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## ACCOUNTS RECEIVABLE AS SECURITY

R. E. O'LEARY\*

### I. INTRODUCTION

Senate Bill No. 2<sup>1</sup> places Missouri among those states operating under the Uniform Commercial Code<sup>2</sup> as of July 1, 1965. Counsel preparing for this event are faced with a formidable task in assimilating the wealth of commentary that is available on the articles of the Code. Article 9, dealing with secured transactions, must not be ignored. The official comment says "the traditional distinctions among security devices, based largely on form, are not retained."<sup>3</sup> This may be an overstatement,<sup>4</sup> but any legislation that may change familiar practices when the vital financing sector of the economy is involved will automatically demand the attention of those charged with responsibility for minimizing the risk exposure of clients.

The great service of Article 9 can be described in one word—flexibility. Counsel may now develop a comprehensive and consolidated financing plan<sup>5</sup> and rely on a single set of rules which delineate the many faceted security interest.<sup>6</sup> With some minor exceptions, he is assured by section 400.9-201 that the security agreement is effective according to its terms, and a careful reading of the article reveals that these terms need not be too complex. This feature of the Code would appear to oppose consideration

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1. Approved August 15, 1963, by the Governor as §§ 400.1-101 to 400.10-102, RSMo 1963 Supp.

2. Throughout the remainder of the article the sections of the Uniform Commercial Code enacted into law in Missouri and the American Law Institute's Official Text are referred to interchangeably as the Code.

3. Comment to § 9-101, UNIFORM COMMERCIAL CODE, 1962 OFFICIAL TEXT WITH COMMENTS, published by the American Law Institute and the National Conference of Commissioners on Uniform State Laws [hereinafter cited UCC (1962)] with a section number, e.g., UCC § 9-101 (1962)1.

4. Coogan, *The Lazy Lawyer's Guide to Secured Transactions Under the Code*, 60 MICH. L. REV. 685, 704 (1962).

5. That this was the objective of the drafters of the Code, see Comment to UCC § 9-101 (1962). For further understanding of these objectives see Coogan, *supra* note 4, at 693, 696, 704; Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code*, 63 COLUM. L. REV. 1, 9 (1963).

6. "Security interest" is defined by § 400.1-201(37) of the Code to be "an interest in personal property or fixtures which secures payment or performance of an obligation." Leaving nothing to chance, § 400.9-102(2) makes it clear that the term is intended to include the more familiar terms of "pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security."

of accounts receivable in isolation from other subjects of security interests, but if the reader considers this effort in the context of the present symposium, the fragmentation should not prove distracting.

Accounts receivable are lumped in a sub-group with contract rights by the official comments of the Code<sup>7</sup> and, whether or not these classes of security are necessarily related,<sup>8</sup> a useful index for deciphering the "numbers game" of the Code is therein provided.

An "account," as contemplated by the Code, is "any right to payment for goods sold or leased or for services rendered"<sup>9</sup> not evidenced by an instrument, and excludes sales of accounts as part of a sale of the business out of which they arose or when assigned for collection only.<sup>10</sup> This definition may not be broad enough to cover all assets of this nature which might be used as collateral,<sup>11</sup> but appears to be consistent with the probable, though unlitigated, scope of the present accounts receivable statute in Missouri.<sup>12</sup> Also consistent with the present statute in Missouri is the identical treatment by the Code of both discounting (sale) and pledging (assignment) of accounts receivable.<sup>13</sup> There would appear to be no justification for a differentiation in establishing the mechanical ground rules for the implementation of these two routes; however, it would seem advisable to bear in mind their conceptual variations. Discounting grew out of the factoring trade and carries with it the imputation of full consideration and assumption by the purchaser of the full credit risk of the account debtor.<sup>14</sup>

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7. Although § 400.9-102(1)(b) includes chattel paper, Comment 5 to UCC § 9-102 (1962) provides an index of sections constituting "special rules" commonly applicable to accounts and contract rights alone.

8. Coogan has suggested that accounts and contracts rights are at best second cousins twice removed and musters strong support for the position by pointing out that an account is ordinarily treated as a current asset on an assignor's balance sheet while a mere contract right will not appear until maturing as an account receivable. Coogan, *Intangibles as Collateral Under the Uniform Commercial Code*, 77 HARV. L. REV. 997, 1000 n. 14 (1964).

9. § 400.9-106, RSMo 1963 Supp.

10. § 400.9-104(f), RSMo 1963 Supp.

11. Account-like general intangibles arising out of other than a sale of goods or the rendering of services which are treated or considered of value on the books of the assignor could arguably have been included within the specific treatment afforded by the Code to accounts as defined. See Coogan, *supra* note 8, at 1001. But note that these general intangibles are intended to be covered by the Code, though excluded from the specific definition of accounts. § 400.9-102(1)(a), RSMo 1963 Supp.

12. §§ 410.010-060, RSMo 1959 entitled "Assignment of Accounts Receivable." 21 V.A.M.S. §§ 410.010-060 (Supp. 1964) notes no decisions and none were found by this author.

13. Compare § 410.010, RSMo 1959, and § 400.9-102(a), RSMo 1963 Supp., with the interpretation discussed in the comment to UCC § 9-102 (1962).

14. For an excellent summary on this point see Greenberg, *Inventory and Accounts Receivable Financing*, 1956 U. ILL. L.F. 601, 616-17.

Pledging, on the other hand, is simply associated with security for the loan of money, features no assumption of credit risk by the assignee, and has grown with the practice of no notification to the account debtor.<sup>15</sup> A very quick glance at forms presently in use in Missouri reveals an attempt in some instances to accomplish both ends in the same transaction, thus contributing to the complexity of the document and confusion as to the respective positions of the parties. The only apparent mechanical variation required under the Code arises after notification of the account debtor<sup>16</sup> and the subsequent allocation of deficits and surpluses arising from collection.<sup>17</sup> This minor difference in treatment should, however, be sufficient cause for counsel to define with some care the kind of secured transaction he contemplates by the use of his form.

The origins of accounts receivable financing and its growth, particularly in the textile industry, have been explored and the reader is referred elsewhere for these historical notes of interest.<sup>18</sup> Missouri originally followed the common law pronouncements of *Dearle v. Hall*<sup>19</sup> and required notification of the account debtor to achieve perfection of the security interest.<sup>20</sup> The Chandler Act in 1938<sup>21</sup> raised fears that this demeaning requirement of notification would be necessary to assure priority over the trustee in bankruptcy. *In re Vardaman Shoe Co.*<sup>22</sup> confirmed these fears and prompted the legislature to establish<sup>23</sup> alternative routes to the perfection of a security interest in accounts receivable that would prevail over the trustee.<sup>24</sup> A later amendment to section 60(a) of the Bankruptcy

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15. § 400.9-105(1)(a), RSMo 1963 Supp., defines "account debtor" as the "person who is obligated on an account, chattel paper, contract right or general intangible."

16. § 400.9-502(1), RSMo 1963 Supp., provides that the right of notification of assignment to the account debtor by the assignee may be the subject of agreement, but accrues in any event upon default of the assignor.

17. §§ 400.9-502, 9-504, RSMo 1963 Supp., outline the allocation of deficits and surpluses from collection under conditions of sale or pledge.

18. See, e.g., Greenberg, *supra* note 14, and SEIDMAN, ACCOUNTS RECEIVABLE AND INVENTORY FINANCING (1957).

19. 3 Russ. 1, 38 Eng. Rep. 475 (Ch. 1823).

20. *Murdoch & Dickson v. Finney*, 21 Mo. 138 (1855).

21. A change in the definition of a preference under § 60(a) of the Bankruptcy Act requiring insulation from even a hypothetical bona fide purchaser to prevail over the trustee in bankruptcy was the critical change. 52 STAT. 869 (1938), 11 U.S.C. § 96(a) (1940).

22. 52 F. Supp. 562 (E.D. Mo. 1943) following the decision in *Corn Exchange Nat'l Bank & Trust Co. v. Klaunder*, 318 U.S. 434 (1942).

23. The rule that state law determines the rights of bona fide purchasers had been established by *Eric R.R. v. Tompkins*, 304 U.S. 64 (1938).

24. Assignees were provided with alternate means for acquiring absolute insulation (perfection) from subsequent creditors, assignees or purchasers of the assignor through the traditional notification of the account debtor or by public filing. § 410.020, RSMo 1959.

Act removed the problem of the subsequent hypothetical bona fide purchaser,<sup>25</sup> but Missouri's provisions for assignment of accounts receivable<sup>26</sup> have remained unchanged to the present.

The quick response of the legislature in the early forties to preserve the business integrity of the use of accounts receivable as collateral is adequate testimony to the vital role that receivables play in commercial financing. Thinly capitalized ventures find in this vehicle a means for generating the cash flow that will enable them to meet current expenses. The strength of rapid inventory turnover may be used to finance expansion. The organization that finds its reward in exploitation of the sales function is provided with an opportunity to shift the credit, collection and accounting functions to a supplier or financing agency. Seasonal businesses, on the other hand, may be satisfied if the vehicle simply dampens their normal cycles. In the past, all of these needs have been fulfilled at a price which is most naturally related to the risks shouldered by the assignees of accounts receivables.<sup>27</sup> The Code offers no relief from this ultimate obligation to pay, but does offer to the assignor of accounts receivable an opportunity to develop a financing plan that will fulfill his particular needs.

## II. SOME COMPARISONS

A method of analysis that will ease the task of counsel in becoming conversant with the Code's treatment of accounts receivable financing will at best be a compromise of several inviting approaches.<sup>28</sup> Although the index and commentary of the 1962 Official Text<sup>29</sup> is quite helpful and should be considered required reading, most readers will need to compare the Code treatment with the provisions of the present Missouri statutes. Hopefully, this article will assist that effort.

Section 400.9-203 of the Code, like section 410.010, the present statute, requires that the security agreement be in writing,<sup>30</sup> but the Code re-

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25. For a discussion of the effect of subsequent amendments to § 60 of the Bankruptcy Act see Virden, *Preference in Bankruptcy—A New Definition*, 16 Mo. L. REV. 39 (1951).

26. §§ 410.010-060, RSMo 1959.

27. An excellent discussion relating to the determination of the true "costs" of accounts receivable financing is presented by SEIDMAN, *op. cit. supra* note 18, at 21-23.

28. For a criticism of several possible approaches and the recommendations for Code analysis by one leading commentator, see Coogan, *supra* note 5, at 2-4.

29. See note 3, *supra*.

30. § 400.9-203(1)(a), RSMo 1963 Supp., permits a security interest to be enforceable against a debtor or third parties without an agreement in writing if the collateral is in the possession of the secured party. The present Missouri statute gives no clue as to the penalty for failure to obtain an agreement in writing

quires that only the debtor (assignor) must sign. This security agreement is to be distinguished from the document to be filed, to which we will later refer. Whereas the present statute only implies the requirement of description,<sup>31</sup> the Code specifies that the agreement shall describe in a manner that will reasonably identify the collateral covered.<sup>32</sup> While the Missouri statute would appear to deny perfection of the security interest,<sup>33</sup> the Code denies enforcement of the security interest itself against the debtor or third parties<sup>34</sup> if the steps indicated have not been accomplished. By any test this is a pretty tough Statute of Frauds, which the official comments justify by concluding that the need for any "equitable mortgage" approach has been alleviated by the reduction of formal requisites to a minimum.<sup>35</sup> Whatever the merits of this conclusion, counsel will want to construct a checklist that will avoid any possible embarrassment after July 1, 1965.

Having already considered the scope of intangible assets falling within the term accounts receivable, we may next turn to the reference concerning their availability as security for "all indebtedness theretofore, contemporaneously therewith, or thereafter incurred."<sup>36</sup> We will not explore the standard contract question of sufficient consideration that may be presented by the antecedent debt situation; however, it is clear that the taking of security for such a debt under this provision of the present statute, as well as under the Code, if it falls within the four month period preceding bankruptcy, would fall prey to the trustee in bankruptcy.<sup>37</sup> Although the present statute has not been defined by the courts, it would appear that the Code represents an expansion of the ability of a creditor to demand security as an afterthought. Section 400.2-609 provides that when a contract for sale is involved, a party-creditor with reasonable

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(signed by both parties) other than the obvious fact that perfection of the security interest is denied by failure to take the necessary steps preliminary to perfection. See § 410.010, RSMo 1959.

31. § 410.010, RSMo 1959, requires that "full information" as to the transaction be made available to bona fide creditors of the assignor on demand.

32. § 400.9-110, on sufficiency of description, is satisfied if the description "reasonably identifies" what is described. Comment to UCC § 9-110 (1962) indicates the clear intention of the drafters to reject the "serial number" test. Although § 400.1-102(1) assures one of the legislative intent that the Act "shall be liberally construed," unless assignment is taken of a readily definable general class of accounts such as "all after (date)" or all accounts arising from a specific class of goods, counsel should consider continuing to require a positive identification of each account assigned.

33. See comments, *supra* note 30.

34. § 400.9-203(1), RSMo 1963 Supp.

35. Comment 5 to UCC § 9-203 (1962).

36. § 410.010, RSMo 1959.

37. 52 STAT. 869 (1938), as amended, 11 U.S.C. § 96 (1958). Cited in the text of this article as the Bankruptcy Act.

grounds for insecurity may demand adequate assurances.<sup>38</sup> Thus a seller who was satisfied that extending normal credit terms to a buyer would not pose too great a credit risk need not sit by until default on the account occurs. He may demand an assignment of accounts receivable to secure payment when he discovers that the customer no longer meets the commercial standard of financial stability thought to exist at the time of sale.<sup>39</sup> With respect to indebtedness "thereafter incurred," we note that Missouri has enjoyed the flexibility of taking present security for future advances. Section 400.9-204(5) of the Code, consistent with the present statute, provides for future advances, but may possibly expand the utilization of this practice. The Code specifically approves of the taking of the security whether or not there is a specific commitment to make the future advances. The present statute makes no reference to this problem, but review of the subject outside the context of the accounts receivable statute indicates that Missouri has not been quite this liberal in its treatment of future advances.<sup>40</sup>

A limited provision covering after acquired collateral may be found presently in section 410.020(3). It permits a security interest perfected by filing to include any account assigned within one year. Code section 400.9-204(3), on the other hand, permits a security agreement to provide that collateral, whenever acquired, shall stand as security for the obligation. Section 400.9-403 establishes a maximum initial period of effectiveness of a filing of five years with no limitations on the equivalent extension periods, so the length of time for which an assignor may commit his collateral is virtually unlimited. After acquired property provisions automatically raise questions as to when the interest of the assignee attaches. Section 400.9-204(1) provides that the security interest attaches when (a) there is

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38. Comment 4 to UCC § 2-609 (1962) indicates that "adequate assurances" is not to be equated with "satisfaction," but instead is intended to be tested against a standard of assurance that would be considered as reasonable in the context of the commercial situation encountered. § 400.2-609(2), RSMo 1963 Supp., is the codification of this concept.

39. Examples of this situation are not difficult to imagine. A customer who has a solid record of payment within thirty day credit periods will be advanced inventory stocks without question when orders are placed. The discovery of an unusual assumption of obligations by the customer, such as contracting to build a new warehouse, would justify the supplier in asking for adequate assurances of performance that might in turn take the form of an assignment of sufficient accounts to cover the amounts due on goods supplied.

40. *Foster v. Reynolds*, 38 Mo. 553 (1866) established the validity of future advances. For a discussion of the subject generally, and an exploration of the validity of future advances which are undetermined in amount and wholly optional on the part of the creditor, see Blackburn, *Mortgages to Secure Future Advances*, 21 Mo. L. REV. 209 (1956). See also Duesenberg, *Financing Inventory Under the Uniform Commercial Code: Resumé for Missouri Lawyers*, *supra* this symposium.

agreement that it attach, (b) value is given<sup>41</sup> and (c) the debtor has rights in the collateral. The official comments conclude that if this subsection is read together with section 400.9-204(3) it becomes clear that the assignee's interest in the account is automatic when the account comes into existence. Thus, the basis for determining the priority is the date of perfection of the original security agreement.<sup>42</sup> A number of commentators have not been so confident that the bankruptcy court will automatically endorse these efforts of the Code to insulate the interest of the assignee in accounts coming into existence during a period when the assignee knows that the assignor is insolvent.<sup>43</sup> Apparently in anticipation of an argument by the trustee that such assignments are voidable preferences,<sup>44</sup> the Code provides in section 400.9-108 that when the secured party has given new value secured by after acquired collateral, the collateral so acquired shall be "deemed" to have been taken as security for new value rather than for an antecedent debt.

A number of cogent arguments can be made to support the Code's policy on this issue,<sup>45</sup> however, there is no argument with respect to which statute is supreme should the court determine that the Code and the Bankruptcy Act are in conflict.<sup>46</sup> Until the courts have finally resolved that no such conflict exists, counsel must consider this potential threat to the security of the assignee as a risk that will be accepted and paid for in the

41. "Value" is a defined term; see § 400.1-201 (44), RSMo 1963 Supp.

42. At this point it is well to take note of the important "purchase money security" concept of the Code. Defined in § 400.9-107, RSMo 1963 Supp., this concept permits a debtor to acquire new inventory even though all of his assets are covered by a broad "after acquired property" clause. Under § 400.9-312, RSMo 1963 Supp., this purchase money security interest is given priority over conflicting security interests in the *same collateral*. This limitation denies any priority over creditors with a secured interest in accounts arising from the sale of the inventory as these are not the same collateral.

43. See Coogan, *supra* note 4, at 685, 698 n. 44, 702; Coogan & Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture*, 69 YALE L. J. 203, 243-49 (1959); Gordon, *Security Interest in Inventory Under Article 9 of the Uniform Commercial Code and the Preference Problem*, 62 COLUM. L. REV. 49 (1962); Spivak, *Financing the Manufacturer: Article 9 of the Uniform Commercial Code*, 48 KY. L. J. 397, 409 (1960); Schwartz, *The Effect of the Uniform Commercial Code on Secured Financing Transactions and Bankruptcy*, 38 ST. JOHNS L. REV. 50 (1963).

44. *Supra* note 37.

45. Coogan & Bok, *supra* note 43, at 244, point out that § 60 is intended to prevent unsecured creditors from jumping in to secure themselves when trouble is imminent, whereas in the "after acquired" security interest situation the creditor has taken every possible step at the earliest possible time to secure his interest.

46. For a full discussion of the supremacy of the Bankruptcy Act, see Schwartz, *supra* note 43, at 60 n.43, 82.

charges for the financing, or limited by reducing the flexibility of the financing plan.<sup>47</sup>

The utilization of the Code's provisions for future advances and after acquired collateral along with section 400.9-205 will permit the formulation of a financing program based on a revolving credit plan.<sup>48</sup> Section 400.9-205 states that a security interest is not invalid or fraudulent against creditors when the assignor of the accounts receivable is permitted to exercise complete dominion over these accounts.<sup>49</sup> This quite obviously reverses the rule of *Benedict v. Ratner*<sup>50</sup> which had required that the assignee police his accounts. The present Missouri statute has adopted *Benedict* by the limitations imposed on proceeds and returned goods. Section 410.040 requires the assignor to immediately pay over all collections and returned property. Until such payment is accomplished, the money and property is held in trust for the assignee. Without cases to advise on the interpretation, one can only assume that a failure to collect as required would have opened the door for the trustee in bankruptcy. Section 410.050 rejects the extensions of *Benedict*—the “part bad, all bad” rule—in that certain acts of dominion over accounts and returned goods do not affect the assignee's secured position with respect to the remaining accounts.<sup>51</sup>

The philosophy prompting removal of this umbrella of legal form from

47. Before leaving “after acquired” problems, we should note two interesting cases. *Howarth v. Universal C.I.T. Credit Corp.*, 203 F. Supp. 279 (W.D. Pa. 1962), is a bankruptcy case featuring among items of interest an after acquired security interest in inventory (equipment, accessories, or replacement parts) and proceeds. Although the opinion fails to reveal whether any of the inventory was received during the four month period prior to the petition in bankruptcy, it is reasonable to assume that this was the case. In any event, C.I.T. was permitted to seize these inventories and retain the proceeds from sale apparently without question by the trustee. The validity and priority of an after acquired accounts assignment was upheld in a different setting against the claims of a surety whose assignment was contingent on default in Hartford Acc. and Indem. Co. v. State Pub. School Bldg. Authority, 26 Pa. D. & C.2d 717 (C.P. 1961).

48. Comments to UCC § 9-205 (1962) indicate that the drafters intended to validate a true floating lien over the assets of a debtor. Risk considerations may well deny any financing plan which is that flexible, but a reasonably limited revolving credit plan such as that described in *Matter of New Haven Clock & Watch Co.*, 253 F.2d 577 (2d Cir. 1958), should not present excessive risk exposure.

49. The dominion over accounts envisioned by § 400.9-205, RSMo 1963 Supp., includes liberty in the debtor to use, commingle or dispose of all or parts of the collateral (including returned goods), or to collect or compromise accounts, contract rights or chattel paper, or to use, commingle or dispose of proceeds without accounting to the secured creditor.

50. 268 U.S. 353 (1925).

51. § 410.050, RSMo 1959. For a discussion of these extensions of *Benedict* and citation to cases, see Comment, *Multistate Accounts Receivable Financing: Conflicts in Context*, 67 YALE L.J. 402, 405, 406 n.21, 417 n.45 (1958).

simple business credit risks has been expressed by one of the leading commentators in this manner:

In effect, by repeal of *Benedict v. Ratner* (and the recognition of the type of financing that can be accomplished without *Benedict v. Ratner*) Article 9 gives protection, not against a debtor's dishonesty or a debtor's defalcations or diversions, but against the *honest insolvency* of a debtor.<sup>52</sup>

This is all well and good, and the flexibility permitting specially tailored financing plans is an obvious contribution; however, counsel who has had the benefit of forced conservatism may be less than enthused as he considers the problems that will necessarily follow a loosening of the credit reins. Such reservations have led several commentators to suggest that many of the old practices be retained.<sup>53</sup> Certainly there is nothing in the Code which prevents the creditor from requiring bookmarking, notification of the account debtor, immediate payment of collections, segregation of accounts assigned and returned goods or any number of policing safeguards that will insulate him from risks beyond honest insolvency of the debtor. It is doubtful, however, whether the press of competition will long permit either commercial financing companies or suppliers to insist on inflexible forms and the parties to accounts receivable financing will find that a process of balancing the risks will determine the format of individual financing plans, just as it guides judgments in other commercial problems.

We have already noted that under Missouri's present statute, problems relating to proceeds (collections and returned goods) are of little significance as they must be paid over immediately to the assignee of accounts receivable. The Code's permissive attitude, with respect to the dominion assignors may exercise over such proceeds, quite naturally results in a need for rather extensive treatment of the mechanics for the handling of and the priorities in such proceeds. This need is amplified by the ability of parties to look to security in collateral that may change form at several stages before ultimate conversion to cash. Section 400.9-306 carries over the perfected security interest in original collateral to the identifiable proceeds. Perfection is terminated, however, after a ten-day grace period unless the financing statement covering the original collateral also covered proceeds, or unless the security interest in the proceeds themselves is perfected prior to the expiration of the ten-day period. Because the proceeds of

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52. Spivak, *supra* note 43, at 405-06.

53. See, e.g., the justification for this policy acknowledged by Coogan, *Intangibles as Collateral Under the Uniform Commercial Code*, 77 HARV. L. REV. 997, 1009 n.42 (1964).

accounts receivable will ordinarily be cash, the great concern of the assignee will be over the disposition of collections that have not been paid over at the time of insolvency of the assignor. Section 400.9-306 presents no problem to the assignee if the collections are identifiable and not commingled or deposited in a bank account of the assignor, or if they are in the form of "checks and the like," in the hands of the assignor. However, if the collections have been deposited in a bank account or commingled, they are subject to rights of set-off and the maximum amount available to the assignee is a sum no greater than the total of collections in the ten days prior to the institution of insolvency proceedings, less such of those collections that have been paid over during that ten-day period.

This "ten-day" rule may be a practical guide to the formulation of payment schedules to be met by the assignor. For example, an assignor functioning in a seasonal business will build up a sizable inventory of goods in preparation for the demand period. Recognizing that a standard thirty-day credit period will overly encumber the assignor (who is a good credit risk), the supplier may be satisfied to take as security the after acquired accounts receivable that these goods will generate. In order that the assignor may retain some needed working capital that would be denied by insisting on immediate payment of collections, the assignee agrees to a periodic payment schedule extending through and beyond the season. He knows, however, that the customers of the assignor traditionally pay on their accounts at the end of each calendar month, so the periodic payment date for the assignor is set within the first week of the month. This insures that the ten-day limit will not cut off the assignee's right to the collections at a time when the cash on hand is greatest. Thus, the assignee will be exposed to a risk of loss of collections because of insolvency only during the twenty-day period when collections are at a minimum. Further insulation from the risks presented by the ten-day rule may of course be accomplished by requiring a payment schedule of shorter intervals. This route should certainly be considered if the assignor is something less than a good credit risk.

When the proceeds in question are returned goods, the interests of the assignee of the accounts receivable may be subject to another problem. Section 400.9-306 provides that the unpaid assignee is subordinated to the rights of the perfected security interest in the goods themselves. Thus, if a purchase money security interest<sup>54</sup> is taken in inventory by another creditor, he will have priority of interest in the same collateral<sup>55</sup> but would

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54. § 400.9-107, RSMo 1963 Supp.

55. § 400.9-312(4), RSMo 1963 Supp.

ordinarily be subordinated to an assignee of accounts receivable with an earlier filing date;<sup>56</sup> however, if the customer of the assignor returned the inventory goods which the account represented, priority of the purchase money security interest over the assignee would be reinstated.

One final area of comparison between the Code and the statute which it repeals<sup>57</sup> should be noted. With respect to accounts receivable as security, it is fair to say that perfection is synonymous with filing.<sup>58</sup> Section 410.020 of the present statute permits perfection by either notice to the account debtor or central filing with the Secretary of State, or both, with priority in order of time. The proviso that no priority is granted to a person taking an assignment with actual knowledge of a prior assignment (presumably whether perfected or not) in the present statute is not carried forward in the Code. Except as noted above with respect to the provisions of section 400.9-306, and except for the protection afforded a transferee for value of a previously assigned though unperfected account by section 400.9-301,<sup>59</sup> the first assignee to file is granted priority under section 400.9-312(5), irrespective of his knowledge of other unperfected assignments. The official comments to that section note that this policy supports the integrity of the filing system and there would seem to be little question but that it does just that.

The mechanics of filing are fully set forth in sections 400.9-401-9-404 and need not be repeated here. As under the present statute, notice filing through a financing statement signed by both parties is permissible, although the security agreement itself may be filed if it contains the required information. Counsel should take note of the fact that a single filing with the Secretary of State may no longer be adequate and multiple filings are required under certain conditions.<sup>60</sup> Note should also be taken of the saving provision of section 400.9-401 protecting those parts of the collateral on which proper filing has been obtained. As the filing provisions are so critical to perfection of the security interest, it is not surprising that they have been narrowly construed<sup>61</sup> and a comprehensive check-list is strongly recom-

56. § 400.9-312(5), RSMo 1963 Supp.

57. The present assignment of accounts receivable statute, §§ 410.010-.060, RSMo 1959, is repealed; see Mo. Laws 1963, at 637, § 10-102.

58. § 400.9-302(1), RSMo 1963 Supp. Note that an assignment of less than a "significant part" of outstanding accounts requires no filing. § 400.9-302(1)(e), RSMo 1963 Supp.

59. § 400.9-301(1)(d), RSMo 1963 Supp.

60. § 400.9-401, RSMo 1963 Supp. provides for filing with the Secretary of State or recorder of deeds of a county, or both; see Donnellan, *Notice and Filing Under Article 9*, *infra* page 517.

61. In the Matter of Babcock Box Co., 200 F. Supp. 80 (D. Mass. 1961).

mended to avoid some inadvertent omission that would permit a gap in perfection. Another point of interest is the rare instance when the assignor shifts the location of his account records.<sup>62</sup> The law of the state where the records are newly located should be checked to insure compliance with its requirements for perfection—yet another area where the minimum requirements have been narrowly construed.<sup>63</sup> A “one time” problem will be faced by Missouri counsel when the Code becomes effective.<sup>64</sup> Although it is said that pre-Code priorities remain undisturbed,<sup>65</sup> it would seem wise to avoid any possible problems by following the advice of one commentator to re-execute existing security interests under the Code.<sup>66</sup> This should present few problems and little inconvenience to those assignees who have perfected by filing under the present statute.

### III. ADDITIONAL AREAS OF INTEREST

The Code purports to be a comprehensive piece of legislation and with rare exception it fulfills this promise. Many areas formerly left to common law or covered by a series of unrelated statutes are now treated with specificity. Some of these should be indicated. Section 400.9-103(1) provides that the laws of Missouri govern assignment of accounts when the records of the assignor concerning the accounts to be assigned are kept in this state. The converse of this is, of course, that Missouri will look to the law (including the conflict of law rules) of the state where such records are maintained. Thus, when an assignor with a principal place of business in Missouri has a branch office in a non-Code state where account records are maintained, if the conflict rules of that state look to the law of the state where the principal place of business is located, the law of Missouri will still prevail. Until the Code is adopted by all states, such problems will continue to demand the cognizance of counsel.

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62. § 400.9-103(1) makes the location of the account records determinative of the applicable state law. It is not beyond possibility that branch offices of a multi-state operation would keep local account records and the creditors would therefore need to consider the risks accompanying a shift of the records to another state. § 400.9-103(3), RSMo 1963 Supp., provides a four month grace period to obtain perfection in the new location if the state has adopted the Code.

63. In the Matter of Dumont-Airplane and Marine Instruments, Inc., 203 F. Supp. 511 (S.D.N.Y. 1962).

64. § 400.10-101, RSMo 1963 Supp.

65. § 400.10-101, RSMo 1963 Supp., provides that rights, duties and interests flowing from transactions valid under prior law shall continue undisturbed.

66. Coogan, *supra* note 8, at 997, 1009 n.42.

Section 400.9-318 contains rules governing claims and defenses among the assignor, assignee and account debtor and should be considered in detail but need not be expanded here. Of special interest, however, are the provisions of subsections (3) and (4). Subsection (3) makes it clear that the account debtor may continue to pay the assignor even after notice or knowledge of assignment until he has been directed to pay the assignee. Subsection (4) re-enforces the Code's policy of preferring alienability even though freedom of contract may suffer. Irrespective of the terms of the contract between account debtor and assignor, the assignor may assign his account rights. This reverses *Allhusen v. Caristo Constr. Corp.*<sup>67</sup> and the law in those states permitting the contracting parties to provide that any assignment of the contract right was void.<sup>68</sup>

Sections 400.9-502 and .9-504 cover the subject of the collection rights of the assignee on default. The difference in treatment of collection when the accounts have been assigned as opposed to those instances where they have actually been sold to the "assignee" has been covered. Section 400.9-502 provides that the parties may agree on the conditions justifying notification of the account debtor, but that default by the assignor will automatically trigger a right of notification in the assignee. This adds some considerations for counsel in Missouri as the present statute appears to have provided for a continuing right of notification in the assignee, and in any event, as the assignor holds all collections in trust for the assignee, problems of default are difficult to conceive. Under the Code, payment schedules will probably become common and revolving accounts not unfamiliar. The substitute for forced statutory policing will be the ability of the assignee to supervise the operations of the assignor to the extent that he may determine when his security is threatened. The failure of the assignor to meet the agreed payment schedules should be more than sufficient warning to the assignee that a more active role in policing is necessary—such as notification and direct collection of accounts.

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67. 278 App. Div. 817, 104 N.Y.S.2d 565 (1st Dept. 1951) (memo. dec.), *aff'd*, 303 N.Y. 446, 103 N.E.2d 891 (1952).

68. No Missouri case was found on this particular point. As a matter of policy, *Herrick v. Edwards*, 106 Mo. App. 633, 81 S.W. 466 (1904), would seem to place the state in the column of those favoring freedom of assignment, but the case deals with a promissory note rather than an intangible asset. There is a series of cases permitting limitations on partial assignments; however, this position enforces a policy favoring the right to obtain the personal services required by the unexecuted contract. Counsel should note the possible conflicts problem that could evolve when an account assigned features an account debtor from another state which permits a prohibition of assignment.

## IV. CONCLUSION

In the course of an article on the effect of the Code on commercial financing, one commentator makes the following statement:

While it is frequently said that recognition in bankruptcy is the test of a security interest, in commercial financing transactions bankruptcy is the rare exception and not a routine matter. The use of security is probably more important vis-à-vis other creditors of the debtor in the normal course of business than in the bankruptcy court, and it gives secured parties a degree of control over the debtor's assets and business which they would not otherwise be able to assert effectively. But a secured party does, nonetheless, want the best security he can get when he takes any security at all.<sup>69</sup>

This statement adequately summarizes the position of the assignee of accounts receivable. The other side of the coin, however, is the interest of the assignor who must recognize the potential of his assets in this form and exploit that potential in a manner that will achieve maximum contribution to profits, at the lowest cost and with the least possible limitation on his freedom to conduct his business as he sees fit. The flexible financing programs that can be developed under the Code, uninhibited for the most part by limitations of form, place both parties in a position to negotiate at arms length to attain their respective objectives. The ultimate arrangement will thus reflect a balancing of the business risks as in any other area of commercial transaction. The great challenge to counsel is to forecast the relative degree of risk exposure and formulate the plan to reduce it to within acceptable limits. The tools to meet this challenge are available in the Code.

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69. Henson, *The Prospective Effect of the Uniform Commercial Code on Commercial Financing*, 1962 U. ILL. L. F. 349, 361-62.