure to raise the argument in the district court precluded its consideration on appeal. Id.

\(^{53}\) See supra note 44 and accompanying text.

\(^{54}\) See infra text accompanying notes 116-22.

\(^{55}\) E.g. *Grain Merchants*, Inc. v. Union Bank & Sav. Co., 408 F.2d at 218. This observation was noted by *Countryman*, supra note 27, at 279. One case did purport to rely on section 9-108, but in that case there was not even a preference problem to begin with. See *In re King-Porter Co.*, 446 F.2d 722 (9th Cir. 1971). In *King-Porter Co.*, a financing statement was filed more than four months before bankruptcy. The debtor acquired 112 air conditioners on open account within the preference period. Undoubtedly, under section 9-108, any prior advances would now have been validly secured since the acquisition of inventory was in the ordinary course of the debtor’s business. However, prior advances were already fully secured. After the air conditioners were acquired the secured party assumed the debtor’s debt to the seller on open account (the functional equivalent of making a new loan) and sought to have its right of reimbursement secured. In upholding the secured party’s contention, the court relied principally on section 9-108, stating that because “good business practice should be good business law,” and because the UCC should be treated as a federal law of commerce, “bankruptcy courts must recognize the general validity of claims based on security interest caused by after-acquired property clauses.” Id. at 732. Consideration of section 9-108, however, appeared to be totally unnecessary since the extension of additional credit in the form of an assumption of liability took place subsequent to the acquisition of the collateral. Where the advance occurs after the collateral has been acquired and where the collateral is covered by a previously filed financing statement, there is never a preference problem because the transfer securing the new advance arises contemporaneously
clearly protected by section 9-108 lends support to the view that
section 9-108 was an unconstitutional attempt to amend the 1898
Act. Indeed, the court in Rosenberg flatly noted that “the definition
of what constitutes an antecedent debt is not one to be determined by
state law.” At the same time, however, the presence of section 9-108,
a clearly articulated state policy favoring the validity of the floating
lien in bankruptcy, may itself have served as a powerful impetus for
the development of theories that interpreted the 1898 Act to reach the
same result. Thus, section 9-108’s influence in this area may have
been powerful, albeit indirect.

3. The Practical Consequences for Secured Creditors

The various theories offered by courts to sustain the validity of
the floating lien were not merely interchangeable rationales leading to
a common result. The choice of theory had important practical conse-
quences not always articulated in the opinions. These differences can
best be brought into focus by posing a series of questions and deter-
mining how each of the theories would resolve the issue raised. While
this analysis may appear obsolete after the enactment of the BRA,
such an inquiry sheds much light on the “improvement of position”
test found in current law and affords valuable insights as to why
Congress chose such a test—which in some ways conforms with none
of the theories articulated above—and as to the problems it fails to
address. The following questions highlight the main points of diver-
sion among the theories.

a. What Types of Collateral Are Protected?

The entity theory apparently protected only after-acquired in-
ventory and accounts receivable, while the sufficient perfection theory

with that advance. Section 9-108, or any other theory, is necessary only where the debt is
antecedent to the acquisition, not when the acquisition precedes the debt. See Skilton, supra note
27, at 993-96.

56 See Countryman, supra note 27, at 274 n.28; Gordon, The Security Interest in Inventory
Under Article 9 of the Uniform Commercial Code and the Preference Problem, 62 Colum. L.
Rev. 49 (1962), reprinted in 1A P. Coogan, W. Hogan & D. Vagts, Secured Transactions Under
the Uniform Commercial Code ch. 11A, at 1161-91 (1973). See also supra note 31 (constitution-
ality of section 9-108).

57 262 F. Supp. at 639.

58 Thus, in Grain Merchants, the court, without relying on section 9-108, expressed its
reluctance to invalidate a provision of the UCC, recognizing that it was a valuable source for
determining federal commercial law. 408 F.2d at 218.

59 Because these theories were developed to circumvent the perceived limitations of section
60 of the 1898 Act, we discuss them in the context of that Act, rather than under current law.
This facilitates comparison between the old law as interpreted by the courts in the light of these
of *DuBay* and the relaxed substitution theory applied with equal force
to all forms of after-acquired property, including items of equipment
that are not commonly regarded as components of a larger "entity." On
its face, section 9-108 of the UCC was also not limited to the
classic floating lien. Nevertheless, since it does require that the acquisi-
tion be made in the ordinary course of the debtor's business (except
in the context of enabling loans), many equipment purchases will fail
to qualify.\(^60\)

**b. Assuming the Collateral Was Covered, What Were
the Necessary Conditions for the Security Interest To Be Validated?**

Even without considering preference law, an Article 9 security
interest survives bankruptcy only if four steps are taken: there must be
a security agreement, the secured party must give value, the debtor
must acquire rights in the collateral (the foregoing three steps consti-
tuting attachment), and the secured party must take the necessary
perfection steps outlined in Part 3 of Article 9.\(^61\) As noted earlier,\(^62\) for

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\(^{60}\) Acquisitions of inventory will generally be in the "ordinary course of business" by definition, at least where the debtor operates a business selling goods of that type. See U.C.C. § 9-109(4) (1972). The same is true for accounts receivable, if generated from the sales of such goods. See id. § 9-106. To the extent that a build-up of inventory or accounts receivable occurs as a result of manipulative or coercive conduct by the secured party—e.g., he orders the debtor to stop payments to employees and to build-up inventory or to conduct a "fire" sale of inventory below cost to "feed" a security interest on accounts receivable—section 9-108 would be unavailable, because such conduct is not in the ordinary course of business. However, even when there is no intent to confer special advantages on the secured party, acquisition of property other than inventory and accounts receivable will often be deemed not in the ordinary course of business. Thus, purchases of equipment due to an unanticipated shift in technological process do not qualify. On the other hand, if new purchases are part of a scheme of scheduled replacement, recurring at specified intervals in the business cycle, they would be covered. See G. Gilmore, supra note 25, § 45.6, at 1314-15.

\(^{61}\) See Breitowitz, supra note 22, at 373 n.56. A security interest that was unperfected against a lien creditor as of the petition date was voidable in bankruptcy under section 70(c) of the 1898 Act. This is still the case under section 544(a) of the BRA. See Breitowitz, supra note 22, at 373 n.58. The statement in the text that all four steps—including acquisition of the collateral—must occur prior to bankruptcy is true even with regard to the "sufficient perfection" theory articulated in the *DuBay* case. Although that theory held that a security interest was deemed perfected against a lien creditor even prior to the debtor's acquisition of collateral—and thus arguably the same could have been true for purposes of section 70(c) where the debtor acquired the collateral after the petition—other sections of the 1898 Act precluded such a result. Property acquired by the debtor after the petition is filed will either be property of the estate or property of the debtor. See 11 U.S.C. § 541 (Supp. IV 1980). In either case, such property is not subject to a prepetition security agreement unless the after-acquired property is proceeds of some prepetition property. Id. § 552. The same was true under the 1898 Act. See, e.g., *In re National Cottonseed Prods. Corp.*, 34 F. Supp. 438 (D. Tenn. 1940); De Gaylor Homes, Inc., 1 Bankr. Ct. Dec. (CRR) 532.
accounts receivable and inventory in the possession of the debtor, the necessary step is the filing of a financing statement in the appropriate office. When did each of these steps have to be taken to prevent avoidance under section 60? This analysis will discuss two situations—where the advance was made prior to the preference period and where it was made during the preference period. We will assume for the purposes of illustration that the debtor was insolvent throughout the preference period.

(i) Advances Made Prior to the Preference Period

Under the entity theory, after-acquired property is protected only to the extent that there was an initial nonavoidable transfer of at least some property which would thereby permit subsequent acquisitions during the preference period to be regarded as part of that entity. Accordingly, it was essential that both the security agreement and the debtor’s acquisition of rights in “some” collateral precede the start of the preference period (though either or both may safely take place after the advance), so that attachment of the security interest under state law would occur at a time when the transfer would not be vulnerable to attack. The financing statement, however, could have been filed even within the preference period, provided filing occurred within twenty-one days of attachment. Although, in such a case

(W.D. Wis. 1975). See also 4 Collier on Bankruptcy ¶ 552.02, at 552-8 (L. King 15th ed. 1979). It is thus safe to say that under all theories, prepetition security agreements are enforceable only against prepetition property. The “sufficient perfection” theory merely dispensed with the need to acquire collateral prior to the preference period, not with the need to acquire it prior to bankruptcy.

63 See supra note 12.
64 U.C.C. § 9-302 (1972); see supra note 12 and accompanying text.
65 The analysis is essentially the same in both cases. The only distinction is that where the advance was made prior to the preference period, it is essential that the transfer itself be deemed made prior to the preference period. Otherwise, it would be a transfer on account of an antecedent debt (in the absence of a special provision such as section 9-108 of the UCC or the like). Where the advance was made during the preference period, the transfer need not, and indeed cannot, be deemed made prior to the preference period. It is essential, however, that it be deemed made contemporaneously with the advance so that it not be on account of an antecedent debt.
66 The use of the term “some” collateral is intended to make clear that, as long as any collateral was acquired by the debtor prior to the preference period, even after-acquired property was protected. The prepreference period acquisition need not necessarily have been the same collateral which the secured party actually received in bankruptcy.
67 While attachment of a security interest normally occurs at the latest of the three events—the execution of the agreement, extension of value, and the debtor’s acquisition of the collateral—section 60(a)(7) could not protect security interests in collateral acquired subsequent to the advance because of its “new value” requirement. See infra note 67. Its protection is limited to collateral requisitions for which the making of the advance was the final stage of attachment.
perfection took place during the preference period, the transfer would be validated under section 60(a)(7), which provided that perfection within twenty-one days of the transfer taking effect between the parties antedated the transfer to the time of its taking effect.\textsuperscript{67}

The same is true for the relaxed substitution theory, although for different reasons. The substitution theory did not purport to manipulate the time of transfer, as did the entity theory. Collateral acquired by the debtor during the preference period was deemed transferred to the secured party only upon that acquisition. The transfer was none-theless valid by virtue of its being in substitution of an earlier nonpreferential transfer. Therefore, it was necessary that the security agreement and acquisition of "some"\textsuperscript{68} collateral precede the preference period so that the original transfer would not be deemed voidable and so that subsequent transfers could be in substitution. Again, section 60(a)(7) would have permitted delayed perfection after the preference period for up to twenty-one days after attachment.\textsuperscript{69}

Under the sufficient perfection theory of the DuBay case, the answer is somewhat more complicated. The DuBay theory essentially eliminated acquisition of rights in collateral as an element of the "transfer" within the meaning of the 1898 Act. The time of transfer was determined solely by reference to priority over lien creditors and, as soon as it was impossible for a subsequent lien creditor to defeat a secured party, the transfer was deemed made whether or not the security interest attached under state law.\textsuperscript{70} It was thus clear that if the execution of the security agreement, extension of value, and filing

\textsuperscript{67} This assumes, of course, that the grace period of section 60(a)(7) was available for all Article 9 security interests, not only those for which there was a grace period under state law. This appeared to be the consensus of most commentators, though the matter was not without doubt. See Breitowitz, supra note 22, at 388-91, 390-91 nn.92-100. Another point to remember is that section 60(a)(7) itself applied only where the security interest attached contemporaneously with the extension of "new value," unlike the analogous 10 day grace period of section 547(e). Id. at 389 n.92. Thus, in order for perfection during the preference period to have a "relation back" effect, the security agreement and the acquisition of "some" collateral had to precede, or be contemporaneous with, the advance. The 21 day period for relation back would then commence from the date of the advance. See infra note 85.

In light of the above, the statement in the text that the execution of the security agreement and the acquisition of "some" collateral may both take place after the advance is true only when no reliance is placed on the grace period in section 60(a)(7) because the financing statement was filed before the start of the preference period. Otherwise, the agreement must precede, or be simultaneous with, the advance.

\textsuperscript{68} See supra note 65.

\textsuperscript{69} In such a case, however, both the agreement and the acquisition of "some" collateral must have preceded the advance because of section 60(a)(7)'s "new value" limitation. See supra note 67.

\textsuperscript{70} DuBay, 417 F.2d at 1287.
of the financing statement took place prior to the preference period, the transfer was valid even if the debtor acquired no collateral until immediately before bankruptcy.\footnote{Note, however, that both the security agreement and the financing statement had to precede the preference period. Merely filing a financing statement in advance of the execution of a security agreement would not have been enough, since filing alone does not guarantee priority over lien creditors. At least one court had failed to recognize this fact. See In re Wilco Forest Mach., Inc., 491 F.2d 1041, 1046-47 (5th Cir. 1974).}

The point that was unclear was whether the twenty-one day grace period of section 60(a)(7) would have permitted a delayed filing with a "relation back" effect. Assume, for example, that on January 1, Secured Party (SP) and Debtor (D) executed a security agreement with SP advancing D $1,000 to be secured by after-acquired inventory. SP filed a financing statement on January 20. On January 30, D acquired a shipment of inventory. On May 15, D filed a voluntary petition in bankruptcy. Here, the filing occurred within the preference period but less than twenty-one days from the execution of the agreement and extension of value. Did section 60(a)(7) deem the transfer to have been made as of January 1, or did the transfer occur only on January 20? Note that January 30 was clearly not the time of transfer since perfection against lien creditors was attained at the latest by the date of filing.

No judicial opinion addressing this issue has been found. It appears likely, however, that the grace period of section 60(a)(7) would not have protected such a transfer. Although the DuBay court argued that the UCC definition of attachment was irrelevant for purposes of section 60(a)(2),\footnote{DuBay, 417 F.2d at 1287, 1289.} which defined "transfer" solely in terms of priority over lien creditors, section 60(a)(7) permitted relation back no earlier than the time the transfer was effective between the parties. The sufficient perfection theory did not attempt to redefine the point in time at which the agreement was enforceable between the parties. It merely assumed that, as long as the interest would not be subordinate to the rights of a subsequent lien creditor, enforceability between the parties (i.e., attachment) was unnecessary.\footnote{Id. at 1287-88.} For purposes of section 60(a)(7), however, which did speak of the transfer being effective, the failure of the debtor to acquire collateral until January 30 would have precluded relation back. Thus, had the financing statement been filed before the start of the preference period, the security interest would have been valid under section 60(a)(2) although no property was acquired until the preference period. If, however, the transfer was
unperfected against lien creditors as of the start of the preference period, the transfer would have been preferential, even if perfected within twenty-one days of the advance and the security agreement, since no transfer between the parties existed until the debtor acquired rights in collateral. Indeed, section 60(a)(7) would have been inapplicable even where the debtor did own inventory on January 1 but such inventory was sold and replaced by new shipments received on January 30. Since with regard to those specific shipments the transfer did not take effect between the parties until January 30, filing a financing statement within twenty-one days of January 1 would have been of no avail (except as to any property left over from the January stock). Essentially, while the Article 9 concept of attachment may have been irrelevant for purposes of section 60(a)(2), it was very much alive under section 60(a)(7). For that reason, the sufficient perfection theory, generally more solicitous to the secured party than its counterparts, imposed a restriction not required by those other analyses, namely, that the UCC financing statement be filed prior to the start of the preference period.

Section 9-108 of the UCC operates in much the same way as the DuBay analysis. As long as the acquisition was made in the ordinary course of the debtor’s business (which will invariably be the case for inventory and for accounts receivable generated from the sale of inventory), the transfer will be valid even though the debtor had no rights in collateral at the start of the preference period. However, section 9–108 required, as the DuBay theory did not, that the security agreement be for “new value.” This means that the agreement must have been executed prior to or contemporaneously with the extension of credit. If the agreement was executed subsequent to the extension

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74 I am assuming, for purposes of illustration, that each theory was exclusive. This is not necessarily the case. It was entirely possible to subscribe to the sufficient perfection theory and uphold security interests for which a filing was made before the preference period, even though no collateral was acquired until afterwards, but at the same time take the position that all accounts receivable and inventory were the changing components of a single mass. Under such a “composite” analysis, if “some” collateral was acquired prior to the preference period, the 21 day grace period of section 60(a)(7) would have then operated to shield even subsequent acquisitions as it did under the entity theory. Section 60(a)(7) would still have been unavailable where no collateral was acquired until after the start of the preference period. At least in that case, the sufficient perfection theory would clearly have necessitated an earlier filing.

75 See supra note 60.

76 As noted earlier, section 9-108 also protected security interests in acquisitions made pursuant to enabling loans. With regard to this prong of section 9-108, see Breitowitz, supra note 22, at 416-29.

77 Note that while the security agreement must be for “new value,” there was no such requirement for the security interest. Thus, although the security interest does not attach until the debtor’s later acquisition of collateral at a time when the debt is already antecedent, section
of credit although prior to the preference period, it was an agreement to secure antecedent debt rather than "new value," and section 9-108 was therefore inapplicable. It must be emphasized that even where the "new value" requirement of section 9-108 was not met, collateral acquired prior to the preference period was still subject to the security interest provided that the financing statement was filed prior to the start of the preference period. (In the absence of "new value," section 60(a)(7) would have been unavailable, by its terms, to permit delayed perfection.) Failure to comply with section 9-108 merely invalidated security interests in property that was acquired by the debtor during the preference period but had no effect on prepreference period acquisitions.

Moreover, a strong argument can be made that, as long as some collateral was acquired prior to the start of the preference period and the security interest in such collateral was perfected by the filing of a financing statement, section 9-108 would protect subsequent transfers even if the security agreement were executed subsequent to the advance. This is so because "new value" includes not only an extension of credit but also the release of a perfected security interest. It has already been pointed out that the release of a perfected security interest constitutes "new value" only when that security interest is itself valid in bankruptcy, i.e., not vulnerable to a preference challenge. See id. at 424-25. Obviously, a security interest may be valid in bankruptcy although the agreement was not executed for "new value"—e.g., the advance was made first but the agreement was executed and the financing statement filed prior to the preference period covering collateral already in existence. In that situation, although the security agreement was executed to secure antecedent debt, because it preceded the release of the perfected security interest, the "new value" prong had been satisfied. Accordingly, it may be possible under section 9-108 to convert security agreements for antecedent debt into those for "new value" by taking and perfecting a security interest in existing collateral which is later released. Nor would there be any timing problem. The fact that the release took place long before the subsequent acquisition is immaterial. Contrary to the assertion of some courts, see the discussion of Grain Merchants, supra note 52, section 9-108 is not based on a theory of substitution of collateral; as long as "new value" was present—whether in the form of an advance or release—all subsequent acquisitions were protected. See Breitowitz, supra note 22, at 423 n.181; see also supra note 77.

It must be pointed out, however, that the foregoing analysis rests on an uncertain premise. Where a security agreement was originally executed to secure an antecedent debt, it is far from certain that a later release of collateral will constitute "new value." It is entirely possible that section 9-108's reference to the release of a perfected security interest is limited to situations where a new security agreement is drawn up providing for the release of old collateral in exchange for new. The reference in section 9-108 to release of security interests may have no application to a security agreement containing an after-acquired property clause that was executed for an antecedent debt.

Even assuming that "bootstrapping" in the manner described would be possible, there are two qualifications. First, the financing statement must have been filed before the start of the preference period, since the lack of an initial "new value" trigger would have precluded the use of section 60(a)(7) for "relation back" purposes. If the required financing statement were filed during the preference period, the subsequent release of such a perfected security interest could not constitute "new value" because the released security interest was itself voidable in bankruptcy. See Breitowitz, supra note 22, at 424-25. Second, although the language of section 9-108 is not entirely clear, it is probable that security interests in after-acquired property are protected.
the preference period, section 9-108 was unique in requiring that the security agreement not only precede the preference period but precede the advance as well.

Section 9-108 does not clearly indicate when the security interest must be perfected since it speaks only of the giving of "new value" "which is to be secured in whole or in part by after-acquired property"—language which refers to nothing more than the existence of a security agreement. Read literally, section 9-108 could suggest that as long as "new value" was given pursuant to a security agreement, a security interest in after-acquired property is effectively insulated from a preference challenge even in the absence of perfection. This could hardly have been the intent of the drafters. In the first place, if the security interest was unperfected as of the petition date, the security interest would have been invalid not only under section 70(c) of the 1898 Act and section 544(a) of the BRA, but under the express terms of Article 9 as well. The fact that section 9-301 of the UCC subordinates the holder of an unperfected security interest to a trustee in bankruptcy necessarily means that the protection afforded by section 9-108 is limited to situations where a filing or some other form of perfection occurred at some point prior to bankruptcy. Moreover, section 60(a)(2) provided that even a transfer made contemporaneous only to the extent of the "new value" given. See id. at 423. If the collateral acquired prior to the preference period which becomes subject to the perfected security interest is less than the amount of the advance which preceded the security agreement, section 9-108 will protect subsequent acquisitions only for that lesser amount. This is to be contrasted with the entity theory which would have provided that, as long as there was a valid and perfected security interest in some collateral prior to the preference period, subsequent acquisitions in excess of that amount would also be protected.

In any case, both of the above limitations apply only where the security agreement was originally executed subsequent to the advance. Where the security agreement was executed prior to, or contemporaneously with, the advance, I have already argued that perfection may take place well within the preference period and that section 9-108 will uphold the security interest to the full extent of the debt. See id. at 423 n.181; see also infra text accompanying notes 79-87 (when security interests must be perfected under section 9-108).

79 Section 9-301(1)(b) subordinates the holder of an unperfected security interest to a lien creditor, and section 9-301(3) defines a "lien creditor" to include a "trustee in bankruptcy from the date of the filing of the petition." Under the 1962 version of Article 9, the lien creditor prevailed only if he did not have knowledge of the security interest at the time he acquired the lien. Section 9-301(3) provided, however, that a trustee in bankruptcy could assert the status of a lien creditor without knowledge regardless of his personal knowledge of the security interest. But see In re Coed Shop, Inc., 435 F. Supp. 472, 475 & n.1 (N.D. Fla. 1977) (UCC knowledge requirement could not affect trustee's hypothetical lien creditor status under section 70(c)), aff'd, 567 F.2d 1367 (5th Cir. 1978). Under the 1972 version of Article 9, the trustee prevails even in that case.

In view of section 70(c) of the 1898 Act and section 544(a) of the BRA, which already give the trustee in bankruptcy lien creditor status, the definition in section 9-301(3) is, in all probability, redundant.
ously with an extension of credit was not deemed made until perfected against a lien creditor.\textsuperscript{80} The UCC does not purport to change that result, even if it could. It is inconceivable that section 9-108 was designed to protect after-acquired property under circumstances where property in existence at the time of the agreement and extension of credit would not similarly have been protected due to a delayed filing and the operation of section 60(a)(2).

A more logical interpretation of section 9-108 is one that would place a security interest in after-acquired property on an equal, but not superior, footing with an interest in property in existence at the time value was extended. Section 9-108 provides that where the secured party gives "new value," the "security interest" in after-acquired property is deemed to be taken for such "new value," rather than for antecedent debt. I would suggest that the term "security interest" refers to the existence of an interest which is enforceable between the parties—i.e., a security interest which has attached but has not yet been perfected. Since section 9-108 is operative only where the security agreement precedes or is contemporaneous with the giving of value and where the property was acquired after the giving of that value, the final stage of attachment will always occur upon the debtor's acquisition of rights in the collateral.\textsuperscript{81} Thus, the intended

\textsuperscript{80} Even if one assumes that section 60(a)(7) would have permitted delayed perfection for up to 21 days after attachment, it is still true that if the security interest is perfected on day 22, it is deemed made on day 22.

\textsuperscript{81} Given the fact that section 9-108 deems the creation of the security interest, i.e., its attachment rather than its perfection, to be for "new value," as long as its conditions are met, it is obvious that section 9-108 is applicable only if at least one element of attachment occurred during the preference period, thereby effecting a transfer that would otherwise be on account of antecedent debt. This means, first of all, that section 9-108 has no application where all three conditions of attachment occurred prior to the start of the preference period since the transfer would then have been outside of the purview of section 60 even without deeming it to be made for "new value." If perfection is then delayed into the preference period, protection must be derived from section 60(a)(7) of the 1898 Act or section 547(e) of the BRA, not section 9-108 of the UCC. See infra text accompanying note 82. Second, section 9-108 of the UCC will invariably be triggered only if the acquisition of collateral is that final step of attachment. This is clearly the case where the advance preceded the preference period. In such a case, section 9-108 applies only if the agreement were also executed prior to the preference period since the agreement must precede the advance. By process of elimination, that leaves only the acquisition of collateral as the necessary step of attachment which must occur during the preference period before section 9-108 of the UCC can become operative.

Where the advance was made during the preference period, section 9-108 in theory could apply even where the acquisition preceded the agreement or advance, as long as the agreement preceded the advance, in which case the advance would be the final stage of attachment. Under these circumstances, however, reliance on section 9-108 of the UCC is totally unnecessary. The security interest in the acquisition is valid not because section 9-108 statutorily deems it to be taken for "new value" but because in fact it was. Of course, section 9-108 would also apply to protect subsequent acquisitions, but that is precisely because the acquisition of that collateral is the final step of attachment for that particular item.
effect of section 9-108 is to statutorily move forward the giving of "new value" to the time the property was acquired by the debtor, thereby insuring that the creation of the security interest, i.e., its attachment, is not on account of an antecedent debt. This alone, however, does not mean that the transfer will necessarily be valid in bankruptcy. The mere fact that the creation of a security interest was contemporaneous with the extension of credit will not validate the transfer, if the transfer is deemed made at a later point in time than its creation. Section 9-108 does not purport to define when a transfer is deemed made; the issue was determined solely by reference to section 60 of the 1898 Act which dated transfers from their perfection, not attachment, subject to the twenty-one day grace period. Thus, rather than simply validating all security interests in collateral acquired in the ordinary course of business during the preference period, section 9-108 insulated such interests only if, under the terms of the 1898 Act, the transfers were deemed made as soon as the debtor acquired rights in the collateral.

Under this analysis, section 9-108 would have necessitated that the financing statement be filed either prior to the debtor's acquisition of the collateral or within twenty-one days thereafter (assuming section 60(a)(7) was available for the typical Article 9 interest). One can readily see that section 9-108 was unique in the broad protection it provided to secured parties. Not only was there no need for any collateral to exist prior to the preference period (as was also true of the DuBay theory), but the secured party also received the benefit of the twenty-one day grace period of section 60(a)(7). While the entity and substitution theories also permitted a twenty-one day grace period for perfection, the protection of section 60(a)(7) was limited to cases only where the advance was made within twenty-one days of the

Thus, in all cases, section 9–108 is both necessary and effective only: (1) if the acquisition of the property in question was the final stage in the attachment of the security interest in that collateral, i.e., the agreement and the value requirements have already been met; and (2) that acquisition occurs during the preference period.

82 The collateral referred to in the text means the collateral that was acquired during the preference period, the security interest on which would be voidable in the absence of section 9–108. The theory of validation based on section 9–108 does not require the filing of a financing statement within 21 days of the acquisition of the original collateral or that the filing be prior to the preference period, nor does it even require that such collateral exist at the time of the agreement.

83 Section 60(a)(7) arguably allowed relation back only where state law independently provided some sort of grace period. See Breitowitz, supra note 22, at 389–91.

84 An exception to the statement in the text involves situations where the "new value" consists of the release of a perfected security interest rather than an extension of credit. In such a case, the debtor must have rights in "some" collateral and the secured party must have filed a financing statement before the start of the preference period. See supra note 78.
filing. Where the advance was made prior to the start of the preference period, in no case would 60(a)(7) permit perfection more than twenty-one days after the start of that period. For the purposes of section 9-108, however, the twenty-one day grace period was measured from the latest acquisition of collateral (since the resulting security interest in that acquisition was deemed taken for "new value"), thereby permitting perfection well beyond twenty-one days from the start of the preference period and, indeed, in some cases, literally on the eve of bankruptcy.

(ii) Advances Made After the Start of the Preference Period

The foregoing discussion dealt with a situation where value was first extended prior to the preference period. If value was first ex-

65 Moreover, because of section 60(a) (7)'s "new value" requirement and because neither the entity nor the relaxed substitution theory deems subsequent acquisitions to be made for "new value," perfection within 21 days of attachment sufficed only if both the acquisition of "some" collateral and the execution of the agreement preceded the advance. Section 60(a) (7) would not protect any acquisition arising after the date of the advance even prior to the start of the preference period. See supra notes 67-68. (The theories diverge, however, on the question of whether the acquisition of "some" collateral prior to the advance, which was therefore covered by section 60(a) (7), would shield subsequent acquisitions of a greater value.)

The above limitation is not true with respect to UCC § 9-108.

66 "Latest" means the actual collateral that is in existence at the time the petition in bankruptcy is filed, although acquired during the preference period. Where that collateral was itself acquired at various times, the secured party under section 9-108 will be entitled to all the collateral existing at bankruptcy only if he filed a financing statement within 21 days of the acquisition of the first item in the group. The term "latest" is thus something of a misnomer but was intended to exclude the need to file against collateral in existence prior to the preference period, as was the case for the entity and substitution theories.

67 Although both section 9-108 of the UCC and section 60(a)(7) of the 1898 Act have a "new value" trigger, the trigger was not identical. Under section 9-108, the "new value" requirement means only that the security agreement must be executed prior to, or contemporaneously with, the advance in which case subsequent acquisitions are protected even though they are on account of an antecedent debt. See supra note 77. By contrast, section 60(a)(7) necessitated that the acquisition of the collateral be for "new value" before delayed perfection could have a "relation back" effect. See Breitowitz, supra note 22, at 389 n.92. Nevertheless, assuming for purposes of argument the validity of section 9-108, see supra note 31, whenever its "new value" requirement was met, the "new value" trigger of section 60(a)(7) would also be satisfied since, by the very terms of section 9-108, subsequent acquisitions are statutorily deemed to be made for "new value." Thus, security interests covered by 9-108 of the UCC would always be able to take advantage of section 60(a)(7) although no acquisition preceded the extension of value.

68 Thus, if five months before the petition Secured Party (SP) and Debtor (D) execute a security agreement for new value and an advance is made (whether within the preference period or beforehand), even if D first acquires collateral one month before bankruptcy, SP may file a financing statement within 21 days of that acquisition. Cf. supra note 78 (where "new value" trigger was the release of a perfected security interest rather than an advance).

Note that, even under section 9-108, if bankruptcy intervened prior to the expiration of the 21 days, postpetition perfection would have been unavailable because of section 70(c). See Breitowitz, supra note 22, at 392-93 (dealing with postpetition perfection under the BRA, but the same analysis holds true under the 1898 Act).
tended during the preference period, the analysis is fundamentally the same, although the timing requirements are somewhat different.\textsuperscript{89}

Under both the entity and substitution theories, the security agreement must have been executed prior to, or contemporaneously with, the advance (although the agreement may have been executed within the preference period). The debtor must also have had rights in "some" collateral prior to the advance\textsuperscript{90} (though the property may have been initially acquired during the preference period). Where the advance was made during the preference period, it was essential that the advance be the final stage in the attachment; if any stage in attachment occurred subsequent to the advance, the resulting transfer would have been on account of antecedent debt. If, however, the debtor did have rights in "some" collateral and the agreement was executed prior to the advance, so that the security interest attached contemporaneously with the extension of value, perfection could be delayed for up to twenty-one days after the advance. Under section 60(a)(7), the initial transfer would have been deemed made as of the date of the original advance (and would therefore be valid as a contemporaneous exchange), and subsequent acquisition of new collateral would have been treated either as part of that original entity or as transfers in valid substitution.\textsuperscript{91}

The DuBay theory also required that the security agreement precede the advance. If the secured party filed a financing statement prior to the advance, the security interest in a later acquisition was protected as a contemporaneous exchange of value, even though no collateral was owned by the debtor when the advance was made. Perfection over lien creditors was achieved in such a case as of the date of the advance. As noted earlier,\textsuperscript{92} filing within twenty-one days of the advance would be ineffective to protect after-acquired property since, in the absence of any collateral, the advance would not effect an attachment to which subsequent perfection could relate back. Filing within twenty-one days of the advance would, however, be effective with regard to collateral that already belonged to the debtor when the advance was made.\textsuperscript{93}

\textsuperscript{89} See supra note 64. Similarly, property acquired subsequent to the filing of the petition would not have been subject to a prepetition security interest even where the requirements of section 9-108 of the UCC have been met.

\textsuperscript{90} See supra note 65.

\textsuperscript{91} But see infra text accompanying notes 95–102 (whether the secured party is limited to the value of those acquisitions which preceded the advance or may he improve his position).

\textsuperscript{92} See supra text accompanying notes 71–74.

\textsuperscript{93} To the extent the divergent theories are not mutually exclusive, see supra note 74, if the debtor did own "some" collateral prior to the advance, and the secured party perfected his
Section 9-108 is similar to the sufficient perfection theory of DuBay. The agreement had to precede the advance (because of the “new value” requirement), and it was unnecessary for the debtor to own any collateral prior to the advance being made. The secured party would, however, have been able to file a financing statement within twenty-one days of a given subsequent acquisition and still be protected, since even subsequent acquisitions were treated as being for “new value.”

c. Assuming the Above Necessary Conditions Had Been Met, to What Extent Was the Security Interest Protected?

All four theories were designed to uphold security interests in collateral acquired by the debtor during the preference period. As noted above, each theory had its own requirements as to when certain necessary steps had to be taken. Yet, even when a particular theory was operative, the extent of its protection was not necessarily the same as that afforded by its counterparts. Specifically, the theories appeared to differ as to the extent a secured party could improve his position during the preference period.

Under section 9-108 and the sufficient perfection theory of DuBay, there was no requirement that the debtor own any collateral either prior to the preference period or prior to the advance. Improvements of position were thus clearly permitted. While section 9-108 required that such improvements arise in the ordinary course of the debtor’s business, the DuBay analysis apparently permitted even gains arising out of manipulative or extraordinary conduct, e.g., a debtor acting under pressure from his creditor sells business equipment on credit to artificially swell the volume of outstanding accounts receivable.

Under the entity theory, “some” collateral had to be owned by the debtor, either prior to the preference period or prior to the ad-

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interest in that collateral within 21 days after the advance, even subsequent acquisitions may be protected, just as they were under the entity and substitution theories.

94 Indeed, the agreement had to precede the advance even where the advance was made prior to the preference period, a requirement existing under no other theory (at least where no reliance was placed on section 60(a) (7), see supra notes 67 & 68). But where the advance was first made during the preference period, the possibilities of “bootstrapping” a security agreement for antecedent debt into one for “new value,” through the release of a perfected security interest, did not exist, since the first security interest would itself not be valid in bankruptcy. See supra note 78.

95 As noted earlier, however, the sufficient perfection theory will protect the creditor under these circumstances only if the financing statement was filed either prior to the preference period or prior to the advance. See supra notes 71-74.
vance. The secured party, however, was not limited to the value of that property. If, for example, prior to the preference period the debtor’s inventory was worth only $1,000 but, by the petition date, new inventory had been delivered to the debtor with a value of $10,000, the secured party would have apparently received the benefit of the entire $10,000. The entity theory also permitted improvements of position, though not to the same extent as section 9-108 and the sufficient perfection theory.

The relaxed substitution analysis was the only approach that clearly precluded any improvement of position arising subsequent to an advance and during the preference period. If collateral was acquired during the preference period at a time when the debt was already antecedent, the resulting security interest was valid only to the extent it was deemed to be in substitution of a previous nonavoidable transfer. While courts adopting this theory dispensed with the traditional notion of timing, i.e., that the release of old collateral to the debtor must occur contemporaneously with the acquisition of new collateral, and had protected new transfers even where the previous equivalent value had already been released, it was still true that the value of the substituted collateral arising during the preference period to secure an antecedent debt could not exceed the value of the collateral it replaced.

In Grain Merchants the principal case relying on “relaxed substitution,” the value of the accounts receivable as of the start of the preference period exceeded the amount of the debt. Thus, the creditor was already fully secured prior to the preference period. Even if at some point during the preference period the creditor would have become partially unsecured, the court concluded that the subsequent increase in accounts receivable could be regarded as a substitution for those which existed previously, restoring the secured party to the position he had occupied before the start of the preference period.

Yet the precise parameters of “relaxed substitution” have never been fully explored, perhaps because of the enactment of the BRA. While it was reasonably clear that a net improvement of position during the preference period (not contemporaneous with an advance) would have been invalid, it was not entirely clear what the appropriate freezing point should be. In other words, “the cases relying on

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96 This would be true whether or not the new acquisitions were made in the ordinary course of the debtor’s business.
98 Id.
relaxed substitution” established that the secured party could not be better off than he was at some time prior to the preference period, but provided no guidance on the exact point in time after which subsequent improvements would be foreclosed. 

Several alternatives were possible: (1) the secured party was entitled to the value of his collateral as of the start of the preference period; (2) the secured party was entitled to the value of his collateral at the time the advance was made; (3) the secured party was entitled to the highest value of his collateral at either one of those two points; and (4) the secured party was entitled to the highest value of his collateral at any time between those two points.

An example will illustrate the problem. Assume on January 1, Secured Party (SP) and Debtor (D) execute a security agreement granting SP a security interest in all of D’s currently owned and after-acquired accounts receivable. Under the terms of the agreement, D has the unfettered right to collect the accounts receivable and utilize the proceeds in the operation of his business, unless there is a default. SP makes an advance of $100,000 on January 1 and files the proper financing statement on the same day. At the time of the advance, the value of D’s accounts is $60,000. Over the course of a month, those accounts receivable are liquidated. By February 1, new accounts receivable have arisen with a value of $100,000. By March 1, through collection and writeoff, the value of the outstanding accounts receivable declined to $50,000. During the next four months, the value of the accounts receivable continually fluctuate. By the time D files for bankruptcy on July 2, SP again is fully secured. Assuming the level of the debt remained $100,000, how much collateral can SP claim in bankruptcy?

Under section 9-108, the entity theory and the sufficient perfection theory, SP would clearly get the benefit of the entire $100,000. Would SP have similarly prevailed under the substitution theory?

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99 Where the advance was made during the preference period, the appropriate cutoff point for limiting subsequent improvements would appear to be the value of the collateral at the time of the advance. But see infra text accompanying notes 222-43 (discussing section 547(c)(5)). Therefore, the question of the appropriate freezing point raised in the text is limited to cases where an advance was made prior to the start of the preference period.

100 This was in fact the test that Congress chose to adopt in section 547(c)(5). It is argued below that this test is overly restrictive to the secured creditor and is not fully consistent with the theory of substitution. See infra text accompanying notes 244-49.

101 The theory here would be one of not penalizing a creditor because of the changing nature of his collateral and would accord to the creditor the value against which he made the original loan. See infra text accompanying notes 235-41.

102 Under section 9-108, the security interest would have been valid even if no financing statement was filed until 21 days after the acquisition of the most recent batch of accounts.
A first reading of Grain Merchants may suggest that SP would not. In upholding the security interest in that case, the court emphasized that the creditor was fully secured as of the start of the preference period. In the example posed, the collateral was worth only $50,000 as of the start of that period and hence SP should be denied the benefit of any increase above that figure. Yet, further reflection indicates that such a conclusion is inconsistent with the logic and mechanics of substitution.

If the collateral was worth $100,000 as of the start of the preference period, had declined to $50,000, and then with the addition of new accounts receivable had increased to $100,000 again, under Grain Merchants the creditor would clearly get the benefit of that final increase on the theory that the increase to $100,000 during the preference period is in substitution of a previously existing equivalent value, although there may have been intervening fluctuations. If fluctuations that occur after March 1 do not prevent subsequent increases from being regarded as substitutions, why should a pre-March fluctuation have that effect? Once the notion of timing is abandoned, to the same extent that the $100,000 of accounts receivable arising in June (during the preference period) could be regarded as substitutions for the $100,000 of accounts receivable which were liquidated in March (but in existence in February), may they not equally be regarded as substitutions for accounts receivable which were liquidated in February or earlier, i.e., at some point prior to the start of the preference period?

Essentially, the fourth alternative appears to be the most reasonable or, at least, the most faithful to its underlying theory. As long as at some point in time SP was fully secured by a nonvoidable transfer, all subsequent acquisitions would be valid substitutions, even if at the start of the preference period SP was already undersecured. Con-

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103 Grain Merchants, 408 F.2d at 213.
versely, if $SP$ was undersecured throughout the term of the loan, but became fully secured immediately before the preference period, then the start of the preference period should be the appropriate point in time for measuring the validity of further improvements. In both cases, fluctuations during and prior to the preference period would have been ignored; $SP$ would get the benefit of the highest value of his security at any point between the advance and the start of the preference period.\textsuperscript{104}

\textsuperscript{104} There is one qualification to this statement. If the financing statement was filed prior to the start of the preference period, then, as the text states, the secured party should clearly get the highest value of his collateral at any point during the preference period. However, where reliance was being placed on section 60(a)(7) to permit delayed perfection during the preference period to relate back, this would not necessarily be the case.

First, where the advance was made more than 21 days before the start of the preference period and the secured party perfected during the preference period, the secured party would have been deemed unsecured notwithstanding the fact that, prior to the start of the preference period, the value of the collateral exceeded the amount of the debt. This is obviously the case with respect to the value of accounts and inventory items acquired by the debtor prior to the making of the advance since the interest in those items would not have been valid in bankruptcy (because perfection occurred more than 21 days after attachment) and could not therefore be the basis of a substitution. Even with respect to collateral acquired by the debtor subsequent to the advance and within 21 days preceding the filing, to the extent the items were acquired after the advance, they do not represent contemporaneous exchanges for "new value" and hence are unprotected by section 60(a)(7). See supra notes 67-68.

Second, where the advance was made within 21 days preceding the preference period filing, the secured party would still be unable to utilize the value of all collateral acquired prior to the start of the preference period but would be limited to the value of these items acquired by the debtor prior to, or contemporaneously with, the extension of credit. Items acquired by the debtor subsequent to the extension of credit are unprotected by section 60(a)(7) because of its "new value" trigger. The same is true under the narrowest reading of Grain Merchants which would limit the secured party to the value of the collateral as it existed at the start of the preference period. The accounts receivable in existence at the start of the preference period were not all generated at the same time and the secured party will be guaranteed the value of those accounts only: (1) if they were acquired before the advance; and (2) the secured party perfects within 21 days of the advance. Of course, filing before the preference period eliminates all of these difficulties but this is hindsight advice. How soon a debtor will descend into bankruptcy is not always ascertainable.

These problems do not exist under the entity theory. As long as there was a nonavoidable security interest on collateral of any amount, subsequent acquisitions in excess of that amount were protected. Thus, assuming some collateral of any amount was in existence at the time of the advance (thus meeting section 60(a)(7)'s "new value" trigger). Perfection within 21 days of the advance would permit the secured party to improve his position. Even under the entity theory, however, section 60(a)(7) would be unavailing if the advance was made more than 21 days before filing even with respect to collateral acquired within 21 days. Nor did these problems arise under the sufficient perfection theory, since that theory would not permit delayed perfection within the preference period. All these theories, however, may be nonexclusive, allowing the secured party to derive the maximum benefit from any given theory. See supra text accompanying note 74.

A similar problem does arise, however, in connection with section 9-108 where the collateral consists of an aggregate of units acquired at different times and where the secured party seeks to perfect within 21 days of attachment. See supra note 81. There, the problem is not one of
Viewed in this light, "relaxed substitution" was almost a mirror image of the traditional substitution doctrine it sought to replace. While the strict timing requirements of the traditional doctrine would have limited the holder of a floating lien to the lowest value of his collateral at any time during the preference period, dispensing with those timing requirements would have given the secured party the benefit of the highest value of his collateral at any time prior to the start of the preference period.\(^{105}\) A time consuming and expensive inquiry into day-to-day fluctuations would have been necessary under either test and may partially explain why Congress opted for yet a third test.

4. Summary

In completing this somewhat exhaustive review of the various problems floating liens created under the 1898 Act, it may be helpful to express my conclusions in graphic form. Such a graph is set forth in Figure 1.

C. The Present Law

The remainder of this section will discuss the major changes which the BRA makes with respect to the treatment of security interests in inventory and accounts receivable. After discussing the basic framework of section 547(c)(5) and its relationship with prior judicial theories, this Article will briefly analyze three specific problem areas: (1) the failure of section 547(c)(5) to provide any protection for security interests in collateral other than inventory and accounts receivable; (2) the inadequacies of the two-point test with suggestions for statutory revision; and (3) the special problems of appreciation value arising from the conversion of raw materials into finished products, or from the ripening of contract rights\(^{108}\) into accounts receivable.

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improvement of position, which section 9-108 permits, but simply of measuring the 21 day grace period for purposes of deeming the transfer made as soon as the collateral is acquired. The secured party would not be entitled to all the collateral in existence on the date of bankruptcy, but only the value of those items acquired within 21 days preceding the filing or acquired afterwards.

\(^{105}\) Under either standard, improvements of position during the preference period, however measured, were voidable only if they arose from new acquisitions in substitution of the old accounts receivable or inventory that were liquidated. If the old collateral in the possession of the debtor prior to the start of the preference period simply appreciated in value due to a rise in market price, such appreciation was clearly not voidable because no transfer within the preference period could be said to occur. See infra text accompanying notes 323-94.

\(^{108}\) The term "contract rights" is borrowed from the 1962 Official Text of Article 9 where it is defined as a "right to payment under a contract not yet earned by performance and not
<table>
<thead>
<tr>
<th>ISSUE</th>
<th>THEORY</th>
<th>ENTITY</th>
<th>SUBSTITUTION</th>
<th>SUFFICIENT PERFECTION</th>
<th>UCC § 9-108</th>
</tr>
</thead>
<tbody>
<tr>
<td>Which property is protected?</td>
<td></td>
<td>Inventory and Receivables.</td>
<td>All types of property.</td>
<td>All types of property.</td>
<td>All types of property if acquired in the ordinary course of business.</td>
</tr>
<tr>
<td>When must a security agreement be executed?</td>
<td>Prior to preference period or prior to advance (if later).</td>
<td>Prior to preference period or prior to advance (if later).</td>
<td>Prior to preference period or prior to advance (if later).</td>
<td>Prior to advance in all cases.</td>
<td></td>
</tr>
<tr>
<td>When must debtor acquire rights in collateral?</td>
<td>Must acquire rights in &quot;some&quot; collateral prior to the start of the preference period or the making of the advance (if later).</td>
<td>Must acquire rights in &quot;some&quot; collateral prior to the start of the preference period or the making of the advance (if later).</td>
<td>May acquire collateral at any time.</td>
<td>May acquire collateral at any time.</td>
<td></td>
</tr>
<tr>
<td>When must financing statement be filed?</td>
<td>a. Advance Made Prior to Preference Period: Either before preference period or within 21 days after attachment (if attachment occurred before the preference period). b. Advance Made After Preference Period: Within 21 days after the advance.</td>
<td>a. Advance Made Prior to Preference Period: Either before preference period or within 21 days after attachment (if attachment occurred before the preference period). b. Advance Made After Preference Period: Within 21 days after the advance.</td>
<td>Prior to preference period or prior to advance (if later).</td>
<td>Within 21 days after the acquisition of collateral in existence at the time of bankruptcy.</td>
<td></td>
</tr>
<tr>
<td>Does the secured party get the benefit of improvements of position?</td>
<td>Yes, but only if &quot;some&quot; collateral was subject to a valid security interest at the start of the preference period or the making of the advance (if later).</td>
<td>No, but whether freezing date is the start of the preference period or highest value of the collateral at any time prior to preference period is unclear.</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
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</tbody>
</table>

a. See supra note 65.
b. Perfection after the start of the preference period for up to 21 days after attachment would have sufficed, however, only where both the agreement and the acquisition of "some" collateral preceded the advance so that the security interest attached for "new value." See supra note 66. The chart also assumes that section 60(a)(7) permitted delayed perfection for every Article 9 security interest. See Breitowitz, supra note 22, at 389-91; infra note d in Figure 1.
c. Where an advance was made during the preference period, it was essential to the validity of the resulting security interest that the agreement already have been executed and that the debtor have rights in "some" collateral so that the security interest arose contemporaneously with the extension of value. Assuming those conditions to have been met, perfection within 21 days of the advance would have had the necessary effect of deeming the transfer made as of the date of the advance, precluding its avoidance as a preference.
d. See supra Figure 1, note b. Although it normally makes no difference for the purposes of the "substitution" theory whether the agreement and acquisition of collateral precede the advance or not, where perfection occurred within the preference period in reliance on section 60(a)(7), it was essential that (1) the extension of value be the final stage in attachment, and (2) the Article 9 filing occurred within 21 days of that event. Note, however, that while, under the entity theory, compliance with this sequence would violate subsequent acquisitions up to any amount, "substitution" theory would limit the protected value to that in existence on the date of advance (where the filing was made in reliance on section 60(a)(7)) not only to that extent, did the secured party have a nonvoidable security interest prior to the start of the preference period. See supra note 104; infra Figure 1, note b.
e. See supra notes 99 & Figure 1, note b. Where the advance was made after the start of the preference period, subsequent acquisitions of collateral were protected during the preference period only to the extent they did not exceed the value of collateral subject to that interest on the day of the advance—a qualification which did not apply to the entity theory.
f. See supra text accompanying notes 71-72. This limitation clearly applied only if no collateral was acquired prior to the preference period or advance (if later). Where some collateral was acquired, section 60(a)(7) would have permitted perfection within the preference period to validate the interest in the preexisting collateral, but the validity of the interest in that circumstance would have had nothing to do with Dubay's construction of section 60(a)(2). But see supra note 70.
g. See supra note 87.
h. In no case, however, could the secured party receive more than the extent of his nonvoidable interest in existence prior to the start of the preference period or date of the advance (if later). If an Article 9 filing was made prior to the start of the preference period, conceivably the secured party could have received the highest value of the collateral at any time prior to the preference period if the filing was made during the preference period in reliance on section 60(a)(7), at most the secured party could receive the highest value of the collateral in existence at some point prior to the making of the advance and could not take any acquisitions made subsequent to the advance even if made prior to the preference period. See supra note 104. Similarly, where the advance was first made during the preference period, the secured party would clearly be limited to the value of the collateral in existence on the date of the advance whether the filing preceded the advance or was made within 21 days afterwards. See supra note 99.
1. The General Operation of Section 547(c)(5)

When the Gilmore Committee began its work in 1966,107 one of its main goals was the protection of the floating lien on inventory and accounts receivable. Yet, as the courts invariably upheld these security interests, the real danger that emerged was that secured parties with a security interest in after-acquired property would leave nothing for general creditors. The Committee was especially concerned with the far-reaching implications of DuBay, which allowed secured creditors to drastically improve their positions in the weeks immediately before bankruptcy to the detriment of the estate. Indeed, under the Ninth Circuit interpretation of section 60(a)(2), there was not even an implied limitation that the improvement or acquisition be made in the ordinary course of business.108 As Professor Gilmore colorfully stated: "[A]t this point in time, the secured creditor bar (if there is such a thing) is basking happily in the warm glow of Judge Hufstedtluer's opinion in DuBay and, we may assume, has lost any interest it may once have had in reform of the Bankruptcy Act."109

The recommendations of the Gilmore Committee were, for the most part, accepted by the Commission on the Bankruptcy Laws of the United States,110 and found their way into section 547(c)(5) of the BRA. Section 547 clearly rejects the DuBay notion that the time of transfer is dependent solely on perfection, i.e., achieving priority over lien creditors. Section 547(e)(3) states that: "[A] transfer is not made until the debtor has acquired rights in the property transferred."111 Similarly, section 547(e)(2) provides that a transfer is made either at the time it takes effect between the parties, if perfected then, or within ten days thereafter, or at the time of perfection if perfected after ten days from the transfer taking effect between the parties.

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107 The work of the Gilmore Committee is described in Breitowitz, supra note 22, at 359 n.7.
108 Cf. U.C.C. § 9–108 (1972) (where the limitation stipulated is that the collateral either be acquired in the ordinary course of business or "under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.").
When a transfer takes effect between the parties is apparently dependent on state law. In this case Article 9's concept of attachment—which requires the debtor to have rights in the collateral—establishes that time. Thus, even disregarding section 546(e)(3) and assuming, as the Ninth Circuit did, that the security interest was perfected from the time a financing statement was filed, section 547(e)(2)(A) would nevertheless delay the transfer to the time it "takes effect." The section adopts as a baseline the notion that a security interest in after-acquired property may indeed be subject to a preference challenge even though covered by a financing statement that was filed well before the start of the preference period.

The possibilities of the undercollateralized Article 9 claimant diverting after-acquired assets from the bankrupt's estate solely by virtue of an earlier filing have been effectively eliminated. At the same time, however, section 547(c)(5) does seek to accommodate the interests of secured creditors as well. It provides as follows:

The trustee may not avoid under this section [547] 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 interests 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. . . .

In other words, a security interest in accounts receivable or inventory acquired by the debtor during the preference period is voidable only to the extent to which there has been an improvement of position at the expense of the estate during that period.\footnote{Unlike section 60(a) of the Bankruptcy Act, which provided that a transfer was deemed made when it was perfected, section 547(e)(2) of the BRA states that perfection controls only if it occurs after 10 days from the transfer. Consequently, an interest that was perfected in the D
dBay sense, prior to a transfer would still be governed by section 547(e)(2)(A) which sets up a "tak[ing] effect between the [parties]" test.}

\footnote{The significance of this additional phrase, which did not appear in the 1898 Act, will be explained in due course. See infra text accompanying notes 339-94.}
ment of position is measured by the difference between the debt and the security at each of two points. If the advance was made prior to the preference period, one compares the debt-security difference on the ninetieth day before bankruptcy with the debt-security difference on the petition date. If the latter figure is the same or greater—i.e., the value of the collateral is the same or has decreased—the security interest is valid, even if the accounts receivable or inventory items comprising the collateral as of the commencement of the case were first acquired during the preference period on account of antecedent debt. If the debt-security differential has decreased—i.e., the value of the collateral has increased\textsuperscript{114}—the security interest, to the extent of the increase, is voidable.\textsuperscript{115} If the advance was first made during the

\textsuperscript{114} In a single loan transaction, the loan-security differential will automatically be reduced through an increase in the value of the collateral, either through the acquisition of new items or through the appreciation of existing collateral. As to the latter, see infra text accompanying notes 323–94. This will not necessarily be the case, however, where additional advances are later made pursuant to a clause in the security agreement providing for future advances. In that case, as long as the value of the collateral does not appreciate in excess of the amount of the additional advances, the necessary differential has been maintained, and the security interest covering both advances will be valid.

Although increase in the value of the collateral is the most common way that the debt-security differential will be reduced during the preference period, such reduction may also occur through payment, to the extent that payments on partially secured claims are allocated to the unsecured portion of the debt. Assume, for example, that 90 days before bankruptcy, a debt of $1,000 is secured by $500 of collateral. During the preference period, the debtor makes payments totaling $100. Although the value of the collateral remained constant, the debt-security differential was reduced from $500 to $400 because the debt was reduced from $1,000 to $900. This situation, however, is not governed by section 547(c)(5) which is limited to cases where the reduction in deficiency occurred as a result of a transfer of collateral. Rather than avoiding the security interest to the extent of $100, the trustee could recover the payments directly under section 547. Indeed, the trustee can do so even if the collateral is of a type not covered by section 547(c)(5), e.g., equipment. (Of course, to the extent the $100 payment is allocated to the secured portion of the debt, no preference issue arises since the net result of the transfer gives the secured party no more than he would have received had the transfer not been made. See Barash v. Public Fin. Corp., 658 F.2d 504, 508 (7th Cir. 1981); Breitowitz, supra note 22, at 366 n.37.)

Because section 547(c)(5) does not condemn all reductions of deficiency but merely those resulting from transfers of collateral, partial forgiveness of a loan would have no effect on the validity of a security interest securing payment of the remainder. Assume, for example, that 90 days before bankruptcy, the debt is $1,000 and the collateral is worth $500. The secured party then forgives $100 of the unsecured portion of the debt. Although the debt-security differential as of the petition date has been reduced by $100, the secured party would nevertheless be able to realize on the full amount of his security.

\textsuperscript{115} The BRA does not specifically provide who has the burden of proving the existence or nonexistence of an improvement of position. In many cases, it may be extremely difficult to determine the value of accounts receivable and inventory as of the 90th day before bankruptcy due to inadequate recordkeeping. Thus, allocation of the burden of proof will often be decisive. Presumably, the burden would be on the trustee as part of his case. This was explicit in the Commission Report, supra note 110, § 4–607(d)(2), and there is nothing in section 547 that would lead to a contrary result.
preference period, a similar calculation is made, except that the appropriate starting point for comparison is the date of the advance. In any case, the creditor is guaranteed the value of his collateral as of the later of the advance or the start of the preference period.

Insofar as section 547(c)(5) precludes improvement of position, its basic theory appears to be one of substitution of collateral—the notion that if a creditor gives back or releases the same value that is taken out, the resulting transfer lacks preferential effect.\textsuperscript{110} Thus, if at the start of the preference period, the secured party has a security interest in accounts receivable valued at $1,000, but then permits the debtor to liquidate these accounts receivable without applying the proceeds to the satisfaction of the debt (i.e., the $1,000 of collections are presumably made available to all creditors of the estate), then to grant the secured party a security interest in $1,000 of new accounts receivable that had arisen during the preference period does not deprive general creditors of assets that would otherwise have been available. While the traditional substitution theory required the release of old collateral to be contemporaneous or subsequent to the acquisition

The Gilmore draft, however, placed the burden of showing a lack of improvement of position on the transferee, apparently in recognition of the difficulties the trustee would have in determining valuation. House Report, supra note 108, at 215–16, reprinted in 1978 U.S. Code Cong. & Ad. News at 6175–76. Even under the Gilmore proposal, the burden of establishing all the other elements of a preference remained with the trustee. Specifically, the trustee would have to show that the specific amount or inventory item was acquired by the debtor during the preference period. Id. The trustee would also have to show that the transfer has a preferential effect, i.e., that the value of the security at bankruptcy was greater than it had been at some time within the preference period, so that unsecured creditors were deprived of otherwise available assets. Id. Only after establishing the existence of a preferential transfer within the preference period could the trustee require the transferee to come forward and show that the security interest nonetheless met the two-point test. Id. There was, however, no need to prove insolvency, nor could the debtor even attempt to rebut a presumption of insolvency, for the Gilmore draft eliminated that element for transfers which failed to meet the two-point test. Id. Cf. infra note 128 and accompanying text (application of section 547(c)(5) to insider transactions). Thus, the shifting of the burden of proof was limited to a very narrow area and could have necessitated, to some degree, the very inquiry into the value of collateral that it was designed to avoid.

\textsuperscript{110} The Gilmore Committee noted that the principal goal of section 60 of the 1898 Act was the prevention of transfers during the months immediately preceding bankruptcy that result in fewer assets being available for creditors. Where the net effect of all preference period transactions was a preservation of the status quo, there was less reason to require avoidance. The Committee also pointed to a number of the early "net result" cases, see Breitowitz, supra note 22, at 411–12 nn.147–48, where, although the courts spoke of "substantial contemporaneity," the real theory appeared to be one of netting the transactions rather than looking at each transfer in isolation. See House Report, supra note 109, at 215, reprinted in 1978 U.S. Code Cong. & Ad. News at 6175. While there is no explicit statement in the legislative history that section 547(c)(5) codifies a "relaxed substitution" rule, it appears that the concept of netting a series of transactions to determine their ultimate preferential effect is precisely the basis for abandoning "strict timing" as a condition for substitution. As such, "relaxed substitution" and netting the transactions are essentially identical theories with different names.
of new collateral, and the secured party was accordingly limited to
the lowest value of the collateral at any time during the preference
period,\textsuperscript{117} section 547(c)(5) ignores these interim downward fluctua-
tions. As long as the net effect as of the petition date is to give the
secured party no more than he had prior to the preference period (or
first advance, if later) the security interest is valid.

In essence, section 547 (c)(5) may be viewed as a codification of
the “relaxed substitution” theory articulated most fully in the \textit{Grain
Merchants} case.\textsuperscript{118} While \textit{Grain Merchants}' reliance on
section 9-205 of the UCC to support its construction of the 1898
Act was problematical,\textsuperscript{119} its rationale is almost directly incorporated
into the BRA. The
word “almost” is significant, however, for in three respects
section 547(c)(5) does not, or at least may not, mirror the standard
as enun-
ciated in the case: (1) section 547(c)(5) is limited to inventory, accounts
receivable and proceeds, while “relaxed substitution” was not;\textsuperscript{120}
(2) section 547(c)(5) clarifies an ambiguity left open in the \textit{Grain
Merchants} case, namely the appropriate point in time for measuring
improvements of position;\textsuperscript{121} and (3) conversely, section 547(c)(5)
is
ambiguous with regard to the need for perfection prior to the prefer-
ence period while \textit{Grain Merchants} was not.\textsuperscript{122} These issues will be
discussed in detail further on.

As a final point concerning the general operation of section
547(c)(5), it must be emphasized that section 547(c)(5) is not an
avoidance provision. It does not provide that improvements in
position are voidable, but merely protects transfers when there is no such
improvement. A transfer which fails to qualify for the protection of
section 547(c)(5) is open to attack only if it would be voidable under
the basic standards of section 547(b).\textsuperscript{123} Accordingly, even where
there is an improvement of position, the trustee may avoid the transfer only
upon establishing the elements of a preference. In the case of a nonin-

\begin{flushleft}
\textsuperscript{117} See infra text accompanying note 48. \\
\textsuperscript{118} See supra note 116. \\
\textsuperscript{119} See supra text accompanying notes 51–54. \\
\textsuperscript{120} But see infra text accompanying notes 177–80 & 217–18 (whether the theory of "relaxed substitution" as applied to other forms of property survives enactment of the BRA). \\
\textsuperscript{121} See supra text accompanying notes 98–105. \\
\textsuperscript{122} See infra notes 135–49 and accompanying text. \\
\textsuperscript{123} But see infra note 176 and text accompanying notes 163–76 (while section 547(c)(5) is not an invalidation provision, it nonetheless implies that certain classes of transfers should be characterized as preference although in its absence those transfers could have been validated through judicial construction). 
\end{flushleft}
invariably result from the acquisition of new accounts receivable or inventory items within the preceding ninety days.\textsuperscript{124} Under section 547(f), there is a presumption that the debtor was insolvent throughout that period.\textsuperscript{125} By definition, improvements of position have preferential effect and are on account of antecedent debt. Section 547 of the BRA no longer requires, as section 60 of the 1898 Act did, that the creditor have reasonable cause to know of the debtor's insolvency. In short, as long as the trustee can demonstrate an improvement of position, this will generally be sufficient to invalidate the transfer to the extent of that improvement.\textsuperscript{126}

This will not necessarily be the case, however, with insider transactions. Under section 547(b)(4) of the BRA the period of avoidance for insiders is one year. Consistent with that extension, section 547(c)(5)(A)(ii) provides that one year prior to the commencement of the case be the point for measuring subsequent improvements, i.e., if the insider was undercollateralized as of twelve months before the petition date, any improvement of position existing as of the commencement of the case is vulnerable to attack, even if the creditor was fully secured at the start of the ninety day period.\textsuperscript{127} Yet, since avoid-

\textsuperscript{124} Improvements of position resulting from the appreciation of existing collateral or from the reduction of outstanding debt do not trigger section 547(c)(5) though the estate may be protected by its ability to recover any payments made and by a denial of the secured party's claim until the preferential payment is surrendered. 11 U.S.C. § 502 (Supp. IV 1980); see supra note 114.

\textsuperscript{125} For the effect of this presumption, see Breitowitz, supra note 22, at 363 & n.26.

\textsuperscript{126} Interestingly enough, the Gilmore Committee draft invalidated transfers of inventory and accounts receivable that failed to meet the two-point test even if the debtor was solvent at the time the accounts receivable or inventory items were acquired, as long as the debtor was insolvent as of the petition date. House Report, supra note 109, at 211, reprinted in 1978 U.S. Code Cong. & Ad. News at 6171. The draft provided:

To the extent that a transfer is voidable under this subparagraph IV, it is voidable without regard to whether the debtor was insolvent at any date prior to the date of filing the petition or whether the transferee had reasonable cause to believe that the debtor was insolvent at the time of any transfer.

Id.

The Commission Report eliminated that particular provision, as does the BRA. Thus, even if there has been a net improvement of position, the trustee can attack a particular transfer only if the debtor was insolvent at the time the specific account receivable arose or inventory item was acquired, although, under section 547(f), the trustee has the benefit of a statutory presumption of insolvency. If it can be shown that debtor was solvent during part of the 90 day period, only the improvement arising from collateral acquired during insolvency will be voidable. Section 547(c)(5) is thus not an "all or nothing" provision. It is entirely conceivable that only part of the net improvement will be recoverable.

\textsuperscript{127} Oddly enough, the Commission Report failed to specify a one year period for insiders with regard to security interests in inventory and accounts receivable. After initially establishing in section 4-607(a)(2) of the report that transfers to insiders could be attacked if made within a year, section 4-607(d) seemed to impose an outer limit of three months to measure improvements of position with regard to inventory and accounts receivable. It apparently incorporated the
ance of transfers to insiders outside the ninety day period requires both proof of insolvency (with no presumption) and reasonable cause for the insider to know of the debtor's insolvency, the trustee may find recovery difficult, if not impossible. Establishing improvement of entire Gilmore proposal on "improvement of position" without realizing that, unlike the Gilmore draft, the Commission had established a two-tier system of avoidable transfers. Thus, as the 1973 bill stood, if the loan was undercollateralized 10 months before the petition but was fully secured 90 days before, the trustee could do nothing.

Indeed, the very considerations that motivated the abolition of the "reasonable cause" standard in the context of all other transactions—difficulties of proof, etc.—may make recovery under the insider provisions virtually impossible, particularly in view of the broad definition of the term. See Breitowitz, supra note 22, at 363 n.29.

Besides the very difficult burden of establishing the existence of "reasonable cause," the application of section 547(c)(5) to insider transactions also poses complex questions of allocation. For example, assume that one year before bankruptcy, the secured party, an insider, is owed a debt of $1,000 secured by inventory worth $500. By the petition date, the secured party is secured by inventory worth $1,000, all of the inventory items having been received during the preference period. Section 547(c)(5) clearly states that only the $500 improvement is potentially voidable. As stated in the text, that amount will be voidable only: (1) if that much collateral was acquired during the preference period; (2) while the debtor was insolvent; and (3) to the extent that collateral was acquired before 90 days, the secured party had reasonable cause to know of the debtor's insolvency. Let us assume, however, that the $1,000 of inventory was received in two shipments. The first shipment worth $500 was received by the debtor six months before bankruptcy, at a time when the secured party did not have reasonable cause to know of the debtor's insolvency (or at a time when the debtor was not insolvent). The second shipment, also worth $500, was received four months before bankruptcy, at a time when the debtor was insolvent and the secured party had reasonable cause to know it. The total improvement of position is $500, and the trustee can in fact show that $500 worth of collateral—the last shipment—is a voidable preference under the general standards of section 547. Yet if the secured party must return up to $500 of collateral, could he not claim the second shipment as the $500 of collateral he is allowed to keep? If he could, the trustee could not then invalidate the security interest in the first shipment, since that interest is not a preference within the meaning of section 547, with the result that the secured party gets the benefit of the full security.

To a lesser extent, this problem may also arise in the case of noninsider transfers as well, the debtor was solvent at the time some new collateral was acquired and was insolvent when other collateral was acquired. Both shipments together effect an improvement of position. Could the secured party characterize the otherwise voidable transfer as the collateral in substitution of the security in existence at the start of the preference period with the nonvoidable transfer being deemed the improvement? Given the presumption of insolvency under section 547(f) and the difficulty of rebuttal, the problem is less likely to arise because, in all probability, all acquisitions during the 90 day preference period would have been voidable and the trustee can therefore reach the improvement of position regardless of the secured party's allocation. In the case of insiders, the issue of allocation remains troublesome.

Research has revealed no cases bearing on this issue. Perhaps the best way of resolving the problem is to initially regard all acquisitions of collateral as substitutions for the collateral that had existed at the start of the preference period. Only acquisitions which, by themselves or when combined with prior acquisitions, exceed that value will be regarded as an improvement. In the example I have set forth, the second shipment would therefore be regarded as the improvement, with the result that the security interest in the second shipment is voidable.

Of course, during the preference period a shipment which initially effected an improvement because of earlier collateral that had not yet been released may become a nonvoidable replacement by the petition date when the security interest on the old collateral is released. After
position under section 547(c)(5) would merely be the first hurdle that the trustee must surmount.

2. Comparisons Between Section 547(c)(5) and Prior Theories Sustaining the Floating Lien in Bankruptcy

a. Which Types of Collateral Are Protected and to What Extent?

In comparing section 547(c)(5) with its predecessors, it is helpful to pose the same three questions that were raised in connection with other theories: (1) What types of collateral does it protect? (2) What are the necessary conditions for the security interest to be valid? (3) To what extent will the security interest be protected? The first and third questions are easily answered. Section 547 (c)(5) is explicitly limited to inventory, accounts receivable, and their proceeds, unlike the “relaxed substitution” theory and section 9-108 of the UCC. It protects acquisitions of new collateral during the preference period only if there were no improvement of position between the later of the advance or the start of such period and the commencement of the case. In that respect, it resembles the “relaxed substitution” theory and avoids the excesses of DuBay and the metaphysics of the entity analysis. At the same time, where the two-point test is met, section 547(c)(5) applies even if the collateral was not acquired in the ordinary course of the debtor’s business, unlike section 9-108 of the UCC. If a creditor, at the start of the preference period, was initially fully secured by accounts receivable during the upswing of a seasonal industry, but off-season becomes undercollateralized as old accounts receivable are collected without new accounts receivable being generated, the creditor will be protected even if the debtor is pressured to “feed” the accounts receivable by sales of inventory below

calculating the total improvement of position, acquisitions should then be allocated to the “substitution” category in order of their acquisition until that category is exhausted. A determination must then be made with regard to the remaining acquisitions as to whether they would be voidable under section 547; as noted, even the acquisitions which clearly do represent improvements of position may not be.

129 The statutory definition of inventory and accounts receivable under section 547(a), however, is considerably broader than the analogous UCC terms. See infra text accompanying notes 181-87.

130 The theories are similar insofar as neither would protect unlimited improvements of position during the preference period. The “relaxed substitution” theory, however, did not necessarily utilize the start of the preference period as its cutoff date. See supra text accompanying notes 98-104.

131 As to whether these alternative theories may continue to be operative under the BRA, see infra text accompanying notes 162-80.
cost.\textsuperscript{132} Thus, while section 547(c)(5) is limited both in the types of collateral it protects and the extent of that protection, it does not require that the acquisition be made in any specific manner or for any specific purpose.\textsuperscript{133}

As to the second question, concerning the proper timing for each of the four events necessary for attachment and perfection of an Article 9 security interest, where the advance was made prior to the preference period, it is essential that the security agreement be executed and that "some"\textsuperscript{134} collateral be acquired prior to that period as well. Otherwise, the debt-security differential would be equal to the total amount of the debt and any improvement would be voidable. Unlike section 9-108 of the UCC, however, "new value" is not a necessary trigger. As long as the security agreement was executed prior to the preference period, although subsequent to the debt, transfers during the preference period will be protected to the extent that the two-point test is met. If the advance is made after the start of the preference period, then execution of the security agreement and acquisition of collateral must precede the advance (so that, as of the date of the advance, the debt-security differential will be less than the debt), but both could occur during the preference period.\textsuperscript{135}

\textsuperscript{132} Forced sales of inventory below cost may be voidable as fraudulent transfers to the extent that the value of the property exceeded the consideration given. See 11 U.S.C. § 548(a)(2)(A)(Supp. IV 1980) ("The trustee may avoid any transfer of an interest of the debtor in property . . . if the debtor received less than a reasonably equivalent value in exchange for such transfer or obligation . . . ."). However, this would not afford any remedy against the secured party. Only the purchasers of inventory would be liable under section 548(a)(2)(A).

\textsuperscript{133} According to the Gilmore Committee, in the normal course of a business declining into bankruptcy, the position of an accounts receivable or inventory lender will generally deteriorate. Improvements of position are, therefore, generally indicative of manipulation. See House Report, supra note 109, at 216, reprinted in 1978 U.S. Code Cong. & Ad. News at 6176. Thus, although section 547(c)(5) does not specifically require that the acquisition be made in the ordinary course of the debtor's business, it was designed, in part, to prevent the same manipulative conduct that section 9-108 of the UCC condemns. As the illustration in the text shows, however, absence of improvement does not necessarily mean absence of manipulation. Moreover, in certain cases, improvements of position may be part of the normal business cycle. For example, certain seasonal industries may have a large volume of accounts receivable during part of the year but off-season do not generate new accounts receivable as the old ones are collected. If at the start of the 90 day period, the secured party was temporarily undercollateralized but becomes fully secured during the preference period as a result of the normal anticipated seasonal upswing, the improvement would be voidable by the trustee irrespective of the fact that it arose in the ordinary course of business.

Thus, the correspondence between section 547(c)(5) of the BRA and section 9-108 of the UCC (which contains an "ordinary course" requirement) is far from exact; despite the suggestion of the Gilmore Committee, the former cannot be regarded as a federal codification of the latter.

\textsuperscript{134} See supra note 65.

While the debt-security differential test clearly necessitates that the agreement and the initial acquisition of collateral precede the later of the advance or the start of the preference period, the statute is unclear as to when the interest must be perfected. It is true that section 547(c)(5) protects only "perfected" security interests in inventory and accounts receivable, but it fails to specify when perfection must take place. As already noted, under section 9-108 of the UCC, the most liberal of the approaches for validating floating liens, "new value" was statutorily projected forward to the time of the debtor's acquisition of collateral. The financing statement could, therefore, be filed within the preference period at any time prior to the acquisition of the last collateral, or even afterwards within the grace period allowed by section 60(a)(7) of the 1898 Act for "relation back." On its face, section 547(c)(5) of the BRA does not even require that much; while a filing would clearly have to be made at some point before bankruptcy to prevent trustee avoidance under section 544(a) as well as to comply with section 547(c)(5)'s explicit directive, arguably any prepetition action would suffice. The anomaly of this result can best be illustrated by a simple example.

On January 1, Secured Party [SP], pursuant to a written security agreement covering all inventory presently owned and to be acquired in the future, lends $10,000 to Debtor [D]. The value of the inventory at that point is $10,000. Two months later, on March 1, SP files a financing statement. On April 1, D files a voluntary petition in bankruptcy. The value of the inventory on the petition date is also $10,000, although the individual components have changed and there have been interim fluctuations. SP seeks realization on his security; the trustee asserts voidability under section 547. What result?

In the absence of section 547(c)(5) of the BRA, it would be clear that such a transfer would be voidable, assuming the presumption of insolvency is not rebutted. Under section 547(e), a transfer is deemed made at the time it takes effect, if perfected then or within ten days thereafter, or at the time of perfection, if perfected more than ten days after taking effect. Section 547(e)(1)(B) defines "perfection" for

136 See supra text accompanying notes 98–100.
137 See supra note 71.
138 Of course, were section 9-108 to be operative under the BRA, the applicable grace period would be 10 days, rather than 21 days from the latest acquisition of collateral. See 11 U.S.C. § 547(e)(2)(B) (Supp. IV 1980).
personal property as attainment of priority over lien creditors. Accordingly, if the financing statement was filed on March 1, one month before bankruptcy, in no instance could the transfer be deemed made prior to February 20 (if the inventory was acquired within ten days preceding the filing). Moreover, to the extent inventory was acquired after March 1, under section 547(e)(3), the transfer would be moved forward to the date of acquisition of each component. In all cases, the transfer was on account of an antecedent debt—the advance of January 1 and was deemed made within ninety days preceding the commencement of the case.

There is no logical reason why section 547(c)(5) should change this result. The purpose of section 547(c)(5) was to prevent avoidance of an originally valid security interest due to the changing nature of the collateral and not to protect inventory financiers from the consequences of delayed perfection. Yet the literal wording of the statute does just that. The statute upholds “transfers” if, as of the date of the petition, there has been no reduction “of any amount by which the debt secured by such security interest exceeded the value of all security interests” at the start of the ninety day period (or the advance, if later). The statute protects only security interests that are “transfers” as of the petition date, but by speaking of the difference between the debt and the security interest—a term which connotes mere attachment—it seems to uphold these later “transfers” to the extent of the security interest existing at the start of the preference period (or advance, if later), although that security interest may have been unperfected at the time. In the example above, because the

139 See id. § 547(c)(5).

140 The problem discussed in the text stems from the fact that section 547(c)(5) seems to say that one compares “transfers” existing at bankruptcy with the “security interests” existing at the start of the preference period, language which implies that even an unperfected security interest at the start of the preference period can validate subsequent transfers up to the same amount.

One way out of the problem is to argue that the word “such” in the phrase “such security interest” refers back to “transfers.” If this construction is accepted, “transfers” on the day of the petition would be compared to “transfers” on the first day of the preference period, thus necessitating compliance with section 547(e). There are two reasons why this response appears to be unsatisfactory. First, from a grammatical standpoint, it is equally possible that “such” refers back to the beginning of the paragraph which speaks of “perfected security interest.” If the latter reading is correct, section 547(c)(5) would never apply, unless the security interest were actually perfected at the beginning of the 90 day period without the benefit of a grace period. The ambiguous antecedent of “such” can hardly serve as a reliable guide to congressional intent. Second, the word “such” is used only in connection with a description of the debt—“debt secured by such security interest.” The word is not used in describing the security interest that was in existence as of the start of the 90th day. As such, it may merely be descriptive of the status of the debt as it existed on the petition date, i.e., a debt that was secured by a transfer, and not of the security interest as it existed 90 days previously.
security interest on the initial collateral attached prior to the preference period and the debt was fully collateralized as of January 1, the subsequent "transfers," i.e., the perfected security interest in new inventory items, would have to be upheld.

Perhaps the argument may be advanced that perfection of a security interest by the filing of a financing statement always constitutes an improvement of position in that it causes a reduction of deficiency in the ultimate bankruptcy distribution. In other words, when the statute speaks of the amount by which the debt exceeds the security, that amount is determined not by asking how much the security is worth in the abstract, but rather how much it would yield in bankruptcy. Since a security interest that can be avoided yields nothing, the difference between the debt and the security in such cases is the total amount of the debt. As thus construed, section 547(c)(5) will avail the creditor only if he filed a financing statement covering present and future property prior to the ninety day period or prior to the advance. 141

This interpretation, however, may be overly restrictive, depriving a creditor of the benefit of the ten day grace period generally allowed by section 547. Another example will clarify the point. SP advances money pursuant to a security agreement covering present and future accounts receivable. He files a financing statement nine days later. Exactly eighty-nine days after the filing, the debtor is placed into bankruptcy. The value of the accounts receivable at the start of the preference period and on the petition date are identical though there have been fluctuations in the interim.

Under the normal rule of section 547(e)(2)(A), because the transfer was perfected within ten days of its taking effect, the transfer relates back and would be protected as a transaction occurring prior to the ninety day preference period (as well as being a transfer for contemporaneous consideration). By itself, however, this grace period could protect only the accounts receivable that had arisen prior to the start of the preference period. Because section 547(e)(3) provides that a transfer is not deemed made until the debtor acquires rights in the collateral, accounts receivable that arose within the ninety day period fall within the definition of a preference and are protected, if at all, only under section 547(e)(5). 142 Accordingly, if the two-point test

141 Under this interpretation, section 547(c)(5) imposes the same filing requirements as existed under the "sufficient perfection" theory. See supra text accompanying notes 71-77.
142 This is true, however, only if there was a downward fluctuation during the preference period before the value of the collateral returned to its pre-90 day level. Even after the enactment of the BRA, traditional substitution of collateral where new collateral is acquired
requires that as of the beginning of the ninety day period there already be a security interest indefeasible in bankruptcy, a security interest unperfected on the ninetieth day would be vulnerable in spite of a later filing being made within ten days. 143 The ten day grace period of section 547(e) will protect accounts receivable or inventory which still exist in bankruptcy and which first attached before the start of the preference period (provided attachment was within the ten day grace period), but it could not protect security interests in after-acquired property where validity of the interest depends on its meeting the two-point standard of section 547(c)(5).

If one accepts the notion that a creditor's rights should not depend on the fluctuating nature of his collateral, this is an unacceptable result. If filing within ten days would have allowed the creditor to realize on those initial accounts receivable, the same should be true for the substituted accounts receivable. Yet it is still true that an unperfected security interest yields nothing in bankruptcy, with the result that the later filing does effect a reduction of deficiency, precluding the use of the two-point test to validate a security interest in after-acquired property.

In short, a literal reading of section 547(c)(5) suggests two methods for calculating the debt-security differential as it existed ninety days prior to bankruptcy (or at the time of the advance, if later), neither of which reaches a result consistent with section 547(c)(5)'s underlying policy. One interpretation would read section 547(c)(5) to require only attachment, not perfection, prior to the preference period or advance, and would permit perfection even beyond the ten day grace period that section 547 generally sanctions. This interpretation is supported by the fact that, in looking at the security interest as of the start of the ninety days, section 547(c)(5) refers only to "security interests" with no mention of perfection, but results in treating security interests in after-acquired inventory or

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143 Although section 547(e)(2) generally permits a 10 day period of relation back to escape a preference challenge, it is still true that were bankruptcy to intervene at the time the transfer took effect, it would be voidable as an interest vulnerable to a hypothetical lien creditor under section 544(a)(1). The postpetition rights of section 546(a) could not prevent this result since, under applicable state law, a later filing will generally be ineffective against an intervening interest. See U.C.C. § 9-301(1)(b)(1972); Breitowitz, supra note 22, at 392-93.
accounts receivable more favorably than other kinds of property in existence at the time of the advance or start of the preference period—a favoritism that is wholly unjustified.

The second interpretation would provide that an improvement of position occurs not only when additional collateral is acquired, but also when the security interest in existing collateral becomes perfected. Since perfection is a necessary element for the validity of a security interest in bankruptcy, filing itself causes a reduction of the debt–security differential during the preference period. Yet this is true whenever filing occurs within such period, regardless of whether the filing was made within ten days of the transfer taking effect or afterwards. By requiring perfection prior to the preference period or advance, this interpretation deprives the secured party of the protections enjoyed by the holders of security interests on nonchanging collateral and runs afoul of the congressional policy of placing both types of secured creditors on equal footing.\footnote{See infra text accompany notes 241–52 for a more detailed discussion of this policy.}

The foregoing objections indicate that a proper interpretation of section 547(c)(5)’s perfection requirements should take account of the historical problem that section 547(c)(5), as well as its predecessor theories, sought to redress: namely, the conversion of a perfected security interest into a preference due to the fluctuating nature of the collateral. Essentially, the congressional judgment in codifying the improvement of position test was that security interests in inventory and accounts receivable should not be disadvantaged because of their constant fluctuation as compared to security interests in other collateral where neither the value nor the particular item tends to change.\footnote{House Report, supra note 109, at 372–75, reprinted in 1978 U.S. Code Cong. & Ad. News at 6328–31.} In light of this policy, section 547(c)(5) should be applicable only under circumstances where, had there been no turnover of collateral during the preference period, the security interest would have been valid. The debt–security differential should therefore be determined not by a simple valuation of the security interest nor even by what the security interest would yield were bankruptcy to occur at that particular time, i.e., ninety days earlier than it did, but rather by what the security would have yielded in the eventual bankruptcy proceeding.\footnote{Indeed, if the security were valued as of the start of the preference period by what it would yield were bankruptcy to occur at that particular time, not only would the security interest have to be perfected prior to the start of the preference period, but it would also have to be invulnerable to a preference challenge. This would have meant that, in some cases, even perfected security interests would be valued at zero. Consider the case of an advance made}
of the transfer taking effect would have validated the security interest in accounts receivable or inventory items acquired prior to the preference period even where the filing took place afterwards, such perfection should similarly suffice to protect after-acquired property.

This construction is also consistent with the basic theory of section 547(c)(5)—that where a secured party gets no more from the estate than what he has given back or released, the transfer has no net preferential effect.\textsuperscript{147} This is true, however, only when the collateral or proceeds that were released would have gone to the secured party in the event of bankruptcy. Thus, both the theory of section 547(c)(5) and the historical problem it was seeking to resolve dictate that its protection apply only where the financing statement was filed either prior to the preference period, or within ten days of the acquisition of collateral prior to the preference period, whichever point is later.

While the appropriate standard appears clear, it is difficult to read it into the statute, which speaks simply of “security interests” existing at the start of the ninety day period. The ambiguity could, and should, be easily clarified by merely substituting the word “transfers” for “security interests” in referring to what is to be looked at on the ninetieth day preceding bankruptcy.\textsuperscript{148} By limiting the secured party to the debt-transfer differential as it existed ninety days before

pursuant to a security agreement 150 days before bankruptcy with the financing statement filed 110 days before bankruptcy. Although by the start of the preference period the security interest was already perfected, it would not have been valid if bankruptcy had occurred just then, since, under these hypothetical circumstances, the transfer was on account of an antecedent debt and was deemed made within 90 days prior to the (hypothetical) petition. Accordingly, the security at that time had no value for purposes of section 547(c)(5). The absurdity of such a result underscores the point being made in the text that, in determining the debt-security differential at the start of the preference period, one must focus not on what the collateral would yield were bankruptcy to occur then, but what the original collateral would have yielded in the bankruptcy which actually took place.

\textsuperscript{147} See supra text accompanying notes 97–107.

It should be noted that the foregoing limitation does not apply were the advance is first made during the preference period. In that case, section 547(c)(5)(B) provides that the date of the advance is the appropriate starting point for measuring improvements of position. As long as the secured party perfects within 10 days of the advance, he will be guaranteed the value of all collateral in existence at the time of the advance, irrespective of when that collateral was acquired. Even if the particular items of collateral were acquired more than 10 days prior to perfection, no transfer took effect between the parties until the advance was made. U.C.C § 9-203(1)(b) (1972). Perfection within 10 days of the advance will always amount to perfection within 10 days of the transfer taking effect, thereby antedating the transfer to the time of the advance.

\textsuperscript{148} The change proposed for section 547(c)(5) would read as follows:

The trustee may not avoid a perfected security interest in inventory or accounts receivable “except to the extent that the aggregate of all such transfers . . . caused a reduction . . . of any amount by which the debt secured by such security interest exceeded the value of all [transfers] for such debt . . . .

See infra notes 233 & 322.
bankruptcy, rather than the debt-security differential, the statute, through the incorporation of the definitional standards of section 547(e)(2), would make clear that the only security interests taken into account are those that were perfected by the ninetieth day, or those that were perfected within ten days after the acquisition of collateral (where acquisition nevertheless preceded the ninetieth day) since only in those two situations would the transfers be deemed made prior to the preference period within the meaning of section 547(e)(2).

\[147\]

\text{c. Is Section 547(c)(5) Exclusive?}

The foregoing analysis demonstrates that section 547(c)(5) has a considerably narrower reach than some of the alternative theories that previously sustained the floating lien under the 1898 Act, both in terms of the property it protects and the extent of that protection. However, it bears repeating that section 547(c)(5) is not an avoidance provision; as noted earlier,\[150\] a transfer which fails to qualify for the protection of section 547(c)(5) is open to attack only if it would be voidable under the basic standards of section 547. If, for example, the collateral giving rise to an improvement of position were acquired at a time when the debtor was solvent, the fact that the transfer is not within the protective confines of section 547(c)(5) would be immaterial, since one of the necessary elements for voidability is lacking. It thus becomes necessary to ascertain whether the enactment of section 547(c)(5) was intended to be the exclusive source of protection for after-acquired property, thereby preempting the application of alternative theories, or whether section 547(c)(5) was merely designed to establish a "safe harbor," marking off a category of transfer which, in the judgment of Congress, was clearly deserving of protection but

\[147\] Where perfection occurs during the preference period, subsequent acquisitions are protected only to the extent of the value of collateral that was acquired: (1) more than 90 days before bankruptcy; but (2) within 10 days immediately preceding the filing. The secured party would not be able to utilize the total value of the collateral as of the 90th day. Security interests in property acquired more than 10 days preceding the filing would not be deemed "transfers" until their actual perfection and, consequently, could not be taken into account in the calculation of the debt-security differential as it existed at the start of the preference period. (Where the advance itself was made within 10 days preceding the filing, however, e.g., the advance was made 95 days before bankruptcy and the financing statement was filed nine days later, property acquired prior the making of the advance will be taken into account even if acquired more than 10 days prior to perfection since no transfer took effect between the parties until value was extended. The same is true for property acquired subsequent to the making of the advance but prior to the start of the preference period.) Whether these perfection requirements hold true under the present wording of section 547 is, as stated in the text, uncertain. See supra note 104.

\[150\] See supra text accompanying notes 122–26.
with no intent to foreclose judicial extension of that protection to other areas. In other words, with regard to after-acquired property not covered by section 547(c)(5), rather than affirmatively deciding that such transfers are voidable preferences, Congress may have simply adopted a "hands off" attitude, leaving the issue to the resolution of the courts exactly as it was under the 1898 Act.\footnote{151}

It is, of course, obvious that not all theories continue to survive the BRA. Section 547 clearly repudiates the "sufficient perfection" theory of Dubay\footnote{152} by providing in section 547(e)(3) that a transfer is not deemed made until the debtor acquires rights in the property transferred and by also providing in section 547(e)(2) that even where a transfer is already perfected at the time it takes effect, the transfer is deemed made only upon its taking effect. Thus, even without considering the proper construction of section 547(c)(5), the structure of

\footnote{151} A similar question of preemption arises under section 546 though the resolution of that issue is not dispositive here. Section 546(c) provides that the avoidance powers of the trustee are subject to any statutory or common law right of a seller, in the ordinary course of business, to reclaim such goods if the debtor has received them while insolvent. Section 546(c) was the validation of the seller's reclamation rights in the event of bankruptcy under section 2-702 of the UCC. See House Report, supra note 109, at 86-87, reprinted in 1978 U.S. Code Cong. & Ad. News at 6047-49. Under the 1898 Act, courts were divided over the issue. Compare In re Telemart Enter., Inc., 524 F.2d 761 (9th Cir. 1975), cert. denied, 424 U.S. 969 (1975) and In re Mel Golf Shoes, Inc., 403 F.2d 638 (6th Cir. 1968) (both of which sustained section 2-702) with In re Giltex, 17 U.C.C. Rep. Serv. 887 (S.D.N.Y. 1975) and In re Good Deal Supermarkets, Inc., 384 F. Supp. 887 (D.N.J. 1974) (both of which invalidated section 2-702 as a statutory lien which first took effect upon the debtor's insolvency). For a good analysis of the issues under prior law, see Weintraub & Edelman, Seller's Right to Reclaim Property Under Section 2-702(2) of the Code Under the Bankruptcy Act: Fact or Fiction, 32 Bus. Law. 1165 (1977).

While the general intent of section 546(c) is to uphold the seller's rights under section 2-702 of the UCC, the former is narrower than the latter in at least one respect, and possibly two. First, section 546 requires that demand within 10 days be made in writing; it is arguable that, under section 2-702, even an oral reclamation demand would suffice. But cf. In re Behring and Behring, 5 U.C.C. Rep. Serv. 600 (N.D. Tex. 1968). Second, and more important, under section 2-702, the seller need not make a demand within 10 days of the buyer's receipt of the goods where the buyer made a written misrepresentation of solvency within three months before delivery. This exception does not appear in section 546(c). The question therefore arises whether section 546(c) was intended to be preemptive or whether section 546 merely establishes a "safe harbor" with nonqualifying sellers placed in the same position as they were under the 1898 Act. Compare Mann & Phillips, The Reclaiming Seller Under the Bankruptcy Reform Act: Resolution or Renewal of Old Conflict, 33 Vand. L. Rev. 1, 51-56 (1980) (authors make convincing argument for "safe harbor" construction) with J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 24.9, at 1027 (2d ed. 1980) (section 5-1-1 (c) probably creates a negative implication). See also infra note 174 (the arguments for a "safe harbor" construction of section 546(c) are inapplicable to section 547(c)(5)).

\footnote{152} 417 F.2d 1277 (9th Cir. 1969); see also supra text accompany 38-43 (Professor Countryman's "Abracadabra" theory).
section 547 precludes any attempt to artificially antedate the transfer to the time of the pre-attachment filing of a financing statement.¹⁵³

On the other hand, nothing in section 547 explicitly repudiates the entity theory.¹⁵⁴ Although section 547(e)(3) does provide that a transfer is not made until the debtor acquires rights in the property transferred, the “property” referred to could be taken to mean the mass of accounts receivable or inventory items, rather than their individual components. The phrase “property of the debtor” for purposes of section 547 is defined with no greater specificity under the BRA than it was under the 1898 Act, and if, under prior law “property of the debtor” was deemed to embrace the aggregate entity being secured, such a construction is equally possible under section 547.¹⁵⁵ Similarly, it is arguable that the “relaxed substitution” analysis adopted in the Grain Merchants¹⁵⁶ case, which rested on a notion of netting the transactions to determine their aggregate preferential effect, should continue to be available as an alternative basis for protection even for property not covered by section 547(c)(5) (or for security interests in inventory and accounts receivable not meeting the two-point test) since such an analysis does not depend on artificially back-dating the transfer in the manner proscribed by 547(e)(3).¹⁵⁷

Determining whether, or when, negative implications may be drawn from statutes is a difficulty not unique to bankruptcy law, and


¹⁵⁴ See supra text accompanying notes 33–36.

¹⁵⁵ This is not to say that the entity theory is likely to survive under the BRA. Wholly apart from my later conclusion that section 547(e)(5) was intended to be the exclusive means of protecting inventory and accounts receivable security interests, even under the 1898 Act the entity theory made little sense from the standpoint of policy, stretched the definition of “property” beyond its conventional limits and was inconsistent with the concept of attachment as articulated in Article 9 of the UCC. See supra note 36. If courts utilized the theory, it was out of the perceived necessity of preventing invalidation of floating liens. Given the fact that many of these liens are now protected under section 547(e)(5), it is unlikely that a court will invoke the entity theory for those that are not. My point is merely that the entity theory does no more violence to the language of the BRA than it did to the language of the 1898 Act, and to the extent it was viable under former law, it could continue to remain so today. Admittedly, however, the “viability” of a theory may depend on whether there is any better way to accomplish the desired end.

¹⁵⁶ 408 F.2d 209 (7th Cir. 1969); supra note 48. See also supra text accompanying notes 46–56 (a discussion of the “relaxed substitution” theory).

¹⁵⁷ See infra note 169. Section 9–108 of the UCC is also potentially available since it does not purport to backdate the transfer but to postdate the giving of “new value.” However, the validity of section 9–108 in bankruptcy was highly questionable even under the 1898 Act. See Breitowitz, supra note 22, at 418 n.165; see also supra note 31 (constitutionality of section 9–108); infra note 175 (validity of section 9–108 in bankruptcy proceedings).
a full resolution of the issue is well beyond the scope of this Article.\textsuperscript{158} Nevertheless, it is clear that the problem cannot be resolved by mechanically invoking the time-honored canon of *inclusio unius est exclusio alterius*.\textsuperscript{159} Like all "rules" of statutory construction,\textsuperscript{160} "sometimes the maxim applies and sometimes it does not, and whether it does or does not depends on context."\textsuperscript{161} Accordingly, it is to the context of the BRA that we must turn.\textsuperscript{162}

In discussing preemption or exclusivity, two issues must be distinguished: first, whether security interests in inventory or accounts receivable not meeting the two-point test may nonetheless be validated under alternative theories; and second, whether any protection at all could be extended to forms of property other than inventory and accounts receivable. While both categories involve collateral outside of the reach of 547(c)(5), the preemptive effect of the statute, ultimately dependent on the legislative intent of Congress, may vary with the issue being considered.

With regard to the first aspect, although the impetus for the adoption of a section validating security interests in after-acquired property may have been a desire to protect secured lenders from the consequences of an overliteral application of the 1898 Act, by the early 1970's such protective measures were totally unnecessary. Both the Gilmore Committee and Congress recognized that the courts were committed to upholding such interests whether or not the 1898 Act was revised.\textsuperscript{163} The perceived need in the promulgation of section


\textsuperscript{159} Latin for "The inclusion of one [item in a statute] is the exclusion of another." Black's Law Dictionary (5th ed. 1979). The rule is sometimes formulated as "expressio unius" (the expression of one) or as the doctrine of negative implication. See C. Nutting & F. Dickerson, Cases and Materials on Legislation 542 (5th ed. 1978).

\textsuperscript{160} See Llewellyn, Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to be Construed, 3 Vand. L. Rev. 395, 401–06 (1950) (author enumerates 28 canons of statutory construction, each of which is subject to a corresponding rule dictating precisely the opposite result). Essentially, there is no such thing as a "rule" or "canon" of statutory construction. All a court does, or should do, is attempt to ascertain probable legislative intent based on the statute's internal structure and extrinsic history. Many of the so-called rules are merely probabilities of meaning based on conventional usages of language. See F. Dickerson, supra note 158, at 227–29 (blind application of canons may subvert legislative message); Johnstone, An Evaluation of the Rules of Statutory Interpretation, 3 U. Kan. L. Rev. 1 (1954); see also infra note 162 (definition of "context").

\textsuperscript{161} Dickerson, The Diseases of Legislative Language, 1 Harv. J. on Legis. 1, 8 (1964).

\textsuperscript{162} "Context" includes both the internal structure of the statute in question including the interrelationship between its various provisions and its extrinsic legislative history. See F. Dickerson, supra note 158, at 138–68.

\textsuperscript{163} See supra text accompanying notes 107–09.
547(c)(5) and its predecessor drafts was not to afford the secured lender the protection he already possessed through judicial construction, but to limit that protection to prevent depletion of the estate at the expense of the general creditors.\textsuperscript{164} In determining the appropriate scope of protection for security interests in inventory and accounts receivable, section 547(c)(5) was thus intended to be not merely a “safe harbor” but an outer limit.\textsuperscript{165}

That the principal concern of Congress was to limit the excesses permitted by the courts may be further evidenced by section 547(e)(3), which was designed to prevent secured parties from asserting that a UCC filing alone is sufficient to antedate the transfer and to definitively overrule case law to the contrary.\textsuperscript{166} Given the fact that Congress explicitly undertook to overrule the DuBay case, any construction of the BRA that would permit substantially the same result would be inconsistent with that expressed intent. Since the entity theory would indeed have sanctioned the same excesses that DuBay had permitted, i.e., improvements of position during the preference period, with the sole proviso that “some”\textsuperscript{167} collateral (no matter how inconsequential in value) be acquired prior to the start of that period,\textsuperscript{168} the notion is necessarily rejected by implication. Stated differently, although as a matter of literal construction the term “property” in section 547(e)(3) could be construed to include the initial acquisitions which comprise the “entity,” such an expansive interpretation would render section 547(e)(3) a virtual nullity by validating the very

\textsuperscript{164} The following excerpts from the Gilmore Committee report incorporated as an appendix to Chapter Four of the House Report shed much light upon the purposes of section 547(c)(5): “In 1966, it appeared that security interests in personal property under Article 9 of the Uniform Commercial Code were in serious jeopardy. . . . [T]he holders of Article 9 security interests became understandably concerned about their fate.” After describing the various court cases upholding the floating lien, the report goes on to state: “What may be called the politics of the project of revising § 60 have thus come full circle during the past few years. \textit{What started out as a rescue mission for secured creditors may end up as a rescue mission for unsecured creditors},” House Report, supra note 109, ch. 4 app., at 207–08, reprinted in 1978 U.S. Code Cong. & Ad. News at 6167–68 (emphasis added).

\textsuperscript{165} See Senate Report, supra note 153, at 88, reprinted in 1978 U.S. Code Cong. & Ad. News at 5874 (section 547(c)(5) is intended to overrule DuBay and Grain Merchants by providing that acquisitions resulting in an improvement of position are subject to a preference challenge). Thus, wholly apart from section 547(e)(3), which was expressly designed to repeal DuBay, see id. at 89, reprinted in 1978 U.S. Code Cong. & Ad. News at 5875, section 547(c)(5) itself was intended to be exclusionary.


\textsuperscript{167} See supra note 65.

\textsuperscript{168} See supra text accompanying notes 64–67.
transfers it intended to avoid. It hardly makes sense to overrule DuBay and then, through incorporation of a broad definition of "property," emasculate the effect of that overruling. The policy of section 547(e)(3), if not its words, necessitates that the entity theory be rejected.

With regard to "relaxed substitution," somewhat different considerations lead to the same result. Insofar as "relaxed substitution" did require that collateral of equivalent value be in existence prior to the start of the preference period, its application does not involve the same evils Congress was seeking to eliminate in section 547(e)(3). Nevertheless, in codifying the two-point test, Congress acted on the assumption (whether empirically justified or not) that, in the normal course of a business declining into bankruptcy, the position of an accounts receivable or inventory lender will generally deteriorate, and in the rare event that there is a net improvement within ninety days of bankruptcy, it will usually be the result of manipulative or fraudulent conduct on the part of the debtor or the preferred transferee. Based on this assumption, it is likely that by extending protection to transfers not resulting in an improvement of position, Congress was affirmatively seeking to deny protection to interests failing to meet such a test, and rather than merely adopting a stance of neutrality through the process of exclusion, Congress made a deliberate policy decision that improvements in position should be voidable.

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169 Note that the appropriate time for measuring permissible value was unclear. See supra text accompanying 96–105; infra note 170.

170 The analysis in the text proceeds on the assumption that "relaxed substitution" did not limit the creditor to the value of his collateral as of the start of the preference period; that it potentially afforded the secured party considerably more protection than does section 547(e)(5); and that the issue of section 547(e)(5)'s preemptive effect must therefore be considered. As I have previously observed, however, see supra text accompanied notes 97–105, this is not necessarily the case. If "relaxed substitution" itself limited the secured party to the value of his collateral as of the start of the preference period—a position which finds some support in the language of Grain Merchants—it would of course be identical to section 547(e)(5)—at least with regard to inventory and accounts receivable—in which case there would be no need to consider the question of exclusivity.


[The predecessor of section 547(e)(5)] seeks to catch in the preference net particularly those situations in which the transferee (as by crash sales of inventory below cost to feed the receivables) has sought to manipulate the prebankruptcy situation to his own advantage. (In the normal course of a business declining into bankruptcy the position of an inventory or receivables lender, far from improving, will almost certainly deteriorate.)

Id.

172 The Gilmore Committee conceded that there are situations where improvements in posi-
In sum, although, as a general proposition, granting statutory protection to one class of interests does not necessarily imply that others cannot be protected under alternative theories, there are three reasons for so construing section 547(c)(5): (1) the legislative history indicates that the primary motivation for the codification of section 547(c)(5) was not to protect the secured creditor, who had already emerged victorious in the courts, but to place limits on that protection; (2) at least the entity theory is inconsistent with the spirit, if not the language, of section 547(e)(3) since its application would resurrect DuBay (which section 547(e)(3) explicitly rejects) in a slightly modified form; and (3) Congress enacted section 547(c)(5) on the assumption that improvements in position are generally indicative of manipulation and hence undeserving of any legal protection. All of these factors suggest that section 547(c)(5) was intended to be exclusionary and preemptive, rather than merely establishing a “safe harbor,” and that it was designed to put a stop to the expansive, and often fanciful, interpretations that the courts engrained onto the provisions of section 60 by substituting a more limited form of protection.

Regarding the Committee’s implication that the harvesting of a crop already subject to a security interest prior to the start of the preference period effects a preferential transfer, see infra text accompanying note 323–94.

172 See supra notes 158 & 160.

174 This factor particularly highlights the key difference between section 547(c)(5) and other protective provisions in the BRA, such as section 546(c). As noted earlier, some commentators have taken the position that section 546(c) is not preemptive; that sellers could continue to assert rights under section 2–702 of the UCC even if they fail to meet the standards of section 546(c); and that section 546(c) was designed merely to insure protection to one class of seller but not deny protection to others. See supra note 151. Section 546(c) was enacted in response to a hotly disputed controversy over the seller’s right of reclamation in the event of the buyer’s bankruptcy. See cases cited id. Accordingly, protective measures guaranteeing that right were necessary. In the case of after-acquired property, however, the situation was reversed. Since courts were virtually unanimous in upholding the claims of secured creditors, section 547(c)(5) was enacted not to protect but to limit.

178 Insofar as this third justification for preemption focuses on the fact that improvements in position are indicative of creditor misconduct, it may be thought inapplicable to section 9–108 of the UCC which (under its first prong) validates security interests in after-acquired property only if the acquisition is made in the ordinary course of business. Nevertheless, the stated policy behind section 547(c)(5) was not merely the invalidation of security interests in improvements where manipulation can actually be shown but the establishment of a general rule to avoid litigation on the issue. See supra note 172. In any case, it was widely assumed that section 9–108 was invalid in bankruptcy proceedings even under the 1898 Act. See supra notes 31 & 157.
to the secured lender, one that more properly accommodates the conflicting interests of unsecured creditors as well.\footnote{176}

Concerning the second aspect of preemption—the issue of whether protection could be extended to security interests in property other than inventory and accounts receivable—the answer is less clear. Certainly any theory rejected by the BRA for inventory and accounts receivable would be similarly unavailable to other types of collateral for exactly the same reasons.\footnote{177} However, assuming there has been no net improvement of position between the start of the preference period and the commencement of the case, could courts validate after-acquired property interests in property other than inventory, accounts receivable or proceeds of either, notwithstanding their exclusion from section 547(c)(5)?

A strong argument can be made that they could be protected, though the precise parameters of that protection are unclear.\footnote{178} The legislative history indicates that the exclusion of collateral other than inventory and accounts receivable from the protections of section 547(c)(5) was not based on a determination that such interests were undeserving of protection, but rather on the fact that the preference problem most commonly arose in the context of the floating lien on inventory and accounts receivable. It was therefore, only in that

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\footnote{176} The conclusion in the text that section 547(c)(5) carries a negative implication and that security interests not meeting the two-point test are voidable is not inconsistent with my earlier assertion that section 547(c)(5) is not an avoidance provision. See supra text accompanying note 136. It is true that section 547(c)(5) does not invalidate security interests where there has been an improvement of position unless the improvement constitutes a voidable preferential transfer within the meaning of section 547(b). Section 547(c)(5) does, however, evince a legislative intent to disallow artificial theories of construction that would characterize later acquisitions as not being preferences within the meaning of section 547(b) despite the fact that the elements of section 547(b) have apparently been met, at least to the extent that such theories would permit a creditor to improve his position after the start of the preference period. In other words, while 547(c)(5) cannot convert what is clearly a nonpreference into a voidable transfer, its policy can, and does, suggest that certain marginal cases, i.e., later acquisitions of property which could have been validated through judicial construction, are to be resolved in favor of their invalidity.

\footnote{177} Thus, to the extent that “substitution of collateral” theories or the application of section 9–108 of the UCC would allow a creditor to improve his position during the preference period, use of those theories would be precluded. But see supra note 161 (“relaxed substitution” may not have done so even on its own terms). The “entity” theory probably applied only to inventory and accounts receivable, see supra text accompanying note 37, and the “sufficient perfection” theory is expressly overruled by section 547(c)(5) of the BRA, see supra text accompanying note 152.

\footnote{178} Even assuming section 547(c)(5) is not preemptive with regard to the protection of after-acquired interests in property other than inventory and accounts receivable, those interests are clearly not protected by section 547(c)(5) and can be validated only if some other provision of general applicability could be construed to permit their validation. The possible theories which could be used to sustain such interests are discussed infra text accompanying notes 210–22.
context that the problem was addressed. This suggests that, with regard to other forms of property, Congress did adopt a stance of neutrality, and while such security interests are not covered by section 547(c)(5), courts remain free to validate those interests on any other basis available (provided that no net improvement of position results from preference period acquisitions).

3. A Critique of Section 547(c)(5)

a. Failure to Include Types of Collateral Other Than Inventory and Receivables

Section 547(c)(5) protects only security interests in inventory and accounts receivable and has no application to security interests in other forms of collateral. It must be noted, however, that under section 547(a), "inventory" includes "farm products," which it does not under Article 9, and "receivables" include not only what Article

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179 In noting that the proposed improvement of position test was limited to the protection of inventory and accounts receivable, the Gilmore Committee stated:

It may be that an argument could be made for expanding the coverage to include all kinds of after-acquired property. However, "inventory" and "receivables" are where the action has been and no doubt will continue to be. There is much to be said for the principle of statutory drafting which counsels that only real problems be dealt with and that sleeping dogs should be left undisturbed.


181 See supra note 177.

182 It is important to note, however, that although security interests in other forms of property are not protected by section 547(c)(5), they are taken into account in measuring the debt-security differential as of the start of the preference period. This result is mandated by the language of section 547(c)(5) which requires comparing the difference between the debt and the security interests in the accounts receivable and inventory as of the commencement of the case with the difference between the debt and all security interests as of the start of the preference period. This insures that upward fluctuations in inventory which are offset by decreases in other collateral will not result in invalidation. This may be illustrated by a simple example. Assume that a debt of $1,000 is secured by $500 of inventory and $500 of equipment. During the 90 days preceding the commencement of the case the value of the inventory swells to $800 due to new acquisitions, but the equipment is scrapped due to obsolescence. Looking at inventory alone, there has been an improvement of position of $300. Since section 547(c)(5) does require that all security interests be taken into account, however, because the creditor was already fully secured, the appreciation of the inventory could not be invalidated.

183 Compare 11 U.S.C. § 547(a)(1) (Supp. IV 1980) ("Inventory means personal property leased or furnished . . . including farm products such as crops or livestock, held for sale or lease.") with U.C.C. § 9-109(3) (1972) ("If goods are farm products they are neither equipment nor inventory."). Thus, under Article 9, "farm products" are treated differently from "inventory." See, e.g., U.C.C. §§ 9-307(1) (buyer in ordinary course of business other than a buyer of farm products takes free of a perfected security interest), 9-301(1)(c) (1972) (buyers of farm products are protected only if the security interest is unperfected, they gave value, and took
9 denominates as "accounts," but all rights to payment whether or not arising from the sale or lease of goods.\textsuperscript{183} Thus, for example, rights to receive tax refunds, patent or copyright royalties, rentals under a real estate lease, or payments under construction contracts are all classified as "receivables" under section 547(a) although they are only "general intangibles" under Article 9.\textsuperscript{184} Indeed, section 547(c)(5) would protect assignments of interests which are altogether excluded from Article 9 but which nonetheless represent valuable payment rights. Assignments of wages, tort claims, judgments, and transfers of rights under insurance policies and in deposit accounts are not subject to Article 9 and are governed by nonuniform local law,\textsuperscript{185} but are nonetheless deemed "receivables" covered by section 547(c)(5). Finally, section 547(a) makes no distinction between rights of payment that are evidenced by instruments or are themselves covered by a security interest and those that are not. A security interest in instruments or

possession without knowledge of its existence). Even under Article 9, however, "farm products" may be converted to "inventory" if they are processed or manufactured. See id. § 9-109 official comment 4 (1972).

It should also be noted that, both under Article 9 and the BRA, "inventory" is not limited to its common meaning of personal property held for sale or lease but includes raw materials, work in progress, and materials used or consumed in a business. Thus, somewhat surprisingly, the gasoline used by a trucking company is classified as "inventory" although none of that gasoline is held for sale. See R. Braucher & R. Riegert, Introduction to Commercial Transactions 438 (1977) (concerning farm products).

\textsuperscript{183} Compare 11 U.S.C. § 547(a)(3) (Supp. IV 1980) ("receivable" means right to payment, whether or not such right has been earned by performance) with U.C.C. § 9-106 (1972) ("account" means any right to payment for goods sold or leased or for services rendered . . . ."). Under the 1962 Official Text of Article 9, the term "contract rights" was used for rights to payment not yet earned by performance and the term "accounts" was reserved for those that were. See U.C.C. § 9-106 (Official Text 1962); supra note 112. Under the 1972 Official Text, both types are characterized as "accounts," and to that extent the BRA and Article 9 are in agreement.

\textsuperscript{184} Under section 9-106 of the UCC, "general intangibles" include any personal property, including choses in action other than goods, accounts, chattel paper, documents, instruments, and money. It is a residual term that embraces a large number of rights to payment not arising out of the sale or lease of goods or for services rendered. See id. § 9-106 official comment (1972); J. White & R. Summers, supra note 151, at 775-76. With regard to real estate rentals, although section 9-104(f) provides that Article 9 has no applicability to the creation or transfer of interests in real property including the transfer of a lease, it is reasonably certain that the rental payments due or to become due under the lease as opposed to the lease itself are nonetheless classified as "general intangibles" and may be assigned pursuant to Article 9 in the same manner as any other right to payment. See U.C.C. § 9-102(3) official comment 4 (1972) (a note secured by a mortgage on realty may be pledged under Article 9 although the mortgage itself may not be).

\textsuperscript{185} Section 9-104 of the UCC contains a long list of interests, the creation or assignment of which are excluded from Article 9. Exclusion from Article 9, however, does not mean that the interest is nonassignable and cannot be used as collateral, but merely that the law governing the assignment is outside of the UCC. See U.C.C. § 9-104 official comments 4, 5 & 7 (1972).
chattel paper is a security interest in a “receivable,” although such collateral does not qualify as an “account” within the meaning of Article 9.\textsuperscript{186} Accordingly, in discussing the limitations of section 547(c)(5)'s coverage, it is important to remember just how expansive its definitions are and that it is hardly restricted to the typical accounts receivable situation which may have been its genesis.\textsuperscript{187}

Nevertheless, section 547(c)(5) does not include everything. Specifically, it does not cover security interests in equipment.\textsuperscript{188} Acquisitions of such collateral within ninety days of bankruptcy are subject to a preference challenge notwithstanding the fact that there has not been a net improvement of position in the ninety days preceding the commencement of the case. As noted,\textsuperscript{189} the reason for this exclusion was not based on any determination that such interest should be voidable but rather on the assumption that the need for statutory protection (and limitation)\textsuperscript{190} was most acute for interests in inventory and accounts receivable and was therefore the only problem that had to be addressed. Yet, notwithstanding this assertion, the failure of

\textsuperscript{186} Under U.C.C. §9–106 (1972), “accounts” are expressly limited to rights to payment which are “not evidenced by an instrument or chattel paper.” “Chattel paper” is defined to include “a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods.” Id. § 9–105(1)(b) (1972). Thus, if a merchant sold goods on credit but retained a purchase money security interest in the goods and then assigned his interest to a lender to secure an advance, the assignment would not be of an “account” but of “chattel paper.” The term “account” under Article 9 is generally limited to an unsecured right to payment not evidenced by a promissory note signed by the buyer, i.e., the typical account receivable.

\textsuperscript{187} It must be admitted that, in many of the aforementioned situations, there may be little occasion to apply the improvement of position test since there is usually no turnover of collateral, e.g., tort claims or judgments. Nevertheless, section 547(c)(5) of the BRA could be quite valuable in protecting security interests in deposit accounts where the debtor continues to make withdrawals and deposits and in insurance policies where a given policy is terminated and a substitute policy later procured. Even where the security interest in the deposit account was created through the delivery and surrender of the passbook with the debtor not having the unqualified right to make withdrawals, section 547(c)(5) permits the secured party to release some or all of the funds to the debtor without fear that a subsequent replenishment of the account would be preferential (provided, of course, that the depletion occurred after the start of the preference period).

\textsuperscript{188} “Equipment” is defined as goods which are “used or bought for use primary in business (including farming or profession) or by a debtor who is a nonprofit organization or a governmental subdivision or agency.” Id. § 9–109(2) (1972). (Property which meets the definition of “inventory,” “farm products,” however, is not classified as “equipment.” Id. § 9–109(3)–(4); supra note 182.) Section 9–102(2) also provides that any goods which are not included in the definitions of “inventory,” “farm products,” or “consumer goods” are to be classified as “equipment,” although the property was not brought primarily for business use. Thus, “equipment” is a residual category for “goods” not falling within any other Article 9 definition, just as “general intangibles” is for choses in action or rights to payment. See supra note 184.

\textsuperscript{189} See supra text accompanying note 179.

\textsuperscript{190} See supra text accompanying notes 163–65.
section 547(c)(5) to extend protection to security interests in equipment does create serious difficulties in at least one area—the corporate indenture. 191 Typically, corporate bonds are issued under trust indentures which contain after-acquired property clauses. For a variety of reasons, such long term corporate debt was, and is, generally secured by a mortgage or Article 9 security interest on fixed assets, such as land, buildings, and machinery. 192 Exclusion of security interests in such assets from the protections of section 547(c)(5) creates a serious risk that in the event machinery is later replaced due to age or obsolescence, the security interest in its replacement may be voidable as a preference. The problem is compounded when it is remembered that due to the long term nature of the indebtedness (often twenty to thirty years), it is virtually impossible to accurately assess the risk of a future bankruptcy at the time the extension of credit is made.

Since security interests in such collateral are not covered by section 547(c)(5), it is necessary to determine the extent to which other sources of protection are available. Nothing in section 547 repeals the doctrine of substitution of collateral; 193 this doctrine is expressly recognized in section 547(c)(1) which excepts from invalidation transfers intended to be “contemporaneous exchange for new value” which is in fact “substantially contemporaneous.” 194 “New value,” as defined in section 547(a)(2), includes not only the making of a new advance but also the “release by a transferee of property previously transferred,”

191 For an extended discussion of this problem, see Coogan & Bok, The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture, 69 Yale L.J. 203 (1959), revised and reprinted in 1 A P. Coogan, W. Hogan & D. Vagts, supra note 54, ch. 13, at 1341–1417. The authors correctly anticipated many of the theories which courts later applied to sustain the floating lien, though perhaps they were overly optimistic with respect to the validity of section 9–108 of the UCC.

192 According to Professor Gilmore, the use of fixed assets in long term corporate financing is directly attributable to Benedict v. Ratner, 288 U.S. 353 (1925), and its progeny. By requiring the creditor to exercise dominion over the proceeds of sold or collected accounts receivable, Benedict made account receivable and inventory financing far too expensive to be utilized on a long term basis. In the pre-Benedict era, security interests under indentures often did include accounts receivable. See G. Gilmore, supra note 6, §§ 8.1, 8.5, at 253, 267.

Benedict is no longer the law under Article 9. See U.C.C. § 9–205 official comments 1–5 (1972). Even today, however, bonds are still primarily secured by fixed assets because such collateral requires less policing and supervision from a business standpoint than does accounts receivable lending.

193 This is true at least with respect to the traditional doctrine requiring simultaneity of exchange and equivalence of value and is not repealed by section 547 of the BRA. See supra note 47.

194 See Breitowitz, supra note 22, at 414–15. Section 547(c)(1) is not limited to substitution of one item of collateral for another but is in fact principally concerned with gaps between the making of an advance and the occurrence of the transfer. It is, however, broad enough to cover substitution as well.
language clearly embracing the release of a security interest. Thus, section 547 continues to recognize that the substitution of one item of collateral for another is not a voidable preference.\(^{195}\) Moreover, by requiring only that the transfer be "substantially contemporaneous," section 547(c)(1) has eliminated the need for strict simultaneity of exchange that courts had formerly imposed.\(^{196}\)

Nevertheless, in the vast majority of situations involving new acquisitions of equipment, the "substantial contemporaneity" test has little utility. Although section 547(c)(1) may have relaxed the need for simultaneity of exchange,\(^{197}\) it still necessitates that the exchange be of

\(^{195}\) Interestingly enough, in its original revision of section 60, the Gilmore Committee went considerably further. The draft had two provisions dealing with security interests in after-acquired property. Section 60(a)(4)(IV), limited to inventory and accounts receivable, codified the "improvement of position" test which disregarded intermediate fluctuations of value. Section 60(a)(4)(III) applied to all species of after-acquired property and provided that a transfer to a creditor in substitution of a release of collateral is not voidable except to the extent that the substituted property exceeds the value of the property released. The draft further provided that the release by the transferee need not take place simultaneously with the new transfer, as long as it is made in contemplation of the transfer and the transfer actually occurs within reasonable time. Thus, under the Gilmore proposal, there was no need for the parties to intend a contemporaneous exchange nor did the exchange have to be "substantially contemporaneous," provided it met an ill-defined "reasonable time" test. Note, however, that the latitude permitted by proposed section 60(a)(4)(III) was limited to cases of substitution of new collateral for old and did not, as does section 547(c)(1), cover gaps between a cash advance and the transfer of the original collateral. In that sense, while section 547(c)(1)'s time limits are more restrictive, its coverage is more expansive.

The Commission bill dropped section 60(a)(4)(III) and contained no provision regarding substitution of collateral. Nevertheless, "antecedent debt" was defined as a debt incurred more than five days before a transfer paying or securing that debt. See Commission Report, supra note 110, Part II, § 4-607(g)(1), at 166-75. The comments to section 4-607 state that the five day grace period would have applied to releases of existing security interests as well as the making of new advances. This would have eliminated the need to codify a "relaxed substitution" rule. The standard suggested by the Commission was wholly objective without regard to the creditor's state of mind at the time of the release.

Section 547(c)(1) is thus considerably narrower in that not only was the five day grace period replaced by the standard of "substantial contemporaneity"—a period of time which in some cases may be of shorter duration—but the substitution is protected only if the requisite intent was present at the time of the release—a factor that was irrelevant under the Commission proposal. See Breitowitz, supra note 22, at 413-15 ("substantial contemporaneity" may in fact permit delay of up to 30 days, substantially longer than the five days permitted under the Commission proposal).

\(^{196}\) See National City Bank v. Hotchkiss, 231 U.S. 50 (1913) (several hour delay converted an otherwise contemporaneous mortgage into a preference). The facts of the case, however, would still not qualify for the protection of section 547(c)(1) since, although the transfer was "substantially contemporaneous," the loan was originally made with no intent to take security. See Breitowitz, supra note 22, at 414; infra text accompanying note 199.

\(^{197}\) Indeed, it has done so in two respects: first, in requiring only that the transfer be "substantially contemporaneous" with the receipt of value and, second, in its utilization of the definition of "transfer" as found in section 547(e). Whether or not a transfer is "substantially contemporaneous" is measured not by when it is perfected but when it is deemed made within
equivalent value; to the extent the creditor receives more than the property released, the creditor has been preferred. If the equipment subject to the security interest is replaced due to age or obsolescence, the value of the new collateral acquired will inevitably exceed that which it replaces, and section 547(c)(1) would therefore be inapplicable.

Moreover, even in the rare situation where collateral of equivalent value was released shortly before the acquisition of new equipment—e.g., still usable machinery was sold and new machinery of the same quality was purchased—section 547(c)(1) would still be inapplicable unless the parties intended the exchange to be contemporaneous. As noted earlier, a transfer which is merely “substantially contemporaneous” will not be protected unless the parties actually intended simultaneity of exchange but, through oversight or omission, failed to achieve it. Thus, to take one example, where the parties intended to perfect an Article 9 security interest eleven days after an advance and the interest is perfected in accordance with that intention, the security interest may be voidable as a preference, for although the transfer was presumably “substantially contemporaneous” with the advance, the parties did not intend actual contemporaneity. Accordingly, before the meaning of section 547(c)(2). See Breitowitz, supra note 22, at 413–15. Thus, as long as attachment was “substantially contemporaneous” with the advance or release and as long as perfection took place within 10 days of attachment, the security interest is protected although perfection was not “substantially contemporaneous.” Assuming, for example, that a delay of up to 30 days is deemed “substantially contemporaneous,” see id. at 413; infra note 200, section 547(c)(1) would permit attachment to take place up to 30 days after the giving of value, with perfection taking place up to 10 days later.

Where, however, attachment was intentionally delayed to a later date that is “substantially contemporaneous” with the advance, the transfer would still fail due to the lack of proper intent. See infra text accompanying note 199.

198 See Breitowitz, supra note 22, at 414–15.

199 Section 547(c)(1) protects a transfer only to the extent that it was intended to be a “contemporaneous exchange” for “new value.” The implication is that to the extent the transfer exceeds the “new value” being received, that portion of the transfer is voidable.

200 The legislative history of section 547(c)(1) suggests that delays of up to 30 days may nonetheless be deemed “substantially contemporaneous” though it is not clear to what extent this would be true for cases other than payment by check. See id. at 413 n.153.

201 Assuming the Article 9 security interest attached simultaneously with the advance and the parties intended to perfect within 10 days after the advance, because the parties intended to effect a transfer which is statutorily deemed made as of the date of the advance, the transfer is protected even if, through error or oversight, perfection was delayed beyond the 10 day period. The requirement of intent has been met and while the transfer is not deemed made 11 days after the advance, such a period still may qualify as being “substantially contemporaneous.” See supra note 199. Where the parties initially intended to delay perfection beyond the ten day period, the resulting transfer may still be “substantially contemporaneous,” but the requisite intent for actual simultaneity is lacking.
section 547(c)(1) could shield the transfer, not only would the old collateral released have to be equivalent in value to the new collateral purchased—an inherently improbable situation—but the secured party would also have to exercise dominion, or at least intend to exercise dominion,\textsuperscript{202} over the proceeds until the new items of collateral were acquired to insure that the release and acquisition were designed to be simultaneous\textsuperscript{203}—an arrangement reminiscent of the long discredited doctrine of \textit{Benedict v. Ratner}.\textsuperscript{204}

Nor does section 547(c)(3) offer much prospect for relief.\textsuperscript{205} It is, of course, possible for the original security agreement to specify that, in the event any collateral is later sold, the proceeds must be used for the acquisition of new collateral, thereby giving the secured party a purchase money security interest in the new acquisition, protectedunder section 547(c)(3).\textsuperscript{206} Section 547(c)(3), however, offers no relief in the more typical case of old collateral being retired or scrapped; rather it limits its protection to the extent of proceeds actually used in the acquisition of new collateral, an amount that may be significantly

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I have previously noted that it is arguable that as long as the parties intended to create a transfer effective between themselves simultaneously with the extension of value, an intentional delay in \textit{perfection} would not necessarily preclude the application of section 547(c)(1) (provided only that the delay in perfection did not prevent the transfer from being “substantially contemporaneous”). See Breitowitz, supra note 22, at 415.

Even if that is the case, however, an intentional delay in \textit{attachment}—e.g., by releasing the old collateral prior to the acquisition of the new—would clearly not qualify for protection under section 547(c)(1) irrespective of whether attachment is “substantially contemporaneous” with the release. Thus, the conclusion in the text that section 547(c)(1) would necessitate that the secured party exercise control, or intend to exercise control, over the proceeds until new equipment is acquired appears to be accurate.

\textsuperscript{202} If the security agreement provided that the debtor could not use the proceeds of collateral until collateral of equivalent value was acquired, even if the debtor reneges on his agreement and dissipates those proceeds, the subsequent transfer of collateral will still be protected as long as it was “substantially contemporaneous” with the dissipation. The requirement of actual simultaneity pertains only to what the parties intend, not to what actually occurs.

\textsuperscript{203} If the acquisition of new collateral precedes the release of the old, the transfer is valid notwithstanding its failure to meet the simultaneity requirement. Its validity, however, derives not from section 547(c)(1), but from section 547(c)(4). Breitowitz, supra note 22, at 411 n.147; supra note 47. The problems raised in the text deal with the more usual situation of the release preceding the acquisition, in which case the acquisition has a preferential effect, and should therefore be voidable unless it qualifies for an exception.

\textsuperscript{204} See supra text accompanying notes 5–13. That case dealt exclusively with security interests in inventory and accounts receivable.

\textsuperscript{205} For a discussion of this exception, see Breitowitz, supra note 22, at 416–29.

\textsuperscript{206} Indeed, such an arrangement appears possible even where the original advance was not an enabling loan. Section 547(c)(3) merely requires that “new value” be given to enable the debtor to acquire collateral and, under section 547(a)(2), “new value” includes the release of a security interest. Thus, even the release of property not subject to a purchase money security interest may enable the creation of such an interest in its replacement.
less than the original indebtedness and would necessitate cumbersome policing on the part of the creditor (or indenture trustee) to insure that proceeds from the secured property were in fact so used.

The express provisions of section 547 do little to address the plight of secured creditors under long term corporate indentures. Whether such creditors are to be protected at all will depend on the extent to which theories not directly incorporated into the text of section 547 continue to survive its enactment. In the preceding section of this Article, I attempted to demonstrate that despite the fact that Congress was acutely aware of the preference problems that arise in the case of after-acquired property and actively sought to address those problems—in section 547(c)(5) and, to a lesser extent, in sections 547(c)(1) and (c)(3), the congressional response was not preemptive; that there is a residual “common law” of preferences that courts developed under the 1898 Act to protect such interests; and at least some of that “common law” continues to survive under section 547 and, indeed, may survive in apparent freedom from the restrictions of the exception embodied in the statute. This is not to say that courts have free reign; obviously the enactment of section 547 imposes cer-

507 Assume, for example, that a secured party made an advance of $10,000 secured by machinery of equivalent value. The advance was not an enabling loan but the security agreement specified that all proceeds from the sale of collateral must be applied solely to the acquisition of new collateral. Five years later, the now-used machinery is sold for $5,000. The debtor, pursuant to the security agreement, uses that $5,000 plus $15,000 of his own funds to buy new machinery at a current cost of $20,000. Assuming the security interest in the new acquisition otherwise qualifies as a preference, section 547(c)(3) would protect the security interest only to the extent of $5,000, for that is the total amount of the “new value” (in the form of a release) that the secured party advanced towards the acquisition of the new item. Since the value of the original collateral at the time of its disposition may be significantly lower than the amount of the debt, section 547(c)(3) does not enable a creditor to return to the fully secured status he enjoyed previously at the time of advance.

This observation is equally true for security interests in inventory as well. While a secured lender can create a purchase money security interest in subsequent inventory acquisitions by directing that inventory proceeds are to be used solely for the replacement of collateral, the extent of the validity of that interest will be subject to downward fluctuations in the value of the inventory being sold. The risk is less serious in the case of inventory, however, since even in the absence of a purchase money arrangement, the creditor is guaranteed the value of his collateral as of the start of the preference period under section 547(c)(5).

508 Section 547(c)(3) of the BRA, like section 9–107 of the UCC, requires that the funds advanced or the property released actually be used to acquire the property. A recital in the security agreement is insufficient. Cf. U.C.C. § 9–108 (1972) (which merely requires specification in the agreement and a contract of a purchase “within a reasonable time after new value is given” in lieu of tracing). See generally Breitowitz, supra note 22, at 418–19, 426–28 (discussion of section 9–108 and “new value”).

509 See supra text accompanying notes 177–80. As noted, while the improvement of position test was indeed intended to be preemptive, section 547(c)(5)’s exclusion of security interests in equipment was not.
tain explicit limitations on what courts may or may not do, and even where no such explicit directive exists, the underlying policies and purposes of section 547 may call for the same result. Nevertheless, where Congress has expressed no policy one way or the other, courts retain the freedom, as they did under the 1898 Act, to modify the rigors of an overliteral application of section 547 in the interest of commercial reasonableness and fairness to secured lenders.

Prior to the enactment of the BRA, courts had articulated three bases—the sufficient perfection, entity, and relaxed substitution theories—for the protection of collateral acquired during the preference period. In addition, section 9–108 of the UCC provided a fourth basis, though courts were understandably reluctant to use a state statute to modify federal law. As noted, two of those bases are no longer applicable under the BRA: the “sufficient perfection” theory because of the definition contained in section 547(e)(3) and the “entity” theory because of the implicit policy behind that definition. Moreover, even under the 1898 Act, it was far from certain that discrete acquisitions of equipment could have been regarded as a single entity. “Relaxed substitution,” insofar as it would allow a creditor to improve his position during the preference period, is similarly unavailing since the stated policy of section 547 is the disallowance of such gains. Finally, while there is nothing in the BRA that expressly overrules UCC section 9–108, neither is there any provision that would support its validity and, in the absence of such a provision, it must be assumed that section 9-108 would fail.

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210 See supra text accompanying notes 32–56.
211 See Breitowitz, supra note 22, at 418 n.165; supra text accompanying notes 27–28.
212 See supra text accompanying notes 152–68.
213 See Manchester Nat’l Bank v. Roche, 186 F.2d 827, 831 (1st Cir. 1951); see also supra text accompanying note 36 (entity theory probably applied only to inventory and accounts receivable).
214 As previously discussed, any theory based on substitution of collateral would necessarily limit its protection to the value of collateral as it existed some time before the start of the preference period. It was unclear, however, whether the value as it existed on the 90th day (or one year in the case of an insider) was controlling. Thus, Grain Merchants, 408 F.2d 209 (7th Cir.), cert. denied sub nom. France v. Union Bank & Sav. Co., 396 U.S. 827 (1969), may have permitted improvements of position over the 90 day period, as long as the new gain was not in excess of the value of the collateral at some earlier point. See supra note 170 and text accompanying notes 98–103.
215 See supra text accompanying notes 160–67. Thus, the improvement of position test is the outer limit of protection that Congress permitted. Although the test appears as a limitation only on security interests in inventory and accounts receivable covered by section 547(e)(5), it is hardly likely that security interests not qualifying for the special protections and advantages of section 547(e)(5) should for that reason alone be entitled to more favorable treatment.
216 See supra text accompanying note 31.
Nevertheless, there appear to be at least two lines of reasoning which could be utilized in escaping the limitations of section 547(c)(5). First, courts could directly incorporate the two-point test, aggregating all transactions occurring within the preference period to determine their ultimate preferential effect. Support for this theory in a context other than security interests in inventory or accounts receivable could be based on the old “net result” cases which may remain valid under the BRA, and on one interpretation of the “relaxed substitution” doctrine in Grain Merchants. “Preferential effect” is an essential element for the invalidity of a transfer and there is nothing in section 547 dictating that the existence of such effect must be ascertained on an item-to-item basis. Through the process of determining net preferential effect, courts can thus extend to security interests in equipment virtually the same protections section 547(c)(5) provides for security interests in inventory and accounts receivable.

Alternatively, without going so far as to guarantee to the secured party the value of his security as of the start of the preference period, courts could sustain the validity of a substitution, as long as the new collateral was acquired within a reasonable time after the release or disposition of the old without requiring the exchange to be simultaneous. In effect, courts could conceivably relax the strict notion of antecedence, as evidenced in cases such as National City Bank v. Hotchkiss, by deeming such transfers to be essentially contemporaneous exchanges, notwithstanding the relatively small gaps in time that may exist between the release and the acquisition. While section 547(c)(1) basically accomplishes the same thing, reliance on a judicial construction of “relaxed antecedence” would obviate the need for the

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217 See Joseph Wilde & Co. v. Provident Life & Trust Co., 214 U.S. 292 (1909); cases cited in Breitowitz, supra note 22, at 411–12 nn.146–48. See also In re Fulghum Const. Co., 14 Bankr. L. Rep. (CCH) 293 (M.D. Tenn. 1981) (applying the “net result” rule under the BRA). These cases involved continuous sales of goods on open account where payments on some shipments were made during the preference period while the buyer was insolvent. The payments were not deemed preferential to the extent they did not exceed the value of the goods shipped. The theory behind this exception has been said to rest on “the fiction of treating all items of the account as one.” Wilcox v. Goess, 92 F.2d 8, 12 (2d Cir. 1937) (Hand, J.), cert. denied, 303 U.S. 647 (1938). But see infra note 234 (“net result” rule is inconsistent with section 547’s basic thrust).

218 408 F.2d 209 (1969). See also supra note 170 (Grain Merchants itself may have applied an improvement of position test).

219 See supra note 195. Essentially, this was the original proposal of the Gilmore Committee which would have protected substitutions of collateral, as long as the release was made in contemplation of the transfer and the transfer occurred within a reasonable time afterwards. My argument is that the adoption of a more rigorous standard in section 547(c)(1) is not necessarily preemptive. But see infra notes 221–22.

220 231 U.S. 50 (1913); see supra note 196.
parties to intend strict simultaneity of exchange. Intent to effect a "substantially contemporaneous" exchange would then be sufficient, though such intent does not qualify under section 547(c)(1).\textsuperscript{221} Such a construction would have to be based on the assumption that section 547(c)(1) is also a "safe harbor" and, in limiting its protection to where the parties intended a strict contemporaneous exchange, carries no negative implication regarding the protection of nonqualifying interests under other theories.\textsuperscript{222}

In sum, security interests in after-acquired property other than inventory and accounts receivable receive little or no protection under the express provisions of section 547 despite the fact that much long term corporate financing is secured by after-acquired equipment. Courts remain free, however, to supplement this limited protection by either a direct incorporation of the two-point test or through a liberal interpretation of "antecedent debt," an otherwise undefined term in the BRA.

Needless to say, to the extent that one regards the indenture problem as serious, the "solutions" briefly presented here are wholly inadequate for a number of reasons and, at best, represent only "stop gap" arguments until Congress elects to deal comprehensively with the issue. First, although courts do remain free to utilize prior theories of construction to protect interests not qualifying for the statutory exceptions, it is doubtful whether they would in fact do so. A court confronted with any issue regarding the validity of security interests in after-acquired property may well decide that the BRA is the exclusive source of all answers in view of the fact that it does deal with some aspects of the problem in considerable detail. There may well be a generalized psychological perception that section 547(c)(5) in particu-

\textsuperscript{221} It is arguable that, freed from the limitations of section 547(c)(1), courts could sustain the validity of a transfer in substitution even if the transfer was not "substantially contemporaneous" but merely was within a "reasonable time," thus incorporating both prongs of the original Gilmore proposal. See supra note 185. However, it is extremely unlikely that courts could modify the notion of antecedence to such a great extent. While a transfer that is "substantially contemporaneous" with the incurring of a debt could be characterized as a transfer not on account of antecedent debt even without an explicit statutory exception, it is difficult to perceive how the same could be said for a transfer which is not even "substantially contemporaneous" with the debt but merely within some indeterminate reasonable proximity. I would therefore conclude that the most a court could do would be to apply the same standard embodied in section 547(c)(1) but without its more rigorous requirements of intent.

\textsuperscript{222} The legislative history provides no insight into the reason why section 547(c)(1) was drafted to require that the parties intend to effect a simultaneous exchange. Accordingly, unlike the situation with regard to section 547(c)(5), it cannot be ascertained whether section 547(c)(1) is also a "safe harbor" or whether it was designed to insure that, in the absence of proper intent, even "substantially contemporaneous" transfers should be voidable.
lar was designed to put an end to the elaborate exercises in judicial theory necessitated under the 1898 Act. Any argument calling upon courts to assume substantially the same role is likely to face an uphill battle.\textsuperscript{223} In any case, pinning the protection of corporate creditors on the willingness or unwillingness of courts to assume an activist role is at best a risky situation, and ultimately an unsatisfactory one, affording those creditors no assurance of what a particular court would say at a particular time.

Second, even if the “net result” rule permits the application of the two-point test to areas not covered by section 547(c)(5), the test has been applied only in the context of a regular and continuous relationship between a buyer and seller of goods, where payments and deliveries are therefore aggregated into a single account.\textsuperscript{224} In the case of a corporate indenture, however, where the replacements are isolated and sporadic and the secured party is not the supplier, there are no precedents for regarding all acquisitions and releases of collateral as a unified, single transaction.

Finally, and most important of all, the alternative theories that are available accomplish virtually nothing. Application of the two-point test may give the secured party the benefit of the value of the equipment as of the start of the preference period, but the very fact that new equipment had to be purchased shortly afterwards, i.e., less than ninety days later, means that, in many cases, the old equipment released must already have been practically worthless.\textsuperscript{225} As for the second argument advanced, while a liberal definition of “antecedent debt” would eliminate the need for actual creditor dominion over the proceeds apparently required by section 547(c)(1), it too would apply only in the rare situation where the collateral released was of equivalent value to the machinery being retired due to age or obsolescence.\textsuperscript{226}

\textsuperscript{223} I have no empirical evidence to support this assertion but it is reasonable to assume that once Congress has addressed a particular problem, albeit incompletely, judges will be considerably more reluctant to propose their own solutions than they would have been if the statute had been silent. But cf. \textit{In re Fulghum Const. Co.}, 14 Bankr. L. Rep. (CCH) 293 (M.D. Tenn. 1981) (court did apply “net result” rule under BRA).

\textsuperscript{224} See Breitowitz, supra note 22, at 411-12.

\textsuperscript{225} It should also be remembered that the protection proposed for security interests in after-acquired equipment is limited to subsequent acquisitions that are in \textit{substitution} of earlier transfers, i.e., where there is a release of collateral. Where the new acquisition was an \textit{addition} to, rather than a replacement of, the old collateral, the security interest in the new item will clearly be voidable since neither the improvement of position test nor a relaxed definition of antecedence applies. See supra note 4.

\textsuperscript{226} If the equipment being replaced is sold rather than retired (i.e., it had some value left), the creditor could then have a valid security interest in the replacement on a substitution of collateral.
Thus, as the law now stands, there is little that can be done for the creditor whose claim is secured by after-acquired property other than inventory and accounts receivable. Perhaps such a situation is comparatively rare; it may indeed be unlikely for an insolvent corporate debtor to make a capital purchase in the ninety days preceding the commencement of the case, and in many such situations, the seller of the equipment would have a superior reclamation right under section 546(c) even if the secured party’s interest would not be deemed a preference.287 Nevertheless, the problem is real, and it is one that Congress has failed to address.

b. The Unwarranted Protection of Undercollateralized Future Advances

(i) Advances Not Made Pursuant to Commitment

Another troubling aspect of section 547(c)(5) involves the favorable treatment it extends to undercollateralized future advances. The improvement of position test does not merely compare the value of the collateral as of the start of the preference period with its value as of the commencement of the case, but rather focuses on the debt-security differential as it exists at each of those two points. Obviously, where the level of the debt remains constant, these two tests produce identical results; any increase in the value of the collateral automatically reduces the debt-security differential, thereby placing the secured party outside of the protections of section

theory (or under section 547(c)(3) if the agreement specified that the proceeds of the equipment were to be so applied) but only to the extent of the value of the collateral released.

287 See 11 U.S.C. § 546(e) (Supp. IV 1980); U.C.C. § 2–702 (1972); supra note 142. The right of a seller to reclaim goods received by a debtor while insolvent is recognized under section 546(c) only to the extent recognized by state law only if the seller makes written demand within 10 days of the buyer’s receipt. In any case, under section 2–702(3), the seller’s right of reclamation may be defeated by the “rights of a buyer in ordinary course or other good faith purchaser.” Under section 1–201 of the UCC, “purchaser” includes a party having a security interest under Article 9. It would thus appear that a secured creditor of the debtor has priority over the competing rights of a seller under section 2–702. It is arguable, however, that this priority is limited to persons who became “purchasers” subsequent to the delivery and not to persons who become “purchasers” by virtue of an earlier security agreement containing an after-acquired property clause. Accordingly, where the seller does have a reclamation right, the secured party could forfeit the value of his security even if section 547 did not invalidate the interest as a preference. See In re American Food Purveyors, Inc., 17 U.C.C. Rep. Serv. 436 (Bankr. N.D. Ga. 1976). Contra In re Daley, Inc., 17 U.C.C. Rep. Serv. 433 (D. Mass. 1975); In re Hayward Woolen Co., 3 U.C.C. Rep. Serv. 1107 (D. Mass. 1967) (all good faith purchasers prevail even where the security agreement and advance precede the delivery). See generally J. White & R. Summers, supra note 151, § 24.9, at 1027–28 (discussion of American Food Purveyors).
547(c)(5), at least to the extent of those incremental gains. However, section 547(c)(5) does permit the value of the collateral to be increased where there is an equivalent increase in the level of the debt through the making of a future advance since, in such cases, the debt-security differential remains constant.

Assume, for example, that ninety days before bankruptcy, a debt of $1,000 is fully secured by accounts receivable. The debt-security differential is therefore zero. One month later, a second advance of $1,000 is made pursuant to the original security agreement which provided for such future advances. The value of the accounts receivable at the start of the preference period was $1,000; the value of the accounts receivable as of the commencement of the case is $2,000. Although the value of the collateral has doubled, the debt-security differential has not been reduced. Since the creditor is fully secured at both points, the security interest in the new accounts receivable is not voidable. Indeed, the foregoing would be true even if, at the time the second advance was made, the additional accounts receivable had not yet arisen and in a real sense were security for antecedent debt since the improvement of position test does not compare the deficiency as of the date the second advance was made, but as of the start of the preference period.

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228 This assumes that the increase in the value of the collateral resulted from the acquisition of new inventory or accounts receivable. If the old collateral simply appreciated in value, the improvement would generally not be voidable. See infra text accompanying notes 323–96. Thus, all references in the following discussion to “improvements of position,” “increases in collateral value” or “reductions of deficiency or of the debt-security differential” should be understood as being limited to cases of new acquisitions during the preference period at a time when the debtor was insolvent.

229 See supra note 19 for a discussion of the Article 9 provisions relating to the rights of creditors who make future advances with respect to intervening lien creditors, bona fide purchasers, and other secured parties.

230 In determining the validity of security interests in bankruptcy, section 547(c)(5) necessitates that one compare the debt-security differential existing at the commencement of the case with that existing at the later of the 90 day (or one year period) and the date that “new value” was first given under the security agreement creating such security interest. Thus, where “new value” was first given prior to the start of the preference period, the differential as it existed as of the start of the preference period will be the baseline for measuring the validity of subsequent improvements even with respect to future advances.

231 The example in the text assumes that the first advance was fully secured at the start of the preference period. The utilization of the 90 day or one year period in relation to a future advance is of considerable benefit to a secured party even where the first advance was undersecured, since section 547(c)(5) limits voidability to a reduction of the differential. Assume, for example, that 90 days before bankruptcy, the secured party had advanced $1,000 when the value of the collateral was $500. During the preference period, the secured party makes a second advance pursuant to the same agreement of an additional $1,000 with the collateral still worth only $500. As of the commencement of the case, the collateral is worth $2,000. The debt–security differential has been reduced from $500 to zero; therefore, the security interest is invalidated only to the
If, however, the initial security agreement made no provision for future advances, the situation would be treated differently. Even where the original debt was fully secured at the start of the preference period, if the subsequent advance was made pursuant to a new security agreement, that second advance could be validly secured only to the extent of the value of collateral in existence at the time the advance was made. 232 If the second loan were undercollateralized at that point, a subsequent increase in the value of the security would be a preference, even though the first advance may have been fully secured. 233 This divergence in result is mandated by section

extent of $500. The secured party gets $1,500 of collateral on a total indebtedness of $2,000. The second advance thus gets paid in full although even the first advance was undersecured both at the time it was made and at the start of the preference period. Indeed, the same result would follow even if the first advance was totally unsecured. See infra note 235.

232 The same would be true where no advance was made at all prior to the start of the preference period. In that case, the creditor would be entitled to the value of the collateral as of the date of the advance only if a financing statement had been filed prior to the advance or within 10 days thereafter. Where an earlier advance had already been made, however, and a financing statement covering the same collateral is already on file, a second filing would be unnecessary even where the first security agreement for which the filing was made did not contemplate future advances. See In re Rivet, 299 F. Supp. 374 (E.D. Mich. 1969); In re Merriman, 4 U.C.C. Rep. Serv. 234 (S.D. Ohio 1967). Contra Coin-o-matic Serv. Co. v. Rhode Island Hosp. Trust Co., 3 U.C.C. Rep. Serv. 1112 (R.I. Super. Ct. 1966) (financing statement covers only the advances that were within the contemplation of the parties at the time of the filing). There are indications, however, that the 1972 version of Article 9 was designed to overrule Coin-o-Matic. See supra note 19. Since the security interest is perfected at the latest when the advance is made, the advance affects a valid contemporaneous exchange, the value of which will be protected in bankruptcy by section 547(c)(5), even if there is a subsequent temporary downward fluctuation.

233 In determining whether or not a future advance is undercollateralized at the time it is made, one must take into account not the total value of the collateral but only the debtor's equity remaining after payment of the first advance. Assume, for example, that an advance of $1,000 was made covered by $1,000 of collateral 90 days before bankruptcy pursuant to an agreement which did not provide for future advances. A second advance of $1,000 is made two months later under a new agreement at a time when the collateral is worth $1,500 ($500 of which comprises the debtor's equity). At the commencement of the case, the inventory and accounts receivable are $2,000. Because the second advance was made pursuant to a new security agreement, section 547(c)(5) directs that the debt-security differential at the time of the advance be used, rather than the debt-security differential at the start of the 90 day period. Taken literally, however, the debt-security differential even at the time of the second advance was still zero since collateral valued at $1,500 was securing a debt of $1,000, with the result that the further increase of collateral to $2,000 does not affect a reduction in that differential. This result, following from a literal reading of the statute, is highly untenable since, with no turnover or increase in collateral, the creditor would have received only $1,500 on an aggregate indebtedness of $2,000 leaving him with a deficiency of $500 which has now been eliminated through the incremental gain.

This outcome can be avoided by deducting from the value of the security any amounts necessary to satisfy prior secured claims including those owed to the same creditor. Thus, in the example above, the debt-security differential with regard to the second advance is $500 [($1,000 debt - ($1,500 of collateral - $1,000 of prior secured claim) = $500]. The subsequent increase to
547(c)(5)(B) which looks to the date of a later advance only where it was first given under the security agreement creating the interest in question. The implication is that in the case of a future advance made pursuant to the same agreement that covered the earlier advance, the ninety day period would govern, since the date of the second advance would not then represent the time when "new value" was first given under the agreement.\textsuperscript{234}

In short, section 547(c)(5) treats future advances within the preference period differently, depending on whether they were made pursuant to the initial security agreement. If the second advance was made pursuant to that earlier agreement, any improvement of

$2,000 reduces that deficiency by $500 so that the security interest is voidable only to the extent of $500, giving the creditor full payment on the first advance and 50\% on the second. But see infra note 298 (amounts needed to pay prior advances are excluded only if they are secured by nonvoidable interests).

It should be noted that a similar calculation may be necessary in the utilization of the 90 day test for a single advance as well. If, for example, there is already a senior security interest, held by a third party covering the same inventory or accounts receivable, the value of the security for purposes of measuring the maximum entitlement of the junior security interest under section 547(c)(5) should be limited to the excess over the amount necessary to satisfy the senior interest. See infra notes 252 & 291.

While the foregoing adjustments are perhaps implicit in the improvement of position test, they are not expressly mentioned in section 547(c)(5). Essentially, this could be easily remedied by amending the statute to refer to the differential between the debt and the secured claim, rather than the differential between the debt and the security interest. Under section 506, a claim is secured only "to the extent of [the] value of the creditor's interest" which automatically excludes senior liens. No such qualifying language appears in section 101(37)'s definition of "security interest." But see infra note 322 (the term "secured claim" may be unsatisfactory because it does not indicate when the interest must be perfected to be taken into account).

\textsuperscript{234} Actually, the wording of section 547(c)(5) is somewhat peculiar. It provides that the applicable time for measuring the debt--security differential is the later of the 90 day [or one year] point and the date on which "new value" was first given under the security agreement. As noted in the text, this language suggests that future advances made pursuant to the same agreement which covered the prior advance are protected through utilization of the 90 day test. However, the language goes considerably further than that. Read literally, the paragraph seems to suggest that if the creditor initially made an unsecured advance during the preference period and only afterwards executed a security agreement, the 90 day limit would still apply even if there had been no earlier advance, since the "new value" in that case was not given "under" the security agreement. Application of the 90 day period will always validate the interest since, in the absence of a prior advance, the debt--security differential will always be zero. Nevertheless, it is highly unlikely that a totally unsecured advance during the preference period would be treated more favorably than an undercollateralized one.

Thus, I am assuming that whenever an advance is first made during the preference period, the date of the advance always governs, whether it was made pursuant to a security agreement or whether the security agreement was executed subsequently. The 90 day period would be applicable only where the future advances were covered by the same security agreement under which the pre--90 day loan was made.
position relative to that second loan can be ignored even though those improvements were transfers on account of an antecedent debt.\(^{235}\)

The favoritism that section 547(c)(5) exhibits towards advances made pursuant to an earlier agreement appears unjustified, or at least

\(^{235}\) It is important to note that the use of the 90 day differential with respect to future advances can operate only to the secured creditor’s advantage. One could indeed hypothesize cases where the secured creditor was better off at the time of the second advance than he was at the start of the 90 day period but, even in those cases, utilization of the 90 day differential would not prejudice his rights.

This can be illustrated by a simple example. Assume that 90 days before bankruptcy the outstanding debt is $1,000 and the value of the collateral is only $500. Two months later, a second advance of $1,000 is made pursuant to the same security agreement, at a time when the collateral is worth $2,000. At bankruptcy, the collateral is still worth $2,000. Using the date of the second advance clearly protects the second loan, since that advance was fully collateralized at the time it was made. But see supra note 233 (this is only true if the value of the collateral was equal to the second advance after excluding the amount of the first indebtedness). Because the second advance was made pursuant to the same agreement that covered the earlier advance, however, section 547(c)(5) dictates that the differential in effect on the 90th day control. The creditor will nevertheless be entitled to the same protection as if the new collateralized advance and the old undercollateralized debt were considered separately. The debt–security differential as of the start of the 90 day period is $500. As of the commencement of the case, the differential is zero. Accordingly, only $500 of the collateral increase is voidable. The creditor gets $1,500 in satisfaction of claims totalling $2,000, the equivalent of the second advance being paid in full, exactly the same result as if the date of the second advance were used as the starting point.

The reason for this advantage is based on the fact that section 547(c)(5) calculates improvements solely on the basis of dollar amounts, rather than the percentage of debt that remains unsecured. In other words, as long as the dollar amount of the deficiency remains constant (or as long as the security interest is voidable to that extent) the creditor will be allowed to realize on the rest of the collateral notwithstanding the fact that the percentage of debt that is unsecured has decreased dramatically. In the above example, at the start of the preference period the creditor’s claim was 50% unsecured. As of the commencement of the case, both claims were 100% secured. Rather than invalidating all improvements which effect a change in that ratio (which would give the creditor only $1,000), section 547(c)(5) allows the creditor to obtain everything except the actual dollar deficiency existing at the start of the preference period. This allows the creditor to actually obtain 75% of the total indebtedness notwithstanding the fact that he was initially only 50% secured.

I argue in the text that the date of an advance made during the preference period should always be the relevant point for measuring improvements of position even where the advance was made pursuant to an agreement securing an earlier loan. Thus, I would agree with the result in the above case since the second advance was fully collateralized at the time it was made. But consider a slight variation of the facts. Assume that both advances of $1,000 were undercollateralized, e.g., at both points the total value of all collateral was only $500, but by the commencement of the case the collateral was worth $2,000. Here, too, section 547(c)(5) entitles the secured party to all of the collateral except for $500 (the extent of the deficiency at the start of the 90 day period). I submit that a creditor who was initially 50% unsecured should not be permitted to improve his position by becoming only 75% unsecured. Such cases should be governed by one of two rules: (1) as stated in the text, each advance would be subject to a different starting date so that the creditor is entitled to realize $500 on the first claim and nothing on the second, see supra note 233; or (2) alternatively, the 90 day test would be applied to both advances as section 547(c)(5) currently provides, but the improvement should be measured by percentage rather than dollar amount. Under this latter rule, if only 50% of the debt was secured as of the start of the preference period, only 50% should be secured at the end, with the result that the creditor should receive only $1,000, not $1,500. See infra text accompanying notes 259–62.
overbroad. If a loan is fully secured at the start of the preference period, it is reasonable that subsequent acquisitions and liquidations should have no effect on the validity of the security interest. But there is little reason to be solicitous of the creditor who makes a second advance on inadequate security and then seeks to improve his position by reference to a debt-security differential in existence well before the second advance was even made. The only theory that would support such a result is one of netting the transactions.236 Given the fact that one of the central policies of section 547 is to prevent creditors from improving their positions as a result of transactions occurring within a short period prior to bankruptcy,237 it could be argued that if, after the net effect of all transactions within the period is considered, the creditor has not improved his position,238 the transfers should be protected.239 Yet this is equally true where the subsequent advance is made pursuant to a new agreement.240 Whenever there is a corresponding increase in debt, additional transfers not in excess of that increase have no net preferential effect. There is no rational

236 See Breitowitz, supra note 22, at 411.
237 See House Report, supra note 109, at 177-79, reprinted in 1978 U.S. Code Cong. & Ad. News at 6138-40. As therein noted, the policy of preventing creditors from improving their position furthers two goals: (1) it facilitates equality of distribution; and (2) it serves to discourage creditors from attempting to dismember the debtor during a period of great financial difficulty, affording the debtor the necessary breathing space to attempt to reach an agreement with his creditors and avoid the drastic remedy of bankruptcy. But see infra note 239.
238 Because the total amount of debtor property transferred to the secured party during the preference period does not exceed the amount which the creditor put back in through the making of additional advances, the transfer has no net preferential effect although the advances and the acquisitions were not contemporaneous.
239 Note, however, that even where the debt-security differential does remain constant, there may still be a net improvement of position on the basis of the percentage of debt remaining unsecured.
240 See infra note 241 regarding the general validity of the “net result” argument. It should also be noted that to the extent preferential transfers are voidable to deter creditors from racing to dismember the debtor’s estate during his slide into bankruptcy, supra note 237, this argument is untenable on yet another ground. By protecting subsequent transfers on account of an initially undercollateralized future advance, section 547(c)(5) actually encourages creditors who have made that advance to seek to improve their positions by putting pressure on the debtor to overstock on inventory or “feed” the receivables by liquidating merchandise below cost. It thus fosters the very situation that section 547 seeks to prevent.
240 Indeed, if one takes the concept of netting to its logical conclusion, even if no loan was made until the preference period and, subsequent to that advance, collateral was acquired, the transfer should still be protected since there was no debt-security differential (since there was no loan) as of 90 days before bankruptcy and, in the aggregate, the creditor has taken out no more than he has put back in. The fact that section 547(c)(5) clearly disallows utilization of the 90 day differential in such a case underscores the fact that, at least in this context, the “net result” rule has little justification. See infra note 241.
reason to distinguish between future advances under old agreements and new advances under new agreements.\textsuperscript{241}

The extent to which security interests in inventory and accounts receivable should be protected depends in large part on one's perception of why such interests should be protected. I would suggest

\textsuperscript{241} In addition to the fact that under the "net result" rule, there is no basis to distinguish between future advances pursuant to the original security agreement and those which are not, there are a number of other reasons why the rule should be inapplicable. First, it is simply erroneous to speak of there being no net preferential effect in view of the fact that the percentage of debt being secured greatly increases. See supra notes 235 & 238. Second, application of the "net result" rule in the context of protecting an undercollateralized future advance fails to deter the race of diligence among creditors that section 547 generally seeks to prevent. See supra note 239.

It should also be noted that the whole notion of aggregating advances and transfers to determine their net preferential effect is essentially inconsistent with the concept of a preference. Every preference by definition involves a transfer on account of an antecedent debt and, where the transfer does not exceed the advance, the estate has not been depleted nor is the creditor any better off than if the advance and transfer had never been made at all (except for the receipt of interest payments and section 547 is clearly not limited to the recovery of interest). The creditor always takes out no more than he put in through an earlier extension of credit and, where he has received more, the excess is recoverable not under section 547 but under section 548 (which invalidates transfers without fair consideration), see Breitowitz supra note 22 at 369 n.48.

The fallacy stems from ignoring the fact that in determining whether a creditor has benefited from a transfer or whether the estate has been depleted, see id. at 366 n.37 (regarding which is the crucial element)—section 547 examines the status of the creditor and the estate as of the time the advance was made, i.e., it compares the situation of the creditor after the transfer was made with his situation prior to the transfer but subsequent to the extension of credit. It is true that an advance followed by a payment or the creation of a security interest places the estate in the same position it was prior to the advance. However, once the creditor does advance funds to the debtor, the potential pool of assets available for distribution to creditors has been enlarged. Merely restoring the estate to the level it was prior to the advance is still a depletion of its new level and it gives the creditor more than he otherwise would have received once he assumed the status of a creditor.

It is thus apparent that section 547 as a whole does not net advances and transfers, at least where the advance preceded the transfer. (Where an advance of unsecured credit was made subsequent to a transfer, section 547(c)(4) allows the advance to "cure" the earlier preference). While there was a "net result" rule under the 1898 Act which may even survive under the BRA, see id. at 411-12 nn.146-48, the doctrine has been described as "being anomalous at best," Willcox v. Goess, 92 F.2d 8, 12 (2d Cir. 1937), and is apparently inconsistent with the general operation of section 547. In any case, the "net result" rule protected payments made during the preference period even for goods received prior to the preference period. It did not limit its netting to transfers and advances made during the 90 day period as does section 547(c)(5).

In sum, where the transfer (either through payment or the creation of a security interest) occurs after the advance, the transfer always has preferential effect and netting is inappropriate even where the transfer does not exceed the consideration which the creditor has previously advanced. An undercollateralized future advance should therefore not be entitled to any subsequent appreciation arising from new acquisitions.

While netting advances and transfers may be improper, netting transfers and releases to protect prior advances which were already fully collateralized at the start of the 90 day period call for a different outcome, not on the basis of a dubious "net result" principle but on the grounds of "nondiscrimination." See infra text accompanying notes 242-51.
that the appropriate basis for such protection is essentially a policy of nondiscrimination against floating liens—i.e., that a secured creditor in bankruptcy should not forfeit his security merely because of the fluctuating nature of his collateral under circumstances where one whose collateral did not fluctuate would have been protected. Historically, it was precisely the inherent inequality of the inventory or accounts receivable lender, as compared with other secured parties, that led to the development of judicial and statutory protection for floating liens,242 and it is that disparity that needed to be eliminated in the BRA. Once this discrimination is eliminated, however, security interests in inventory and accounts receivable should not be subject to the same rules that apply to every other form of collateral.

Based on this analysis, the only transactions deserving special protection are security interests that were initially valid and nonpreferential, either because they were deemed made contemporaneously with an extension of credit or deemed made before the start of the relevant preference period which would have now become potentially invalid due to a collateral turnover.243 Allowing the creditor the benefit of the debt-security differential at the later of the ninety day period or advance generally guarantees that such forfeiture will not occur. Where an undersecured advance is made during the preference period, however, the secured party never had a valid nonpreferential security interest covering the full extent of that advance, and the fact that additional collateral is later acquired affords no basis for protection. There is a clear distinction between validating transfers which were originally deemed made prior to the preference period or which were contemporaneous exchanges and those which from their inception were on account of an originally undercollateralized antecedent debt. One who extends unsecured credit during the debtor's slide into bankruptcy should be made to assume the risk that bankruptcy will ensue within ninety days and that subsequent transfers of collateral to him will be voidable preferences. The risks of a bankruptcy ensuing within ninety days of an advance are identical for the inventory or accounts receivable lender and for one who lends on the basis of any other after-acquired

242 See supra text accompanying notes 19-29.
243 For this reason, as argued earlier, although section 547(c)(5) does not explicitly provide when the security interest must be perfected, its policy would dictate that the transfer either be perfected prior to the preference period or that it have attached prior to the preference period, with perfection within 10 days thereafter, since only under those circumstances, would the security interests be valid in the absence of turnover or fluctuation. See supra text accompanying notes 141-49.
property and, where the risks are identical, there can be no
discernible policy to favor one over the other. To the extent the
secured lender on inventory or accounts receivable already had a
nonvoidable interest, however, special protection is necessary not to
afford the inventory or accounts lender a more favored position, but
simply to place him on equal footing with all other secured lenders.

In short, the appropriate level of protection in section 547(c)(5) is
one that would place security interests in inventory and accounts
receivable on parity with security interests in other types of collateral.
This parity is attained by eliminating turnover of collateral during the
preference period as a basis for invalidation since such turnover will
commonly not occur with respect to other types of collateral. While
problems involving after-acquired property may indeed arise even in
connection with equipment financings, turnovers and fluctuations
are simply not as common as in inventory or accounts receivable
financing where the debtor is expected to liquidate old collateral and
substitute new items. Thus, in the case of nonfluctuating security, a
creditor who was fully secured prior to the start of the preference
period will usually be fully secured in bankruptcy simply because both
the collateral and its value will tend to remain constant. Similarly, if a
creditor makes a fully collateralized advance against such property
even during the preference period, he will usually be protected on the
basis of the transfer being a contemporaneous or substantially
contemporaneous exchange. In those identical circumstances
however, in the absence of section 547(c)(5) or some alternative
theory, the lender on inventory or accounts would not be protected
due to the high probability that the original collateral would be

\footnote{I recognize that there may indeed be legitimate reasons for treating security interests in
inventory and accounts receivable more favorably, e.g., because of the often cyclical nature of
accounts and inventory builds. But as noted, infra text accompanying notes 275-77, section
547(c)(5) is wholly unresponsive to these concerns. There is no basis for favoring the inventory
and accounts receivable lender in the narrow context of an undercollateralized future advance
during the preference period where such protection does not exist for an advance that was
undercollateralized at the start of the preference period. Both are equally subject to the vagaries
of off-season depletion.}

\footnote{See supra text accompanying notes 181-227.}

\footnote{See supra note 4.}

\footnote{To effect a contemporaneous exchange, the secured party would have to perfect within 10
days of the advance being made so that the transfer would be deemed made under section 547(e)
as of the date of the advance. For the transfer to qualify as a “substantially contemporaneous”
exchange under section 547(c)(1), the secured party would still have to intend to perfect within
10 days, though, if he inadvertently failed to do so, later perfection would not necessarily be fatal.
See Breitowitz, supra note 22, at 413-15 nn.153-58; supra text accompanying notes 199-204.}
replaced by subsequent preference period acquisitions.\textsuperscript{246} The principal aim of section 547(c)(5) should be to redress this imbalance and, indeed, it generally does so.\textsuperscript{249} Nevertheless, section 547(c)(5) goes considerably further than is necessary; it should not protect security interests in inventory or accounts receivable under circumstances where, even if the collateral were nonfluctuating, the transfer would be voidable—precisely the case when an undercollateralized future advance is made during the preference period and new collateral is subsequently acquired.

If transfers are deserving of protection only to the extent that the creditor previously had a nonvoidable security interest, then the relevant measuring point should always be the later of ninety days or the giving of “new value” regardless of whether the new advance was the first advance made, was made pursuant to a new security agreement, or was made pursuant to the same agreement which covered an earlier extension of credit.\textsuperscript{250} In determining the maximum level of protection, each advance should be analyzed separately, and any advance made during the preference period should be validly secured only to the extent of collateral in existence at the time the advance was made,\textsuperscript{251} irrespective of whether all prior advances were fully secured at the start of the ninety days.\textsuperscript{252}

(ii) Advances Made Pursuant to Commitment

There is, however, one qualification to this analysis. A plausible distinction can be drawn between discretionary future advances made

\textsuperscript{246} If the value of accounts or inventory items remained constant throughout the 90 day period, even this turnover would pose no problem since each new acquisition could be regarded as a substitution for an item that had been released before the collateral rises to its prior level. However, it is almost inevitable that there will be some downward fluctuation. See supra text accompanying notes 41–48.

\textsuperscript{249} But there are situations where it does not. See infra text accompanying notes 275–78.

\textsuperscript{250} Where there was a previous advance, however, the date of the second advance would be used only with regard to that second advance. If, for example, the first loan was fully secured as of 90 days before bankruptcy, but by the date of the second advance the value of the collateral was insufficient to satisfy either claim, the first advance would still be entitled to any subsequent improvement through the use of the 90 day security differential. Under the analysis presented here, the second advance would not.

\textsuperscript{251} “Collateral in existence” means collateral in excess of that necessary to satisfy any prior secured advances, see supra note 227, in which the secured party has a security interest already perfected at the time of the advance or within 10 days thereafter. See supra text accompanying notes 232 & 140–49.

\textsuperscript{252} It is important to note, however, that where several advances are made during the preference period, the calculation of the debt–security differential with respect to each advance must exclude the amounts necessary to pay off a prior advance (whether pre-90 or post-90 day) although both advances are owed to the same person. See supra note 233; infra notes 291 & 298.
pursuant to an earlier agreement and those which are obligatory.\footnote{This distinction is expressly recognized in U.C.C. § 9-204(3) (1972), which provides that "obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment." See id. § 1-201(44)(a) (1972).} Where the secured party was under no obligation to make the loan, yet elected to extend credit during the preference period, he has voluntarily assumed the risk of the debtor's going bankrupt within ninety days and, accordingly, should be limited to the collateral in existence at the time of the loan. Where an irrevocable commitment to extend credit had already been made prior to the start of the preference period, the obligatory commitment should itself be treated as an advance even though the actual advance was not made until later and may have been undersecured at the time.

The basis for this distinction can be understood if one remembers that, under section 9-203 of the UCC, one of the conditions for attachment is that the secured party give "value." Under section 1-201(44), "value" includes a "binding commitment to extend credit." Thus, under Article 9, it is entirely possible for a security interest to attach, and therefore be perfected, even prior to an advance being made, if the written security agreement contains an obligatory commitment. Since the secured party has a perfected security interest from the date of the commitment (assuming a financing statement was filed), he should be entitled to utilize differential effect on the ninetieth day even with respect to advances made subsequently.\footnote{This is simply another application of the "nondiscrimination policy" alluded to earlier. See supra text accompanying notes 242–43. In the case of other collateral where the particular items or their value generally do not change over short periods of time, once a creditor has given an obligatory commitment to advance funds and has filed the necessary financing statement before the preference period (or within 10 days after the commitment), he will be entitled in most cases to realize upon the full extent of the value in existence as of the 90th day before bankruptcy, since the transfer is deemed made within the meaning of section 547(e) not when the funds are actually advanced but as of the date of the commitment at which time the security interest took effect between the parties. Since secured parties with interests in equipment or other nonfluctuating collateral would be protected by virtue of their pre-90 day loan commitment, section 547(e)(5) should afford the same protection to lenders on inventory and accounts receivable. But see infra text accompanying notes 271–74 regarding the difficult issue where the collateral appreciated between the date of the commitment and date of the advance.}

Even with this qualification, the analysis suggested here is considerably narrower than the approach embodied in section 547(c)(5). Assume, for example, that ninety-one days before bankruptcy the creditor advances $1,000 to the debtor pursuant to a security agreement which calls for an additional obligatory advance of $1,000 within a month. At the time of the first advance, and at the
start of the preference period, the collateral was worth only $1,000. At the time of the second advance, the collateral was still worth only $1,000, but, by the time a bankruptcy petition was filed, new acquisitions swelled its value to $2,000, an amount sufficient to pay off both debts. Under section 547(c)(5), as long as the first advance was fully secured, the second advance made pursuant to the same agreement is protected even though it was undersecured when it was made.255 Under the suggested analysis, while the ninety day period would still be utilized, the obligatory commitment would itself be counted as an advance. Consequently, as of the ninetieth day there was indeed a debt-security differential of $1,000 which has now been eliminated due to appreciation in the value of the collateral. The security interest is therefore voidable to the extent of $1,000, giving the secured party only fifty percent on his claims.256

At the same time, considering obligatory commitments as part of the debt may actually benefit the secured party where no advance was made until the preference period, but was made pursuant to a loan commitment executed more than ninety days before bankruptcy. Under section 547(c)(5), the applicable debt-security differential is the one existing at the later of the ninetieth day or the date "new value" is first given under the security agreement. While the matter is not without doubt, it appears likely that an obligatory commitment to advance funds does not fall within the definition of "new value" under section 547(a)(2).257 Accordingly, the deficiency as of the date of the

255 Section 547(c)(5) provides that the applicable differential is the one existing at the later of the 90 days or the date "new value" was first given under the security agreement. In the example above, because "new value" was first given more than 90 days before bankruptcy, it is clear that the differential as of the 90th day will be controlling. However, in stating what is to be looked at on the 90th day, section 547(c)(5) refers to the difference between the debt and the security interest. "Debt" is defined in section 101(11) of the BIA to mean "liability on a claim." It is obvious that although an obligatory commitment may arguably constitute "value," but see infra note 257, it creates no immediate personal liability on the part of the debtor and consequently cannot give rise to a "debt." Accordingly, 90 days before bankruptcy, the outstanding debt was only $1,000 (excluding the additional $1,000 commitment). Since it was fully secured, the second advance made pursuant to the commitment would be protected as well. Similarly, even if the first advance was itself undersecured, e.g., collateral was worth only $500 before appreciating to $2,000 by the end of the preference period, the security interest would be voidable only to the extent of $500 ($1,000 debt−$500 security) not $1,500 ($1,000 debt + $1,000 commitment−$500 security) as my analysis suggests. See supra note 235; infra text accompanying notes 259–262 & 271.

256 Note, however, that this is true only where a deficiency existed both at the start of the preference period and at the time of the second advance. See infra text accompanying notes 267–74.

257 Section 547(a)(2) provides that "new value" includes "money or money's worth in goods, services, or new credit." Unlike section 1–201(44) of the UCC, it makes no mention of binding
advance would control. Assuming that on the ninetieth day the collateral was sufficient to cover any future advance, but that by the date of the advance it had temporarily depreciated before returning to its prior level at the commencement of bankruptcy, section 547(c)(5), as currently written, would limit the creditor to the lower value at the time of the advance. Under the suggested analysis, because the loan commitment itself constitutes "new value," the creditor could take advantage of the ninety day differential, at which point the collateral was sufficient to cover any future debt.\footnote{258}

(iii) Summary and Recommendations

To recapitulate, section 547(c)(5)'s treatment of future advances appears inadequate in a number of respects. First, in its application of the ninety day test to protect undercollateralized future advances not made under commitment (but pursuant to the original security commitments. It is possible, however, that such commitments constitute "new credit," in which case the 90 day period would indeed apply. Given the fact that, in all probability, commitments do not constitute "debt," see supra note 255, such a construction leads to the bizarre result that a creditor would be protected even if he was undercollateralized both at the start of the preference period and the time of the later advance. The commitment being classified as the first "new value" would trigger the 90 day test. However, since the commitment does not qualify as "debt," the debt-security differential is zero, so that no subsequent improvement could be voidable, a result that is highly illogical.

Thus, although the questions of whether a commitment constitutes "new value" and whether it constitutes "debt" raise separate interpretive issues, the consequences that ensue from their differentiation make it likely that obligatory commitments constitute neither "debt," for the reasons stated earlier, supra note 235, nor "new value."

It is possible, of course, that I am in error on both points and that obligatory commitments do constitute "debts" and "new value," in which case section 547(c)(5) as currently written would produce the same results that I am suggesting. Since the statute is unclear, amendments would nonetheless be helpful.

\footnote{258} This result would clearly follow if, along with the redefinition of "new value" and "debt" to include obligatory commitments, the word "first" would be retained so that the statute would provide that whenever "new value" was first given prior to the preference period, the applicable differential is the one in existence 90 days before bankruptcy. However, in light of my suggestion that the word "first" be dropped to insure that advances not made pursuant to commitment are not covered by the 90 day differential, see supra text accompanying note 250, obtaining this result is somewhat more difficult. Although the commitment may have been the first "new value" given, the advance also represents "new value" and, once the term "first" is eliminated, the statute provides no guidance as to which "new value" date is to be taken into account. Thus, if the statute provides that the applicable differential is the one in existence at the later of the 90th day before bankruptcy or the giving of "new value," such language may compels using the date of the advance.

The same problems arise in the converse situation where the debt-security differential is lower on the date of the advance than it was 90 days before bankruptcy. See infra note 260. In both cases, however, as a matter of policy the creditor should be entitled to assert the lowest differential at either of these two points. See infra text accompanying notes 267-74.
agreement) section 547(c)(5) is oversolicitous of secured creditors who make additional unsecured loans during the preference period.\textsuperscript{259} Second, even where utilization of the ninety day standard is proper, by failing to take into account obligatory commitments in calculating the debt-security differential, section 547(c)(5) protects advances later made under those commitments, although they were not covered at the start of the ninety days.\textsuperscript{260} Finally, by its failure to include "obligatory commitments" in the definition of "new value," even commitments which were fully secured at the start of the preference period, but for which no advance had yet been made, may be denied protection by applying the "date of the advance" test.

Section 547(c)(5) should be amended to correct these inequities. Specifically, the statute should provide:

(1) In the absence of a prior obligatory commitment, the applicable differential for advances made during the preference period should always be the one in existence on the date of the advance, regardless of whether this was the first advance made under the security agreement (as section 547(c)(5) provides) or was covered by the same agreement which secured an earlier one. In both cases, utilization of the ninety day differential is improper.\textsuperscript{261} Accordingly, the word "first" should be deleted from section 547(c)(5)(B).\textsuperscript{262}

(2) Where there was an obligatory commitment entered into prior to the preference period, the secured party should be able to invoke the ninety day differential (to the extent it is more gener-

\textsuperscript{259} In the context of an underecollateralized future advance that was nonobligatory, this misplaced generosity is actually expressed in two ways: (1) by utilizing the 90 day period rather than the date of the second advance where the advance is underecollateralized at the time it is made; and (2) by computing the 90 day debt-security differential on a dollar, rather than a percentage, basis. Thus, where the first (pre-90 day) advance was fully secured and the second one was not, the infirmity of section 547(c)(5) rests wholly on the fact that it uses the 90 day test to protect the second loan. Where the first advance was only 50% secured, however, and the second advance was wholly unsecured, not only does section 547(c)(5) apply the 90 day test, but it does so in a manner which actually permits the creditor to be better off than he was at the start of the 90 days. For example, $1,000 is lent at a time when collateral was worth only $500, a second advance of $1,000 is made during the preference period when total collateral is still worth only $500, and by the commencement of the case, the collateral has increased to $2,000. Section 547(c)(5), as written, treats him as a secured creditor on 75% of his claim rather than 50%. Thus, even if the 90 day test should apply with respect to nonobligatory future advances, section 547(c)(5) is still overly generous. See supra note 235; infra note 262.

\textsuperscript{260} See supra note 256.

\textsuperscript{261} See supra note 252.

\textsuperscript{262} Thus, whenever "new value" is given within 90 days preceding bankruptcy, regardless of whether it is the "first" "new value" given, the date of that value should be used for determining the debt-security differential, but only with regard to that "new value." Advances made prior to the preference period will continue to be governed by the deficiency in effect as of the 90th day. See supra note 250.
ous\textsuperscript{263} whether or not some earlier advance was actually made.\textsuperscript{264} This result can be attained by specifying in section 547(a) that "new value" includes "loan commitments."\textsuperscript{265}

(3) Where the ninety day differential is utilized, the obligatory commitment should be considered as part of the debt. The definition of the term "debt" should be so amended.\textsuperscript{266}

(4) In the case of an obligatory commitment made more than ninety days before bankruptcy, where the creditor's position has improved between the start of the preference period and the later making of the advance, the secured party should be able to claim the higher collateral value at the time of the advance.\textsuperscript{267}

A few words are necessary concerning this final recommendation since, to some extent, it appears to be declaratory of existing law.\textsuperscript{268} Nevertheless, while the creditor may already have this right under current law, special provision must be made for its continuation in

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\textsuperscript{263} See infra text accompanying notes 267–74 & 303–05.

\textsuperscript{264} Under section 547(c)(5), as currently written, obligatory commitments that were given when the collateral was sufficient to cover any advance made under those commitments are not entitled to the protection of the 90 day test unless some advance was actually made. See supra text accompanying note 257.

\textsuperscript{265} But see supra note 258.

\textsuperscript{266} As noted, supra note 255, "debt" is defined in section 101(11) of the BRA to mean "liability on a claim." The proposal to broaden the term to include commitments should appear only in section 547. The basic definition as applicable to all other provisions of the BRA should remain unchanged.

\textsuperscript{267} Putting the second and fourth recommendations together, where the creditor makes a commitment more than 90 days before bankruptcy, but makes the advance within the preference period, he should be able to claim the highest value, or lowest debt–security differential, at either of those two points, i.e., the 90 day value or the value at the time of the advance. See also infra text accompanying notes 275–94 (where it is argued that there may be yet a third date—the date of commitment—that the creditor may use).

Similarly, in the case of a commitment first made during the preference period which was then followed by an advance, the secured party should be able to utilize either the debt–security differential at the time of the commitment or at the time of the advance, whichever is lower.

\textsuperscript{268} This is true only in the narrow context covered by my fourth recommendation, i.e., where the collateral was insufficient to cover the commitment at the start of the preference period but subsequently increased so that by the time the advance was made, it was fully secured. In the converse situation, however, where the commitments were fully secured 90 days before bankruptcy but the advances were undersecured when made, section 547(c)(5), as presently written, would limit the secured party to the value of the collateral at the time of each advance ("the date new value was first given under the agreement") unless at least one advance was made more than 90 days before bankruptcy. Under the suggestion advanced in the text, the creditor would be entitled to the highest value at either of these two points. See infra note 270.
view of the other amendments suggested above. Under section 547(c)(5), as it currently stands, future advances will be subject either to the ninety day test (if some prior advance was made) or to the standard in existence on the date of the advance (if no prior advance was made). Assuming that the future advances were fully secured at the time they were made, they will be protected under either test. As previously explained, application of the ninety day test can only benefit the lender who later makes an undercollateralized future advance but cannot harm the lender who later makes a fully secured one. This stems from the fact that commitments to make future loans are not included in computing the debt-security differential. Even if there is a "gap" between the debt and the value of the collateral as of ninety days before bankruptcy, the making of a later advance even pursuant to commitment cannot widen that gap.\(^{270}\)

In contrast, under the proposals here advanced, where there was a pre-ninety day obligatory commitment, the ninety day period controls even in the absence of an advance. Moreover, obligatory commitments are treated as part of the pre-ninety day debt even where the advance comes later. Putting these two amendments together, if ninety days before bankruptcy the collateral was insufficient to cover the advance(s) for which a commitment had been made, there would be a deficiency that could not be cured by subsequent appreciation. Thus, while use of the ninety day period alone could never prejudice the lender who later makes a fully secured advance, (since the amount of that advance was not considered as part of the pre-ninety day debt) use of that period coupled with a redefinition of "debt" to include commitment does indeed result in such prejudice.\(^{271}\)

\(^{269}\) See supra note 235.

\(^{270}\) Indeed, by limiting voidability to the debt-security differential existing 90 days before bankruptcy and by excluding commitments from the definition of "debt," section 547(c)(5) protects the future advance even if it was undercollateralized both at the start of the preference period (when the advance is still a loan commitment) and at the time of the actual advance provided that at least one separate advance was made more than 90 days before bankruptcy. Moreover, even if that single separate advance was undersecured, only that differential is voidable and, to the extent the collateral at bankruptcy is sufficient to cover both advances, the second advance will be paid in full, despite the fact that it was undersecured at the time of the commitment, at the start of the preference period, and at the time the advance was actually made. See supra note 235. This particular result would be eliminated by the third proposal in the text.

\(^{271}\) Even under these proposals, however, this result does not follow inexorably. Section 547(c)(5) currently provides that the period for measuring the debt-security differential is the later 90 days or the date "new value" is first given under the security agreement. Under my first proposal, supra text accompanying note 262, the term "first" would be omitted to provide that whenever "new value" is extended during the preference period, the date of that "new value" would determine the applicable debt-security differential. Although "new value" would be
The incorrectness of this outcome is evident when one considers that security interests in collateral existing at the time of an advance can never be deemed preferential because those interests are transfers in exchange for contemporaneous "new value." Even where an advance was preceded by a commitment and the security interest attached and perfected prior to the advance, but subsequent to the commitment, the transfer is still not one on account of antecedent debt. \(^{272}\) An extension of credit which occurs after the transfer clearly validates the transfer under section 547(c)(4), even for species of collateral not protected by section 547(c)(5). Accordingly, utilization of the ninety day differential could invalidate the interest only in situations where the collateral in existence on the date of the advance is liquidated and replaced by lower values before returning to its previous level. Absent this replacement and downward fluctuation, the creditor is protected simply because no preference is involved.

The fact that the secured party would have been protected had the collateral not been replaced suggests that section 547(c)(5) should not be construed to deny protection when there is fluctuation. Denying the creditor the benefit of the value in existence at the time of the advance because the collateral was replaced would effect precisely the same discrimination against floating liens that section 547(c)(5) as a whole is designed to prevent. Accordingly, in the case of an obligatory commitment entered into more than ninety days before bankruptcy with the advance being made within ninety days, the creditor should be entitled to the highest values\(^{273}\) at either of those two points.\(^{274}\)

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\(^{272}\) Even without considering section 547(c)(4), this is clearly true under current law which defines "debt" as "liability on a claim," and excludes commitments. 11 U.S.C. § 101(11) (Supp. IV 1980).

\(^{273}\) More accurately, the lowest debt-security differential at either of two points includes as "debt" all outstanding commitments not yet made, as well as actual advances. See supra note 267.

\(^{274}\) In the case of a nonobligatory advance, however, the 90 day period would never control and the secured party would be limited to the value of the collateral at the time of the actual advance, at least with respect to that advance. See supra text accompanying note 262.

It should also be noted that the proposals in the text are based on the assumption that the exclusive date for pre-90 day advances should be the start of the preference period as section
c. The Failure to Protect Fully Collateralized Advances

(i) The Problem Under Current Law

The foregoing section has sought to demonstrate that, except with respect to certain marginal situations, the use of the ninety day test to validate subsequent future advances is generally overprotective of secured lenders. Commentators have pointed out, however, that the test embodied in section 547(c)(5) sometimes works to the disadvantage of secured lenders. Section 547(c)(5) was enacted on the assumption that any buildup of inventory or accounts receivable in the ninety days preceding bankruptcy (or within one year in the case of an insider) is generally indicative of fraud or manipulation. Yet, in many businesses, improvements of position are part of the normal business cycle. Certain seasonal industries, like farming or toy manufacturing, may have a large volume of accounts receivable during part of the year but off-season do not generate new accounts receivable. Limiting creditors to the value of whatever accounts receivable happen to be in existence ninety days before bankruptcy may severely curtail the extension of credit to such businesses, since it would be impossible to determine at what point in the year the preference period would begin. The inability to predict what the collateral will yield in bankruptcy greatly increases the risks of nonpayment to the secured creditor and may ultimately result in fewer loans being made, at higher cost, a situation that is detrimental both to debtors and to the economy as a whole.

Indeed, UCC section 9-108 is considerably more responsive to these concerns by providing that, as long as “new value” was given pursuant to a security agreement, any property that is acquired in the ordinary course of business—including, for example, seasonal increases in accounts receivable—are not deemed transfers on account

547(c)(5) presently provides. As the author attempts to show further on, this assumption is highly questionable and the date of the advance should indeed be relevant even with respect to pre-90 day advances. See infra text accompanying notes 275-94.

275 Where, on the 90th day before bankruptcy, the collateral sufficed to cover the commitment but had depreciated by the date of the advance, utilization of the 90 day test would appear to be proper, but that is precisely the case where section 547(c)(5) disallows its use, unless one advance under the same agreement had already been made. See supra text accompanying notes 257-58.

276 See Hogan, supra note 27, at 564.

277 See supra text accompanying notes 171-72.

278 Despite the congressional belief that section 547(c)(5) would prevent creditor misconduct, even an absence of improvement does not necessarily mean an absence of manipulation and, conversely, as the example in the text indicates, improvements of position may be part of the normal business cycle. See supra notes 133 & 172.
of antecedent debt. While section 9-108 of its own force is probably
invalid in bankruptcy, there is considerable merit in the policy it
expresses, and a strong case can be made for its incorporation into the
BRA by amendment.279

At the same time, it cannot be denied that the test for
improvements in position in section 547(c)(5), even with the
adjustments suggested, has the virtue of almost mechanical
application and prevents tedious and asset-exhausting litigation over
the existence or nonexistence of creditor misconduct.280 Preference
law, by and large, is no longer concerned with subjective
culpability,281 and while there may indeed be creditors who are being
shortchanged by section 547(c)(5), Congress could reasonably
conclude that the costs involved in the individual determinations
necessary to avoid such shortchanging justifies the imposition of a
general rule.

Nevertheless, the virtues of simplicity must not be taken too far.
Section 547(c)(5) fails to afford adequate protection even for the
transaction it was designed to help, i.e., where the creditor who was
initially fully secured temporarily lost the benefit of that security due
to collateral turnover and fluctuation. If, for example, a creditor was
fully secured five months before bankruptcy but by the ninetieth day
before bankruptcy a deficiency developed, under section 547(c)(5) a
subsequent increase will be preferential. Yet the same consideration
justifying the two point test—the belief that creditors should not be
disadvantaged because of the fluid nature of their collateral—would
argue for the validity of the above security interest as well. To avoid
penalizing a creditor who was fully secured at some point prior to
bankruptcy, a good argument could be made for the adoption of a
“new value” test even where value was extended prior to the start of
the preference period. Thus, although at the start of the preference

279 One commentator has suggested that net improvements of position should give rise to a
rebuttable presumption that the acquisition was not in the ordinary course of business, giving the
creditor the opportunity to validate his security by demonstrating that it was. As does section 9–108,
this would permit the creditor to take advantage of anticipated seasonal upswings. See Kron-
man, supra note 27, at 147–49. (For a definition of “rebuttable presumption,” see Fed. R. Evid.
301; Breitowitz, supra note 22, at 363 n.26.) Under Professor Kronman’s proposal, the creditor
would not have to establish the nature of the acquisition unless it resulted in a net improvement
of position. This partial incorporation of section 9–108 would thus inure only to the benefit of the
secured party and would not invalidate any manipulative security interest that would survive
under section 547(c)(5) as currently written, even where the collateral subject to that interest did
not meet the ordinary course of business test.

280 See supra note 172.

281 This is evidenced by the abolition of the “reasonable cause” requirement for transfers
occurring within the 90 days preceding bankruptcy. See Breitowitz, supra note 22, at 359 nn.8 &
9, 362–63.
period the debt happened to have been undercollateralized, a subsequent increase would not be invalid. Simply substituting “new value” in lieu of ninety days, however, is equally unsatisfactory, for it would have the effect of cutting off incremental gains which accrued at a time when the creditor was entitled to improve his position. By setting up the later ninety day comparison point, the statute protects those gains.

If the policy of section 547(c)(5) is the prevention of forfeitures due to turnovers and fluctuations of collateral and if creditors are therefore protected in bankruptcy to the extent they did have a perfected indefeasible security interest prior to the preference period, there is no apparent reason why only the value on the ninetieth day should be accorded any special significance. If a creditor makes an advance more than ninety days before bankruptcy, he should, in theory, be entitled to the highest value of his collateral at any point between the date of the advance and the beginning of the preference period. Otherwise, secured parties would lose what they already had solely because of the type of collateral that was taken as security.\(^{282}\) Thus, while advances made within the ninety days preceding bankruptcy should be limited to the value in existence on the date of the advance, since any subsequent appreciation represents a transfer on account of an antecedent unsecured debt, where the advance was made more than ninety days before bankruptcy, the secured party should be able to utilize the lowest debt-security differential that had existed prior to the start of the preference period even if that differential had been increased by the ninetieth day.\(^{283}\) It is the former, rather than the latter, differential that truly represents the extent to which the creditor was validly secured and should therefore be the basis for determining any illicit improvement of position.\(^{284}\)

\(^{282}\) I have advanced a similar interpretation regarding the scope of “relaxed substitution” under the 1898 Act. See supra text accompanying notes 97–104.

\(^{283}\) In order for the secured party to be guaranteed this differential, however, it would be essential that the security interest be perfected prior to the start of the preference period. Where perfection occurs within the preference period in reliance on section 547(e), the secured party would be limited to the value of any collateral acquired by the debtor more than 90 days before bankruptcy but within 10 days preceding the filing. See infra text accompanying notes 296–300.

\(^{284}\) In the case of an obligatory commitment, this would mean that the secured party should be able to invoke the lowest debt-security differential at any time between the commitment and the start of the preference period even if no advance was made until afterwards, since Article 9 provides that the commitment constitutes “value” for purposes of attachment and perfection and, as I have earlier suggested, should be deemed “new value” for purposes of section 547. See supra text accompanying notes 263–64. Moreover, if the advance was actually made within 90 days preceding bankruptcy, he could even invoke the debt-security differential at the time of the advance as well, if more advantageous. See supra text accompanying note 267.
While this position may have conceptual merit and may entail less difficulty than a wholesale adoption of UCC section 9-108, it too is hardly practical. Under old "substitution" doctrine, the validity of a floating security interest was limited to the lowest value of the collateral within the preference period. The proposal outlined above would limit the interest to the highest value of the collateral at any time prior to the ninety day period. Thus it would necessitate the very inquiry into fluctuating values at various points that the provision was designed in part to avoid. As the Gilmore Committee noted, the two-point test not only avoids inquiry into subjective intent but seeks to eliminate complicated and expensive litigation on valuation problems as well. Computing the debt-security differential for each day of the indebtedness up to the start of the preference period may simply be too costly and time consuming to be required as a matter of course in every bankruptcy where creditors are claiming security interests in after-acquired inventory and accounts receivable. The very frequency of the issue calls for a rule that can be applied with almost mechanical simplicity and that can resolve the rights of secured creditors in an expeditious manner.

(ii) Proposed Amendments to the Ninety Day Test

The impracticality of computing the debt-security differential on a daily basis, however, does not preclude the adoption of an intermediate approach, one that is considerably more protective of secured lenders than is section 547(c)(5). A legitimate argument can be made for disregarding upward fluctuations of collateral between the date of the advance and the ninetieth day before bankruptcy but nonetheless taking into account the value of the collateral on the date of the advance, if that value was greater (or the debt-security differential was lower) than it was at the ninety day point. To the extent that a creditor improves his position only because of a collateral

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585 Only in the sense of not inquiring into the subjective intent of the parties. In point of fact, it may be considerably more difficult to ascertain a daily debt-security differential than to determine whether a given acquisition was made in the ordinary course of business.

586 See supra text accompanying notes 41–47. This was to insure that the value of the property transferred did not exceed the value of the property contemporaneously released to the debtor.


588 See Proposed Bankruptcy Rule 1001 advisory committee note (1982) (the "objective of expeditious and economical administration of cases under the [Bankruptcy] Code has frequently been recognized by the courts to be a chief purpose of the bankruptcy laws") (citing Katchen v. Landy, 382 U.S. 323, 328 (1966); Bailey v. Glover, 88 U.S. (21 Wall.) 342, 346–47 (1874); Ex parte Christy, 44 U.S. (3 How.) 292, 312–14, 320–22 (1845)).
turnover subsequent to the making of the advance, there is little basis for complaint if the same process results in a higher debt-security differential by the beginning of the preference period.\footnote{Where the benefit arises because of some special characteristic of the collateral and that same characteristic results in a forfeiture of that benefit, the secured party is in a position where he must take the "bitter with the sweet." Cf. Arnett v. Kennedy, 416 U.S. 134, 154 (1974).} Placing security interests in inventory and accounts receivable on parity with security interests in other forms of collateral hardly necessitates that the secured party get the benefit of subsequent appreciation arising from collateral replacement and fluctuation which then dissipates by the ninetieth day—a circumstance that in all probability would not even have occurred with respect to these other forms of collateral. The "windfall" nature of such fortuitous appreciation,\footnote{The term "windfall" is somewhat of a misnomer as applied to anticipated seasonal upswings in collateral. Nevertheless, where a creditor places principal reliance on collateral turnover and appreciation as a basis for his security, he is attempting to utilize an advantage that is not generally available to one who lends on equipment or other nonfluctuating security, and, in that sense, is indeed receiving a "windfall."} coupled with the administrative inconvenience and expense in ascertaining it, justifies using the ninety day value as a ceiling although the collateral may have been worth more at some earlier date.

Neither of these considerations should operate to deprive the creditor of the value of his security on the date of the advance. To the extent of that value, there was no express reliance on any upward fluctuation, and while arguably the secured lender should run the risk of downward fluctuation, the basic premise of section 547(c)(5) is to place the inventory or account receivable financier in as favorable a position as one who lends on stable security. Consistent with that premise, section 547(c)(5) should go further than it does, and not only permit the secured party to utilize the debt-security differential existence ninety days before bankruptcy but, at the same time, should guarantee the value of the collateral at the time the advance was made by giving the creditor the benefit of the higher value (or the lower debt-security differential) at any of those two points.\footnote{Allowing the secured party to utilize the debt-security differential as of the date of the advance would appear to benefit the secured party not only where the collateral depreciates between the date of the advance and the start of the preference period, but also where additional advances were made covering the same collateral. In fact, however, where the value of the collateral remained constant, but the differential was increased by additional pre-90 day advances, the results under the proposed test are identical to those under section 547(c)(5) as currently written. Assume, for example, that six months before bankruptcy a creditor lends a debtor $1,000 secured by collateral of equivalent value. Three months later, the creditor lends an additional $1,000 at a time when the collateral is still worth $1,000. Thus, by the 90th day of bankruptcy, there is a total debt of $2,000 secured by collateral of $1,000. Utilizing the 90 day period, as does section 547(c)(5), the creditor is undersecured to the extent of $1,000. Utilizing the lower differential at the date of the first advance, the creditor would be fully secured.} The
mere addition of one more date in the determination of the validity of an improvement of position should not generate protracted litigation on valuation questions and appears to be more consistent with the overall policy of nondiscrimination.292

Section 547(c)(5)(A) currently requires use of the debt-security differential as it exists (i) ninety days before bankruptcy or (ii) one

Nevertheless, this is true only with regard to the first advance which was fully secured at the time credit was extended. When the second advance was made, the $1,000 of collateral was already covering the first advance, see supra note 233, and there was in fact no security at all covering the second advance. The debt-security differential with regard to the second advance was equal to the amount of the debt both on the date of the advance and on the 90th day before bankruptcy. Just as one who lends during the 90 day period should be unable to invoke the lower debt-security differential existing on the 90th day, see supra text accompanying note 262, subsequent advances made prior to the start of the preference period should not be protected by reason of the lower differential that was applicable to earlier loans. But see infra note 298 (amounts necessary to pay prior advances are excluded only if those advances are secured by nonavoidable interests).

Accordingly, while section 547(c)(5) as it currently reads would provide that there is a debt-security differential of $1,000 for a total debt of $2,000, the proposal would provide that the debt-security differential for the first advance is zero. For the second advance, the differential is $1,000. Therefore, to the extent the collateral at bankruptcy is worth more than $1,000—the amount sufficient to pay off the first advance—the security interest will be unprotected under both section 547(c)(5) and the proposed amendment.

The basis for excluding the value of collateral necessary to satisfy the first advance in the calculation of the debt-security differential existing at the time of the second advance rests on the fact that, had the loans been made by two different persons, the holder of the first loan would generally be entitled to payment before any distribution is made to the second creditor, at least in cases where both parties have filed financing statements simultaneously. Indeed, this is true even if the security interest covering the first advance was unperfected at the time the second advance was made. See infra text accompanying note 296. While section 9–312(5) of the UCC generally provides that, as between two competing Article 9 interests, the “first to file or perfect” has priority, where neither party perfected or both perfected simultaneously priority would be accorded to the “first to attach”—which in this case would mean the first who gave value. (In the example given, the interest securing the second advance could never be perfected before the interest securing the first advance simply because, as soon as a financing statement is filed, it will automatically cover both advances). Thus, although, as a matter of state law, the secured party may be able to allocate the $1,000 of collateral to the payment of either the first loan or the second loan, in calculating the differential at the time of the second advance amounts needed to satisfy the first advance will be excluded. This prevents the secured party from asserting that each loan individually viewed is in fact fully secured because the value of the collateral is sufficient to pay it off. In this respect, section 547(c)(5) as currently written precludes this argument more directly by simply aggregating all pre–90 day debts in determining the applicable differential. Under a proposal which allows each advance to have a separate starting point, however, this aggregation is not possible.

In sum, the sole benefit in giving the secured party the option of two measuring dates occurs in cases where the debt-security differential is increased through collateral depreciation. The proposed test will not help the secured party if the differential was increased through the incurrence of additional debt.

292 It is true that the policy of “nondiscrimination” offers little solace to the seasonal lender who finds himself undercollateralized both at the time of his advance and at the start of the preference period, and who then becomes fully secured during the preference period as a result of anticipated seasonal upswings. But given the fact that determining the proper extent to which
year before bankruptcy if the preferred creditor was an insider, provided that the first "new value" preceded the start of the relevant preference period. To achieve the objective outlined above, a proviso should be added to the end of section 547(c)(5)(A) to the effect that if, on the date "new value" was extended under the security agreement, the difference between the debt and the security was lower than it was at the time specified in (i) and (ii), that date shall be substituted for (i) or (ii), whichever would otherwise apply.  

such lenders should be protected is unduly expensive and administratively inconvenient, see supra text accompanying notes 270–81, the proposals advanced are at least a second best choice, preventing some, if not all, of the forfeitures allowed by section 547(c)(5).

It must be emphasized that the creditor's only option is to utilize the differential on the date of the advance or the 90th day and that he cannot utilize any interim values, even those in existence at the time of attachment. Where value was extended pursuant to a security agreement, the values at the time of the advance and at the time of the initial attachment are identical. But this will not always be the case. Attachment may take place subsequent to an advance where the agreement is executed to secure antecedent debt. Assume, for example, that six months before bankruptcy, a creditor lends the debtor $1,000 on unsecured credit. One month later, the parties execute a security agreement covering the antecedent debt. At the time the agreement is executed, the collateral is worth $1,000. Ninety days before bankruptcy, the collateral has depreciated to $500 due to turnovers and fluctuations. As of the date of attachment, the collateral was worth $1,000. Since the security interest attached subsequent to the extension of credit, its value should not be used in calculating the debt–security differential. The debt–security differential at the time of the advance was $1,000, since no security interest had been taken. The differential at the time of the preference period ($500) is lower and would therefore control.

As a matter of policy, it is not entirely clear whether this outcome is justified. To the extent the creditor is getting no more than he had at the time when the security interest originally attached, the secured party was not improving his position by reliance on the fluid nature of the collateral. See supra text accompanying note 291. Accordingly, a good argument could be made for substituting the date of initial attachment (or, more accurately still, the date on which the security interest would have attached if the debtor had property), rather than the date of the advance, as the creditor's initial point of reference.

While this approach appears to be even more consistent with the policy of nondiscrimination suggested in the text, the proposal in the text does not go so far for a number of reasons. First, the date of "new value" will generally be the date of initial attachment except in the relatively infrequent case of a creditor who initially makes an unsecured loan and then takes a security interest. Second, the date of "new value" is necessarily the required point of reference with regard to advances made during the preference period under section 547(c)(5)(B). To the extent the post–90 day advance was unsecured at the time it was made, subsequent execution of the security agreement clearly effects a transfer on account of an antecedent debt. It may therefore be preferable to adopt the same standard as a modification to section 547(c)(5)(A) rather than introduce a third variable.

Finally, the formulation of an alternative standard in lieu of "new value" is very difficult. While it is certainly arguable that the secured party should not be limited to the value of the collateral at the time of the advance where the security agreement was executed subsequently, the date of attachment is not necessarily the proper alternative. If a creditor makes an advance pursuant to a security agreement at a time when the debtor had no collateral, that creditor should not be entitled to invoke the value that arises later although the security interest attaches only upon the acquisition of that value. The appropriate cutoff date would be neither the date of "new value" nor the date of initial attachment, but the later of the giving of value and execution.
This proviso should not be taken to imply that if the deficiency is greater on the day of the advance (i.e., the value of the collateral is less), the ninety day or one year differential would necessarily control. It must be emphasized that the proposed revision deals solely with advances made more than ninety days before bankruptcy where the statute currently provides exclusive reference to the ninety day differential and the proposed amendment would extend that reference to encompass the date of the advance as well. With regards to a future advance during the preference period, however, for the reasons stated earlier, a creditor should clearly not be entitled to invoke the ninety day differential and would be limited to the value of the collateral on the date of the advance, at least where the advance was not made pursuant to prior commitment. The proviso suggested here would thus be applicable only for cases falling under section 547(c)(5)(A), i.e., when advances are made prior to the appropriate preference period. This new proviso merely operates to protect the value of the collateral at the time of the earlier advance. It would have no effect when section 547(c)(5)(B) applies because “new value” is first given within the preference period.

(iii) Perfection Requirements Under the Proposed Test

While the application of this modified test is fairly straightforward, it does raise certain complications regarding the necessary time of the security agreement, i.e., the date on which the interest would have attached if the debtor had property. Only the value, if any, on that date truly represents the extent to which the creditor was not relying on the fluctuating nature of the collateral to improve his position. Adoption of this standard creates an intolerably complex statute which would first provide that the applicable differential is the one in existence at the later of 90 days or the giving of “new value” and would then go on to say that, where the advance was made prior to the preference period, the 90 day differential would govern only to the extent that it is less (i.e., collateral is more) than the differential in effect on the later of the giving of the advance or the execution of the security agreement. There is a limit (even for this author) as to how far one goes in the name of conceptual neatness.

It should again be emphasized that the discussion in this note as to whether advances made more than 90 days before bankruptcy should be subject to the differential on the date of attachment, the date of “new value,” or some third alternative refers only to situations where the differential at any of these points is less than the one in existence on the 90th day. To the extent the creditor’s position has improved by the start of the 90th day, the secured party would clearly be entitled to the benefit of that improvement, as the statute currently provides. Thus, unlike the utilization of the “new value” date in section 547(c)(5)(B), which is exclusive, the proposed “new value” date added as a proviso to section 547(c)(5)(A) merely gives the creditor an additional option.

284 See supra text accompanying notes 243-51 & 262.
285 This would be true even if the future advance was made pursuant to the same security agreement which covered an earlier advance, as long as the second advance was nonobligatory. See supra text accompanying notes 253-58.
ing for perfection. In providing that the secured party is entitled to the lower debt-security differential at the time of the advance or on the ninetieth day preceding bankruptcy, the above proposal would clearly grant the creditor this option even if the security interest was unperfected at the time of the advance (and at the time of the higher value), as long as a filing was made at some time prior to the preference period. \textsuperscript{296} If, for example, six months before bankruptcy, the secured party lends debtor $1,000 secured by accounts receivable having a value of $1,000, but does not file a financing statement until ninety-one days before bankruptcy at a time when the accounts are worth only $500, the secured party could still assert the status of a fully secured creditor on the basis of the debt-security differential being zero at the time of the advance although the secured party never had a perfected interest in that higher value. \textsuperscript{297} Where a filing was made within the preference period, however, the secured party would be limited to the value of any collateral items acquired by the debtor before the start of the preference period but within ten days preceding the filing and could not utilize higher

\textsuperscript{296} See supra text accompanying note 283. It should be pointed out that drafting language to reach this logical result may pose formidable difficulties. It has been previously observed that section 547(c)(5) fails to specify whether, and when, a security interest must be perfected before it can be included in calculating the debt security interest differential. See supra text accompanying notes 136–49. As noted, the use of the term “transfer” in lieu of “security interest” would clarify that the secured party is not entitled to utilize the value of all collateral in existence at the start of the preference period but only the collateral in which a “transfer” has been effected, i.e., the security interest was already perfected on the 90th day or had attached by the 90th day and was perfected within 10 days of its attachment. Yet, while “transfer” is the correct concept to use in connection with the 90 day differential, it is unduly restrictive as applied to the date “new value” was given. There is no need for the security interest on the date of “new value” to be a “transfer.” Even if the security interest at that date was perfected more than 10 days after attachment, as long as it was perfected before the start of the preference period, that value would have been realizable in bankruptcy and, accordingly, should be available as a base for determining the permissible level of protection. Use of the term “security interest,” however, is equally inappropriate since it would connotate that mere attachment would suffice when in fact perfection at some point before the 90th day (or else within 10 days of attachment) should be necessary. The amendment to section 547(c)(5) would therefore have to specify which security interests are to be taken into account in calculating the differential on the “new value” date. Use of the previously suggested term “transfer” would not be sufficient.

\textsuperscript{297} This again follows from the nondiscrimination principle discussed previously. See supra text accompanying notes 241–44. Whenever perfection takes place prior to the start of the preference period, the creditor is always entitled to whatever collateral was then in existence (even in the absence of section 547(c)(5) which is designed to protect preference period acquisitions) and, had there been no turnover or downward fluctuation, that would have included those higher values. The fact that the higher value was partially dissipated by the start of the preference period is an adverse consequence unique to the inventory and accounts receivable lender for which he should not be penalized. Thus, giving the secured party the benefit of whatever he would have received had the collateral been stable compels utilization of a lower differential on the date of the advance whenever perfection occurs prior to the start of the preference period.
values to the extent they represented acquisitions at an earlier date. Assume, for example, that six months before bankruptcy, a creditor lends the debtor $1,000 secured by accounts receivable of an equivalent value. On the nineteenth day before bankruptcy, the accounts receivable are still worth $1,000, though the specific accounts at the two points are not the same. The secured party files a financing statement five days later. The secured party would not be able to deem himself fully secured either at the time of the advance or at the start of the preference period and would be limited to the value of the specific accounts receivable that were acquired in the last five days preceding the start of the preference period (which are within ten days of the filing). Only to that extent did the creditor have a valid security interest that would have been realizable in bankruptcy in the absence of a collateral turnover. In this particular case, the results obtained under the proposed test are identical to those under section 547(c)(5) as currently written.

There are situations, however, where the tests differ even where perfection occurs within the ninety day period. Assume that ninety-five days before bankruptcy a creditor lends the debtor $1,000 secured

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298 It should be noted that, to the extent an advance is not protected by section 547(c)(5) due to a delay in perfection, amounts otherwise necessary to pay that advance should not be excluded from computing the debt–security differential relative to a second advance whether by the same or a different lender. Assume, for example, that the secured party lends debtor $1,000 at a time when the value of the collateral is worth $1,000. One month later, on the 91st day before bankruptcy, the secured party makes a second advance of $1,000 but, both at the time of the second advance and at the start of the preference period, the collateral is still worth only $1,000. Assume further that the second advance was not pursuant to commitment and the secured party perfects within 10 days of the second advance. In the absence of the prior advance, he would clearly be deemed fully secured as of the 90th day. See infra text accompanying note 301. Under those circumstances, although generally even the second advance would be deemed unsecured since after deducting amounts necessary to pay the senior interest, there is no excess left to pay the senior claim, see supra notes 233 & 291, because the first advance itself has no valid security interest in bankruptcy (since its interest was perfected within the preference period and more than 10 days after attachment), the entire value of the collateral may be applied for purposes of section 547(c)(5) to the second advance. The same result follows if, e.g., two advances were made during the preference period with perfection taking place within 10 days of the second. Because the first advance would then be deemed unsecured within the meaning of section 547(c)(5), an amount equivalent to that advance need not be excluded in valuation of the collateral for purposes of the second advance which was timely perfected.

299 Put differently, the debt–security differential at the time of the advance is equal to the entire advance since none of the security interest would have been valid in bankruptcy. The debt–security differential on the 90th day is lower because some of the security interest would have been enforceable in bankruptcy, i.e., the interest in acquisitions made within 10 days preceding perfection. Consequently, the 90 day differential would control.

300 I am assuming that the perfection standards under the current version of section 547(c)(5) are those that I have previously suggested. See supra text accompanying notes 136–49; infra text accompanying note 309.
by accounts receivable worth $1,000. By the start of the preference period, the accounts receivable are only worth $500. The creditor files a financing statement eighty-six days before bankruptcy. At the commencement of bankruptcy, the accounts receivable (all of them new accounts generated during the preference period) are once again worth $1,000. Because perfection of the security interest took place within ten days of the advance (which is a necessary step for attachment), it is clear that the creditor did have a valid, nonpreferential security interest in all the accounts receivable that were in existence prior to the ninetieth day, even those that were acquired by the debtor more than ten days before the filing. No transfer of a security interest in accounts receivable occurred until the advance, and section 547(e) validates pre-ninety day transfers that are perfected during the ninety day period as long as they are perfected within ten days of their taking effect. The only issue then becomes whether section 547(c)(5) should operate to protect the accounts receivable that were acquired during the preference period. Section 547(c)(5) as currently written limits the secured party to the debt-security differential on the ninetieth day before bankruptcy, notwithstanding the fact that he was fully (and validly) secured at the time of the advance. The secured party is accordingly only entitled to $500 of collateral. Under the proposal here advanced, because the secured party could have asserted a security interest in $1,000 of accounts receivable had there been no fluctuation, he can now assert that status in bankruptcy under section 547(c)(5). The same result would follow if the financing statement were filed prior to the preference period. Section 547(c)(5) as written would still limit the creditor to $500. The proposal would give him $1,000.

Thus, whenever perfection occurs within the preference period (unless it also occurs within ten days of the advance), both analyses would limit the secured party to the value of whatever collateral was acquired within the ten days preceding the filing of a financing statement (but in existence on the ninetieth day). The analyses differ, however, where the financing statement was filed more than ninety days before bankruptcy or where the financing statement was filed during the preference period but within ten days of the pre-ninety day advance.\textsuperscript{301}

\textsuperscript{301} Both standards deny the secured party the benefit of any appreciation arising subsequent to the making of the advance which dissipates by the 90th day even where that higher value would have been enforceable in bankruptcy had it not been replaced. See supra text accompanying notes 291-92. In the case of perfection within the preference period, this would mean that not only are creditors limited to the value of accounts receivable that were acquired in the 10 days preceding the filing (but prior to the preference period) but can regard themselves as secured only to the extent of those new accounts existing on the 90th day. If, for example, in the 10 days
(iv) Loan Commitments Under the Proposed Test

I have already argued that an obligatory loan commitment should be characterized as "new value." As applied in the present context, the secured party would be entitled to invoke the lower differential on the date of the commitment or on the ninetieth day, just as one who had actually advanced funds would have been able to utilize either date. In addition, where the advance itself was made within ninety days, the secured party could even use the differential on the date of the advance to the extent that it is more favorable. Thus, the creditor who made an obligatory commitment would be able to utilize the best of three points to measure the permissible level of protection in bankruptcy: (1) the date of commitment; (2) the

preceding perfection, $500 of new accounts receivable were generated but by the 90th day only $100 of those accounts remained uncollected, the secured party who delays filing is limited to the $100 value. This is true although the value of all accounts receivable in existence on the 90th day may exceed $500.

303 See supra text accompanying notes 236-43.

304 Where an advance is made during the preference period pursuant to an earlier commitment, the secured party is entitled to realize on the collateral in existence at the time of advance not because the resulting transfer is contemporaneous with the extension of credit for, unlike the case of a discretionary advance, the interest may attach even prior to the advance at any time after the commitment was given. Rather the basis for protection lies in the fact that where the transfer preceeds the extension of credit, the advance cures the preference under section 547(c)(4). See supra text accompanying notes 271-72. Whatever the reason, however, as long as the secured party would have been entitled to realize on that value in the absence of a collateral turnover, the proposed revision of section 547(c)(5) would protect interests in new acquisitions to the same extent.

It should be noted that allowing the secured party to utilize the debt-security differential on the date of the advance made during the preference period even where the commitment was given more than 90 days before bankruptcy benefits the secured party in two ways. First, it gives him the benefit of any collateral appreciation, i.e., reduction of deficiency, between the 90th day and the date of the advance. Second, it permits the inclusion of security interests that were unperfected at the start of the preference period (or within 10 days thereafter), as long as the interests were perfected by the date of the advance, so that the transfers were deemed made prior to the advance, allowing section 547(c)(4) to come into play. Moreover, even if perfection occurs after the advance, transfers which attached before the advance and within 10 days preceding perfection will still be taken into account, although, unlike the situation of a discretionary future advance, perfection within 10 days of the advance will not guarantee that all collateral in existence at the time of the advance will be included. See infra text accompanying notes 306-07. Indeed, the foregoing analysis could be pursued one step further. Even if the collateral depreciates between the 90th day and the date of the advance, and the secured party desires to invoke the lower differential in effect on the date of the commitment or on the 90th day, it would still be unnecessary to perfect prior to the start of the preference period or even within 10 days thereafter. Perfection at any time prior to the advance would have protected those higher values under section 547(c)(4) (assuming no downward collateral turnover), and, accordingly, those values should be protected under section 547(c)(5) as well. The oft-repeated statement in the text—that the only security interests that can be taken into account in determining the debt-security differential on the 90th day are those which were perfected prior to the preference
ninetieth day before bankruptcy; and (3) the date of the advance. Indeed, the creditor should have the option of utilizing the debt-security differential on the date of the advance whether the advance under the commitment was made during the preference period or beforehand, e.g., where the collateral appreciated between the date of the commitment and the date of the advance but then depreciated by the ninetieth day before bankruptcy.

Under the proposal outlined in the text, the secured party would have these three options regardless of whether any other advance was actually made more than 90 days before bankruptcy. (Of course, existing collateral must first be allocated to earlier advances, so that the particular advance under consideration may be undercollateralized. See supra note 233 & 291.) Moreover, as noted supra note 303, any of these options may be exercised even if no financing statement was filed until the time of the advance. Under section 547(c)(5) as currently written, if no advance on a prior loan commitment was made until the preference period, the secured party may utilize only the differential in effect on the date of the advance (which required that the interest either be perfected prior to the advance or within 10 days of attachment, see supra note 303). The proposed amendment is thus considerably more generous in affording the secured party two additional options, neither of which entails any additional perfection requirements.

It must be noted, however, that where some advance was made prior to the preference period, the current version of section 547(c)(5) is actually more protective with respect to the second advance. Section 547(c)(5) presently provides that, as long as the second advance was made pursuant to the same agreement which covered the first one, and a fortiori where the second advance was made pursuant to a commitment, the applicable differential with respect to both advances is the one in existence on the 90th day. Although, on its face, this appears to be more restrictive than the three options available under the suggested revision, it must be remembered that, in calculating the level of debt on the 90th day before bankruptcy, section 547(c)(5) probably does not include commitments. See supra text accompanying note 257. Utilization of the 90 day differential with respect to a future advance always has the effect of permitting the payment of the second advance in full (to the extent that collateral in existence at the time of bankruptcy is sufficient to do so). Indeed, because the debt-security differential is based on a fixed dollar amount rather than on the percentage of debt remaining unsecured, the second advance will be paid in full (irrespective of its being undercollateralized at the time it was made) not only where the first advance was fully secured but even if it were only partially secured or even unsecured. See supra note 235.

Where the commitment was made more than 90 days before bankruptcy but where the advance was made within the preference period, the creditor should be entitled to the value as of the date of the advance (if higher) since any advance made subsequent to a transfer cures the transfer under section 547(c)(4); collateral acquired prior to the advance represents a value that would have been realizable in bankruptcy had there been no collateral turnover. See supra text accompanying notes 271–72. Section 547(c)(4) has no bearing, of course, in situations where both the commitment and the advance were made more than 90 days before bankruptcy. Where the advance is also made prior to the preference period, the basis for utilizing the value on the date of the advance under my proposal lies in the fact that any collateral that was acquired at any point more than 90 days before bankruptcy would always have been realizable in bankruptcy had there been no collateral turnover and therefore section 547(c)(5) should protect new acquisitions to the same extent.
The foregoing is clearly true where the security interest was perfected prior to the preference period. Where perfection occurs within the preference period and validation is sought through the use

In that sense, however, the date of a pre-90 day advance is no more significant than any other date in the interim between the commitment and the start of the preference period. I have already argued that appreciation during that interim period should be ignored. See supra text accompanying notes 289-92. The date of the advance should be material only insofar as the value on that date represents the extent to which the creditor was not relying on the fluctuating nature of the collateral in his decision to extend credit to the debtor. See supra note 293. Where the secured party was already obligated to make the advance as a result of a prior commitment, the only relevant measuring point should be the value as of the date of the commitment. In short, the statement in the text that the secured party can utilize the higher value at the date of the advance even where the advance was preceded by a commitment may appear at first blush to be inconsistent with the earlier argument against the use of interim values.

In theory, this criticism is well founded and, in point of fact, is equally applicable where the advance was made during the preference period. While section 547(c)(4) may suffice to protect collateral in existence at the time of the later advance, the policy of nondiscrimination should not necessarily dictate that the value of such collateral be the baseline for determining the permissible level of protection under section 547(c)(5), at least where the collateral was at a lower level at the time of the commitment.

Nevertheless, there are several countervailing considerations that argue to the contrary. First, it is certainly clear that at least in some cases the date of the advance is an appropriate measuring point. Where the advance was not made pursuant to commitment, the date of the advance will either be the only date that is used in calculating the applicable debt-security differential (if the advance is made during the preference period) or will be one of two dates (where the advance is made prior to the preference period, supra text accompanying note 293).

The term “new value” as it appears in section 547(c)(5) must therefore be defined to include “advances” (which it currently does) as well as commitments (which it currently does not). To further provide that advances are deemed “new value” only in some circumstances and not in others may create an overcomplicated statutory definition. Cf. supra note 293 (where a similar point was made regarding the utilization of the “new value” date, rather than the date of attachment). Nor could this result be achieved by providing that the date of “new value” can be used only if it was the date that “new value” was first given under the agreement. While this language would indeed preclude the use of the advance date where it was preceded by a commitment, it would also preclude the use of the advance pursuant to the same security agreement, a result that is unacceptable for the reasons stated earlier. See supra text accompanying notes 236-51.

Second, even in cases where an advance was preceded by a commitment, the secured party always retains the option to renge (even if reneging would constitute a breach of contract) and, depending on the language of the commitment, may actually have the right to do so if the debtor’s financial condition falls below a certain level. Accordingly, the date of the advance is not merely an arbitrarily chosen point in time between the commitment and the 90th day but represents the point in time at which the previous commitment was finalized and, in a practical sense, became irrevocable. The value on that date is not merely an upward fluctuation subsequent to a previously given extension of credit but a present value, on the basis of which the loan was actually made. To the extent the secured party did not exercise his de facto (if not de jure) option to renge, the motive was based in part on the current value of the collateral, and that value should therefore be taken into account in measuring the permissible level of protection.

Finally, it should be observed that the proposed disallowance of interim appreciation rests in part on concerns of expense and administrative inconvenience in determining debt-security differentials on a daily basis. See supra text accompanying notes 285-88. This policy is not materially frustrated by merely adding one additional day (the date of the advance as well as the date of the commitment) to the calculation.
of the ten day grace period in section 547(e), the extent of the protection is considerably more limited.\textsuperscript{306} Because a security interest attaches as soon as a commitment is given, perfection within ten days of the advance but after the start of the preference period cannot have a relation back effect when perfection occurs more than ten days after the commitment. Section 547(e) allows "relation back" only if the transfer is perfected within ten days of attachment, which occurs as soon as the commitment is given and collateral is acquired. In the absence of a prior commitment, a creditor who perfects his security interest after the start of the preference period, and within ten days of making an initial advance, has acquired a valid security interest in all collateral in existence at the time of the advance and all collateral acquired between the date of the advance and the start of the preference period. Under the proposed revision, he would therefore be entitled to utilize the lower differential at the time of the advance or on the ninetieth day. In the same situation, the creditor who has previously given a commitment and who would normally be afforded a choice of three dates is ironically placed at a disadvantage. Because the initial attachment of his interest occurred on the date of the commitment rather than on the date of the advance, the secured party would be entitled only to the value of the collateral that was acquired within ten days preceding perfection and before the start of the perfection period, for that is the extent of the security interest that would have been available in bankruptcy had there been no collateral turnover. The value that may have been around at the time of the advance, but acquired more than ten days before perfection, could not have been deemed transferred prior to that perfection, and can therefore serve not as a basis for measuring the permissible level of protection under section 547(c)(5).

In sum, with regard to advances made prior to the start of the preference period where the security interest is perfected more than ninety days before bankruptcy, the secured party should always be entitled to the higher value as of the date of the advance and the ninetieth day. If the advance were preceded by an obligatory commitment, the creditor would be entitled to the highest value at any of the

\textsuperscript{306} Protection will be limited, however, only where both the commitment and the advance were given more than 90 days before bankruptcy. Where the commitment was given before the preference period but the advance was given afterwards, the secured party would be able to invoke any of his three options (including the utilization of the debt-security differential on the 90th day) even if the security interest were unperfected at the start of the preference period or within 10 days afterwards, as long as the transfers were perfected (or at least deemed made) prior to the advance. See supra note 303.
three points. Where the interest was perfected within the preference period (but the advance was made before), in all cases the maximum value the secured party can claim is the value of security interests which attached prior to the preference period but within ten days before perfection. In all cases, if value were first given more than ten days before perfection, the secured party is limited to the value of collateral that was acquired during the ten days immediately preceding perfection (and before the start of the preference period). Yet, where the advance was not preceded by a commitment, as long as the advance was made within ten days of the filing, the secured party would still be able to utilize either the debt-security differential at the time of the advance or the debt-security differential on the ninetieth day—the same option that was available if the interest would have been perfected prior to the start of the preference period. If, on the other hand, the advance were preceded by an earlier commitment, the secured party could use neither the total value at the time of the advance nor the total value as of the ninetieth day; he would be limited to the value of whatever collateral was acquired in the ten days preceding perfection (and before the start of the preference period). Nor would he even be guaranteed that. For reasons of administrative convenience, the proposed amendment does not purport to give the secured party the highest pre-ninety day value that he could have realized in bankruptcy. Rather, it gives him only the higher value of two points, with the additional qualification that the higher of those two values must have been realizable in bankruptcy in the absence of a collateral turnover. Thus, assuming in those ten days preceding perfection the debt-security differential reached a lower point than it had been either at the time of the advance or on the ninetieth day itself, the secured party would be unable to utilize that interim appreciation of value.

In short, while the various permutations are quite complex, the guiding principle is straightforward, and it is one that has been consistently employed throughout this Article in analyzing section 547(c)(5) and in proposing suggestions for change. The creditor should be entitled to the debt-security differential either at the time of the advance (or commitment) or at the start of the preference period, whichever is lower, but only to the extent that the higher value used would itself have been realizable in bankruptcy (thanks to timely perfection) in the absence of a collateral turnover. Only to that extent is the creditor deserving of special protection. This in turn always necessitates that the security interest used in calculating the differential be deemed transferred to the secured party prior to the preference period, which means either that it was perfected prior to the prefer-
ence period or that it attached prior to the preference period and was perfected within ten days of its attachment.\footnote{307} These principles should serve to resolve virtually all perfection problems.

\textit{d. Summary}

This somewhat complicated critique of section 547(c)(5) essentially makes two points.\footnote{308} First, at least where the advance was not made pursuant to commitment, any advance made during the preference period should be governed solely by the differential in effect on the date of the advance, irrespective of whether some earlier advance was made pursuant to the same agreement. In other words, section 547(c)(5) should not protect, as it currently does, an undercollateralized future advance by reference to the differential in effect on the ninetieth day.\footnote{309} All collateral in existence on the date of the advance, to the extent not necessary for the satisfaction of a prior secured advance,\footnote{310} should be included in the calculation of this differential, as long as a financing statement was filed before the advance was made or within ten days afterwards.

Second, with regard to advances made more than ninety days before bankruptcy, the creditor should clearly be entitled to the differential in effect on the ninetieth day as the statute currently provides. However, the secured party should also be entitled to invoke collateral values at the time of the advance to the extent those values

\footnote{307} It must be reiterated that the statement in the text is limited to cases where both the commitment and the advance preceded the start of the preference period. Where the advance was made during the preference period, even if the commitment was given earlier, the secured party would be entitled to utilize the lower differential in effect on any of three dates as long as the interest was perfected by the date of the advance. Perfection subsequent to the advance however, would protect only the value of collateral acquired prior to the advance within 10 days preceding the filing. See id. This is to be contrasted with preference period advances not made pursuant to commitment where perfection within 10 days of the advance will protect the value of all collateral in existence on the date of one advance since the advance was the final step in attachment, triggering the grace period of section 547(e), which antedates the transfer to the time of the advance where it becomes a contemporaneous exchange.

\footnote{308} These points are in addition to the fact that section 547(c)(5)'s failure to provide protection for security interests in inventory and accounts may create serious difficulties for long-term corporate lenders. Supra text accompanying notes 181-227.

\footnote{309} As noted earlier, utilization of the 90 day differential with reference to a post-90 day advance as section 547(c)(5) currently permits always has the effect of allowing that advance to be paid in full even if the collateral on the 90th day had no value. See supra note 235 and text accompanying notes 228-51.

\footnote{310} See supra note 233. This would be equally true under current law where the post-90 day advance was made pursuant to a new security agreement so that, under section 547(c)(5)(B), the differential for the date of "new value" controls. There too, the value of collateral necessary to satisfy pre-90 days advances must be excluded.
are higher.\textsuperscript{311} In calculating the debt-security differential at either one of those points, all collateral in existence (except what is necessary to satisfy an earlier secured advance)\textsuperscript{312} should be taken into account if a financing statement was filed more than ninety days before bankruptcy.\textsuperscript{313} Where the filing was afterwards, however, the secured party would be able to utilize only the value of collateral that was acquired before the preference period and within ten days of the filing, so that the secured party would never be protected if perfection were delayed more than ten days into the ninety day period.\textsuperscript{314} In all cases, the applicable differential should represent a value that would have been realizable in bankruptcy had there not been a collateral turnover.

The analysis becomes complicated only when one considers the effect of obligatory commitments. It is clear that obligatory commitments made more than ninety days before bankruptcy should be treated the same as pre-ninety day advances, thereby enabling the secured party to utilize the higher value at the time of the commitment or the ninetieth day (again excluding at both points amounts necessary to satisfy prior secured indebtedness).\textsuperscript{315} Conversely, where the commitment itself was given within the ninety day period, only the value on the date of the commitment and not on the ninetieth day should be controlling. The difficult issue is whether the date of the advance should be accorded any special significance when it is preceded by an obligatory commitment. The issue arises in three contexts: (1) Where the commitment and advance were both made more than ninety days before bankruptcy, should the secured party be limited to the differential in effect on either the date of the commitment or on the ninetieth day, or may he also take advantage of any interim temporary appreciation in existence at the time of the advance? (2) Where the commitment was made more than ninety days before bankruptcy but the advance was made afterwards, can the

\textsuperscript{311} See supra text accompanying notes 285-94.

\textsuperscript{312} See supra notes 291 & 298. In this particular context where more than one advance was made before the 90th day, the issue of excluding amounts necessary to satisfy prior secured indebtedness does not arise under current law because section 547(c)(5) already accomplishes the same goal by aggregating all pre-90 day debt and applying only the differential in effect on the 90th day. But see supra note 310 (exclusion is necessary with regard to post-90 day advances made pursuant to a new agreement).

\textsuperscript{313} See supra note 283. Filing prior to the 90th day should permit the use of the higher value on the date of the advance, even if that higher value has dissipated by the date of perfection.

\textsuperscript{314} See supra text accompanying note 299.

\textsuperscript{315} See supra text accompanying notes 253-58.
secured party utilize the differential on the date of the advance to the extent that it is more advantageous? and (3) Where both the commitment and the advance were made during the preference period and the secured party can therefore not utilize the differential in effect on the ninetieth day (irrespective of whether some other advance was made earlier), should the secured party be limited to the differential in effect on the date of the commitment or may he also utilize the one in existence on the date of the advance?

The resolution of this issue is not clear. It is true that, in the absence of a collateral turnover the secured party would always receive whatever collateral was in existence at the time of the advance since the advance cures the transfer of its preferential effect under section 547(c)(4). That factor alone, however, should be insufficient to trigger the protections of section 547(c)(5) for new acquisitions just as it is insufficient to protect a pre-ninety day appreciation between the advance and the ninetieth day, although that value would have been available in bankruptcy had there been no subsequent downward fluctuation by the ninetieth day. The central governing principle is that section 547(c)(5) should eliminate discrimination between fluctuating and nonfluctuating liens, and this principle militates for the view that the date of the loan commitment should displace the date of the advance in section 547(c)(5). Nevertheless, for the reasons stated earlier, the proposed revision does treat the date of the advance as equivalent to the date of the commitment with respect to all three situations. The practical result is that, where the commitment and the advance were both made before the preference period or where the commitment was made before the preference period and the advance afterwards, the secured party may utilize the lowest of three differentials, whereas under current law the secured party would either be limited to the value on the ninetieth day (where an advance was made before the preference period) to the value on the date of the advance (where the first advance was made during the preference period although preceded by a commitment). Where both the commitment and the advance were made within ninety days preceding bankruptcy, the secured party would be entitled to utilize the lower of two differentials but under no circumstances could he apply the ninety day test, even if some other advance had been previously made pursuant to the same agreement.

316 See supra text accompanying notes 272-77.
317 See supra note 305 and text accompanying notes 288-92.
318 See supra note 305.
Finally, while the applicable differential dates may differ, with respect to perfection requirements, i.e., when must a security interest be perfected to be included in the calculation of a debt-security differential, there will generally be no distinction between advances made pursuant to commitment and those which were not. In the case of a pre-ninety day advance, just as, in the absence of a commitment, the secured party would be entitled to utilize the value of all collateral in existence at either the time of the advance or on the ninety-first day, only if a financing statement were filed before the start of the preference period, the right of a creditor lending pursuant to an obligatory commitment to utilize the values at any of three points is subject to the same limitation. The one exception to this identity of treatment is where the secured party perfects during the preference period but within ten days of the advance. In the case of a pre-ninety day advance not made pursuant to a commitment, perfection within ten days of the advance guarantees that the secured party will be entitled to receive the higher value at the time of the advance or on the ninety-first day. In the case of the commitment, however, unless perfection also occurred within ten days of the commitment, the creditor could not be deemed validly secured at any of the three points and hence would not be protected by section 547(c)(5), except to the extent of the value any collateral that was acquired by the debtor in the ten days immediately preceding perfection and prior to the start of the preference period—a value which can always be claimed even if the advance was made more than ten days earlier.

The same analysis holds true for advances made within the preference period, whether the commitment was made before the preference period or afterwards. Perfection at any point prior to the actual advance would permit the secured party to utilize the highest value on any of the three measuring dates even where the commitment was given more than ninety days before bankruptcy. This again is

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310 See supra note 303 (perfection by the date of the advance permits utilization of the differential in effect on the 90th day or the date of the loan commitment even if the collateral depreciated by the time the advance was made). It should be noted that permitting perfection even within the preference period at any time prior to the advance does not depend on the ability of the secured party to utilize the value of the date of the advance. Even if one concluded on the basis of the considerations enumerated earlier, supra note 305, that the secured party should not be entitled to utilize the differential in effect on the date of the advance where the advance was preceded by a commitment and that the extent of the secured party's protection should be the value of the collateral on the 90th day or the date of commitment only, the date of the advance would still be the cutoff point as far as perfection is concerned. Any transfer deemed made prior to the time of the advance would have been valid in bankruptcy even where it initially took
equally true for post-ninety day advances not made pursuant to commitment (except the only differential that could be used there is the one in existence on the date of the advance). In the latter case, however, perfection within ten days of the advance will always suffice to allow the secured party to claim the value of all collateral in existence on the date of the advance. In the absence of a commitment, perfection within ten days of an advance is tantamount to perfection within ten days of attachment. In such a case section 547(e)(2)(A) deems the transfer made as of the date of attachment—a time which is contemporaneous with the advance. By contrast, where an advance during the preference period was preceded by a commitment, perfection within ten days of the advance will not necessarily have a "relation back" effect, unless the commitment was also within the ten day period. With no relation back, the secured party would be limited to the value of collateral that was acquired prior to the advance but within ten days preceding perfection.

In sum, the application of section 547(c)(5) to any particular transaction involves a dual inquiry. First, what is the applicable date or dates for determining the debt-security differential that controls the secured party's level of protection? Second, what security interests are included in calculating the differential on that date? Concerning the first issue, the proposal herein presented grants the secured party the option of two dates (and sometimes three) with respect to pre-ninety day advance, and forecloses the opportunity of utilizing the ninety day test with respect to post-ninety day advances. These results are clear departures from current law and can be obtained only by amending section 547(c)(5)(A) and by deleting the word "first" from section 547(c)(5)(B).320

Concerning the second issue, however, while section 547(c)(5) speaks only of the difference between the debt and the "security interest"—the latter being a term that generally denotes mere attachment—the underlying policy of section 547(c)(5) should in itself dictate that a creditor be deemed secured at whatever date is chosen only

320 See supra text accompanying notes 262-67 & 289-94.
to the extent that he would have received the benefit of that security in bankruptcy.\textsuperscript{321} If the security interest in the collateral existing on the ninetieth day would have been voidable anyway (for lack of perfection), there is no justification for using that security as the basis for protecting subsequent acquisitions. Accordingly, although it has been previously suggested that the term “transfer” be substituted for “security interest,”\textsuperscript{322} much of the discussion concerning perfection requirements is, or at least should be, equally applicable to the law as currently written and one would hope that courts will recognize this fact.

4. Appreciation Value

A final point to be considered is section 547(e)(5)’s requirement that the reduction in deficiency be to the prejudice of “other creditors holding unsecured claims” intended to clear up ambiguities in the former law, it can be understood only by examining that law.

Section 60 of the 1898 Act, insofar as it dealt with transfers for security, was clearly applicable to transfers of new items of property during the preference period. Its applicability to appreciation of collateral in which the secured party already had rights prior to the preference period was less clear. A favorite example of law professors, though one not likely to be litigated, would be the fattening of a mortgaged calf with unmortgaged grain.\textsuperscript{323} But the problem may similarly arise in more lucrative situations, including the harvesting of

\textsuperscript{321} See generally supra text accompanying notes 145–49 (section 547(c)(5) sought to redress the problem of fluctuating collateral).

\textsuperscript{322} See supra text accompanying note 147. While “transfer” is the correct term to use in connection with the calculation of the 90 day differential, there is no need for there to be a “transfer” on the date of the earlier advance in order for the differential on that date to be used. See supra note 296. Thus, the term “transfer” accurately describes the level of perfection required only in the context of the reference points currently appearing in the statute. It was also suggested that the term “secured claim” be used in place of “security interest” to insure that the value of collateral with respect to any particular advance be reduced by amounts necessary to satisfy senior liens or prior secured advances. See supra note 233. The term “secured claim” standing alone, however, does not necessarily imply a perfection requirement. A creditor having an unperfected security interest may still have a “secured claim” within the meaning of section 506 of the BRA although the security interest would ultimately be voidable under section 544(a)(1) or section 547. Section 506 merely requires that the claim being secured be allowable within the meaning of section 502. Use of the term “secured claim” therefore offers no guidance concerning the necessary timing for perfection.

Thus, while the term “transfer” is unduly restrictive, the term “secured claim” is overly generous or at least overly vague.

\textsuperscript{323} According to one commentator, this was a favorite example of Professors Kaufman and Braucher of the Harvard Law School. Countryman, supra note 27, at 273; see also Hogan, supra note 27, at 559 (for a similar example).
crops, the conversion of raw materials into finished products, the
ripening of contingent contract rights into liquidated obligations by
performance of the debtor, or the seasonal fluctuations in inventory
prices. In all these cases, there is no new item of property that
became subject to a security interest within the four months—rather,
the existing collateral increased in value.

Professor Countryman has noted that similar appreciation issues
may arise in proceeds cases. Normally, a security interest in the
proceeds of collateral sold within the preference period would not, by
that fact alone, be vulnerable to attack. Although the security interest
in proceeds could not attach until the debtor acquired rights in them
and, therefore, the transfer could not be deemed made until that
point, because the proceeds became subject to a security interest
contemporaneously with the release or disposition of the old collat-
eral, the resulting exchange effects a valid substitution of collateral
without a preferential effect. This will not be the case, however, if

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[324] All of the examples in the text are covered by section 547(c)(5). Although section 547(c)(5)
is limited to security interests in inventory and accounts receivable, the statutory definition of
these terms is considerably broader than the corresponding definitions under Article 9. See supra
text accompanying notes 181–87.

Although the 1972 Official Text of Article 9 eliminated the “contract rights” currently
characterizing all rights to payment for the sale or lease of goods as “accounts,” the following
discussion will continue to utilize the now discarded term “contract rights” to distinguish
between rights to payment that are fixed and those that are contingent on the debtor’s perform-
ance, a distinction that is crucial in analyzing appreciation value problems.

[325] Countryman, supra note 27, at 273.

[326] As noted earlier, under traditional substitution doctrine, if new collateral of equivalent
value was acquired contemporaneously with, or prior to, the release of old collateral, no
preference was said to exist. See supra text accompanying notes 45–48. This will invariably be
the case in “proceeds” situations. If inventory is sold, it will be sold for either cash or credit. If
sold for cash, cash payments will either be received in advance of delivery, in which case the
acquisition of new collateral preceded the release of the old, or cash payments will be made
simultaneously with delivery. If the sale is wholly or partially on credit, an account receivable
arises simultaneously with the debtor’s giving up rights in the inventory. When the account
receivable is later collected, simultaneously with the collection, i.e., the acquisition of a security
interest in cash proceeds, the interest in the account (an entity which no longer exists) is pro tan
e extinguished. Thus, ignoring valuation problems, conversion of collateral into proceeds generally
involves a simultaneity of exchange.

It is important to keep in mind, however, that even the security interest in proceeds may be
voidable where section 9–306 of the UCC imposes perfection requirements and compliance with
those requirements is delayed. If the proceeds are identifiable cash proceeds or are a species of
property for which a financing statement could have been filed in the same place where the filing
covering the original collateral was actually made, no supplementary action is required. U.C.C.
§ 9–306(3)(a)–(b)(1972): Otherwise, the secured party must reperfect within 10 days after
“receipt of the proceeds.” Id. § 9–306(3)(c). If the secured party perfects more than 10 days after
“receipt of the proceeds,” perfection lapses and is reinstated only prospectively. If the phrase
“receipt of proceeds” is identical to the debtor’s acquiring rights in the proceeds, then the grace
period of section 9–306(c) parallels that of section 547(e)(2). But if “receipt of the proceeds” can
the value of the proceeds exceeds the value of the collateral. Thus, the conversion of secured inventory into accounts receivable may be preferential to the extent that the book value of the accounts receivable exceeds the liquidation value of the inventory. While the standard of occur after the debtor has the right to receive proceeds, the grace periods are not parallel. It would then become essential to determine whether compliance with section 9-306 by perfecting within 10 days of receipt could successfully antedate the transfer to the time of its taking effect because of the doctrine of continuous perfection, even though a new financing statement was not filed within the time allowed by section 547(e). This is the same issue discussed before in connection with the 10 day grace period of section 9-301(2) and essentially turns on the definition of perfection as it is used in section 547(e). See Breitowitz, supra note 22, at 395-99. It would appear, however, that the debtor's right to receive cash or other tangible property is itself an "account" or at least a "general intangible" which the debtor has "received" as soon as the right has arisen. The "receipt" of that right accordingly triggers the 10 day grace period of section 9-306(3) and section 547(e). Because the debtor's obtaining rights to receive proceeds and the receipt of proceeds are synonymous, the purported conflict between section 9-306(3) and section 547(e) may be largely illusory. Both grace periods will expire at the same time. For a consideration of the grace period in section 9-306(3) under the 1898 Act, see infra Appendix.

A final point concerns the fact that the right of a secured party to pursue proceeds is not his only remedy. The foregoing discussion has analyzed "proceeds" issues in terms of release and substitution of collateral. In the case of inventory and accounts receivable, this is true. See supra note 4. When inventory is sold, it will generally be in the ordinary course of the seller's business and the right of the secured party to pursue the collateral will be cut off. U.C.C. § 9-307(1) (1972). In the case of accounts receivable, once an account is collected it ceases to exist. However, there are other types of collateral where the generation of proceeds is not in replacement of the original collateral but provides a supplementary source of recovery. See id. § 9-306(2). Consider a secured party who has a perfected security interest in the debtor's business equipment. The debt is $1,000, but the machinery is worth only $500. During the preference period, the machinery is sold for $500 to a buyer not in the ordinary course of the debtor's business. In this case, the old collateral was not released. As a result of the transfer, the secured party is now in a position to assert a secured claim against $1,000 of collateral, rather than just $500. Arguably, the security interest in the proceeds could be characterized as a preferential transfer even though it did arise contemporaneously with the sale or disposition.

Even here, however, as long as the value of the proceeds does not exceed the value of the original collateral, it is likely that the security interest will be valid in bankruptcy. In calculating whether a transfer has preferential effect or, to use the language of section 547, whether it enables the creditor to receive more than he would have had the transfer not been made, one looks exclusively at the property of the estate, i.e., does the transfer enable the secured party to receive more of the property of the estate than he would otherwise receive? If the answer is no, the transfer lacks preferential effect although the net result of the transfer is that the secured party collects his entire claim. In the example given, prior to the sale of the equipment, the secured party would have received $500 from the property of the debtor. After the sale, he receives exactly the same amount from that source although he may recover an additional $500 by pursuing the purchaser. The ability to collect a debt from a third party is analogous to acquiring a surety. It could hardly be argued that obtaining a surety during the preference period effects a preferential transfer; the sale of collateral allowing the secured party to pursue the purchaser essentially does the same thing. Here, too, however, it is essential that the secured party reperfect within 10 days of the sale so that the transfer will be deemed made as soon as the proceeds are acquired. Otherwise, the transfer is not deemed made until perfected, at a time when it is on account of antecedent debt. But see infra note 234 (timely reperfection is unnecessary if proceeds are not deemed to be "property of the estate" or their transfer does not prejudice unsecured creditors).
valuation is not clear, if the test is what the collateral would yield in a bankruptcy sale, conversion of inventory into accounts receivable will frequently constitute an improvement of position, since bankruptcy sales, like all judicial sales, realize far less than sales in the ordinary course of business. Similarly, if accounts receivable are not valued at their total face value but at a standard percentage of collectibility, liquidation of accounts receivable for cash may be preferential to the extent that collections exceed that estimate.

There has been surprisingly little litigation over these questions. In the proceeds cases, perhaps the parties simply assumed that the value received was equivalent to the value released. Some cases are simply not worth the expense of going to court, especially since the trustee could not invalidate the security interest in toto but only to the extent that it exceeded the value of the interest in the original collateral. Conceptually, the secured party could argue that, even where his position has been improved, there has been no transfer of the debtor's property within the preference period. Any gains are due to either the enhancement of existing collateral or the proceeds of its disposition which never became part of the debtor's general estate. The surface

327 See Palmer Clay Prods. Co. v. Brown, 297 U.S. 227, 229 (1936); see also Breitowitz, supra note 22, at 364 n.31 (preferential effect determined as of the final distribution of the bankrupt estate).

328 The "no transfer" argument actually breaks down into two parts.

First, with regard to the enhancement of existing collateral, no new item of collateral has been transferred to the debtor during the preference period. This is clearly true in the case of a harvested crop, the processing of raw materials into a finished product (if no unsecured components are added), or mere upward fluctuation in price. To a lesser extent, this is also the case where unmortgaged grain fattens the mortgaged calf. Although the secured party is getting grain that was formerly not subject to his security interest, he is getting it in the form of additional weight or maintenance of the cow, the asset that had already been transferred prior to the preference period. Second, with regard to "proceeds," the "no transfer" argument is less clear. To the extent the value of the proceeds does not exceed the value of the collateral, there is, of course, no problem. If, however, the value of the proceeds exceeds the value of the collateral, a new transfer has clearly taken place. Proceeds are new assets that were previously not subject to the secured party's interest. In what way can it be said that no transfer has taken place? One argument may be that "transfer" implies that, at one point in time, the property was part of the debtor's general estate available to his creditors prior to the transfer. The proceeds are property which were never part of that "pot," for, as soon as they are acquired, they are immediately subject to the security interest. Their acquisition does not constitute a transfer even when they effect an improvement of position. This argument appears erroneous, however, for taken to its limit it would justify the DuBay holding, 417 F.2d 1277 (9th Cir. 1969), though for a different reason. Any after-acquired property covered by a previously filed financing statement never became "property of the estate" in the sense of being available to general creditors, since, as soon as it was acquired by the debtor, the transfer to the secured party was immediately deemed made. Such a construction is clearly inconsistent with present law. Most courts and commentators (including those who advanced the protection of appreciation value) rejected it under the 1898 Act as well. But see infra note 334. Moreover, if one assumed that proceeds do not involve property of the estate at all, it is not clear why reperfection would have to take place within 10
plausibility of this argument,\textsuperscript{329} coupled with the prospects of only minimal returns, may well have dissuaded trustees from pursuing the issue to its final resolution.

The sparse case law that does exist seemed to suggest that, under the 1898 Act, appreciation of collateral during the preference period was not a voidable preference. In \textit{Rockmore v. Lehman},\textsuperscript{330} the Second

days of the receipt of the proceeds. Such reperfection would be necessary only if there were a transfer which could be protected by compliance with section 547(e). Finally, to assert that once property is subject to a perfected security interest neither it nor its proceeds is regarded as property of the debtor appears inconsistent with Article 9, which does not regard the creation or perfection of a security interest as a transfer of title to the secured party. See U.C.C. § 9-202 (1972).

In short, proceeds coming into the estate are property of the estate; their becoming subject to a perfected security interest does effect a transfer, as is true with any after-acquired property. The basis for asserting lack of a transfer lies in the fact that if proceeds do exceed the value of the collateral, presumably that must have been due to an enhancement of the original collateral that was not accounted for in its valuation. It is thus the enhancement of the original collateral that does not involve a transfer. Once the "no transfer" argument is utilized to give the secured party the benefit of the enhancement, the secured party is entitled to proceeds not because proceeds do not involve a "transfer," but because the proceeds are an exchange or substitution of equivalent value. As applied to proceeds, the "no transfer" argument is simply a variation of "substitution of collateral" and should be clearly identified as such. Perfection within 10 days is therefore necessary to insure that the substitution is contemporaneous. See supra note 326.

Both variants of the "no transfer" argument should be distinguished from the "no loss to the estate" argument which focused on policy considerations not explicitly recognized in the language of section 60 of the 1898 Act. See infra text accompanying notes 331-40.

\textsuperscript{329} Indeed, the "no transfer" argument may retain its validity even under the BRA. See infra text accompanying notes 387-95.

\textsuperscript{330} 128 F.2d 564 (2d Cir.), rev'd, 129 F.2d 892 (2d Cir. 1942), cert. denied, 317 U.S. 700 (1943). The facts of the case are somewhat complicated. Surf was undergoing corporate reorganization. Surf had previously agreed to furnish and maintain signs for Calvert, and Calvert agreed to make installment payments as work progressed. 128 F.2d at 565. Surf's contract rights were assigned to Abrams for advances totalling $39,056.73. Id. Prior to the reorganization, Abrams had already collected $31,893.38 from installment payments that Calvert made to Surf. Id. For some reason, the trustee did not bring an action under section 60 to recover payments already made. While I can only speculate as to the reason why, perhaps those payments became due and owing more than four months before bankruptcy. Alternatively, since Abrams was making a continuous series of advances, the receipt of installment payments may have been substantially contemporaneous with a new advance. The trustee did contend, however, that Abrams was not entitled to receive any further sums in the reorganization if those funds became due after the start of the preference period or commencement of the case. The district court ruled that Abrams did have a security interest that was validly perfected prior to the preference period and awarded him $4,410.16 on his $7,167.35 balance. The Second Circuit initially reversed on the ground that an assignment of contract rights not yet earned by performance was analogous to a mere promise to pay an assignee out of funds to be created in the future; as such, the interest was only equitable and could be defeated by a subsequent lien creditor. Id. at 567. Because transfer could be deemed made until monies were actually earned through the debtor's performance, for only at that point could the assignment be perfected against a lien creditor, any security interest in funds that were earned in the four months preceding bankruptcy was voidable. Id. at 566-67. Abrams was therefore not entitled to claim as a secured creditor. On rehearing, the court reversed itself and upheld the district court's order. 129 F.2d at 892. Upon further examination, it concluded that New York law recognized the legal validity of assigning contract rights not yet earned by
Circuit assumed that a valid assignment of contract rights not yet earned by performance would protect subsequent payments to the assignee that became due within the preference period as a result of the debtor’s performance, as long as the initial assignment took place prior to the start of the preference period and, at that time, was already perfected against subsequent lien creditors. The court’s opin-

performance, and such assignments were effective against lien creditors. Id. at 892–93. Since the assignment occurred well before the start of the preference period, amounts paid or which became payable during the preference period, while the debtor was insolvent could not be recoverable because of the date of assignment (which was before the start of the preference period), rather than the date the debt actually became due, governed the time of the transfer. 129 F.2d at 892–93.

The difficulty that the Second Circuit had in resolving what it regarded as the central issue of the case—the validity of contract right assignments against subsequent lien creditors—is an excellent example of the confusion in this area of the law prior to the advent of the UCC. See 128 F.2d at 567–68 (Clark, J., dissenting). Article 9 explicitly provides that one may perfect a security interest in “accounts” by filing a financing statement. U.C.C. § 9–302(1)(c) (1972). Under section 9–106, “account” includes “any right to payment . . . whether or not it has been earned by performance.” Under section 9–301(1)(b), a perfected Article 9 security interest prevails over a lien creditor. The same result followed under the 1962 version of Article 9 except that “contract rights” and “accounts” were regarded as two different species of collateral and the latter were “proceeds” of the former. See U.C.C. § 9–106 (1962) (Reasons for 1972 Change); see also infra note 354 (discussing the application of section 9–106 to the Rockmore situation).

In addition to its own rights against Calvert, Surf had also acquired additional rights against Calvert through assignment from Fiegel Advertising Co., Inc. Surf, in turn, assigned that right to Abrams as well, both assignments occurring prior to the preference period. Prior to assigning its right to Surf, Fiegel had made an earlier assignment to Lehman. Hence, Abrams (through Surf) and Lehman each sought priority for their Fiegel assignment. Here the court was presented with two issues: (1) Was the subsequent assignment to Surf valid or was it subordinate to the prior assignment to Lehman? (2) If the assignment to Surf was valid, would the funds go to Surf’s estate or to Abrams as assignee? In its initial opinion, proceeding on the assumption that assignments of unearned contract rights were subordinate to lien creditors, the court allowed the trustee to invalidate Fiegel’s assignment to Lehman by asserting the status of a lien creditor under section 70(c) of the 1898 Act, to enforce the assignment made to Surf, and to invalidate the assignment made to Abrams. 128 F.2d at 567. Surf’s assignment to Abrams, like the assignment of Surf’s own rights against Calvert, was not perfected against a lien creditor prior to the preference period, and was therefore void. That aspect of the case, the most complicated to unravel, is not directly pertinent to this discussion. It should be noted, however, that the court’s use of section 70(c) to invalidate Fiegel’s assignment to Lehman, a transaction to which Surf was not a party, is surprising. If an assignment is subordinate to the rights of a lien creditor, presumably that means a lien creditor of the assignor. The case thus permitted the trustee of Surf to hypothesize the rights of a lien creditor of Fiegel. This result appears contrary to the language of section 70(c) which gave the trustee the status of a lien creditor of the debtor, as does section 544(a)(1) of the BPA. Alternatively, the court may have assumed as a matter of New York law that even a lien creditor of the second assignee (Surf) could invalidate an earlier assignment, although it is unclear why such a lien creditor should be able to supersede the earlier assignment.

In any case, in finally holding that assignments of contract rights are perfected against lien creditors, the court found that: (1) the earlier assignment to Lehman was valid and had priority over the assignment to Surf; (2) Abrams, as assignee to Surf, therefore had no rights to the fund; and (3) Abrams, however, did have a valid assignment of Surf’s own rights against Calvert and had the status of a secured creditor as to those rights. Id. at 566–67.
ion, however, was devoted almost totally to discussing the relative priorities under New York law of an assignee of unearned contract rights vis-a-vis a creditor who later levies on those rights. The court did not discuss the fact that, even if the assignment were perfected, the ripening of a contingent right of payment into an absolute one in itself gives the assignee more than he had prior to the preference period and could, for that reason alone, arguably have been vulnerable under section 60.

As a matter of policy, it is often asserted that appreciation value should be protected because the gains do not arise through the appropriation of assets otherwise available to unsecured creditors or from the proceeds of such assets. This policy argument is to be distinguished from the "no transfer" argument advanced earlier. Conceding that some appreciation does involve the acquisition of new items of property not previously subject to the security interest, it is maintained that those new items are not reducing the pool of assets previously available to creditors. Thus, while the sale of unsecured inventory producing accounts receivable subject to a security interest is at the expense of the estate, since the unsecured inventory would have been used to pay general creditors, sales of secured inventory are not, since even in the absence of the sale, the secured inventory would have been used to pay the secured party. Similarly, gains from the

331 See Kronman, supra note 27, at 150–53. An earlier report of the Gilmore Committee to the National Bankruptcy Conference in 1967 stated: "A change in the form of collateral . . . is not necessarily preferential even when the result of the conversion is an increase in value." Report of Committee on Coordination of Uniform Commercial Code and Bankruptcy Act 18 (1967) in papers of H. Kriple, 1 National Bankruptcy Conference (available in New York University Law Library) [hereinafter cited as 1967 Committee Report]; see Kronman, supra note 27, at 152–53.

332 See supra note 329 and accompanying text.

333 For example, proceeds. See supra note 328.

334 This argument assumes that a transfer should be voidable only to the extent that it diverts assets that were previously available to satisfy the claims of general creditors. Since enhancement of existing collateral had never been available for those other claimants, its utilization by the secured party should not be proscribed. At first glance, this may appear to be true in every case of after-acquired property. Assume, for example, that six months before bankruptcy, a debt is only partially secured. During the preference period, the debtor acquired additional property. As soon as those assets were acquired, they were immediately subject to the security interest. They were never part of the general estate available to creditors and, accordingly, the pool of assets that was available to those creditors prior to the acquisition of those new items has not been diminished, yet no one has ever suggested that all after-acquired property be immune from a preference challenge. Even *Dubay*, 417 F.2d 1277 (9th Cir. 1969), protected such security interests solely on the theory that where a financing statement was filed prior to the preference period, the transfer was deemed made as of the date of filing, but not on the basis of assets not being diverted from creditors. See also supra note 328 (where a similar argument that proceeds do not represent "property of the estate," and hence do not involve a "transfer," was rejected for precisely the same reason—that it would protect not only appreciation value but after-acquired property as well).
conversion of raw materials into finished products which do not involve the incorporation of any additional components or parts not already subject to the security interests should go entirely to the

At least with regard to the "depletion of the estate," however, after-acquired property is clearly distinguishable from appreciation value. One must not forget the obvious point that something does not come out of nothing; if new items of collateral were acquired during the preference period, the debtor must have given something up to acquire them. Inventory is acquired with cash, accounts receivable are acquired with inventory, etc. In the typical case of a secured party with a security interest in accounts receivable, any after-acquired accounts were generated through the liquidation of property that was in fact part of the pool available to unsecured creditors. Thus, although the accounts receivable themselves were never subject to the competing claims of unsecured creditors, their transfer to the secured party is nevertheless a depletion of the estate. This is not true in the "proceeds" cases where the conversion of secured inventory into accounts receivable involves the appropriation of property already subject to a security interest. But see infra note 337 and text accompanying notes 325-43. (This distinction, however, does not validate the "no transfer" argument previously rejected, supra note 328. That argument focused on whether or not the particular asset now going to the secured party had been previously available to general creditors and, in that respect, proceeds of collateral and after-acquired property are identical.)

It should also be noted that upholding security interests in proceeds (even where they exceed the value of the original collateral) on the theory that the estate is not being depleted does not run afoul of section 9-203 of the UCC. Unlike the "no transfer" argument, supra note 328, this theory fully concedes that a security interest in proceeds does involve a transfer of property belonging to the debtor although, as soon as the property was acquired, it was immediately subject to a perfected Article 9 security interest. This, however, does not change the fact that while the property may, for purposes of legal title, be deemed that of the debtor, there was never a moment in time when that property was reachable by general creditors. Thus those creditors suffer no loss. Id.

The "no transfer" argument previously rejected, id., and the "depletion of the estate" theory advanced here, do share one common feature: under both analyses, it would be unnecessary for the security interest in proceeds to be reperfected within the grace periods of section 547(e) of the BRA and section 9-306(3)(c) of the UCC. Timely reperfection before lapse is necessary to avoid a preference challenge only if the basis for upholding the interest is by characterizing it as a contemporaneous substitution of collateral. See supra note 326. To the extent that proceeds are not "property of the debtor" or that their transfer does not involve a loss to other creditors, the interest would be valid even if its creation was not contemporaneous with the disposition of the original collateral. While perfection at some point is essential to prevent avoidance under section 544(a)(1), there is certainly no need to perfect before the expiration of 10 days, just as there would be no need for the proceeds to be of equivalent value to the collateral released. Neither prong of substitution would have to be met.

335 Under U.C.C. § 9-315 (1972), if a security interest in goods was perfected and subsequently the goods, or a part thereof, become part of a product or mass, the security interest continues in the entire product if the identity of the original components is lost. See C. Gilmore, supra note 25, § 31.4-.5, at 845-56. Thus, the use of materials not subject to the security interest clearly diverts assets that would otherwise have been available for unsecured creditors and the security interest, to the extent of the value of those components, should therefore be voidable.

Query, however, whether the incorporation of new components can be analogized to the fattening of a mortgaged cow with unmortgaged grain, where no new transfer is deemed to occur. See supra notes 323 & 328. Nevertheless, the cases are clearly distinguishable. In the example of the cow, all that is involved is the appreciation or maintenance of a preexisting entity. By contrast, combining raw materials subject to a security interest with components not subject to a security interest creates a new entity in which the secured party formerly had no interest. Accordingly, the argument that the processing of raw materials into finished products
secured party because there too no new assets are being diverted away from unsecured creditors. While the secured party may be getting more, other creditors are not getting less.\textsuperscript{336}

This distinction, whatever its theoretical merits, was not expressly recognized in the language of section 60, which did not require that assets be taken away from unsecured creditors but merely that the “transfer” involve “property of the debtor” and that, by the transfer, the creditor received more than he otherwise would have received.\textsuperscript{337} Unless one characterizes the creation of the original security interest as a divestiture of title—a position that Article 9 re-

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\textsuperscript{336} As noted earlier, Breitowitz, supra note 22, at 366 n.37, even where a transfer was harmful to the interests of general creditors it was not voidable under section 60 of the 1898 Act or section 547 of the BRA, unless the transferee has been preferred. See 11 U.S.C. § 547(b)(5) (Supp. IV 1980). The example given was the use of an unsecured bank account to pay a creditor who had a senior perfected security interest on a piece of collateral which was also subject to a junior security interest. Although the net effect of the payment is the application of the collateral to the debt of the junior lienholder and general creditors are getting less than they would otherwise have received, as long as the secured party is not getting more the transfer is not a preference. But cf. infra Appendix. Preferential effect is clearly an essential condition to voidability. The issue here, however, is whether preferential effect alone is sufficient or whether that preferential effect must also be coupled with detriment to general creditors. But see infra note 327 (regarding the definition of detriment). As suggested in the text, under the 1898 Act the answer may very well have been that a showing of detriment was unnecessary. Note, however, that even preferential effect is measured not by the aggregate benefit to the transferee but only by the increase in his share of the debtor’s property (including property of the debtor that was never available to, and therefore not taken away from, unsecured creditors). See supra note 326.

\textsuperscript{337} It should also be pointed out that, even if the applicable test required detriment to creditors in addition to benefit to the transferee, that standard did not necessarily mean that the transfer must deprive creditors of property they already had. A transfer which prevents creditors from receiving what they otherwise would have received may be just as injurious as depriving them of assets that were already available for the satisfaction of their claims. Since, in the absence of an Article 9 transfer that is deemed to occur during the preference period, the appreciation would have gone to the unsecured creditors of the estate, the effect of the transfer is detrimental to their interests. Defining detriment in terms of what general creditors actually had, instead of what they would have had, is unduly restrictive. Under the broader definition of “detriment,” “detriment” and “benefit” would always have a perfect correspondence. The benefit to the secured party from postpreference period appreciation is exactly the amount that the unsecured creditors are unable to reach and, therefore, the amount by which they are being harmed. The so-called dichotomy between “benefit” and “detriment” may thus be nonexistent.

Defining “detriment” in terms of general creditors forfeiting the sources of recovery they already had does not, of course, protect all after-acquired property for as noted earlier, supra note 227, even property that was never subject to the claims of unsecured creditors will generally be acquired or generated by property that was (except where the newly-acquired property is proceeds of collateral). However, consider the following case. Assume that, as of the start of the preference period, the secured party had executed a security agreement and filed a financing statement but nonetheless was undersecured. During the preference period, the debtor acquired additional property through bequest or inheritance which immediately becomes subject to a perfected security interest. Should the security interest in that new acquisition be voidable as a preference? Here, too, no assets are being diverted from general creditors since the newly-
jects— the typical appreciation value arising from conversion of collateral into "proceeds," whether or not unsecured creditors have been harmed, met both of these tests. The notion that depletion of the estate was a necessary condition of avoidance (and that mere benefit to the secured party was insufficient) may, however, find support in the cases that have upheld transfers of exempt property that would otherwise be preferential on the grounds that such property was not available to unsecured creditors.

Even if one assumes that there was an implicit requirement that the transfer be detrimental to the interests of general creditors, the idea that "mere" appreciation was not harmful was an oversimplification. Commentators have pointed out that this is true only in the most literal sense that the collateral is not physically composed of assets or proceeds of assets that were previously available to unsecured creditors. Only by looking at the collateral in isolation can one assert that

\textsuperscript{338} See U.C.C. § 9-202 comment (1972); see also supra notes 328 & 334 (the "no transfer" argument may retain its validity even under the BRA).

\textsuperscript{339} With regard to appreciation from the harvesting of crops, the conversion of raw materials into inventory, or the ripening of contingent contract rights into fixed obligations, one could argue that no transfer had in fact occurred, but that argument is independent of the assertion that a depletion of the estate was a necessary condition of voidability. See supra note 328.

\textsuperscript{340} See cases collected in 3 Collier on Bankruptcy, supra note 42, ¶ 60.13, at 819. It should be noted that section 67(d) of the 1898 Act had specifically provided that exempt property was not subject to recovery as a fraudulent conveyance. Section 6 of the 1898 Act provided that the debtor could not claim exemptions out of property which the trustee recovered pursuant to an avoidance power. Section 6 was never construed to authorize a preference action for transfers of exempt property; its operation was limited to situations where the debtor sought to claim the exemption after the property was already recovered. See 1A Collier on Bankruptcy ¶ 6.11[3]-[4], at 851–57 (J. Moore 14th ed. 1978). If the debtor did in fact claim the exemption before recovery of the property, neither the trustee nor the debtor would have been able to attack the transaction as a preference. See Kennedy, Limitations of Exemptions in Bankruptcy, 45 Iowa L. Rev. 445 (1960).

The legislative history of the BRA indicates that the wording of section 547 was intended to overrule older case law by providing that transfers of any of the debtor's property, including exempt property, could be avoided. See Commission Report, supra note 110, Part I, at 204. To the extent that prior case law has been overruled, any inference regarding the need for depletion of the estate that could have been drawn from the inability of the trustee to recover exempt property does not exist under the BRA. See infra note 394.

It should also be noted that, even if the case law concerning exempt property does indicate that detriment to creditors is an essential prerequisite to avoidance, that does not necessarily mean that appreciation value should be protected. See supra note 337.

\textsuperscript{341} E.g., Countryman, supra note 27, at 273; Kripke, The Code and the Bankruptcy Act: Three Views on Preferences and After-Acquired Property, 42 N.Y.U. L. Rev. 279, 290–91
nothing has been taken away from the debtor's estate. The harvesting of crops or the processing of raw materials also involves labor and manufacturing costs which ultimately operate to deplete the estate, either by those payments actually being made or simply by increasing claims against the estate. Unsecured creditors may be hurt not only by a depletion of assets but by a proliferation of new claims with equal or greater priority. The same holds true for the liquidation of secured inventory into accounts receivable or cash (which involves sales expenses, allocation of overhead and the like) or the conversion of contract rights into noncontingent obligations. The debtor's performance, which resulted in the sale or ripened the contract rights into an account receivable, not only enhanced the value of the collateral but inevitably drained the estate of funds even though those funds in a strict sense may not have "gone" into the collateral. Indeed, the only appreciation which is wholly nonprejudicial to creditors is a seasonal fluctuation, and that may be protected under the rationale of Palmer Clay Products Co. v. Brown anyway. Given the fact that virtually all appreciation of collateral was prejudicial to unsecured creditors, there appeared to be little justification in policy for sustaining its validity.

(Kronman, supra note 27, at 151-58 (good summary of opposing views); Skilton, supra note 27, at 1006.

The reference in the text to "proceeds of assets" was designed to cover the case of after-acquired property for which an Article 9 filing was already made. Although the after-acquired property itself had never been available to satisfy the claims of unsecured creditors, it will usually be the proceeds of property that were available. See supra note 334. But see supra note 337.

Even this generalization is untrue for some cases of appreciation, e.g., the proverbial mortgaged cow that is fattened with unmortgaged grain. There, the collateral is indeed physically composed of assets that were previously available to unsecured creditors. While such appreciation may be valid due to the lack of a transfer, see supra note 328, it would be incorrect to speak of nothing being taken away from creditors.

Whether a creditor has received a preference is to be determined, not by what the situation would have been if the debtor's assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, but by the actual effect of the payment as determined when bankruptcy results.

Id. at 229. If collateral appreciates in price during the preference period, it is arguable that, under Palmer, no preference has occurred since the valuation of the collateral for purposes of preference law was always to be determined by its liquidation value at the time of bankruptcy. In other words, its value at the start of the preference period is deemed to be whatever it will be worth at the time of the petition, regardless of its current liquidation value.

Of course, this argument will not avail the secured party where the inventory was liquidated at a price higher than the value it would realize at bankruptcy. There, the Palmer rationale would suggest that the excess value be recoverable by the trustee unless no transfer was deemed to occur. See supra note 328 and text accompanying note 327.
Professor Kripke, in a letter to the Gilmore Committee in 1970,\textsuperscript{344} maintained that, notwithstanding the common element of loss, appreciation of existing collateral was substantially different from the transfer of a new item. In a classic preference situation, the entire transfer is voidable because everything the secured party received was at the expense of the estate. This is not true in the appreciation cases. For example, processing of raw materials into finished products involves labor and other expenses, but the expense is not necessarily equivalent to the enhancement of value to the collateral and in a profitable business would never be. In such cases, the secured party should enjoy the benefit of the increase and simply reimburse the estate for costs and obligations incurred.\textsuperscript{345}

Professor Kripke supported his analysis by citing \textit{Meinhard, Greeff \& Co. v. Edens}.	extsuperscript{346} In that case, the debtor was undergoing a corporate reorganization. In conducting the debtor's business, the trustee had processed raw materials subject to a security interest into finished products at a cost of $14,031.20.\textsuperscript{347} Upon disposition of the collateral, it was necessary to allocate the proceeds between the secured party and the estate. Rejecting the trustee's contention that the secured party should be limited to the value of the collateral as of the date of petition, the court awarded the secured party the entire im-


\textsuperscript{345} By 1974, Professor Kripke had modified his position by differentiating between raw materials and collateral that were already partially processed at the start of the preference period. He maintained that, only in the latter case, should the secured party get the benefits of appreciation and reimburse the estate. See infra note 366 and text accompanying notes 369–73. The \textit{Meinhard} case, however, allowed the secured party the value of the completed product although the materials were unprocessed at the start of the preference period or indeed at the time of the petition. Of course, \textit{Meinhard} may not necessarily be a direct precedent. See infra note 348.

\textsuperscript{346} 189 F.2d 792 (4th Cir. 1951). The essence of the \textit{Meinhard} holding appears to be codified in section 552 of the BRA which provides that, although generally property acquired by the estate or the debtor after the commencement of the case is not subject to a prepetition security agreement containing an after-acquired property clause, the secured party is entitled to postpetition proceeds, rents, offspring, and profits. Section 506(c) provides, however, that the secured party must reimburse the estate for the expenses incurred by the trustee or the debtor in possession in the disposition or preservation of collateral, and presumably its appreciation as well. It should be noted that the enumerated examples of postpetition appreciation in section 552 do not involve situations where the original collateral itself takes on a new form as is the case with the conversion of raw materials into finished products or the ripening of contract rights into fixed obligations. It is thus arguable that, under a literal reading of section 552, such appreciation would constitute a new postpetition transfer and be invalid under section 552(a) and section 549. \textit{Meinhard}, however, is still a viable precedent, at least in the context of postpetition appreciation, and suggests that regardless of the form the appreciation takes, the secured party may indeed receive the benefit of that appreciation, as long as the estate is reimbursed.

\textsuperscript{347} Id. at 794.
provement less the production costs. Arguably, the same could hold true for prepetition manufacturing activities.

While this may be an equitable accommodation of opposing interests, a cost allocation approach had little support in the statutory language of section 60 of the 1898 Act which seemed to adopt an "all or nothing" approach stressing recovery based on improvement of position, i.e., what the transferee received, rather than cost, i.e., what the estate lost. In many cases, cost may in fact be the proper measure of that improvement. For example, the costs of sale would normally come out of the proceeds realized upon liquidation. If instead the debtor liquidates collateral at his own expense, the transfer of the proceeds to the creditor is preferential to the extent of the costs that were not deducted. Nevertheless, that is not the same as saying that, despite actual improvements above the cost to the estate, recovery should still be limited to the latter.

The foregoing was a brief summary of the issues under the 1898 Act. Essentially, whether, or under what circumstances, appreciation of collateral constituted new transfers subject to attack was doubtful. Did it depend on the appreciation resulting from a new acquisition of property, e.g., proceeds, or was the enhancement of existing collateral sufficient? Was recovery based on the detriment to the estate or the benefit to the preferred party? Or was recovery precluded in all instances? Assuming detriment to the estate was the appropriate standard, how was this detriment defined or measured? Should different types of appreciation be treated differently? Was there in fact a

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348 Id. at 796.
349 There is, however, a legitimate distinction between postpetition manufacturing activities conducted by order of the reorganization court and prepetition appreciation. In allowing the secured party the benefit of his appreciation, the court observed: "[T]he duty of the court to protect the rights of all persons having interests in the property, not merely the interests of the debtor and general creditors." Id. at 797. Conversely, it is arguable that even Meinhard's requirement of reimbursement applies only to postpetition manufacturing with the secured party allowed to keep all appreciation arising prior to the commencement of the case. See infra notes 380 & 395. At the same time, the court did suggest in dictum that the same result would follow if the debtor himself would have completed the manufacturing process prior to the filing of the petition. 189 F.2d at 796.
350 Indeed, as noted earlier, preferences were arguably voidable even if there was no loss to the estate at all. See supra note 324 and text accompanying notes 337–39. See also infra text accompanying notes 388–90 (prejudice to creditors). Of course, in reality there are few, if any, situations which do not involve some loss to the estate.
351 Although costs of administration are generally subordinated to valid liens, costs allocated to the preservation or disposition of the secured property which benefit the holder of the security interest must be paid first. See 11 U.S.C. § 506(c) (Supp. IV 1980). The same was true under the 1898 Act. See 3A Collier on Bankruptcy ¶ 64.105[3], at 2098–101 (J. Moore 14th ed. 1978).
principled basis or a unified theory by which appreciation of collateral could be consistently distinguished from other forms of the after-acquired property or should issues of appreciation value be resolved on a case-by-case basis, focusing on the individual characteristics of the particular transaction in question? Did it even make sense to lump together disparate problems relating to price fluctuation, proceeds, processing of raw materials, and ripening of contract rights under the single rubric of “appreciation value,” where the reasons for protecting one type of appreciation may be inapplicable to another?

Apart from the isolated statements in Rockmore which were susceptible to various interpretations and the analogies drawn from postpetition appreciation of collateral which were not directly on point, there was virtually no judicial authority providing guidance on these difficult problems. Nor was the language of section 60 very

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352 See supra note 330. The implications of Rockmore are not entirely clear. Rockmore arose under section 60 of the 1898 Act which provided that a transfer was deemed made when it was perfected against a lien creditor. Accordingly, its holding could be based on the notion that, as long as the interest was invulnerable from attack by a lien creditor, the transfer was protected even if no collateral was acquired until the start of the preference period, similar to the “sufficient perfection” analysis of DuBay. The court may never have meant to imply that appreciation does not constitute a new transfer; rather, even if it does, the transfer was deemed made from the date of its perfection. Read in such a manner, Rockmore had little relevance to the courts and commentators who rejected DuBay and certainly could not be a guide to the proper interpretation of present law.

353 See supra note 348.

354 The point should be made that, at the very least, appreciation of existing collateral constituted a species of after-acquired property and that some of the theories that would have sustained security interests in new acquisitions of property would have protected appreciation as well. For example, the entity theory would protect the conversion of contract rights into accounts receivable or the liquidation of inventory into cash. It could also apply to the mortgaged cow fattened with unmortgaged grain. (Although the cow may not be an item of inventory, the appreciation is clearly an enhancement of a preexisting entity and, as such, would be protected.) The sufficient perfection theory would have covered all forms of appreciation, as long as a financing statement was filed before the start of the preference period and, indeed, may have been the basis of the Rockmore holding. See supra note 352. Substitution of collateral, on the other hand, would not be an available line of argument since appreciation involves additional, rather than substitutional, increments of value. See supra note 4. But see supra note 328 (one can combine a “no transfer” argument with a substitution of collateral analysis to protect appreciated collateral which later generates proceeds).

Interestingly enough, section 9-108 of the UCC may not protect appreciation value. Where “new value” is given pursuant to a security agreement, after-acquired property is deemed to be acquired for that new value and not on account of antecedent debt. Section 9-108 is applicable, however, only where the value is secured in whole or in part by after-acquired property. Appreciation of existing collateral resulting from the harvesting of a crop or the processing and manufacturing of raw materials does not involve the acquisition of new items of property and, hence, the extension of new value could not be postdated. Similarly, under Article 9’s current
helpful. In the course of its general revision of section 60, the Gilmore Committee sought to resolve some of the ambiguities in this area.

In its original redrafting of section 60 in 1967, the Committee inserted a specific provision dealing with appreciation. The draft provided that any increase in the value of collateral in which there was a perfected security interest prior to the preference period did not constitute a preference if the increase was due to: (1) fluctuating market values; (2) conversion of inventory into accounts receivable by sale in the ordinary course of business; or (3) the manufacture of raw materials into finished products, except to the extent that items not subject to the security agreement were incorporated into the finished product during the preference period. The Committee cited Rockmore v. Lehman with approval.

By 1970, the Committee seemingly reversed itself. Their final draft simply provided that transfers of accounts receivable or inventory were voidable to the extent of an improvement in position during the preference period. This provision apparently denied the secured creditor the benefit of any enhancement of his collateral. If this was classification, a right to payment that is earned by performance during the preference period is not regarded as after-acquired property or the proceeds of a previous contract right, but the appreciation of a preexisting account. U.C.C. § 9-106 (1972); Cf. id. (1962). Thus, in the Rockmore situation, although Article 9 clearly recognized that the assignment could have been perfected against a lien creditor prior to the preference period, section 9-108 would be unavailable to protect the appreciation. See supra note 330. (Of course, the fact that a matured account receivable is not deemed a new item of property is in itself an argument that no transfer has occurred within the preference period, see supra note 328, but validity of the interest would not then depend on section 9-108.)

355 See Kronman, supra note 27, at 152.
356 Interestingly enough, although the Gilmore draft generally allowed a 21 day period for relation back, appreciation value was protected only if the security interest in the original collateral was actually perfected before the start of the preference period. While perfection within 21 days of the transfer taking effect would have validated the security interest to the extent of its value at the start of the preference period, it would not have validated subsequent appreciation. Why the grace period was inapplicable to this situation is unclear. See infra text accompanying notes 384–85.
357 This apparently meant the sale of secured inventory already subject to the creditor's security interest and not a case of "feeding" the lien by taking unsecured assets out of the estate. Note that section 9-108 of the UCC would permit even the latter if done in the ordinary course of the debtor's business, but the Gilmore proposal did not purport to go as far. See Kronman, supra note 27, at 152–53; see also infra text accompanying note 383 (conversion of secured inventory into accounts receivable protected so long as no prejudice to other creditors).
358 See supra note 335.
359 1967 Committee Report, supra note 331, at 16. Although the Gilmore Committee relied on Rockmore v. Lehman, its draft failed to include the one type of appreciation that case was concerned with—the ripening of contingent rights to payment into fixed obligations through the debtor's performance during preference period. See infra text accompanying note 382.
not clear enough, their accompanying report to the National Bankruptcy Conference contained the following example:

A secured party owing a debt of $25,000 has a security interest in raw materials worth $10,000 four months prior to bankruptcy. These materials are converted into finished products with a market value of $20,000. Since at the start of the four months, there was an initial deficiency of $15,000 the reduction of that deficiency by a $10,000 gain in the collateral is voidable and recoverable by the trustee.\textsuperscript{361}

The Committee further noted that if Rockmore \textit{v.} Lehman suggested the contrary, its holding would be overruled. Why the Committee radically shifted its position within a relatively short period is not clear. Professor Gilmore's statement that the omission of the additional section from the 1970 draft simply reflected a consensus not to address the issue\textsuperscript{362} is belied by the Committee comments given above. A contrary position was in fact taken.

The Commission bill reverted to the original position of the Gilmore draft.\textsuperscript{363} The preference section of that bill provided that a perfected transfer of inventory and accounts receivable was not voidable, except to the extent the transferee had improved his position by an increase in the value of the security \textit{at the expense of the estate}.\textsuperscript{364} The Commission Report explained this addition by noting that a mere reduction in deficiency would not be preferential unless it involved diverting assets away from unsecured creditors.\textsuperscript{365} The wording was intended "partially" to meet Professor Kripke's criticism that, under the then current law, harvesting of crops and completion of work in progress would constitute voidable preferences.\textsuperscript{366}

\textsuperscript{361} Id. at 217–18 app., reprinted in 1978 U.S. Code Cong. & Ad. News at 6177–78.

\textsuperscript{362} Kronman, supra note 27, at 154 n.142 (quoting Professor Gilmore to that effect).

\textsuperscript{363} Unlike the Gilmore draft, however, the Commission bill, as did the BRA, dealt with the issue of appreciation value through the formulation of a general standard ("at the expense of the estate"), rather than explicitly protecting designated types or transactions. For a discussion of the practical consequences of these differing approaches, see infra text accompanying notes 381–84.

\textsuperscript{364} Commission Report, supra note 110, Part I, \S 4-607(d), at 209–10 (emphasis added).

\textsuperscript{365} Id. (accompanying comments).

\textsuperscript{366} Inexplicably, the Commission had earlier quoted with seeming approval those portions of the final Gilmore Report that were directly contrary to the view ultimately embodied in its proposed section 4-607. Id. at 209. Professor Kripke has suggested that the Commission was distinguishing between raw materials and collateral that was already partially processed at the start of the preference period with appreciation fully recoverable by the trustee only in the former situation. See infra text accompanying notes 369–73. Since the example in the Gilmore Report involved the conversion of raw materials into finished products, the Commission correctly cited it as an instance where, even under its own proposals, appreciation value would be denied. Letter from Professor Kripke to R. Skilton (Oct. 9, 1974), reprinted in Skilton, supra note 27, at 1008 n.169.
The BRA carries forward the Commission’s concept. Section 547(c)(5) provides that security interests in inventory and accounts receivable that fail to meet the two-point test are voidable only if the improvement of position was to “the prejudice of other creditors holding unsecured claims.” While the House and Senate Judiciary Reports shed no light on the significance of this phrase, presumably it, like the analogous wording in the Commission bill, was designed to protect appreciation of existing collateral. There must be both an improvement of position and a detriment to the estate.

In protecting improvements of position where the improvement was not “to the prejudice of other creditors,” section 547(c)(5) could hardly mean that the creditor gets the benefit of the entire gain, since the costs of labor and production incurred by the debtor in improving the collateral do indeed diminish the debtor’s estate and invariably do prejudice the rights of other creditors. At best, then, section 547(c)(5) cannot prevent recovery by the trustee but can only limit such recovery to the costs incurred, allowing the secured party to receive the benefit of excess appreciation. Yet even this limited protection does not necessarily follow from the wording of the statute. While section 547(c)(5) conditions avoidance on an improvement of position that operates to the prejudice of other creditors, it does not necessarily limit voidability to the extent of that prejudice.\(^{367}\) As long as there were assets diverted from the estate—whether those assets were incorporated into the collateral or were expended for its enhancement—arguably the entire improvement would be recoverable. Alternatively, by conditioning recovery of the improvement on prejudice to creditors, section 547(c)(5) implicitly limits recovery to the amount of that prejudice.

With regard to the validity of this distinction under the BRA, see infra text accompanying notes 372–80.

\(^{367}\) Although section 547(c)(5) does provide that security interests in inventory and accounts receivable are voidable only to the extent that there is a reduction of deficiency (i.e., improvement of position) “to the prejudice of other creditors,” that language does not resolve the issue raised here. Stating that a security interest is voidable only to the extent of an improvement which prejudices other creditors is not the same thing as stating that an improvement is voidable only to the extent of prejudice. In the former, the limiting force of the phrase “to the extent” dictates only that voidability requires the existence of an improvement which has the characteristic prejudicing the rights of unsecured creditors. Since most collateral appreciation does possess this characteristic, such improvement could still fall within the class of transfers that section 547(c)(5) condemns or at least fails to protect. See infra text accompanying note 387. By contrast, if the words “to the extent” had appeared after the reference to the need for a reduction of deficiency, the import would clearly be that the entire improvement is not voidable, but only that part which represents the loss to the estate. As the statute currently reads, however, no such inference can be drawn. See also infra note 368 (interpretation of prejudice).
In short, while section 547(c)(5) invalidates transfers only if there
is both an improvement and a detriment during the preference period,
it is unclear which factor determines the size of the recovery.\textsuperscript{368}

Professor Kripke has suggested that whether or not the entire
improvement is recoverable should depend on the status of the collat-
eral at the start of the relevant preference period.\textsuperscript{369} Taking the example
of inventory which was processed into finished goods (without the
incorporation of components not previously subject to the security
interest),\textsuperscript{370} he would distinguish between collateral that was totally
unprocessed (i.e., raw materials) and work in progress. Raw materials
have a resale value; work in progress, unless it is completed, does not.
Denying the secured party the benefit of the improvement in the
former situation does nothing more than limit the secured party to the
original resale value of his collateral; in the latter case, denial of
improvement is tantamount to giving him nothing at all. Arguing that
a secured party should not be “penalized” when the debtor seeks to
make the collateral a valuable asset, Professor Kripke concluded that,
where the collateral was work in progress, the secured party should
get the appreciation, merely reimbursing the estate for the debtor’s
expenses. Where the collateral was totally unprocessed, however, the
entire improvement should be recoverable.

\textsuperscript{368} It should be noted that, even if section 547(c)(5) is construed to mean that improvements
are voidable only to the extent of prejudice, it is possible to argue that unsecured creditors are
prejudiced within the meaning of section 547(c)(5) not only when they lose a source of recovery
for their claims that they already had but also when, as a result of a transfer deemed to occur
during the preference period, they are deprived of an asset that would otherwise have been
available were the transfer not made. See supra note 337. This contention would mean that all
appreciation is prejudicial to general creditors and, accordingly, should be recoverable by the
trustee.

While such a construction may be highly justifiable in terms of the policy it espouses, it is
hardly likely that the term “prejudice” in section 547(c)(5) was intended to be defined so broadly.
If all appreciation, by definition, is prejudicial to general creditors, the additional element of
“prejudice” found in section 547(c)(5) would be mere surplusage, serving no useful purpose. It is
therefore probable that unsecured creditors are deemed to be “prejudiced” by a transfer only to
the extent that assets previously available for the satisfaction of their claims were diverted,
directly or indirectly, into the enhancement of the collateral.

As noted, infra text accompanying notes 374–80, the same considerations that suggest a
narrow definition of prejudice—the fact that, under the broader definition, the prejudice
requirement would be mere surplusage—also compel the conclusion that the extent of that
prejudice (narrowly defined to include only the costs to the estate, not the benefit to the
transferee) is the outer limit for the trustee’s recovery. The point made in the text merely relates
to the fact that the language of the BRA leaves the measure of recovery uncertain.

\textsuperscript{369} Professor Kripke made this distinction in connection with the Commission proposal which
contained substantially similar language. See supra note 366. This was a modification of his
earlier view that cost to the estate should always be the appropriate measure of recovery. See
supra note 345 and text accompanying notes 344–46.

\textsuperscript{370} See supra note 335.
Presumably, the same argument holds true for contract rights. The assignment of a contract right has value only insofar as it will entitle the secured party to payment in the event of performance by the debtor.\textsuperscript{371} Denying the secured party the benefit of receiving those payments when the payments became due during the preference period is essentially a denial of security. Accordingly, under the Kripke analysis, in the case of contract rights which ripen into fixed obligations during the preference period, the secured party could receive payments as they accrue, but would have to reimburse the estate for expenses and obligations incurred by the debtor in performance of his contract.\textsuperscript{372} On the other hand, a security interest in unharvested crops is akin to a security interest in unprocessed raw materials, where all appreciation in value resulting from harvesting would be denied to the secured party.\textsuperscript{373}

Under this analysis, the test of "prejudice to other creditors" has a different application, depending on the nature of the collateral. With regard to some types of collateral, the existence of prejudice permits the recovery of the entire improvement; with regard to other types, recovery is limited to the amount of the estate's loss—and therein lies the difficulty of the explanation. While the distinction between raw materials and work in progress is not without merit, the statute itself contains only a single standard which may mean one thing or the other, but could hardly mean both. If "prejudice to other creditors" means that the trustee's recovery is limited to the amount of expense

\textsuperscript{371} While a secured party may realize immediate value if he assigns his security interest in the debtor's contract rights to another, see U.C.C. § 9-405 (1972), ultimately the ability to make such an assignment rests upon the secured party's assurance that, upon performance by the debtor, payment will be forthcoming. If section 547 prevents such an assurance from being given, the feasibility of the assignment is eliminated. See supra note 373.

\textsuperscript{372} Indeed, this would appear to be the case not only where the payments became due during the preference period but also where the obligation became fixed subsequent to the commencement of the case. For a discussion of Rockmore, see supra note 330 (assignments of contract rights made more than four months before bankruptcy entitled the secured party to receive payment which accrued postpetition), and Meinhard, see supra note 333 (a security interest in raw materials that was perfected prior to the preference period entitled the secured party to postpetition appreciation).

\textsuperscript{373} While the author has no evidence on this point, there is no apparent reason why an unharvested crop cannot be assigned a fair market value based on the additional expenses a purchaser would have to incur to harvest it. It should be noted, however, that the difference in value between a harvested and an unharvested crop is likely to be equivalent to the costs of harvesting. Thus, the incremental increase in value, i.e., the appreciation, and the cost to the estate are likely to be one and the same. In any case, an unharvested crop is to be distinguished from an unearned contract right. In the latter, the asset in which the secured party has an interest is the right to receive payment upon the debtor's completion of performance. As of the start of the preference period, that right ceases to have any value at all if the debtor's completion of performance effects a voidable transfer.
incurred for work in progress and for changing contract rights into accounts receivable, that standard should apply equally to the processing of raw materials. If, on the other hand, prejudice to creditors forecloses the allowance of any improvement, then the holder of a security interest in work in progress should be denied the benefit of the completed product. The issue is not one of “penalizing” the secured party for his industry. The inquiry simply focuses on whether assets were diverted from unsecured creditors during the three months (or one year, in the case of an insider) prior to bankruptcy. The holder of a security interest in work in progress may indeed be undercollateralized and may have advanced funds in anticipation of the work being completed, but the account receivable financier who lends on the strength of future accounts receivable is similarly situated and yet is nevertheless subject to the “improvement of position” test. Thus, in applying the statutory test, one can argue either that the entire appreciation is recoverable or that recovery by the trustee is limited to the expenses and obligations incurred by the debtor, but there is no statutory basis for applying the test differently depending on the extent the collateral was processed as of the start of the preference period.

Once the possibility of a double standard is discounted, it obviously becomes necessary to determine the extent of avoidance in all cases of appreciation. For several reasons, it appears probable that, in all cases of improvement of position regardless of the nature of the collateral, trustee recovery should be limited to the estate’s detriment.\(^{374}\) First, since virtually all appreciation involves some expense to the estate (other than seasonal fluctuations of prices),\(^{375}\) if section 547(c)(5) permitted avoidance of the entire improvement, any protection to the secured party that the “prejudice” test was apparently designed to afford would be nonexistent. There is little sense in imposing an additional requirement for voidability if that requirement will be met in every case of improvement.

Second, the Commission bill contained language substantially similar to that in section 547(c)(5) and was equally ambiguous as to

\(^{374}\) See supra note 368 (for a narrow definition of detriment to the estate).

\(^{375}\) It should be noted that 11 U.S.C. § 506(c) (Supp. IV 1980) already provides that the secured party must reimburse the estate for expenses incurred in the preservation or enhancement of collateral and this section is considerably broader than any right to reimbursement that could be inferred from section 547. See infra note 380. Nevertheless, construing the “to the prejudice of other creditors” phrase in section 547 to limit recovery to expenses does not render the language superfluous since the purpose of the proviso is to preclude recovery of the entire appreciation on a theory of its being a “transfer.” Moreover, section 506(c) may have no application to expenses incurred by the debtor prior to the commencement of the case. Id.
whether avoidance was limited to detriment or the entire improvement.\textsuperscript{376} The Commission Report indicated, however, that harvesting of crops and processing of raw materials into inventory were intended to be protected transactions.\textsuperscript{377} In the absence of legislative history to the contrary, it is plausible to assume that, in adopting similar language, Congress had a similar intent.\textsuperscript{378}

Finally, while Professor Kripke’s argument does not warrant the imposition of a double standard, his observation that some forms of collateral have value only if expenses are incurred for their enhancement argues against a construction of the statute that would leave the holders of validly perfected security interests in such collateral with nothing.\textsuperscript{379} To avoid this injustice and, at the same time, avoid the incorporation of distinctions with no statutory basis, rather than provide that only those creditors get the benefit of improvement less the expense, section 547(c)(5) should be construed to provide this advantage for all secured parties.\textsuperscript{380}

\textsuperscript{376} See supra text accompanying notes 363–64. There appears to be little difference between the Commission’s requirement that improvements be at “the expense of the estate” and the BRA’s requirement which necessitates “prejudice to other creditors holding unsecured claims.” Neither provision completely settled whether avoidance was absolute or was limited to the extent of the expense or prejudice.

\textsuperscript{377} See supra note 365.

\textsuperscript{378} While the Commission Report does not indicate to what extent the secured party should be protected, it is clear that “an expense of the estate” formula, like the analogous wording in section 547(c)(5), requires at a minimum that expenses be reimbursed. See supra text accompanying notes 366–67. The only ambiguity that the formulation leaves open is whether trustee recovery is limited to these costs or includes all appreciation. Since the latter alternative would afford no protection at all to secured parties, and the Commission indicated that protection is appropriate, the cost allocation approach is the only remaining possible construction. But see supra note 366.

\textsuperscript{379} As discussed, infra text accompanying note 387, no construction of section 547(c)(5) actually has the effect of invalidating security interests on improvements since even transfers excluded from the protection of section 547(c)(5) are voidable only if they otherwise fall within the basic definition of a preference, and it is questionable whether appreciation of existing collateral does. The issue is not what section 547(c)(5) invalidates, merely what it protects or does not protect. Nevertheless, to the extent that section 547(c)(5) affords no protection for appreciation of collateral where there is a detriment to creditors, it at least creates a possibility that some secured creditors will simply forfeit their security. Avoidance of this possibility may itself be a basis for choosing an alternative construction that guarantees the secured creditor the benefit of his security upon reimbursement to the estate.

\textsuperscript{380} This last factor in particular applies with equal force to postpetition perfection under section 552, granting the secured party the benefit of such appreciation, as long as the estate is reimbursed, although section 552 itself is not very clear on this point. See supra note 372. Indeed, with respect to postpetition appreciation, the Meinhard case, 189 F.2d 792 (4th Cir. 1951), adopting a cost-location approach, is a direct precedent. See also infra note 395.

In any case, as thus interpreted, section 547(c)(5) is essentially a codification of the 1970 Kripke proposal letting the secured creditor retain the appreciated values, but requires restoration of the assets that were diverted away from general creditors. See supra text accompanying
If the element of “prejudice to other creditors” merely requires the secured party to reimburse the estate but does not deprive him of appreciation, it can readily be seen that the adoption of a general

notes 344–50. Cf. text accompanying note 369. It merely excludes from its protection appreciation to the extent of prejudice to creditors. If the trustee desires to recover these expenses, he may encounter difficulty under the “no transfer” argument. See supra note 328; infra text accompanying note 390. A second point to keep in mind is that, to the extent the trustee seeks to recover expenses incurred by the debtor in enhancing the value of the collateral, by asserting voidability under section 547, the trustee is nonetheless compelled to proceed through avoidance of a transfer. In other words, there is no general principle embodied in section 547 that permits a trustee to recover from secured creditors monies expended on their behalf within the preference period. The basic standard of section 547(b) is benefit the transferee, not detriment creditors. See supra note 336. Thus, all a trustee can seek to do is to recover all or part of that benefit. See infra text accompanying note 391. Section 547(c)(5) does not substitute detriment for benefit, rather it limits the benefit recoverable by the amount of the detriment. Benefit is still the touchstone of voidability.

This distinction is important for two reasons. First, to the extent the appreciation was less than the costs of its enhancement, the recovery of the trustee would be limited to the appreciation (assuming he could surmount the “no transfer” argument). See supra note 328. If no appreciation resulted, e.g., unmortgaged grain was used not to fatten a mortgaged cow, but simply to maintain it at the same weight and health that it was prior to the preference period, the trustee who proceeds under section 547 is without recourse. Second, improvements of position that prejudice other creditors are voidable under section 547 only if, at the time of the transfer, the debtor was insolvent and, in the case of an insider where the transfer occurred more than 90 days, but within one year of bankruptcy, only where the transferee had reasonable cause to know of the debtor’s insolvency. See supra text accompanying notes 123–28. The costs involved in the enhancement of collateral during the preference period may all be incurred at different times, e.g., wage claims, materials, machinery costs. Some expenses may be incurred while the debtor was still solvent or at a time when the insider transferee had no reasonable cause to know of the debtor’s insolvency. Nevertheless, the trustee is not recovering costs per se (which, by themselves, are not transfers to the secured party), but is avoiding a benefit where costs are merely a limitation on the amount of recovery. The only transfer (if any) subject to avoidance under section 547(b) is the appreciation of collateral. The date of appreciation, rather than the date various expenses were incurred, is therefore the appropriate point to determine insolvency and reasonable cause. Thus, if the debtor spent the 90 days preceding bankruptcy in the performance of his contractual obligation, the fact that he was solvent as the expenses were incurred is irrelevant, as long as he was insolvent on the date that performance was completed and the contract right ripened into a fixed payment obligation.

It should be noted that the foregoing limitations apply only where the trustee attempts to recover costs by alleging the existence of a preferential transfer arising from the enhancement of collateral during the preference period. Section 506(c), however, may constitute an independent authority for the recovery of expenses incurred in the enhancement as preservation of collateral. See 11 U.S.C. § 506(c) (Supp. IV 1980). Proceeding directly under section 506 rather than section 547 has three distinct advantages. First, recovery of costs is permitted not only where the expenses incurred enhance the value of the collateral but even where the costs merely preserve it (although recovery could not exceed the value of the collateral since section 506(c) limits “recovery to the extent of any benefit to the secured party”). Second, the costs are recoverable regardless of when they were incurred or of the debtor’s solvency at the time they were incurred. (This may even be true under section 547 as well, but is certainly more questionable.) Finally, the costs are recoverable regardless of when the underlying transfer (if any) is deemed to occur. The existence or nonexistence of a “transfer” is wholly irrelevant under section 506 and even if the collateral appreciated more than 90 days before bankruptcy, the trustee retains a right of recovery.
standard, in lieu of the specific examples enumerated in the original Gilmore draft, is of significantly greater benefit to secured creditors in at least two respects. First, it protects appreciation of collateral in cases other than the processing of raw materials or the liquidation of inventory. Specifically, it permits secured parties to receive the gains arising from the ripening of contract rights into fixed obligations or from the harvesting of crops. Second, the conversion of secured inventory into accounts receivable is protected even where the sale is not made in the ordinary course of business, as long as it is not to "the prejudice of other creditors."

It should also be noted that while first Gilmore draft provided that the security interest in the original collateral had to be perfected prior to the start of the preference period, it is probable, though not certain, that under section 547(c)(5) all that is necessary is that the security interest in the original collateral be valid in bankruptcy. As

Nevertheless, it is far from certain that section 506 has any application at all to expenses incurred by the debtor prior to the commencement of the case. The legislative history indicates that section 506(c) was designed to deal with the costs of disposition or preservation of collateral incurred by the trustee or the debtor-in-possession subsequent to the filing of the petition. See Senate Report, supra note 153, at 68, reprinted in 1978 U.S. Code Cong. & Ad. News at 5854; 3 Collier on Bankruptcy, supra note 42, § 506.06, at 506-10. Accordingly, attempts to recover prepetition expenses may be possible only under section 547 in which case the limitations of timing and insolvency, as well as the need to show a "transfer" may severely curtail the possibilities of a success and would leave the trustee with no remedy at all, if the expense merely resulted in preservation of the collateral, rather than its enhancement.

This last factor in particular applies with equal force to postpetition perfection under section 552, granting the secured party the benefit of such appreciation, as long as the estate is reimbursed, although section 552 itself is not very clear on this point. See supra note 371. Indeed, with respect to postpetition appreciation, the Meinhard case, 189 F.2d 792 (4th Cir. 1951), adopting a cost-allocation approach, is a direct precedent. See also infra note 394.

In any case, as thus interpreted, section 547(c)(5) is essentially a codification of the 1970 proposal letting the secured creditor retain the appreciated values, but requires restoration of the assets that were diverted away from general creditors. See supra text accompanying notes 344-50.

These points are equally valid with regard to the Commission draft, which utilized a similar formula of "expense to the estate." See supra text accompanying notes 363-66.

Obviously this is true only if the "prejudice to other creditor" does not deprive the secured party of the appreciation in excess of the detriment. If it does, then the ripening of contract rights into fixed obligations always involves costs that, under a strict reading, would foreclose receipt of any benefit by the secured party (if the trustee can surmount the "no transfer" argument). See infra text accompanying note 391.

Where unsecured inventory generates accounts receivable subject to a security interest, any resulting improvement in position is clearly voidable, even where the sale was in the ordinary course of business. The same was true under the Gilmore proposal. See supra notes 334 & 357 and accompanying text. But cf. U.C.C. § 9-108 (1972).

See supra note 356.

See supra text accompanying notes 136-49. While section 547(c)(5) is not entirely clear, its policy and history indicate that there must be a "transfer" in existence prior to the preference period which in turn incorporates the 10 day grace period of section 547(e).
such, perfection within ten days of the pre-ninety day transfer's taking effect would be sufficient, even if perfection occurs within the preference period. Just as such perfection would serve to validate security interests that met the two-point test, so too would it validate interests in which there was an improvement of position which was in excess of any prejudice to creditors. At the same time, section 547(c)(5) makes clear that, to the extent the estate did suffer a detriment, the security interest in the improvement may be voidable. At a minimum, the secured party would have to reimburse the estate for its losses. This was not necessarily true under the original Gilmore draft which simply protected certain types of appreciation without specifying that costs had to be reimbursed. 386

Section 547(c)(5), with regard to appreciation value, is thus more expansive in its protection and more liberal in its perfection requirements than its original predecessor but, in the situations covered by the first Gilmore draft, more rigorous in preventing depletion of the estate.

A final point regarding the application of section 547(c)(5) to appreciation value is perhaps the most crucial of all. In light of the foregoing discussion, one might assume that section 547(c)(5) definitively resolves the problem of appreciation by denying the creditor the benefits of that appreciation unless the estate is compensated for its losses. This, however, is a serious mischaracterization. A close reading of section 547(c)(5) reveals that there is truly "less than meets the eye" in its formulation.

In understanding the limited effect of section 547(c)(5), two points must be kept in mind. First, as explained earlier, 387 section 547(c)(5) is not an invalidation provision, but an exception from invalidation designed to shield transfers that would otherwise be voidable. Consequently, even security interests that fail to qualify for its protection will be invalid only if they are preferences within the meaning of section 547. In speaking of a transfer being voidable under section 547(c)(5) for failure to meet the two-point test, what is really meant is that the transfer is not protected by section 547(c)(5) and is therefore voidable under section 547(b). Section 547(c)(5) can only protect; it cannot invalidate.

Second, the phrase "to the prejudice of other creditors" appears only in section 547(c)(5); it does not appear in the basic definition of a

386 The Gilmore draft was only a proposed revision of section 60 of the 1898 Act. As such, it contained no analogue to section 506(c) of the BRA. Even such a provision, however, does not necessarily permit recovery of prepetition expenses. See supra note 380.
387 See supra text accompanying notes 123-28.
preference in section 547(b). It would thus appear that it is generally not essential to the existence of a preference that assets which were previously available to unsecured creditors be taken away. As long as the result of the transfer is to enable the secured party to receive more of the property of the debtors than he otherwise would have received, the transfer is voidable even if other creditors would not be getting less. Conversely, if the transfer has no preferential effect, i.e., the secured party is getting no more than he would have otherwise received, the transfer is valid even though it does have a detrimental effect on the rights of other creditors. Loss without improvement is not actionable; but at least in the absence of section 547(c)(5), improvement without loss is actionable. Section 547(b), however, does require that there be a “transfer” of the property of the debtor.

With these two preliminary points in mind, consider some typical examples of appreciation value: conversion of raw or semiprocessed materials into finished goods; ripening of contract rights into fixed obligations; harvesting of crops; and even the proverbial mortgaged cow fattened on unmortgaged grain. In all these cases, the appreciation clearly produces a preferential effect. It is equally obvious that unsecured creditors are being harmed, if not to the full extent of the appreciation, at least to the extent of the debtor’s expenses. The real issue, however, is whether a new transfer has taken place during the preference period. Where existing collateral has been enhanced, can a transfer be deemed to occur? If the concept of “transfer” is defined narrowly to include only new acquisitions of inventory or accounts receivable, then regardless of preferential effect or detriment to creditors, the security interest in the appreciated value will be valid.

Yet, it is precisely this issue that section 547(c)(5) fails to address. Section 547(c)(5) protects security interests in inventory and accounts receivable if one of two conditions are met: (1) there was no net improvement of position during the preference period; or (2) to the extent there was an improvement, such improvement did not operate “to the prejudice of other creditors.” As previously interpreted, the second prong of section 547(c)(5) will shield a transfer if the estate is reimbursed or, phrased differently, will limit avoidance of the trans-

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388 See supra note 336. A showing of such prejudice, however, would be necessary if the transfer would otherwise be protected by section 547(c)(5).
389 See supra note 326 (preferential effect is not measured solely in terms of how much a creditor receives, but of how much he receives of the property of the debtor).
390 See Breitowitz, supra note 22, at 366 n.37.
391 For a summary of the “no transfer” argument and its application to proceeds, see supra note 328.
fer to the amount necessary to secure reimbursement. If there is an improvement of position and the estate is not reimbursed, the only consequence expressly specified in the statute is that the resulting security interest falls outside of the protections of section 547(c)(5). Exclusion from section 547(c)(5), however, carries no implication that the security interest in the appreciation is voidable. Just as improvements of position are voidable only if they arose at a time when the debtor was insolvent and, in the case of an insider, when the transferee had reasonable cause to know of the debtor’s insolvency, such improvements are voidable only if they constitute “transfers.” Whether they do was questionable under the 1898 Act and the question appears to be very much alive under the BRA.

It is of course arguable that the fact that section 547(c)(5) conditions its protection (in the case of improvement) on a lack of prejudice to other creditors may itself imply that appreciation which does deplete the estate is voidable as a transfer. It is equally possible, however, that section 547(c)(5) is merely a “safe harbor” provision. Without resolving the appreciation issue one way or the other, Congress wanted to insure that, even if appreciation does constitute a transfer, the trustee’s recovery is limited to the estate’s loss and not, as would generally be the case, to the total benefit received by the transferee.302

While section 547(c)(5) guarantees that the secured party is protected if he reimburses the estate, it does not foreclose the possibility that, because no transfer occurred, the secured party may be equally protected even without making such reimbursement.303 The BRA takes no position on this issue and the matter is left to the courts, exactly as it was under the 1898 Act.304

At best, then, the problem of appreciation value has been resolved in only one direction. Formerly, appreciation of collateral

302 A similar “safe harbor” analysis was discussed in connection with the issue of whether section 547(c)(5) was exclusive. My earlier conclusion that it was exclusive does not preclude a “safe harbor” approach with regard to appreciation. See supra notes 151 & 174 and text accompanying notes 150–80.

303 Of course, to the extent that section 506(c) authorizes the recovery of expenses incurred in the enhancement or preservation of collateral, the proper construction of section 547 is irrelevant. Even if section 547 itself does not invalidate the security interest to the extent of the debtor’s expenditures or the estate’s loss, section 506(c) does substantially the same thing without the need to even show a transfer during the preference period. As noted earlier, however, the authorization of section 506(c) may be limited to the recovery of postpetition expenses. See supra note 380.

304 In one respect, the case for avoidance of appreciation may be stronger under the BRA. One of the arguments for protecting appreciation of existing collateral under the 1898 Act was based on case law upholding transfers of exempt property. See supra text accompanying note 340. If that result was changed by the BRA, see supra note 340, the “no transfer” theory becomes somewhat less convincing.
during the preference period was either totally nonrecoverable by the trustee, totally voidable, or voidable only to the extent of loss to the creditors. Section 547(c)(5) has eliminated the second possibility. As between the first and third alternatives, the statute is silent.

The same ambiguity, however, does not exist with respect to postpetition appreciation under section 552. While section 552(b) apparently protects postpetition appreciation to the extent the estate has not been harmed, see supra note 346, section 506(c) explicitly permits the trustee to recover the expenses of preservation, and presumably appreciation of collateral. See Meinhard, 189 F.2d 792 (4th Cir. 1951); 11 U.S.C. § 552 (Supp. IV 1980) (the qualifying language at the end section 552 which grants the bankruptcy court the authority to modify the secured creditor's claim to postpetition profits or proceeds "based on the equities of the case"). Note, however, that the grant of authority in section 552, and possibly in section 506 as well, is limited to postpetition appreciation and has no relevance to preferential transfers under section 547. See supra notes 380 & 385.

Thus, section 506 forecloses (for postpetition appreciation) the possibility existing under section 547 which would permit the secured party to keep the appreciation without having to reimburse the estate. At a minimum, such reimbursement is necessary. The only question section 552 leaves open is whether appreciation arising from a change in the form of the original collateral, such as the processing of raw materials into finished products, is governed by section 552(b), which allows the secured party to retain the benefit provided the estate is reimbursed or whether, because of the change in the collateral's form, the appreciation is regarded as a postpetition transfer of a new item of property with the resulting security interest therefore voidable under section 552(a). The Meinhard holding does suggest that in all cases of postpetition appreciation, reimbursement of expenses is sufficient and there is nothing in the BRA to the contrary. See supra notes 346–48.

The foregoing analysis proceeds on the assumption that the ability of a secured party to claim appreciation arising subsequent to the commencement of the case depends on his reimbursing the estate under section 506 although, with respect to prepetition appreciation, such reimbursement may be unnecessary. See supra notes 380 & 392. It should be remembered, however, that the distinction between prepetition and postpetition appreciation may cut the other way. Under the 1898 Act, it was arguable that all appreciation arising during the preference period was recoverable by the trustee, even that in excess of the debtor's costs. See supra text accompanying notes 336–51. Although Meinhard clearly validated the security interest to the extent the estate was reimbursed, the holding may have been limited to postpetition appreciation on the theory that only there was the secured party entitled to any appreciation at all, since it was the duty of the debtor-in-possession to process the goods with due regard for the interests of secured parties. See supra notes 346–48. Moreover, even under the BRA, there may be situations not covered by section 547(c)(5) where appreciation value will be totally voidable under section 547 (if the trustee can surmount the 'no transfer' argument, see supra note 328) despite the fact that, had the appreciation arisen subsequent to the commencement of the case, it would have been protected under section 552(b) only to reimbursement under section 506(c). See infra note 396.

In short, the fact that section 552(b) together with Meinhard apparently validates postpetition appreciation provided the secured party reimburses the estate essentially says nothing with respect to prepetition appreciation. Such prepetition appreciation may not require reimbursement at all in any case or, alternatively, may be fully voidable at least in cases not covered by section 547(c)(5). (In cases covered by section 547(c)(5), however, the latter alternative is clearly ruled out by its requirement that the improvement be to the "prejudice of other creditors holding unsecured claims." See supra notes 374–85.

Even the limited clarification that section 547(c)(5) does provide is limited to security interests in inventory, accounts receivable, and their proceeds. The element of "prejudice to other creditors" is found only in section 547(c)(5). Collateral not covered by section 547(c)(5) will continue to be governed by the basic rule of section 547(b) which makes no mention of the
Conclusion

In the first part of this Article, it was posited that a successful revision of the preference law would have to achieve three goals: simplification of language, coordination with the Uniform Commercial Code, and the adoption of substantive rules and exceptions that strike a proper balance between the conflicting policies of distributive equality and the facilitation of secured credit. Measured by these standards, how does section 547 stand up?

As a necessary prerequisite to any meaningful reform, section 60 of the 1898 Act had to be updated. Its application to Article 9 security interests had to be clear and not based on vague analogies to earlier forms of chattel security. On this level, section 547 of the BRA succeeds admirably. It has brought the section up to date and, in the process, cut through the thicket of words that left section 60 shrouded in obscurity for anyone other than a bankruptcy specialist. Elimination of the "equitable lien" concept by the substitution of a single lien creditor test for transfers of personality and the establishment of a uniform grace period of ten days, without reference to state laws setting up longer or shorter periods, are perhaps the two outstanding illustrations of the preexisting law being simplified and coordinated with the UCC. We now know, for example, that all Article 9 security interests have a ten day grace period and that purchase money security interests in consumer goods perfected without filing will not be converted into preferences by virtue of their being subject to the rights of certain buyers.

The third goal is more elusive: whether the substantive rules of the BRA—and of section 547 in particular—are justifiable both in terms of an overall philosophy of bankruptcy, and of the specific aims of section 547 in particular. Naturally, the results are mixed. The BRA...
continues to recognize state statutory liens arising within ninety days of petition although, in view of its general “objective” approach to preferences not focusing on state of mind or manipulative conduct, it is not clear why this should be so. On one hand, section 547 abolishes the “reasonable cause to believe insolvency” standard on the grounds that a creditor’s “culpability” is both irrelevant and almost impossible to prove. Yet it retains the same subjective inquiry for insider transactions making recovery under that provision extremely difficult. The “improvement of position test” still arbitrarily allows fully secured creditors to lose the value of their collateral due to a temporary fluctuation on the ninetieth day before bankruptcy and conversely permits a creditor to engage in manipulative conduct immediately prior to bankruptcy.

The purchase money security interest exception recognizes, as does Article 9, the special equity of the enabling lender but, by adopting a timely perfection requirement different from the one existing under Article 9, section 547 creates confusion as to whether compliance with Article 9 will be sufficient. Section 547(e) permits perfection within ten days of attachment to antedate the transfer to the time of attachment, although the original justification of a grace period statute in federal law has been negated by Article 9. Finally, the statute fails to address the recurring and vexing problems of appreciation value.

In short, section 547 embodies a series of compromises dealing with problems that are to some extent intractable. Perhaps the ultimate solution would be the total severance of security interests from preferences. The relevant inquiry would no longer be if a given “transfer” is on account of antecedent debt, but would focus directly

399 See id. at 359 n.8, 362.
400 Id. at 363 n.29.
401 See supra text accompanying notes 133 & 275-84.
403 The original justification for grace period statutes was derived from the fact that, under state law, creditors were unable to publicly record their security interests until after the advance was made. Consequently, some delay between the attachment and perfection of the interest was unavoidable. Section 60(a)(7) was designed to prevent this inescapable delay from converting contemporaneous exchanges into preferences. Id. at 388-89. This rationale does not exist under Article 9 since the financing statement could have been filed prior to the advance, eliminating any gap between attachment and perfection. See U.C.C. § 9-303 (1972).
404 Indeed, this was precisely the approach the Gilmore Committee initially adopted back in 1966—the drafting of an entire new section of the 1898 Act setting out “the truth, the whole truth and, hopefully, nothing but the truth” on the validity of security interests in bankruptcy. House Report, supra note 109, at 204, reprinted in 1978 U.S. Code Cong. & Ad. News at 6164. That approach was eventually discarded because the “accumulated and encrusted burden of history was . . . too heavy to be sloughed off.” Id.
on when Article 9 interests should be recognized in bankruptcy. As the Gilmore Committee noted, however, the legal community has been accustomed for too long to treating security interests under section 60 of the 1898 Act to make such a radical reform feasible.\footnote{Id.}

Nonetheless, section 547 is a valuable contribution towards the evolution of such a rational, functional policy. It is not a panacea; there are a number of points that could be improved upon. No doubt, analysis and litigation will reveal further defects not anticipated by Congress or even the academics, but in the imperfect world of legislative compromise—a world not particularly interested in bankruptcy reforms\footnote{Congress' general lack of concern with bankruptcy issues is perhaps best evidenced by the fact that, of this writing, bankruptcy courts are currently without the constitutional and statutory authority to hear cases due to congressional failure to respond to the Supreme Court's mandate in Marathon Pipeline Constr. Co. v. Marathon Pipe Line Co., 102 S. Ct. 2858 (1982).}—section 547 may be as good as one could hope for.
Appendix

In my earlier discussion concerning perfection requirements and grace periods for transfers of personal property, repeated reference was made to section 547's predecessor, section 60 of the 1898 Act, specifically section 60(a)(6) (which apparently adopted a "third-party purchaser" standard in lieu of the simple lien creditor standard of section 60(a)(2)) and section 60(a)(7) (which provided that, under some circumstances, perfection within 21 days of attachment had a "relation back" effect). See Breitowitz, supra note 22, at 378–80, 389–91. As therein noted, section 547(e) eliminates the dual perfection standard formerly found in section 60 and clarifies that at least some grace period will be applicable to all Article 9 security interests, not only to those which can be retroactively perfected under state law. The grace period, however, has been shortened from 21 to 10 days.

The following comments are intended to supplement that earlier discussion. Much of what follows is admittedly of historical interest only, but a solid understanding of the ambiguities and complexities existing under the 1898 Act can afford genuine insight into the purpose and operation of current law. Moreover, some of the discussion is a revision of material which appeared earlier.

I. Regarding the scope and application of section 60(a)(6) to security interests created under Article 9: see Breitowitz, supra note 22, at 383 nn.78–79. A few words should be said about the interrelationship between the alternative perfection standard of section 60(a)(6) and the grace period of section 60(a)(7), a subject that was not fully explored in the original discussion. In essence, section 60 deemed a transfer made either at the time of its perfection against lien creditors or at the time of its perfection against third persons other than buyers in the ordinary course of trade. Section 60(a)(7) then provided that whatever level of perfection is necessary may be attained for up to 21 days after attachment if, under state law, perfection within that period would be permitted. As noted, id. at 390 n.95, Professor Gilmore took the position that section 60(a)(7) permitted "relation back" only if, under state law, delayed perfection had the same effect. See C. Gilmore, supra note 25, § 14.8, at 1328. (Even then, "relation back" was not permitted where perfection took place more than 21 days after attachment) The fact that state law merely permitted perfection to be effective prospectively against lien creditors or third party purchasers was insufficient to trigger section 60(a)(7) if state law did not endow that later perfection with the ability to defeat interests arising in the gap between attachment of the security interest and its perfection.

Thus, in applying section 60(a)(7) to any given transaction, there were three issues that had to be resolved. First, what was the standard of perfection applicable to the particular transaction—the section 60(a)(2) lien creditor test or the section 60(a)(6) third-party purchaser test? Second, had that standard of perfection been met within 21 days of attachment? To the extent that section 60(a)(6) was the standard that governed the transaction, the fact that the interest was perfected against a lien creditor by day 21 would be of no significance. The 21 day grace period of section 60(a)(7) was tied in to whichever standard of perfection applied under section 60(a)(2) or section 60(a)(6). Finally, did state law permit delayed perfection to have a "relation back" effect with respect to defeating the intervening interest against whom perfection is required? If section 60(a)(6) supplies the necessary standard, a "relation back" effect for purposes of defeating a prior lien creditor would be unavailing. Under the Gilmore analysis, this would be true even if third parties not in the ordinary course of business could indeed be defeated prospectively.

The practical importance of this last point is evident when one considers the status of purchase money security interests in nonconsumer goods under the 1898 Act. (Purchase money security interests in consumer goods could not be characterized as "equitable liens" and were therefore subject only to section 60(a)(2), not section 60(a)(6). See Breitowitz, supra note 22, at 383 n.78. Because such interests are perfected against lien creditors as soon as they attach, U.C.C. § 9-302(1)(d) (1972), the standard of section 60(a)(2) had already been met as of the date of attachment and application of section 60(a)(7) was totally unnecessary.) Under the Gilmore analysis, section 60(a)(7) did not apply to the typical Article 9 security interest because, under Article 9, delayed perfection has no "relation back" and is effective only prospectively. Purchase money security interests in nonconsumer goods, however, may be perfected with retroactive
effect under section 9-301(2) with respect to lien creditors, although such interests are unperfected against purchasers until a UCC filing is actually made. See U.C.C. § 9-301(1)(c) (1972).

It has been universally assumed that purchase money security interests perfected under section 9-301(2) of the UCC were within the protections of section 60(a)(7). Even Professor Gilmore, who limited section 60(a)(7) to grace period statutes, characterized section 9-301(2) as being such a statute. The only point of disagreement was whether purchase money security interests were protected only if they were perfected within 10 days or whether they had the entire 21 day period. See Breitowitz, supra note 22, at 391 nn.99–100.

In light of the above, however, it is questionable whether even perfection within 10 days would have sufficed. U.C.C. § 9-301(2) (1972) creates a 10 day grace period only to the limited extent of defeating interim gap lien creditors. If (1) section 60(a)(7) was limited to grace period statutes and (2) if the applicable standard of perfection for purchase money security interests was the one contained in section 60(a)(6), rather than the one in section 60(a)(2), the transfer would have been deemed made only as of the date of perfection, because section 9-301(2) did not permit "relation back" with respect to the interest against which perfection was required by section 60(a)(6). Thus, contrary to an earlier suggestion, Breitowitz, supra note 22, at 383 n.79, the issue of whether purchase money security interests were governed by section 60(a)(2) or section 60(a)(6) was not rendered moot by the application of section 60(a)(7). On the contrary, whether or not the protections of section 60(a)(7) were available depended squarely on which perfection standard could be said to govern. This is a point that seemed to have escaped the notice of most courts and commentators.

The foregoing analysis holds true only to the extent that section 60(a)(7) was limited to grace period statutes. If section 60(a)(7) was not limited to grace period statutes, the subsection would clearly have shielded the transfer regardless of whether section 60(a)(2) or section 60(a)(6) applied. The only issue in such cases would have been whether purchase money security interests had the same 21 day grace period as any Article 9 security interest or whether the effect of section 9-301(2) was a shortening of the period to 10 days. As noted earlier, it would be highly illogical to penalize purchase money security interests because of their more favored status under state law; the entire 21 day period should therefore have been available. See Breitowitz, supra note 22, at 391 nn.99–100.

II. The meaning of perfection under section 60(a)(2): There is one remaining issue. Under the 1988 Act, were purchase money security interests in nonconsumer goods deemed perfected against lien creditors within the meaning of section 60(a)(2) from the time of attachment (since, if a timely filing is made, priority over lien creditors will be attained as of the date of attachment) or were such interests deemed perfected under section 60(a)(2) only as of the date of the filing (since, only as of that date, was lien creditor priority unconditionally established although, once established, there was a "relation back" effect)? For the identical issue under section 547(e) of the BRA, see Breitowitz, supra note 22, at 395–98.

At first blush, it may appear that resolution of this issue is irrelevant. Assuming that section 60(a)(2) was the applicable perfection standard—leaving aside for the moment the difficult problem of section 60(a)(6) and the equitable lien—whether or not it was deemed perfected as of the date of attachment, the transfer would still have been protected, as long as it was perfected within 10 days. If the security interest was perfected pursuant to section 9–301(2), there seems to be little difference between protecting it on the basis of its being perfected on the date of attachment or protecting it on the basis of its being perfected within 10 days of attachment through the use of section 60(a)(7). Conversely, if the interest was perfected more than 10 days after attachment, it clearly would not have met the standard of section 60(a)(2) until actual filing (at which point it would then be prospectively perfected against lien creditors) and, if there was "relation back," it could only have been because section 60(a)(7) applied even if there was no "relation back" under state law. In short, while the question of applying section 60(a)(2) or section 60(a)(6) was of considerable importance (at least if section 60(a)(7) was limited to grace period statutes), once it was assumed that section 60(a)(2) was the only standard that had to be met, nothing appeared to have turned on the exact point in time at which the interest was deemed perfected, as long as perfection complied with section 9–302(2) of the UCC.

In fact, however, there were at least two situations where a purchase money security interest in nonconsumer goods could have been perfected in accordance with section 9-301 and
nonetheless could not have qualified for the protection of section 60(a)(7). Unlike the grace period currently in effect under section 547(e), section 60(a)(7) applied only if the security interest were created for "new value," not antecedent debt. See Breitowitz, supra note 22, at 389 n.92. If the purchase money security interest were created to secure a previously extended enabling loan, section 60(a)(7) would be unavailing because attachment would have occurred subsequent to the extension of credit. It would then have been essential to determine whether "relation back" under state law may in itself deem the transfer perfected as of the date of attachment even where the federal grace period was unavailable. (This particular issue could not arise under present law since section 547(e) does not require "new value.")

The second instance which necessitated the determination of when the security interest was perfected stemmed from the fact that the 10 day period of section 9-301(2) and the 21 day period of section 60(a)(7) did not commence to run from the same point. It was possible for perfection to occur within 10 days of the debtor's receiving possession of the collateral (the section 9-301(2) starting point) but more than 21 days after attachment (the section 60(a)(7) starting point). Was compliance with section 9-301(2) alone sufficient where the period provided for in section 60(a)(7) already expired? This issue remains very much alive under section 547(e) of the BRA as well. See Breitowitz, supra note 22, at 395-99.

In resolving this issue under the 1898 Act, it should be noted that to the extent that section 60(a)(7) was limited to grace period statutes, as Professor Gilmore maintained, it would have been clear that perfection over lien creditors which was contingent on later action being taken would not by itself have met the standards of section 60(a)(2) since it was precisely that situation where section 60(a)(7) necessitated perfection within 21 days and the existence of "new value." See Breitowitz, supra note 22, at 391 nn.99-100; see also id. at 389 nn.92 & 94. In other words, under the Gilmore analysis, if conditional perfection itself met the standards of section 60(a)(2) (i.e., the effective date of the transfer was the time of attachment), there would never have been situations where compliance with section 60(a)(7) was both necessary and effective. It was obvious that, under the Gilmore reading, security interests for which there is a grace period under state law were not deemed to have met the standards of section 60(a)(2) as of the date of their attachment and were therefore subject to the limitations of section 60(a)(7). The issue of whether conditional perfection qualified under section 60(a)(2) could arise only if section 60(a)(7) were interpreted to cover all security interests, even those not having a grace period under state law. Indeed, the issue resurfaces under section 547(e) of the BRA, precisely because the 10 day delay in perfection sanctioned by section 547(e) is clearly not limited to grace period statutes.

III. Summary of perfection requirements under the 1898 Act for purchase money security interest in nonconsumer goods: Assume that a purchase money security interest attached prior to the preference period, at a time when the debtor was not insolvent, at a time when the transferee did not have reasonable cause to know of the debtor's insolvency, or at a time that was contemporaneous with the extension of value, as is the case where a purchase money security interest is retained by a seller. The secured party filed a financing statement during the preference period at a time when all the other conditions for voidability were present. Under the 1898 Act, would the transfer have been deemed made as of the date of attachment (and therefore valid) or would the transfer have been deemed made as of the date of filing (and hence voidable)?

A. Filing occurred within the grace period of section 9-301(2) and within the 21 day period of section 60(a)(7) (with "new value" present): If the applicable perfection standard was that contained in section 60(a)(2), the transfer was valid either because the section 60(a)(2) standard was already met as of the date of attachment or because section 60(a)(7) would clearly have permitted "relation back" where there is a grace period under state law. Even if the applicable perfection standard was that contained in section 60(a)(6), the transfer was still valid if section 60(a)(7) was not limited to grace period statutes. The transfer was invalid, however, if the applicable perfection standard was the one in section 60(a)(6) and if section 60(a)(7) was limited to grace period statutes.

B. Filing occurred within the grace period of section 9-301(2) of the UCC and within the 21 day period of section 60(a)(7) of the 1898 Act (no "new value" present): Section 60(a)(7) had no application to this transaction. The security interest was valid only if the lien creditor test in
section 60(a)(2) applied and if that standard was deemed to have been met as soon as the interest attached without regard to the requirements of section 60(a)(7). If the applicable perfection standard was the third-party test in section 60(a)(6) or even if the standard was the lien creditor test contained in section 60(a)(2), but priority over lien creditors contingent on some timely action to be taken in the future did not meet the section 60(a)(2) standard, the transfer was invalid. While section 60(a)(7) is not directly relevant to this category of cases, as noted above, the construction of section 60(a)(7) may indirectly indicate the proper construction of section 60(a)(2).

C. Filing occurred beyond the grace period of section 9-301(2) of the UCC but within the 21 day period of section 60(a)(7) of the 1898 Act (with “new value” present): The transfer was valid only if section 60(a)(7) was not limited to grace period statutes. If it was not, the transfer was valid even if the applicable standard of perfection was that contained in section 60(a)(6). Conversely, if section 60(a)(7) was limited to grace period statutes, the transfer was invalid even under the lien creditor test of section 60(a)(2), since the secured party delayed perfection beyond the point where “relation back” was permitted under state law. Mention should be made of the view expressed in 3 Collier on Bankruptcy, supra note 45, ¶ 60.51, that even if section 60(a)(7) were not limited to grace period statutes so that it afforded a 21 day period for all Article 9 security interests, purchase money security interests were still limited to 10 days under U.C.C. § 9-301(2) (1972). However, this position had neither logic nor precedent to sustain it. A purchase money security interest perfected 11 days after the debtor received possession of the collateral is exactly the same as any Article 9 security interest perfected 11 days later, and treatment under section 60(a)(7) should have been identical.

D. Filing occurred beyond grace period of section 9-301(2) of the UCC but within 21 day period of section 60(a)(7) (no “new value” present): In the absence of “new value,” section 60(a)(7) was inapplicable. Regardless of the governing perfection standard, the transfer was not deemed made until filing and was therefore voidable.

E. Filing occurred beyond the 21 day period of section 60(a)(7) but within the grace period of section 9-301 (e.g., debtor obtained physical possession of the collateral three weeks after he acquired his rights): The transfer was voidable if section 60(a)(6) was the applicable perfection standard. The transfer would have been valid only if: (1) section 60(a)(2) determined the necessary level of perfection; and (2) that level was deemed met as soon as the interest attached without regard to section 60(a)(7). As noted earlier, the latter contention is untenable if section 60(a)(7) was limited precisely to those interests that were conditionally perfected from the date of their attachment. Accordingly, while section 60(a)(7) is not directly relevant in this particular case, the Gilmore interpretation of that provision would compel the conclusion that the above transfer would have been voidable, regardless of which perfection standard applied.

It can be readily seen that the dual perfection standard of section 60(a)(2) and section 60(a)(6), coupled with the additional ambiguity surrounding the scope and operation of the grace period contained in section 60(a)(7), was a source of great confusion in the law. This point was amply demonstrated before, but what I have tried to show here is that the difficulties created by the presence of section 60(a)(6) especially with respect to purchase money security interests could not have been resolved through section 60(a)(7) and that the very application of section 60(a)(7) depended in large part on which perfection standard controlled the transaction, a point that was not fully developed in the first part of this Article.

Section 547 of the BRA eliminates most of these difficulties. See Breitowitz, supra note 22, at 391–93. Indeed, if one substitutes the 10 day period of section 547(e) for the 21 day period of section 60(a)(7) of the 1898 Act, section 547 would clearly validate all of the transactions in the first four cases and would do so even for nonpurchase money security interests. The 10 day grace period of section 547(e) of the BRA is not limited to grace period statutes nor does it have a “new value” trigger. The only problem area under section 547(e) is the situation under the fifth example, where compliance with Article 9 occurs after the expiration of the grace period under section 547. I have previously argued that section 547 would probably invalidate the interest in such a case. Breitowitz, supra note 22, at 395–98. This is the same result that would have been obtained under the 1898 Act (under the Gilmore reading).

IV. Grace periods as to lien creditors, but not as to buyers other than those in the ordinary course of trade. As I previously noted, there are two examples under the UCC of security
interests with different standards of perfection as against lien creditors and buyers not in the ordinary course of business. Breitowitz, supra note 22, at 384 n.79. An unperfected purchase money security interest receives a grace period against lien creditors, U.C.C. § 9-301(2) (1972), but none against buyers not in the ordinary course of business. Id. § 9-301(1)(c). A security interest in instruments is temporarily perfected against lien creditors for 21 days after attachment, id. § 9-304(4), but can be defeated by a purchaser who takes possession of the instrument under section 9-308 of the UCC. Id. § 9-308. Both of these interests could arguably have been characterized as "equitable liens" under the test proposed earlier, Breitowitz, supra note 22, at 384 n.79, with the result that section 60(a)(6), rather than section 60(a)(2), determines the applicable standard of perfection.

In both these cases, the choice of tests—the lien creditor test of section 60(a)(2) and the good faith purchaser test under section 60(a)(6)—became irrelevant if: (1) perfection necessary to defeat the good faith purchaser (filing, for purchase money security interests in nonconsumer goods, and taking possession of the chattel paper under U.C.C. § 9-308) occurred within the 21 day period of section 60(a)(7); and (2) section 60(a)(7) applied across the board to all security interests, not just those with grace periods under state law. If these two conditions are assumed, the transfer of the security interest would have been deemed to have occurred at the time of attachment. (A third condition—the presence of "new value" as required by section 60(a)(7)—is not an issue, since purchase money security interests (at least those security interests retained by sellers) are always created for "new value" and under the express terms of section 9-304(4) of the UCC a security interest in instruments or documents is temporarily perfected only if it too attached for "new value." See U.C.C. §§ 9-107, -304(4) (1972).)

What is important to add in this Appendix is that the results change if: (1) we assume, as does Professor Gilmore, that section 60(a)(7) applied only where grace periods existed under state law; and (2) both purchase money security interests in nonconsumer goods and temporarily perfected security interests in instruments were "equitable liens" so that the rigorous perfection standard of section 60(a)(6) applied. Neither section 9-301(2) nor 9-304(4) allows a grace period to defeat a buyer not in the ordinary course of business. Under Gilmore's assumption of what section 60(a)(7) meant, there could be no relation back for these security interests. The choice between the section 60(a)(2) test and the section 60(a)(6) test could have become crucial to saving or avoiding such interests where attachment occurred prior to the preference period or contemporaneously with the extension of "new value."

To my knowledge, this proposition, although a logical corollary of the Gilmore thesis, had never been advanced, probably because few had any real idea of what section 60(a)(6) meant under the UCC, with the result that the limitation it may have placed on the operation of section 60(a)(7) was simply ignored.

A final point to consider: even assuming that section 60(a)(7) protected purchase money security interests under section 9-301(2) and temporarily perfected security interests in documents and instruments under section 9-304(4), regardless of whether those interests were governed by section 60(a)(2) or section 60(a)(6), purchase money security interests taken by enabling lenders (which attach subsequent to the extension of credit) clearly would not have qualified under section 60(a)(7) which required that the interests be for "new value." See U.C.C. § 9-107 (1972); Breitowitz, supra note 22, at 425–26. In those particular cases, the issue of which perfection standard to apply where attachment (i.e., conditional protection against lien creditors) occurred prior to the preference period but filing or possession (i.e., priority over "buyers in the ordinary course of trade") occurred during the preference period was unresolved. Under section 60(a)(2), the transfer might have been valid, depending upon whether section 60(a)(2) permitted the use of state law grace periods to antedate the transfer to the date of "attachment." Under section 60(a)(6), it would definitely have been a voidable preference. Cf. 11 U.S.C. § 547(c)(3) (Supp. IV 1980); Breitowitz, supra note 22, at 416–29.

V. Extension of time and substitution of old debt as "new value" under section 9-108: In Part I of this Article, I noted that to the extent the second prong of 9-108 of the UCC was intended to cover purchase money financing, agreements executed to secure antecedent debt could never qualify for its protection, even in the absence of a "new value" requirement just as such agreements could not create purchase money security interests under section 9-107 of the UCC which does not explicitly require "new value." Accordingly, I concluded that the principle
purpose of the “new value” requirements in section 9-108 was the exclusion of antecedent debt where the acquisition was made in the ordinary course of business—section 9-108’s first prong. See Breitowitz, supra note 22, at 421-22.

It should be noted, however, that there are some comparatively rare situations where an agreement to secure antecedent debt could indeed have qualified for the second prong of section 9-108 (and as a purchase money security interest under section 9-107), failing to do so only because section 9-108 requires the agreement to be made for “new value.” One situation is where the funds originally advanced on unsecured credit have not yet been dissipated by the date of the agreement.

If the original funds have not yet been dissipated, there is an identifiable fund that may be used for the purchase of collateral, meeting section 9-107’s requirement of tracing. A simple direction (embodied in a security agreement) to apply those proceeds to the acquisition of collateral could not, however, create a purchase money security interest under section 9-107 because of its additional requirement that the lender give value for the purpose of enabling the debtor to acquire the collateral. This condition could rarely, if ever, be met where the extension of credit preceded the agreement. See Breitowitz, supra note 22, at 420 n.173, 421 n.176. But such a direction coupled with an extension of time (which, in the absence of an exclusionary “new value” definition in section 9-108, could be deemed an extension of value) could indeed satisfy the twin requirements of tracing and intent. The transaction would therefore give rise to a valid purchase money security interest under section 9-107, and would fail under section 9-108 only because of its “new value” requirement. But see U.C.C. § 9-107 comment 2 (1972) (a security interest taken to secure antecedent debt can never have purchase money status).

In light of the above discussion, however, I would argue that although the statement in the comment to section 9-107 appears to be true in most cases, there are two situations where an agreement executed to secure antecedent debt would qualify as a purchase money security interest under section 9-107: (1) where the funds were advanced with the intention of enabling the debtor to acquire the collateral (and with the intention that the secured party would have a security interest in that acquisition) but the security agreement was not executed until after the advance was made, Breitowitz, supra note 22, at 421 n.176; and (2) the situation here presented, where, even if the funds were not advanced with the requisite enabling intent, the original funds have not yet been dissipated and the secured party now directs that they be used for the purchase of collateral, coupling that direction with an extension of time. In both cases, the secured party’s funds must actually have been used to acquire the collateral.

To the extent that treatment of purchase money security interests in section 9-108 rests on a presumption of tracing, as Professor Gilmore maintained, G. Gilmore, supra note 25, § 45.6, at 1314-15, where the proceeds have already been spent by the time the agreement was executed, section 9-108 would be inapplicable even if it did not contain a “new value” requirement which excludes from its scope agreements executed to secure antecedent debt. It is only in the somewhat marginal situation specified above, where the funds were not dissipated at the time the security agreement was executed, that the section 9-108 exclusion of antecedent debt has any real utility, at least in reference to its second prong.

VI. The grace period in section 9-306(3): The “new value” exclusion would appear to be unnecessary, however, in the first example given above. Where the funds were advanced with the intention of enabling the debtor to acquire the collateral and with the intention that the secured party would have a security interest in that acquisition, the lender could arguably have a valid purchase money security interest although the security agreement was not executed until after the advance was made and the property acquired. See Breitowitz, supra note 22, at 422 & n.178. Despite its meeting all the standards of section 9-107, and despite the ability to trace the funds into the collateral, such an acquisition is clearly not protected by section 9-108. One reason, of course, is because of its “new value” requirement. But even without such a requirement, section 9-108 applies only if the acquisition was made pursuant to the security agreement, a condition that could never be met where the acquisition preceded the execution of the agreement.

In any case, the point to remember is: (1) notwithstanding the statement in the Official Comment, there are two situations where an agreement to secure antecedent debt can create a purchase money security interest under section 9-107; and (2) in both situations, section 9-108
would be inapplicable at least because of its "new value" requirement and possibly for other reasons as well. Of course, neither example is protected by section 547(c)(3) which contains its own "new value" requirement. See supra text accompanying note 207. It has been previously noted that security interests in proceeds that were acquired during the preference period will generally constitute contemporaneous exchanges of value, even where section 9-306 of the UCC required reperfection within 10 days of receipt. This result followed from the fact that compliance with section 9-306(3) will always constitute compliance with section 547(e) thereby antedating the transfer to the date of the disposition of the original collateral. See supra note 326. Accordingly, in the context of proceeds, it was unnecessary to consider the issue of whether conditional perfection met the lien creditor standard of section 547.

Under section 60 of the 1898 Act, which defined "transfer" solely in terms of perfection, the problem was considerably more acute. Even if the secured party did reperfect within 10 days after receipt of proceeds, the transfer could still be deemed made on account of antecedent debt—i.e., on account of the release and disposition of the original collateral—unless the interest in the proceeds was already deemed perfected, within the meaning of section 60(a)(2), as of the date of attachment by reason of the grace period permitted under state law. While section 60(a)(7) in any case would have provided that perfection within 21, or at least 10, days of attachment antedated the transfer to the time of attachment, section 60(a)(7) itself was limited to transfers effected for "new value" and not on account of antecedent debt. What this limitation meant in the context of "proceeds" was anyone's guess. Assuming the original security interest had attached to secure antecedent debt, would the security interest in the proceeds nonetheless have been considered a transfer for "new value" since it attached simultaneously with the release of collateral or did the "new value" requirement relate to the security interest in the original collateral? Under the second construction, section 60(a)(7) would have been inapplicable in the above case, thus squarely posing the question whether conditional perfection (i.e., the time of attachment) was deemed perfection.

Note, that under the 1898 Act, this particular problem existed even if the proceeds were identifiable and not commingled with the debtor's general funds. Cf. In re Gibson Prods., 543 F.2d 652 (9th Cir. 1976); Fitzpatrick v. Philco Fin. Corp., 491 F.2d 1288 (7th Cir. 1974), regarding the status of section 9-306(d) of the UCC, an issue which remains very much alive even under the BRA.

In short, assuming the value of the proceeds received was equivalent to the value of the collateral released, the security interest in proceeds acquired during the preference period will not be a preference, as long as the security interest is deemed to arise contemporaneously with the release or disposition of the original collateral. This will always be the case where: (1) no supplementary perfection action is required; or (2) the necessary perfection action is taken within the grace periods of section 547(e) and section 9-306 of the UCC without regard to the doctrine of continuous perfection. But see supra note 321 (whether timely perfection is always necessary). Under the 1898 Act, at least where the security interest in the original collateral attached for "new value," perfection could similarly have been delayed for at least 10, and possibly 21, days—again without regard to the continuous perfection doctrine—but where the security interest originally attached on account of antecedent debt (even prior to the preference period), it was doubtful whether even perfection within 10 days of receipt would have sufficed, since in the absence of section 60(a)(7), section 60 deemed transfers made only as of the date of their perfection, at which time the debt may have already been antecedent. The interest would be valid only if one of two arguments were accepted: (1) that conditional perfection met the standards of section 60(a)(2) without regard to section 60(a)(7); or (2) security interests in proceeds were always deemed to be transfers for "new value," irrespective of whether the security interest in the original collateral was a "new value" transfer and, accordingly, section 60(a)(7) would always have applied. Both propositions were highly questionable.

VII. Payments to senior secured parties and resulting preferences to junior secured parties: By focusing on benefit to the transferee, rather than detriment to general creditors, section 547 precludes the avoidance of transfers which in a very real sense do prejudice unsecured creditors. See Breitowitz, supra note 22, at 366 n.37. The example given involved a situation where two secured parties had security interests in collateral that was sufficient to pay only the senior interest. The debtor's only other nonexempt asset was a bank account of equivalent amount.
Assuming the debtor during the preference period used the proceeds of that bank account to pay off the debt owed to the senior interest, section 547 would apparently not permit the recovery of those payments, since the senior interest was receiving no more than he would have realized in bankruptcy anyway (assuming he was fully secured). However, the result of the payment is the elevation of the junior secured party to senior status allowing him to realize on the collateral with no assets remaining for unsecured creditors. By contrast, had the transfer not been made, the senior secured party would have been paid out of the proceeds of the collateral and the bank account would have been distributed pro rata to all remaining creditors including the junior secured party.

Upon further reflection, however, this hypothetical poses little, if any, difficulty. Under section 506, a creditor is deemed to have a secured claim only to the extent of the value of the creditor's interest in the property of the estate. Consequently, for purposes of the BRA, where the collateral is already encumbered by a senior interest and there is no excess equity available for payment of the junior interest, the latter claim is deemed unsecured notwithstanding the fact that all the attachment and perfection requisites of Article 9 have been complied with. Accordingly, although the "preferential effect" test would not permit avoidance of the transfer made to the fully secured senior interest, the test may prevent the conversion of an unsecured claim into a secured one. It is clear that the creation or perfection of a security interest during the preference period is subject to a preference challenge. See 11 U.S.C. § 101(40) (Supp. IV 1980). It is arguable that even where a valid security interest had already been perfected prior to the preference period, the conversion of that interest into a secured claim similarly affects a transfer. Thus, section 547 would necessitate that the rights of the junior interest be the same as they would have been had the payment to the senior interest never taken place with the result that the collateral be distributed among all creditors pro rata.

The conversion of an unsecured claim into a secured one, where the security interest itself was created and perfected prior to the preference period, is essentially another variant of the appreciation value problem. As noted, supra text accompanying notes 387-96, whether such appreciation should be voidable is an open question under the BRA, especially in light of the "no transfer" argument. See supra note 328. To the extent this "no transfer" argument is accepted and the elevation of the junior claim to senior status is allowed to stand, the criticism in Breitowitz, supra note 22, at 366 n.37, is well founded (but not because of the inadequacy of the "preferential effect" test as therein stated but because of an over literal adherence to the notion of "transfer"). If, however, the basis for protecting appreciation value lies in the fact that appreciation of existing collateral does not always deplete the estate, see supra text accompanying notes 374-79, in the example above where the appreciation arising from the payment to the senior interest is exactly equivalent to the amounts being diverted from unsecured creditors, the conversion of the junior interest into a secured claim would clearly be voidable without the need to reformulate section 547.

VII. Errata. In the rush to publication, a few printer's errors crept into Part I of this article. What follows is a short list of items which should be corrected.

Breitowitz, supra note 22, at 391 nn.99-100: Notes 99 and 100 are actually one continuous footnote. Readers should delete the number "100" and the first sentence following that number from the footnote. The deleted sentence should be a separate footnote following note 99.

Id. at 404: In the last sentence of the first full paragraph, the word "lien" in "lien buyer" should be deleted.

Id. at 411 n.145: The reference to U.C.C. § 4-607 should have read "see Commission Report, supra note 3, Part II, § 4-607 (with accompanying comments)."