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Article Nine’s Treatment of Commingled Cash Proceeds in Non-Insolvency Cases

William H. Henning*

INTRODUCTION

One of the most difficult questions arising under Article 9 of the Uniform Commercial Code is the extent to which a secured party’s interest in collateral continues to be enforceable against the proceeds generated upon disposition of that collateral. Much of the difficulty surrounding this issue springs from the fact that proceeds occupy a position at the nexus of two competing Code policies. On the one hand, Article 9 validates the floating lien and minimizes the extent

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1. Collateral is defined in U.C.C. § 9-105(1)(c). Unless otherwise indicated, all references in this article are to the 1972 version of Article 9.

2. U.C.C. § 9-306(1) provides:

“‘Proceeds’ includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts, and the like are ‘cash proceeds.’ All other proceeds are ‘non-cash proceeds.’”

This provision differs from the 1962 version by expressly including insurance payments as proceeds and by inclusion of deposit accounts in the definition of cash proceeds.

3. U.C.C. § 9-205 provides in part 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 (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral.

The purpose of this provision was to repeal cases like Benedict v. Ratner, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 991 (1925), which had interpreted New York law to void accounts receivable financing arrangements which allowed the debtor too much dominion over the collateral. U.C.C. § 9-205, Comment 1.

Benedict v. Ratner was one manifestation of judicial hostility toward secret liens created by allowing the debtor to retain possession and control of collateral. For additional discussion of the role of U.C.C. § 9-205 in the context of commingled cash proceeds, see text at notes 124-130 infra.
to which a secured party must continue to “police” a transaction once his interest has been perfected. On the other hand, it is important for third parties to be able to ascertain the extent to which property in a debtor’s possession is subject to encumbrances. The problem becomes especially severe when the proceeds are cash proceeds that have become commingled with funds from other sources in the debtor’s general banking account.

The Code addresses some of the problems associated with proceeds through a network of complex provisions, but many of the most important issues cannot be resolved by direct reference to statutory language. For example, when a secured party has an enforceable security interest in collateral, section 9-203(3) grants him, absent agreement to the contrary, “the right to proceeds provided by section 9-306.” This ties in with section 9-306(2), which states the general rule that “a security interest . . . continues in any identifiable proceeds including collections received by the debtor.”

4. The conflict between these opposing principles is neatly illustrated by the 1972 revision of U.C.C. § 9-306(3). Under the 1962 version of U.C.C. § 9-306(3), a security interest in proceeds was temporarily perfected for 10 days and was then continuously perfected if the interest in the original collateral was perfected by a filed financing statement that also covered proceeds. The 1972 revisions reduce the scope of perfection so that after the 10 day period of temporary perfection a prospective lender can always find on file, in the appropriate office for the type of collateral against which he contemplates making a loan, a financing statement showing that at least some property of the prospective debtor is encumbered.

Since this article deals primarily with the identifiability of cash proceeds and since U.C.C. § 9-306(3)(b) provides for continuous perfection without refiling where “a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds,” it will be presumed, unless otherwise stated, that if cash proceeds are identifiable then the secured party’s interest in them is perfected. For further discussion of U.C.C. § 9-306(3), see text at notes 143-147 infra.

5. This provision for an automatic interest in proceeds resolved an apparent ambiguity in the 1962 version that had caused some concern that courts would hold that a claim to proceeds had to be based on 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 (April 25, 1971); Epstein, “Proceeding under the Uniform Commercial Code,” 30 Ohio St. L.J. 787 (1969); 1 G. Gilmore, Security Interests in Personal Property, § 11.4 at 351.

6. U.C.C. § 9-306(2) also continues the security interest in the original collateral unless the disposition was authorized or a specific provision of Article 9 provides otherwise. Comment 3 to U.C.C. § 9-306 notes that “[t]he secured party may claim both proceeds and collateral, but may of course have only one satisfaction.”
From these rules, it seems clear that the security interest does not continue in proceeds unless those proceeds remain identifiable, but nowhere does the Code define what is meant by the term "identifiable." When cash proceeds become commingled with funds from other sources, an issue arises as to whether the commingling destroys identifiability. If it does, the security interest is no longer enforceable against the proceeds. Even without commingling, an argument can be made that depositing cash proceeds in a bank account prevents them from being recovered in specie, thereby rendering them unidentifiable.

The question whether commingled cash proceeds remain identifiable may arise in a variety of contexts. By far the most common situation involves a conflict between a bank which has exercised a right of set-off against the account and a secured party claiming that the set-off was wrongful as to property subject to its security interest; but the conflict may also be a priority fight between two secured parties or between a secured party and a creditor with a judicial lien on the account, usually arising out of garnishment proceedings. Where funds have been withdrawn from the account, the secured party may seek to assert his interest against new assets purchased with the funds or against recipients of the funds, including cases where the bank is the


transferee of funds from the account under circumstances not involving set-off.\(^\text{12}\) Finally, the issue may arise where a secured party seeks to defeat a claim by a bankruptcy trustee that a payment by the debtor amounted to a voidable preference.\(^\text{13}\) In each instance, the court must initially determine whether the proceeds retained their identifiability after commingling so that the secured party has an interest on which to base his claim.

In recent years, a series of cases has held that cash proceeds remain identifiable notwithstanding commingling in the debtor's bank account.\(^\text{14}\) The courts in many of these cases have analogized the facts before them to situations in which constructive trusts have been imposed and have determined that the debtors should be regarded as trustees of funds which belong, in equity, to the secured parties.\(^\text{15}\) Once this basic analogy between security arrangements and constructive trusts has been established, the secured party is armed with tracing principles that allow him to determine, artificially, that portion of the deposit account that is allocat-


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ble to proceeds.\textsuperscript{16} Under this approach, “identifiable” is construed as the equivalent of “traceable.”

Research suggests that the drafters, if they considered the issue at all, did not intend for commingled cash proceeds to be identifiable. The use of the term “identifiable” in section 9-306 and other provisions of Article 9 is ambiguous at best and in some instances inconsistent with the view that it is the equivalent of traceable. Tracing originated as an equitable remedy to permit an individual wrongfully deprived of his property to recover that property \textit{in specie} by means of a decree of specific restitution; even today its use is generally dependent on the commission of some wrongful act as the basis for imposing a constructive trust. That some tracing is permitted in the commercial world of secured transactions is implicit in the very concept of a security interest in proceeds, but this right to trace is modified by the fact that the proceeds must be identifiable. One possible interpretation is that simple tracing to specific property is permitted by section 9-306(2), but the artificial tracing rules that are necessary to make an allocation of a commingled bank account are not available to secured parties unless the debtor has committed a wrongful act.

Courts may have sensed this limitation and sought to avoid it by resorting to the constructive trust analogy, but the analogy is weak in the context of many modern financing arrangements. In cases where the debtor’s disposition was wrongful, there has been a conversion of the collateral; and the imposition of a constructive trust as a vehicle permitting the use of artificial tracing rules is appropriate. In such cases, resort to these rules to follow cash proceeds into commingled accounts is clearly proper, not because the proceeds are identifiable but because the constructive trust with all its remedies is available through section 1-103 to supplement the provisions of the UCC.\textsuperscript{17} Where both the disposition of

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\item[\textsuperscript{16}] The fictional tracing principles are discussed in detail in the text accompanying notes 103-105 \textit{infra}.
\item[\textsuperscript{17}] U.C.C. § 1-103 states:

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capac-
\end{itemize}
original collateral and the commingling of proceeds were authorized by the secured party, his relationship with the debtor is purely commercial and does not contain any of the elements that have traditionally supported the constructive trust.

Ultimately, this article takes the position that the use of artificial tracing rules is not prohibited by the Code and that the recent cases reach a proper result notwithstanding the weaknesses of the constructive trust analogy. Since the UCC encourages secured parties to permit debtors to retain proceeds and use them in conducting their businesses pending default, it makes sense to give secured parties who make use of these liberal provisions some protection. Given the nature of the potential priority conflicts and the fact that third parties will rarely have relied on the funds in the account in making extensions of credit, the courts are justified in developing remedies to assist secured parties, although it should be recognized that the constructive trust is being employed as a fiction to permit use of these remedies. On the other hand, it can be argued that while the Code validates the floating lien it makes good sense to build in incentives for the secured party to engage in a modicum of policing. This article will suggest an approach to conflicts involving rights of set-off that will penalize the secured party for permitting commingling in situations where banks actually rely on funds in the account in deciding to extend credit without completely stripping him of his security interest in the proceeds.

This article will approach the issues by examining the situations in which commingling is likely to occur, reviewing the right to trace proceeds under some of the pre-Code financing devices, and analyzing the use of the term "identifiable" in the context of Article 9. It will then examine the modern line of cases involving secured parties' claims to commingled cash proceeds and will conclude by suggesting how some of the potential conflicts can be resolved in a man-

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* to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.*
ner that protects the interests of secured parties while remaining sufficiently flexible to grant priority to third parties in the relatively rare situations where the equities warrant such a result.

SITUATIONS IN WHICH COMMINGLING OCCURS

As a preliminary matter, it may be helpful to discuss briefly the situations in which cash proceeds are likely to find their way into the debtor's bank account, because the just resolution of conflicts may vary according to the factual background. Of course, the debtor may make an unauthorized sale of collateral and deposit the proceeds to his account, but in most cases the disposition of collateral is authorized by the secured party and the deposit is made with his express or at least tacit approval. In such cases, the deposits may be made to accounts containing only proceeds or they may be made to accounts to which the debtor also deposits funds from other sources. If the account contains only proceeds, the bank's records may or may not reveal this fact\(^\text{18}\) and the procedure for handling proceeds may or may not have been specified in the security agreement. Where the funds are deposited to a commingled account it is less likely that such a procedure would be expressly approved in the security agreement, but the secured party may be well aware of the practice. As with accounts containing only proceeds, the bank may or may not be aware of the origin of the deposits.

Cash proceeds are most likely to be deposited by the debtor where the original collateral is inventory\(^\text{19}\) or accounts.\(^\text{20}\) In the case of inventory, the security agreement may require the debtor to turn over the proceeds of sale as soon as they are received or it may call for periodic pay-

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18. For example, the account might be listed in the name of the debtor as trustee for the secured party, or even in the name of the secured party as sole owner with the debtor authorized to draw checks against the account.
19. Inventory is defined at U.C.C. § 9-109(4).
20. Accounts are defined at U.C.C. § 9-106 and, for present purposes, essentially mean accounts receivable. They must be distinguished from deposit accounts, which are defined at U.C.C. § 9—105(1)(e) and generally mean bank accounts.
ments to the secured party that are unrelated to the sales of specific items, thus allowing the debtor to use the proceeds in the conduct of his business. In the latter instance, unless the parties agree to the establishment of a special bank account for proceeds the debtor will probably deposit them in his general account. Even where proceeds are to be turned over immediately it is likely that the debtor will first deposit them in his general account and then remit to the secured party, usually by check drawn on that account. While this practice may violate the terms of the security agreement in some instances, it is more likely to occur with at least tacit approval from the secured party.

Where the original collateral is accounts, the secured party may, of course, notify the account debtors and collect directly from them. It is not unusual, however, for the debtor to make the collections and then remit, a procedure known as non-notification financing. As with inventory, remittance may be immediate or by periodic payments, and in either case it is likely that the collections will pass through the debtor's general banking account at some point in the process.

HISTORICAL PERSPECTIVE

I. Introduction

In order to appreciate fully the meaning of the term "identifiable proceeds," it is necessary to examine the rights of secured creditors under the myriad financing devices that preceded enactment of the UCC. If there was a right to follow cash proceeds into a commingled bank account under those devices, that fact would be some evidence of the drafters' intent in promulgating section 9-306(2).

Comment 2(c) to section 9-306 suggests that "whether a debtor's sale of collateral was authorized or unauthorized, prior law generally gave the secured party a claim to the proceeds." That a right to proceeds arose in cases where dispo-

21. Notification financing. U.C.C. § 9-318 provides rules governing the relationship between the assignee (secured party) and the account debtor, a term that is defined at U.C.C. § 9-105(1)(a).
sition was unauthorized is not contested, although there were occasional cases to the contrary. The wrongful disposition was a conversion, and imposition of a constructive trust allowing artificial tracing rules to be used was proper. However, research indicates that the position of Comment 2(c) with regard to authorized dispositions is too broad. In the area of chattel mortgages, for example, many courts did grant the mortgagee a right to proceeds; but a substantial number of cases reached the opposite result, frequently on the ground that consent to sale amounted to a waiver by the mortgagee of any lien on the proceeds. Of course, the cases denying any right to proceeds are no longer directly relevant because of the specific Code provisions granting the secured party an interest in proceeds.

A close reading of the cases leads to the conclusion that in cases where the disposition of the original collateral was authorized and the mortgagee was granted an interest in proceeds, the courts were actually relying on a wrongful act to achieve an equitable result. The wrongful act was most frequently a failure by the mortgagor to fulfill a contractual provision requiring him to account immediately for the proceeds. It is true that many courts imposed constructive trusts and used tracing terminology, but this seems to have been based on the finding of an equitable lien as a result of the mortgagor's failure to account and is not analogous to the automatic shift of the security interest to proceeds to which we have become accustomed under the


UCC. For example, in *Tyler Production Credit Ass'n v. Tyler State Bank & Trust Co.*\(^{27}\), the court stated as follows:

The sale having been made pursuant to the agreement, was with the consent of the mortgagee, whereby the purchaser took the property free of the lien, and against whom the mortgagee can have neither foreclosure nor damages for conversion . . . . Nor does the mortgage lien attach to the proceeds of the sale . . . . But there is nothing in the statutes or decisions of this state to prevent the proceeds from becoming a trust fund, when the sale is made by the mortgagor pursuant to an agreement with the mortgagee on condition that the proceeds be applied on the debt.\(^{28}\)

The court in *Tyler Production Credit Ass'n* saw more clearly than most that the right to proceeds did not arise automatically, as would be the case today, but instead was tied to the mortgagor's failure to abide by a term in the mortgage instrument. The constructive trust was necessary to find any interest in proceeds, regardless of commingling. This is no longer necessary under the UCC, and today the constructive trust is being used not as a basis for finding an interest in proceeds generally but as a vehicle to extend the automatic interest in proceeds to commingled funds. The cases are not all as clear as *Tyler Production Credit Ass'n* about the origin of the right to proceeds. Many cases use trust terminology indiscriminately, and this may have led to the impression that there was a generally accepted right to trace proceeds prior to the adoption of the UCC.

In cases where the collateral was inventory, most courts would not validate the mortgage itself without a clause imposing on the mortgagor a duty to account strictly for the proceeds;\(^{29}\) and attempts to let the mortgagor retain all the proceeds for use in his business were usually invalidated.\(^{30}\)

\(^{27}\) 178 S.W.2d 886 (Tex. Civ. App. 1944).

\(^{28}\) Id. at 887. (Citations omitted.)

\(^{29}\) According to Cohen & Gerber, *Mortgages of Merchandise*, 39 Colum. L. Rev. 1338, 1345 n.32 (1939), a clause placing the mortgagor under a duty to account rendered the mortgage valid in all jurisdictions except Virginia and, perhaps, Illinois.

\(^{30}\) Id. at 1346-47. The article notes that several mortgagees tried to overcome the problem by provisions allowing the mortgagor to retain part of the proceeds and
It is not surprising that the courts imposed constructive trusts in such cases. Where the mortgagor was under a duty to account, his failure to do so could be treated as a wrongful act resulting in the imposition of a constructive trust, thereby giving the courts a rationale for protecting the mortgagee by granting him an interest in the proceeds. These cases, then, are simply not precedent for imposing constructive trusts in cases decided under the UCC where the secured party's interest in proceeds is automatic. In Code cases in which disposition is authorized and the debtor is allowed to keep the proceeds without being under a duty to account, use of the constructive trust is clearly a fiction and a means to an end (the use of artificial tracing rules) notwithstanding its prevalence in chattel mortgage cases.\(^3\)

The idea that the debtor had to account for proceeds was carried over into another major inventory financing device, the trust receipt, and into non-notification receivables financing in the case of *Benedict v. Ratner*.\(^3\)\(^2\) Because this article is primarily concerned with situations where the disposition of collateral is authorized, the focus of this historical perspective will be on devices that were used in the financing of inventory and accounts receivable.

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\(^3\) This is not to suggest that there are not cases to the contrary of each position taken in the preceding paragraphs. There are cases in the area of chattel mortgages to support virtually any position one might care to take, as was pointed out in the following excerpt on one aspect of inventory mortgages dealing with power of sale clauses from one of the most painstakingly accurate articles ever written in the area:

Briefly, and without purporting to develop the various ramifications into which this enigma has led the courts, in about half the states a mortgage of a stock of goods held for resale with a power of sale vested in the mortgagor is invalid against creditors of the mortgagor, while the other jurisdictions hold that it is merely evidence of fraud but valid unless additional proof of intention to defraud creditors is forthcoming. Within these rules can be found a multitude of variations, apparently without rhyme or reason.


32. 268 U.S. 353 (1925).
II. Inventory

A. Chattel Mortgages

Until the adoption of the UCC, there were always problems for creditors seeking to use their debtors' inventory as collateral. At early common law, any mortgage of personality where the mortgagor retained possession was viewed as a secret lien and therefore fraudulent as to creditors, but by the time inventory financing began to develop in the nineteenth century the use of possessory mortgages had been validated in this country by the enactment of chattel mortgage recording statutes. The problems with mortgages on inventory did not stem from the fact that the mortgagor continued in possession but rather that he had a power to sell the collateral and that the mortgagee claimed an interest in new inventory as it was acquired. The problem with the after-acquired property clause sprang from the common law rule that property could not be encumbered before its acquisition. This rule began to break down with the development of the doctrine of potential possession, beginning with the case of Grantham v. Hawley, and it was thoroughly discarded by Justice Story in the famous case of Mitchell v. Winslow. Unfortunately, Mitchell

34. This article draws heavily from the historical perspectives advanced in the two volume treatise, G. Gilmore, Security Interests in Personal Property (Little, Brown & Co. 1965) (hereinafter cited as Gilmore).
36. 17 F. Cas. 527 (C.C.D. Me. 1843) (No. 9,673). In that case, a manufacturer obtained a loan and, as security, gave a mortgage on his plant "together with all tools and machinery . . . which we may at any time purchase for four years from this date, and also all the stock which we may manufacture or purchase during said four years." Id. at 529. The mortgage was properly recorded and, after default, the mortgagee took possession of some tools that had been acquired after the mortgage was executed and sold them to a third party. The mortgagor then declared bankruptcy and the issue of the validity of the after-acquired property clause came before Justice Story. He validated the mortgage as follows:

It seems to me a clear result of all the authorities, that wherever the parties, by their contract, intended to create a positive lien or charge, either upon real or upon personal property, whether it is then in esse or not, it attaches in equity as a lien or charge upon the particular property, as soon as
v. Winslow did not permanently dispose of the issue, and the states developed a variety of rules to deal with after-acquired property clauses. Eventually, the courts began to accept the after-acquired property clause in the context of equipment financing, but the problem of the after-acquired property clause on inventory was never fully resolved.

Even in states which validated the after-acquired property clause, the power of sale clause was likely to vitiate the mortgage. Obviously, for a mortgage on inventory to be attractive to either lender or borrower, the borrower must have a power of sale; but the courts in a vast majority of states held that such a power is fraudulent either as a matter of law, thereby voiding the mortgage entirely, or is at least presumptively fraudulent. The idea that a power of sale rendered a mortgage on personality a fraudulent conveyance stemmed from the view that a debtor with such a power would appear to third parties as the full owner of the property. The mortgagee was seen as having imbued the mortgagor with the most important aspect of ownership, the power of alienation. This "ostensible ownership" might be used to defraud other creditors.

the assignor or contractor acquires a title thereto, against the latter, and all persons asserting a claim thereto, under him, either voluntarily, or with notice, or in bankruptcy.

Id. at 533.

37. Four years later, in Moody v. Wright, 54 Mass. 17 (1847), the Massachusetts Supreme Court held that a mortgagee under an after-acquired property clause lost to an assignee for the benefit of creditors where the mortgagee had done nothing to reperfect his interest after the mortgagor obtained possession of new property.

38. In some states they were valid between the original parties and as to all third parties, including purchasers, lien creditors and subsequent mortgagees; in some states they were valid between the original parties but the mortgagee was subordinated to purchasers and lien creditors whose interests arose before the mortgagee took possession or refiled; and in some states they were invalid even between the original parties. The result was a confusion that deterred creditors from using the chattel mortgage as a security device where the collateral was inventory. These rules are collected, along with complete annotations, at Cohen & Geber, The After-Acquired Property Clause, 87 U. Pa. L. Rev. 635 (1939). See also, Stone, The "Equitable Mortgage" in New York, 20 COLUM. L. REV. 519 (1920).


40. One of the earliest cases to take this position was Lang v. Lee, 24 Va. 410 (1825). See also Griswold v. Sheldon, 4 N.Y. 581 (1851); Robinson v. Elliott, 89 U.S. (22 Wall.) 513 (1874).
The problem of the power of sale clause was reviewed by the United States Supreme Court in *Robinson v. Elliott*, where Justice Davis invalidated such a mortgage and made the following statement:

> It is not difficult to see that the mere retention and use of personal property until default is altogether a different thing from the retention of possession accompanied with a power to dispose of it for the benefit of the mortgagor alone. The former is permitted by the laws of Indiana, is consistent with the idea of security, and may be for the accommodation of the mortgagee; but the latter is inconsistent with the nature and character of a mortgage, is no protection to the mortgagee, and of itself furnishes a pretty effectual shield to a dishonest debtor.

Justice Davis went on to note that there are economic reasons for mortgages with powers of sale, but that there were other problems with the case before him. In particular, he noted that the mortgagor had been in default for twenty-one months but the mortgagee had not sought to foreclose. Also, he was no doubt referring to the fact that the mortgagor was allowed to use the proceeds of sale when he critically noted that “there is no covenant to account with the mortgagees.”

Later cases picked up on the idea that even though the power of sale clause posed a problem, it might be overcome if the mortgagor was rigidly bound to account to the mortgagee for the proceeds of sale. The idea apparently was that such a duty rendered the mortgagor an agent for the mortgagee for the purpose of making the sale, and this fiction permitted the courts to accept the power of sale. In addition,

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41. 89 U.S. (22 Wall.) 513 (1874).
42. *Id.* at 523-24.
43. *Id.* at 524.
He [the mortgagee] need merely provide in the mortgage that all the proceeds of the sales of merchandise shall be turned over to the mortgagee-bank, and practically all jurisdictions will accept the mortgage as valid for all purposes. The traditional theory upon which this is based is that . . . [the mortgagor] is now the agent of the bank with a power of sale over the goods and a duty to account for the proceeds. This unrealistic approach has become so well known to draftsmen of chattel mortgages that provisions
the traditional fiduciary relationship between principal and agent may have induced the courts to impose a constructive trust where the mortgagor failed to account properly, even though they might not have done so had they viewed the relationship between the parties as strictly debtor/creditor.\textsuperscript{45}

The ultimate result of all the problems with chattel mortgages on inventory was that other devices were developed to meet what, by the sheer number of cases on the subject, was a pressing need of the business community. Professor Gilmore notes that:

The problem of the stock in trade mortgage, like the problem of the after-acquired property interest, eventually received what might be called a pragmatic solution. In this instance, however, the solution was long in coming and, when it came, was completely outside the framework of mortgage law. That is to say, a merchant's or manufacturer's stock in trade (or, as we shall say, his inventory) became safely available as security only with the judicial or statutory validation of such devices as the trust receipt, the factor's lien and field warehousing.\textsuperscript{46}

In sum, the courts in chattel mortgage cases simply did not resolve the issues presented by commingled cash proceeds resulting from authorized dispositions, and the constructive trust, which is the basis on which modern cases have found a right to trace to commingled cash proceeds, was necessary in the chattel mortgage cases to find any interest in proceeds, regardless of commingling. The cases imposing constructive trusts are not precedent for interpreting section 9-306(2), primarily because an interest in proceeds arises automatically under the UCC and the patterns of financing in chattel mortgage cases were not really analogous to those being explored in the modern context where

\textsuperscript{45.} \textit{See generally,} Turner v. Williams, 114 Kan. 769, 221 P. 267 (1923), which strikingly illustrates the different results that could be reached depending on whether the sale was authorized or not. The case is also interesting because its language foreshadows the identification problem encountered under the UCC with commingled cash proceeds.

\textsuperscript{46.} 1 GILMORE, § 2.5 at 39.
the debtor is given full power to retain and use cash proceeds until he defaults on the security agreement.

B. Conditional Sales

The conditional sale was never used extensively as an inventory financing device, although there are a number of cases where the buyer was authorized to resell the original sales item. In *Peoples State Bank v. Caterpillar Tractor Co.*, the conditional buyer resold tractors purchased under a conditional sales agreement and deposited the proceeds in its general banking account, where they were commingled with funds from other sources. In a decision highly reminiscent of recent cases using the constructive trust analogy to find that commingled funds are identifiable, the court preferred the conditional seller over a bank exercising a right of set-off against the account. While *Peoples State Bank* does offer some support for a right to trace into a commingled account, it does not represent a widely held position. In fact, in another case involving similar facts, *Kilgore v. State Bank*, the court rejected the conditional seller's claim that he had a trust interest in his buyer's general banking account and held that the parties' relationship was really one of debtor and creditor. As with chattel mortgages, the cases on conditional sales do not support the view that there was a generally accepted right to trace cash proceeds into commingled accounts prior to the adoption of the UCC.

C. Trust Receipts

Professor Gilmore noted that the right to proceeds was never really resolved prior to the UCC in the following except:

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47. 213 Ind. 235, 12 N.E.2d 123 (1938).
48. Interestingly, the conditional buyer had already arranged the resale when it purchased the tractors and had assigned the purchase order and all moneys received under it to the conditional seller as part of the original agreement. Also, the conditional buyer was referred to by the court as an agent for the conditional seller for the purpose of resale. Thus, two of the elements present in chattel mortgage cases using trust terminology, a duty to account and the agency concept, were also present in this case.
Except in inventory financing, the proceeds problem has not been of much importance and never will be. None of the pre-Code statutes dealt expressly with the problem, except in the context of inventory, but there can be no doubt that a mortgagee has always been entitled to trace and take the proceeds received by a mortgagor who has without authority disposed of the mortgaged property. Since there has never been much litigation of this type, the calculus of priorities in proceeds between the mortgagee and third parties was never thoroughly explored. [Emphasis supplied.]

The reference to a pre-Code statutory provision governing rights as to proceeds is to section 10 of the Uniform Trust Receipts Act (UTRA), the predecessor of section 9-306 of the UCC. Because the trust receipt was an important pre-Code inventory financing device and because the term "identifiable proceeds" was first used statutorily in UTRA, this area will be developed in some detail.

The trust receipt was first used in the importation of raw materials from foreign countries for use in the manufacture of goods. An American bank would issue what amounted

50. 2 GILMORE, § 45.9 at 1336-37.
52. For an excellent history of the common law trust receipt, see, Frederick, The
to a letter of credit guaranteeing the payment of drafts drawn on an American buyer and in this manner would finance the buyer's acquisition of the materials. The materials would then be shipped under a bill of lading made out to the bank directly or indorsed to the bank by the seller. Under these facts, the bank became the owner of the goods with full title to them, and it controlled possession of the goods through the bill of lading. It could then turn the bill of lading over to the buyer and obtain a receipt containing the buyer's promise to use the materials only for the temporary and limited purposes of processing and resale. Under this scheme, the bank had an effective financing device that could be used where the collateral was inventory; and the entire scheme was similar to a pledge of the goods by the borrower to the bank with a return for a temporary and limited purpose. While the device is to all appearances a disguised chattel mortgage, the courts validated it and distinguished it from a pledge on the technical ground that title was at all times in the bank and never passed to the buyer. 53


53. The trust receipt may have been inspired by analogy to an outgrowth of the law of pledges. The pledge was the earliest and safest form of financing device because it did not allow the debtor to remain in possession and, therefore, did not create the secret liens that were so abhorrent to the courts. It developed, however, that under certain circumstances the pledgee could release the collateral to the pledgor for a temporary or limited purpose without terminating the pledge. This rule is expressed in § 11 of the Restatement of Security as follows:

(2) A pledge is not terminated by delivery of the chattel to the pledgor for a temporary and limited purpose relating to the maintenance of the value of the pledgee's interest and having to do with the protection, improvement or sale of the chattel, or where the chattel is an instrument or document, its handling or collection.


This exception to the general rule that the pledgee had to maintain possession coupled with an extension of the pledge to cases involving intangibles so long as the underlying obligations were expressed in a controlling writing (the Restatement refers to the writing as an "indispensable instrument" and defines that term as "the formal written evidence of an interest in intangibles, so representing the intangible that the enjoyment, transfer or enforcement of the intangible depends upon posses-
The receipt executed by the buyer was actually a contract with the bank promising to repay the bank from the proceeds of sale of the finished product and containing a variety of other provisions. It was not really a trust transaction because legal title remained in the bank.\textsuperscript{54} The trust terminology may have induced courts to allow some tracing, and the duty to account for proceeds may likewise have been influential, just as it was in the area of chattel mortgages on inventory. It is not clear, however, that there was a generally accepted right to use artificial tracing techniques to follow cash proceeds right into a commingled account,\textsuperscript{55} although

\textsuperscript{54} An interesting passage from Professor Gilmore describes two of the most important provisions of the contract and also suggests an origin for the unusual analogy between what is essentially a debtor/creditor relationship and the law of constructive trusts. It also suggests that this analogy is inapt, an idea that will be discussed in considerable detail later in this article.

The instrument drafted by counsel for the banks provided that, in consideration of the bank's releasing the goods to its customer, for processing and resale, 1) the bank should have the right \textit{at any time} during the manufacturing process, without prior notice and for any reason it deemed sufficient, to retake the goods and hold them as a pledgee in possession after default; and 2) the bank's lien rights should survive the resale after processing and attach to the proceeds of sale with the same force and effect as to the goods. The statement of conditions possibly suggests the analogue of a wrongdoer holding property (or its proceeds) on a constructive trust for his victim; such a flight of fancy may explain the curious choice of "trust" to describe the receipt incorporating the bank's terms which the customer signed. The customer—trustee—was not of course a wrongdoer and unlike the trustee, \textit{ex maleficio} or otherwise, never had 'legal title' to the goods, which the bank reserved to itself.


\textsuperscript{55} In an early case, Carter v. Arguimbau, 31 Abb. N. Cas. 3 (N.Y. Com. Pl. 1884), the buyer made an assignment for the benefit of creditors and the financing bank sought to recover the goods or their proceeds. Noting that title remained in the bank, the court granted it a right to the goods "and in case of their sale on the specific proceeds thereof \textit{so long as those proceeds remain distinguishable from other funds.}" \textit{Id.} at 5. (Emphasis supplied.) In another early case, Dennistown v. Barr, 31 Abb. N. Cas. 21; 28 N.Y. Supp. 255 (Sup. Ct. 1893), a bank was granted a similar right to proceeds which were in the form of an account receivable since the ultimate purchaser had not paid for the goods. The court noted that "'[t]here had thus been no actual intermingling of the proceeds with the general assets of Thomas M. Barr & Co."

31 Abb. N. Cas. at 27, 28 N.Y. Supp. at 258. The implication is that the right to
there is some authority permitting the entruster to do so in some circumstances.\textsuperscript{56}

The trust receipt later became a commonplace financing device in domestic transactions involving such large consumer goods as automobiles and appliances, and in 1935 the Uniform Trust Receipts Act was promulgated as a general validating statute that resolved certain conceptual problems that had arisen in the case law. Under section 10(c) of UTRA, the entruster was granted a lien on all “identifiable proceeds” so long as the trustee was under a duty to account for proceeds (presumably, this would always be the case) and the entruster had not waived that duty. The entruster could waive the duty to account by words or conduct, and specifically by failing to demand that proceeds be turned over within ten days after learning of their receipt by the trustee. In addition, under section 10(b) the entruster had the right to any proceeds or their value, whether or not they were identifiable, if they were received by the trustee within a ten day period prior to insolvency proceedings involving the trustee or a demand by the entruster for an accounting.

\textsuperscript{56} See In re Mulligan, 116 F. 715 (D. Mass. 1902), which involved a debtor under a trust receipt who became insolvent after turning over proceeds to his broker to speculate in the stock market. The broker had commingled the proceeds with other funds in his account and then purchased stock with them. The trust receipt had contained the usual provision requiring the debtor to turn over the proceeds immediately. The court was prepared to apply artificial tracing principles from the law of trusts but held that the petitioners had not sustained their burden of proof. The propriety of this position was not questioned by one of the commentators, who stated:

\begin{quote}
Suppose the signer of the trust receipt has collected the purchase price and instead of immediately deliver ing it to the bank, has deposited it in his own bank account, in which he continues to make deposits and from which he pays out by check or otherwise. \textit{Obviously, the identity of the money is lost}. Nevertheless, it has a certain resemblance to a mingling of fungible goods. Any rules regarding the identity of the funds used from time to time are largely arbitrary—mere presumptions. They are, nevertheless, well recognized . . . . \textit{[They are] the rule with respect to the proceeds of trust receipt property.} [Emphasis supplied.]
\end{quote}

Thus, section 10(b) of UTRA, like section 9-306(4) of the UCC, clearly contemplated that some proceeds were beyond the reach of the entruster's lien because they had been rendered unidentifiable, but there was a right to the value of even unidentifiable proceeds in certain limited situations. Section 10(b) has generally been seen in the literature as a special rule for insolvency cases, which it was in part, but it also gave priority to the entruster for the value of unidentifiable proceeds where the entruster had demanded an accounting. Thus, it is likely that at least part of the purpose of section 10(b) was to encourage the entruster to police the trustee's account, and if he did so he would have special rights that would not accrue to him absent such policing.\textsuperscript{57} Section 10(b) did not limit the entruster's right to proceeds or their value in the event of insolvency, which was the other area in which an interest in unidentifiable proceeds would be protected; it simply gave the entruster the same rights to unidentifiable proceeds that he could have obtained by demanding an accounting on the tenth day preceding bankruptcy.\textsuperscript{58}

The important point for the moment is that while the term "identifiable proceeds" clearly originated in statutory form with UTRA, the statute built on the foundation of cases that had discussed proceeds issues for almost a century. If it is true that, by the time of UTRA's promulgation, the weight of authority favored artificial tracing of commingled proceeds (and this is by no means clear), the drafters must have been aware of that fact. In this atmosphere, a logical explanation of section 10 is that it was intended to limit the tracing right except for a limited exception in insolvency cases and in cases where the entruster had demanded an accounting; and the reason for this limitation may well have been a desire to promote policing by creditors to enforce the

\textsuperscript{57} This interpretation, albeit speculative, seems especially appealing since UTRA was drafted in the period immediately following the U.S. Supreme Court's decision in \textit{Benedict v. Rainer}, with its implications regarding policing in the area of non-notification accounts financing. \textit{See} text at note 61 \textit{infra}.

\textsuperscript{58} This point will be discussed further with reference to the most appropriate interpretation of U.C.C. § 9-306(4)(d), which is the UCC counterpart of § 10(b) of UTRA. \textit{See} text at notes 82-86 \textit{infra}.
duty to account for proceeds. If this theory is correct, the implication is that section 9-306, the direct descendant of section 10 of UTRA, continued this policy. This theory may explain the following passage from Professor Gilmore with reference to section 9-306(2):

It should be noted that the interest in proceeds continues only so long as the proceeds (including collections received by the debtor) remain "identifiable." . . . The cut-off point is when the collections cease to be identifiable . . ., normally by deposit in a bank account . . . . If a secured party allows his debtor to make and keep collections, he loses his interest (except for a limited right in insolvency proceedings) when the collections are commingled with other deposits in the debtor's bank account.59 [Emphasis supplied.]

D. Field Warehousing

One final inventory financing device is worth a brief mention. The field warehouse, even more clearly than the common law trust receipt, developed out of the temporary and limited purpose exception that developed in the law of pledges.60 The creditor would take advantage of the exception by establishing an independent warehouse on the debtor's business premises and obtaining documents of title in the form of warehouse receipts as new inventory was received. These receipts could later be delivered to the debtor, who would use them to obtain inventory from the warehouse for the temporary and limited purposes of processing and/or resale. Frequently, payment was required before the goods could be removed from the warehouse. As in the case of the pledge generally, the cases never really resolved the creditor's right to proceeds generally, much less proceeds in the form of commingled bank accounts.

III. Accounts Receivable

Non-notification financing of accounts receivable is a twentieth century phenomenon, and its development was

59. 2 GILMORE, § 27.4 at 735-36.
60. RESTATEMENT OF SECURITY, § 11, Comment d.
shaped in large measure by the famous decision in *Benedict v. Ratner*. In that case, the Hub Carpet Company assigned the respondent all its accounts receivable, including future accounts, but retained the right to collect the accounts pending default. The company eventually became insolvent and the petitioner was appointed as receiver. Both the District Court and the Second Circuit\(^6\) supported the respondent and upheld the validity of the assignment, but the Supreme Court noted the assignor's power to retain and use proceeds and, in an opinion by Justice Brandeis, held that: "Under the law of New York 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."\(^6\)

This decision has been criticized on the ground that it was based on the ostensible ownership doctrine that had limited the utility of the chattel mortgage as an inventory financing device; but, whatever its basis, it led to what Professor Gilmore has referred to as the professionalization of non-notification receivables financing. The following excerpt illustrates the pattern of such financing following *Benedict v. Ratner*:

To escape from *Benedict*, the lender was required to exercise dominion over his security. [Footnote omitted.] What came to be accepted as the proper way of asserting dominion in non-notification financing was a requirement that the proceeds of collection be remitted daily by assignor to assignee. Nothing was to go directly into the assignor's bank account; all checks, notes and acceptances must be indorsed and delivered to the assignee.\(^6\)

Because of procedures such as these, the courts were never forced to resolve issues involving tracing into commingled accounts.\(^6\)

\(^6\) In re Hub Carpet Co., 282 F. 12 (2d Cir. 1922).
\(^6\) 268 U.S. 353, 360 (1925).
\(^6\) 1 GILMORE, § 8.3 at 260.
\(^6\) For a thorough discussion of accounts financing generally, see Koessler, Assignment of Accounts Receivable, 33 CALIF. L. REV. 40 (1945).
Other accounts financing, such as factoring, utilized the notification method of financing and the issue of commingling did not arise because payments were made directly to the assignee by the account obligor. The accounts receivable statutes which were developed in the area of non-notification financing following the Supreme Court's decision in *Corn Exchange National Bank and Trust Co. v. Klauder* did not deal with the issue of commingled proceeds at all. These statutes were passed to avoid the impact of the Chandler Act, a 1938 amendment to section 60(a) of the Bankruptcy Act, which added the following language to the provisions on preferential transfers:

A transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred, superior to the rights of the transferee therein, and if such transfer is not so perfected prior to the filing of the petition in bankruptcy . . . it shall be deemed to have been made immediately before bankruptcy.

The *Klauder* case held that under Pennsylvania law a subsequent assignee could obtain rights superior to a prior assignee up until the time the account obligor was notified of the assignment. Since by its very nature non-notification financing precluded notice to the obligor except after default, the transfer was deemed to be in consideration of an antecedent debt and therefore voidable. In other states where notification of the obligor was not required to obtain priority over subsequent assignees, the assignment was presumably not voidable.

The accounts receivable statutes that followed the *Klauder* decision fell into several different categories, sometimes requiring recordation as a condition of perfection and some-

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66. 318 U.S. 434 (1943).


times merely clarifying or reversing a state’s common law to protect non-notifying assignees from subsequent assignees. A Uniform Assignment of Accounts Receivable Act was drafted and took the latter approach; but, like the state statutes, it did not deal in any way with problems stemming from commingling of proceeds, presumably because *Benedict v. Ratner* was believed to be still applicable to the area even if the threat of *Klauder* had been removed.

IV. Summary

In summary, there is no consistent treatment of commingled cash proceeds in the context of the pre-Code financing devices used in the area of inventory and non-notification receivables financing. In large measure, this can be explained by the duty promptly to account for proceeds that was almost universally imposed on debtors. Cases supporting almost any conceivable viewpoint can be found; but a careful reading of the cases suggests that where trust terminology was employed there was almost always some wrongful act by the debtor, although this act was frequently no more than a breach of a contractual provision. The significance of the breach was magnified, however, by courts that treated the mortgagor as the agent of the mortgagee for the purpose of resale. Since the agent’s duty to account to his principal rests on a fiduciary basis, it is not difficult to see how the courts came to treat a simple breach of contract as the basis for imposing a constructive trust. This approach may in part be explained by the courts’ desire to approve of commercial practices while being constrained by the traditional approach to power of sale clauses. Thus, even the cases supporting the trust analogy can’t really be used as precedent for typical Article 9 financing arrangements where the debtor retains full use of the proceeds without being under a duty to account. Perhaps the bias against the debtor having full dominion over proceeds could not be broken until the enactment of section 9-205 of the UCC.

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69. *Id.* at 174.
70. *Id.* at 180.
This historical perspective has not attempted an exhaustive review of the case law under each of the pre-Code devices. They are numerous and difficult to reconcile. What has been presented is a representative sampling sufficient to refute the belief that there was a generally accepted right to use artificial tracing rules to follow cash proceeds into commingled bank accounts prior to the adoption of the UCC.

ARTICLE 9'S TREATMENT OF PROCEEDS IN BANK ACCOUNTS

The 1962 version of Article 9 contained a provision excluding from its scope "a transfer in whole or in part of... any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization." While this apparently excluded any interest in bank accounts from the scope of Article 9, it was in potential conflict with section 9-306(4)(d), which granted the secured party a limited interest in bank accounts containing proceeds in the event of insolvency proceedings involving the debtor. This potential conflict was resolved by cases holding that section 9-104(k) only excluded the creation of original security interests in bank accounts and did not apply to continuing security interests in the form of proceeds deposited to bank accounts.

This explanation was incorporated into the 1972 version of the Code, which added "deposit account" as a defined term and revised section 9-104(k) [now at section 9-104(1)] to exclude from Article 9 "a transfer of an interest in any deposit account...", except as provided with respect to pro-

71. U.C.C. § 9-104(k). In the 1972 version, this provision has been amended and appears at U.C.C. § 9-104(l).


73. Deposit account is defined at U.C.C. § 9-105(1)(e) as "a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit."
ceeds . . . and priorities in proceeds . . . ."\(^74\) In addition, the definition of cash proceeds at section 9-306(1) was expanded to include deposit accounts, and amendments to section 9-306(4) make it clear that the term "deposit account" is broad enough to include "separate deposit accounts containing only proceeds . . . ."\(^75\) and "deposit accounts . . . in which proceeds have been commingled with other funds . . . ."\(^76\) What remains unclear, however, is whether proceeds in deposit accounts remain identifiable so that the secured party has a continuing interest in them in non-insolvency cases to which section 9-306(4) does not apply.

While the meaning of identifiable in section 9-306(2) is by no means clear, its usage and the usage of words with the common root "ident-"\(^77\) in other sections of Article 9 suggest that the draftsmen did not consider it to be the equivalent of traceable, at least to the extent that tracing involves artificial rules for the allocation of commingled funds. Section 9-306(2) clearly contemplates some tracing by permitting a security interest to continue in proceeds. The very process of transferring the interest from property in one form to property in another form requires that tracing be employed. Seen in this context, use of the term "identifiable" appears to be a modification limiting the right to proceeds in section 9-306(2). The scope of the limitation is unclear, however, and there is nothing to suggest that the use of "identifiable" was intended to prohibit the use of artificial tracing rules. It may well be that the term was incorporated straight from section 10 of UTRA without any real consideration as to its meaning.

Whenever cash proceeds are deposited in a bank account they become part of the bank’s general assets and may be used for any permissible banking purpose. The depositor becomes a general, unsecured creditor of the bank, and the

\(^75\) U.C.C. § 9-306(4)(a).
\(^76\) U.C.C. § 9-306(4)(d).
\(^77\) An invaluable research tool is Hawkland, UCC Concordance, 1974 Ill. Law Forum 1.
bank makes no effort to segregate the specific funds of its various depositors. The only evidence of the amount of the bank's debt is in the records of deposits to and withdrawals from the account maintained by the bank and the depositor. The loss of identity, as that word is commonly used, could not be more complete, and it makes no difference whether cash proceeds have been deposited to accounts containing only proceeds or to accounts in which the proceeds are commingled with funds from other sources.

Where the deposit account contains only proceeds, there is no practical reason why this loss of identity should prejudice a secured party, and this conclusion is supported by the revision of section 9-306(1) to include deposit accounts in the definition of cash proceeds. In fact, even without this definitional change a strong argument can be made that even though the money placed in the account cannot be returned in specie the account is nonetheless identifiable. After all, the cash proceeds have been converted into a single, intangible bank obligation running in favor of the debtor, and the account itself can be identified as a whole through use of the account number designated by the bank. The secured party has traced his proceeds to a specific asset, albeit intangible, and he should not be required to prove more than that cash proceeds of collateral subject to his security interest were deposited in the account and that no commingling has occurred.

The situation changes when cash proceeds have been commingled with funds from other sources in a deposit account. Where the account has been the subject of frequent deposits from various sources and withdrawals for various purposes over an extended period of time, the secured party is unable to show the extent to which the balance at any given point in time represents proceeds of his collateral. It is

78. In fact, where cash proceeds are in the form of checks, the bank could not segregate funds in specie since it collects the check from the drawee bank through the process of bank settlements.

79. This does not necessarily mean that the secured party will prevail in all priority contests. The treatment of priority rights where the secured party is contesting the right of a bank to exercise set-off is discussed in text at notes 115-116 infra.
only by resort to artificial tracing principles such as the "lowest intermediate balance"\textsuperscript{80} rule that courts are able to make an allocation; and, since the issue most frequently arises in the context of a priority fight involving the secured party and the depositary bank\textsuperscript{81} or some other third party not involved in the original secured transaction, the use of artificial tracing rules to permit identification is necessarily arbitrary. An argument can be made that allocation by this method is less appropriate in light of the fact that the commingling may well have originally occurred with the consent of the secured party and may have been allowed to continue because the secured party permitted the debtor to retain the proceeds and use them in his business pending default. In such cases, there is no duty to account to the secured party for the proceeds, a practice which was almost universally present in pre-Code cases. Since the secured party has permitted the commingling in the first instance, perhaps the courts should allow him to suffer the consequence of losing his security interest rather than resorting to artificial rules that permit him to prevail over an innocent adversary. This argument becomes more compelling in cases where the third party has relied on the balances in the account in its decision to extend credit to the debtor.

The argument against the secured party, while superficially appealing, ignores the fact that the UCC specifically allows secured parties to permit their debtors to retain, use and commingle collateral and proceeds; and where cash proceeds are retained for use in the business it would be illogical to require debtors to keep them segregated. There are certain risks that a secured party runs when he allows his debtor to retain and use cash proceeds, but loss of his security interest should not be one of them. It would make no sense for section 9-205 to validate security agreements where commingling is allowed but then construe section 9-306(2) in

\textsuperscript{80} See text accompanying note 103 \textit{infra}, for a detailed explanation of the operation of the lowest intermediate balance rule.

\textsuperscript{81} This term is not being used in the technical sense as defined at U.C.C. § 4-105(a) but rather as a term of convenience to designate the bank at which the debtor maintains the deposit account.
such a way as to terminate the security interest in commingled proceeds. The inducement to the secured party to police his debtor's business should rest primarily on business reasons. Such a policy is alluded to in Comment 5 to section 9-205, which states that: "Nothing in Section 9-205 prevents such 'policing' and dominion as the secured party and the debtor may agree upon; business and not legal reasons will determine the extent to which strict accountability, segregation of collections, daily reports and the like will be employed." In addition, the circumstances in which the bank holding the proceeds or some other third party will have relied on them in extending credit are rare. These factors suggest the policy of the law ought to be the protection of secured parties' interests.

Since the Code does not define the term "identifiable," it is appropriate to examine its use in sections other than section 9-306(2) to gain insights into the drafters' intent, and a good place to begin is section 9-306(4), which defines the secured party's right to proceeds in the event the debtor becomes involved in insolvency proceedings. Section 9-

82. U.C.C. § 9-306(4) states as follows:

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(a) in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds;

(b) in identifiable cash proceeds in the form of money which is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a deposit account prior to the insolvency proceedings; and

(d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph (d) is

(i) subject to any right to set-off; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4).

83. U.C.C. § 1-201(22) defines insolvency proceedings as "any assignment for
306(4)\textsuperscript{84} sharply differentiates between deposit accounts containing only proceeds and commingled accounts. Section 9-306(4)(a) continues without limitation the interest of a secured party with a perfected security interest in proceeds into separate accounts containing only proceeds; but under section 9-306(4)(d) the secured party's right to proceeds in commingled accounts is sharply curtailed. Section 9-306(4)(d) is the only Code provision that specifically refers to funds being commingled in a deposit account, and it is worth noting that while sections 9-306(4)(a)-(c) each contain the word identifiable, section 9-306(4)(d) does not. One possible interpretation is that while "deposit accounts" includes both commingled accounts and accounts containing only proceeds, the funds in commingled accounts are not identifiable and the secured party has no enforceable interest in them except the limited rights granted in insolvency proceedings. Arguably, this interpretation is consistent with the provisions of section 9-306(4)'s predecessor, section 10(b) of the Uniform Trust Receipts Act. Analogies are imprecise, however, because section 10(b) of UTRA gave priority to the entruster in non-insolvency cases where a demand for proceeds had been made, while section 9-306(4)(d) does not.

It must be noted that this is not the conventional analysis of section 9-306(4). Several commentators have suggested that section 9-306(4)(d) simply substitutes a mathematical formula in insolvency proceedings for a right to trace proceeds into a commingled account that accrues to the secured party absent such proceedings by virtue of section 9-306(2).\textsuperscript{85} That is, section 9-306(4)(d) limits the secured party's rights in insolvency rather than conferring the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved."

\textsuperscript{84} For a detailed explanation of the operation of U.C.C. § 9-306(4) see 2 Gilmore, § 45.9; Epstein, "Proceeding" Under the Uniform Commercial Code, 30 Ohio St. L.J. 787 (1969).

additional rights on the secured party where insolvency occurs. This view finds some support in Comment 2(a) to section 9-306, which states as follows:

Whether a debtor’s sale of collateral was authorized or unauthorized, prior law generally gave the secured party a claim to the proceeds. . . . This section provides new rules for insolvency proceedings. Paragraphs 4(a) through (c) substitute specific rules of identification for general principles of tracing. Paragraph 4(d) limits the security interest in proceeds not within these rules to an amount of the debtor’s cash and deposit accounts not greater than cash proceeds received within ten days of insolvency proceedings less the cash proceeds during this period already paid over and less the amounts for which the security interest is recognized under paragraph 4(a) through (c).

Interestingly, however, Comment 2(a) to the 1962 version of section 9-306 stated that section 9-306(4)(d) “relates to non-identifiable cash proceeds,” directly refuting the view that the section limits rights in the event of insolvency. The argument that section 9-306(4)(d) is a right-limiting provision seems to be based on a belief that financers were granted artificial tracing rights in non-insolvency cases involving commingled proceeds under pre-Code financing devices, but it has been demonstrated that this proposition is subject to considerable debate and qualification.

The view that section 9-306(4)(d) is a right-limiting provision fails to take account of the fact that Article 9 is strongly advantageous to the secured party throughout and seems to favor the secured party over the bankruptcy trustee.86 Viewing section 9-306(4)(d) as restricting the secured party’s rights in insolvency proceedings goes against

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86. For example, U.C.C. § 9-108 was an attempt to influence bankruptcy courts into holding, on the basis of state law, that security interests in after-acquired collateral are deemed to be for new value and not for antecedent debts in order to limit the effect of the voidable preference provisions of the Bankruptcy Act. The policy of favoring the secured party over the bankruptcy trustee continued in the 1972 revisions, with the most notable example being U.C.C. § 9-313(4)(d). Section 9-313 generally requires an interest in fixtures to be perfected by a recording that is integrated into the real estate records, but U.C.C. § 9-313(4)(d) creates an exception that allows any filing that would be valid under U.C.C. § 9-401 to defeat the trustee.
this overall trend. In addition, section 9-306(4) is derived from section 10(b) of UTRA but does not continue the UTRA provisions granting an interest in unidentifiable proceeds following a demand by the entruster for an accounting. It is entirely possible that the drafters accidentally created in section 9-306(4) a statutory lien that gives the secured party additional rights in the event of insolvency. Because of the wider scope of section 10(b) of UTRA, this argument could not be made as forcefully with respect to that provision. The drafters may simply have failed to realize the impact of the accounting provision in section 10(b). Ultimately, however, it must be conceded that the issue of identifiability cannot be finally resolved by reference to section 9-306(4) any more than it could be resolved by reference to section 10(b) of UTRA.

Section 9-306(4) is not the only Code provision that can be employed to shed light on the issue of identifiability of proceeds. Two other provisions in Article 9 deal with identifiability of collateral in the context of commingling, and both suggest that they are mutually exclusive. Section 9-207(2)(d) provides that "(2) Unless otherwise agreed, when collateral is in the secured party's possession . . . (d) the secured party must keep the collateral identifiable but fungible collateral may be commingled." [Emphasis supplied.] This is entirely consistent with the proposition that commingling destroys identifiability because if fungible collateral that is commingled remains identifiable then section 9-207(2)(d) is redundant.

Of more importance is section 9-315, which provides rules for cases in which goods subject to a security interest have become commingled or processed. It provides in part that:

(1) If a security interest in goods was perfected and

87. If U.C.C. § 9-306(4)(d) confers a right on the secured party that he does not possess absent insolvency proceedings, then that right becomes more vulnerable to attack by the trustee as a statutory lien under § 545(1)(A) of the Bankruptcy Reform Act of 1978. That section states that: "The trustee may avoid the fixing of a statutory lien on the property of the debtor to the extent that such lien—

(1) First becomes effective against the debtor—

(A) When a case under this title concerning the debtor is commenced. . . ."
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... [Emphasis supplied.]

This provision embodies a straightforward statement that, in the case of goods, commingling destroys identifiability. It resolves problems that stem from this result by adopting a rule that specifically permits continuation of the security interest into the resulting mass. A similar statement in section 9-306 that a security interest in proceeds can continue into a fungible mass even though identity is technically destroyed would resolve the issue, but unfortunately such a statement is lacking. Nonetheless, it can be argued that the policy of section 9-315 should be applied to section 9-306(2) by analogy.

Summarizing the review of the Code's treatment of the term “identifiable” (and other words sharing a common root) in the context of commingling, it appears likely that, if the drafters considered the issue at all, they did not intend for cash proceeds commingled with funds from other sources to remain identifiable; nor did the Review Committee for Article 9 resolve the issue differently in the 1972 version. However, there is sufficient ambiguity in the Code, as there was under pre-Code authority, to permit an expansive reading of “identifiable” if such an interpretation will permit a more equitable resolution of litigation involving proceeds.

RECENT CASES AND RESOLUTION OF CONFLICTS

I. Universal C.I.T. Credit Corp. v. Farmers Bank

The number of cases holding that “identifiable” in sec-

88. Identification may have a different meaning in Article 2. Under U.C.C. § 2-501(1)(a), identification of goods to a contract of sale occurs, absent agreement to the contrary “(a) when the contract is made if it is for the sale of goods already existing and identified.” Comment 5 to U.C.C. § 2-501 suggests that undivided shares in an identified fungible mass can be identified to a contract of sale, and this is supported by U.C.C. § 2-105(4).

tion 9-306(2) is the equivalent of "traceable" and applying the constructive trust analogy to permit the use of artificial tracing rules has become so significant that it represents a clear trend. In fact, in the recent case of *C.O. Funk & Sons, Inc. v. Sullivan Eqpt., Inc.*, the court summarily disposed of the issue by pointing out that, in reference to defendant's argument that commingling destroys identifiability, "the argument that a proceeds security interest terminates when those proceeds are deposited in a bank account since they can no longer be identified has found little favor with the courts." There are only a few cases decided under the UCC that suggest that commingled funds are not identifiable and those cases were decided under section 9-306(4) and are not direct authority for interpreting section 9-306(2). For example, in *Morrison Steel Co. v. Gurtman*, the court stated that "generally, as is true here, proceeds will have been rendered unidentifiable by having been commingled with other funds in a simple bank account."

Perhaps the best case to illustrate the trend and the mechanics of tracing is *Universal C.I.T. Credit Corp. v. Farmers Bank*. Because the case cuts across so many of the issues that arise where a secured party asserts a claim to commingled cash proceeds and because it is the best case for explaining the operation of the lowest intermediate balance

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90. 89 Ill. 2d 27, 431 N.E.2d 370 (1982).
91. 431 N.E.2d at 372.
93. 274 A.2d 306, 310, 8 UCC Rep. 1203, 1207. *See also In re Gibson Products of Arizona, 543 F.2d 652 (9th Cir. 1976), cert. denied 430 U.S. 946 (1976)*, where the court, in holding that U.C.C. § 9-306(4)(d) created a preferential transfer under § 60 of the Bankruptcy Act of 1898, made the following statement:

Section 9-306(4)(d) deals only with nonidentifiable cash proceeds. If cash proceeds could be "identified," i.e., had not been commingled, the secured party would have a perfected security interest in the whole fund under § 9-306(4)(b), just as he did in pre-Code days, without any of the limitations imposed by Section 9-306(4)(d).

543 F.2d at 656.

rule, a lengthy statement of the facts of the case and the court's holding will be useful. This statement will be followed by critiques of specific issues raised in the case.

In Universal C.I.T., Gerald Ryan, an automobile dealer, entered into a floor plan arrangement with plaintiff under which he was required to remit proceeds as each new car subject to the arrangement was sold. Plaintiff obtained a perfected security interest in the cars purchased by Ryan under the arrangement, together with the proceeds of sale. Plaintiff at least tacitly approved commingling because remittances were to be by check drawn on Ryan's account at defendant bank. Plaintiff terminated the floor plan arrangement and Ryan, apparently bitter toward plaintiff, went to defendant's president after banking hours and told him to debit the account for a $12,000 demand note which the bank was holding, and the bank did so with full knowledge that there were checks outstanding to plaintiff. Plaintiff brought suit on the theory that the defendant's exercise of its right to set-off amounted to a conversion of collateral subject to its perfected interest.

The court first noted that even if the commingled proceeds were identifiable within the meaning of section 9-306(2), Comment 2(c) to that section suggests that certain recipients of the funds would take free of the security interest. While Comment 2(c) does not specify the precise reason for this result, the idea is apparently bound up in the concepts of currency and good faith purchase. If the funds are paid out in the form of a check to a person who qualifies

94. In fact, the bank's president first suggested that Ryan give the bank a check for $12,000 and Ryan suggested that the account be debited instead because of several outstanding checks in favor of the plaintiff.
95. Comment 2(c) to U.C.C. § 9-306 states:

(c) Where cash proceeds are covered into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party.
as a holder in due course, the holder in due course takes free of the security interest under section 9-309. One of the risks taken by a secured party who permits commingling is that his security interest will be severed in this manner. If the holder of the check knows of the adverse claim to the funds represented by the instrument, he will not qualify as a holder in due course, but he may still take free of the security interest if he qualifies under the rules of section 9-308(b). Qualification under section 9-308(b) would be unusual in the present context because it requires the giving of new value and one of the requirements for a bank's exercise of set-off is that there be a matured debt. In Universal C.I.T., the court found that the defendant bank did not take the funds in the ordinary course of its business and therefore could not benefit from the ordinary course recipient exception suggested by Comment 2(c).

96. U.C.C. § 3-302.
97. U.C.C. § 9-309 states in relevant part that:

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (Section 3-302) . . . and the holders . . . take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders . . . .

98. U.C.C. § 3-302(1)(c).

99. U.C.C. § 9-308(b) gives priority to a purchaser of an instrument who “gives new value and takes possession of it in the ordinary course of his business . . . .” where the instrument “(b) . . . is claimed merely as proceeds of inventory subject to a security interest (Section 9-306) even though he knows that the . . . instrument is subject to the security interest.”

Arguably, U.C.C. § 9-308(b) does not apply to “second generation” proceeds such as checks drawn on an account into which the original proceeds have been deposited, but there is nothing in the language of the section specifically to prevent its application in the present context. In any event, it is limited to situations where the original collateral is inventory.

100. For a general discussion of the conditions under which a bank may properly exercise set-off, see Clark, Bank Exercise of Setoff: Avoiding the Pitfalls, 98 BANKING L.J. 196 (March, 1981). For a discussion of set-off in the context of priority fights between banks and secured parties claiming a right to proceeds, see Skilton, 1977 So. ILL. L.J. 120, 186-207.

101. It is difficult to define the contours of the ordinary course recipient exception. Comment 2(c) to U.C.C. § 9-306 suggests that a fraudulent conveyance would not shelter the transferee from the security interest, and the court in Universal C.I.T. seized on this concept to defeat the bank's claim. The court noted that “Missouri has long recognized that one indicia of a fraudulent conveyance is a transaction outside the usual course of doing business,” 358 F. Supp. at 324, and then determined that since the bank's president knew of the checks outstanding to plaintiff and debited
Having answered this threshold question in plaintiff's favor, the court noted that section 1-103 permits the Code to be supplemented by other bodies of law so long as they are not displaced by specific Code provisions and concluded that proceeds are "identifiable" if they can be traced in accordance with the state law governing the transaction. Missouri has recognized in an analogous situation—suits to impose a constructive trust—that special funds may be traced into commingled funds. . . . The mere fact that the proceeds from the sales of the six automobiles were commingled with other funds and subsequent withdrawals were made from the commingled account does not render the proceeds unidentifiable under Missouri law.102

The actual tracing was handled by reference to two presumptions imported from the law of trusts. First, it is presumed that payments made from the account were made from individual funds not subject to the trust or, in this instance, the security interest.103 If the balance in the account

Ryan's account after business hours it was not acting in the ordinary course of its business.

The court failed to emphasize that Ryan approached the bank and that the bank really did nothing more than act expeditiously to protect its interests. The court's assumption that this amounted to a fraudulent conveyance is tenuous.

In a state that has adopted the Uniform Fraudulent Conveyance Act, it could be argued that the bank gave a fair consideration, which expressly includes the satisfaction of antecedent debts under § 3(a), and was protected from the plaintiff's claim of fraudulent conveyance by the good faith purchaser exclusion of § 9. Missouri has not adopted the UFCA, but it has enacted into statutory form its own good faith purchaser exclusion, although this provision only provides protection where the purchaser has given a "valuable consideration," and antecedent debts would not be so classified. Mo. Rev. Stat. § 428.070 (1978).

Assuming the transfer to defendant was nothing more than a preference at common law or under the UFCA, it might still be argued that the bank was not the kind of ordinary course recipient who should take free of an adverse claim to the account because it was, at the least, on inquiry notice as to the existence of that claim, and one characteristic of the bona fide purchaser has always been his lack of knowledge or notice of adverse claims. (The buyer in the ordinary course of business under U.C.C. § 9-307(1) is a notable exception to this rule.) Thus, arguably, the court did not have to go so far as to find a fraudulent conveyance in order to hold that the defendant did not take the funds in the ordinary course of its business. For further discussion of this problem, see text at notes 137-141 infra.

102. 358 F. Supp. at 324.

103. RESTATEMENT (SECOND) OF TRUSTS, § 202, Comment on Subsection (1)(i) (1957); RESTATEMENT OF RESTITUTION, § 211 (1937). The rule originated as the Rule
TRACING PROCEEDS

falls below the amount of the funds subject to the plaintiff's interest that have been deposited in the account, the plaintiff is limited to the lowest intermediate balance between the time of commingling and the time at which rights in the account are to be determined. Second, where additional deposits of non-trust funds are made, they are not deemed to be in restitution of the amount by which trust funds have been depleted unless the depositor manifests an intention that there be restitution or the account is maintained as a trust account rather than an individual account.\textsuperscript{104} The court applied these presumptions to the transaction as follows:

It was stipulated at trial that the following deposits were received by Ryan from the sale of the six automobiles and their proceeds in which plaintiff held a continuously perfected security interest:

<table>
<thead>
<tr>
<th>Vehicle</th>
<th>Serial No.</th>
<th>Purchaser</th>
<th>Date of Deposit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 1969 Chev.</td>
<td>866578</td>
<td>Campbell</td>
<td>12-19-69</td>
<td>$5,700.00</td>
</tr>
<tr>
<td>2. 1970 Olds.</td>
<td>217371</td>
<td>Faulkner</td>
<td>12-20-69</td>
<td>4,125.00</td>
</tr>
<tr>
<td>3. 1969 Chev.</td>
<td>890453</td>
<td>Hunter</td>
<td>1-09-70</td>
<td>1,599.94</td>
</tr>
<tr>
<td>4. 1970 Chev.</td>
<td>138013</td>
<td>Carlisle</td>
<td>1-12-70</td>
<td>2,237.50</td>
</tr>
<tr>
<td>5. 1970 Olds.</td>
<td>160314</td>
<td>Rone</td>
<td>1-15-70</td>
<td>2,700.00</td>
</tr>
<tr>
<td>6. 1970 Chev.</td>
<td>141638</td>
<td>Hendricks</td>
<td>1-15-70</td>
<td>1,705.00</td>
</tr>
</tbody>
</table>

The court has examined the banking records of the Ryan account and finds that the identifiable proceeds in which plaintiff held a continuously perfected security interest on January 15, 1970 prior to the bank's $12,000 debit entry was $11,429.11. This amount may be traced according to the following summarization:

\textsuperscript{104} Restatement (Second) of Trusts, § 202, Comment on Subsection (1):(j) (1957); Restatement of Restitution, § 212 (1937).

On January 15, 1970, the bank debited against the Ryan account checks aggregating $516.65 and in addition made the $12,000.00 debit entry in its favor. The $12,000.00 debit entry was made at 3:00 p.m. after the close of business. It may, therefore, be inferred that the checks aggregating $516.65 were received prior thereto in the ordinary course on January 15, 1970, during banking hours. The pro forma balance prior to the $12,000.00 debit entry was, therefore, $15,823.35. Subtracting from this amount the "proceeds" remaining in the account ($11,429.11), the amount which the bank was entitled to debit was $4,394.24. Accordingly, plaintiff is entitled to recover from the bank the excess amount debited, or $7,605.76. That amount is identified as proceeds in which plaintiff had a perfected security interest, and plaintiff is entitled to recover this amount, together with interest at 6% from October 26, 1970, the filing date of the complaint.105

Having determined the extent of plaintiff’s interest, the Court had to decide the priority issue between a secured party and a bank exercising its right of set-off. The Court cited the case of Associates Discount Corp. v. Fidelity Union Trust Co.106 for the proposition that even though section 9-

104(i) provides that Article 9 does not apply "(i) to any right of set-off," this simply means that Article 9 does not govern the creation of a right of set-off. Under this limited view of section 9-104(i), priority questions between a secured party and a bank exercising its right of set-off are still governed by Article 9, particularly section 9-201.\textsuperscript{107}

II. Analogy to Constructive Trusts

There are several points worth exploring arising from the holding in \textit{Universal C.I.T.} First, the analogy to the constructive trust situation is weak given the facts of the case but is probably justified in light of the result reached. Historically, the constructive trust has been used as an instrument to prevent unjust enrichment.\textsuperscript{108} It originally rested exclusively on an underlying fiduciary relationship; and this is still the case in England and in some American states, but most states have dropped the fiduciary requirement.\textsuperscript{109} Even in these latter states, however, there must be some wrongful act before a constructive trust will be imposed. The \textit{Restatement of Restitution} suggests that the constructive trust may be imposed in cases involving conversion, mistake, fraud, duress and undue influence.\textsuperscript{110} Even though the courts did use the constructive trust analogy in some cases under pre-Code security devices, the usage generally rested on the breach of a duty to account for proceeds. Thus, there was a wrongful act, albeit not of the type suggested by the \textit{Restatement of Restitution}, under circumstances which the courts likened to an agency relationship between creditor and debtor. The combination of the wrongful act and the fiduciary concept flowing from the agency fiction may have originally induced courts to impose constructive trusts in such

\textsuperscript{107} U.C.C. \textsuperscript{\$} 9-201 provides in part: "Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors . . ." Since this is not a situation where the Code provides otherwise, the secured party will always defeat the bank to the extent that it can prove the amount subject to its security interest.


\textsuperscript{109} See cases collected at 38 A.L.R.3d 1354 (1971).

\textsuperscript{110} \textit{Restatement of Restitution}, \textsuperscript{\$\$} 163, 166, 168 (1937).
cases; but, whatever the rationale, the result was justified to the extent that it encouraged financers to lend on the strength of inventory as collateral.

The real value of the constructive trust is that its imposition gives rise to a right to trace assets and, ultimately, to a decree for specific restitution of traced assets.\footnote{111} Tracing, then, is a remedy that may be employed in circumstances involving unjust enrichment, not a substantive rule of law that can be applied absent such circumstances. As mentioned previously,\footnote{112} some tracing is obviously contemplated in secured financing through the operation of section 9-306(2), but it is one thing to permit a certain amount of tracing to specific assets and another thing to permit artificial allocation of bank accounts. In fact, it might be preferable analytically to consider these artificial tracing rules as constructs altogether divorced from the remedy of tracing one specific asset into another.\footnote{113} While section 9-306(2) clearly permits tracing from one specific asset to another, an argument can be made that a wrongful act of some sort leading to the unjust enrichment of a party is necessary before the constructive trust with its artificial tracing remedy is called into play.

There are cases where artificial tracing could be used apart from the provisions of section 9-306(2). Where the debtor's disposition of the collateral is wrongful as to the secured party, a conversion has occurred and the secured party should be allowed to trace the proceeds of sale. Where the


According to Professor Palmer, the action in quasi-contract developed at common law and was used to prevent unjust enrichment. The remedy in quasi-contract was a personal judgment against the defendant. The constructive trust developed in equity and was also used to prevent unjust enrichment. The major difference was that under constructive trust theory a claimant could trace specific assets and obtain a decree of specific restitution. \footnote{112} Palmer, §§ 1.1 at 4-5, 2.2 at 59, 2.14 at 175-77.

\footnote{113} Terminology in this area is frequently confusing. For examples, a quasi-contract is not really a contract and a constructive trust is not really a trust.
proceeds are commingled in a deposit account and that account is garnished or subjected to a set-off, the lowest intermediate balance rule should be used to determine the extent of the secured party’s interest in the account. This result can be achieved, however, by imposing a constructive trust through section 1-103 rather than section 9-306(2), and the secured party would not claim a security interest in the proceeds but rather a right dependent on the conversion. In this situation, priority between the parties would be determined under the common law rules governing garnishment or the right of set-off and not under the Code’s priority rules. That is precisely what happened in *Rodi Boat v. Provident Tradesmen’s Bank & Trust Co.*, where the debtor made an unauthorized sale of a boat subject to plaintiff’s security interest and deposited the proceeds in his general account with the defendant. The court held that the unauthorized sale was a conversion of the boat and that the proceeds were impressed with a constructive trust in favor of the plaintiff.

Since *Rodi Boat* is the only reported case to date that has taken this approach, it is unclear to what extent its rationale will be applied. For example, suppose the security agreement permits the debtor to sell inventory or collect accounts but requires that the proceeds be deposited in an account containing only proceeds. If the debtor commingles the proceeds, he has breached the agreement; but is his action sufficiently wrongful to invoke the rationale of *Rodi Boat*? If so, then the secured party can obtain some measure of protection by requiring the segregation of proceeds even if commingled proceeds are not identifiable within the meaning of section 9-306(2). Similarly, if the secured party has the right to an immediate accounting and has not waived that right through lax supervision in the past, an argument that he should be allowed artificial tracing via section 1-103 is plausible, particularly in light of pre-Code cases. In both of these situations, however, it could also be argued that breach of a term in a contract between debtor and creditor, whatever the effect *inter se*, should not prejudice the rights of

114. 236 F. Supp. 935 (E.D. Pa.), *aff’d per curiam* 339 F.2d 259 (3d Cir. 1964).
third parties. The constructive trust analogy is still weak. Furthermore, this approach cannot be stretched to cover the situation where the secured party allows his debtor to use the proceeds in his business. Requiring the secured party to insist that the proceeds be segregated in such cases would serve no useful purpose, and so it should not be made a condition for continuing the security interest in the proceeds. Ultimately, it is simply not possible to resolve the issues by channeling the analysis through section 1-103. The meaning of “identifiable proceeds” in section 9-306(2) must be tackled head-on.

The court in *Universal CIT* was not necessarily wrong in finding a constructive trust even under a more traditional analysis. While it is true that the plaintiff permitted the commingling, it is also true that the debtor, Ryan, committed a wrongful act against the plaintiff by encouraging the defendant bank to debit his account at a time when remittance checks had already been drawn in plaintiff's favor. In addition, Ryan was under a contractual duty to account to plaintiff for the proceeds. If his actions amounted to a conversion of those proceeds that had been deposited to the account, then the imposition of a constructive trust and the subsequent use of the lowest intermediate balance might have been rationalized through an extension of the *Rodi Boat* doctrine and not because the proceeds were identifiable under section 9-306(2).

In most instances where a secured party permits commingling, the set-off by the bank will be without the knowledge or consent of the debtor and, unlike *Universal CIT*, under circumstances where the debtor is not under a duty to account to the secured party. In such cases, the underlying relationship between the parties to the security agreement is simply debtor/creditor in nature and the debtor will have committed no wrongful act vis-a-vis the secured party. Based solely on historical precedent, then, imposition of a constructive trust in such circumstances is inappropriate; but there are other considerations. The UCC encourages precisely this kind of open financing arrangement and there should be protection for financers who take advantage of the
TRACING PROCEEDS

UCC provisions. Under pre-Code security devices where there was a duty to account, the constructive trust was used to protect mortgagees who took the socially desirable risks associated with inventory financing. From the standpoint of precedent, the constructive trust was not really appropriate at that time because the wrongful act was really just a breach of a contractual duty to account; but its use served an important purpose in encouraging financing on secured credit. In light of these cases, it seems desirable to make a further extension of the constructive trust to protect Article 9 secured parties who finance inventory and accounts receivable without requiring their debtors to account. Use of the trust may rest on a fiction or a weak analogy, but it is ultimately justified if it promotes a social policy favoring certain kinds of financing arrangements.

III. Priority Between Secured Party and Bank
Exercising Right of Set-off

A second and more valid criticism of *Universal C.I.T.* is its assumption that section 9-104(i) merely excludes the creation of rights of set-off from Article 9 and does not prevent the use of Article 9’s priority rules in a contest between a secured party and a bank exercising its right of set-off. This is the view espoused by Professor Gilmore and by several decisions, most notably *Associates Discount Corp. v. Fidelity Union Trust Co.*, the case relied on in *Universal C.I.T.* In *Associates Discount*, the Court stated its position as follows:

This section [9-104(i) (1962)], however, cannot mean that

115. 1 GILMORE, § 10.7 at 315-16.
a general creditor, as the bank is here with respect to the funds in question, may abrogate a perfected security interest simply by having a right to and opportunity for set-off. All this section means is that a right of set-off may exist in a creditor who does not have a security interest.\footnote{118} 

If this view is accepted, then a finding that commingled funds are identifiable, coupled with sufficient proof of daily balances by the secured party to enable the court to use the lowest intermediate balance rule, will permit the secured party to win absent some factor such as estoppel\footnote{119} or a subordination agreement.\footnote{120} This is so because section 9-201 generally validates the perfected security interest against third parties\footnote{121} except where the Code specifies a different result, and no other Code provision aids the bank in these circumstances.\footnote{122} 

This view of section 9-104(i) is subject to question, particularly in cases where the secured party has acquiesced in both the commingling and the retention of funds by the debtor. Since the bank, having exercised its right of set-off, will be in possession of the proceeds, the court is being asked to alter the status quo between two basically innocent parties. Courts have historically been loathe to intervene in such situations.\footnote{123} Although several recent cases have held

\footnote{118} 268 A.2d at 332. 
\footnote{119} Estoppel might be raised via U.C.C. § 1-103. For example, the Restatement of Restitution, § 173, at comment j, states that: 

Where a person holds property upon a constructive trust, the beneficiary of the constructive trust may be estopped from asserting his beneficial interest against a creditor who has extended credit to the constructive trustee, being induced by the words or conduct of the beneficiary to believe that the constructive trustee was the beneficial owner of the property (compare Restatement of Trusts § 313). 

\footnote{120} U.C.C. § 9-316 states that “Nothing in this Article prevents subordination by agreement by any person entitled to priority.” 

\footnote{121} Arguably, perfection is irrelevant in this situation since U.C.C. § 9-201 states a general Code rule that is not contingent on perfection. 

\footnote{122} Set-off is frequently described as a self-help procedure, although it may also arise pursuant to statutes. See, Skilton, 1977 So. Ill. L.J. 120, 186-7. In neither event does the bank acquire rights sufficient to defeat a perfected security interest under any of the provision of Article 9. 

that section 9-205 indicates a general Code policy that favors the secured party where commingling occurs, an equally valid view is that section 9-205 is neutral as to priorities and merely repeals the rule of Benedict v. Ratner, thereby validating security interests even though the secured party permits commingling. It does not suggest that there should be no penalties for commingling, simply that invalidation of the security agreement is not one of them. In fact, it can be argued that, on the whole, Benedict v. Ratner was beneficial in that it required financers to police their debtors' businesses closely and thus prevented additional losses from piling up as debtors in financial distress looked to new sources of credit in an effort to stave off bankruptcy. This is not to suggest that rigid policing requirements like those developed

refused a recovery, stating that: "It is a misfortune which has happened without the defendant's fault or neglect. If there was no neglect in the plaintiff, yet there is no reason to throw off the loss from one innocent man upon another innocent man . . . ." 97 Eng. Rep. at 872.


125. 268 U.S. 353 (1925).

126. Neither U.C.C. § 9-205 nor the Official Comments to that section express approval of the practice of commingling. However, U.C.C. § 9-205 does allow commingling and does not provide that identity ceases when commingling occurs. The court in Michigan Nat'l Bank v. Flowers Mobile Home Sales, Inc., 26 N.C. App. 690, 217 S.E.2d 108, 17 UCC Rep. 861 (1975), a case involving a priority contest between a garnishing creditor and a secured party, refused a narrow construction of U.C.C. § 9-306(2) that would have resulted in a concomitant restriction of U.C.C. § 9-205 in the following passage:

It may be conceded that had plaintiff required its debtor, Flowers, to maintain a separate bank account into which there should be deposited only the proceeds of sale of items of original collateral . . . . and had plaintiff further adequately policed Flowers's handling of such an account, the problem of tracing 'identifiable proceeds' would have been greatly simplified. Such cumbersome formalities, however, seem hardly compatible with the stated underlying purpose of the Uniform Commercial Code 'to simplify . . . the law governing commercial transactions' and 'to permit the continued expansion of commercial practices through custom, usage and agreement of the parties.' G.S. § 25-1-102(2).

217 S.E.2d at 111-12, 17 UCC Rep. at 866.

The court also stated that while U.C.C. § 9-205 and U.C.C. 9-306 did not resolve the problem "they do indicate strongly the spirit in which the Uniform Commercial Code is to be applied." 217 S.E.2d at 11, 17 UCC Rep. at 864.

127. Professor Gilmore suggests that U.C.C. § 9-306(4)(d) is the Code's version of
after *Benedict v. Ratner* should be re instituted, but it may be worthwhile to encourage a modicum of policing by imposing some limitations on secured parties who permit commingling. Professor Gilmore suggests that this is the case in the following excerpt:

Thus, the *Benedict*-style assignee knew from day to day the state of his debtor's business health. He would recognize—or at all events be in a position to recognize—the symptoms of the last fatal plunge toward bankruptcy. . . . The assignee's self-interest in this context ran parallel with the interest of his debtor's other creditors. They benefited from the fact that a professional with a substantial stake in the enterprise was acting as their policeman. It is reasonable to assume that in many cases shaky enterprises were preserved as a result of the timely intervention and that in many others the final disastrous ballooning of the unsecured debt just before bankruptcy was prevented by the assignee's cutting off the source of essential working capital.

We may conclude that the *Benedict* rule produced some exceedingly good results in forcing non-notification receivables financing into a desirable pattern.\(^{128}\)

If commingled proceeds are not identifiable, the bank will always prevail absent some wrongful act since the secured party will have no legally enforceable interest in the funds in the account. As indicated previously, the secured party deserves some protection and identification of cash proceeds through artificial tracing techniques is justified. However, there should be some limits to this protection.

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\(^{128}\) *Gilmore*, § 8.4 at 261.

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*Benedict v. Ratner* and that the Code draftsmen intended to provide incentives for secured parties to police their transactions:

Under § 9-205, Article 9 repeals the rule of *Benedict v. Ratner* and any other lingering vestiges of Twyne's case. [footnote omitted]. A secured party is no longer required, as a matter of law, to "police" his debtor's affairs on pain of having his security transaction treated, if he fails to meet the policing requirements, as a fraudulent conveyance. Nevertheless, the Code draftsmen recognized as sound the idea that a secured lender, particularly if he takes as security the inventory and receivables which are the most liquid assets of any enterprise, should, not only in his own interest but in the interest of other creditors, be under compulsion to pay close attention to the course of the debtor's affairs.

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\(^{2}\) *Gilmore*, § 45.9 at 1341.

\(^{128}\) *Gilmore*, § 8.4 at 261.
Where the bank, without knowledge that there are proceeds in the account, actually relies on the account in making its decision to extend credit, it should take priority over the security interest. While we have certainly come a long way since Twyne's Case, it is true that a secured party who authorizes disposition of collateral and commingling of proceeds may be creating an appearance of financial strength which his debtor does not actually possess; and third parties who rely on this appearance to their detriment should be protected. If section 9-104(i) is read to exclude issues involving set-off from the scope of Article 9, then the priority rules, particularly section 9-201, do not apply and the priority contest will be decided under the common law of the state. This is the approach that was taken in Commercial Discount Corp. v. Milwaukee Western Bank.\(^\text{129}\) A detailed discussion of the common law of set-off is beyond the scope of this article,\(^\text{130}\) but courts in this country have generally applied one of two basic rules. The first rule, called the legal rule, denies set-off where the bank actually knows that the funds belong to a third party or if it has knowledge of circumstances that would place it on inquiry as to the possibility of an adverse third party interest in the account.\(^\text{131}\) The second rule, called the equitable rule, requires more than lack of knowledge or notice before the

\(^{129}\) 61 Wis. 2d 671, 214 N.W.2d 33, 13 UCC Rep. 1202 (1974).

\(^{130}\) For a collection of cases on a bank’s right to set off, see Annot., 8 A.L.R.3d 235 (1971); see also Clark, Bank Exercise of Setoff: Avoiding the Pitfalls, 98 BANK. L.J. 196 (1981); Comment, Automatic Extinction of Cross-Demands: Compensatio from Rome to California, 53 CALIF. L. REV. 224 (1965).

\(^{131}\) The following excerpt from Universal C.I.T. indicates the type of knowledge the court thought would be necessary to defeat a bank’s right of set-off under the legal rule:

An exception to that general rule is that a bank is not entitled to a set-off where it has sufficient knowledge of facts relating to the interests of others in the account as to put the bank on inquiry to ascertain the trust character of the account. . . . The bank’s knowledge that Ryan had floor plan financing with plaintiff, that Ryan issued checks to plaintiff and Ryan’s insistence that bank run a debit against his account, coupled with communication of such facts after banking hours, were sufficient to put the bank on inquiry as to the possible trust character of all or part of the funds deposited in Ryan’s account.

358 F. Supp. at 325.
bank can exercise its right of set-off. Under this rule, the bank must also show that it changed its position in reliance on the debtor’s account in order to create superior equities. It is difficult to conceive of many situations in which a bank could be said to have relied on an account when the debtor has the right at any time to withdraw all the funds, and the secured party would usually prevail. However, the rule does provide for flexibility and thus permits more equitable results. For example, if a bank, without knowledge that an account contained proceeds, advanced money to the debtor on the condition that the account never be depleted beyond a certain level and then placed a hold on the account at that level, it should prevail in a priority fight with the secured party. At the other extreme, if it merely considered the account as one asset in the debtor’s total financial structure, it should not prevail. Between these extremes are a wide range of possibilities that would best be disposed of on an ad hoc basis. At the very least, however, it would seem that a bank should contractually require the debtor to maintain a minimum balance in the account before it could claim to have relied on the account.

While it is true that banks will rarely prevail under the approach suggested above, it must be recognized that in most cases there is no reason to prefer the bank over the secured party. The bank is frequently a general creditor which, by fortuitous circumstances, is able to seize and apply funds of the debtor without resort to legal process. In a sense, the lowest intermediate balance rule is a method of splitting the pie between the parties, and this result may seem appropriate to courts that are sensitive to the value of secured financing in our society and to the need to protect secured parties where doing so will not work an injustice. In fact, an argument can be made that where the secured party is granted priority the tracing rules should be modified so that non-proceed funds deposited to the account are deemed to be in restitution of prior proceed deposits to the extent

132. Cases adopting the equitable rule generally trace their lineage to the U.S. Supreme Court’s decision in Bank of Metropolis v. New England Bank, 47 U.S. (6 How.) 212 (1848).
that they have been depleted by withdrawals. Since the allocation is in any event arbitrary, however, it seems preferable to retain the present approach as a means of splitting the pie between the two innocent parties.\textsuperscript{133}

Once a court determines that commingled funds are identifiable, the best approach to the secured party/bank conflict is to give an expansive reading to section 9-104(i) and then adopt the equitable rule of bank set-off. It should be noted that this rule would govern priorities in cases involving commingled accounts and in cases where the account subjected to set-off contains only proceeds. The rationale\textsuperscript{134} for this approach is expressed well in the following excerpt from \textit{Commercial Discount}:

\begin{quote}
The "equitable" rule is the better rule because it eliminates the problems of proving knowledge on the part of the institution. This rule is not harsh as applied to the bank because a bank is in a superior position to all other creditors because it has funds of its debtor at its disposal to immediately seize and apply as a set-off. (The right of set-off is based on the dual relationship of the bank and depositor—the bank being a debtor to the depositor and a creditor on a loan at the same time.) Other creditors can exercise the right of set-off only as a partial or full defense to an action brought against them by the debtor/creditor.\textsuperscript{135}
\end{quote}

Adoption of the equitable rule provides an incentive for the

\textsuperscript{133} To the effect that the secured party bears the burden of proof, see, Domain Indus., Inc. v. First Sec. Bank & Trust Co., 230 N.W.2d 165, 16 UCC Rep. 1417 (Iowa 1975); Howarth v. Universal C.I.T. Credit Corp., 203 F. Supp. 279, 1 UCC Rep. 515 (W.D. Pa. 1962). In C.O. Funk & Sons, Inc. v. Sullivan Equip., Inc., 92 Ill. App. 3d 659, 415 N.E.2d 1309, 30 UCC Rep. 1459 (1981), aff’d, 89 Ill.2d 27, 431 N.E.2d 370 (1982), the Illinois Court of Appeals rejected the secured party’s suggestion that it trace by looking at the debtor’s “large asset picture.” This apparently meant that the secured party would only have to prove that proceeds went into the account initially and would not have to present evidence of daily deposits and withdrawals in order to calculate the lowest intermediate balance. The court held that the secured party had failed to sustain its burden of proof under the lowest intermediate balance rule.

\textsuperscript{134} Originally, the rationale for the equitable rule seemed to be the idea that the antecedent debt to the bank did not provide value to support the set-off where there was a conflicting claim to the funds in the account. \textit{Skilton}, 1977 So. Ill. L.J. 120, 192. \textit{See}, Peoples State Bank v. Caterpillar Tractor Co., 213 Ind. 235, 12 N.E.2d 123 (1938).

\textsuperscript{135} 214 N.W.2d 33, 39, 13 UCC Rep. 1202, 1207-8.
secured party to engage in some "policing" by exposing him to the danger of set-off but does not reward the bank merely because it is in a favorable position to obtain funds in the debtor's possession.  

IV. Garnishors and Transferees in the Ordinary Course

Of course, a recognition of the right of the secured party to use artificial tracing rules to assert his claim against commingled funds will not protect him in all cases. As mentioned previously, recipients in the ordinary course will still sever his security interest, and presumably this includes depositary banks which receive payment by some method other than set-off. For example, in Anderson, Clayton & Co. v. First American Bank, 137 the debtor drew a check payable to the depositary bank on an account containing proceeds from the disposition of collateral subject to the plaintiff's security interest. The court held that while the rationale of Comment 2(c) to section 9-306138 was potentially applicable in favor of the bank, the bank was not a transferee in the ordinary course under the facts of the case. The court analogized the transferee in ordinary course who takes commingled funds free of an adverse security interest to a buyer in the ordinary course of business under the UCC and noted that the definition of the latter term at section 1-201(9) involves the concepts of good faith and lack of knowledge. The court then held that "[t]he circumstances surrounding this transfer reveal[ed] that Bank demanded payment of a note not yet due out of an account known to it to contain the proceeds of the sale of collateral." 139 The secured party was allowed to follow its proceeds from the account to the bank

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136. In National Acceptance Co. of America v. Virginia Capital Bank, 498 F. Supp. 1078, 30 UCC Rep. 1145 (E.D. Va. 1980), the court gives an excellent discussion of the arguments for and against an expansive reading of U.C.C. § 9-104(i) and a good discussion of the legal and equitable rules of set-off. Ultimately, it does not resolve the issues in Virginia because of a finding that the defendant bank would lose under any circumstances.


138. The text of Comment 2(c) is set out at note 95 supra.

139. 614 P.2d 1091, 1095, 29 UCC Rep. 280, 283-84.
as payee.\textsuperscript{140}

Where lien creditors, primarily garnishors, are involved, allowing artificial tracing will result in priority for the secured party to the extent to which he can prove the lowest intermediate balance. This result stems from section 9-301(1)(b) and assumes that the secured party's interest is perfected.\textsuperscript{141} As with set-off under the equitable rule, however, this result is not necessarily inappropriate since it is unlikely that the lien creditor will have relied on the funds in the account in making the original extension of credit. In fact, it is far less likely that a non-bank creditor will have actually relied on the existence of funds in a deposit account than that a bank, which can exercise some control over the account, will have done so.

V. Following Commingled Proceeds into New Assets

Another result of permitting artificial tracing is that it will allow secured parties in some circumstances to trace proceeds out of the commingled account and into new assets purchased by the debtor. \textit{C.O. Funk & Sons, Inc. v. Sullivan Eqpt., Inc.}\textsuperscript{142} involved a contest between two secured parties. Plaintiff had a perfected interest in specific items of inventory and a bank had a later perfected interest in all inventory. The debtor sold the specific items for cash and commingled the cash with funds from other sources in its general banking account. It then used the funds in the account to purchase more inventory, traded that inventory for still more inventory, and finally sold that inventory at auction and deposited the cash proceeds with the court. The

\textsuperscript{140} In Farns Assoc., Inc. v. South Side Bank, 93 Ill. App. 3d 766, 417 N.E.2d 818, 30 UCC Rep. 1729 (1981), plaintiff and defendant had both perfected security interests in debtor's accounts under circumstances giving priority to plaintiff. Defendant had failed to discover plaintiff's filed financing statement. Defendant then received checks payable to the debtor from an account debtor, supplied debtor's indorsement, collected the checks and applied the proceeds to its loan to debtor. In holding that this amounted to a conversion, the Court differentiated the case from one where a party receives a check drawn on the debtor's bank account in the ordinary course of business.


\textsuperscript{142} 89 Ill.2d 27, 431 N.E.2d 370 (1982).
court accepted the view that plaintiff had a potential claim to the deposit but ruled in favor of the bank on the ground that plaintiff had failed to submit sufficient evidence to allow calculation of the lowest intermediate balance in the debtor’s general banking account.

The court in *C.O. Funk & Sons* did not discuss whether plaintiff’s interest in the proceeds had become unperfected by operation of section 9-306(3)(a),143 although that provision is a potential limitation on the secured party’s interest in assets purchased with funds from a commingled account. Lack of perfection would subject the secured party to the interests of lien creditors, other secured parties and purchasers not in the ordinary course of business. In this circumstance, the secured party would obtain greater protection from the 1962 version of section 9-306(3),144 which made it easier for him to have a perfected interest in proceeds.

In another case, *Girard Trust Corn Exchange Bank v. Warren Lepley Ford, Inc.*,145 the court held that funds could be traced out of the debtor’s general banking account and into cars which were not specifically subject to the security agreement. While the court did not discuss the problems of tracing in this context, it did remand the case for a determination of “what other moneys were in the . . . bank accounts at the time the new automobiles were purchased. There should be determined the daily balance of each account and the parties may consider whether tracing is limited in any way if funds from other sources were present in these accounts.”146

143. Under U.C.C. § 9-306(3)(a), the security interest in proceeds is temporarily perfected for ten days but then ceases to be perfected unless:

(a) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds . . . [Emphasis supplied.]

144. Under the 1962 version of U.C.C. § 9-306(3), a security interest in proceeds was temporarily perfected for ten days and then continuously perfected if “(a) a filed financing statement covering the original collateral also covers proceeds.”


One potential difficulty in this area is that if commingled proceeds are identifiable then the lowest intermediate balance rule may lead to odd results in some cases where the secured party is seeking to trace funds out of the account and into a new asset. For example, suppose the secured party has a security interest in a specific good, such as a boat, and the debtor makes an unauthorized sale of the boat for $10,000 and commingles the proceeds in his general banking account with $10,000 in funds from other sources. If the debtor purchases a replacement boat for $10,000 and then pays out the other $10,000 in the ordinary course of business, application of the lowest intermediate balance rule results in the secured party failing to have a security interest in the replacement boat because it is presumed that the first money withdrawn from the account was the debtor's individual funds. In such cases, courts desirous of protecting secured parties in general may want to adopt, as a corollary to the lowest intermediate balance rule, a rule that where the sale is unauthorized and the proceeds are used within a brief period of time to purchase an item that is an obvious replacement for the original collateral, the security interest can be traced through the account and attach to the replacement item. However, another way to view the problem is that the secured party could have protected himself by providing for the security interest to attach to the replacement item through the use of an after-acquired property clause and should not be protected from his failure to do so.

CONCLUSION

This article has not attempted an exhaustive analysis of potential priority disputes, the intricacies of tracing or the common law rules governing set-off. What it has done is to suggest that the UCC is unclear about the meaning of

147. This situation is ameliorated in cases where the security agreement contains an after-acquired property clause as permitted by U.C.C. § 9-204(1). In cases where the disposition of the original collateral is authorized, which are the primary focus of this article, it is likely that the security agreements will contain after-acquired property clauses.

148. The most exhaustive treatment of these topics to date in the context of secured transactions is the excellent article by Skilton at 1977 So. ILL. L.J. 120.
identifiability and that the draftsmen, to the extent they considered the problem at all, probably did not equate identification with the use of artificial tracing rules, at least in cases where both the disposition of original collateral and the commingling of cash proceeds are authorized. It has also attempted to demonstrate that the analogy to constructive trusts made by several recent cases is faulty historically but justified on the basis of the result achieved. There is nothing so constant in the law as change, and old theories are continually being modified and expanded to deal with new situations. The constructive trust is not new to the area of secured financing, but the recent cases have applied it to new situations and it is important to recognize what they are doing in its historical context.

It would be perfectly consistent with the Code for courts to hold that commingling destroys identifiability, and this position might even be desirable to the extent that it provides incentives for secured parties to police their debtors' affairs to a moderate extent. Nonetheless, secured financing plays an important role in our economy and analysis suggests that application of artificial tracing rules will not destroy all incentives to police, nor will it result in injustice considering the nature of the parties likely to be involved in contests with secured parties. The ultimate conclusion, then, is that notwithstanding the drafters' intent there is nothing to prohibit courts from construing "identifiable" to mean "traceable" and then imposing constructive trusts to permit artificial allocation of commingled accounts. Recent cases that have taken this approach seem to have intuitively struggled to the right result.