

Probably the most expeditious procedure would be for individuals or groups who see the local needs to apply to the state commission for a conservancy district. After determining the nature of the problem and the feasibility of proposed solutions, the commission could formulate, subject to hearings and judicial review, a definite plan and mark off the geographical limits of the district. Such a commission would also be able to coordinate the operations of one district with another, and with municipalities and other governmental agencies concerned with the problems of water management.<sup>98</sup> Maximum use must be made of every district, *e.g.* the prime purpose of a given district may be flood control, but the district administrators should be free to sell the retained water to farmers, towns, and industries, and where possible, make recreational facilities available for public enjoyment.<sup>99</sup>

Provision for adequate financing is most essential. Bonding power, coupled with the power to tax or assess to retire the obligations, are required for the large capital outlays which would be necessary in many of the conservation plans. Since one conservancy act has been declared unconstitutional, a new act must be drafted with great care so that investors will not hesitate to purchase the obligations necessary to finance the projects Indiana needs for its future development.<sup>100</sup>

## INDIANA CHATTEL SECURITY DEVICES v. ARTICLE 9 UNIFORM COMMERCIAL CODE

In 1955 the Indiana Legislature added to the already overburdened area of chattel security statutes by enacting a factor's lien act.<sup>1</sup> In so

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expert in water management either as to recognition of problems or the feasibility of alternative methods of solution. Under this procedure each district became a separate entity without provision for an interchange of ideas and experience with other districts having similar problems.

98. There are many federal agencies involved. *e.g.* The Army Corps of Engineers, The Soil Conservation Service, the United States Geological Survey.

99. The goal of maximum beneficial use must be carefully balanced with the goal of governmental non-interference with the individual. The old Conservancy Act was deficient in this respect because of the wide powers given the district commissioners to pursue objectives of water management not petitioned for and possibly not desired by the people affected.

100. When the Pennsylvania RR. attacked the constitutionality of the Conservancy Act, an *amicus curia* brief was filed by the firm of Ross, McCord, Ice, and Miller calling attention to the fact that there were two issues of bonds outstanding from existing conservancy districts. The Court did not rule on the question of the bonds validity but did call attention to a line of cases which indicated that the obligations of the district, even though unconstitutionally created, were valid. *Indiana ex rel. Pennsylvania RR. v. Iroquois Conservancy District Court*, 133 N.E.2d 848, 855 n.10 (Ind. 1956).

1. IND. ANN. STAT. §§ 43-1201 to -1210 (Burns Supp. 1955).

doing the Legislature has affirmed the questionable reasoning that every chattel security problem should be met by a separate security device.<sup>2</sup> The Factor's Lien Act, which permits a lender to obtain a valid lien on inventory of a borrower, seeks to answer the problems raised by the use of inventory as collateral. Obviously inventory, usually maintained at a fairly stable total amount, is constantly turning over as items are sold and replacements are purchased; items originally subjected to the lien are soon replaced. If the business needs of the borrower require a loan remaining at a constant level for a period of time rather than a short term self-liquidating loan,<sup>3</sup> then the security device should provide for three things: (1) borrower's authority to sell the originally secured inventory; (2) the lien's automatic attachment to after-acquired replacement inventory; (3) sufficient flexibility of the lien to allow the borrower to use at least part of the proceeds from his sales to meet his business expenses.<sup>4</sup> A device containing these provisions is commonly referred to as a floating lien.

The rash of factor's lien acts erupting in the last fifteen years<sup>5</sup> is a symptom of the business need for inventory financing and also indicates that prior security devices were too restrictive to make such financing practical.<sup>6</sup> Obviously, the common law pledge, which requires the pledgee to retain possession of the collateral, is inadequate.<sup>7</sup> In many jurisdictions a chattel mortgage which allows the mortgagor to sell the collateral is void as a fraud on the creditors of the mortgagor,<sup>8</sup> and a number of jurisdictions do not permit a lien to attach to after-acquired property.<sup>9</sup> The trust receipt, as codified in the Uniform Trust Receipts Act, although permitting the sale of the collateral, cannot be used to encumber after-acquired inventory.<sup>10</sup> Furthermore, the Uniform Trust Receipts

2. For an excellent article criticizing this reasoning and indicating some inherent pitfalls see Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 LAW & CONTEMP. PROB. 27 (1951).

3. A self-liquidating loan requires the borrower to turn over proceeds of the sale of collateral to the lender to reduce the debt. The life of such a loan is therefore limited to the period required for the borrower to sell enough of the encumbered merchandise to pay off the loan.

4. See Gilmore and Axelrod, *Chattel Security*, 57 YALE L.J. 517, 533-35 (1948).

5. See note 15 *infra*.

6. See Skilton, *The Factor's Lien On Merchandise*, 1955 WIS. L. REV. 356.

7. RESTATEMENT, SECURITY § 1 (1941).

8. Cohen and Gerber, *Mortgages of Merchandise*, 39 COLUM. L. REV. 1338 (1939). Authorities by jurisdiction are exhaustively compiled, *id.* at 1338 n. 4.

9. See Cohen and Gerber, *The After-Acquired Property Clause*, 87 U. PA. L. REV. 635 (1939).

10. UNIFORM TRUST RECEIPTS ACT § 14; IND. ANN. STAT. § 51-614 (Burns 1951). This section provides that the trust receipt may be used to obtain a security interest in goods only when new value is given by the lender or when the particular goods to become subject to the trust receipt lien are already subject to a previous security interest in the lender. The latter provision envisions a situation where the lender already has a

Act only permits borrowers to acquire new inventory from a third party; the trust receipt cannot be used to secure a loan on inventory already in the hands of the borrower.<sup>11</sup> The conditional sale for resale,<sup>12</sup> appropriate only for lenders who are also sellers of the goods, is of minor importance in inventory financing. Field warehousing, however, can be useful in a proper situation. This pledge device permits the pledgee to take possession of the goods at the borrower's place of business and to release them to the borrower as they become needed.<sup>13</sup> Unfortunately, field warehousing in many situations is comparatively expensive, cumbersome, and may be easily upset by a trustee in bankruptcy if a court considers the pledgee's control over the goods or records of the transaction insufficient.<sup>14</sup> To overcome these restrictions in prior security law, twenty-three states have enacted factor's lien acts permitting lenders to obtain a security interest in the inventory or accounts receivable of the borrower.<sup>15</sup>

In contrast to most states, Indiana security law before enactment of the Factor's Lien Act was relatively unrestrictive. The Indiana Chattel

security interest in the goods and surrenders that interest in exchange for a trust receipt security interest in the same goods. New value is defined to include new advances or loans, but to exclude extensions or renewals of existing obligations of the borrower. The extension of the lender's lien, which is security for an already existing debt, to after acquired goods would not come within the permissible limits of this section. See Bogert, *The Effect of the Trust Receipts Act*, 3 U. CHI. L. REV. 26 (1935).

11. UNIFORM TRUST RECEIPTS ACT § 2(1)(a) limits the use of the device to situations where "the entruster or any third person delivers to the trustee goods. . . ."

12. UNIFORM CONDITIONAL SALES ACT § 9; IND. ANN. STAT. § 58-808 (Burns 1951).

13. See Friedman, *Field Warehousing*, 42 COLUM. L. REV. 991 (1942).

14. *Compare* McGaffey Canning Company v. Bank of America, 109 Cal. App. 415, 294 Pac. 45 (1930), *with* Barry v. Lawrence Warehouse Co., 190 F.2d 433 (9th Cir. 1951).

15. Alabama (1947), ALA. CODE tit. 47, §§ 132 (1)-(8) (Supp. 1955); Connecticut (1945), CONN. GEN. STAT. §§ 7256-64 (1949); Delaware (1947), DEL. CODE ANN. tit. 25, §§ 3301-10 (1953); Indiana (1955), IND. ANN. STAT. §§ 43-1201 to -1210 (Burns Supp. 1955); Maine (1945), ME. REV. STAT. c. 181, §§ 4-11 (1954); Maryland (1945), MD. ANN. CODE GEN. LAWS art. 2, §§ 22-29 (1951); Massachusetts (1945), MASS. ANN. LAWS c. 255, §§ 40-47 (Supp. 1955); Michigan (1947), MICH. COMP. LAWS §§ 570.501 to .512 (1948); Minnesota (1947), MINN. STAT. ANN. §§ 514.80-91 (West Supp. 1955); Missouri (1945), MO. ANN. STAT. § 430.320 (Vernon 1952); New Hampshire (1943), N.H. REV. LAWS c. 446, §§ 446:1-10 (1955); New Jersey (1942), N.J. REV. STAT. §§ 2A:44-178 to -186 (Supp. 1952); New York (1911), N.Y. PERS. PROP. LAW § 45 (1949 as amended Supp. 1955); North Carolina (1945), N.C. GEN. STAT. §§ 44-70 to 76 (1950); Ohio (1945), OHIO CODE ANN. §§ 1311.59-64 (1953); Rhode Island (1938), R.I. GEN. LAWS c. 447, §§ 1-10 (1938); South Carolina (1938), S.C. CODE §§ 45-401 to -410 (1952); Tennessee (1953), TENN. CODE ANN. §§ 64-1801 to -1807 (1955); Texas (1947), TEX. STAT., REV. CIV. art. 5506c §§ 1-10 (1948); Vermont (1947), VT. REV. STAT. §§ 2738-51 (1947); Virginia (1944), VA. CODE §§ 55-143 to -152 (1950); West Virginia (1945), W. VA. CODE ANN. § 3946 (17)-(24) (1955); Wisconsin (1951), WIS. STAT. § 241.145 (1953). A table comparing the provisions of the various statutes is found in Skilton, *op. cit. supra* note 6, at 396.

Mortgage Act<sup>16</sup> is one of the most liberal in the country, and by authorizing a mortgage on inventory<sup>17</sup> and permitting the mortgagor to sell the collateral<sup>18</sup> it resembles a factor's lien act. The mortgage may include replacements of any mortgaged property,<sup>19</sup> and may also secure future advances made by the mortgagee.<sup>20</sup> However, the act is not flexible enough to permit the mortgagor to use the proceeds of sales to meet his business expenses; proceeds must be applied to the liquidation of the debt.<sup>21</sup> This requirement prevents a true floating lien by demanding that the loan be self-liquidating. However, the parties may avoid this result by creating a revolving-type transaction. Under such an arrangement the mortgagor turns the proceeds of sales over to the mortgagee, but the mortgagee periodically makes new loans of amounts needed by the mortgagor. The new loans are secured by the original mortgage, as permitted by the future advance section of the statute.<sup>22</sup> The mortgagee should require the mortgagor to maintain his inventory at a minimum inventory-to-loan ratio, and since the statute allows the mortgage to attach to replacement inventory, the mortgagee would have his loan secured by such inventory. This inconvenient arrangement would have to be closely controlled by the mortgagee, but it would have the effect of a floating lien.<sup>23</sup>

Likewise, the liberal Indiana Trust Receipts Act<sup>24</sup> fails to provide an "easy" floating lien. Indiana has substantially modified the Uniform Trust Receipts Act by expressly permitting use of a trust receipt to secure

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16. IND. ANN. STAT. §§ 51-501 to -521 (Burns 1951).

17. *Id.* § 51-501 (k).

18. *Id.* § 51-506.

19. *Id.* § 51-505.

20. *Id.* § 51-503.

21. *Id.* § 51-506.

22. *Id.* § 51-503.

23. See HONNOLD, CASES AND MATERIALS ON THE LAW OF SALES AND SALES FINANCING 527 (1954); Dunham, *Inventory and Accounts Receivable Financing*, 62 HARV. L. REV. 588 (1949). Dunham explains the mechanics of such a revolving transaction. "The lender agrees to loan up to 50 percent of the cost of the inventory. Each day's proceeds are paid over to the lender, who then makes new loans to bring the loan ratio back up to the 50 per cent agreed upon. Suppose, for example, the X Manufacturing Company borrows \$100,000 on security of \$200,000 cost value of inventory. On a typical day it sells inventory costing \$4,000 for \$8,000, which sum is transferred to the lender. It also receives new inventory costing \$4,000. The loan has been reduced to \$92,000, but the collateral, counting the deduction and the addition, is still \$200,000. The X Manufacturing Company is accordingly entitled to a new loan of \$8,000. Realistically, of course, this arrangement is equivalent to a 'floating course'—a loan of \$100,000 on security of inventory costing \$200,000 with an agreement to keep the security at this value, but with no obligation to account for proceeds." *Id.* at 596.

24. IND. ANN. STAT. §§ 51-601 to -621 (Burns 1951).

a loan on inventory already in the hands of the borrower.<sup>25</sup> This provision allows the Indiana trust receipt to operate substantially as a chattel mortgage, and greatly expands its normal function of enabling the borrower to acquire new inventory.<sup>26</sup> However, the trust receipt covers neither after-acquired goods<sup>27</sup> nor future advances,<sup>28</sup> and would thus be inadequate for creating a floating lien, although a revolving-type loan might be possible.<sup>29</sup>

It is also possible in Indiana to lend money on the security of a borrower's accounts receivable.<sup>30</sup> When the assignment of the accounts is in writing, signed by the borrower, and given for a valuable consideration, the requirements of the Assignment of Accounts Receivable statute are met.<sup>31</sup> No filing is required, account debtors need not be notified, and the borrower may continue to collect the accounts.<sup>32</sup> However, the statute does not provide for the attachment of the lender's lien on future accounts. A valid floating lien on accounts receivable can not be perfected.<sup>33</sup>

Since prior Indiana statutes permitted a lender to acquire a valid lien on the inventory or accounts receivable of a borrower, the Legislature apparently adopted the Factor's Lien Act either to make such a transaction easier and more convenient to accomplish, or to validate the floating lien without the necessity of the parties resorting to cumbersome revolving-type loan procedures. Unfortunately, the latter goal has not been entirely accomplished. Moreover, the Legislature apparently felt that existing devices were an adequate solution to the financing problems of retail merchants, since the new act is expressly limited to "owner[s] of merchandise at wholesale."<sup>34</sup>

25. In Indiana the trust receipt may be used in a transaction whereby "the entruster gives new value in reliance upon the transfer by the trustee to such entruster of a security interest in goods or documents in possession of the trustee and the possession of which is retained by the trustee." *Id.* § 51-602(1) (c).

26. This amendment has been characterized by Karl N. Llewellyn, the draftsman of the Uniform Act, as "disemboweling." *HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS*, 48th Annual Conference 105 (1938).

27. See note 10 *supra*.

28. *IND. ANN. STAT.* § 51-614 (Burns 1951).

29. This could be accomplished by requiring the borrower to pay over proceeds of sales and by then making new loans on the security of trust receipts on replacement inventory. Since the Trust Receipts Act adopts notice filing rather than recording, there would be no necessity of filing the subsequent trust receipts. See note 23 *supra*.

30. *IND. ANN. STAT.* §§ 19-2101 to -2104 (Burns 1950).

31. *Id.* § 19-2102.

32. *Id.* § 19-2103.

33. Again, however, a revolving transaction similar to that described in note 23 *supra* could be utilized by extending new loans on the security of new accounts receivable. See Note, 101 *U. PA. L. REV.* 392 (1952).

34. *IND. ANN. STAT.* § 43-1201 (Burns Supp. 1955).

Briefly, the act provides that the lender (factor) and the borrower file a notice of lien with the county recorder.<sup>35</sup> The factor and borrower must enter a written agreement which gives the factor a continuing lien upon such merchandise of the borrower as is designated.<sup>36</sup> The lien attaches automatically to all proceeds from the sale of the designated merchandise, presumably attaches to after-acquired inventory,<sup>37</sup> and secures the factor for future loans.<sup>38</sup> Although the provisions are not too clear, the Act also seems to permit a lien on the security of accounts receivable independent of any accompanying lien on merchandise.<sup>39</sup> Ap-

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35. *Id.* § 43-1203.

36. *Id.* § 43-1202.

37. IND. ANN. STAT. § 43-1202 (Burns Supp. 1955) provides that the "lien shall be valid from the time of filing the notice hereinafter referred to, whether such merchandise shall be in existence at the time of the execution of the written agreement providing for the creation of the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower." This provision would appear to extend the lien to after-acquired inventory. However, rather unfortunate wording earlier in § 43-1202 has evoked some concern that in order to perfect a lien on replacement inventory it will be necessary for the parties to execute separate written designations covering such inventory as it is received by the borrower. Letter from Paul R. Moo, Assistant General Counsel, Associates Investment Company, South Bend, Indiana, to *Indiana Law Journal*, May 1, 1956. "If so provided by any written agreement with the borrower, a factor shall have a continuing lien upon such merchandise of the borrower as is from time to time after the execution of said written agreement designated in one or more separate written statements dated and signed by the borrower and delivered to the factor. . . ." IND. ANN. STAT. § 43-1202 (Burns Supp. 1955). Under this language it is questionable whether a designation of "all the raw materials, goods in process, and finished products which are or subsequently will be held in the borrower's plant" would be sufficient to cover merchandise to be later acquired. If a new designation must be executed to extend the lien to inventory received after the original designation, then problems arise as to how often the factor should require such "separate written statements." If this construction were placed on the act, it would appear that a trustee in bankruptcy would prevail over the factor as to all inventory received by the borrower subsequent to the last designation. Such an unfortunate construction would require the parties to engage in a mass of unnecessary paperwork. Indiana apparently borrowed this language with some modification from a section of the Ohio act which has received no judicial construction. OHIO CODE ANN. § 1311.60 (1953). In construing the words "continuing general lien" in the New Hampshire act, the court held that separate designations were not necessary to perfect the factor's lien on after-acquired goods. "It seems improbable that our Legislature intended that a general store borrower, for example, must separately consign each spool of thread, can of beans or package of gum to a lender bank in order to maintain the lien." *Colbath v. Mechanicks National Bank*, 96 N.H. 110, 113, 70 A.2d 608, 610 (1950).

38. IND. ANN. STAT. § 43-1202 (Burns Supp. 1955).

39. There are several situations in which accounts receivable could become involved in a factor's lien transaction: (1) When they arise as proceeds of the sale of encumbered merchandise. The factor clearly obtains a lien on these accounts. *Id.* §§ 43-1202, 07. (2) When a factor obtains a lien on the borrower's merchandise and also receives as additional security an assignment of the borrower's accounts not arising out of the sale of encumbered merchandise. The act apparently permits this; § 43-1205 provides "where accounts receivable, whether or not arising out of the sale of merchandise which has become subject to the lien provided for by this act, are assigned to a factor. . . ." (3) When the factor is interested in obtaining a lien on accounts receivable and not on merchandise. The portion of § 43-1205 quoted above would appear to permit this. Section 43-1202 (c) states that the filing statement must contain "the general character of

parently only present and not future accounts receivable may be encumbered<sup>40</sup> unless the future accounts arise out of the sale of merchandise already subject to the lien of the factor.<sup>41</sup>

The foregoing examination of the Indiana security situation reveals an unusual degree of overlap between the various statutes: at least four separate statutes permit a lender to gain a security interest in the inventory of a borrower.<sup>42</sup> Each statute has its own formalities, and each gives different rights and duties to the immediate parties to the transaction and to interested third parties.<sup>43</sup> Two statutes are specifically

merchandise and/or accounts receivable subject to the lien." Reading "and/or" in the disjunctive, it would appear that the lien could be perfected solely on accounts receivable without including merchandise. However, § 43-1202, the heart of the act, speaks only of a lien on merchandise and accounts receivable rising out of the sale of encumbered merchandise. To further confuse the issue § 43-1201 defines factors as "persons . . . who advance money on the security of merchandise. . . ." Reading the act as a whole, however, it would appear that the factor's lien can be used to finance on the sole security of accounts receivable.

40. Assuming that the act may be used for accounts receivable financing, see note 39 *supra*, it remains silent on the subject of assignment of future accounts receivable. Thus, it appears that the common law prohibition against such assignment remains in force. This result was reached by a court in construing a similar provision of the New Hampshire factor's lien act. *Manchester Nat. Bank v. Roche*, 186 F2d 827 (1st Cir. 1951). Actually future accounts receivable are analogous to after-acquired inventory, and there seems to be no overriding policy reason for permitting a mortgage of the latter and prohibiting an assignment of the former. If filing is enough notice to prospective creditors to protect them in their dealings with a borrower who has encumbered his after-acquired inventory, then it should likewise protect them if he has assigned his future accounts. See 2 GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* § 592 (1940).

41. Section 43-1207 provides that the creation of a lien on the borrower's merchandise will operate as an automatic assignment of accounts receivable which will result from the sale of such merchandise.

42. The Conditional Sales Act, Chattel Mortgage Act, Trust Receipts Act, and Factor's Lien Act.

43. For example, the conditional sale is valid against third parties without recording. The chattel mortgage and factor's lien must be recorded with the county recorder to be valid against third parties, while the validity of the trust receipt depends upon filing with the Secretary of State. Recording in the wrong set of books renders the lien void in most cases. The chattel mortgage is valid from the time of recording as against all unsecured creditors and all subsequent lienors. IND. ANN. STAT. §§ 51-502,504 (Burns 1951). An unrecorded chattel mortgage, however, is invalid against subsequent mortgagees and creditors, but apparently valid as against prior creditors. *Id.* § 51-504. The trust receipt is valid for 30 days without filing as against all creditors of the trustee. IND. ANN. STAT. § 51-608 (1) (Burns 1951). It is void "as against lien creditors who become such after such 30 day period and without notice of such interest and before filing." *Id.* § 51-608 (2). The factor's lien is effective "from the time of filing as against . . . unsecured creditors . . . and . . . subsequent liens of creditors. . . ." IND. ANN. STAT. § 43-1204 (Burns Supp. 1955). From this variety of provisions a number of possible situations could arise in which the rights of creditors would vary depending on the form of the transaction. For example, assume that B has received merchandise and has received a loan from L in return for a security interest in the merchandise. L delays filing. C, a creditor of B, attaches the merchandise 20 days later. If the security arrangement between B and L is a chattel mortgage or a factor's lien, C will prevail over L since the security interest does not become perfected until filed. If the security arrangement is a trust receipt, L will prevail since his lien is valid for

concerned with assignment of accounts receivable; again the rights of the immediate and of third parties may vary depending upon what form the immediate parties adopt.<sup>44</sup> Many inventory finance problems could be handled under any one of these acts, and little justification exists for treating the rights of the immediate parties and especially the rights of third parties differently merely because of the form which the transaction takes.

Overlap in security statutes was the precise evil which the draftsmen of Article 9 of the Uniform Commercial Code sought to avoid.<sup>45</sup> The Code would supersede existing security devices and "provide a simple and unified structure within which the immense variety of present-day secured financing transactions could go forward with less cost and with greater certainty."<sup>46</sup> The Code bases the important distinctions on the type of property constituting the collateral and not on the form of the transaction. Where appropriate, special rules are applied to transactions involving different types of property. "The scheme of the Article is to

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30 days without filing. If L has received his security interest as a result of a conditional sale to B, then L will prevail because the conditional sale need not be recorded and is valid from the time it is made.

The statutes vary on the procedures necessary when the borrower defaults. The provisions in the Conditional Sales Act are fairly strict as to what the conditional seller may do on default. IND. ANN. STAT. §§ 58-814 to -824. The provisions of the Trust Receipts Act are considerably less strict. IND. ANN. STAT. § 51-606 (Burns 1951). Neither the Chattel Mortgage Act nor the Factor's Lien Act contains any default provisions. The rights of the lender and third parties to the proceeds of sales also vary from act to act.

44. For example, under the Factor's Lien Act the borrower may make adjustments and grant credits and allowances to account debtors. IND. ANN. STAT. § 43-1205 (Burns Supp. 1955). However, the Assignment of Accounts Receivable Act contains no such provisions and presumably under the doctrine of *Lee v. State Bank and Trust Co.*, 38 F.2d 45 (2d Cir. 1930), the borrower would be precluded from making such adjustments. See note 69 *infra* and accompanying text. Under the Factor's Lien Act a lender's security interest in a borrower's accounts is a matter of record and affords notice to the borrower's prospective creditors. However, an assignment of accounts under the Accounts Receivable Act is not recorded and prospective creditors or subsequent assignees may therefore be unable to easily discover the lender's interest in the accounts.

45. "Existing law recognizes a wide variety of security devices, which came into use at various times to make possible different types of secured financing. Differences between one device and another persist, in formal requisites, in the secured party's rights against the debtor and third parties . . . and in filing requirements, despite the fact that today many of those differences no longer serve any useful function. [I]n some states half a dozen separate filing systems . . . are maintained . . . each of which must be separately checked to determine a debtor's status. In recent years our security law has grown in complexity at an alarming rate. The growing complexity of financing transactions forces us to keep piling new statutory provisions on top of our inadequate and already sufficiently complicated nineteenth-century structure of security law. The results of this continuing development are, and will be, increasing costs to both parties and increasing uncertainty as to their rights and the rights of third parties dealing with them." UNIFORM COMMERCIAL CODE § 9-101, Comment.

46. *Ibid.*



make necessary distinctions along functional rather than formal lines."<sup>47</sup> Unfortunately, Indiana is enmeshed in the exact security tangle from which the draftsmen of the Code have extended a means of escape.

In addition to the general problem of overlap just discussed, the Indiana statutes fail to deal with several specific problems. The first of these concerns the rights of the lender and of third parties in the proceeds of sales of encumbered inventory. Neither the Chattel Mortgage Act nor the Assignment of Accounts Receivable Act makes specific provision for the rights of various parties in the proceeds arising from the borrower's disposition of the collateral. Neither act informs the lender how often he should police the borrower's activities to maintain his lien on proceeds, and neither appears to face the problem of the lender's rights in proceeds which are misapplied by the borrower. The Trust Receipts Act extends the lender's security interest to proceeds or the value of proceeds, whether such proceeds are identifiable or not, received by the borrower within ten days prior to bankruptcy or to a demand made by the lender for an accounting.<sup>48</sup> The lien is also extended to any other identifiable proceeds unless the lender has waived his right to an accounting.<sup>49</sup> Thus the Trust Receipts Act improves upon the Chattel Mortgage Act by informing the lender how often he should police the borrower's activities to protect his lien on proceeds.<sup>50</sup>

The Factor's Lien Act gives the factor a lien on the accounts receivable or other proceeds arising from the sale of encumbered merchandise.<sup>51</sup> However, the act is silent as to the factor's position when the borrower receives proceeds and applies them to his own use. This statutory void leaves unanswered the question whether the lien on the proceeds continues or is lost, and, if lost, when and as to what classes of third parties. The act also fails to consider that proceeds may take different forms. It would appear unreasonable to allow the lien to continue on cash proceeds or negotiable instruments so that the factor could follow such proceeds into the hands of third parties. On the other hand there might be justification for allowing the factor to follow conditional sales contracts into the hands of a subsequent assignee who could more

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47. *Ibid.*

48. IND. ANN. STAT. § 51-610(b) (Burns 1951).

49. *Id.* § 51-610(c). The entruster's lien may be waived "by words or conduct; and knowledge by the entruster of the existence of proceeds, without demand for accounting made within ten days from such knowledge, shall be deemed a waiver." *Ibid.* See also *Universal Credit Company v. Citizens State Bank*, 224 Ind. 1, 64 N.E.2d 28 (1945).

50. To protect his lien on proceeds the entruster should demand accountings every 10 days since a waiver by conduct would likely result if the entruster, knowing that the borrower's business entailed frequent sales, failed to demand such frequent accountings.

51. IND. ANN. STAT. §§ 43-1202, 07 (Burns Supp. 1955).

justifiably be held on notice of the factor's interest, since the assignment of such contracts is less likely to be in the ordinary course of the borrower's business. Apparently when proceeds are accounts receivable the factor will prevail over a subsequent assignee of the accounts from the borrower.<sup>52</sup>

The Uniform Commercial Code, unlike existing Indiana statutes, clearly spells out the rights of the secured party to proceeds. Section 9-306 delineates the situations in which a third party will prevail over the secured party. The secured party's interest continues on identifiable proceeds without further act of the parties.<sup>53</sup> If the proceeds are cash (defined to include checks) the security interest continues on identifiable cash proceeds; when insolvency proceedings intervene, the secured party has only a right to an amount of the debtor's cash and bank accounts equal to the amount of cash proceeds received by the borrower within ten days of insolvency proceedings, without regard to whether funds in the debtor's possession are identifiable as cash proceeds.<sup>54</sup> However, the secured party leaves proceeds in the hands of the borrower at his own risk. If the borrower transfers these in the ordinary course of business the transferee generally will prevail over the secured party.<sup>55</sup> The secured party can neither follow cash proceeds into the hands of third parties,<sup>56</sup> nor follow negotiable instruments or negotiable documents of title into the hands of a holder in due course or a bona fide purchaser, as filing does not constitute notice to such third parties.<sup>57</sup> A buyer of goods in the ordinary course of business will prevail over the secured party's interest in goods received by the borrower as proceeds.<sup>58</sup> Likewise, a purchaser of chattel paper from the borrower for new value in the ordinary course of business with or without actual knowledge of the secured party's interest will prevail.<sup>59</sup> If the proceeds are accounts receivable the

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52. *Id.* § 43-1207. This section provides that such accounts are deemed assigned to the factor under the provisions of the Assignment of Accounts Receivable Act. IND. ANN. STAT. §§ 19-2101 to -2104 (Burns 1950). The assignment is deemed perfected immediately after the sale of the goods without further acts of the parties. The Accounts Receivable Act provides that the first assignee prevails over a subsequent assignee.

53. UNIFORM COMMERCIAL CODE § 9-306 (1).

54. *Id.* § 9-306(2), Comment 2(a).

55. *Id.* § 9-306, Comment 2(c).

56. *Id.* § 9-306 (2).

57. *Id.* § 9-309.

58. *Id.* § 9-307.

59. *Id.* § 9-306(4). Comment 2(c) explains this policy on chattel paper. "Notice that, unlike § 9-308 where the original collateral is the chattel paper itself, it is not required that the transferee of the conditional sales contract constituting proceeds be ignorant of the inventory lien. This is a deliberate distinction, made in order that financiers of inventory may not have a legal right to monopolize the financing of the resulting chattel paper. In § 9-308, where the original collateral is the chattel paper

secured party will prevail over a subsequent assignee.<sup>60</sup>

It is apparent that the Indiana chattel security statutes overlap each other in a confusing manner and also fail to adequately delineate the rights of various interested parties in the proceeds of sales of encumbered merchandise. In addition, all of the Indiana statutes appear to fall into at least one of the two basic traps that menace liens on inventory and accounts receivable: the threat of at least partial avoidance as a preference in bankruptcy or the threat of total avoidance as a fraudulent conveyance.

While the Bankruptcy Act was amended in 1950 to eliminate the most serious obstacle to inventory financing,<sup>61</sup> there remains another bankruptcy problem inherent in any inventory security arrangement

itself, this reasoning does not apply, and the transferee's actual knowledge that the specific chattel paper is subject to the security interest defeats the transferee."

60. *Id.* § 9-306(1), Comment 4.

61. The 1938 amendment to § 60 of the Bankruptcy Act, Act of June 22, 1938, c. 575, § 60, 52 STAT. 869, as interpreted by Corn Exchange National Bank and Trust Co. v. Klauder, 318 U.S. 434 (1943), posed two very serious threats to inventory and accounts receivable financing. The amendment provided that unless a transfer by a debtor to a creditor was so far perfected that no bona fide purchaser from or creditor of the debtor could acquire rights superior to the transferee's, the transfer would be deemed to have been made immediately before the debtor's bankruptcy. Such transfer was thus voidable as a preference. The *Klauder* case held that under Pennsylvania law a non-notification assignment of accounts receivable was voidable by the trustee in bankruptcy since a hypothetical subsequent assignee of the accounts who first collected or first notified the account debtors would prevail over the original assignee. Many states reacted almost immediately to this holding by passing legislation to avoid the rule. Indiana's Accounts Receivable Statute, IND. ANN. STAT. §§ 19-2101 to -2104, was passed in response to the *Klauder* case and avoided the rule by providing that the first assignee would prevail over a subsequent assignee. However, the rule of the *Klauder* case went deeper than accounts receivable and threatened all inventory security devices. Under all such devices a purchaser from stock in the ordinary course of the borrower's business takes good title as against the secured party. A literal interpretation of the 1938 version of § 60 would mean that such a security interest could never be so far perfected as to pass the test of the hypothetical bona fide purchaser. Therefore all such interests were vulnerable to avoidance by the trustee in bankruptcy.

Secondly, most inventory security devices have to be recorded before effective against the borrower's creditors. Since there is almost always some time lag between making the loan and recording, a literal interpretation of § 60 would mean that such transfer of security would be deemed to have been made at the time of recording. As recording would necessarily occur after the loan was made, the loan would become a transfer for an antecedent debt and would be voidable as a preference for four months after recording.

Fortunately, in 1950 Congress again amended § 60, 64 STAT. 24 (1950), 11 U.S.C. § 96 (1952). The test of perfection was changed from the hypothetical bona fide purchaser concept to a consideration of whether a hypothetical "subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could have become superior to the rights of the transferee." *Ibid.* This part of the amendment overcomes the first threat raised by the *Klauder* case since a lien creditor under inventory security statutes does not prevail over the secured party. The second problem was overcome by providing that a recording within 21 days of the transfer would cause the transfer to be deemed to have been made at the actual time of the transfer. See Countryman, *The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act*, 16 LAW & CONTEMP. PROB. 76 (1951).

which permits the lien to attach to after-acquired property. The secured party gets a security interest in property which comes into the borrower's hands after the loan has been made. Such property, if received within four months of bankruptcy, might be deemed security for an antecedent debt and voidable as a preference.<sup>62</sup>

Both the Chattel Mortgage Act and the Factor's Lien Act permit the security interest to extend to after-acquired property. The former act makes no attempt to solve this problem, and a mortgage which included after-acquired property thus might be avoided by the borrower's trustee in bankruptcy to the extent that the inventory on hand had been received within four months of bankruptcy. The Legislature apparently anticipated this problem in drafting the Factor's Lien Act by providing that the time of the lien's attachment to after-acquired property relates back to the time that the notice is filed rather than to the date on which the property is actually acquired by the borrower.<sup>63</sup> This commendable provision should abrogate a problem which would otherwise increase the factor's uncertainty.

Section 9-108 of the Code meets this preference problem in a more direct manner. "Where a secured party . . . gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for such new value and not as security for a pre-existing claim. . . ."<sup>64</sup> The Code goes a step further by anticipating that the same preference argument might be used in relation to proceeds of sales received by the borrower within four months of bankruptcy. Under Section 9-306, whenever a debtor sells collateral the security interest "continues on any identifiable proceeds received by the debtor. . . ."<sup>65</sup> The Code emphasizes "that the four-month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the

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62. Cf. *Irving Trust Co. v. Commercial Factors Corp.*, 68F. 2d 864 (2d Cir. 1934); *In re Baumgartner*, 55 F. 2d 1041 (7th Cir. 1931); *Wolfe v. Bank of Anderson*, 238 Fed. 343 (4th Cir. 1916); *In re Lambert and Braceland Co.* 29 F. 2d 758 (E.D. Pa. 1928). *But cf. In re Pusey*, 122 F. 2d 606 (3d Cir. 1941).

63. IND. ANN. STAT. § 43-1202 (Burns Supp. 1955).

64. UNIFORM COMMERCIAL CODE § 9-108 (2). A few commentators express doubt whether such a provision would stand up in bankruptcy. Kupfer, *Accounts Receivable, Trust Receipt, and Related Types of Financing Under Article 9 of the Uniform Commercial Code*, 27 TEMP. L.Q. 278 (1953); Kripke, *The Modernization of Commercial Security Under the Uniform Commercial Code*, 16 LAW & CONTEMP. PROB. 183 (1951). Kripke states, "Assuming that the intent is to state that the uncomfortable fact shall not have its ordinary legal consequences, it may be questioned whether any state legislation can affect the definition of preference in the Bankruptcy Act. At any rate, the point has been a troublesome one and the effort to solve it is all to the good." *Id.* at 195.

65. UNIFORM COMMERCIAL CODE § 9-306 (1).

security interest in the original collateral and not with the date of his obtaining control of the proceeds."<sup>66</sup>

A further threat facing inventory and accounts receivable financing devices is the threat of avoidance as a fraudulent conveyance. The fraudulent conveyance threat is commonly associated with the case of *Benedict v. Ratner*,<sup>67</sup> which held that an assignee of accounts receivable must require the assignor to account for all proceeds from collections of accounts. The *Benedict* doctrine prohibits the borrower from diverting these proceeds to his own use. If he does divert the proceeds, the assignee's lien is void as against creditors of the borrower not only as to the proceeds appropriated by the borrower, but on all other assigned accounts as well, such a transaction being "deemed fraudulent in law."<sup>68</sup> The *Benedict* doctrine has been extended to situations where the borrower accepts returned goods from the account debtor, credits the latter's account, and then takes dominion over the goods. In such a case the borrower must segregate the returned goods from the balance of his inventory and cannot re-sell these goods unless he remits the proceeds of sale to the assignor.<sup>69</sup> A companion rule, the doctrine of ostensible ownership, demands that the lender require the prompt remittance of proceeds of sales of inventory to maintain the validity of his lien.<sup>70</sup>

The *Benedict* case purported to announce the New York rule applicable to the borrower's control of proceeds of sale of inventory and then by analogy extended the rule to control over proceeds of accounts receivable.<sup>71</sup> Since the rule is founded in state law, its effect can be abrogated by state statute.<sup>72</sup> Unless Indiana has a rule, similar to New York's, which will invalidate a lender's lien on inventory or accounts receivable when the borrower is permitted unrestricted dominion over the proceeds, the *Benedict* doctrine poses no threat to inventory and accounts receivable financing in Indiana. However, a line of cases, applying the Indiana fraudulent conveyance statute,<sup>73</sup> has held that when there is no agreement that borrower account for proceeds, and the borrower is permitted, either by an express or implied agreement, to sell the property

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66. *Id.* § 9-306, Comment 2 (b).

67. 268 U.S. 353 (1925).

68. *Id.* at 360.

69. *Lee v. State Bank and Trust Co.*, 38 F. 2d 45 (2d Cir. 1930).

70. See cases collected in Annot., 73 A.L.R. 236 (1931).

71. "Whether the rule applies to accounts does not appear to have been passed upon by the Court of Appeals of New York. But it would seem clear that whether the collateral consist of chattels or of accounts, reservation or dominion inconsistent with the effective disposition of title must render the transaction void." *Benedict v. Ratner*, 268 U.S. 353, 361-62 (1925).

72. See 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 583 (1940).

73. IND. ANN. STAT. §§ 33-408 to -409 (Burns 1949).

and appropriate the proceeds to his own use, the transaction will be void as a fraud on creditors.<sup>74</sup> This rule developed before the adoption of the Chattel Mortgage Act which codified the rule by requiring, as a condi-

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74. The early Indiana cases held that a mortgage on a stock of goods which permitted the mortgagor to remain in possession and which did not contain a stipulation requiring the mortgagor to apply the proceeds of sale to his own use was void on its face. Also, even if the mortgage was valid on its face, proof that the mortgagor had disposed of goods and applied the proceeds to his own use would void the mortgage. *Robinson v. Elliott*, 89 U.S. (22 Wal.) 513 (1874) (case arose in Indiana); *Davenport v. Foulke*, 68 Ind. 382 (1879); *Mobley v. Letts*, 61 Ind. 11 (1878); *The New Albany Insurance Co. v. Wilcoxson*, 21 Ind. 355 (1863). The rule was changed somewhat by *McFadden v. Fritz*, 90 Ind. 590 (1883), which held that a mortgage on goods could not be held void on its face but that fraud in such a case was a question of fact. The court stated that the earlier cases had properly applied the common law rule, but that an Indiana statute (§ 4924 R. S. 1881) had modified that rule by making fraud in all such cases a question of fact. However, the court failed to indicate what facts would need to be proved to void the mortgage. It is interesting to note that the statute on which the court relied was enacted in 1852 [1 R.S. 1852, ch. 42, § 21, p. 299, now IND. ANN. STAT. § 33-412 (Burns 1949)] and was the Indiana law when the earlier cases were decided. The case of *New v. Sailors*, 114 Ind. 407, 16 N.E. 609 (1887), defined the rule more clearly by specifying what the party attacking the mortgage would need to prove to void it. In this case the terms of the mortgage authorized the mortgagor to sell the mortgaged goods in the course of trade. The mortgage contained no agreement that the proceeds be applied to the debt. The plaintiff contended that the mortgage was void in the absence of an affirmative showing that mortgagor was required to account. The court pointed out that this did not necessarily follow. "The question of fraudulent intent is a question of fact, and not of law. Therefore, until the contrary appears, it will be presumed that a mortgagor who is permitted to retain possession of and sell mortgaged chattels does so under an agreement to account as the agent of the mortgagee. . . . This is the limit to which presumptions in favor of good faith will be carried under § 4924, Rev. St. 1881. If, however, it affirmatively appears that there was no agreement to account, and the mortgagor is permitted, either by an express or implied agreement with the mortgagee, to continue in possession, with the right to sell the property and appropriate the proceeds to his own use, the transaction will be regarded as a fraud upon creditors, and void. . . . Such an understanding may appear by proof of an oral agreement, or it may be inferred from the fact that the mortgagor made sales of the property and used the proceeds, with the knowledge of the mortgagee, without being asked or required to account." *New v. Sailors*, *supra* at 412-413, 16 N.E. at 611. *Accord*, *Vermillion v. First National Bank of Greencastle*, 59 Ind. App. 35, 105 N.E. 530 (1914); *Hamrick v. Hoover*, 41 Ind. App. 411, 84 N.E. 28 (1907); *Stout v. Price*, 24 Ind. App. 360, 56 N.E. 857 (1899); *Fletcher v. Martin*, 126 Ind. 55, 25 N.E. 886 (1890); *Mayer v. Feig*, 114 Ind. 577, 17 N.E. 159 (1887). In the case of *General Highways System v. Thompson*, 88 Ind. App. 179, 155 N.E. 262 (1928), the court apparently took a slightly different view on the rule. There the mortgage on its face required the borrower to account for one-half of the proceeds of sale and was silent as to the other one-half. The court, after reviewing the Indiana cases, held the mortgage void as to general creditors for permitting the mortgagor to retain and sell the merchandise and to withdraw one-half of the proceeds for operating the business. This case would appear to hold that the mortgage agreement must require the mortgagor to apply proceeds to the debt, or at least that the mortgage will be void if the mortgagor uses proceeds for other purposes. Whether it accurately states the Indiana law is questionable, as no other Indiana Case raised the point prior to the passage of the 1935 Chattel Mortgage Act which substantially codified the *General Highways* rule. *In re. Jettner*, 24 F. 2d 734 (D. Ind. 1928) held a mortgage on goods void, but there it was proved as a fact that the mortgagor, with the consent of the mortgagee, did not apply proceeds to the debt. At least, it appears safe to say that if it can be proved that the borrower has not applied proceeds to the debt, with the express or implied permission of the lender, the mortgage will be void as to creditors.

tion to the validity of a mortgage which permits sale of mortgaged property, that the proceeds of the sale be applied to the reduction of the mortgage debt.<sup>75</sup> Unfortunately the borrower may not be in a financial position to apply all the proceeds from sales to reduce the debt. Payrolls and operating expenses must be met, and his flow of incoming inventory must be maintained. As a consequence, if all the proceeds are turned over to the lender, new loans may be required to allow the borrower to remain in business. The requirement of application of all proceeds to the debt may force the borrower to pay the loan faster than is economically feasible and may necessitate a series of new loans. Thus, the Indiana Chattel Mortgage Act offers no satisfactory solution to the fraudulent conveyance threat.

The fraudulent conveyance situation under the Trust Receipts Act is ambiguous. The act applies the *Benedict* rule to proceeds, and the lender must demand an accounting every ten days to insure that his lien on such proceeds remains valid.<sup>76</sup> However, the act is silent as to the effect of the *Benedict* rule on retained inventory. The question arises whether the lender loses not only his lien on proceeds, but also on inventory remaining in the hands of the borrower, if he allows the borrower free use of the proceeds of sale. Since the act discloses no intention to change the *Benedict* rule, the usual rules of law apply<sup>77</sup> and the lien on retained inventory is probably lost.<sup>78</sup> However, the only reported case dealing with the matter, while not holding squarely on the point, indicates that the lender's failure to police will not destroy the lien on retained merchandise.<sup>79</sup> At best the point is uncertain, and in the ab-

75. IND. ANN. STAT. § 51-506 (Burns 1951); *Ed Hughes Furniture Company v. Caughran*, 218 F. 2d 906 (7th Cir. 1955); *Goldberg v. Britton*, 119 Ind. App. 90, 84 N.E. 2d 201 (1949).

76. IND. ANN. STAT. § 51-610 (Burns 1951).

77. The act specifically states that, in cases not provided for, the rules of law and equity continue to apply. *Id.* § 51-617.

78. See 4 COLLIER ON BANKRUPTCY § 70:58 n. 6 (14th ed. 1941); 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 558 (1940).

79. *Universal Credit Company v. Citizens State Bank*, 224 Ind. 1, 64 N.E. 2d 28 (1945). Here the borrower had sold seven cars held under a trust receipt arrangement with the lender, and had taken conditional sales contracts as proceeds. The borrower had then assigned the contracts to defendant bank. The lender sued the bank to recover the contracts. The complaint showed on its face that the lender had failed to demand the proceeds from the sales of six of the cars until more than ten days after the dates of sale, but had made such a demand within ten days from the sale of the seventh car. The trial court sustained the bank's demurrer to the complaint. On appeal the Supreme Court affirmed as to the paragraphs of complaint concerning the first six cars, but reversed as to the paragraphs concerning the seventh car, holding that the lender's demand within ten days of sale perfected his lien on the proceeds from that sale even as against a third party. While the point was not specifically discussed, one could argue from this holding that the lender's failure to police adequately, although destroying his lien on the proceeds of goods sold more than ten days before demand for accounting, did not operate to destroy his lien on merchandise still in the hands of the borrower. The court

sence of clear judicial construction it behooves the lender to periodically police the activities of the borrower.

The Indiana Accounts Receivable Statute makes no attempt to avoid the *Benedict* rule. The statute allows the borrower to collect the accounts,<sup>80</sup> but is silent as to what disposition he must make of collections. It is therefore presumed that if the lender allows the borrower to have "unfettered control" of these proceeds the *Benedict* rule will apply to void the lender's lien as against third parties. Also the rule voiding the lender's lien if the borrower has control over merchandise returned by account debtors is probably applicable.<sup>81</sup> Therefore, the lender must regularly police the transaction as to both proceeds collected and returned goods.<sup>82</sup>

Unfortunately the Factor's Lien Act does not expressly answer the threat of *Benedict v. Ratner*. It may be argued that the *Benedict* doctrine does not apply to the factor's lien;<sup>83</sup> but, if applicable, it might be used to destroy the lien not only on proceeds, but also on the remaining

recognized the validity of the lien on proceeds from such merchandise in the one instance where the lender made the requisite demand. If the lender's failure to police adequately had destroyed his lien on merchandise as yet undisposed of, then presumably the court would not have recognized the validity of his lien on the proceeds of such merchandise.

A 1946 study made by the New York Law Revision Commission indicates that failure to police will not destroy the lien on remaining goods held under trust receipt, but the report warns that the opposite result could be reached. REPORT OF THE LAW REVISION COMMISSION 351, at 485 (1946).

80. IND. ANN. STAT. § 19-2103 (Burns 1950).

81. See note 69 *supra* and accompanying text.

82. The requirement that the borrower pay over proceeds of collected accounts is probably desirable under a statute like Indiana's which requires neither notification of account debtors nor recording. The policing requirement is a judicially developed rule for the protection of unsecured creditors who would otherwise be injured in the event that upon borrower's insolvency the lender could satisfy the entire amount of his original loan out of the borrower's accounts. The policing rule causes the amount outstanding on the loan to be reduced as accounts are collected and also requires the lender to keep a close watch on the borrower's activities. These two attributes of the policing rule afford some measure of protection to unsecured creditors who may be unaware of the lender's interest and may be unable to discover such interest in the absence of any recording. In addition, the very mechanics inherent in policing may give some notoriety to the existence of the assignment. However, when recording of the assignment of accounts is required, the need to retain the policing rule diminishes. If the lender's interest is recorded, prospective creditors can check the record to discover outstanding interests and need not rely on appearances. Recording would, in effect, replace policing as a means of protecting creditors.

83. Mr. Justice Brandeis in a footnote to his opinion in the *Benedict* case intimated that the rule might not apply to the New York factor's lien act. "N.Y. Personal Property Law, § 45 authorizes the creation of a general lien or floating charge upon a stock of merchandise, including after-acquired chattels, and upon accounts receivable resulting from the sale of such merchandise. It provides that this lien or charge shall be valid against creditors provided certain formalities are observed and detailed filing provisions are complied with. It is possible that, if its conditions are performed, the section does away with the rule 'that retention of possession by the mortgagor with power of sale for his own benefit is fraudulent as to creditors.'" 268 U.S. 353, 361 n. 11 (1925). The force which can be given to this dictum is questionable.



goods and accounts, were the borrower given free use of proceeds. However, *Colbath v. Mechanics National Bank*,<sup>84</sup> the only reported case which has considered the application of the *Benedict* rule to a factor's lien when the statute<sup>85</sup> was silent as to control of proceeds, held that the rule did not apply to defeat the lien on merchandise still retained by the borrower, even though the borrower had applied the proceeds freely to his own use. Although the *Benedict* rule was the common law of New Hampshire,<sup>86</sup> the court concluded that the factor's lien act abolished the rule since the act contained no requirement for policing.<sup>87</sup> Whether the Indiana courts or a federal court in bankruptcy would adopt this same line of reasoning in construing the Indiana act is at least questionable.

The applicability of the *Benedict* rule to accounts receivable held under a factor's lien is likewise uncertain under the Indiana act. The act does abolish the harsh rule that the lien is lost merely because the borrower accepts returned merchandise and thereafter deals with it, or because he grants credits or adjustments to account debtors.<sup>88</sup> However, as to the borrower's control over proceeds from accounts receivable, the act is silent. In construing a section of the New Hampshire act<sup>89</sup> which was very similar to the Indiana act, the First Circuit held that dominion by the borrower over the proceeds of accounts receivable "rendered the assignment void as a fraud on creditors under the doctrine of *Benedict v. Ratner*. . . ."<sup>90</sup> The *Colbath* case<sup>91</sup> was held applicable only to goods. In response to this decision the New Hampshire Legislature abolished the policing rule as to accounts receivable.<sup>92</sup> Whether or not the Indiana

84. 96 N.H. 110, 70 A. 2d 608 (1950).

85. N.H. LAWS 1943, c. 161.

86. *In re Freeman*, 84 F. Supp. 441 (D. N. H. 1949); *Putnam v. Osgood*, 52 N.H. 148 (1872). See cases cited annot., 73 A.L.R. 236, 241 (1931).

87. While the case might be criticized on its reasoning that legislative silence overruled common law, policy-wise the decision seems correct. As pointed out in note 82 *supra*, once the lender's interest is recorded, there is less reason to retain the policing requirement to protect creditors. The New Hampshire Court by judicial construction seems to have carried out legislative intent which was not clearly expressed in the statute.

88. IND. ANN. STAT. § 43-1205 (Burns Supp. 1955).

89. N.H. LAWS 1943, c. 161, § 5.

90. *Manchester Nat. Bank v. Roche*, 186 F. 2d 827, 833 (1st Cir. 1951). "The legislature of New Hampshire seems to have chosen . . . not to abrogate entirely the rule of *Benedict v. Ratner* but rather to qualify it, so as to render it inapplicable to certain extreme situations . . ." *i.e.*, returned goods and adjustments with account debtors. While the court was probably correct in its strict statutory interpretation, it seems to have frustrated legislative intent. The case stands as a caveat to vague draftsmanship. Unfortunately, the Indiana Act contains language very similar to the New Hampshire Act.

91. See note 84 *supra* and accompanying text.

92. After the *Manchester* case was handed down in February, 1951, the New Hampshire Act was amended. See N.H. REV. LAWS c. 446, § 446:7 (1955).

Legislature intended to abolish the accounts receivable policing rule, in light of the New Hampshire cases it would appear foolhardy for a factor to proceed on the theory that the rule was abrogated.

It is unfortunate that the Legislature has failed to deal clearly with these problems. In the absence of a clear rejection of the *Benedict* rule, the factor, to safely retain his lien, must apparently require the borrower to account for the proceeds of sales. Thus, the Factor's Lien Act is subject to the same objection as the Chattel Mortgage Act. Neither provides a safe, simple means whereby the parties can create a floating lien on the borrower's inventory or accounts.

The Uniform Commercial Code expressly repeals the rule of *Benedict v. Ratner*.<sup>93</sup> The secured party does not lose his interest in the original collateral merely because he allows the borrower to exercise dominion over proceeds. The original security agreements may embrace after-acquired collateral, including future accounts, without further action by the parties.<sup>94</sup> Furthermore, Article 9 expressly validates the floating lien.<sup>95</sup> Thus, Article 9 does several important things which the Indiana statutes fail to do. 1) It takes a definite stand on the rule of *Benedict v. Ratner*. 2) By its position on after-acquired goods, future accounts, and future advances it clearly validates the floating lien without necessitating a mass of cumbersome and costly paper-work. 3) It equates accounts receivable with inventory. 4) It defines the rights of the various classes of parties to the various forms of proceeds arising from the disposition of collateral.

Any change in existing law as revolutionary as Article 9 will naturally elicit much comment. While the majority of the comments

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93. UNIFORM COMMERCIAL CODE § 9-205.

94. *Id.* § 9-204.

95. See *id.* § 9-205, Comment 1. The Code defends its repeal of the *Benedict* rule on policy grounds: "The principal effect of the *Benedict* rule has been, not to discourage or eliminate security transactions in inventory and accounts receivable—on the contrary such transactions have vastly increased in volume—but rather to force financing arrangements in this field on to a self-liquidating basis. Furthermore several Circuit Court cases drew implications from . . . *Benedict* . . . which have required lenders . . . to observe a number of needless and costly formalities: for example it has been thought necessary for the debtor to make daily remittances to the lender of all collections received, even though the amount remitted is immediately returned to the debtor in order to keep the loan at an agreed level. Nothing in section 9-205 prevents such degree of 'policing' or dominion as the secured party and the debtor may agree upon; business and not legal reasons will determine the extent to which strict accountability, segregation of collections, daily reports and the like will be employed." *Ibid.*

have been favorable,<sup>96</sup> the Article has not been free from criticism.<sup>97</sup> The chief criticism has been directed at the possibility that one lender may be able to monopolize all credit extension to a borrower by getting a security interest in all of his present and future assets. While the possibility of abuse exists, freedom of competition should safeguard against monopoly in financing, and the remote possibility of abuse seems far outweighed by the benefits which can accrue from a proper use of Article 9.

The existing confusion in almost all jurisdictions over the law of security on shifting collateral is intensified in Indiana because of the large degree of overlap between statutes. The new Factor's Lien Act, while somewhat simplifying the creation of a security interest in shifting merchandise, fails to settle serious problems existing before its adoption.

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96. See, e.g., Birnbaum, *Article 9—A Restatement and Revision of Chattel Security*, 1952 WIS. L. REV. 348; Kripke, *The Modernization of Commercial Security Under the Uniform Commercial Code*, 16 LAW & CONTEMP. PROB. 183 (1951); Shattuck, *Secured Transactions—A Comparison of the Law in Washington and the Uniform Commercial Code, Article 9*, 29 WASH. L. REV. 1, 195,263 at 288-91 (1954).

97. See, e.g., Beutel, *The Proposed Uniform Commercial Code as a Problem in Codification*, 16 LAW & CONTEMP. PROB. 141 (1951); Kupfer, *Accounts Receivable, Trust Receipt, and Related Types of Financing Under Article 9 of the Uniform Commercial Code*, 27 TEMP. L.Q. 278 (1953). The pros and cons were presented to the New York Law Revision Commission. See NEW YORK LEGISLATIVE DOCUMENTS No. 65 (H), (I), (J) (1954). The comments vary from extremely favorable to extremely opposed. For example, a letter from Mr. Joseph S. Techteler, chairman of the Commerce and Industry Association of New York task force assigned to study Article 9, reports that the task force highly recommends adoption of Article 9 even if the balance of the Code fails of enactment. The task force particularly favored the repeal of *Benedict v. Ratner* and the validation of the floating lien. *Id.* No. 65 (H) at 5. On the other hand the report of the National Commercial Finance Conference, Inc. voiced strong opposition to the floating lien on the grounds that one lender could monopolize the financing activities of one borrower. *Id.* No. 65 (H) at 22-26. Other objections are that the easy credit provisions will work hardships on unsecured creditors, that new terms used will be confusing to businessmen and will result in a vast increase in litigation, that lenders at their peril will have to determine the correct classification of the goods, that recording of accounts receivable financing will hurt borrowers in the eyes of their customers, and that the secured creditor's rights of redemption are too restrictive. But the answers to many of these objections are apparent. The extent to which unsecured creditors would be hurt is of course speculative, but a number of commentators do not think they would be affected to any great extent. See e.g., Birnbaum, *supra* note 96, at 389-90; Memo of Robert W. Weeks, Submitted on Behalf of the John Deere Plow Co., NEW YORK LEGISLATIVE DOCUMENT No. 65 (H) 61 at 69 (1954). Certainly if business men can understand such complex statutes as the Trust Receipts and Factor's Lien Acts they can master the Code. New terms and provisions were introduced in former security acts and the litigation that arose was strikingly scarce; provisions remain which have yet to be judicially construed. It would appear easier for lenders to correctly classify goods as equipment or inventory than to correctly classify their transaction as a conditional sale, or trust receipt, or chattel mortgage. That recording of a statement of accounts receivable financing will hurt a borrower in the eyes of his customers or suppliers is doubtful and seems to be a throwback to a stigma of days gone-by. Certainly the secured creditor's rights on default are less restrictive than under the Conditional Sales Act and no more restrictive than under the Trust Receipts Act. To the extent that objections to the Code are valid they should be considered, but it appears that most of the objections are simply not well founded.

While attempting to resolve Indiana's security problems, the Legislature has only compounded confusion by the enactment of the Factor's Lien Act. The solution lies in legislation which deals squarely with the problem areas and which simplifies and consolidates the entire law of chattel security. Article 9 of the Uniform Commercial Code does this by repealing existing legislation and by taking a clear and comprehensive approach toward modern chattel security problems. Article 9, or legislation approaching the problem in a similar manner, should be adopted, even if the balance of the Uniform Commercial Code is ignored. Only through such positive action can the problems inherent in chattel security be satisfactorily resolved.<sup>98</sup>

### THE ATTRACTIVE NUISANCE DOCTRINE

In general, the possessor of land is not liable for harm to trespassers caused by his failure to put his property in a safe condition for their reception.<sup>1</sup> An increasing regard for human safety has led to the development of certain exceptions to this rule, among which is the so-called attractive nuisance doctrine.<sup>2</sup> This doctrine has been applied generally, but not uniformly, by the American courts to allow, under proper circumstances, recovery for injuries suffered by infant trespassers. Some jurisdictions have made more conservative applications of the doctrine than others and a few have rejected it altogether, but the mass of prece-

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98. The fate of the Uniform Commercial Code as a whole has been left in doubt by the failure of the New York Law Revision Commission to recommend its enactment in New York. NEW YORK LEGISLATIVE DOCUMENT No. 65 (A) (1956). The Commission, after three years study, stated that codification of commercial law would be of value to both the legal profession and the public, but concluded that the Uniform Commercial Code was not satisfactory in its present form. *Id.* at 105-6. However, the Commission's report as to Article 9 of the Code is favorable. "Article 9 would accomplish a significant reform of the law of personal property security. The Commission believes that the approach taken by Article 9 as a whole is sound in theory and satisfactorily developed in most of its elements." *Id.* at 90. The Commission specifically approved the Code's approach in validating the floating lien, *id.* at 82-3, in abrogating the rule of *Benedict v. Ratner*, *id.* at 81, and in adjusting priorities of claims to the proceeds of the original collateral, *id.* at 84. Thus, while codification of the entire commercial law does not appear likely in the immediate future, enactment of a comprehensive chattel security statute patterned after Article 9 would be a significant present improvement in the Indiana law.

1. PROSSER, TORTS § 76 (2d ed. 1955); RESTATEMENT, TORTS § 333 (1934).

2. "Nuisance" because it is an unreasonable use by a person of his land, working an injury to another; "attractive" because in the early cases it was thought that an attraction to trespass was essential to the action. Though today a great majority of the states do not require an initial attraction, the original nomenclature has been retained.