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UCC Section 9-315: A Historical and Modern Perspective

David Frisch*

INTRODUCTION

Article 9 of the Uniform Commercial Code¹ has frequently been described as a "floating lien" statute.² In support of this sobriquet, it is standard fare to limit discussion to four of its provisions.³ There is, however, a fifth and largely ignored section, UCC section 9-315, that is also supportive of the phrase "floating lien." This section, entitled "Priority When Goods Are Commingled or Processed," outlines the ways in which a party's perfected security interest in certain goods can continue in the product or mass into which those goods are manufactured, processed, assembled, or commingled.⁴ Section 9-315 is

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1. Unless otherwise indicated, all references and citations in this Article to articles, sections, and comments of the Uniform Commercial Code are to the 1978 official text [hereinafter cited as the Code or the U.C.C.].

2. See, e.g., Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 HARV. L. REV. 838, 839-40, 850-55 (1959); Jackson & Kronman, *A Plea for the Financing Buyer,* 85 YALE L.J. 1, 1 (1975).

3. Those provisions are: U.C.C. § 9-204(1) ("[A] security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."); U.C.C. § 9-204(3) ("Obligations covered by a security agreement may include future advances . . ."); U.C.C. § 9-306(2) ("[A] security interest continues . . . in any identifiable proceeds including collections received by the debtor."); and U.C.C. § 9-205 (the abolition of the policing rule of *Benedict v. Ratner*, 268 U.S. 353 (1925)). For a brief discussion of *Benedict*, see *infra* note 83.

4. The complete text of U.C.C. § 9-315 is as follows:

Priority When Goods Are Commingled or Processed.

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

- (a) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or
- (b) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

thus functionally similar to sections 9-306, covering proceeds, and 9-204, covering after-acquired collateral, in that each section has the effect of transferring a secured party's lien to property not subject to that lien at the time the parties entered into their secured transaction. Moreover, in situations covered by sections 9-306 and 9-315, this transfer can have significant practical consequences because whenever a secured party has lost, or is unable to assert, an in specie claim to the original collateral,⁵ a derivative claim to substitute property is the only thing that prevents an unhappy slide into unsecured status.⁶

Whatever justifications exist for having a system of secured

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

(2) When under subsection (1) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

5. The loss of an in specie claim could occur where the debtor's disposition of the original collateral was authorized, *see* U.C.C. § 9-306(2), or where a priority rule terminates a secured party's lien, *see, e.g.*, U.C.C. § 9-307(1) (awarding priority to most buyers in the ordinary course of business). At other times, a secured party will retain an interest in the original collateral, but be unable to assert it. This would occur, for example, if the collateral's whereabouts were unknown.

6. Although § 9-306 is functionally similar to § 9-315, there is a conceptual difference between the two sections. Under § 9-306(2), a security interest continues only in identifiable proceeds, while § 9-315(1)(b) requires that the original collateral *lose* its identity.

The § 9-306(2) identification requirement can seriously affect the extent to which a secured party may claim an interest in the debtor's property. It has been particularly troublesome to secured parties when cash proceeds have been deposited in a debtor's bank account and commingled with non-proceeds. Whether the proceeds remain identifiable has been an issue with which courts, *see, e.g.*, *Brown & Williamson Tobacco Corp. v. First Nat'l Bank*, 504 F.2d 998, 1001-04 (7th Cir. 1974); *National Acceptance Co. of Am. v. Virginia Capital Bank*, 498 F. Supp. 1078, 1081-85 (E.D. Va. 1980); *C.O. Funk & Sons, Inc. v. Sullivan Equip. Inc.*, 89 Ill. 2d 27, 30-33, 431 N.E.2d 370, 372-73 (1982); *Michigan Nat'l Bank v. Flowers Mobile Home Sales, Inc.*, 26 N.C. App. 690, 694-97, 217 S.E.2d 108, 111-12 (1978); *Anderson, Clayton & Co. v. First Am. Bank*, 614 P.2d 1091, 1093-94 (Okla. 1980), and commentators, *see, e.g.*, Henning, *Article Nine's Treatment of Commingled Cash Proceeds in Non-Insolvency Cases*, 35 ARK. L. REV. 191, 193-94 (1981); Henson, "Proceeds" Under the Uniform Commercial Code, 65 COLUM. L. REV. 232, 238-41 (1965); Skilton, *The Security Party's Rights in a Debtor's Bank Account Under Article 9 of the Uniform Commercial Code*, 1977 S. ILL. L.J. 120, 122-40, have wrestled. This same question, but in a different context, has recently been the subject of a comprehensive report by the Law Reform Commission of British Columbia. *See* LAW REFORM COMMISSION OF BRITISH COLUMBIA, REPORT ON COMPETING RIGHTS TO MINGLED PROPERTY: TRACING AND THE RULE IN CLAYTON'S CASE (1983).

credit, they are grounded in large part on a need for commercial certainty.⁷ A secured creditor must be able to determine whether and to what extent his or her security interest will attach to the debtor's property as well as the risk of being subordinated to other claims to that property.⁸ This desire for certainty, perhaps, partially explains the wealth of literature engendered by section 9-306.⁹ Because of the functional equivalence of sections 9-306 and 9-315, one would expect to find a similar interest in section 9-315. Although described as a "complex provision"¹⁰ and one of its subsections is characterized as "notably obscure,"¹¹ section 9-315 to date successfully has escaped detailed analysis.¹² This lack of analysis may result from a general failure to appreciate the section's wide scope and potential utility.

Once an appreciation of section 9-315's intended breadth is triggered, however, troublesome questions arise regarding its application. Because these questions are not answered in section 9-315 itself, this section must be analyzed in light of its common law origins and the general policies of Article 9. Part

7. For views regarding the justifications for secured credit, see White, *Efficiency Justifications for Personal Property Security*, 37 VAND. L. REV. 473, 476-79 (1984); Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1, 2 (1981); Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1147-49 (1979).

8. The more uncertain a secured party's status, the higher the rate of return he or she will demand, thus potentially reducing the efficiency of the secured credit system. See Jackson & Kronman, *supra* note 7, at 1149-50.

9. See *supra* note 6.

10. 2 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* § 31.4, at 846 (1965).

11. *Id.* § 31.5, at 852 (discussing § 9-315(2)).

12. The majority of references to § 9-315 are to the priority statement of subsection (2), and then only for analogical purposes without much discussion. See, e.g., Coogan, *The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code*, 81 HARV. L. REV. 1369, 1407-08 (1968) (I.R.S. and secured party should share pro rata when property in which the secured party has priority is combined with property in which the I.R.S. has priority); Gilmore, *The Purchase Money Priority*, 76 HARV. L. REV. 1333, 1376 (1963) (two purchase money secured parties should share pro rata if each interest attached and became perfected at the same time); Henson, *Priorities Under the Uniform Commercial Code*, 41 NOTRE DAME LAW. 425, 434 (1966) (two purchase money secured parties should share pro rata regardless of time of filing); Payne, *Uniform Commercial Code*, 1983 DET. C.L. REV. 575, 597 (two purchase money secured parties should share pro rata regardless of time of filing); Stone, *Allocation of Risk for Products Recall Expenditures: A Legislative Proposal*, 1975 DET. C.L. REV. 1, 26-27 (use of § 9-315(2) formula suggested for allocating recall expenditures between manufacturer and supplier).

I of this Article therefore examines the historical origins of section 9-315 through a discussion of the common law doctrines of accession, specification, and confusion—property doctrines firmly rooted in civil and common law that retain a surprising vitality under the Code. Part II explores the drafting history of section 9-315, noting trends in earlier drafts that help delineate the precise contours of the security interest created. Part III analyzes the mechanics of section 9-315 in detail, initially focusing on the different ways a security interest can attach to a product or mass under subsections (1)(a) and (1)(b). It next explains why a secured party's interest in a section 9-315 product should extend to the full amount of the secured debt while an interest in a confused mass should be limited to the value of the commingled collateral. It then argues that although a pre-confusion purchase money security interest in goods should continue in a confused mass, pre-affixation purchase money status should terminate when goods are assembled into a section 9-315 product. Finally, Part IV examines the applicability and application of the priority rule in subsection (2) and explains why it should apply only when conflicting interests in the end product or mass have each attached under subsection (1).

I. THE HISTORICAL ORIGINS OF SECTION 9-315

The concept of title has always been important in resolving conflicting claims to property,¹³ and it is therefore not surprising that various rules and doctrines regarding its location have developed over the years. Section 9-315 was included in the Code to deal with three such doctrines—accession, specification, and confusion—all rooted in both civil and common law.¹⁴ Be-

13. Prior to the Code, many commercial problems were resolved by "resorting to the idea of when property or title passed or was to pass." U.C.C. § 2-101 comment. In many situations, the location of title was difficult to pinpoint. See 1 K. LLEWELLYN, HEARINGS BEFORE THE NEW YORK LAW REVISION COMMISSION ON THE UNIFORM COMMERCIAL CODE 96 (1954); J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 5-1, at 176 (2d ed. 1980) ("Who had title and what caused title to pass from the seller to the buyer were often mysteries to both lawyers and the courts."). Perhaps because of this problem, the drafters of the Code attempted to downplay the importance of location of title. There are situations under the Code, however, where location of title is relevant. For example, Article 2 contains a title section, § 2-401, and location of title might be critical in some situations. See, e.g., Jackson & Kronman, *supra* note 2, at 21-26 (location of title will determine whether a buyer takes free of a security interest under § 9-307(1)).

14. For a discussion of a subtle difference in how the three doctrines were perceived under Roman and common law, see generally Slater, *Accessio, Specificatio and Confusio: Three Skeletons in the Closet*, 37 CAN. BAR REV.

cause much of the substance of these "three skeletons in the closet"¹⁵ retains its vitality in the Code, any analysis of section 9-315 should begin with an examination of these doctrines' influence on pre-Code property and security law.

A. ACCESSION

Accession occurs when a lesser good, the accession, is united with a principal good so as to become an integral part of the principal good. As a result of this integration, title to the accession passes to the owner of the principal good.¹⁶ Because

597, 597-98 (1959) (under Roman law, accession was a property doctrine whereas early common law viewed all three doctrines as lying within the realm of tort law).

15. This phrase is borrowed from Slater, *supra* note 14.

16. See, e.g., *Mossler Acceptance Co. v. Norton Tire Co.*, 70 So. 2d 360, 361 (Fla. 1954); *Passieu v. B.F. Goodrich Co.*, 58 Ga. App. 691, 692-93, 199 S.E. 775, 776-77 (1938); *Bozeman Mortuary Ass'n v. Fairchild*, 253 Ky. 74, 78-80, 68 S.W.2d 756, 758 (1934).

Although originated by the Romans, see Lorenzen, *Specification in the Civil Law*, 35 YALE L.J. 29, 29 (1925), the doctrine of accession has long been a part of English common law. Blackstone summarized the doctrine as follows:

[I]f any given corporeal substance received afterwards an accession by natural or by artificial means, as by the growth of vegetables, the pregnancy of animals, the embroidering of cloth, or the conversion of wood or metal into vessels and utensils, the original owner of the thing was intitled [sic] by his right of possession to the property of it under such its state of improvement: but if the thing itself, by such operation, was changed into a different species, as by making wine, oil, or bread, out of another's grapes, olives, or wheat, it belonged to the new operator; who was only to make a satisfaction to the former proprietor for the materials, which he had so converted.

2 W. BLACKSTONE, COMMENTARIES *404-05.

Under Blackstone's formulation, the process of accession includes at least two distinct operations. Accession could occur when one article is attached to a different article, or it could occur when a single item is transformed into a different item through the labor of a craftsman. Thus the term "accession," which simply means "something added," see R. BROWN, *THE LAW OF PERSONAL PROPERTY* § 6.1, at 49 (3d ed. 1975), was a generic term referring to the transformation of an object through the "addition" of either property or labor.

Accession may also occur through natural rather than artificial means, in which case the property or labor of a third party would not strictly be involved. It is well settled, for example, that "in the case of domestic animals . . . the owner of the mother acquires the ownership of the offspring." *Id.* In addition, "pre-Code law held that a chattel mortgage or conditional sale contract covering an animal also covered automatically the offspring of the collateral." Nickles, *Accessions and Accessories Under Pre-Code Law and U.C.C. Article 9*, 35 ARK. L. REV. 111, 113 n.4 (1981). Whether this continues to be the rule under the Code is unclear. The 1962 official text does provide that the debtor has no rights "in the young of livestock until they are conceived." U.C.C. § 9-204(2)(a). When the debtor acquires rights in the collateral is, however, not the same question as whether the good is, in fact, collateral.

classification of a good as "lesser" or "principal" is often difficult, and because varying degrees of affixation are possible, it is not easy to determine the location of title. When determining whether the required integration has occurred, courts have traditionally considered the extent to which the lesser good is capable of being readily identified and easily detached from the principal good.¹⁷ Often the conclusion reached depends upon whether and to what extent a detachment will damage either good.¹⁸ Assuming sufficient integration, title to the whole vests

Although there appear to be no cases involving this issue, Professor Clark seems to suggest that a secured party's claim to livestock acquired by natural increase depends upon there being a reference to after-acquired livestock in the security agreement. B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* § 8.4, at 8-17 (1980). This view necessarily assumes that the Code has displaced the common law rule, an assumption far from evident. See Nickles, *supra*, at 117 n.14 (the Code was never meant to displace all common law doctrines); see also U.C.C. § 1-103 (unless displaced by the Code, common law principles should supplement Code provisions).

For purposes of clarity, this Article uses the civil law terms "accession" and "specification" to refer to the addition of the property or labor of another respectively. Accession refers to "the transfer of title which [takes] place when two chattels belonging to different persons [are] combined into a single article, as when A's cloth is used to patch B's coat." See Slater, *supra* note 14, at 598. Following the accession, the resulting product is "identified with but one of the preexisting articles," Arnold, *The Law of Accession of Personal Property*, 22 COLUM. L. REV. 103, 103 (1922) (emphasis in original), and "title to the resulting product goes to the owner of the principal goods," R. BROWN, *supra*, § 6.3, at 52. Specification, on the other hand,

comprehends the case of one who by his labor and skill, has created a new product out of another's article, as where marble is carved into a statue or cloth made into a dress. It is frequently referred to as accession by skill or labor. Here none of the original article is found, and a *nova species* is created.

Arnold, *supra*, at 103.

Because accession and specification are conceptually distinct, this Article considers each operation separately. An important similarity between the two doctrines, however, is that both operate only when the end product cannot be divided. It is for this reason that one party must receive title to the whole product. This all or nothing approach is a consequence of the fact that "the policy of the law favors absolute ownership in one when a partition is impossible, rather than a tenancy in common of undivided shares." Note, *Accession: Power of agent to acquire title by accession*, 22 CORNELL L.Q. 119, 123 (1936). Compare this reluctance with the judicial willingness to find just such a cotenancy when goods have been commingled. See *infra* notes 60 and 61 and accompanying text.

17. See, e.g., *Mossler Acceptance Co. v. Norton Tire Co.*, 70 So. 2d 360, 361 (Fla. 1954); *Goodrich Silvertown Stores v. Caesar*, 214 N.C. 85, 87-88, 197 S.E. 698, 700 (1938); *Frankling Serv. Stations v. Sterling Motor Truck Co.*, 50 R.I. 336, 337-39, 147 A. 754, 755-56 (1929); *Clark v. Wells*, 45 Vt. 4, 7 (1872).

18. See, e.g., *Franklin Serv. Stations v. Sterling Motor Truck Co.*, 50 R.I. 336, 338-39, 147 A. 754, 755-56 (1929); *Clark v. Wells*, 45 Vt. 4, 7 (1872). For an

in the party having title to the principal good regardless of the circumstances surrounding the affixation.¹⁹

Prior to the Code, the doctrine of accession also operated in the arena of secured transactions where it could enlarge or impair a secured party's interest.²⁰ Two basic scenarios presented themselves, distinguishable according to the identity of the competing claimants, but each involving a claim to the accessorial good by a secured party with an original interest in the principal good. One type of situation involved a debtor who affixed his or her own property to the secured party's collateral. In such a case, if the attached property became an integral part of the original collateral, it too was subject to the secured party's lien.²¹ A more common situation, however, was when the competing claimant to the accessorial good was not the debtor, but rather the seller of the accessorial good who had retained an interest to secure its purchase price.²² In such a situation, while the rules theoretically remained the same, the result somehow changed. What was a sufficient integration vis-a-vis the debtor was, for some unknown reason, an insufficient integration when the disputants were two secured parties.²³

The focus of many of these early decisions arguably was

in-depth analysis of the various tests employed to determine whether a sufficient integration has occurred, see Nickles, *supra* note 16, at 118-36.

19. It would seem, therefore, "that if A steals B's paint, and with it paints A's automobile, both the automobile and the paint will belong to A." R. BROWN, *supra* note 16, § 6.3, at 52.

20. Although the doctrine is grounded in the concept of title, its application did not seem to depend on whether a secured party was said to have "title" to or a "lien" on the principal good. See Nickles, *supra* note 16, at 116 n.12.

21. See, e.g., Peoples Loan & Inv. Co. v. Whittle, 205 Ark. 35, 36-37, 166 S.W.2d 1013, 1013-14 (1942); Purnell v. Fooks, 32 Del. 336, 338-39, 122 A. 901, 901-02 (1923); Auto Owner's Fin. Co. v. Evers, 94 N.H. 180, 183, 49 A.2d 507, 509-10 (1946); Blackwood Tire & Vulcanizing Co. v. Auto Storage Co., 133 Tenn. 515, 517-21, 182 S.W. 576, 576-77 (1915).

22. The interest retained was usually title. Prior to the Code, there existed numerous personal property security devices, the use of each dependent on the transaction involved. The conditional sale was used primarily by sellers to secure all or a portion of a good's purchase price. Conceptually, it was said that the seller retained title to the good until the purchase price had been paid in full. This and other pre-Code security devices are treated at length in 1 G. GILMORE, *supra* note 10, §§ 1.1-8.8, at 3-286.

23. See, e.g., Mossler Acceptance Co. v. Norton Tire Co., 70 So. 2d 360, 361-62 (Fla. 1954); Passieu v. B.F. Goodrich Co., 58 Ga. App. 691, 692-93, 199 S.E. 775, 776-77 (1938); Goodrich Silvertown Stores v. Pratt Motor Co., 198 Minn. 259, 261-63, 269 N.W. 464, 465-66 (1936); Havas Used Cars, Inc. v. Lundy, 70 Nev. 539, 541-42, 276 P.2d 727, 728 (1954); Turner v. Superior Tire Serv., 9 Tenn. App. 597, 600-01 (1929).

misplaced, because the issue of whether an accessorial good becomes an accession should in no way hinge on the parties' identity. A person other than the debtor claiming a security interest in accessorial goods is irrelevant to the issue of whether or not the goods have physically or functionally become an integral part of the principal good.²⁴ To conclude "that the tires and tubes become an integral part of the truck, as between the owner and the holder of the contract retaining title to the truck, and that they do not become an integral part of it as to the seller of the . . . tires and tubes"²⁵ was recognized by one court as, perhaps, not "entirely logical."²⁶

Today, the pre-Code accession doctrine continues to influence the law of secured transactions, being only partially supplanted by the Code. The Code section that usually comes to mind when discussing accessions is section 9-314.²⁷ That section

24. Nickles, *supra* note 16, at 127.

25. *Passieu v. B.F. Goodrich Co.*, 58 Ga. App. 691, 692, 199 S.E. 775, 777 (1938).

26. *Id.* Professor Nickles suggests that such inconsistent results may have been a by-product of the pre-Code rule that a secured party's interest can only attach to and cannot exceed the debtor's interest in the collateral. See Nickles, *supra* note 16, at 128-33. Under such a rule, "the interest acquired by a prior encumbrancer in after-acquired property was generally subject to the same limitations and restrictions under which the debtor got the property." *Id.* at 128. Although this observation may in part explain the results of the pre-Code accession cases, it cannot justify them because the doctrine of accession is antithetical to the notion of a derivative rights doctrine. The latter has the effect of preserving pre-existing property interests whereas the former disrupts those interests. A more satisfying explanation is that courts were trying to reach what they perceived to be an equitable result, recognizing that the concept of sufficient integration is a malleable one. That the sufficiency of integration must depend, at least in part, on "equity, good conscience and other considerations of public policy" was recognized in *Passieu v. B.F. Goodrich Co.*, 58 Ga. App. 691, 692, 199 S.E. 775, 777 (1938).

In any event, when deciding whether an affixed good is an accession, the relevant focus is not on the status of the parties but on the sufficiency of integration—if the affixed good cannot be easily identified and readily detached with a minimum of damage to both goods, it is an accession. See *Mixon v. Georgia Bank*, 154 Ga. App. 32, 32, 267 S.E.2d 483, 484 (1980) (rejecting the view that the relationship between the parties controls the accession issue in favor of an approach that examines "the relationship that [a] chattel bears to another"); see also Nickles, *supra* note 16, at 134 (the decision under Article 9 whether goods are accessions "should not be influenced by pre-Code cases involving a third party with an interest in the goods and thus holding inapplicable the doctrine of accession").

27. Note that this section only states "when a secured party claiming an interest in goods installed in or affixed to other goods is entitled to priority over a party with a security interest in the whole." U.C.C. § 9-314 comment. It offers no guidance on whether a good is, in fact, an accession. Whether an affixed good is an accession is often a threshold question under § 9-314, and, as

alters the pre-Code "winner take all" approach by giving a party with a security interest in a good that becomes an accession the opportunity to retain priority with respect to that good over a party with an interest in the whole.²⁸ Further, the party with a security interest in the accession is given the right to remove it from the principal good upon the debtor's default.²⁹ This approach unfortunately effects at least a partial destruction of the economic integrity of the principal good. It is not surprising, therefore, that the drafters took an alternative approach to the problem of accessions in section 9-315—one that preserves the economic integrity of the end product while protecting the competing parties' interests.³⁰

B. SPECIFICATION

Specification occurs when a new article is made out of one person's chattel through the skill and labor of another, as when A's leather is made into shoes by B, or X's grapes are made into wine by Y.³¹ Because this doctrine involves the addition of another's labor and skill, the issue under property law of who possesses title to the end product depends not, as in the case of a purported accession, on the sufficiency of integration, but rather on whether a *nova species* has been created.³² If the

developed *infra* notes 117-121 and accompanying text, under § 9-315 as well. To make these determinations, one must resort to the common law of accession.

28. See U.C.C. § 9-314(1)-(3).

29. See U.C.C. § 9-314(4). The accessions secured party must reimburse the party with an interest in the whole for any physical damage caused by the removal. *Id.*

30. See *infra* notes 117-121 and accompanying text.

31. See R. BROWN, *supra* note 16, § 6.2, at 50-51.

32. See *id.*; Arnold, *supra* note 16, at 105; Cross, *Another Look at Accession*, 22 Miss. L.J. 138, 138 (1951); Slater, *supra* note 14, at 597-98. In a suit brought by the original owner against the specifier, however, a "location of title" determination is not always necessary. It would not be required, for example, if the purpose of the suit is to recover conversion damages rather than to recapture the good. Instead, the decision to be made is how to apportion the present value of the good. In such a case, present value would consist of original value, plus the value of the specifier's labors, plus any synergistic increase caused by the combination of these two value components.

Although much depends upon the equities of the particular case, see Arnold, *supra* note 16, at 104, two general methods of apportioning present value seem to have emerged in such conversion actions. If the original appropriation was in good faith, damages are limited to the good's original value. See, e.g., *Chamberlain v. Collinson*, 45 Iowa 429, 434 (1877); *Hinman v. Heyderstadt*, 32 Minn. 250, 252, 20 N.W. 155, 156 (1884); *Lamoreaux v. Randall*, 53 N.D. 697, 703, 208 N.W. 104, 106 (1926); *Forsyth v. Wells*, 41 Pa. 291, 296-97 (1861). *But see* *Robertson v. Jones*, 71 Ill. 405, 407 (1874). If the appropriation can be char-

specificator has succeeded in creating a new species of good, the original owner's interest terminates; if not, the owner of the original goods retains title to the end product.³³ Although the doctrine is easily stated, its application often requires the skills of a metaphysician, for the determination of whether a certain chemical transformation or physical change has been sufficient to shift title to the specificator is fact-specific and inherently subjective.³⁴ As one court succinctly noted, "[the authorities] have not agreed upon any rule by which it can in all cases be ascertained whether this transformation has or has not taken place."³⁵ It is, therefore, not surprising to discover that the reported cases paint a picture of "uncertainty, confusion and inconsistency."³⁶

acterized as culpable, however, recovery is allowed up to the value of the good in its improved condition. *See, e.g.,* Sunnyside Coal & Coke Co. v. Reitz, 14 Ind. App. 478, 485, 39 N.E. 541, 543 (1895); State v. Shevlin-Carpenter Co., 62 Minn. 99, 102, 64 N.W. 81, 84 (1895); King v. Merriman, 38 Minn. 47, 54, 35 N.W. 570, 572 (1887); Barnes v. Moore, 199 Va. 227, 232, 98 S.E.2d 683, 686 (1957).

33. Often relevant to the doctrine's applicability is the specificator's good faith. As one court has observed, a "wilful wrongdoer acquires no property in the goods of another, either by the wrongful taking or by any change wrought in them by his labor or skill, however great that change may be." *Silbury v. McCoon*, 3 N.Y. 379, 387 (1850); *see also* *Eaton v. Langley*, 65 Ark. 448, 458-59, 47 S.W. 123, 127 (1898) (considering whether one who converted timber into cross ties acted in good faith); *McKinnis v. Little Rock, M.R. & T. Ry.*, 44 Ark. 210, 211 (1884) ("a willful trespasser . . . who converts timber into cross ties, posts or rails, is not permitted to acquire a right to, or interest in, the material he has devoted his labor upon"); *Potter v. Mardre*, 74 N.C. 36, 40 (1876) ("property changed by a change made in its species or substantial form, if made by one who was acting in good faith and under an honest belief that the title was in him"); *Brown v. Sax*, 7 Cow. 95, 96-97 (N.Y. 1826) ("[t]he rule, in case of a wrongful taking, is that the taker cannot, by any act of his own, acquire title").

34. *See* *Arnold*, *supra* note 16, at 105 ("It should be noted that while every change of species would result in a change of physical identity, not every loss of physical identity would create a new species.").

35. *Eaton v. Langley*, 65 Ark. 448, 452, 47 S.W. 123, 124 (1898). For example, compare *Potter v. Mardre*, 74 N.C. 36, 40 (1876) ("The property is changed by a change made in its species or substantial form . . .") with *Lampton's Ex'rs v. Preston's Ex'rs*, 24 Ky. (1 J.J. Marsh.) 455, 460 (1829) ("[N]o change of *mere form* could divest the right of the owner of the material, as leather made into shoes, cloth into a coat, timber into plank, blocks or shingles; in all which cases the material is *not altered in its qualities or kind*, and can be easily identified.") (emphasis in original).

36. *Cross*, *supra* note 32, at 139. *See, e.g.,* *Riddle v. Driver*, 12 Ala. 590, 591-92 (1847) (wood transformed into charcoal is same species of good); *Eaton v. Langley*, 65 Ark. 448, 455, 47 S.W. 123, 125-26 (1898) (timber transformed into cross ties is same species of good); *Burris v. Johnson*, 24 Ky. (1 J.J. Marsh.) 196, 197-98 (1829) (timber transformed into a boat frame is same species of good); *Lampton's Ex'rs v. Preston's Ex'rs*, 24 Ky. (1 J.J. Marsh.) 454,

Further complicating matters, some courts have decided specification cases by using the theory of relative or comparative value.³⁷ This approach involves comparing the value of the original good to that of the altered good. If the value added is great enough, a new species is recognized. When employed, however, this approach is also plagued by uncertainty, for courts disagree on how much added value is "enough."³⁸ The cases lead inexorably to the conclusion that "the theory of relative value is as arbitrary and unsatisfactory as is reliance upon the factors of chemical transformation and physical change."³⁹

467 (1829) (clay transformed into fired brick is a new species of good, but clay transformed into unfired brick is the same species of good); *Potter v. Mardre*, 74 N.C. 36, 42 (1876) (timber transformed into canoe is a new species of good).

Such differences in result, although perhaps not justifiable, may be better understood by examining the historical roots of the specification doctrine. Like that of accession, *see supra* note 16, the doctrine of specification originated in Roman law, and its common law evolution has been influenced by civil law notions of property rights. There is a distinction made under the civil law, however, that has not been accepted wholesale by common law courts. Under Roman law, if the specifier transformed the original good into a new item with different physical properties than the original, title to the good vested with the specifier. If, however, merely the size or shape of the original good were altered, the owner of the original good retained title to the end product. *See R. BROWN, supra* note 16, § 6.2, at 50. This distinction apparently has not been rigorously maintained in the common law. As Professor Brown has noted:

[the Roman] doctrine . . . is artificial and unconcerned with an ethical determination of the problem it purports to solve. It is arbitrary and unjust to hold that he who makes wine from another's grapes acquires title to the resulting product, while he who carves a work of art from another's stone does not. From the standpoint of justice the law cannot ignore the proportion in which the materials of one and the labor of another contribute to the value of the result product.

Id.

Because of these types of concerns, common law courts have looked more kindly than civil law courts on the innocent specifier who effects only a change in the size and shape of the original goods. *See, e.g., Wetherbee v. Green*, 22 Mich. 311, 320 (1871) (innocent trespasser who converted lumber into barrel hoops acquired title to the new goods). The extent to which this view has supplanted the Roman law distinction is unclear, because notions of fault, *see supra* note 33, and comparative value, *see infra* note 38 and accompanying text, often play a major role in specification cases. *See generally R. BROWN, supra* note 16, § 6.2, at 50-53 (modern specification doctrine is "arbitrary and uncertain").

37. *See cases cited infra* note 38.

38. *See, e.g., Eaton v. Langley*, 65 Ark. 448, 457, 47 S.W. 123, 126-27 (1898) (increment of six times original value held insufficient); *Wetherbee v. Green*, 22 Mich. 311, 320 (1871) (increment of twenty-eight times original value held sufficient); *Louis Werner Stove Co. v. Pickering*, 55 Tex. Civ. App. 632, 635-36, 119 S.W. 333, 334-35 (1909) (increment of three times original value held sufficient).

39. *Cross, supra* note 32, at 145.

The impact of the specification doctrine on the pre-Code rights of secured parties is not altogether clear. In many early opinions, courts appear to be grappling with the problem of how to apply the doctrine to a secured credit system grounded on distinct policy concerns. This resulted in a body of case law in which many decisions were controlled by factors somewhat unrelated to traditional specification doctrine.⁴⁰

It would seem that the doctrine would be relevant in a wide variety of cases where work is performed on collateral—for example, the manufacturing of an item from materials subject to a lien. In such a situation, the question whether the secured party's interest will continue in the new product and embrace the increased value derived from the labor of the mortgagor would seem to require a specification analysis. Although not explicitly using the term "specification," a number of courts faced with such situations have used language indicating the need for the same type of *nova species* inquiry used in specification cases not involving security interests.⁴¹ For example, the court in *Netzorg v. National Supply Co.*⁴² observed:

It is not to be doubted that a mortgage placed upon some one article, will cover that article as subsequently changed, *provided the integrity of the article remains*. Precisely as with a mortgage upon a house and lot, where the mortgage will remain a lien upon the house although painted and improved during the time of the existence of the mortgage and before it is foreclosed.⁴³

Many of the early opinions justified such a *nova species* inquiry by focusing on the nature of the secured credit system itself. One such justification was to preserve the pre-Code filing system as a source of information regarding a secured party's claim.⁴⁴ If the filed description of the collateral was no longer

40. See *infra* notes 41-47 and accompanying text.

41. See, e.g., *Comins v. Newton*, 92 Mass. (10 Allen) 518, 518 (1865); *Crosby v. Baker*, 88 Mass. (6 Allen) 295, 298 (1863); *Harding v. Coburn*, 53 Mass. (12 Met.) 333, 342-43 (1847).

42. 28 Ohio C.C. Dec. 112 (1905).

43. *Id.* at 118 (emphasis added).

44. See, e.g., *Perry v. Pettingill*, 33 N.H. 433, 436 (1856). The *Perry* court, after deciding that, as against the mortgagor, the mortgagee's security interest continues regardless of how the good changes, stated:

In case materials were mortgaged by a particular description, and with the assent of the mortgagee were manufactured into articles not answering to that description, and so changed that with reasonable diligence a creditor could not know that they were the same, if he should, without actual notice of the claim under the mortgage, attach them for the debt of the mortgagor, it would deserve serious attention whether, under our statute requiring mortgages of personal property

descriptive of the new good, the filing would no longer be performing its assigned function. Another apparent rationale was the resistance of common law courts to recognize the ability to grant *in praesenti* a lien on property not then owned.⁴⁵ If the new good were a different species from the original, it would theoretically follow that it was not in existence when the security interest was first given. In many jurisdictions, it would, therefore, be an "after-acquired" good not subject to the lien of the secured party without the execution of a supplemental mortgage.⁴⁶

A final concern in pre-Code specification cases, most evident when the original security interest was in raw materials, was whether the parties had actually intended the security interest to encompass the finished product. Since the source of the secured party's interest was contractual, it was appropriate to determine the terms of the contract. In the absence of language in the mortgage clearly indicating an intent to include the finished product or transformed good, courts, by focusing on the degree of change, would have been doing no more than establishing a framework for determining and protecting the expectations of the parties.⁴⁷

to be registered, the mortgagee could hold against the attaching creditor.

Id.; see also *Dehority v. Paxson*, 97 Ind. 253, 259 (1884) ("such furniture was sufficiently described by the terms of the mortgage"); *Comins v. Newton*, 92 Mass. (10 Allen) 518, 519 (1865) ("changes thus made did not so far destroy its identity as to make it substantially incapable of identification").

45. For a discussion of security interests in after-acquired property, see 1 G. GILMORE, *supra* note 10, §§ 2.3-2.5, at 27-47; Cohen & Gerber, *The After-Acquired Property Clause*, 87 U. PA. L. REV. 635 (1939).

46. One escape from limitations placed upon the "after-acquired property" clause was the doctrine of "potential existence." It would permit "the sale or encumbrance of future personal property having a so-called potential existence arising from the fact that the processes of creation have already begun, with the limitation that the basic substance which yields the increment must be owned by the vendor or mortgagor." Cohen and Gerber, *supra* note 45, at 635-36. This doctrine was probably the cause of the court's conclusion in *Ex parte Ames*, 1 Fed. Cas. 746, 749 (D. Mass. 1871) (No. 323), that "[i]f any locomotives were in course of manufacture when the mortgage was given, the additions to them would pass by accretion . . . even if the materials were not included in the mortgage But . . . a mere mortgage of materials would not convey new articles made out of those materials." For two cases holding that the improved good was not after-acquired, see *Dehority v. Paxson*, 97 Ind. 253, 259 (1884) and *Putnam v. Cushing*, 76 Mass. (10 Gray) 334, 335-36 (1858).

47. For example, because of language in the mortgage explicitly including the product of collateral, the court in *Dunning v. Stearns*, 9 Barb. 630 (N.Y. App. Div. 1850) had no difficulty finding that

[i]t was clearly the intention of the parties to the agreement to create

Although the exact role specification played in the pre-Code law of secured transactions is thus unclear, the situations ostensibly covered by the doctrine now lie within the domain of section 9-315. To some degree the law has been clarified, but as will be seen,⁴⁸ important problems persist.

C. CONFUSION

A third doctrine, historically and functionally related to accession and specification, but distinct from either, is confusion.⁴⁹ A confusion of goods occurs whenever "there has been such an inter-mixture of goods owned by different persons, that the property of each can no longer be distinguished."⁵⁰ Confusion can occur in two ways. Similar types of goods belonging to different persons can be commingled, resulting in a confused *mass*, as when A's wheat is mixed with the same type of wheat belonging to B.⁵¹ Another type of confusion occurs when different types of goods are commingled to form a confused *product*, as where X's eggs are mixed with Y's flour and Z's sugar to form a cake mix.

In the case of a confused mass, although each unit of the newly created mass can no longer be identified as belonging to a particular person,⁵² each retains its independent physical

a lien, as well upon the potash to be manufactured as upon the articles out of which it should be made It was an agreement to hypothecate the products of the particular property pledged, and the lien would attach upon the new article as fast as it came into existence.

Id. at 633-34; see also *Dehority v. Paxson*, 97 Ind. 253, 259 (1884) ("It was a mortgage . . . with a sufficient manifestation . . . that it should hold the manufactured articles"); *Frank v. Playter*, 73 Mo. 672, 674 (1881) ("This mortgage covered all spelter made after said date from ore then on hand").

48. See *infra* notes 134-163 and 184-197 and accompanying text.

49. The doctrine of confusion also dates from the days of Justinian. Unlike the common law, however, the civil law has always maintained a distinction between a confusion of things liquid and those not liquid, referring to the former as *confusio* and the latter as *commixtio*. See Arnold, *Confusion*, 23 COLUM. L. REV. 235, 235-36 (1923).

50. R. BROWN, *supra* note 16, § 6.8, at 62 (citing *Hesseltine v. Stockwell*, 30 Me. 237 (1849)).

51. A confused mass may be composed of fungible or non-fungible goods. For example, if A's wheat were of different color and quality than B's, commingling would result in a confused mass of non-fungible goods. Such subtle distinctions can be important when determining A or B's title to the wheat. See *infra* notes 52-64 and accompanying text.

52. If this were not the case, there would be no confusion. Thus, not every intermixture of goods will result in confusion. There will be no confusion

identity. This differs from accession and specification since those doctrines require, to some extent, a change in or loss of a good's independent existence. It is essentially this difference that accounts for what is often a different approach to the question of title. When similar goods have been commingled, the resultant mass is usually capable of physical division and distribution to each of the contributing owners, whereas in the case of specification and accession, the physical integrity of the end good precludes its division. Thus, although an all-or-nothing title approach is preferable in the latter situation, it can be and often is avoided in the former.

Because a confusion of goods will occur only when the constituent parts can no longer be identified as belonging to a particular person, it would naturally follow that the goods involved are usually fungible, and of equal quality and value.⁵³ In that case, if the relative contribution of each owner is known, there is no reason why each should not be entitled to an aliquot part. Accordingly, each contributor will be allowed to retain title to his or her proportionate share regardless of fault.⁵⁴

as long as the property of the respective owners can be identified and returned. . . . Each owner retains his right and title to his separate goods, and the only task is the mechanical one of ascertaining and separating them. . . . There is no confusion if those who are familiar with the property in question can identify and separate the goods of the respective owners.

R. BROWN, *supra* note 16, § 6.8, at 62; *see also* Banque de France v. Chase Nat'l Bank, 60 F.2d 703, 706 (2d Cir. 1932) ("where it is possible to distinguish the goods by their appearance or by their marks, there is no confusion"); Finance Co. v. Lowry, 36 Ga. App. 337, 339, 136 S.E. 475, 476 (1927) ("There was no confusion here of the goods themselves, since they consisted of separate and distinct articles."); Smith v. Armstrong, 118 Mont. 290, 297, 166 P.2d 793, 796 (1946) ("this doctrine has no application to horses or other property that can be readily identified"), *aff'd as modified*, 121 Mont. 377, 198 P.2d 795 (1948); Robinson v. Holt, 39 N.H. 557, 563 (1859) ("If the goods of several intermingled can be easily distinguished and separated, no change of property takes place, and each party may lay claim to his own.").

53. R. BROWN, *supra* note 16, § 6.8, at 62; *see supra* note 51.

54. Even where the confusion is the result of fraud or intentional wrongdoing by one of the parties, there will be no forfeiture if the relative contributions of each owner are known. This approach characterized the Supreme Court's opinion in *The Idaho*, 93 U.S. 575 (1876). The Court there said:

But all the authorities agree, that if a man wilfully and wrongfully mixes his own goods with those of another owner, so as to render them undistinguishable, he will not be entitled to his proportion, or any part, of the property. Certainly not, *unless the goods of both owners are of the same quality and value.*

Id. at 585-86 (emphasis added); *see also* Vest v. Bond Bros. 223 Ala. 552, 553, 137 So. 392, 393 (1931) ("if goods of the same kind and value are intermingled, so that the party not at fault may be protected by giving him an aliquot part of

A different result occurs if a proportionate separation of the goods is impossible. Such would be the case if the intermixture is "of goods of different kinds or qualities, or where the amounts contributed by the respective parties are unknown."⁵⁵ Because the contributors in such situations cannot be returned to the pre-confusion status quo, courts have generally decided title disputes by focusing on the cause of the confusion.⁵⁶ If the mixture is made by consent of the parties,⁵⁷ by natural causes,⁵⁸ or by a third party,⁵⁹ the owners become tenants in common of

the whole, this is the measure of his right"); *In re Assignment of Thompson*, 164 Iowa 20, 29, 145 N.W. 76, 80 (1914) ("there is no forfeiture in case of a fraudulent intermixture, when the goods intermixed are of equal value"); *Heseltine v. Stockwell*, 30 Me. 237, 242 (1849) (The admixture "might have been of such a character, the logs being of equal value, that the plaintiff would have been entitled to recover . . . such proportion . . . as the logs cut upon his land bore to the whole number."); *Page v. Jones*, 26 N.M. 195, 199, 190 P. 541, 542 (1920) ("harsh rules are not generally applied where the confused goods, though indistinguishable, are of equal and uniform value"); *Brown v. Bacon*, 63 Tex. 595, 599 (1885) ("No change of ownership will take place if the goods can be easily distinguished and separated . . ."); *Farrow v. Farrow*, 238 S.W.2d 255, 257 (Tex. Civ. App. 1951) ("if the goods are of the same nature and value and the portion of each owner is known . . . then each owner may claim his aliquot part"); *St. Paul Boom Co. v. Kemp*, 125 Wis. 138, 145-46, 103 N.W. 259, 261 (1905) ("To operate such a forfeiture it must appear that the lumber manufactured out of the respondent's and that of appellant with which it was mixed were so different in description, quality, and value that the whole mass could not be ratably apportioned . . .").

55. R. BROWN, *supra* note 16, § 6.11, at 66. The result of such a commingling would be either a confused product, a confused non-fungible mass, or a confused fungible mass with the amount of each party's contribution unknown.

56. One court observed that:

four cases may arise in which there may be a confusion of rights involved in the confusion of goods: (1) Where the mixture is made by consent of the parties. (2) Where it arises from the willfull or tortious conduct of one of the parties. (3) Where it is made by unintentional mistake. (4) Where it is the result of inevitable accident.

In re Thompson, 164 Iowa 20, 29, 145 N.W. 76, 79 (1914).

57. See, e.g., *Kinney v. Cullman County Farm Bureau*, 217 Ala. 569, 570, 117 So. 189, 190 (1928); *Drudge v. Leitner*, 18 Ind. App. 694, 695-96, 49 N.E. 34, 35 (1898); *In re Thompson*, 164 Iowa 20, 28-29, 145 N.W. 76, 79 (1914); *Jennings-Heywood Oil Syndicate v. Houssiere-Latuelle Oil Co.*, 127 La. 971, 996, 54 So. 318, 326 (1911); *Ayre v. Hixson*, 53 Or. 19, 33, 98 P. 515, 520 (1908); *Trustees of Ashland Lodge v. Williams*, 100 Wis. 223, 224, 75 N.W. 954, 955 (1898); *Edwards v. Willson*, 30 Wyo. 275, 281, 219 P. 233, 234 (1923).

58. See, e.g., *Hobbs v. Monarch Refrig. Co.*, 277 Ill. 326, 327-28, 115 N.E. 534, 534 (1917).

59. See, e.g., *Buckeye Cotton Oil Co. v. Taylor*, 186 Ark. 284, 287, 53 S.W.2d 428, 429 (1932); *Johnson v. Covey*, 1 Utah 2d 180, 181, 264 P.2d 283, 283 (1953); *Manti City Sav. Bank v. Peterson*, 33 Utah 209, 211-12, 93 P. 566, 566-67 (1908).

the product or mass,⁶⁰ and in the absence of contrary evidence, the shares of each will be equal.⁶¹ If, however, the confusion is caused by a party with wrongful or fraudulent intent, the wrongdoer will forfeit his or her interest in the mass or product, and title will vest exclusively in the innocent party.⁶² Where the commingling occurs through the simple negligence of one of the parties, most courts have declared the innocent party to be the owner of the whole;⁶³ others, however, have sought to preserve the negligent party's interest.⁶⁴

It thus appears that the "excellently named doctrine of confusion"⁶⁵ is not so much a matter of substantive law as it is a rule of evidence.⁶⁶ If there has been adequate proof of commin-

60. *See Trustees of Ashland Lodge v. Williams*, 100 Wis. 223, 226, 75 N.W. 954, 955 (1898). Where fungible goods are delivered to a warehouseman, this result is codified in U.C.C. § 7-207(2) which provides that "[f]ungible goods so commingled are owned in common by the persons entitled thereto."

61. *See, e.g., Van Liew v. Van Liew*, 36 N.J. Eq. 637, 642-43 (1883) ("Where two persons hold either real or personal estate in joint tenancy or in common, the presumption, in the absence of evidence to the contrary, is that they hold in equal shares or moieties.").

62. *See, e.g., The Idaho*, 93 U.S. 575, 586 (1876); *Hardy v. Hardy*, 235 F. Supp. 208, 211-12 (D.D.C. 1964); *Lightner Mining Co. v. Lane*, 161 Cal. 689, 708, 120 P. 771, 779 (1912); *Little Pittsburg Consol. Mining Co. v. Little Chief Consol. Mining Co.*, 11 Colo. 223, 230, 17 P. 760, 763 (1888); *Ontario Livestock Comm'n Co. v. Flynn*, 256 Iowa 116, 125-26, 126 N.W.2d 362, 368 (1964); *Allis Chalmers Mfg. Co. v. Security Elevator Co.*, 140 Kan. 580, 582, 38 P.2d 138, 140 (1934).

Interestingly, this is not the civil law approach. If the intermixture was wilfully made without mutual consent, then the civil law gave the whole to him who made the intermixture, and compelled him to make satisfaction in damages to the other party for what he had lost. The common law, with more policy and justice, to guard against fraud, gave the entire property, without any account, to him whose property was originally invaded, and its distinct character destroyed.

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63. *See, e.g., Peoples Nat'l Bank v. Mulholland*, 228 Mass. 152, 157, 117 N.E. 46, 48 (1917); *Ayre v. Hixson*, 53 Or. 19, 32, 98 P. 515, 519 (1908); *Weaver v. R.L. Neal & Co.*, 61 W. Va. 57, 61, 55 S.E. 909, 910 (1906).

64. *See, e.g., Clafin v. Continental Jersey Works*, 85 Ga. 27, 46, 11 S.E. 721, 723-24 (1890); *International Lumber Co. v. Bradley Timber Ry. & Supply Co.*, 132 Minn. 155, 158, 156 N.W. 274, 275 (1916). Many of these cases have been criticized for failing to enunciate a clear standard for determining how the respective interests are to be apportioned. *See R. BROWN, supra* note 16, § 6.12, at 70.

65. *See 2 G. GILMORE, supra* note 10, § 31.2, at 841.

66. *See Holloway Seed Co. v. City Nat'l Bank*, 92 Tex. 187, 191, 47 S.W. 95, 97, *modified*, 92 Tex. 194, 47 S.W. 516 (1898). There the court explained:

The rule as to the confusion of goods is merely a rule of evidence. The wrongful mingling of one's own goods with those of another, when the question of identification of the property arises, throws

gling, the burden of establishing the quantity and quality of the respective contributions will be on the party most responsible for the confusion. Only in the absence of such evidence will title to the entirety vest in the innocent party. Such an approach is attractive because it protects the innocent party only to the extent required.⁶⁷ Neither party receives an unnecessary windfall nor suffers an unnecessary loss.

This judicial bias against forfeiture is also apparent in early confusion cases in the secured transactions context. The majority of these cases deal with confused masses, created where property subject to a security interest had been confused with similar unencumbered property belonging to the debtor or a third party. As in the cases not involving security interests when division of the mass was possible, forfeiture was avoided if the party bearing the identification burden could prove the proportionate contributions of the competing claimants.⁶⁸ Which party bore this burden depended on the identity of the

upon the wrongdoer the burden of pointing out his own goods, and, if this cannot be done, he must bear the loss which results from it. It is but an application of the principle that all things are presumed against the spoliator; that is to say, against one who wrongfully destroys or suppresses evidence.

Id.

67. See *Brown v. Bacon*, 63 Tex. 595, 598 (1885) ("The doctrine of confusion is extended no further than necessity requires.").

68. For cases in which a confused mass was proportionately divided between a secured party and another claimant, see *Mahoney v. Citizen's Nat'l Bank*, 47 Idaho 24, 271 P. 935 (1928) (secured party v. secured party); *Clay, Robinson & Co. v. Larson*, 125 Minn. 271, 146 N.W. 1095 (1914) (secured party v. secured party); *D.M. Osborne & Co. v. Cargill Elevator Co.*, 62 Minn. 400, 64 N.W. 1135 (1895) (secured party v. debtor's vendee); *Horne v. Hanson*, 68 N.H. 201, 44 A. 292 (1895) (secured party v. debtor's vendee); *Colley v. H.L. Edwards & Co.*, 258 S.W. 191 (Tex. Civ. App. 1924) (secured party v. debtor's vendee); *Belcher v. Cassidy Bros. Live-Stock Comm'n Co.*, 26 Tex. Civ. App. 60, 62 S.W. 924 (1901) (secured party v. secured party); *Mittenthal v. Heigel*, 31 S.W. 87 (Tex. Civ. App. 1895) (secured party v. debtor's vendee).

There are several cases, however, where the entire confused mass was awarded to one of the claimants. Such forfeiture occasionally resulted when the party bearing the identification burden was unable to prove the value of his or her contribution to a fungible mass. See, e.g., *Kreth v. Rogers*, 101 N.C. 263, 272, 7 S.E. 682, 686 (1888). In other cases, the entire mass was awarded to one claimant without mention of whether a proportionate division was possible. Perhaps these cases would have been decided differently if division had been possible. See, e.g., *Allis Chalmers Mfg. Co. v. Security Elevator Co.*, 140 Kan. 580, 38 P.2d 138 (1934) (secured party v. debtor's vendee—mass awarded to secured party); *First Nat'l Bank v. Lindenstruth*, 79 Md. 136, 28 A. 807 (1894) (secured party v. lien creditor—mass awarded to lien creditor); *Williard v. Rice*, 52 Mass. (11 Met.) 493 (1846) (secured party v. debtor—mass awarded to secured party).

party opposing the secured party and the relative fault of each contributor.⁶⁹

The simplest case was one involving only a secured party and the debtor and a mingling of the secured property with similar property belonging to the latter.⁷⁰ As one might expect, the courts placed the identification burden on the debtor.⁷¹ For example, in *Allis Chalmers Manufacturing Co. v. Security Elevator Co.*,⁷² the court recognized:

It would be manifestly unfair to hold that a farmer might free the wheat [he raised] of a lien held by a third party by mingling it with wheat on which there was no lien. If this were held to be the rule, then an unscrupulous debtor would never have his goods so that a chattel mortgage could be made effective. The corollary of this would be that no one would lend money on chattels which could be easily confused with other goods.⁷³

The results were less certain when the claimant opposing the secured party was not the commingling debtor. In most cases, such a claimant fell into one of two general categories.⁷⁴ The first category consisted of parties claiming a pre-confusion interest in property not originally subject to the secured party's

69. The term "fault" as used herein should not be read as including only active wrongdoing. It is also meant to include any breach of contract and nonfeasance by one with knowledge of the commingling and the power to stop it.

70. Such cases were often the necessary consequence of the pre-Code antipathy to after-acquired property clauses. See *supra* notes 45-46 and accompanying text. If the original collateral was inventory, it would inevitably be commingled with later-acquired inventory not, at first, subject to the secured party's lien. Consequently, it was impossible for the secured party to identify the mortgaged stock. For cases involving this fact pattern when the party opposing the secured party is or is not the debtor, see *In re Thompson*, 164 Iowa 20, 145 N.W. 76 (1914) (secured party v. assignee for the benefit of creditors); *Rosenberg v. Thompson*, 8 S.W. 895 (Ky. Ct. App. 1888) (secured party v. assignee for the benefit of creditors); *First Nat'l Bank v. Lindenstruth*, 79 Md. 136, 28 A. 807 (1894) (secured party v. lien creditor); *Wellock v. Cowan*, 246 Mich. 45, 224 N.W. 413 (1929) (secured party v. debtor).

71. See, e.g., *Wilson v. Windham*, 213 Ala. 31, 32, 104 So. 232, 233 (1925); *Gibson v. McIntire*, 110 Iowa 417, 421-22, 81 N.W. 699, 701 (1900); *Wellock v. Cowan*, 246 Mich. 45, 48, 224 N.W. 413, 414-15 (1929).

72. 140 Kan. 580, 38 P.2d 138 (1934).

73. *Id.* at 581, 38 P.2d at 139. An interesting variation of the usual secured party v. debtor case would occur if the mingling were done by a secured party to whom goods had been pledged. In that case, the debtor should be entitled to recover the mass unless the secured party could identify his or her own goods.

74. A debtor's vendee who subsequently mingles his or her own property with the mortgaged property fits neither category. The burden of identification is usually on the vendee in such a case. See, e.g., *Fuller v. Paige*, 26 Ill. 358, 360 (1861); *Gibson v. McIntire*, 110 Iowa 417, 422, 81 N.W. 699, 701 (1900).

lien.⁷⁵ Although the courts did not always attribute the same significance to the same facts,⁷⁶ they did, in these cases, consistently direct their attention to the question of fault. Unless the parties were equally innocent, the burden of identification, and therefore the risk of forfeiture, was placed on the more blameworthy claimant.⁷⁷

The second category of non-debtor claimants consisted of parties who claimed a post-confusion interest in the entire mass.⁷⁸ When this type of claimant was involved, the results were inconsistent. When allocating the burden of identification, some courts thought fault significant⁷⁹ whereas others did

75. This first category would consist of third party owners of goods mingled with the mortgaged goods, as well as other secured parties with liens on separate, but similar, property of the debtor that subsequently becomes mingled with the property subject to the first lien.

76. In *Kreth v. Rogers*, 101 N.C. 263, 272, 7 S.E. 682, 686 (1888), a case involving the commingling of goods subject to separate liens, the burden of identification was placed on the secured party who was later in time because that party was on notice of the prior lien and of the possibility that the collateral would be commingled. A different approach, however, was taken in *Belcher v. Cassidy Bros. Live-Stock Comm'n Co.*, 26 Tex. Civ. App. 60, 64, 62 S.W. 924, 926 (1901). There the court concluded that "the mortgagees here are equally innocent of intentional wrong, and neither should be given advantage in equity over the other." *Id.* at 64, 62 S.W. at 926. No mention was made of the fact that the second secured party had at least constructive notice of the first lien. One possible explanation for the court's willingness to treat the two parties equally is that their proportionate interests in the mass were easily ascertainable and no real significance would attach to a particular allocation of the burden of identification. *See id.* at 64-65, 62 S.W. at 926.

77. *See, e.g., Loupee v. Michigan Cent. R.R. Co.*, 243 Mich. 144, 150-51, 219 N.W. 727, 729 (1928) (burden on third party owner because aware of commingling); *Clay, Robinson & Co. v. Larson*, 125 Minn. 271, 274, 146 N.W. 1095, 1097 (1914) (secured parties equally innocent so neither received an advantage over the other); *Kreth v. Rogers*, 101 N.C. 263, 272, 7 S.E. 682, 686 (1888) (burden on secured party who was second in time because that party was on notice of first lien); *Wells v. Batts*, 112 N.C. 283, 291-92, 17 S.E. 417, 419 (1893) (burden on third party owner because aware of commingling); *Belcher v. Cassidy Bros. Live-Stock Comm'n Co.*, 26 Tex. Civ. App. 60, 64, 62 S.W. 924, 926 (1901) (secured parties equally innocent so neither received an advantage over the other). A similar policy decision to provide equal treatment to equally innocent parties can be found in U.C.C. § 7-207, which provides that when there has been an overissuance of warehouse receipts the loss is shared by all the owners in common.

78. This second category would consist of parties who purchased the confused mass from the debtor, as well as creditors of the debtor who assert an interest in the whole.

79. *See, e.g., In re Thompson*, 164 Iowa 20, 30, 145 N.W. 76, 80 (1914) (secured party v. assignee for the benefit of creditors—burden on secured party because aware of commingling); *Allis Chalmers Mfg. Co. v. Security Elevator Co.*, 140 Kan. 580, 581-83, 38 P.2d 138, 139-40 (1934) (secured party v. debtor's vendee—because secured party was without notice of commingling and vendee

not.⁸⁰ Finally, there are some cases in which the identification issue was completely ignored because the relative shares of each party could be easily ascertained.⁸¹

As the foregoing illustrates, the pre-Code status of secured parties with interests in goods whose identity was lost through commingling was uncertain. Much depended upon the facts of the particular case. Because of this, a secured party with an interest in collateral capable of being confused with similar property always ran the risk of losing priority when it was most needed. This was a risk the drafters of the Code sought to minimize in section 9-315.

II. THE DRAFTING HISTORY OF SECTION 9-315

The history of Article 9 leaves little doubt that its drafters recognized that no statute regulating security interests in personal property could be considered comprehensive without addressing those situations within the purview of the doctrines of accession, specification, and confusion. As early as the 1948 draft of the Code, that recognition prompted a slow process of evolution ending, at least temporarily, with what is now section 9-315. "Intermingling and Processing of Inventory Subject to Lien," section 315 of that early draft, provided:

(1) When identification or segregation of inventory subject to an inventory lien disappears by commingling processing or otherwise with the acquiescence of the financier, the lien is lost.

(2) When identification or segregation disappears without acquiescence of the financier, the financier loses the specific inventory lien but is entitled to a general inventory lien on the resulting mass to the extent the rights under any other perfected general inventory lien

was on notice of lien, vendee lost; the court did not indicate whether vendee could avoid forfeiture by identifying secured party's interest in the mass); *Rosenberg v. Thompson*, 8 S.W. 895, 896 (Ky. 1888) (secured party v. assignee for the benefit of creditors—burden on secured party because aware of commingling); *Ayre v. Hixson*, 53 Or. 19, 29, 98 P. 515, 518 (1908) (secured party v. debtor's vendee—burden on vendee because on notice of lien).

80. *See, e.g., Thomas Roberts & Co. v. Robinson*, 141 Md. 37, 54, 118 A. 198, 204 (1922) (secured party v. commission merchant with lien—secured party lost; the court did not indicate whether the secured party could have avoided forfeiture by identifying each party's interest); *D.M. Osborne & Co. v. Cargill Elevator Co.*, 62 Minn. 400, 402, 64 N.W. 1135, 1136 (1895) (secured party v. debtor's vendee—secured party lost. The court did not indicate whether the secured party could have avoided forfeiture by identifying each party's interest).

81. *See, e.g., Horne v. Hansen*, 68 N.H. 201, 203, 44 A. 292, 293 (1894) (secured party v. debtor's vendee); *Colley v. H.L. Edwards & Co.*, 258 S.W. 191, 191-92 (Tex. Civ. App. 1924) (secured party v. debtor's vendee); *Mittenthal v. Heigel*, 31 S.W. 87, 87 (Tex. Civ. App. 1895) (secured party v. debtor's vendee).

are not affected.⁸²

Several aspects of this section merit brief mention. First, the continuation of a secured party's lien depends on that party's own behavior. The section is thus grounded in fault and reminiscent of the pre-Code law of confusion in many jurisdictions. Unlike that law, however, this section attaches no relevance to the identity or comparative fault of the competing claimant.⁸³

Another aspect of note is that no provision is made for partitioning a confused mass if the extent of the secured party's interest can be determined. Finally, although subsection (2) is somewhat ambiguous, it apparently contains a priority statement. The lien of the secured party will always be subordinate to any competing security interest in the mass, no mention is made of a product, that is not dependent for its existence on section 315.

A further measure of protection for a secured party was added in the September 1949 version of the Code. A new subsection (1) was incorporated into what was to become section 8-410, creating an exception to the general rule that a secured party's acquiescence in the collateral's loss of identity results in a loss of lien.⁸⁴ It provided that "[w]hen goods subject to a security interest become part of a fungible mass, the security in-

82. U.C.C. § 315 (Tent. Draft No. 2, Article VII, Aug. 6, 1948).

83. One possible explanation for this one-sided focus is that the drafters were still having difficulty shedding the effects of the landmark case of *Benedict v. Ratner*, 268 U.S. 353 (1925). There the Supreme Court held that "a transfer of property which reserves to the transferor the right to dispose of the same, or to apply the proceeds thereof, for his own uses is, as to creditors, fraudulent in law and void." *Id.* at 360. Although the case was decided under New York law and involved accounts receivable financing, other courts readily accepted it as a rule of general applicability. See, e.g., *McCance v. D.A. Schulte, Inc.*, 91 F.2d 733, 735 (2d Cir.), *cert. denied*, 302 U.S. 744 (1937). The drafters of Article 9 took a contrary position in § 9-205, which provides that "[a] security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral." Although formally rejecting the rule of *Benedict*, the drafters nevertheless may have wanted to encourage creditors to monitor their debtors' activities. U.C.C. § 315 (Art. VII, 1948 draft) would certainly have had that effect. For a relatively recent discussion of *Benedict*, see Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605, 621-27 (1981). It will no doubt surprise some to read Professor Gilmore's conclusion that "the substance of the rule in *Benedict* should have been preserved." *Id.* at 627.

84. The drafters provided some idea of what they meant by "acquiescence" in the second comment to § 8-410, which states "[a] lender's 'acquiescence' may be by affirmative act or may be inferred from the nature of the transaction (as in the case of inventory held for processing) or from his knowledge of a continuing course of conduct by a borrower, despite contrary provi-

terest continues on an undivided share of the mass."⁸⁵ Although no reason was given for this exception, the most likely explanation was simply that it would often be unreasonable to require the debtor to segregate those fungible goods that are subject to a particular security interest from those which are not. If not segregated, then a loss of identity is inevitable. Without an exception to the general acquiescence rule, it would be unlikely that any creditor would be willing to accept a security interest in only a portion of a debtor's fungible goods.⁸⁶ Arguably, the most important feature of section 8-410(1), however, was the absence of any attempt by the drafters to improve the secured party's pre-Code status. Upon the debtor's default, the creditor would only be entitled to claim a "share" of the mass. This anti-forfeiture point of view echoes pre-Code practice.

Section 8-410 was short-lived, being replaced by section 8-314 of the October 1949 draft.⁸⁷ This section contained a major change from the previous drafts. Although a secured party's acquiescence remained a relevant consideration, it did not necessarily preclude the lien's continuation. Even if a secured party acquiesced in the collateral's loss of identity, that party's interest in the collateral continued in a product or mass "if the security agreement so provides,"⁸⁸ and continued perfected in a product "if the financing statement indicates that the interest

sions in the underlying security agreement." U.C.C. § 8-410 comment 2 (Sept. 1949 draft).

85. U.C.C. § 8-410(1) (Sept. 1949 draft).

86. Other explanations for this exception are possible. One is that a fungible mass is usually easily apportionable. Recognizing a lien's continuation need not, therefore, result in the subordination of other claims. Another possible explanation is that the description of the collateral in the filing statement will also describe the fungible mass. Thus, an interested third party would be on notice of the secured party's interest.

87. U.C.C. § 8-314(1) (Oct. 1949 draft) provided:

(1) If raw materials, component parts or other goods which contribute to a product are manufactured, processed or commingled so that their identity is lost, a security interest in such goods continues on the product or resulting mass if the security agreement so provides or if the lender has not acquiesced in the loss of identity. The security interest in the product continues as a perfected security interest if the financing statement indicates that the interest covers the product or in case the lender did not acquiesce in the loss of identity even if the statement does not so indicate.

Note that in this draft fungible goods no longer received the special treatment of the September 1949 draft. Furthermore, the drafters of this section were more concerned with "the problem of priority where raw materials subject to a security interest are processed into the finished product," U.C.C. § 8-314 comment (Oct. 1949 draft), than with problems of commingling.

88. U.C.C. § 8-314(1) (Oct. 1949 draft).

covers the product."⁸⁹ Section 8-314, however, did not mention whether a security interest which continues in a mass remains perfected. Another significant change was the deletion of the priority statement addressing the rights of the secured party with an interest in collateral as against a party claiming a security interest directly in the mass or product.⁹⁰

Except for a change in the section's title,⁹¹ no changes of any significance were made until the 1956 revision of Article 9. It was then that the section was rewritten in its present form.

III. SECTION 9-315 OF THE UNIFORM COMMERCIAL CODE

Section 9-315 is the progeny of three related but conceptually distinct pre-Code doctrines—accession,⁹² specification,⁹³ and confusion.⁹⁴ The scope of this relatively short section is surprising and may account for much avoidable complexity and ambiguity. Moreover, even a cursory reading of the section reveals its dual nature. Unlike most sections in Article 9,⁹⁵ section 9-315 is intended to perform two distinct functions: it specifies the ways in which a security interest in goods can attach to a product or mass of those goods,⁹⁶ and it provides a priority

89. *Id.*

90. This new priority statement, a forerunner of the current § 9-315(2), stated:

(2) Where under subsection (1) more than one security interest attaches to the product, each is on a basis of equality in such product in the ratio that the cost of the goods to which the interest originally attached bears to the cost of the total product of the manufacture or processing in which the original collateral was used or to which it contributed.

U.C.C. § 8-314(2) (Oct. 1949 draft). Similar to the provision in § 8-314(1) regarding continuation of perfected security interests, subsection (2) provides a priority statement for products but does not mention masses.

91. Section 8-314 became § 9-315 in 1950, and the word "priority" was added to the title in 1951. It then read: "Priority When Goods Are Commingled or Processed." U.C.C. § 9-315 (Proposed Final Draft No. 2, 1951).

92. *See supra* notes 16-30 and accompanying text.

93. *See supra* notes 31-48 and accompanying text.

94. *See supra* notes 49-81 and accompanying text.

95. Most sections in Article 9 address only one aspect of the law of secured transactions. It is, therefore, possible to describe a section as defining terms, delineating the scope of the security interest, containing priority rules, defining the rights and duties of the parties upon default, etc. Rarely does a section deal with more than one of these matters. One notable exception is § 9-306, which both delineates the scope of a secured party's interest, *see* § 9-306(2), and contains priority rules, *see* § 9-306(5).

96. U.C.C. § 9-315(1).

rule for resolving conflicting claims to the product or mass.⁹⁷ The drafters were, perhaps, overly ambitious in this undertaking because, as written, the section performs neither of these two functions satisfactorily.

A. ATTACHMENT OF THE SECTION 9-315(1) SECURITY INTEREST

Subsection (1) of section 9-315 describes the ways in which a security interest in specific goods can "continue" in the product or mass into which those goods have been processed or commingled. This subsection states:

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

In a case to which paragraph (b) applies, no separate security interest in that part of the original goods which has been manufactured, processed or assembled into the product may be claimed under Section 9-314.⁹⁸

This automatic shift of a security interest to property not covered by the original lien stands in stark contrast to most Article 9 provisions. In most cases, property only becomes subject to a security interest if a debtor expressly agrees to that interest in the security agreement.⁹⁹ When a security interest shifts

97. U.C.C. § 9-315(2).

98. U.C.C. § 9-315(1).

99. A security interest does not usually attach unless "the debtor has signed a security agreement which contains a description of the collateral." U.C.C. § 9-203(1)(a). Furthermore, to be effective against third parties, the Code normally requires a secured party to either file a financing statement "indicating the types, or describing the items, of collateral," U.C.C. § 9-402, or to take possession of the collateral. See U.C.C. §§ 9-302 to 9-305. These twin requirements of consent and notice to third parties are the foundations upon which the structure of Article 9 is built. Yet, these requirements often seem to beg the questions of how consent must be manifested and how much notice is required.

The drafters were willing to relax both the consent and notice requirements with regard to proceeds. Prior to the 1972 version of the Code, it was unclear whether a right to proceeds was dependent upon a specific clause in the security agreement. See FINAL REPORT OF THE REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, Appendix E-19 at 218 (Apr. 25, 1971). This ambiguity was resolved in the 1972 Code which expressly gave a secured party an interest in proceeds unless otherwise agreed. See §§ 9-302(2), 9-306(2). Another change wrought by the 1972 Code involved notice to third parties of a secured party's claim to proceeds. The 1962 version of § 9-

to a product or mass under section 9-315(1)(a), however, the shift occurs without the express consent of the debtor. The rationale behind the decision to make attachment automatic may be discernible from the drafting history of the section. Secured parties had always been given the means by which to preserve their secured status if they feared that the original collateral would lose its identity.¹⁰⁰ Because it would have been costly and inefficient to require secured parties to take an affirmative action that they inevitably would have taken, the section's automatic shift can be seen as one of those "off the rack" rules mirroring what the parties would or should have agreed to, and it is, on that basis, unobjectionable.¹⁰¹

There are, however, two prerequisites to the section 9-315(1)(a) automatic shift. The first is that the original collateral must have lost its identity. This is a logical requirement, consistent with the pre-Code laws of confusion¹⁰² and specification,¹⁰³ and distinguishes the application of subsection (1)(a)

306(3) provided that the security interest in proceeds would continue perfected if the original financing statement covered proceeds. This did little to advance the goal of notice, especially if the debtor was involved in multi-state activities. The 1972 amendments to § 9-306(3) improved the plight of third parties by requiring that a secured party refile in those situations in which the inability to discover a security interest in a particular proceed would be most acute. Because a refile is not required in all situations, third parties must often still rely on the willingness of the debtor to disclose outstanding interests.

100. Section 8-314 (Oct. 1949 draft) allowed continuation of the security interest in the product or mass if the parties had so provided in the security agreement. See *supra* notes 87-88 and accompanying text. Even before that draft, a secured party could always protect against a loss of lien by taking an original interest in all of the debtor's inventory. See U.C.C. § 8-410 comment 1 (Sept. 1949 draft).

101. It has been suggested that

[f]acing positive transaction costs, . . . the legal system provides ready-made rules based on common assumptions about typical contracting behavior. These 'off the rack' contract rules reduce the costs of exchange by specifying the legal consequences of typical bargains where the expected cost of explicit negotiation exceeds the utility derived from individualized exchange.

Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 588 n.87 (1977).

Although § 9-315(1)(a)'s automatic shift arguably represents what most parties would have agreed to, there may be times when the parties would not wish to be bound by the provision. Although there is no provision in § 9-315 similar to that in § 9-203(3) which permits parties to agree that the security interest will not attach to proceeds, there appears to be no reason to prohibit the parties from opting out of § 9-315(1)(a) if they wish.

102. See *supra* notes 49-81 and accompanying text.

103. See *supra* notes 31-48 and accompanying text.

from that of (1)(b).¹⁰⁴ Whether there has been a sufficient loss of identity would seem to necessitate the same sort of determination traditionally made when the doctrines of specification and confusion were thought to be applicable.¹⁰⁵

The second prerequisite for application of subsection (1)(a) is that the original interest must have been perfected.¹⁰⁶ While one would expect to find priority over third parties conditioned on perfection, it is difficult to understand why perfection also conditions the *attachment* of the security interest. The reason for such a requirement may be found in the priority rule of section 9-315(2),¹⁰⁷ which does not distinguish between perfected and unperfected secured parties. If two secured parties are to be treated equally, as the priority rule requires, it does not seem unreasonable to require that their status be equal. Such would not be the case if one were perfected and one were not. In addition to its intuitive appeal, this approach also has the advantage of preserving the integrity of the Code's other priority rules¹⁰⁸ and its filing system.¹⁰⁹

104. See *infra* notes 117-119 and accompanying text.

105. "There is no elaboration, in text or Comment, of the meaning of the phrase 'loss of identity.'" 2 G. GILMORE, *supra* note 10, § 31.4, at 850. It is therefore permissible and desirable to look for its meaning in pre-Code law. As Gilmore notes, the Code

assumes the continuing existence of a large body of pre-Code and non-Code law on which it rests for support, which it displaces to the least possible extent, and without which it could not survive. The solid stuff of pre-Code law will furnish the rationale of decision quite as often as the Code's own gossamer substance.

Gilmore, *Article 9: What it Does for the Past*, 26 LA. L. REV. 285, 286 (1966).

Pre-code confusion and specification cases can thus be of particular value in determining whether or not identity has been lost. In the § 9-315 context, the concept is a functional one and should reflect the policies underlying the section. Because the purpose of § 9-315 is to protect secured parties who can no longer lay claim to a specific and discrete piece or mass of collateral, loss of identity should be defined as occurring when it is either impossible or manifestly impractical to separate a product or mass into its original components and return each specific constituent of these components to its original contributor in its original condition. Such a definition generally comports with pre-Code law. See, e.g., R. BROWN, *supra* note 16, § 6.8, at 62.

106. This requirement is in marked contrast to the Code's treatment of proceeds in § 9-306. Section 9-306(2) gives a secured party an interest in proceeds regardless of whether the original security interest was perfected. Although an unperfected interest is enforceable against the debtor, it is vulnerable to the claims of most third parties. See, e.g., U.C.C. § 9-301.

107. See *infra* notes 221-241 and accompanying text.

108. The Code's priority rules, the bulk of which are located in §§ 9-306 to 9-315, consistently favor perfected over unperfected secured parties. Also, if both perfected and unperfected interests were treated equally under § 9-315(2), some rather curious disputes would be possible. For example, if a § 9-

Although there is nothing particularly troublesome about subsection (1)(a),¹¹⁰ the same cannot be said for subsection (1)(b). At first glance the provision seems clear enough, but closer examination reveals several potential trouble spots. Because the provision addresses accession-type situations, these trouble spots need to be analyzed in light of both pre-Code accession doctrine and section 9-314, a response to that doctrine.

Prior to the Code, if a good were characterized as an accession, all pre-affixation security interests in that good would be subordinated to outstanding interests in the principal good.¹¹¹ The primary rationale for this rule was that it prevented an economically inefficient severance of the lesser good from the principal good. Because the value of the post-affixation whole would exceed the value of the pre-affixation parts following an often-damaging severance, this approach maintained the economic integrity of the end product.¹¹² Section 9-314 ostensibly changes this rule by allowing a secured party with priority in an accession to remove the accession from the product.¹¹³ Sec-

315(1)(a) product or mass were transferred to a third party, that party may take free of the unperfected interest under § 9-301(1)(c) but may be subject to the perfected interest. In such a case, it would be difficult to determine the priorities of the parties.

109. A secured party would often be unable to ascertain the existence of prior unperfected secured parties with whom sharing under § 9-315(2) would be required. Such a party could rely on the debtor for this information, but "because of the possibility of debtor misbehavior, it is undesirable to rely on the debtor for information about claims to [the debtor's] own assets." Baird & Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175, 179 (1983). As for subsequent secured parties with whom sharing is required, that potential can never be eliminated, but its likelihood can be reduced by the use of restrictive covenants in the security agreement that limit the debtor's right to further encumber his or her property.

110. One issue that should be mentioned, however, is whether § 9-315(1)(a) applies if the collateral's loss of identity is caused by one other than the debtor-obligor. If, for example, collateral comes into the possession of a third party subject to a security interest and is then commingled with similar property of the third party, will the security interest shift to the newly created mass? For an affirmative answer, see *In re San Juan Packers, Inc.*, 696 F.2d 707, 710 (9th Cir. 1983) (commingling by third party); *Sterling Nat'l Bank & Trust Co. v. Southwire Co.*, 713 F.2d 684, 688 (11th Cir.) (processing by third party), *reh'g denied*, 718 F.2d 1115 (1983); *First Sec. Bank v. Zion First Nat'l Bank*, 573 P.2d 1024, 1026 (Utah 1975) (commingling by third party).

111. See *supra* notes 16-30 and accompanying text.

112. This explains why most courts thought the character of the affixation depended, in great part, upon the amount of damage a severance would cause to either the lesser or principal good. See *supra* notes 16-19 and accompanying text.

113. See U.C.C. § 9-314 comment a. Prior to the Code, courts usually concluded that the attachment was not an accession where the pre-affixation in-

tion 9-315(1)(b) offers the accession secured party an alternative¹¹⁴ to section 9-314: it allows the secured party to transfer his or her interest in the accession to the final product.¹¹⁵ Such an alternative, mirroring the common law concern for economic efficiency, cannot be faulted. It preserves the integrity of the final product and greatly reduces the potential for overreaching by an accessions secured party.¹¹⁶

Because subdivision (1)(b) is an alternative to section 9-314, arguably it should be available only if the original collateral becomes a true accession—that is, if it becomes such an integral part of the final product that it would be ultimately counterproductive to remove it. For example, assume that a secured party has an interest in a set of tires, and these tires are subsequently placed on an automobile. The tires clearly remain identifiable, thereby removing the case from the coverage of section 9-315(1)(a).¹¹⁷ If they are not accessions,¹¹⁸ however, section 9-314 would not always apply, and even if it would,

terest was a type of security interest. *See supra* notes 20-36 and accompanying text. Section 9-314 thus really only changes the rules of the game, and not, as is frequently thought, its outcome. *See Nickles, supra* note 16, at 146 n.88 (suggesting that § 9-314 expressly perpetuates the pre-Code rule).

114. *See* U.C.C. § 9-315 comment 3 (“[A] secured party is put to an election . . . by the last sentence of subsection (1), whether to claim under this section or to claim a security interest in one component under Section 9-314.”); E. REILEY, *GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY* § 5.4(a) (1981).

115. A third alternative, which may be provided by non-Code law, is for the secured party to assert a common law or statutory artisan’s lien on the whole. These liens are discussed in Lee, *Liens on Personal Property not Governed by the Uniform Commercial Code*, 44 N.C.L. REV. 322 (1966). For purposes of this Article, it is assumed that the secured party is unable or unwilling to rely on such a lien.

116. In many instances it would be impractical to remove the accessory after affixation. It would make little sense if its removal would substantially damage it or the principal good. In the latter case, the secured party must compensate all claimants to the whole, other than the debtor, for the harm caused. *See* U.C.C. § 9-314(4). What the secured party would want in either case is a security interest in the end product. If, however, the identity of the specific product is initially unknown (e.g., the exact auto to which the accessory will be affixed) many creditors would, in the absence of § 9-315(1)(b), demand an original interest in the entire class of potential products (e.g., the entire inventory of autos).

117. Subsection (1)(a) applies only where the original collateral has *lost its* identity. U.C.C. § 9-315(1)(a).

118. Drawing a line between accessions and non-accessions can often be a difficult matter. *Compare* *Bozeman Mortuary Ass’n v. Fairchild*, 253 Ky. 74, 79, 68 S.W.2d 756, 758 (1934) (tires are accessions); *Blackwood Tire & Vulcanizing Co. v. Auto Storage Co.*, 133 Tenn. 515, 520, 182 S.W. 576, 577 (1916) (tires are accessions) *with* *Mossier Acceptance Co. v. Norton Tire Co.*, 70 So. 2d 360,

there is no need for the section 9-315(1)(b) alternative.¹¹⁹

The secured party's interest would, therefore, be limited to the tires with no right to claim a security interest in the automobile as a whole under section 9-315(1)(b). Such a result makes sense when one realizes that removing the tires causes no damage to either the automobile or to the tires themselves. Even section 9-314 recognizes, if not the probability, certainly the possibility that removal of the accessorial good will damage the whole.¹²⁰ Conversely, if a good, although attached to another good, is not a true accession, then no presumptive reason exists for keeping the two together and an alternative to dismemberment of the product is unnecessary.

In addition to the functional interplay of sections 9-314 and

361 (Fla. 1954) (tires are not accessions); *Passieu v. B.F. Goodrich Co.*, 58 Ga. App. 691, 692-93, 199 S.E. 775, 777 (1938) (tires are not accessions).

As noted *supra* text accompanying notes 21-26, such results often were controlled by the status of the party opposing the claimant to the principal good. The better view, however, focuses not on the status of the parties but rather on the sufficiency of integration. *Id.*

119. As Professor Nickles stated:

U.C.C. section 9-314 defines accessions as goods that are installed in or affixed to other goods. But this definition only establishes the scope of section 9-314 which is designed solely to solve certain priority disputes. The section exists "[t]o state when a secured party claiming an interest in goods installed in or affixed to other goods is entitled to priority over a party with a security interest in the whole;" it does not state when goods are accessions for the purpose of deciding whether an interest in the principal collateral reaches them, too, by operation of law. This determination depends on whether the goods are accessions under common law principles according to which, it is clear, goods are not accessions and part of the whole simply because they are installed in or affixed to the principal collateral. Therefore, section 9-314's scope as a priority provision includes conflicts over goods that are accessions under common law doctrine and, also, conflicts over goods that are not even though they are installed in or affixed to collateral, *i.e.*, goods that are categorized as "accessories" for this article's purposes. But section 9-314 is totally irrelevant to the issue whether accessions or accessories, however defined, are subject by operation of law or otherwise to anyone's security interest.

Nickles, *supra* note 16, at 118 (footnotes omitted) (quoting U.C.C. § 9-314 comment 1). Section 9-314's right of removal, therefore, is only necessary when the accessorial good has become subject to the security interest in the principal good.

The party with a security interest in the principal good may acquire an interest in the accessorial good other than through the doctrine of accession if the original security agreement so provides. If this were the case, § 9-314's removal right would apply even if the good were not a true accession. *See id.* at 136-43. In these situations, § 9-315(1)(b) arguably should not apply. Because the affixed good is not an integral part of the principal good, there is no need to supply an alternative to § 9-314's removal right.

120. *See* U.C.C. § 9-314(4).

9-315, there is a further justification for limiting section 9-315(1)(b) to situations involving true accessions. When a secured party elects to be treated under section 9-315(1)(b), the financing statement will not accurately describe or indicate the ultimate collateral. It will only reflect the original collateral and the section 9-315(1)(b) election.¹²¹ In such a case, a subsequent party is less likely to know that a product to which the original collateral is affixed is subject to a security interest. This, in turn, could adversely affect the efficacy of the Code's system of notice filing. Seen in this context, it is preferable that the right to elect a security interest in the whole should be limited to those cases when it would produce a net benefit, a result achieved only when the lesser good is a true accession.

Section 9-315(1)(b) raises several other points worth exploring. First, an effective election requires that the original security interest be perfected. This requirement is imposed by both the introductory language of the section and the specification that the election must be made in a financing statement. This exception to the Article 9 norm can perhaps be explained by the failure of section 9-315(2) to distinguish between perfected and unperfected security interests.¹²² Requiring perfection as a condition for automatic attachment under section 9-315(1)(a) is of little consequence; the same is not true, however, when a section 9-315(1)(b) election is implicated. Because this election is precluded if the interest is not perfected, a secured party would then be forced to rely on section 9-314 and sever its original collateral from the product regardless of the costs involved.¹²³ This problem could, of course, be easily remedied by removing the perfection requirement from section 9-315(1) and, instead, incorporating the concept into the priority rule of section 9-315(2).

When a secured party decides to elect treatment under section 9-315(1)(b), a practical problem arises. The provision states that the financing statement must cover "the product into which the goods have been manufactured, processed or assem-

121. See *infra* notes 124-128 and accompanying text.

122. See *supra* notes 107-109 and accompanying text.

123. If, after severance, the combined value of the lesser and principal good would be less than the value of the whole before severance, it would effect a reduction in the debtor's net worth. Such a result is not only detrimental to the debtor, but would also work to the collective disadvantage of its other creditors. Cf. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, 91 YALE L.J. 857, 860-71 (1982) (discussing the aggregate advantages to creditors of collective bankruptcy proceedings).

bled."¹²⁴ It is unclear whether this language requires a specific description of the product, a simple checking of a "products box,"¹²⁵ or a repetition of the non-descriptive language of the statute.¹²⁶ Although the failure to actually describe the product impairs the effectiveness of the filing,¹²⁷ in many cases it is an unavoidable result. Often a secured party will not know the identity of the end product. In such a case, requiring more than a general indication that the security interest extends to products of the described collateral would rob section 9-315(1)(b) of its utility.¹²⁸ Moreover, if a secured party knew the identity of

124. U.C.C. § 9-315(1)(b). Because the financing statement must be signed by the debtor, U.C.C. § 9-402(1), the election requires the debtor's consent. This contrasts with the "consent is assumed" approach of § 9-315(1)(a). See *supra* notes 99-101 and accompanying text. Although the financing statement must cover products, it is unclear whether provision for products must also be made in the security agreement. Even if such provision is required, nothing should hinge on its absence. When determining if the requirements of § 9-203 have been met, courts should be willing to read the financing statement in conjunction with any document entitled "security agreement." See, e.g., *National Ropes, Inc. v. National Diving Serv., Inc.*, 513 F.2d 53, 57-60 (5th Cir. 1975) (determining scope of security interest by interpreting "General Pledge Agreement"); *In re Numeric Corp.*, 485 F.2d 1328, 1332 (1st Cir. 1973) ("an adequate agreement can be found when a financing statement is considered together with other documents"); *Little v. County of Orange*, 31 N.C. App. 495, 498, 229 S.E.2d 823, 825 (1976) ("two or more writings can be incorporated to satisfy the requirements").

125. Most, if not all, standard financing statements provide a box to be checked if a claim to products is intended. See B. CLARK, *supra* note 16, § 2.9, at 2-31 to 2-32. The form financing statement set forth in § 9-402(3) requires nothing more.

126. Although courts that have considered this issue have done so in a superficial manner, the opinions do hint at a need for specificity. The financing statement in *First Nat'l Bank v. Bostron*, 39 Colo. App. 107, 564 P.2d 964 (1977), apparently contained the catchword "products." *Id.* at 108, 564 P.2d at 965. Yet, the court there found that "since the financing statement did not specifically cover the product . . . the language of § 4-9-315(1)(b) . . . does not support [the secured party's] claim." *Id.* at 109, 564 P.2d at 966 (emphasis added). See also *Sterling Nat'l Bank & Trust Co. v. Southwire Co.*, 713 F.2d 684 (11th Cir.), *reh'g denied*, 718 F.2d 1115 (1983), where although § 9-315(1)(a) was apparently the relevant provision, the court justified its decision that the secured party's lien attached to the product on the ground that "the financing statement did so cover the goods in process and the finished product, the copper cathode." *Id.* at 688 (emphasis added).

127. This statement assumes that a legal rule that requires, wherever possible, a specific description of collateral is preferable to one which would permit overbroad descriptions. Compare *Baird & Jackson*, *supra* note 109 (endorsing a specific description of collateral), with *Shanker, A Proposal for a Simplified All-Embracing Security Interest*, 14 U.C.C. L.J. 23 (1981) (arguing that the formalistic ceremony of specific descriptions should be scrapped).

128. Because a secured party often is unable to predict the eventual disposition of proceeds when a financing statement is first filed, these same issues

the end product in advance, there would be no real need for the subsection because a security interest could then be taken directly in that product.

One word of caution, however, is in order. Although many courts have been loathe to impose filing obligations on secured parties other than those expressly required by Article 9, such an occurrence remains a possibility.¹²⁹ If, for example, a secured party knew the identity of the product at the time of filing, a court might find that the omission of its description amounted to an act of bad faith. Such a finding would, presumably, negate the attempted election and result in the secured party's interest being limited to the original collateral.¹³⁰

Another issue under section 9-315(1)(b) concerns the revocability of the election. The official comment suggests that once made, such an election is irrevocable.¹³¹ Why this should be the rule remains a mystery, since irrevocability would not appear to advance any Code policies and would serve only to

have been addressed in the § 9-306 context. Prior to the 1972 amendments, § 9-306(3) provided that a security interest was continuously perfected in proceeds if the financing statement "covers proceeds." When construing this language, courts required no more than an abstract reference to proceeds. *See, e.g., Matthews v. Arctic Tire, Inc.*, 106 R.I. 691, 695, 262 A.2d 831, 834 (1970).

129. For example, prior to the addition of § 9-402(7) in 1972, one recurrent issue was whether a refiling was necessary following a debtor's name change. The majority of courts refused to require a new filing. *See, e.g., In re Kittyhawk Television Corp.*, 516 F.2d 24, 28 (6th Cir. 1975); *Continental Oil Co. v. Citizens Trust & Sav. Bank*, 397 Mich. 203, 208-09, 244 N.W.2d 243, 245 (1976); *In re Pasco Sales Co.*, 77 Misc. 2d 724, 726, 354 N.Y.S.2d 402, 404 (N.Y. Sup. Ct. 1974). Some courts, however, did require such filing, in certain circumstances, as when the secured party had knowledge at the time of the filing that a name change was imminent. *See In re Kalamazoo Steel Process, Inc.*, 503 F.2d 1218, 1222-23 (6th Cir. 1974); *see also In re A-1 Imperial Moving & Storage Co.*, 350 F. Supp. 1188, 1189 (S.D. Fla. 1972) (debtor's name change required new filing despite secured party's lack of knowledge of the change). It is, therefore, conceivable that a court might rely on the latter cases or perhaps analogize § 9-315(1)(b) to the 1972 amendments to § 9-306(3) and impose a refiling obligation under § 9-315(1)(b) once the product's identity becomes known.

130. *See also* 1A P. COOGAN, W. HOGAN, D. VAGTS, & J. McDONNELL, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE (MB) § 7.11A[2][y] [hereinafter cited as SECURED TRANSACTIONS] (suggesting that under § 9-315(1)(b), "reliance on the English language for an adequate description is plainly advisable"); *cf. In re Kalamazoo Steel Process, Inc.*, 503 F.2d 1218, 1222-23 (6th Cir. 1974) (failure to file under a name later adopted by the debtor results in a loss of perfection when the secured party was aware that the name change was imminent at the time of the original filing).

131. Comment 3 to § 9-315 states, in part, that "a secured party is put to an election at the time of filing, by the last sentence of subsection (1), whether to claim under this section or to claim a security interest in one component under Section 9-314." (emphasis added).

make a secured party's interest less valuable.¹³² Certainly the language of the section itself does not mandate this result.¹³³ The last sentence of section 9-315(1) should be read as providing for an irrevocable election at the time the security interest is *enforced*, not when it is perfected. That a section 9-315(1)(b) election should become irrevocable at some point becomes clear when one realizes that the purpose of the election is to provide an alternative to the dismemberment of the product that would otherwise result under section 9-314. A change in election from section 9-314 to section 9-315(1)(b), or vice-versa, after enforcement of the security interest would require the accession either to be removed or reinstalled—clearly an unacceptable result under an efficiency analysis as well as one potentially unfair to parties other than the claimant. There are no such reasons, however, to preclude such a change of election at any time prior to enforcement.

B. THE EXTENT OF THE SECTION 9-315(1) SECURITY INTEREST

Under section 9-315(1), a perfected security interest in goods that have become part of a product or mass continues in that product or mass. Although it is clear that this continued interest initially embraces the entire product or mass, the section does not state whether upon enforcement of this interest the secured party is entitled to satisfaction of the entire secured debt, assuming the disposition proceeds are sufficient, or merely to recover the value of the original collateral. If the secured party was initially undercollateralized, a common occurrence, this issue becomes extremely important.¹³⁴

An analysis of section 9-315(1) might lead one to conclude that the drafters intended nothing more than to permit a se-

132. Because application of § 9-315(1)(b) does not necessarily give a secured party a proportionate share under § 9-315(2), *see infra* notes 222-241 and accompanying text, it is quite possible that the secured party would be better off proceeding under § 9-314. Requiring such an uninformed decision at the time of filing reduces the secured party's perception of the value of his or her position.

133. This is true even though Professor Gilmore suggests that the "[c]omment may be taken as an authoritative statement of what the text was meant to mean." 2 G. GILMORE, *supra* note 10, § 31.4, at 849.

134. In the case of a § 9-315(1) product, a security interest limited only by the value of the secured debt would grant to an undersecured creditor the value added by the debtor's labor, other materials used, and any synergistic increase attributable to the resulting combination. In the case of a § 9-315(1)(a) commingled mass, the additional value will result from the value of the additional items commingled with the collateral.

cured party to trace his or her collateral into the final product or mass. Tracing is a restitutionary remedy originally developed by courts of equity to allow a beneficiary of a trust to follow and claim, as part of the trust res, the product of trust assets misappropriated by the trustee.¹³⁵ The result was to give the beneficiary an in specie claim to property not otherwise subject to the provisions of the trust. The doctrine eventually sprouted several branches, including "exchange tracing" and "commingled fund tracing."¹³⁶ Exchange tracing was permitted when property was wrongfully transferred and the transferor received, in exchange, other property.¹³⁷ Commingled fund tracing allowed a claimant to follow money improperly placed into a fund that also included money belonging to the wrongdoer.¹³⁸

Many of the principles of exchange and commingled fund tracing appear in the Code's treatment of proceeds in section 9-306(2). Indeed, that section appears to adopt exchange tracing almost wholesale,¹³⁹ with the only deviation being that a secured party's claim to proceeds is in no way dependent on any wrongdoing by the debtor.¹⁴⁰ The applicability of commingled fund tracing under section 9-306(2) is not quite as apparent. Its incorporation into the section is the product of the Code's requirement that proceeds, in order to be subject to a security in-

135. For a general discussion of this doctrine, see RESTATEMENT OF RESTITUTION §§ 202-215 (1936); 5 A. SCOTT, *THE LAW OF TRUSTS* §§ 507-522 (3d ed. 1967). See also Oesterle, *Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306*, 68 CORNELL L. REV. 172 (1983), in which the doctrine is justly criticized for many of its basic assumptions.

136. See Oesterle, *supra* note 135, at 174.

137. Professor Scott emphasizes the present scope of this branch of the doctrine, stating:

The principal is a broad one. It is applicable not only where the wrongdoer is an express trustee, not only where he is a fiduciary, but wherever a person wrongfully transfers property in which another has the beneficial interest, whether legal or equitable, and receives other property in exchange therefor.

5 A. SCOTT, *supra* note 135, § 507, at 3571.

138. Historically, English courts were of the opinion that because "money has no earmark" its tracing should not be permitted. It was not until 1879, when Jessel, M.R., wrote the opinion in *In re Hallett's Estate*, 13 Ch. D. 696 (1880), that this branch of tracing firmly took root.

139. See Oesterle, *supra* note 135, at 211 ("The section generally adopts exchange tracing—hook, line, and sinker.").

140. See U.C.C. § 9-306(2). Some courts have, however, misread the section, reaching the erroneous conclusion that a secured party has no interest in proceeds if it authorized the disposition of its collateral. See, e.g., *First Nat'l Bank v. Bostron*, 39 Colo. App. 107, 110, 564 P.2d 964, 966 (1977).

terest, must be identifiable.¹⁴¹ It is now relatively settled that the drafters intended tracing principles to be employed to make identifiable, albeit artificially, cash proceeds that have been mingled with cash from other sources.¹⁴²

As noted earlier,¹⁴³ section 9-315 is similar to section 9-306 in that both sections provide for the extension of a secured party's lien to property not originally subject to that lien. Indeed, the major difference between the two sections in this regard is definitional, not functional.¹⁴⁴ As one of the drafters of

141. See U.C.C. § 9-306(2).

142. See *supra* note 6 and sources cited therein. The doctrine of tracing is superseded, however, where a debtor is the subject of an insolvency proceeding. In its place is substituted a perplexing formula, see § 9-306(4)(d), that has proved troublesome both for courts, see, e.g., *In re Gibson Products*, 543 F.2d 652, 655-57 (9th Cir.), cert. denied, 430 U.S. 946 (1976); *Fitzpatrick v. Philco Fin. Corp.*, 491 F.2d 1288, 1291-92 (7th Cir. 1974), and for commentators, see 2 G. GILMORE, *supra* note 10, § 45.9; Epstein, "Proceeding" Under the Uniform Commercial Code, 30 OHIO ST. L.J. 787, 792-808 (1969); Skilton, *supra* note 6 at 129; Note, *Bankrupting the Proceeds Section: Recent Interpretations of Section 9-306(4)(d) of the Uniform Commercial Code*, 55 TEXAS L. REV. 891, 897-910 (1977).

143. See *supra* notes 5-6 and accompanying text.

144. See 2 G. GILMORE, *supra* note 10, § 31.4, at 847, where it is explained that:

the § 9-306 term "proceeds" is restricted to what is received by a debtor "when collateral or proceeds is sold, exchanged, collected or otherwise disposed of." In the § 9-315 situation, the product or mass remains in the hands of the debtor who had the goods: since there has been no disposition, the "proceeds" provisions of § 9-306 are not applicable; the product or mass is not, technically, "proceeds" of the goods

Id. (quoting U.C.C. § 9-306).

Section 9-315 or 9-306 will, in most cases, provide substitute collateral where resort to the original collateral is no longer feasible. There are situations, however, where neither section will apply. Consider, for example, the situation in *First Nat'l Bank v. Bostron*, 39 Colo. App. 107, 564 P.2d 964 (1977), in which a creditor with a security interest in feed asserted a security interest in the cattle that ate the feed under §§ 9-306 and 9-315. The court rejected both claims, concluding "that cattle are neither a 'product' nor a 'mass' as these terms are used in the statute," *id.* at 109, 564 P.2d at 966, nor are they "traceable proceeds to which the security interest may be said to have attached," *id.* at 110, 564 P.2d at 966. Anticipating such a case, one commentator expressed concern that if § 9-315 is applied, the pro rata sharing rule of § 9-315(2) might greatly deflate the value of the original security interest in the cattle because "[t]he cost of the unfattened dairy calf may not be as great as the aggregate cost of its feed over a long period of time." Clark, *Some Problems in Agricultural Lending Under the UCC*, 39 COLO. L. REV. 352, 363 (1967). This concern, however, erroneously assumes that application of § 9-315(1) requires application of § 9-315(2). Section 9-315(1) could have been used, even if only by analogy, to extend the lien on the feed to the cattle without necessarily implicating § 9-315(2). See *infra* notes 199-214 and accompanying text.

section 9-315 noted, “[a]s a matter of English usage, there would be no difficulty in saying that a product represents the ‘proceeds’ of the materials that have gone into it.”¹⁴⁵ Because of this functional similarity, one would expect to find a similarity in the operative provisions of each section. The admirable goal of treating similar situations similarly would also suggest that ambiguities in the sections be resolved, if possible, in a like manner.¹⁴⁶ It therefore may be helpful to keep the tracing principles of section 9-306 in mind when asking whether these principles can be used to define the extent of the section 9-315(1) security interest.

Like section 9-306,¹⁴⁷ section 9-315(1) clothes a secured party with what appears to be the equivalent of the equitable right to trace by allowing a secured party to lay claim to goods that differ from the original collateral. Although technically there is no exchange of property, a secured party is in fact able to “exchange” an interest in specific goods for an interest in the product into which those goods are manufactured, assembled, or processed.¹⁴⁸ Principles of commingled fund tracing appear in the section 9-315(1) approach to commingled masses, albeit regarding goods instead of money.¹⁴⁹ The apparent presence of tracing principles in section 9-315(1) as well as in section 9-306(2) suggests that these principles may be of value when ascertaining the extent of the section 9-315(1) security interest.¹⁵⁰

145. See 2 G. GILMORE, *supra* note 10, § 31.4, at 846.

146. The policy decisions made in § 9-306 should, unless a justification for the contrary appears, receive recognition when applying the provisions of § 9-315. See U.C.C. § 1-102 comment 1 (“The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole . . .”).

147. See *supra* notes 139-142 and accompanying text.

148. That this type of “exchange” occurs is supported by the fact that for a secured party to be treated under § 9-315(1)(b), he or she must relinquish any claims under § 9-314. See *infra* notes 113-115 and accompanying text. Thus, in a case in which the collateral maintains its original identity, the secured party “exchanges” an interest in the original collateral for an interest in the final product.

149. See U.C.C. § 9-315(1)(a).

150. The Code itself recognizes the continued vitality of extra-Code principles, see *supra* note 105, especially equitable principles. See U.C.C. § 1-103; Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 Nw. U.L. REV. 906, 908 (1978). Common sense dictates, however, that “[c]aution should be used in borrowing rules from other fields and applying them to secured transactions.” Skilton, *supra* note 6, at 156.

Beyond the scope of this Article is the extent to which the Bankruptcy Code taketh away what § 9-315(1) giveth. A secured party must be concerned about the possible occurrence of a preference, see 11 U.S.C. § 547 (1982), and

Under the exchange tracing branch of the doctrine, the extent of the claimant's interest depends on the nature of the wrongdoing. If the substitute asset is held by a "conscious wrongdoer" who obtained the original property by "fraud, duress, . . . undue influence, or . . . intention[al] convers[ion]," the claimant is entitled to the imposition of a constructive trust.¹⁵¹ Because the substitute property is received in specie, the claimant receives its full value, which may very well exceed the value of what was lost. On the other hand, if the substitute property is possessed by an "innocent converter,"¹⁵² successful tracing will entitle the claimant only to an equitable lien on the substitute property in the amount of the misappropriated property's value.¹⁵³ This precludes the realization of any profit if the newly acquired property is worth more than the original.

Applying these exchange tracing principles to a section 9-315 product, however, would lead to anomalous results. As previously discussed, one of the most noteworthy features of the early drafts of what is now section 9-315(1) was that the continuation of the security interest in the product often depended on whether the debtor's actions had been authorized.¹⁵⁴ In other words, these drafts were fault-based. Because the present section 9-315 does not address culpability, it would be anomalous to once again interject this concept into the section when determining the extent of the interest. It would also be inconsistent

that tracing assets into a commingled mass will not be allowed. *See, e.g., In re Independence Land Title Corp.*, 18 Bankr. 673 (Bankr. N.D. Ill. 1982).

151. *See* RESTATEMENT OF RESTITUTION § 202 comment c (1936). The constructive trust was developed in equity "for much the same reason that brought forth the quasi-contract at law: it was needed to prevent unjust enrichment and force a restitution to the plaintiff of something that in equity and good conscience did not belong to the defendant." D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES, § 4.3, at 241 (1973).

152. This phrase is borrowed from RESTATEMENT OF RESTITUTION § 203 (1936). An innocent converter includes one who disposes of the claimant's property without knowledge that the disposition is unauthorized as well as a gratuitous transferee. *Id.* §§ 203-204.

153. *Id.* at § 203. The difference between an equitable lien and a constructive trust can be summarized as follows:

[T]he constructive trust gives a complete title to the plaintiff, the equitable lien only gives him a security interest in the property, which he can then use to satisfy a money claim. Thus an equitable lien may be "foreclosed," by selling the property that has been subjected to the lien and by applying the proceeds to payment of the plaintiff's claim. This results in only a money payment to the plaintiff and obviously does not carry with it the advantages of recovering specific property.

D. DOBBS, *supra* note 151, § 4.3, at 249.

154. *See supra* notes 82-89 and accompanying text.

with the principles underlying sections 9-306(2)¹⁵⁵ and 9-205¹⁵⁶ to give fault a role to play, however minor. Furthermore, there would be a practical significance to elevating the concept to relevance. Every case in which a secured party's claim to a product depended on section 9-315(1) would then involve an additional issue. Because a myriad of factors conceivably could bear on a determination of fault,¹⁵⁷ secured parties would often be unsure of their status, leading to inefficiency and possible judicial intervention.¹⁵⁸ Therefore, to whatever extent exchange tracing principles appear in section 9-315's treatment of products, traditional notions of fault should not be employed to define the extent of the security interest.

Rejecting fault-based notions regarding section 9-315(1) products still leaves unanswered the question of the extent of the security interest in those products. For a number of reasons, this interest should be limited by the value of the secured debt, rather than the value of the original collateral. One problem is that a limited interest¹⁵⁹ might have the deleterious effect of decreasing the product's value at a forced sale, thereby increasing the likelihood of a deficiency or the amount of an unavoidable deficiency. For example, assume that the amount of the secured debt is \$75, but the value of the original collateral is less than \$75. Further assume that the collateral is manufactured, assembled, or processed into a product such that the

155. Fault is relevant under § 9-306(2) for the purpose of determining whether the security interest continues in the original collateral, but not for determining whether it attaches to identifiable proceeds. One justification for the disparate approach is that in the former instance the rights of third parties are directly affected, whereas, in the latter, they are not.

156. See *supra* note 83.

157. The complexity of determining which actions of a debtor are or are not authorized is best evidenced by those cases involving the struggle to decide whether a debtor's disposition of collateral was "otherwise" authorized under § 9-306(2). See, e.g., *United States v. Central Livestock Ass'n*, 349 F. Supp. 1033, 1034 (D.N.D. 1972); *In re Cadwell Martin Meat Co.*, 10 U.C.C. Rep. Serv. (Callaghan) 710, 716 (E.D. Cal. 1970); *Planters Prod. Credit Ass'n v. Bowles*, 256 Ark. 1063, 1071, 511 S.W.2d 645, 649 (1974); *Central Cal. Equip. Co. v. Dolk Tractor Co.*, 78 Cal. App. 3d 855, 860, 144 Cal. Rptr., 367, 371 (1978); *Milnes v. General Elec. Credit Corp.*, 377 So. 2d 725, 728 (Fla. Dist. Ct. App. 1979); *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96, 98 (Iowa 1973); *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 559, 425 P.2d 726, 731 (1967); *Central Washington Prod. Credit Ass'n v. Baker*, 11 Wash. App. 17, 19, 521 P.2d 226, 227 (1974).

158. See *supra* notes 7-8 and accompanying text.

159. The term "limited interest" will be used to signify a security interest in a product or mass that is limited to the value of the original collateral. "Unlimited interest" refers to a security interest in a product or mass that is limited only by the value of the underlying secured debt.

secured party's interest attaches to the product under section 9-315(1). If the secured party's interest in the product were limited to the value of the original collateral, he or she would have no incentive to dispose of the collateral after default for more than that amount.¹⁶⁰ Attempts to obtain any more would initially inure to the benefit of the debtor and other creditors. On the other hand, if the claim were limited only by the amount of the debt, the secured party would have every reason to actively seek a price of \$75 which would, if obtainable, avoid any deficiency.¹⁶¹

Another problem which would inexorably flow from a decision to limit the secured party's claim is how that claim is to be valued. Irrespective of the method used, it must be based on the value of the original collateral. There are problems with such a valuation process. For example, the relevant value could be either wholesale, retail, or forced disposition. Further, this value could be determined at different times: at the time the security interest first attached, at the time of the collateral's integration into the product, or at the time of the product's disposition.¹⁶² Even if these and similar issues could be satisfactorily resolved, it is unlikely that parties with competing interests would ever assign the same value to the same good. Whatever the valuation method, costly and wasteful litigation would be inevitable.

Another factor that militates against a limited security interest in a product is the desirability of maintaining a parallel with the exchange tracing principles of the Code's treatment of proceeds. There is nothing in the language of section 9-306(2) that would suggest an intention to equate the interest in the proceeds with the value of the original collateral.¹⁶³ It would

160. The disincentive to maximize the disposition price is further reinforced by "[t]he fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner." U.C.C. § 9-507(2).

161. This example assumes that upon default the creditor has the right to control disposition of the collateral. See Nickles, *Rights and Remedies Between UCC Article 9 Secured Parties with Conflicting Security Interests in Goods*, 68 IOWA L. REV. 217, 219 (1983).

162. For a valuable discussion of many of the issues inherent in any valuation process, see Cohen, *"Value" Judgments: Accounts Receivable Financing and Voidable Preferences Under the New Bankruptcy Code*, 66 MINN. L. REV. 639 (1982).

163. *In re Guaranteed Muffler Supply Co.*, 27 U.C.C. Rep. Serv. (Callaghan) 1217 (Bankr. N.D. Ga. 1979) appears to be the only case in which a court felt that an interest in proceeds should be limited. Involved was a secured

be odd to permit a secured party to improve his or her position as the result of a disposition of collateral but to prohibit that improvement where collateral has been integrated into a product or in some other way altered.

The final justification for an unlimited security interest in a product pertains only when section 9-315(1)(b) applies. If the primary purpose of that subsection is to provide an alternative to the product's dismemberment,¹⁶⁴ limiting the security interest would defeat that purpose. The reason a secured party would elect an interest in the product in the first place is that the value of the secured party's share of this product would exceed the value of the accession if severed. It would be counterproductive to adopt a rule that has the effect of taking from a secured party that excess value.

The suggestion that a security interest that attaches to a section 9-315(1) product should be unlimited still leaves open the question of the extent of a secured party's interest in a section 9-315(1)(a) mass because of the fundamental difference between a product and a mass. A mass is easily divisible without risk of harm to its component parts, whereas a product is not. Given this and other practical differences, it is quite possible that a different conclusion is called for.

The common law has always treated the problem of property interests in a commingled mass differently from title disputes involving a single article. Whenever evidence was available regarding the extent of the respective interests in a commingled mass, those interests were respected.¹⁶⁵ Even those who would abrogate the doctrine of confusion and directly apply the commingled fund branch of tracing suggest limiting the interest of the claimant to the value of the original collateral.¹⁶⁶ Moreover, the drafting history of section 9-315(1)(a) discloses an intent by the drafters to provide a secured party with a limited interest.¹⁶⁷ Although it would be analytically sound to premise a conclusion that the security

party's claim to shares of stock received by the debtor partnership in exchange for its inventory and accounts, which were subject to the original security interest. Without explanation, the court stated that "to whatever extent [the shares] represent that portion of the partnership's assets which are attributable to the inventory and accounts, [the secured party] has a valid claim to the shares." *Id.* at 1222.

164. See *supra* notes 112-120 and accompanying text.

165. See *supra* notes 49-81 and accompanying text.

166. See RESTATEMENT OF RESTITUTION § 214 (1936); 5 A. SCOTT, *supra* note 135, § 520, at 3642-44.

167. See *supra* notes 85-87 and accompanying text.

interest does not attach to the entire value of the mass solely on common law and statutory antecedents of section 9-315(1)(a), there are more compelling reasons for reaching that result.

It bears repeating that the Code is not an ad hoc collection of commercial statutes, each operating within its own sphere of influence, but is rather a system of interlocking parts woven together by strands of common policy concerns. It is, therefore, highly desirable that a construction of section 9-315(1)(a) should be congruent with perceived policy determinations evidenced by other Code sections.¹⁶⁸ Much insight can be gained from a brief reconsideration of section 9-306(2) and the problem of commingled cash proceeds.

The continuation of a secured party's interest in proceeds depends on their being identifiable. When commingled in a bank account, it is clear that proceeds are no longer identifiable if the term is given its literal meaning. The overwhelming majority of courts, however, have defined that term expansively to permit identification by resort to traditional tracing rules.¹⁶⁹ These rules limit the security interest in the account to the amount of proceeds deposited.¹⁷⁰

Equally supportive of a limited interest in a section 9-315(1)(a) mass is section 9-207(2)(d), which provides that "[u]nless otherwise agreed, when collateral is in the secured party's possession . . . the secured party must keep the collat-

168. Referring to the Code, Chancellor Hawkland observed that [i]t is systematic in that all of its parts, arranged in an orderly fashion and stated with a consistent terminology, form an interlocking, integrated body, revealing its own plan and containing its own methodology. It is comprehensive in that it is sufficiently inclusive and independent to enable it to be administered in accordance with its own basic policies.

Hawkland, *Uniform Commercial "Code" Methodology*, 1962 U. ILL. L.F. 291, 292.

169. See *supra* note 6. Although several methods of tracing are possible, see D. DOBBS, *supra* note 151, § 5.16, at 421-30, the prevailing view is to use the lowest intermediate balance rule or, as it is sometimes called, the Rule of Jessel's Bag, derived from the opinion of Jessel, M.R. in *In re Hatchett's Estate*, 13 Ch. D. 696 (1879). Briefly stated, the rule presumes that withdrawals from the fund are of monies not subject to the security interest. If the balance of the fund slips below the amount of commingled proceeds, the secured party's claim is limited to the lowest intermediate balance between the time of commingling and the time the fund is to be distributed. For an excellent illustration of how this rule operates, see *Universal C.I.T. Credit Corp. v. Farmers Bank of Portageville*, 358 F. Supp. 317, 325 (E.D. Mo. 1973).

170. See, e.g., *C.O. Funk & Sons, Inc. v. Sullivan Equip., Inc.*, 89 Ill. 2d 27, 32-33, 431 N.E.2d 370, 373 (1982); Henning, *supra* note 6, at 229.

eral identifiable but fungible collateral may be commingled." That provision hardly contemplates that the sole act of commingling by the secured party should work to the debtor's advantage by allowing the debtor to receive back more goods than he or she parted with or upon his or her default to be credited with the value of the entire mass or its proceeds.

Apart from textual and historical support for a limited interest,¹⁷¹ there is an independent policy reason calling for this approach. If the entire value of the mass stood as potential collateral, a "situational monopoly" would occur.¹⁷² Because the security interest would not be temporally defined,¹⁷³ it would potentially extend not only to the mass as it existed at the time of the original commingling, but also to the mass as it changes over time. Put another way, a secured party's interest would attach to after-acquired property that becomes part of the mass. The secured creditor with an interest in the after-acquired property would then enjoy an advantage in dealing with the debtor not enjoyed by most other creditors.¹⁷⁴ Although per-

171. There is also some judicial support for this position, but it lacks persuasiveness. In *In re Agricultural Business Co.*, Bankr. No. 9628-B-1, (D. Kan. Oct. 29, 1976) (available on LEXIS, Genfed library, Dist file) (order granting motion to alter or amend), a case involving the commingling of fertilizer subject to a security interest, the court summarily stated that the secured party "can claim a perfected security interest in the equivalent dollar value of fertilizer as it arrived at the facility. . . . To this extent, it can claim a perfected security interest in the entire mass of commingled fertilizer." *Id.* Detracting from the significance of this statement is the following language in the parties' security agreement: "In the event the Debtor blends the above products into other fertilizer solutions the *equivalent dollar value* of the goods supplied . . . shall be deemed collateral." *Id.* (emphasis added). It is, therefore, unclear whether the court is construing § 9-315(1) or simply carrying out the intent of the parties.

172. For an extensive treatment of the situational monopoly resulting from a secured creditor's claim to a debtor's after-acquired property, see Jackson & Kronman, *supra* note 7, at 1167-75. Other examples of situational monopolies can be found in Demsetz, *When Does the Rule of Liability Matter?*, 1 J. LEGAL STUD. 13, 23-25 (1972); Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 367 (1978).

173. If it were, the extent of the security interest would be determined as of a specific date. If, following that date, the value of the mass were to increase, the interest would be limited to its predetermined value. This, of course, contradicts the present assumption.

174. Because of the first-in-time priority rule of § 9-312(5), other creditors who later take a security interest in the mass or items that become part of that mass will be forced into a subordinate position. This competitive advantage awarded to the after-acquired creditor is lessened somewhat by the super-priority afforded purchase money security interests, see U.C.C. § 9-312(3)-(4); Jackson & Kronman, *supra* note 7, at 1167-75, and by § 9-315(2)'s pro rata sharing rule, see *infra* notes 222-239 and accompanying text.

mitting a security interest to attach to after-acquired property has its benefits,¹⁷⁵ there are inherent societal costs.¹⁷⁶ If a secured party's interest were unlimited, those costs would often be excessive because the monopoly position is presumably unbargained for and would not be reflected in the rate of return demanded. Moreover, the transaction giving rise to this after-acquired interest frequently would not involve the type of financing pattern to which such an interest is best-suited.¹⁷⁷

The conclusion that a secured party's interest in the mass should be limited to the value of the commingled collateral raises the issue of who should bear the burden of proving this value. In most cases, it should be shouldered by the party opposing the section 9-315(1)(a) claimant.¹⁷⁸ Once a secured party can show commingling, he or she initially should be able to lay claim to the entire mass. The opposing party could then limit this claim by proving the value of the original collateral. Once this value has been determined, the original claimant would receive a portion of the mass or proceeds equal in value to that of the original collateral. Such a system generally comports with pre-Code confusion cases.¹⁷⁹

The notion of a limited interest in a section 9-315(1)(a) mass is fully consistent with the argument favoring an unlimited interest in a product. A mass is apportionable, and there is no reason why a secured party upon default should not receive collateral or proceeds equal in value to the original collateral. Because a product normally cannot be so divided, a secured party must look to a share of the proceeds upon disposition. In

175. By including an after-acquired property clause in the security agreement, the parties can accomplish in one transaction what would otherwise take numerous transactions to accomplish. Therefore, "[b]ecause it allows transaction cost savings, a legal regime that recognizes the validity of after-acquired property clauses is more efficient than one that does not." Jackson & Kronman, *supra* note 7, at 1167 (footnote omitted).

176. One such cost would be a reduction in the availability of credit. Because other creditors are placed at a disadvantage, the debtor's cost of future credit would be higher than it would be if the security interest were limited.

177. After-acquired property financing arrangements best lend themselves to situations where a creditor lends money on a more or less continuing basis. See R. SPEIDEL, R. SUMMERS, & J. WHITE, *COMMERCIAL AND CONSUMER LAW*, 213-242 (2d ed. 1974). These types of creditors would not normally base a claim to the mass solely on § 9-315(1).

178. One exception to this proposal is when the party claiming under § 9-315(1) seeks purchase money status. To receive such status, the party seeking that treatment should bear the burden of apportioning the mass. See *infra* note 198 and accompanying text.

179. See *supra* notes 70-81 and accompanying text.

such a case, fairness,¹⁸⁰ efficiency,¹⁸¹ and uniformity¹⁸² favor limiting the secured party's interest only by the amount of the secured debt.

C. THE NATURE OF THE SECURITY INTEREST

Although a security interest continues in a product or mass if the prerequisites of section 9-315(1) have been satisfied, that subsection offers no guidance on whether the security interest continues as a purchase money security interest¹⁸³ if it was of that type originally.¹⁸⁴ Purchase money status is significant only where a competing claim to the collateral is asserted by a party other than the debtor, usually another secured party.¹⁸⁵ For this reason, the nature of a section 9-315(1) security interest must be analyzed in this context.

Where the opposing claimants to a product or mass are both secured parties, a priority dispute is possible on one of two

180. See *supra* notes 160-161, 164 and accompanying text.

181. See *supra* note 162 and accompanying text.

182. See *supra* note 163 and accompanying text.

183. A purchase money security interest is defined in § 9-107 as follows:

A security interest is a "purchase money security interest" to the extent that it is

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

184. Another question unanswered in the section is whether the perfected security interest in the original collateral continues perfected in the product or mass. Although Professor Gilmore has stated that "there can be no doubt that the 'continuing' interest is also perfected and presumably will so continue as long as the original interest would have been perfected," 2 G. GILMORE, *supra* note 10, § 31.4, at 846, things may not be quite so simple where perfection is governed by rules lying outside Article 9. For example, under § 9-302(3), perfection requirements regarding motor vehicles may be governed by non-Code state law. Because an interest in collateral affixed to a motor vehicle may attach under § 9-315(1) to the vehicle itself, continued perfection arguably depends on compliance with state certificate of title law. Cf. *In re Lyford*, 22 Bankr. 222, 226 (Bankr. D. Me. 1982) (certificate of title law supplants § 9-314(1)); *International Atlas Servs., Inc. v. Twentieth Century Aircraft Co.*, 251 Cal. App. 2d 434, 438, 59 Cal. Rptr. 495, 499 (1967) (Federal Aviation Act supplants § 9-314), *cert. denied*, 389 U.S. 1038 (1968); *Wooden v. Michigan State Bank*, 117 Ga. App. 852, 854, 162 S.E.2d 222, 223 (1968) (certificate of title law supplants § 9-314(1)).

185. This does not necessarily pertain where a debtor is the subject of a bankruptcy proceeding. In such event purchase money status may matter in the absence of a third party claimant. For example, the Bankruptcy Code gives a consumer debtor the power to avoid certain non-purchase money security interests. See 11 U.S.C. § 522(f) (1982).

levels. A section 9-315(1) creditor might be opposed either by another section 9-315(1) creditor or by a party whose security interest in the product or mass is in no way dependent on section 9-315. The level of dispute involved will dictate the appropriate priority rule and the nature of the continuing security interest. If both competing secured parties are asserting an interest under section 9-315(1), the applicable priority rule is section 9-315(2).¹⁸⁶ Although the application of the formula itself is somewhat confusing,¹⁸⁷ the intent of the rule is clear. The "rank equally"¹⁸⁸ language of the text, together with the comment's explanation that "[t]he rule stated treats all . . . interests as being of equal priority,"¹⁸⁹ leaves little doubt that purchase money status is irrelevant.

When the section 9-315(1) claimant is opposed by a secured party whose interest has attached other than through section 9-315(1), however, purchase money status may become important. In such a case, the conflict should be settled not by section 9-315(2)'s priority rule,¹⁹⁰ but by other rules that grant purchase money status priority in certain situations. The conclusion of Professors Jackson and Kronman that "[t]here is no reason, based either upon the statutory scheme of the Code or upon general considerations of policy, why the transferred security interest cannot, or should not, remain a purchase money security interest,"¹⁹¹ therefore, needs to be re-examined.

In the case of a section 9-315(1) product, there are several reasons to deny purchase money status to secured creditors. Initially, such status would entitle the secured party to the superpriority granted in section 9-312(3) or (4).¹⁹² Further, this

186. For a discussion of the applicability and application of this subsection, see *infra* notes 199-239 and accompanying text.

187. See *infra* notes 222-239 and accompanying text.

188. U.C.C. § 9-315(2).

189. U.C.C. § 9-315 comment 4.

190. Although several courts and commentators have assumed that § 9-315(2) should apply in all conflicts between secured parties where one party asserts a claim under § 9-315(1), such an approach is not mandated by § 9-315(2). This issue is treated in more detail *infra* notes 199-220 and accompanying text.

191. Jackson & Kronman, *supra* note 2, at 29; see also *In re Smith*, 29 Bankr. 690, 693 (Bankr. W.D. Mo. 1983) (a purchase money security interest continues under § 9-315 even if the collateral is transformed through manufacturing, processing or assembly).

192. Under § 9-312(3) and (4), purchase money security interests take priority over conflicting interests if certain requirements are met. See § 9-312(3), (4). Election of treatment under these provisions assumes that the competing secured party was first to file a financing statement. If the facts were other-

super-priority will be enjoyed regardless of the relative values of its original collateral and the final product. In the event of the debtor's default, the section 9-315(1) creditor, with priority over the prior secured party, would have the right to control the disposition of the collateral.¹⁹³ Because the Code sheds little light on the rights and remedies of priority and subordinate secured parties vis-a-vis each other, the now subordinated creditor would find his or her position mired in uncertainty.¹⁹⁴ This added uncertainty would inevitably manifest itself in a higher rate of compensation demanded from the debtor.¹⁹⁵ Another unfortunate consequence would be that the section 9-315(1) creditor, who is presumably owed considerably less than the value of the completed product, would lack the incentive to maximize the sale price of that product because he or she would not be entitled to any amount greater than the amount of the secured debt.¹⁹⁶

Another important reason to deny purchase money status to creditors with a section 9-315(1) interest in a product is that a party with a prior security interest in the product will often be unaware of any loss of priority. Such knowledge would be important if and when a future advance is contemplated. Notification to the prior secured party becomes necessary, however, only if he or she "had filed a financing statement covering the same types of inventory" as the section 9-315(1) secured party's original collateral.¹⁹⁷ Although this may often be the case, it need not always be. If the financing statement filed by the product financier covers only the finished product, notice is not required and the loss of priority would be unknown. To avoid this unknown loss of priority it would be necessary to either expand the scope of the original security interest or carefully

wise, the § 9-315(1) creditor would assert priority under the "first in time" rule of § 9-312(5).

193. See, e.g., *American Heritage Bank & Trust Co. v. O. & E., Inc.*, 40 Colo. App. 306, 309, 576 P.2d 566, 568 (1978); *Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co.*, 385 So. 2d 1151, 1153 (Fla. Dist. Ct. App. 1980); *Recchio v. Manufacturers & Traders Trust Co.*, 55 Misc. 2d 788, 793, 286 N.Y.S.2d 390, 395 (Sup. Ct. 1968), *rev'd*, 35 A.D.2d 769, 316 N.Y.S.2d 915 (1970).

194. Many of the issues surrounding the rights and remedies of competing secured parties are explored in Nickles, *Rights and Remedies Between UCC Article 9 Secured Parties with Conflicting Security Interests in Goods*, 68 IOWA L. REV. 217 (1983).

195. See *supra* notes 7-8 and accompanying text.

196. See *supra* text accompanying notes 160-161.

197. See U.C.C. § 9-312(3).

monitor the debtor's activities after the original extension of credit.

Although the above analysis is equally applicable to a security interest which attaches to a product pursuant to section 9-315(1)(a) or (b), different considerations lead to a different conclusion where the claim is to a section 9-315(1)(a) mass. The reasons that militate against a purchase money security interest continuing in a product are simply not present when a commingled mass is involved. A mass is apportionable and it is therefore possible to recognize a superior right of disposition, limited to a portion of the whole. When so limited, one no longer encounters many of the difficulties resulting from multiple claims to a single item, nor does there exist the potential disparity between the value of the collateral and the amount of the debt that is so troublesome in the case of a product. Finally, section 9-312(3) would eliminate the possibility of a secret priority. Because the first financing statement would describe the same type of goods as those supplied by the purchase money secured party, notice would be required under section 9-312(3). If the purchase money secured party can successfully trace his or her collateral into the mass,¹⁹⁸ there seems to be no reason why that status should not be preserved.

IV. THE SECTION 9-315(2) PRIORITY RULE

A. THE RULE'S APPLICABILITY

As noted earlier,¹⁹⁹ section 9-315 differs from most Code sections in that it not only governs the attachment of security interests but also provides a priority rule for resolving conflicting claims. Perhaps because these two topics are addressed in the same section, it frequently has been taken for granted that if a security interest attaches to a mass or product under section 9-315(1), the priority of that interest should always be governed by section 9-315(2).²⁰⁰ This assumption arguably is incorrect; not every conflict involving a section 9-315(1) claim is governed by section 9-315(2). Statutory construction and policy

198. See *supra* note 178.

199. See *supra* note 95 and accompanying text.

200. See, e.g., *In re San Juan Packers, Inc.*, 696 F.2d 707, 711 (9th Cir. 1983); 2 G. GILMORE, *supra* note 10, § 31.5, at 854-56; SECURED TRANSACTIONS, *supra* note 130, § 7.11A[2][y]; Jackson & Kronman, *supra* note 2, at 29 n.118; Hogan, *Financing the Acquisition of New Goods Under the Uniform Commercial Code*, 3 B.C. IND. & COM. L. REV. 115, 152-53 (1962); cf. U.C.C. § 9-312(1) (stating that "[t]he rules of priority stated in other sections of this Part . . . shall govern when applicable . . .").

considerations support the view that other priority rules will often apply.

When determining the scope of a priority rule, the logical starting point is the language of the rule itself. Section 9-315(2) states: "*When under subsection (1) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.*"²⁰¹ When given its plain meaning, the rule's introductory language seems to limit its applicability to situations in which *each* competing security interest has attached under section 9-315(1). If one or more security interests have attached to the product or mass by means other than "under subsection (1)," as when a competing claimant is given a security interest directly in the end product or mass, another priority rule would have to apply.²⁰²

It is unfortunate, but perhaps understandable, that those who ascribe to the view that section 9-315(2) applies whenever any section 9-315(1) interest is involved have failed to consider the implications of such an approach. The subsection's pro rata sharing rule stands in stark contrast to the "winner-loser" approach of Article 9's other priority rules²⁰³ and, as a result, has a certain intuitive appeal to one's sense of fairness. Beneath such an attractive surface, however, lurk troublesome problems that require analysis in the light of the Code's policy-grounded priority system.

An excellent vehicle for discussing both the actual and potential role that section 9-315(2) should play in the Code's well-ordered system of priorities is *In re San Juan Packers, Inc.*²⁰⁴ San Juan, a food processor, purchased cans on credit from National Can Corporation, giving it a security interest in all inventory. San Juan also purchased vegetables on credit from several farmers, some of whom had given Peoples State Bank (Bank) a security interest in these vegetables. In the ensuing bankruptcy of San Juan, the Bank claimed a priority interest in

201. U.C.C. § 9-315(2) (emphasis added).

202. Unfortunately, the drafters' comments regarding the priority rule shed little light on its intended scope. The comment merely states that the rule "is new and is needed because under subsection (1) it is possible to have more than one secured party claiming an interest in a product." U.C.C. § 9-315 comment 4. Note that the comment does not even address conflicting claims to a mass.

203. See U.C.C. §§ 9-301 to 9-314.

204. 696 F.2d 707 (9th Cir. 1983).

the farmers' vegetables sold to San Juan and the fund of proceeds created by their sale.²⁰⁵

Before deciding the appropriate priority rule, the Ninth Circuit had to decide whether there actually were two competing security interests in the mass of vegetables. National Can argued that any security interest the Bank originally might have had was lost because the vegetables were commingled with those purchased from other farmers and were no longer identifiable.²⁰⁶ The court had little trouble rejecting this argument, correctly noting that the Bank's security interest continued in the mass under section 9-315(1).²⁰⁷ National Can next argued that the fund should be apportioned on a pro rata basis in accordance with section 9-315(2) because it had a security interest in the entire inventory of vegetables. The court agreed with this assertion and remanded the case for an apportionment of the fund.²⁰⁸

In deciding that the section 9-315(2) priority rule applies where only one claimant's interest attached under section 9-315(1),²⁰⁹ the *San Juan* court failed to realize the effect that such a rule has on the Code's system of notice filing. To illustrate this point, assume that the facts of *San Juan* were slightly different in that the farmers retained a purchase money security interest in vegetables they sold directly to San Juan. Further assume that San Juan segregated each farmer's vegetables such that they remained clearly identifiable. In such a case,

205. See *id.* at 707-08. Prior to the action, the parties agreed to the sale of San Juan's entire inventory of vegetables and the creation of a fund from the sale's proceeds. The purpose of the suit was therefore to determine the competing parties' rights to these proceeds.

206. See *id.* at 709-10. The sale of the vegetables to San Juan would not have terminated the Bank's security interest even if San Juan had been a buyer in the ordinary course of business. See U.C.C. § 9-307(1).

207. 696 F.2d 707, 710 (9th Cir. 1983). The court was also forced to address two interesting arguments made by the Bank. The first, surprisingly accepted by the district court, was that § 9-315(1) "requires the attachment of two security interests to the product or mass." See *San Juan*, 696 F.2d at 710-11. The court disposed of this contention, correctly concluding that the attachment of two security interests is "an explicit condition only to the operation of section 9-315(2), not section 9-315(1)." *Id.* at 711 (footnote omitted). The second argument was that the § 9-315(2) priority rule was inapplicable because the vegetables had not been sufficiently processed. The court responded that § 9-315(1)(a) and the section title refer to processing *and* commingling, and that there was "no indication that the drafters meant to exclude simple mixing of fungible goods." *Id.*

208. *Id.*

209. National Can's interest attached pursuant to the "floating lien" it had on all San Juan's inventory, not because of § 9-315(1). See *id.* at 708.

section 9-315(1) would be irrelevant and section 9-315(2) clearly would not apply. Because the farmers' security interests would qualify as purchase money interests, their priority over National Can, whose security interest would have attached to the vegetables pursuant to its after-acquired property clause, would have depended upon compliance with section 9-312(3). They must, therefore, have given notice of their intended interest to National Can before giving their vegetables to San Juan.²¹⁰ Such notice is not a mere formality without substance. Its purpose is best stated in Official Comment 3 to section 9-312 which reads, in pertinent part:

The reason for the additional requirement of notification is that typically the arrangement between an inventory secured party and his debtor will require the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party. The notification requirement protects the inventory financier in such a situation.²¹¹

Now change this hypothetical example so that the vegetables are commingled and their identity is lost. Section 9-315(1)(a) would now apply, but the section 9-315(2) priority rule certainly should not. Its application would eliminate the notice requirement even though National Can's need to receive notice is as great as before. Such disparity of treatment is impossible to justify.²¹²

Furthermore, the sole act of commingling by the debtor elevates the farmers to a position of parity.²¹³ Although Article 9 provides for a change of priorities as the result of subsequent events, never is such an event within the exclusive control of the debtor.²¹⁴ To permit the debtor, either by action or inac-

210. See U.C.C. § 9-312(3)(b).

211. U.C.C. § 9-312 comment 3.

212. The drafters may have been concerned that some courts would read § 9-315 as supplanting the notice requirements of § 9-312(3). Such concern could explain the inclusion in the early drafts of what was to become § 9-315 of a provision that an interest acquired in the mass under that section would be subordinate to a prior perfected inventory lien. See *supra* notes 82-91 and accompanying text.

213. Assuming that the farmers failed to give notice, they would be subordinated to the inventory financier where no commingling occurs, yet would stand on an equal footing if the vegetables were commingled. See U.C.C. §§ 9-312(3), 9-315(2).

214. See, e.g., U.C.C. §§ 9-103(1)(d)(i) (failure of secured party to refile after collateral is removed to another jurisdiction), 9-403(2) (failure of secured party to file a continuation statement).

tion, to alter established priorities would open the door to all sorts of potential misbehavior.

Viewed in light of the plain meaning of section 9-315(2)'s language, these policy considerations support mandatory application only when each competing interest in the whole arises under section 9-315(1).²¹⁵ There may be situations, however, where the rule can be helpful even though the Code does not mandate its use. As noted earlier,²¹⁶ several commentators favor applying section 9-315(2) by analogy to situations where equity concerns so dictate. Indeed, *San Juan* may have been a classic example of a case where, although not required, the rule was ultimately beneficial.

If section 9-315(2) was the wrong priority rule in *San Juan*, it follows that the correct priority rule would have been section 9-312(5). Under that provision, because National Can had filed first, it would have enjoyed an absolute priority over the Bank. But, as suggested by at least one commentator,²¹⁷ the first-to-file rule was never meant to apply where, as in *San Juan*, two debtors are involved.²¹⁸ Sanctioning its use would not only thwart the justifiable expectations of the Bank²¹⁹ but would, as Professor Clark points out, run counter to "the general property rule that you can't alienate what you don't own."²²⁰ The Ninth Circuit was, therefore, right in applying section 9-315(2), but for the wrong reason.

215. Although the policy concerns discussed in the *San Juan* context are most evident in situations involving conflicting claims to a confused mass, the conclusions based thereon arguably apply with equal force in the case of a § 9-315 product. Initially, § 9-315(2)'s language is nondiscriminatory and requires conflicting claims to a product or mass to attach under subsection (1). See *supra* text accompanying notes 201-202. Furthermore, as in the case of a mass, a product financier whose security interest attached by means other than under § 9-315(1) has no way of knowing that a competing claimant to that product has entered the picture.

216. See *supra* note 12.

217. See B. CLARK, *supra* note 16, § 3.8(4), at 3-53 to 3-54.

218. For another example of where § 9-312(5), although literally applicable, must be ignored, see Frisch, *U.C.C. Filings: Changing Circumstances Can Make a Right Filing Wrong. But Can They Make a Wrong Filing Right?*, 56 S. CAL. L. REV. 1247, 1274-75 (1983).

219. When the Bank filed its financing statement, it established its priority over buyers, § 9-307(1), lien creditors, § 9-301(1)(b), and subsequent secured parties who received their interest directly from the farmers, § 9-312(5). It understandably would come as a surprise to the Bank to learn that its priority was lost because of the fortuitous circumstance that its debtor had sold collateral to another secured party's debtor and that that secured party had filed first—a filing which was undiscoverable by the Bank.

220. B. CLARK, *supra* note 16, ¶ 3.8(4), at 3-53.

B. THE APPLICATION OF THE SECTION 9-315(2) PRIORITY RULE

Section 9-315(2)'s priority rule attempts to set forth a formula by which competing claimants to a product or mass can "share ratably" in that product or mass.²²¹ As written, however, the formula is confusing; not only is its language ambiguous, it also fails to account for the fundamental differences between products and masses. The unfortunate result of this approach is what one commentator has called a priority rule that "raises more questions than it solves."²²² To answer these questions, it is necessary to examine the rule in light of the purpose it was meant to serve: equitable apportionment among unequally contributing claimants.

The first problem raised by the apportionment formula is definitional. Under the formula, the respective interest of each secured claimant is based on the ratio of the cost of each claimant's original collateral to the cost of the total product or mass.²²³ For example, if A and B each assert a section 9-315(1) security interest in a product or mass,²²⁴ their interests under the formula could be represented as follows:

$$\text{A's interest} = \frac{\text{cost of A's original collateral}}{\text{cost of product or mass}}$$

$$\text{B's interest} = \frac{\text{cost of B's original collateral}}{\text{cost of product or mass}}$$

The term "cost," however, is not defined in the section or elsewhere in the Code, and has a number of possible meanings.²²⁵ By determining functionally what the numerators and denominators *should* equal in the above example, it may be possible to

221. See U.C.C. § 9-315(2), § 9-315 comment 4.

222. Murray, *Priority Problems in Receivables Financing: The German Experience and the Uniform Commercial Code Compared*, 11 B.C. IND. & COM. L. REV. 355, 405 (1970); see also 2 G. GILMORE, *supra* note 10, § 31.5, at 852 (stating that "the meaning of the . . . formula . . . is notably obscure").

223. See U.C.C. § 9-315(2).

224. Recall that § 9-315(2)'s priority rule should usually be used only when each competing claimant's interest arose under subsection (1). See *supra* notes 199-220 and accompanying text.

225. As noted by one commentator:

the term "cost of the total product or mass" is not defined. It is not clear whether it refers to the value of the manufactured product or to the cost of the components. If it refers to the value of the product, it is unclear whether 'cost of the goods' refers to their value at the time of incorporation or to the price paid or to be paid for them by the debtor.

Murray, *supra* note 222, at 405.

work backwards and determine what the drafters had in mind when they used the term "cost."

If a product is involved, A and B will have no choice but to share ratably²²⁶ in the proceeds received from the product's eventual sale.²²⁷ In that case, the only sensible approach is to await the sale and use the amount realized as the denominator of each ratio. If, however, the subject of controversy is a mass, although a sharing of proceeds is possible, it is not necessary.²²⁸ If the mass is sold without division, the denominator should again equal the sum received. If the mass itself, rather than its proceeds, is apportioned, the denominator selected should be that which will most closely approximate the amount of proceeds had there been a sale. This would, in most cases, be the current market value of the mass.

Once the ratio's denominator or "pie to share" is established, the numerator will yield the percentage of the pie that section 9-315(2) allots to A and B. Because the denominator reflects, in part, the value of each creditor's original collateral, it seems only fair that A and B share according to the proportionate contribution made by their collateral. The best method for determining that proportionate contribution is to compare the relative values of their collateral at the time of incorporation into the product or commingling with the mass. Accordingly, if A's collateral had a value twice that of B's, A should be entitled to a slice of the pie that is correspondingly twice as large.

Having decided that the formula should be geared to value,²²⁹ we are equipped to examine the subsection's focus on cost. One reasonable explanation for this focus is that the drafters contemplated value but for efficiency's sake chose instead to base the formula on what they thought to be a suitable

226. See 2 G. GILMORE, *supra* note 10, § 31.5, at 852 ("The secured parties who rank equally do not of course share equally: they share, as the Comment puts it, 'ratably.'").

227. Because § 9-314 would be inapplicable, the only option available to the parties is to sell the otherwise indivisible product as a whole.

228. Because a mass of goods is physically divisible, apportionment is possible prior to sale.

229. At least one court has decided that § 9-315(2) addresses relative value. In *In re Agricultural Business Co.*, Bankr. No. 9628-B-1 (D. Kan. Oct. 29, 1976) (available on LEXIS, Genfed library, Dist file) (order granting motion to alter or amend), the court totally ignored the subsection's use of the term "cost," concluding that the secured party could claim an interest in the mass "to the extent of the equivalent *dollar value* of the fertilizer [the secured party] delivered." *Id.* (emphasis added).

surrogate.²³⁰ Regarding the formula's numerator, whether or not the term "cost" indeed approximates the collateral's value depends on whether cost was intended to mean acquisition price. Although some commentators have espoused such a view,²³¹ arguably such is not the intent of the formula. The drafters knew how to use the term price when they wished to do so.²³² Furthermore, price tends to overstate value if it includes such extraneous costs to the debtor as finance, shipping, and other handling charges. If, however, cost is defined so as to exclude these expenses, its equivalence to value is apparent.²³³

Next consider section 9-315(2)'s statement of the ratio's denominator: "cost of the total product or mass." If the denominator should ideally equal the amount of proceeds received from the disposition of the product or mass, cost could be inferred to mean the cost to the third party purchaser. If the product or mass has actually been sold, there is no reason to estimate its value by computing its cost to the debtor.²³⁴ In the case of a product, a "cost to debtor" computation of the component parts will not reflect the product's ultimate value since the synergistic effect of incorporating the various components is not considered. Where a *mass* is not sold prior to its division, however, its cost to the debtor indeed provides a rough estimate of its value and is, for that reason, a workable substitute.

Once the numerator and denominator for each competing claimant is determined, the formula's operation is relatively straightforward. For example, assume A and B are claimants to a section 9-315 mass of fungible goods. If the cost to the debtor of A and B's original collateral was \$3 and \$5 respec-

230. The drafters could have been seeking to avoid many of the time-consuming inquiries that inevitably become part of any valuation process. See *supra* note 162 and accompanying text.

231. See, e.g., 2 G. GILMORE, *supra* note 10, § 31.5, at 852; Hogan, *supra* note 200, at 153.

232. See Hogan, *supra* note 200, at 153 n.151 ("'Costs' are not clearly defined, and an argument that the term includes more than acquisition price . . . may be made from the fact that elsewhere the Code uses terms clearly indicating 'price.' U.C.C. §§ 9-107, 9-302(1)(C), 9-307(2), and 9-505.").

233. The problem of what charges should be considered as part of a good's cost is reminiscent of the similar problem of what charges, other than the cash price of a good, should be accorded purchase money status. See, e.g., Note, *Preserving the Purchase Money Status of Refinanced or Commingled Purchase Money Debt*, 35 STAN. L. REV. 1133, 1177-78 (1983).

234. This approach also avoids the need to indulge in the difficult task of allocating a portion of the debtor's total labor and overhead costs to the particular item involved.

tively and the cost of the total mass is \$10,²³⁵ A would receive $\frac{3}{10}$ of the mass and B would receive $\frac{5}{10}$.²³⁶ If the mass had been sold upon default, the amount A and B receive obviously would depend on the sale price. If the sale price were \$8, A would receive $\frac{3}{8}$ of \$8, or \$3, and B would receive $\frac{5}{8}$ of \$8, or \$5. If the sale price had been \$10, A and B would again receive \$3 and \$5 respectively, and \$2 would go to the debtor. If the sale price had been \$7, however, the formula will not work, because it is impossible for A to receive $\frac{3}{7}$ of \$7, or \$3, while B receives $\frac{5}{7}$ of \$7, or \$5. In such a case, A and B should share the \$7 in a 3-to-5 ratio, with A getting $\frac{3}{8}$ of \$7, or \$2.62, and B getting $\frac{5}{8}$ of \$7, or \$4.38. In this case, the amounts of A and B's secured debt would be irrelevant,²³⁷ as would the purchase money status of either claimant.²³⁸

If the claim is to a section 9-315 product, the situation changes somewhat. For example, assume X and Y are competing claimants to a product that was sold for \$15 at a disposition sale.²³⁹ The cost to the debtor of X's original collateral was \$3 and the amount of X's secured debt was \$4, while the cost to the debtor of Y's original collateral was \$5 and the amount of Y's secured debt was \$7. Although X's security interest extends to the value of the secured debt,²⁴⁰ i.e., \$4, the formula dictates that when opposed by Y, X is entitled initially to claim only $\frac{3}{15}$ of \$15, or \$3. Similarly, Y may initially claim $\frac{5}{15}$ of \$15, or \$5. Seven dollars are left over when both of these claims are satisfied, so X and Y may now claim additional proceeds up to the values of their secured debts. X thus ends up with \$4, Y with \$7, and the debtor with \$4. If the disposition price had been \$10 instead of \$15, after the initial \$3 and \$5 claims had been satisfied, X and Y would be able to share the remaining \$2 in a 3-to-

235. These figures are borrowed, with slight modification, from the hypothetical offered by Professor Gilmore. See 2 G. GILMORE, *supra* note 10, § 31.5, at 852-53.

236. These examples assume for simplicity's sake that there are no additional claimants to the mass or product whose claim arises other than under § 9-315. If such a claimant does exist, arguably § 9-315(2) should apply between any § 9-315(1) claimants and other priority rules would usually govern disputes between these § 9-315(1) claimants and non § 9-315(1) claimants. See *supra* notes 199-220 and accompanying text.

237. See *supra* notes 165-179 and accompanying text.

238. See *supra* notes 188-189 and accompanying text.

239. As discussed *supra* notes 226-227 and accompanying text, because products are indivisible, § 9-315 claimants have no choice but to assert their claims against the proceeds received when the product is sold. See *supra* notes 226-227 and accompanying text.

240. See *supra* notes 159-164 and accompanying text.

5 proportion.²⁴¹ X would then have received a total of \$3.75 and Y would have received \$6.25.

CONCLUSION

Under section 9-315(1) of the Uniform Commercial Code, a perfected security interest in goods can continue in the product or mass of which those goods have become part. When two or more security interests attach to a product or mass under subsection (1), the subsection (2) priority rule governs these competing interests and allows the claimants to share ratably either in the mass itself or in the proceeds received when a product or mass is sold subsequent to the debtor's default. Although the general purposes of the section seem clear, problems can develop when it is applied to different types of fact situations. Many of these problems arise because the section fails to take into account the fundamental differences between products and masses. The pre-Code property doctrines of accession, specification, and confusion, upon which the section is grounded, are helpful references when determining if these fundamental differences necessitate different treatment of products and masses under both section 9-315(1) and (2).

Although the section's scope and potential usefulness are broad, it remains relatively unknown and rarely used in commercial litigation. The reasons for this obscurity are puzzling because it would seem that section 9-315 would be important in a wide variety of commingling²⁴² and processing-type²⁴³ situa-

241. This situation is similar to the one described *supra* text accompanying notes 236-237, where the formula cannot be used. In both cases, if the cash available for distribution is used as the denominator, a payout in excess of 100% of the proceeds received would be required.

242. An example of a situation in which § 9-315 apparently would have been useful is *Associated Poultry, Inc. v. Wake Farmers Coop., Inc.*, 17 N.C. App. 722, 195 S.E.2d 325 (1973). In that case, the Farmers Home Administration held a perfected security interest in the debtor's eggs and their proceeds. Wake Farmers Cooperative, Inc. (Wake) purchased eggs from the debtor, agreeing to pay the price directly to the FHA. When received by Wake, the value of the eggs was recorded and the eggs were then commingled with eggs of other farmers. Before the purchase price was paid, however, Wake was placed in receivership. The FHA asserted priority over unsecured creditors on the ground "that Wake acted as a trustee holding the purchase price of the eggs in trust." *Id.* at 723, 195 S.E.2d at 326. The court rejected this contention, holding that "[the FHA] failed to establish anything beyond a debtor and creditor relationship between them and Wake." *Id.* at 724, 195 S.E.2d at 327. The FHA would arguably have fared better had it asserted an interest under § 9-315(1) rather than trust beneficiary status. Under § 9-315, its security interest would have continued in the mass of commingled eggs and would therefore

tions. In any event, section 9-315 can often be a useful tool for secured parties who take the time to probe its mysteries. Hope-

have had priority over the competing general creditors. Presumably, ignorance of § 9-315 led to the FHA's loss.

The above discussion presupposes that the sale to Wake did not terminate the FHA's interest. Although § 9-307(1) would be of no benefit to Wake, § 9-306(2) provides that a transferee takes free of a security interest if the transfer was authorized by the secured party; which in this case it was. The FHA's consent, however, was contingent on a payment which failed to materialize. Because performance of this condition was within the control of Wake, non-compliance should result in vitiation of the consent, *see In re Sunriver Farms, Inc.*, 27 Bankr. 655, 665 (Bankr. D. Or. 1982); *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96, 98 (Iowa 1973); *South Omaha Prod. Credit Ass'n v. Tyson's, Inc.*, 189 Neb. 702, 704, 204 N.W.2d 806, 808 (1973). For another, more recent example of a court's failure to consider § 9-315, notwithstanding its applicability, *see In re McBee*, 714 F.2d 1316, 1325-31 (5th Cir. 1983) (determining the extent and priority of three security interests following a bulk transfer of inventory and its subsequent commingling with after-acquired property).

The Code itself suggests the applicability of § 9-315 in a slightly different commingling context. Section 9-306(5) allows a chattel paper secured party to take priority over an inventory secured party in "returned inventory." *See* U.C.C. § 9-306(5)(b). Once returned, however, commingling with identical inventory becomes a possibility. If such is the case, the chattel paper secured party may be unable to identify the original inventory. As noted in *Skilton & Dunham, Security Interests in Returned and Repossessed Goods Under Article 9 of the Uniform Commercial Code*, 17 WILLAMETTE L.J. 779 (1981):

[i]n some cases, it may be difficult or impossible to trace or identify a part of all of the inventory as goods returned to the dealer. Tracing a returned automobile with its serial number or other readily identifiable items may present no difficulty. Smaller items such as clothing or toothpaste, however, pose real tracing problems.

Id. at 816. If identification is thus impossible, § 9-315 is needed to enable the chattel paper secured party to maintain priority. *See id.* at 815-18.

243. Consider, for example, the commercial operation variously referred to as "refining," "processing," "milling," "converting," "upgrading," and "tolling," as described in *Harrington, A Caveat for Commodity Processing Industries: Insolvent Processors' Creditors vs. Putative Owners of Raw Materials*, 16 U.C.C. L.J. 322, 323 (1984). Regardless of the label, the operation essentially consists of converting raw or scrap materials into finished products, frequently by one other than the owner of the materials. Often, similar materials obtained from different sources are commingled by the processor. *See id.* at 322. Although Professor Harrington would argue that such a delivery of raw materials to a processor should be viewed as a sale, *see id.* at 335, most courts would classify it as a bailment, *see, e.g., In re Sitkin Smelting & Ref., Inc.*, 639 F.2d 1213, 1217 (5th Cir. 1983); *In re Medomak Canning Co.*, 25 U.C.C. Rep. Serv. (Callaghan) 437, 448 (Bankr. D. Me. 1977). Whether classified as a sale or a bailment, the materials when received by the processor will usually be subject to a security interest. If the transaction is characterized as a bailment, the materials would remain subject to any security interest previously given by the owner. *See* U.C.C. § 9-201. If characterized as a sale, the original owner would often reserve a security interest to secure the processor's obligation to process and return the material in its upgraded form. In any event, for the interest to continue following a commingling, § 9-315 is needed.

fully, this Article has provided needed guidance in unraveling some of these complexities.

