THE CASE FOR LAUNDERED SECURITY INTERESTS

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A predominant conveyancing principle in commercial law is that the assignee of an interest acquires only the quantum of interest its assignor possesses. There are familiar exceptions: the power of one possessing legal tender to transfer greater rights in the tender than it has,\(^1\) the power of transferee acquiring voidable title to goods to convey good title,\(^2\) the power of a holder of a nonduly negotiated document to duly negotiate it,\(^3\) the power of an owner of a certificated security to transfer it to a bona fide purchaser free of adverse claims,\(^4\) and the power of a debtor to transfer chattel paper free of encumbrances.\(^5\) In each exception the assignee of an interest acquires a greater interest in the asset assigned than its assignor possesses. The exceptions allow the assignor to launder its interest: to convey more than the legal entitlements of the assignor. In these cases, laundering typically involves conversion, theft, or breach of contract between the assignor and a third party. The euphemistic connotation of the term suggests as much. Laundering is permitted as a cost associated with Kaldor-Hicks efficient rules. It is something we tolerate.

This Article makes a case for laundered security interests under Article 9. At issue are the proper treatment of assigned unsecured claims and the effect of an assignment on claims held by the assignee. Is an unsecured claim, assigned to a creditor holding secured claims under a security agreement containing a cross-collateralization clause, appropriately considered a secured claim having the same priority as the assignee’s

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2. *See U.C.C. § 2-403 (1989); cf. § 7-205 (1992) (buyer in ordinary course of fungible goods sold and delivered by warehouse now takes free of claims to the goods by holds of a duly negotiated document).*


secured claims? Is an advance made by an assignee after assignment of a secured claim and security agreement appropriately considered a secured claim having the same priority as the assigned secured claim? Article 9 is silent on both matters, and settled law is confusing and confused. This Article argues for recognition of floating secured claims;6 unsecured claims that become secured upon assignment and post-assignment advances which acquire the priority of the secured claims assigned. In both cases, proper treatment under Article 9 requires that the assignee acquire a property or priority right greater than the assignor held. Hence, floating secured status under Article 9 requires laundered security interests.

 Laundered security interests are not costs associated with net beneficial rules. Instead, they are a consequence of Article 9’s scheme of notice filing and accompanying behavioral assumptions. The scheme contains informational and priority components. The informational component provides no data about the existence or extent of secured claims held by a filing creditor. The priority component prevents prospective creditors from relying on collateral described in a filed financing statement. The conjunction of informational and priority components renders prospective creditors indifferent to the rights acquired by a filing creditor or its assignee. Their loan decisions therefore are unaffected by the possibility that secured creditors or assignees acquire more rights than their assignors possess. Article 9 should recognize in fact what it allows in consequence: floating secured claims.

 Part I of this Article presents a taxonomy of the priority contests in which floating secured status is at stake. Part II describes and rejects settled law’s treatment of floating secured claims. Such treatment, Part II argues, is inconsistent and fails to incorporate Article 9’s notice filing scheme and its underwritten behavioral assumptions about prospective creditors. Part III presents the normative case for granting floating secured claim status without restriction. The case depends on taking as sound the notice filing scheme of Article 9. Also taken as sound are rules concerning secured credit and Article 9’s predominant priority rule. Thus, Part III’s case is constructive and not revisionary. Part IV considers and rejects some candidates objections to granting unrestricted floating secured claim treatment. A conclusion briefly compares the case for floating secured

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claims under Article 9 with justifications of laundering under other commercial law rules.

I. AN UNPROVIDED-FOR STATUS: FLOATING SECURED CLAIMS

The issue posed above is well recognized. It is illustrated by the following simple example. Assume that a debtor grants a creditor (C1) a security interest in one of the debtor’s assets in exchange for a loan of $50. The security agreement between C1 and debtor contains a cross-collateralization clause granting C1 a security interest in the described asset “to secure all debts owed or owing by debtor to C1.” C1 properly perfects its security interest by filing a financing statement. Assume also that debtor’s asset serving as collateral has a value of $100. Subsequently, debtor borrows $50 from each of two creditors, C and C3, on an unsecured basis. Still later, C3 assigns its unsecured claim of $50 to C1. Debtor defaults on its loan obligations to C1-C3, its only creditors. At the time of default the collateral retains its value of $100. Debtor also has no other assets at the time of default. Does C1 have a secured claim for $100, C’s $50 unsecured claim remaining unsatisfied? Or does C1 have a secured claim of $50 and an unsecured claim of $50, C1 sharing ratably with C in the $50 of the collateral ($25 each)?

If C1 has a secured claim for $100, C1 is treated as a “floating secured creditor”: a secured creditor whose claims assigned to it have the same priority as its secured claims. If C1 has a secured claim for $50 and an unsecured claim for $50, C1’s floating secured status is denied. Article 9, of course, recognizes the validity of a floating lien. However, a floating lien is not a floating secured claim. A floating lien secures an existing secured obligation with collateral acquired after the execution of a security agreement. A floating secured claim is a claim acquired by a secured creditor or its assignee after the execution of a security agreement. Article 9 is entirely silent on the matter of a floating secured claim. Article 9, unsurprisingly following pre-Code law, permits the assignment of a security interest. However, the Article says nothing explicitly about the permissibility, or consequences, of an assignment of a security agreement.

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9. Section 9-302(2)'s allowance of an assignment of a security interest cannot be taken to allow the assignment of a security agreement since the two notions are not equivalent. See U.C.C. §§ 9-105(1) (1992), 1-201(37) (1992). But see David G. Epstein,
Article 9 is silent about what the assigned interest secures: loans made by the assignor only or loans by the assignee as well. Nor does Article 9 say anything about the treatment of the assignment of unsecured claims to a secured party, and that is the assignment at issue in the simple example.

The issue cannot be settled by treating the assigned interest as a future advance. Article 9 recognizes the priority status of future advances by giving the same priority to future advances as to initial advances. But unsecured claims assigned to a secured creditor are not future advances. Although undefined, "advances" under Article 9 clearly contemplates a flowing of value from the secured creditor to the debtor. There is no advance from CI to debtor in the above example. Future advance priority therefore cannot be used to determine the treatment of the "floating secured creditor" in the simple example above. Article 9's provisions cannot be used to decide between the alternative treatments of CI's claim.

The narrow issue illustrated by the simple example concerns the treatment of an unsecured claim when assigned to an over-collateralized secured creditor. The example is an instance of a broader problem: the effect of assigned claims on those claims or claims held by the assignee. To see the broader problem, consider the following three variants of the simple example:

Variant (1): CI properly perfects a security interest in debtor's assets to secure a $50 loan to debtor. The applicable security agreement contains a clause securing "all debts owed or owing by debtor to CI." Debtor's assets have a value of $100. Later, C properly perfects a security interest in the same assets to secure a $50 loan to debtor. Still later, C3 loans $50 to debtor and properly perfects a nonpurchase money security interest in debtor's assets. C3 then assigns its secured claim to CI.

Variant (2): As before, CI properly perfects a security interest in debtor's assets to secure a $50 loan to debtor. The security agreement between CI and debtor contains a clause allowing for future advances. Debtor's assets have a value of $100. Later, C properly perfects a security interest in debtor's assets to secure a $50 loan to debtor. CI subsequently assigns to C3, a noncreditor, CI's $50 secured claim along with the security agreement between debtor and CI. C3 then loans debtor $50 on a nonpurchase money secured basis.

Variant (3): As in Variants (1) and (2), CI properly perfects a security interest in debtor's assets to secure a $50 loan to debtor. A clause in the applicable security agreement secures all debts "owed or owing to CI or its

Security Transfers by Secured Parties, 4 GA. L. REV. 527, 538 (1970) (arguing that a secured party can transfer or assign a security agreement).


assignee by debtor.” As before, debtor’s assets are valued at $100. C2 subsequently loans debtor $50 on a secured basis. C3 later makes a $50 loan to debtor on an unsecured basis. Still later, C1 assigns to C3 its $50 secured claim along with the security agreement between debtor and C1.

Variant (1) involves an assignment of a secured claim from a junior (C3) to a senior secured creditor (C1). Variant (2) involves an assignment of a secured claim from a senior secured creditor (C1) to an initial noncreditor (C3). Variant (3) involves an assignment of a secured claim from a senior secured creditor (C1) to an unsecured creditor (C3). Each of the variants presents the same issue: the treatment of the junior claim either assigned by a creditor, as in Variants (1) and (2), or held by the assignee, as in Variant (3). In Variant (1), does C1 have priority in debtor’s assets to the extent of $100 or only $50? In Variant (2), does C3 have priority in debtor’s assets to the extent of $100 or only $50? In Variant (3), does C3 have priority in debtor’s assets to the extent of $100 or only $50? Since the simple example above concerns the effect of the assignment of an unsecured claim to a senior over-collateralized secured creditor, the example is identical in structure to Variant (3). Because each of the variants present the same issue, the example above is an instance of a general problem unaddressed by Article 9: the effect of assigned claims on either those interests or interests already held by the assignee.

II. FLOATING SECURED CLAIMS UNDER SETTLED LAW

Settled law resolves the simple example above and its variants differently. In the simple example, an unsecured claim assigned to an over-collateralized secured creditor is treated as an unsecured claim. In doing so, courts deny the assignee the status of a “floating secured creditor.” The assigned unsecured claim retains its status notwithstanding assignment or the status of the assignee. Because Variant (1) involves the assignment of a junior secured claim to a senior secured creditor, and Variant (3) involves the assignment of a senior secured claim to a junior unsecured claimant, the same principle presumably applies as in the simple example. In Variant (1), the junior secured claim would remain junior; in Variant (3), the junior unsecured claim would remain junior. Settled law resolves Variant (2) differently. Where a post-assignment advance is made by an assignee of a senior secured claim, the advance has the priority of the

13. Id.
14. Id.
assigned interest. Courts grant the assignee the status of a “floating secured creditor.” The difficulty is to explain when, and why, the assignee is granted such status.

The differential treatment of assigned claims raises three questions. First, why should an unsecured claim remain unsecured when assigned to an over-collateralized secured creditor in the simple example and in Variants (1) and (3)? Put simply, why should floating secured status be denied in these circumstances? Second, why should a post-assignment advance made by an assignee of a senior secured claim be treated as a senior secured claim in Variant (2)? The third question is one about consistency: Why should floating secured status be denied in the simple example and in Variants (1) and (3) but recognized in Variant (2)? Extant case law gives either unconvincing or inconsistent answers to these questions. Part II considers each question in turn as a matter of settled law. It argues that settled law is unconvincing because it ignores the consequences of a notice filing regime for potential creditor behavior. Part III, in making a case for the proper treatment of floating secured claims, takes up each question as a normative matter.

A. The Denial of Floating Secured Status

In re E.A. Fretz is the leading case denying floating secured claim status. Fretz involved a security agreement that secured payment of all debts owed by Fretz to Revlon or its affiliates. At the time Fretz filed a bankruptcy petition, two of Revlon’s wholly-owned subsidiaries held unsecured claims against Fretz. Subsequently the wholly-owned subsidiaries assigned their claims to Revlon. Revlon, in turn, sought to have the assigned claims treated as secured claims. The court rejected Revlon’s argument, finding that “the UCC does not ... contemplate ‘floating secured parties,’ that is, an open-ended class of creditors with unsecured and unperfected interests who, after the debtor’s bankruptcy, can assign their claims to a more senior lienor and magically secure and perfect their interests under an omnibus security agreement and financing statement.” Fretz presents the same fact pattern as in the simple example

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17. 565 F.2d 366 (5th Cir. 1978).
18. Id. at 367-68.
19. Id.
20. Id. at 369.
21. Id. For cases distinguishing Fretz, see Robert B. Lee Enter. v. Champion Credit Corp. (In re Robert B. Lee Enter.), 980 F.2d 606, 608 (9th Cir. 1992); Sommers v. International Business Mach., 640 F.2d 686, 691-92 (5th Cir. 1981); Fifth Third Bank v. Orix
presented. Hence, in both the simple example and Variant (3) above, the Fretz court would treat CI as having a secured claim for only $50 and unsecured (assigned) claim for $50.

Fretz relies on bad arguments. To begin with, the status of assigned claims is a matter of U.C.C. law, as the Fretz court acknowledges.\textsuperscript{22} The status of assigned claims is not a matter of the law of assignment. As an assignment, the over-collateralized secured creditor, of course, can acquire only the rights assigned to it.\textsuperscript{23} If the assigned claim is unsecured, the secured creditor \textit{qua} assignee acquires only an unsecured claim. But the assignee is a secured creditor with rights granted under a security agreement with the debtor. The governing security agreement may secure all debt held by the secured party, as it did in Fretz. The question therefore is what rights the assignee-secured creditor acquires as a secured party. Even if rights cannot be augmented by assignment, it does not follow that rights cannot be augmented by the laws governing secured credit. That is, even if as an assignee an unsecured claim is acquired, the assigned claim could be treated as a secured claim when the assignee is a secured creditor.\textsuperscript{24} Hence, arguments are needed for or against treating the assigned claim as a secured claim under the U.C.C.

The Fretz court relies on the Code policy against secret liens.\textsuperscript{25} An unsecured creditor need not provide public notice of its claim as a condition of

\textsuperscript{22} \textit{See In re} E.A. Fretz Co., 565 F.2d at 369.

\textsuperscript{23} \textit{See, e.g., RESTATEMENT (SECOND) OF CONTRACTS §§334, 336 (1979), E. ALLAN FARNSWORTH, CONTRACTS § 11.8, at 810-11 (2d ed. 1990). Even as a matter of assignment, the court in Fretz arguably was wrong on the facts presented to it. The terms of the security agreement between Revlon and Fretz provided the described collateral secured “[f]all debts, liabilities . . . owing by Debtor [Fretz] and/or any of its present and future divisions and affiliates . . . .” Fretz, 565 F.2d at 368 n.2. Revlon’s wholly-owned subsidiaries being “affiliates” of Revlon, this language seems to create a security interest in their favor. If so, the subsidiaries arguably held secured claims, which they assigned to Revlon. The only basis for denying Revlon’s subsidiaries secured status would be that they did not satisfy § 9-402(1)’s requirement that the secured party be named in the financing statement. \textit{But see} U.C.C. § 9-402(8) (1992). On appeal, Revlon conceded that its subsidiaries did not hold secured claims. \textit{Fretz}, 565 F.2d at 369 n.11.

\textsuperscript{24} \textit{Cf. Thorp Sales Corp. v. Dolese Bros. Co.}, 453 F. Supp. 196, 200-02 (W.D. Okla. 1978) (“floating secured” status denied where language of security agreement was insufficiently clear to allow it; implication is that status would have been allowed had language been sufficiently clear).

\textsuperscript{25} \textit{See Fretz}, 565 F.2d at 371.
the claim’s validity. Article 9’s notice filing regime, by requiring a filed financing statement to perfect nonpossessory security interests, provides third party creditors with information about potential encumbrances on a debtor’s assets. Treating an initially assigned unsecured claim as secured when assigned fails to give notice to third parties. Such treatment, the Fretz court concludes, violates the notice filing requirements of Article 9. The argument is a bad one for at least two reasons. First, it misconstrues Article 9’s notice filing regime. There is no requirement that a financing statement contain a statement of the amount of debt being secured, if any. Hence, as far as notice filing goes, potential creditors cannot use the financing statement to determine how much initially held debt is secured. In fact, under Article 9, potential creditors cannot even determine who might hold a security interest. For section 9-302(2) permits the assignment of security interests, while sections 9-405(1) and (2) merely permit a financing statement to disclose an assignment. Because notice of the assignment is not required under section 9-405(1) and (2), a potential creditor may not discover that a security interest has been assigned by examining a financing statement.

Second, the argument misconstrues the purpose of notice filing. Only potential secured creditors are concerned with the contents of a financing statement. And such creditors do not make their loan decisions based on


27. See U.C.C. § 9-402 & cmts. 1, 2 (1992) (possible security interest; filing allowed even before security interest arises).

28. Section 9-208 allows a potential creditor to elicit this information through the debtor. U.C.C. 9-208 (1992); see also I GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 15.3, at 472-73 (1965). However, the same means are available to discover the existence of unsecured debt.


30. The court in Fretz therefore is mistaken when it says that

[w]e believe that at the time a bank makes a loan, it should be secure in the knowledge of . . . precisely what, and how many, secured parties claim a prior interest in the same collateral. And it should be able to make that initial determination by resorting to financing statements which meet the “simple” § 9-402 standards.

In re E.A. Fretz, 565 F.2d at 372.

31. See infra text accompanying notes 94-99 and note 105.
the identity of a creditor disclosed in a financing statement. This is because under the pure race priority scheme of Article 9, priority is determined by the order of perfection or filing, whichever occurs first.\textsuperscript{32} Thus, a potential creditor will not care about the identity of the secured creditor listed in the financing statement. Instead, a potential creditor will care only about the existence of a secured party and collateral listed in a filed financing statement. A financing statement will give a secured creditor, whatever its identity, priority in collateral whenever the secured creditor makes a loan.\textsuperscript{33} A potential creditor, knowing this, will consider the party listed as a secured party in the financing statement as enjoying priority in the collateral listed there. Accordingly, without a subordination agreement, the potential creditor will price the loan at the rate of an unsecured loan. Hence the absence of public notice of an initially unsecured debt will have no effect on the potential secured creditor’s loan decision. Treating an unsecured claim as secured when assigned to an over-collateralized secured creditor therefore does not violate Article 9 policy against secret liens.

The simple example above can be used to illustrate this conclusion. Assume that $C_2$, the intervening junior secured creditor, is considering making debtor a secured loan of $50. $C_2$’s search of the relevant registry reveals a financing statement listing $C_1$ as the secured creditor. The financing statement further reveals that $C_1$ may have a security interest in a described asset of the debtor. Knowing Article 9’s priority rules, $C_2$ will infer that any loan $C_1$ makes to debtor can have priority up to $100, the assumed value of the collateral. This is the only inference that the notice provided by the financing statement permits.\textsuperscript{34} The fact that $C_1$ has not made a secured loan to debtor to date, or has not made secured loans up to $100, will not affect $C_2$’s loan decision. Given $C_1$’s priority, $C_2$ will assume that there is a risk that its $50 loan will be unsecured. Whether $C_1$ has a secured claim of $50 and an assigned unsecured claim of $50 is irrelevant to $C_2$. As far as the information provided by $C_1$’s financing statement goes, $C_1$ can obtain priority in the described collateral up to $100. The character of the assigned claim therefore is irrelevant to $C_2$’s loan decision. The \textit{Fretz} court’s argument against treating $C_1$ as having a floating secured claim fails. The argument fails because it ignores the information provided by notice filing and by creditor behavior given the information.

\textsuperscript{33} See U.C.C. § 9-312 cmt. 5 ex. 1 (1992).
\textsuperscript{34} The information disclosed by the financing statement, of course, permits further inquiry into the debtor’s financial condition. See U.C.C. § 9-402 cmt. 2 (1992). Further inquiry would reveal, directly or indirectly, the contents of the security agreement between $C_1$ and debtor. Since that agreement contains a future advances clause as well as securing all debt owing to $C_1$, further inquiry would put $C_2$ on notice of the extent of $C_1$’s potential priority in the described collateral.
B. The Granting of Floating Secured Status

Settled law treats advances made by an assignee differently when the assigned security interest contains a future advances clause. Advances made by the assignee are deemed to retain the priority of the assignor’s advances. The assignee’s advances are granted the status of floating secured claims. Robert B. Lee Enterprises\textsuperscript{35} is a representative case.\textsuperscript{36} Champion Credit Corporation took an assignment of a security agreement containing a future advances clause from a senior secured creditor.\textsuperscript{37} Intervening creditors had extended funds to the debtor on a secured basis. Champion subsequently extended funds to the debtor to enable it to purchase some inventory.\textsuperscript{38} At issue in Robert B. Lee Enterprises was the status of Champion’s subsequent advance: did it have the same status as advances made by its assignor, the senior secured creditor, or was it junior to the intervening creditors’ intervening secured claims?\textsuperscript{39} Champion’s advance was deemed to have the same status as its assignor’s security interest.\textsuperscript{40} Advances made by an assignee who is initially a noncreditor are considered floating secured claims. Hence, in Variant (2) above, the Robert B. Lee Enterprises court would treat C3 as having a secured claim of $100.

The court’s justification for treating the assignee’s advance as a floating secured claim is rightly based on notice filing.\textsuperscript{41} However, the justification

\textsuperscript{35} 980 F.2d 606 (9th Cir. 1992).
\textsuperscript{37} Robert B. Lee Enter., 980 F.2d at 607.
\textsuperscript{38} Id.
\textsuperscript{39} Id.
\textsuperscript{40} Id. at 608.
\textsuperscript{41} Id. at 609. The Robert B. Lee court also gives another justification based on Oregon’s version of § 9-405(3). Oregon’s version of Article 9 provides that “[a]fter the disclosure or filing of an assignment . . . the assignee is the secured party of record.” OR. REV. STAT. § 79.4050(3) (Supp. II 1994). The court seems to find the provision sufficient to deem the assignee’s advance to have the priority of its assignor’s security interest. See Robert B. Lee Enter., 980 F.2d at 608–09 (emphasis added by court). The apparent finding is mistaken. Section 79.4050(3) only concerns the identity of the secured party when an assignment is disclosed or recorded. The section says nothing about the issue in the case: the treatment of an advance made by the assignee after the assignment of the security agreement containing a future advances clause. Because the assignment occurred after there were intervening secured creditors, as far as § 79.4050(3) goes, the subsequent advance by the assignee still could not be treated as junior to those creditors’ claims. Hence, another justification for granting the advance “floating secured claim” status is required. The court gives the required justification, see infra note 42, based on notice filing, see infra text accompanying
is incomplete, and several details are wrong. The court's assertion that filing notice allows prospective creditors to infer that a security agreement exists is false but harmless.\textsuperscript{42} A financing statement filed by the assignor gives notice to prospective creditors that the filing creditor might have taken a security interest in the debtor's assets.\textsuperscript{43} Filing notice gives prospective creditors information about the assignor's priority: all advances made by the assignor have priority over competing secured claims in the debtor's assets. Prospective creditors do not need to discover the existence or details of a security agreement between the debtor and the filing creditor, contrary to what the court implies.\textsuperscript{44} Filing establishes priority, not the date or details of a security agreement.\textsuperscript{45} The court adds that such creditors cannot complain when they obtain secured claims in the face of the information provided by notice filing.\textsuperscript{46} The court also could have added the behavioral consequence of notice: Intervening creditors, with filing notice, will charge a price that takes into account the risk of being junior to the filing creditor. Given notice, intervening creditors taking security interests will receive a premium to be junior to the creditor who has filed first.

The same justification can be extended to assignees of secured creditors who file. Again, prospective creditors infer that any advances that the filing creditor makes enjoy priority over competing secured claims they might have. Given filing notice, prospective creditors therefore will charge the debtor a price which reflects the risk of being junior to the filing creditor. The fact that an assignee of the senior secured creditor makes an advance does not affect that risk because there is a risk that an advance will be made by the filing creditor. The extent of the risk of being junior to the advances made by a senior creditor therefore remains constant.\textsuperscript{47} The prospective creditor, recognizing the risk, will demand compensation for having to bear the risk. Hence, the intervening creditor is no worse off after an assignment of a security interest than before.\textsuperscript{48} The \textit{Robert B. Lee Enterprises} court's

\begin{itemize}
  \item notes 43-46.
  \item \textit{Robert B. Lee Enter.}, 980 F.2d at 609.
  \item See U.C.C. § 9-402(1) (1992) ("A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.").
  \item The court in \textit{Robert B. Lee Enter.} stated:
  When, as here, the security agreement contains a future advance clause together with a clause permitting assignment, creditors contemplating extending credit to a debtor are put on notice that the secured party or its assignee may make future advances under the security agreement and that those advances will have priority consistent with the agreement and applicable law.
  \item \textit{Robert B. Lee Enter.}, 908 F.2d at 609.
  \item \textit{Robert B. Lee Enter.}, 980 F.2d at 609.
  \item The assumption of invariant risk is defended at infra pp. 398-99, note 106.
appeal to the information conveyed by notice filing supports granting floating secured status to post-assignment advances.\textsuperscript{49}

Sometimes, courts recognize this point implicitly. \textit{In re Southwest Pennsylvania Natural Resources, Inc.} is an example.\textsuperscript{50} Sinclair, the senior creditor, perfected a security interest in the pieces of the debtor’s equipment by filing a valid financing statement.\textsuperscript{51} The security agreement covered by the financing statement contained a future advances clause, as well as a clause securing “all other past, present and future direct or contingent liabilities of Buyer to Seller.”\textsuperscript{52} Sinclair immediately assigned the security agreement to Westinghouse.\textsuperscript{53} Subsequently, Beckwith, the intervening creditor, perfected a security interest in the same equipment by filing a financing statement.\textsuperscript{54} Still later, the debtor refinanced the debt held by Westinghouse and executed a security agreement covering equipment covered by Beckwith’s security agreement.\textsuperscript{55} At issue in the priority contest between Westinghouse and Beckwith was the priority of the secured debt held by Westinghouse: whether it had the priority of the security interest assigned by the senior creditor, Sinclair, or only had priority dating from Westinghouse’s filing a financing statement.\textsuperscript{56} The court found that Westinghouse’s security interest had the priority of the assigned security interest.\textsuperscript{57}

Only the \textit{Southwest Pennsylvania} court’s justification is relevant here. The justification appeals to the notice provided by the filing of the assignor’s financing statement. The court assumes that the refinanced secured debt held by Westinghouse did not extinguish the secured debt assigned to it by Sinclair.\textsuperscript{58} The court also assumes that the clause in the

\textsuperscript{49} Robert B. Lee Enter., 980 F.2d at 609.

\textsuperscript{50} 11 B.R. 900 (Bankr. W.D. Pa. 1981). This case involves an assignment of a security interest from a senior to a junior secured creditor. See infra text accompanying notes 51-57. Variant (1) in part I involves the reverse—an assignment of a security interest from a junior to a senior secured creditor. Because the question in both the case and variant concerns the effect of assignment on claims held by the assignee, both concern the status of floating secured claims.


\textsuperscript{52} Id. at 902 (emphasis omitted).

\textsuperscript{53} Id. at 901.

\textsuperscript{54} Id.

\textsuperscript{55} Id.

\textsuperscript{56} Id. at 902.

\textsuperscript{57} Id.

\textsuperscript{58} Section 9-302(2) allows a perfected security interest to remain perfected upon assignment without the assignee filing a financing statement. See U.C.C. § 9-302(2) (1992);
debtor’s security agreement with Sinclair securing all “liabilities of Buyer [debtor] to Seller [creditor]” extended to Sinclair’s assignee. Treating Westinghouse’s refinancing of the debt it held as an advance by Westinghouse to the debtor, the court considers Westinghouse’s advance to have the same priority as the assignor’s (Sinclair’s) security interest. The court’s justification refers only to notice filing: information that a filed financing statement provides to the intervening creditor at the time the intervening creditor makes its loan to the debtor. An intervening creditor could adjust the interest rate of its loan accordingly. The court makes this point with respect to the senior secured creditor’s filed financing statement. The court does not mention the absence of the assignee’s filed financing statement at the time the intervening creditor extends its loan. Hence, the court assumes that, given notice of the assignor’s financing statement, the intervening creditor’s loan decision is unaffected by a post-assignment advance.

C. Treatment of Floating Secured Status Compared

Under settled law, the different treatment of assigned unsecured claims and post-assignment advances is difficult to justify. Doctrinally different treatment of the two, of course, is straightforward. Unsecured claims remain unsecured notwithstanding assignment to a senior secured creditor. Advances made by an assignee after an assignment of a security agreement have the priority of the assigned security interest. However, convincing
reasons for different treatment of the claims arising from an assignment virtually are nonexistent. Settled law provides none.

One difficulty concerns the consistency in treatment of assigned unsecured claims themselves. Assigned unsecured claims are not given the same status under Article 9 and real estate law. Assigned claims deemed unsecured under Article 9 can be deemed secured under the real estate financing law. Unsecured claims are not uniformly considered to remain unsecured notwithstanding assignment when a mortgage or deed of trust secures the debt.\textsuperscript{63} State law treatment varies. Under some state real estate law, a broadly drafted cross-collateralization clause can apply to the debts owed by the debtor to third parties and subsequently assigned to the mortgagee.\textsuperscript{64} Black-letter real estate law in most states considers such assigned debts as remaining unsecured.\textsuperscript{65} But even in these states, an unsecured debt assigned to a mortgagee will be treated as secured by the mortgage if the pertinent cross-collateralization clause is clear.\textsuperscript{66} Thus, prevalent state real estate law grants floating secured status to assigned unsecured claims under some conditions. The treatment of assigned unsecured claims under prevalent real estate law and Article 9 therefore differs. There is an inconsistency in treatment even within the class of assigned unsecured claims.

Another difficulty concerns the justification of different treatment of assigned unsecured claims and post-assignment advances. Settled law justifies the priority of post-assignment future advances by considerations of notice filing.\textsuperscript{67} The obvious problem is that the same argument can be

\textsuperscript{63} See infra note 64.


\textsuperscript{65} See, e.g., First S. Dev. Corp. v. Chandler (\textit{Ex parte} Chandler), 477 So. 2d 360, 363-64 (Ala. 1985) (intentions for mortgage to include other notes must be clear); Pongetti v. Bankers Trust Sav. & Loan Ass'n, 368 So. 2d 819 (Miss. 1979); Wood v. Parker Square State Bank, 400 S.W.2d 898, 901 (Tex. 1966) (mortgage stipulations securing future indebtedness apply only to those debts reasonably conenteplatable by parties); see also Nelson & Whitman, \textit{supra} note 64, § 12.8, at 940.


\textsuperscript{67} See \textit{supra} text accompanying notes 41-46, 50-62.
used to justify treating unsecured claims as secured upon assignment. Hence, if an argument based on notice filing justifies post-assignment future advance priority, it also justifies treating as secured assigned unsecured claims. To illustrate this point, consider again Fretz and the simple example in Part I. In both cases, a secured creditor holding cross-collateralized secured claims took an assignment of unsecured claims. The pertinent security agreement secures all debts owing to the assignee-creditor, whatever their nature. Given the financing statement filed by the assignee-creditor, all intervening creditors are on notice that the filing creditor may have priority in the described collateral up to its value. Intervening creditors also have notice about another consequence: that any advances made by the filing creditor or its assignee have the same priority as the initial advance. Because an initial advance can be equal to the value of the debtor’s collateral, intervening creditors are on notice that their loans may be unsecured; intervening creditors, having notice, therefore set the price of their loans accordingly. The probability of subsequent advances does not affect their loan decisions.

The same is true in the case of assigned unsecured claims. Filing notice is given to intervening creditors that the filing creditor may have priority in the described collateral up to its value. As before, having notice, intervening creditors can set the price of their loans accordingly. Of course, intervening creditors cannot be charged with knowledge about the priority of unsecured claims assigned to the secured creditor of record. That priority is the conclusion of an argument for granting assigned unsecured claims floating secured status. Hence, an intervening creditor’s knowledge cannot be assumed to establish that priority. (Nor, for the same reason, can its absence be assumed.) Such knowledge, unlike knowledge of future advance priority, therefore cannot be used here. But knowledge of the priority of assigned unsecured claims is irrelevant to intervening creditors, as in the case of future advances. For the filing creditor has priority up to the amount of its initial loan to the debtor, if and when the loan is made. Filing establishes this priority. Because an initial loan by the creditor of record may be equal to the value of the described collateral, intervening creditors are on notice that their loans may be unsecured. Intervening creditors, given filing notice, will set the price of their loans accordingly. Whether or not assigned unsecured claims are treated as secured, therefore, does not affect the loan decisions of intervening creditors. Their loan decisions are determined only by the probability that the filing creditor will make an initial loan.

The argument for post-assignment advance priority based on notice filing also applies to the priority of assigned unsecured claims. The argument cannot distinguish the two. Because notice filing is relevant to the loan decisions of intervening creditors, and both post-assignment future

68. See Robert B. Lee Enter., 980 F.2d at 609. See also U.C.C. § 9-312(7) (1992).
advances and the assignment of unsecured claims are irrelevant to their loan
decisions, settled law cannot consistently grant floating secured status to one
and not the other based on notice filing. Hence, factors relating to future
advances and unsecured claims cannot justify their different treatment. For
example, the fact that assignors in *Fretz* were unsecured creditors,\(^69\) while
the assignor in *Robert B. Lee Enterprises* was a noncreditor is unimpor-
tant.\(^70\) Nor is it important that the assignee in *Fretz* was a secured creditor,
while the assignee in *Robert B. Lee Enterprises* was a noncreditor.\(^71\) As
far as notice filing goes, intervening creditors treat assignments made to a
filing creditor and advances made to an assignee of a filing creditor as
indistinguishable. In both cases, their loan decisions are unaffected. Thus,
settled law cannot justify differential status based on notice filing. Notice
filing requires parity of treatment. It is another matter as to what parity of
treatment requires. Part III argues for the unrestricted treatment of both
post-assignment advances and assigned unsecured claims as floating secured
claims.

III. THE CASE FOR UNRESTRICTED FLOATING SECURED STATUS

Normative arguments concerning the status of post-assignment advances
and assigned unsecured claims can be of two types. One type is revisionary.
Such arguments first establish the efficiency properties of particular systems
of asset-based financing. A particular system from within the set considered
is preferred on the basis of its efficiency properties. The status of post-
assignment advances and assigned unsecured claims is then recommended
under that system. If Article 9 and its notice filing scheme are not selected,
the recommended status of such claims obviously can be inconsistent with
Article 9’s filing scheme. The other type of argument is constructive. Such
arguments take as given Article 9 and its notice filing scheme. The status
of post-assignment advances and assigned unsecured claims is recommended
as being consistent with Article 9’s filing scheme. Efficiency properties of
Article 9, if any, provide only independent support for the treatment
recommended. The case below for unrestricted floating secured status is
constructive.\(^72\)

\(^69\) See Republic Nat’l Bank of Dallas v. Fitzgerald (*In re E.A. Fretz Co.*), 565 F.2d
366, 369 (5th Cir. 1978).

\(^70\) See *Robert B. Lee Enter.*, 980 F.2d at 607.

\(^71\) Both differences are sometimes invoked to justify denying “floating secured”
status to assigned unsecured claims while granting the status to claims arising from post-
assignment advances. See, e.g., *Robert B. Lee*, 980 F.2d at 608; *In re Cycle Prod.

\(^72\) The distinction between revisionary and constructive arguments is not precise.
For instance, consider a proposal for determining the priority of both secured and unsecured
A. The Behavioral Consequences of Notice Filing

As noted, the case takes as a given Article 9 and its notice filing scheme. Three assumptions follow. First, the case assumes that a system of asset-based secured financing is justified. Second, it assumes that Article 9's priority rules are defensible. Third, the case assumes that Article 9's scheme of notice filing optimally reduces the costs of discovering prior secured debt. The justification of Article 9's ordering of claims in a debtor's assets depends on the soundness of the assumptions. Each may be false. However, their truth is irrelevant here. For the case takes as true the three assumptions and asks how post-assignment advances and assigned unsecured claims should be treated. In particular, it asks: Given Article 9's scheme of notice filing and priority, and prospective creditor behavior, what is the proper treatment of such claims? Because the question makes the assumptions mentioned, the case for the proper treatment of post-assignment advances and assigned unsecured claims is constructive. The preferred status of these claims might be different if another scheme of asset-based financing were justified.

Since Article 9's scheme of notice filing is assumed, its requirements serve as a constraint. The constraint is one of consistency. Requirements not present in Article 9's scheme of notice filing cannot be imposed to decide the preferred status of post-assignment advances and assigned unsecured claims. A sufficient financing statement need not include a statement of the amount of debt being secured. Nor need it recite that any advances made are covered by the statement. Again, a sufficient financing statement need not recite that a security agreement covered by it allows for assignment. Article 9's notice requirements do not demand disclosure of any of these matters. They are additional requirements. The claims by the date of the filing of a financing statement. The proposal would require significant changes in Article 9. To that extent the proposal is supported by a revisionary argument. At the same time, it takes as given the notice filing scheme of Article 9. It also might be supported by the constructive argument in part III.A. infra. For both reasons, the argument would contain constructive elements. The argument in part III.A contains no hybrid elements. The possibility of hybrid arguments therefore does not affect the characterization of the argument in part III.A.


constraint of consistency therefore excludes imposing such requirements to justify the preferred status of assigned and post-assignment claims.

Schematically, the argument for unrestricted treatment goes as follows: Debtors and initial filing creditors often are better off executing security agreements containing cross-collateralization clauses than not doing so. Only prospective intervening secured or lien creditors rely on the presence of a filed financing statement in making loan decisions. Given a filing by the initial creditor, their loan decisions are unaffected by assignments of unsecured claims to the filing creditor or advances made by the filing creditor’s assignee. Hence, prospective intervening secured creditors or lien creditors are no worse off ex ante if assigned unsecured claims and post-assignment advances are given floating secured status. Since the initial filing creditor is better off with such treatment, the proper status of floating secured claims should be unrestricted. This argument provides the case for unrestricted treatment of floating secured claims. It rests on the assumption that Article 9’s scheme of notice filing and priority is defensible.

The case for unrestricted status obviously depends on the soundness of the argument. The argument’s soundness in turn depends on the soundness of its claims. As stated, the argument consists of three claims: (1) that debtors and initial filing creditors are better off executing agreements containing cross-collateralization clauses; (2) that only prospective secured creditors and actual lien creditors rely on filed financing statements; and (3) that their loan decisions are unaffected by treating as secured assigned unsecured claims and post-assignment advances. Each of these claims is sound. Consider each in turn.

Claim (1). Claim (1) is clearly true. Debtors and initial creditors often execute security agreements in which collateral secures all “indebtedness of whatever kind or character, whether otherwise secured or not.”77 And they do so even in the face of settled law’s denial of floating secured status to assigned unsecured claims.78 “All debts owing” clauses in security agree-

77. See Shaw v. Walter E. Heller & Co., 258 F. Supp. 394, 396 n.1 (N.D. Ga. 1966); cf. Thomas S. Hemmendinger, HILLMAN ON COMMERCIAL LOAN DOCUMENTATION 186 (4th ed. 1994) (definition of “obligation[s]” from sample form which includes “all indebtedness . . . owing from Borrower to others that Lender may have obtained by purchase, negotiation, discount, assignment, or otherwise . . . .”). For other examples, see Ryder v. Bank of Hickory Hills, 612 N.E.2d 19, 21 (III. App. Ct. 1993) (“Bank’s security interest secures all other existing and future indebtedness and obligations of debtor to Bank.”); Harris Trust and Sav. Bank v. Wayne J. Klein Corporation (In re Klein), 97 B.R. 394, 396 (Bankr. N.D. Ill. 1989) (“To secure the payment of this and any and all other liabilities of the undersigned or any of them to said bank, whether now existing or hereafter arising and howsoever evidenced or acquired . . . .”); In re Brady, 171 B.R. 635, 637 (Bankr. N.D. Ind. 1994) (“It [the security interest] secures any other loans you have with the credit union now or in the future and any other amounts you owe the credit union for any reason now or in the future . . . .”).

ments are bargained-for. Absent a showing of misinformation or procedural defects, this contracting behavior is prima facie evidence of the welfare-enhancing effect of the relevant cross-collateralization clauses on debtors and initial creditors.  

Section 9-201 recognizes the possibility. Under section 9-201, a security agreement is enforceable between the parties, unless otherwise provided under the U.C.C. Determining the scope of the relevant clause in a security agreement is another matter. Scope here is a matter of contract interpretation, not peculiar to security agreements. How frequently debtors and initial secured creditors employ “all debts owed” cross-collateralization clauses is a further matter. Both matters are consistent with the fact that the relevant cross-collateralization clause, when used, enhances the welfare of the debtor and the initial filing creditor.

79. For some possible reasons why, see infra pp. 388.

80. See U.C.C. § 9-201 (1992). Section 9-201 also states that, unless otherwise provided by the U.C.C., a security agreement is effective according to its terms against creditors. Hence, unless the U.C.C. provides otherwise, a security agreement containing an “all obligations” clause is effective against the debtor’s creditors. Since no provision of the U.C.C. alters the effect of such clauses if the security interest has attached, § 9-201 underwrites the unrestricted status of floating secured claims. (Thus, § 9-201 provides the answer to the Fretz court’s question as to how Article 9 allows the assignment to transform an unsecured claim into a secured claim. See Fretz, 565 F.2d at 374.) Claim (1) above only relies on § 9-201's statement of the effectiveness of the terms of a security agreement between the debtor and the secured creditor.

81. See, e.g., TENN. CODE ANN. § 47-50-112 (Supp. 1995) (“All contracts . . . shall be prima facie evidence that the contract contains the true intention of the parties, and shall be enforced as written . . . .”); Bank of Kansas v. Nelson Music Co., 949 F.2d 321, 323 (10th Cir. 1991) (“[a]pplying Kansas rules of contractual construction and interpretation” to a dragnet clause in a mortgage); Kimbell Foods v. Republic Nat’l Bank of Dallas, 557 F.2d 491, 496 (5th Cir. 1977), aff’d 440 U.S. 715 (1979) (noting that the words of a contract are the “truest test of the parties’ intention . . . .”); Kitmitto v. First Pa. Bank, 518 F. Supp. 297 (E.D. Pa. 1981) (determining the scope of a security interest by applying general contract interpretation law of Pennsylvania to the security agreement); Ex parte Chandler, 477 So. 2d 360 (Ala. 1985) (construing a future advances clause with regard to the rule that “in this contractual setting . . . the contemplation and intent” of the parties is a consideration); Farm Credit Bank of St. Louis v. Nat’l Bank of Aledo (In re Swanson), 104 B.R. 1 (Bankr. C.D. Ill. 1989) (requiring that the securing of a certain obligation be within the contemplation of the parties to a security agreement with a dragnet clause); Premier Bank v. Prevost Motors, 597 So. 2d 1136 (La. Ct. App. 1992) (applying contract interpretation principles to a dragnet clause); In re Phillips, 161 B.R. 824 (Bankr. W.D. Mo. 1993) (refusing to settle on a rule of interpretation for dragnet clauses, only because the obligation at issue clearly fell under any interpretation of the dragnet clause in question); In re Sunshine Books, Ltd., 41 B.R. 712 (Bankr. E.D. Pa. 1984) (considering various rules of contract interpretation to determine the inclusiveness of a future advances clause); see also Campbell, supra note 66, at 1009-10 (noting the different rules of construction that various jurisdictions apply to future advance clauses).
An "all debts owed" clause can be welfare-enhancing for the debtor. Given two weak assumptions, it can be a cost-effective response to anticipated changes in financial structure over time. Assume at time $t$ that the optimal mix of financing for a debtor consists of secured and unsecured debt. This assumption may be valid because unsecured creditors (e.g., trade creditors) incur lower costs in screening low-risk debtors than do secured creditors. Alternatively, it may be cheaper for a single creditor both to sell and finance specific assets to the debtor, or there may exist complementarities in monitoring debtors. Assume also that at time $t$ there is a probability that the optimal mix of financing for the debtor will change at $t'$. In particular, assume that there is a probability that the optimal mix at $t'$ consists of an increased ratio of secured to unsecured debt. Perhaps the riskiness of debtor's projects is expected to increase over time. Alternatively, there may exist economies of scale in monitoring by a single secured creditor. Efficient monitoring might require that increased positive externalities at $t'$ produced by monitoring be internalized by a secured creditor. Given the two assumptions, the debtor is to select a financial contract for periods $t$ and $t'$.

Debtor's financing decision is one under risk. It is to select a financial device at $t$ which minimizes debtor's total debt bill over periods $t$ and $t'$. Three devices are possible. (1) Secured and unsecured debt is issued at $t$. Further secured debt is issued to secure previously unsecured debt at $t'$. (2) Secured and unsecured debt is issued at $t$. Further secured debt is issued to an existing secured creditor at $t'$ in exchange for an advance. The debtor uses the advance at $t'$ to retire some unsecured debt. (3) Secured and unsecured debt is issued at $t$, the security agreement covering the secured debt containing an "all debts owed" clause. At $t'$, unsecured debt is assigned to a secured creditor holding this agreement. Because all three devices result in the same mix of secured and unsecured debt at each period, only the cost of obtaining these mixes can affect debtor's total debt bill. Thus, the debtor selects the device which induces the lowest contracting costs in obtaining credit over time.

Estimates suggest that device (3) has lower contracting costs than devices (1) and (2). Device (1) requires three transactions: unsecured debt issued at $t$, execution of a security agreement at $t'$, and the filing of a

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financing statement by the creditor at \( t \) or \( t_{1} \). Device (2) also requires three transactions: unsecured debt issued at \( t \), an execution of a security agreement and advance to the debtor at \( t_{1} \), and retirement of unsecured debt at \( t_{1} \). Device (3) requires only two transactions: unsecured debt issued at \( t \) and an assignment from an unsecured creditor (or to a secured creditor) at \( t_{1} \). Assignments of a number of unsecured claims against the debtor can be effected without satisfying any formal requirements. Transfers of other claims against the debtor require memorization in a security agreement. Because assignments of both types require one fewer transaction than in (1) and (2), the contracting costs associated with device (3) are lower than those associated with devices (1) and (2). A debtor therefore would select device (3) and the “all debts owed” clause it contains.

The possible welfare-enhancing effect of “all debts owed” clauses is consistent with candidate theories of secured credit. Such theories explain secured credit as responses to either of two types of disparity in information between debtor and creditor. One type of informational disparity concerns information at the time debt is issued about the likelihood of repayment. The other type concerns actions the debtor might take after debt is issued that affect the likelihood of repayment. Screening and signaling cost theories explain secured credit as a contractual device for reducing the first type of informational disparity. Monitoring cost theories explain it as a contractual device for reducing informational disparity of the second type.

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83. The above assumes that perfection is achieved by filing a financing statement. If it were achieved by possession of collateral, the third transaction would be possession.

84. See, e.g., U.C.C. § 9-104(d), (f), (h), (i), (k), (l) (1992) (enumerating types of transfers and interests transferred which are excluded from scope of Article 9).

85. See U.C.C. §§ 9-102(1)(b) (any sale of an account), 9-203(1)(a) (written security agreement required), 9-105(1)(d) (“Debtor” includes seller of accounts), 9-105(1)(m) (1992) (“Secured party” includes buyer of accounts).


88. See Jackson & Kronman, supra note 73; Saul Leve, Monitors and Freeriders in Commercial and Corporate Settings, 92 YALE L.J. 49 (1982) (discussing competing monitoring cost theories); cf. Alan Schwartz, The Continuing Puzzle of Secured Debt, 37
Accordingly, the theories divide over the source of informational disparity concerning repayment risk. The possible welfare-enhancing effect of “all debts owed” clauses above relies on uncertainty in the debtor’s financing plans over time: the particular mix of unsecured and secured debt required at ti. However, the welfare-enhancing effect is neutral as to the source of that uncertainty.89 Because candidate theories of secured credit identify different sources of informational disparity about repayment risk and the possible welfare-enhancing effect of “all debts owed” clauses is neutral about them, the two are consistent with each other.

To illustrate, consider Scott’s relational theory of secured credit.90 Scott is concerned with a pattern of financing debtors who exploit long-term financial prospects with unknown contingencies that cannot be contracted for completely.91 The presence of unknown contingencies at the time debt is issued is an informational disparity of the first type identified. Long-term financial prospects allow a debtor to engage in actions which affect the likelihood of repayment, the second type of informational disparity. Blanket security interests governed by Article 9, according to Scott’s theory, reduce both types of disparity in information because they give a single secured creditor the exclusive right to benefit from the debtor’s financial prospects. Uncertainty about the distribution of firm value among creditors therefore is eliminated. A blanket security interest also reduces aggregate monitoring costs by allowing a decrease in the number of monitoring creditors.92 Uncertainty is thereby reduced as to the debtor’s actions after debt is issued altering the likelihood of repayment. “All debts owed” clauses make possible the same effect over time. They enable a secured creditor to have assigned to it at ti all debt held by other creditors. Benefits from a single secured creditor holding debt therefore can be realized. Similarly, scale economies in monitoring costs occurring at ti also can be realized. “All debts owed” clauses make possible the internalizing of benefits and reduction in monitoring costs by which the theory explains secured credit. Thus, the welfare-enhancing effect of “all debts owed” clauses is consistent with Scott’s relational theory.93


89. See supra notes 83-88 and accompanying text.
90. See Robert E. Scott, A Relational Theory of Secured Financing, 86 COLUM. L. REV. 901 (1986). Scott’s theory is offered to explain some persistent patterns of secured financing, not to explain all features of secured debt. See id. at 912, 970. Because the theory is being used for illustrative purposes only, I ignore the limitation below.
91. See id. at 903; cf. Charles J. Goetz & Robert E. Scott, Principles of Relational Contracts, 67 VA. L. REV. 1089, 1091 (1981) (stating that a contract is relational to the extent that it cannot completely provide for every future contingency).
92. See Scott, supra note 90, at 955-57.
93. Note the role of consistency with theories of secured credit in the constructive argument of this Part. Consistency with theories of secured credit is not employed to establish claim (1): that “all debts owed” clauses are welfare-enhancing. Instead, consistency
Claim (2). Claim (2) also is cogent: only prospective secured and lien creditors rely on filed financing statements. This claim is familiar. Prospective unsecured creditors look to the cash flow of the debtor for payment. They do not rely on the debtor’s assets. Nor could prospective unsecured creditors rely on the debtor’s assets. Article 9’s predominant priority rule is one of first in time, and a filed financing statement assures the filing creditor priority over subsequent competing claims in the same collateral. Hence, for both reasons, potential unsecured creditors do not employ information conveyed by financing statements. Prospective secured and lien creditors are different. A prospective secured creditor requires a right to priority in an asset of the debtor. Because the order of filing generally determines priority rights under Article 9, investigation of filed financing statements is needed. Similarly, a prospective lien creditor is junior to perfected security interests in the asset levied upon. Article 9’s predominant priority rule requires obtaining information about assets possibly encumbered by existing security interests. Filed financing

is used to independently support the presumptively welfare-enhancing effect suggested by the presence of “all debts owed” clauses in security agreements. The introduction of consistency therefore does not make the argument in this Part a revisionary argument. See supra note 87 and accompanying text.

94. See Douglas G. Baird, Notice Filing and the Problem of Ostensible Ownership, 12 J. LEGAL STUD. 53 (1983); cf. Corwin W. Johnson, Purpose and Scope of Recording Statutes, 47 IOWA L. REV. 231, 235 (1962) (“The creditor is more interested in the general financial status of his debtor than he is in the debtor’s ownership of particular realty . . . .”); see also Schwartz, Loan Priorities, supra note 87, at 222-26 (arguing that even secured creditors can dispense with the need for a filing system of public notice).


statements provide that information. Only prospective secured and lien creditors, therefore, rely on filed financing statements.

Of course, prospective secured and lien creditors do not rely only on minimal information provided by financing statements. Secured creditors, like unsecured creditors, also are concerned about the debtor's cash flow. This is because distributions to secured creditors in bankruptcy often are less than the amount of their claims.98 Existing covenants restricting or barring a debtor's ability to borrow are an additional concern. Because their violation may result in default, restrictive covenants affect the cost of a loan to a prospective secured creditor.99 Further, prospective lien creditors need to take into account the cost of locating and levying on unencumbered assets. Prospective unsecured creditors, for their part, might find filed financing statements useful.100 For instance, a debtor's misrepresentation about its financial condition is less likely to be effective given even the minimal information notice filing provides. Claim (2) does not deny these obvious facts. It only asserts that prospective secured and lien creditors alone rely on filed financing statements. Claim (2) is consistent with their reliance on extra-filing information as well.

Claim (3). Claim (3) is sound: the loan decisions of prospective secured and lien creditors are unaffected by treating as secured assigned unsecured

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98. See United Sav. Ass'n v. Timbers of Inwood Forest Assoc., 484 U.S. 365 (1988) (holding that creditors are not entitled to recover compensation for the bankruptcy delay of the satisfaction of their claims); see also Lawrence A. Weiss, Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims, 27 J. FIN. ECON. 285, 303-04, 310 (1990) (providing several instances of bankruptcy reorganizations in which the secured creditors receive less than the full amount of their claims); Michelle J. White, Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis, 63 IND. L.J. 1, 37-39 (1987) (indicating that secured creditors generally receive less than the full value of their claims in personal bankruptcies); cf. U.S. Accounting Office, Pub. No. GGD-94-173, Bankruptcy Administration: Case Receipts Paid to Creditors and Professionals 39 (Table III.2) (1994) (average disbursement to secured creditors in Chapter 7 cases between 1991-92 $43,500; no data about percentage of secured creditors paid part of their claims).


100. Cf. Dolan, supra note 95, at 29; Mian & Smith, supra note 95, at 79 ("Greater corporate attention to credit evaluation of potential customers combined with advances in technology have made it much more likely today that external credit reports will be requested and furnished prior to sale."); David M. Phillips, Secured Credit and Bankruptcy: A Call for the Federalization of Personal Property Security Law, LAW & CONTEMP. PROBS., Spring 1987, at 51, 78 n.146, 79 (stating that trade creditors rely on credit-information agencies and such agencies perform filing searches as part of their credit investigation). For anecdotal evidence suggesting that the reports of credit-information agencies, based on filing searches, are insufficiently accurate, see Ronald J. Mann, Explaining the Pattern of Secured Credit From the Ground Up 19-20 nn. 51-52 (Working Paper Series, Washington University School of Law, Aug. 1995) (on file with the author).
claims and post-assignment advances. As an illustration, consider the effect of that treatment on the loan decisions of prospective secured and lien creditors under Article 9's notice filing scheme. Assume that a creditor has filed a financing statement. There are two possibilities. One possibility is that the prospective secured or lien creditor obtains a subordination agreement from the filing creditor. The subordination agreement can provide that claims owed by the debtor to the filing creditor or its assignees have lower priority than claims owed to the secured or lien creditor. Given the agreement, priority established by the filing of a financing statement is eliminated. There is therefore no risk that claims held by the filing creditor or its assignee have priority. Unsecured claims assigned to the filing creditor or advances made by an assignee of the filing creditor cannot affect that risk. Accordingly, the loan decision of the prospective secured or lien creditor will not take the risk into account.

The second possibility is that no subordination agreement has been obtained by the prospective secured or lien creditor. Absent a subordination agreement, filing a financing statement gives the filing creditor priority up to the value of the described collateral. The filing creditor has priority if it makes secured loans or advances for no more than the collateral value. Hence, the prospective secured or lien creditor has to assess the risk that the filing creditor either has done so or will do so. The prospective creditor will assume that a secured loan or advance will be made at least equal to the collateral value because it is more advantageous to act on the assumption. Notice first the two loan decisions respectively available to each creditor. The prospective creditor can either loan on a secured or unsecured basis, and the filing creditor can either extend or not extend a loan to the debtor on a secured basis. Assume that if a secured loan is made by the filing creditor the loan will be at least equal to the value of the collateral. The assumption obviously is plausible. Thus, if the filing creditor extends a secured loan or advance to the debtor, the prospective creditor's loan will be unsecured. If the filing creditor does not extend a secured loan or advance, the prospective creditor's claim will be secured.

102. See, e.g., U.C.C. § 9-316 (1992); Bank of the West v. Commercial Credit Fin. Servs., 852 F.2d 1162, 1173 (9th Cir. 1988) (providing an example of a subordination agreement).
103. The effects on repayment risk of subordination and the debtor incurring unsecured debt or receiving secured advances are distinct. Restrictive covenants, not a subordination agreement, prohibit the incurring of debt. The argument above is only that, given a subordination agreement, a prospective creditor's "priority risk" is unaffected by assigned unsecured claims or post-assignment advances. Its loan decisions of course might be affected by unsecured debt or advances.
Because the filing and prospective creditors' decisions are independent of each other, there are four possible outcomes. (1) If the filing creditor makes a secured loan and the prospective creditor assumes the filing creditor will not do so, the prospective creditor's claim will be unsecured. The prospective creditor will charge a secured (lower) rate for making an unsecured loan. (2) If the filing creditor makes a secured loan and the prospective creditor assumes the filing creditor will do so, the prospective creditor's claim will be unsecured. The prospective creditor will charge an unsecured rate for making an unsecured loan. (3) If the filing creditor does not make a secured loan and the prospective creditor assumes the filing creditor will not do so, the prospective creditor's claim will be secured. The prospective creditor therefore will charge a secured rate for a secured claim. (4) If the filing creditor does not make a secured loan and the prospective creditor assumes the filing creditor will do so, the prospective creditor's claim will be secured. Thus, the prospective creditor will charge an unsecured (higher) rate for making a secured loan.

In possibilities (1) and (3), the prospective creditor assumes that the filing creditor will not make a secured loan. In possibilities (2) and (4), the prospective creditor makes the contrary assumption. The prospective creditor charges an interest rate commensurate with its claim in possibilities (2) and (3). Thus, in (2) and (3) the prospective creditor's claim is unaffected by the assumption about the existence of the filing creditor's secured loan. An interest rate higher than the associated claim is charged in possibility (4) and lower than the associated claim in (1). Possibility (4) is not feasible because the debtor will not pay the higher cost of an unsecured rate when issuing secured debt. Possibility (1) is feasible because the debtor prefers to pay the lower cost of issuing secured debt when issuing unsecured debt. The debtor's commitments or representations not to issue or have issued secured debt are enforceable by the prospective creditor only against the debtor. They are unenforceable against the filing creditor.\(^\text{105}\) Hence, a commitment or representation to the prospective creditor by the debtor is not credible. In (1), the prospective creditor is worse off by assuming that the filing creditor will not make a secured loan to the debtor. The prospective creditor therefore will consider its loans to the debtor unsecured.

Notice the irrelevance of assigned unsecured claims and post-assignment advances. They have no effect on the prospective creditor's assumption about the loan decision of the filing creditor. There is a risk that the filing creditor takes an assignment of unsecured claims. There is also the risk that

\(^{105}\) See U.C.C. § 9-311 (1992) (stating that a debtor's rights in collateral may be transferred regardless of the security agreement); see also Marine Midland Bank v. Conerty Pontiac-Buick, 352 N.Y.S.2d 953, 961-62 (1974) (noting that a debtor may create junior liens in the same collateral even though such creation constitutes a default under the senior security agreement, and that, though the debtor defaulted, the junior interest would remain valid).
an assignee of the filing creditor makes an advance to the debtor. Both risks are independent of each other. They are also independent of the risk that the filing creditor has made or will make a secured loan to the debtor. But, again, the prospective creditor assumes that the filing creditor has made or will make a secured loan equal to the collateral value. The prospective creditor therefore considers the fact that any loan it makes will be unsecured. Accordingly, the prospective creditor will charge the debtor the unsecured rate for making a loan. The possibility that the filing creditor could secure unsecured claims assigned to it or the assignee of the filing creditor could secure advances made by it has no affect on that decision. Given the prospective creditor’s assumption about the filing creditor’s behavior, the possibilities are irrelevant. Claim (3) is sound. This completes the case for giving unrestricted status to floating secured claims.

Current law recognizes the argument for unrestricted floating secured status in a limited case: future advance priority. It simply does not describe the argument supporting future advance priority in these terms. The

106. The above argument for claim (3) can be stated in decision theoretic terms. The prospective creditor’s decision to loan is risky. Two alternative courses of action are available to the creditor: to loan on a secured or unsecured basis. Either of two mutually exclusive states of the world are possible: the filing creditor has loaned or will loan an amount to the debtor equal to the collateral value, or it has not loaned. A probability distribution is defined over the two states such that \( p \) and \( 1 - p \) describe the associated probabilities, respectively. A mapping of a state of the world onto a course of action defines an outcome. Four outcomes are possible: \( O1 \) (secured loan; the filing creditor loans); \( O2 \) (secured loan; the filing creditor does not loan); \( O3 \) (unsecured loan; the filing creditor loans); and \( O4 \) (unsecured loan; the filing creditor does not loan).

A secured loan made by the prospective creditor has greater value to it when the filing creditor does not loan. Thus, \( O1 < O2 \). An unsecured loan made by the prospective creditor has the same value to it whether or not the filing creditor loans. Hence, \( O3 = O4 \). Since the prospective creditor’s loan decision has no effect on the filing creditor’s loan decision, \( p \) (and therefore \( 1 - p \)) is stochastically independent of the prospective creditor’s course of action. Hence pairwise comparisons of outcomes alone are possible. \( O1 < O3 \) because the interest charge in \( O1 \) is lower than in \( O3 \). \( O2 < O4 \) because the interest charge in \( O4 \) also is greater than in \( O2 \). Since \( O3 \) and \( O4 \) are the possible outcomes associated with the prospective creditor loaning on an unsecured basis, loaning on an unsecured basis dominates loaning on a secured basis.

Two conditional probabilities can be defined. Let \( p(a/l) \) be the probability that an unsecured claim will be assigned to the filing creditor given that it has loaned. And let \( p(b/l) \) be the probability that an advance will be made by the assignee of the filing creditor given that the filing creditor has loaned. The two conditional probabilities are independent of each other; therefore, \( p(a/l) \neq p(b/l) \). But the two probabilities also are independent of the filing creditor’s loan decision. Therefore, \( p(a/l) = p(l) \) and \( p(b/l) = p(l) \). Since only the unconditional probability of the filing creditor loaning is relevant, \( p(a/l) \) and \( p(b/l) \) do not affect the dominance of the prospective creditor loaning on an unsecured basis. The possibility that \( p(a/l) \neq p(b/l) \) therefore does not affect the creditor’s loan decision.
standard rejection of the *Coin-O-Matic* treatment of future advance priority shows as much. *Coin-O-Matic*’s treatment of future advances as not covered by a financing statement when a security agreement does not provide for them is inconsistent with notice filing. A filed financing statement puts prospective creditors on notice that any secured loan the filing creditor makes has priority. Whether the loan has been or will be made is irrelevant. The same is true for future advances. Given filing notice, prospective creditors will adjust their loan terms accordingly. *Coin-O-Matic*’s treatment of future advances is considered to be inconsistent with the filing notice given to prospective creditors. The case for unrestricted floating secured status extends the operative assumption about creditor behavior and its consequence to assignments. Given filing notice, any secured loan the filing creditor makes has priority. Thus, prospective creditors will consider the possibility of an assignment of unsecured claims or post-assignment advances irrelevant to their loan decisions. In both cases, prospective creditors consider their loans unsecured. Loan terms reflect this priority. Unrestricted floating secured status is justified because unsecured claims assigned to a creditor under a security agreement containing an “all debts owed” clause are secured claims, and post-assignment advances have the priority of the assigned secured claims.

The case for unrestricted treatment just given is, as noted, constructive. But it also worth noting that the treatment is consistent with some revisionary proposals. Alan Schwartz’s recommendation for revising Article 9 is an example. Schwartz proposes that the initial financer, whether secured or unsecured, have priority over later financiers, with a limited exception for some purchase money security interests. The consequence of Schwartz’s proposal is that assignment should not affect that priority. If the assignor’s claim ranks junior to an intervening creditor, the claim should remain junior upon assignment. If a post-assignment advance ranks junior to an intervening creditor, assignment of a senior claim should not alter the advance’s ranking. Assignment does not affect the claim’s ranking in either case. Schwartz proposes a permissive default rule only; the debtor and initial creditor can agree to another ranking. An agreement containing

109. See supra note 106 and accompanying text.
111. *Id.* at 211.
112. *Cf.* *id.* at 211, 250.
a cross-collateralization clause could be sufficient to give the initial creditor or its assignee priority in claims it holds, whenever it acquires them. The agreement is necessary for floating secured status under the case for unrestricted treatment. In essence, Schwartz's proposal allows for the debtor and initial creditor to agree to rank as senior any assigned claims and advances made by an assignee. The consequence of Schwartz's proposal is therefore consistent with the treatment proposed above.

B. Limited Floating Secured Status Rejected

The case contained in Part III.A can be used to reject other proposals for the treatment of floating secured claims. One proposal would give such claims limited status. The recommendation distinguishes between credit extended in reliance on floating secured claims and credit extended without such reliance. For instance, reliance on floating secured claims is lacking when a security agreement is executed to secure a previously unsecured loan. Reliance is present when a loan is made on condition that a security agreement is executed which contains a clause securing all debts owed from the debtor to the creditor, however acquired. According to the proposal, assigned unsecured claims are secured if the assignee relies on such claims in making the assignee's initial secured loan. The assigned claims have the priority of the secured claim held by the assignee. Floating secured status is granted. Assigned unsecured claims or advances by the assignee also can be secured if not relied upon in making an initial secured loan, but the priority of such claims or advances by the assignee dates from the time of the assignment. The assigned claims do not have the priority of the secured claims held by the assignee or assignor. Floating secured status is denied. Because floating secured status is granted for some assigned claims or advances and denied for others, the proposal recommends limited floating secured status.

The simple example and its variants in Part I illustrate the different consequences between limited and unrestricted floating secured status. Consider the example and Variant (2). In the simple example, unrestricted floating secured status means that the unsecured claim C3 assigns to C1 becomes secured. C1 has priority up to $100. Limited floating secured status means that C3's $50 unsecured claim becomes secured upon

113. See id. at 249.
114. Fletcher, supra note 6, at 718-21. Fletcher intends his proposal as visionary as he urges that Article 9's predominant priority rule, § 9-312(5), be redrafted to not apply in the case of floating secured claims. Id. at 721. My assessment of the proposal does not depend on its visionary elements.
115. Id. at 719, 720.
116. Id. at 727.
117. Id. at 719.
assignment only if $C1$ relied on the assignment in making its initial secured loan to the debtor. If $C1$ relied on the assignment, it has priority over $C2$ up to $\$100$. If $C1$ did not rely on the assignment, priority dates from the date of assignment. Because $C3$ assigned its claim to $C1$ after $C2$ perfected its security interest, limited status gives $C2$ priority over $C1$ to the extent of $\$50$. In Variant (2), unrestricted floating secured status means that $C3$’s post-assignment advance of $\$50$ is secured. Therefore $C3$ has priority up to $\$100$. Under limiting floating secured treatment, $C3$’s $\$50$ advance is secured. If $C3$ relied on the $C1$’s assigned security interest in making the advance, $C3$ has priority up to $\$100$. If $C3$ did not rely, priority of the advance dates from the date of the advance. Because $C3$ made its advance after $C2$ perfected its security interest, the limited status gives $C2$ priority over $C3$ to the extent of $\$50$.

There are administrative and foundational difficulties with the proposal for limited floating secured treatment. The administrative difficulties are obvious. Since the priority of assigned claims differs according to reliance by the assignee on them, two types of security agreements require identification: those in which the secured creditor relies on assignments and those in which the creditor does not. Litigation and judicial costs are induced in making the inquiry. Because the proposal dates the priority of assignments not relied upon by the secured party from the date of the assignment, determination of those dates also is required. Litigation and judicial costs are incurred in making the determination. Assignments need not be evidenced by a writing.\textsuperscript{118} Even when they are evidenced by a writing, more than one writing executed at different times may serve as evidence. To be sure, priority under Article 9 also can turn on the date a security agreement is executed, where perfection occurs before filing.\textsuperscript{119} Dating the execution of a security agreement is necessary to determine the date of perfection,\textsuperscript{120} but the proposal for limited floating secured status requires also determining the date of an assignment of a claim. Hence, the proposal induces more administrative costs than the present application of Article 9.

The foundational difficulties with the proposal are more serious than the administrative difficulties. The argument for limited floating secured status is as follows: assume two secured loans, one made in reliance on subsequently obtaining assigned unsecured claims or subsequently making advances, and one made without such reliance. Assume also positive costs in obtaining subordination agreements from all creditors holding claims senior to the assigned unsecured claims or advances made by the assignee.

\textsuperscript{118} E.g., E. Allan Farnsworth, Contracts § 11.3, at 790 (2d ed. 1990).

\textsuperscript{119} See U.C.C. § 9-312(5)(a) (1992) ("Conflicting security interests rank according to priority in time of filing or perfection."). Dating execution of a security agreement also is needed in the rare case where priority is determined by the order of attachment under § 9-312(5)(b).

\textsuperscript{120} See U.C.C. § 9-303 (1992).
The price of the “reliance loan” will be lower than the price of the “nonreliance loan” by an amount equal to the costs incurred in obtaining such subordination agreements. And subordinated creditors presumably will increase the prices of their loans to reflect the subordinated status of their claims. Granting floating secured status to “nonreliance loans” confers an unbargained-for benefit on the assignee while imposing unbargained-for costs on other creditors.\textsuperscript{121} Thus, the increase in the debtor’s debt bill is not offset by a reduction in the cost of “nonreliance” debt.

The argument is flawed. It relies on a false behavioral assumption about prospective secured creditors’ loan decisions, as shown in Part III.A. The argument assumes that competing creditors take into account the type of loan made by the secured creditor in pricing their loans. In particular, the argument assumes that competing creditors would increase their loan price if “nonreliance loans” were given priority and reduce the loan price if “nonreliance loans” were not given priority over their loans. The assumption is unsound. Prospective secured creditor’s loan decisions are unaffected by the priority given to certain types of secured loans. Whatever the type of loan given priority, the risk remains constant that the filing creditor will make the loan.\textsuperscript{122} If both “reliance” and “nonreliance” loans are given priority, a risk exists that the filing creditor will make such loans. If only “reliance loans” are given priority, the risk remains constant that the filing creditor will make a “reliance loan.” Because this loan can be equal to the value of collateral, prospective secured creditors assume that their secured loans will have a value equal to that of unsecured loans. They will price their loans at an unsecured rate. The possibility that “nonreliance loans” are also given priority has no effect on the price of loans prospective unsecured creditors would make. Hence, the argument for limited floating secured status rests on a false assumption about creditor behavior. The proposal for limited treatment therefore is unsatisfactory.

\section*{C. Floating Secured Claims in Bankruptcy}

Bankruptcy can affect the status of floating secured claims for obvious reasons. The case for unrestricted status in Part III.A relies on the effect of notice filing on prospective creditors’ behavior. It justifies treating assigned unsecured claims as secured claims having the priority of the assignee’s secured claims when the debtor is solvent. Post-assignment advances also are treated as having the priority of the assigned claim under the same circumstances. When a bankruptcy petition is filed, concerns other than the effect of notice filing on creditor behavior are at stake.\textsuperscript{123} Bankruptcy law

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{121} \textit{See} Fletchner, \textit{supra} note 6, at 719.
\item \textsuperscript{122} \textit{See supra} pp. 394-95.
\end{itemize}
\end{footnotesize}
and policy may operate to limit a floating secured claim. The priority of a floating secured claim under Article 9 may be upset by provisions of the Bankruptcy Code.

This possibility is unexceptional and applies to secured claims under Article 9 other than floating secured claims. Unperfected secured claims are avoidable by the bankruptcy trustee. Also, perfected secured claims found to be preferential transfers or fraudulent conveyances may be avoided. More generally, property and priority rights effective outside of bankruptcy are limited within bankruptcy. This does not mean that such rights, and their justification, do not obtain. It simply means that bankruptcy restricts some property and priority rights as well as their justification. Bankruptcy law restricts floating secured claims in the same way it restricts other claims held against a debtor.

Consider in this regard the avoidability of floating secured claims as preferential transfers. Bankruptcy law and policy treats post-assignment advances and assigned unsecured claims differently. Post-assignment advances are not avoidable as preferences. Correspondingly, assigned unsecured claims sometimes can be avoided as preferential transfers if secured upon assignment. A straightforward dating of the transfer under section 547 of the Bankruptcy Code shows why. Suppose C1 assigns to C3 its perfected secured claim of $50 outside the preference period along with a security agreement securing all debts owed to C1 or its assignee. Also, suppose that C3 subsequently makes an advance of $50 to the debtor within the preference period. Two transfers of an interest in the debtor's property have occurred under section 547. One transfer occurred when C1's security interest securing its $50 claim took effect and was perfected, according to section 547(e)(2)(A). C1's security interest took effect when it attached. It was also perfected at the same time, by assump-

(examining the "other forces" at work in bankruptcy).

125. See 11 U.S.C. §§ 547, 548 (1994); cf. Fed. R. Bankr. P. 1003(a) (1991) (stating that a transferor or transferee of a claim must attach a statement to the bankruptcy petition indicating that the claim was not transferred for the purposes of commencing the bankruptcy proceeding).
128. See id.
129. See 11 U.S.C. § 547(e)(2)(A) (1988) ("...[A] transfer is made—(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time... ").
130. See Kellogg v. Blue Quail Energy, Inc. (In re Compton), 831 F.2d 586, 591 (5th Cir. 1987); S. Rep. No. 989, 95th Cong., 1st Sess. 87 (1977); Douglas G. Baird, Standby Letters of Credit in Bankruptcy, 49 U. Chi. L. Rev. 130, 150 (1982) (no policy in § 547 recommending that the "transfer takes effect" occur at any other time than is determined.)
tion. Hence, under section 547(e)(2)(A), the transfer occurred outside the preference period; the assignment to C3 is irrelevant. The assigned claim therefore is not avoidable under section 547. The second transfer occurred within the preference period because the transfer took place when C3’s security interest securing its $50 advance arose and was perfected. C3’s security interest took effect when it attached. Attachment requires giving value, and C3 gave value to the debtor in the form of the $50 advance. Because perfection occurred at the same time, by assumption, a transfer also occurred at the same time as the $50 advance was made. The exchange was contemporaneous. Hence, C3’s $50 post-assignment advance is not voidable as a preference.

under state law. But cf. Grant v. Kaufman, P.A. (In re Hagen), 922 F.2d 742, 747 (11th Cir. 1991) (Johnson, J., dissenting) (when “transfer takes effect” is not defined by Bankruptcy Code and U.C.C.; one possibility is that the transfer takes effect when security agreement signed).


132. Id.

133. In In re Compton, 831 F.2d 586, 591 (5th Cir. 1986), the court held that for purposes of § 547(e)(2)(A) a future advance relates back to the date on which the security interest attached. The holding cannot be correct. Compton involves an indirect preference: A bank having a security interest in debtor’s assets issued a letter of credit outside the preference period in favor of an unpaid seller of the debtor. Id. The bank secured the issuance of the credit under the existing security agreement with the debtor. Id. at 589. The seller-beneficiary drew upon the letter of credit within the preference period. Id. At issue was whether the trustee could recover from the bank when the bank’s payment to the seller constitutes a voidable preference. Id. The Compton court determined that the trustee could not recover from a direct transferee (the bank) in these circumstances. Id. at 595. Presupposed in its determination is a dating of the debtor’s transfer to the bank within the preference period. Id. at 591. The court found that there was an indirect preference: a transfer to the bank for the benefit of the seller-beneficiary. Id. at 594. However, if the transfer took effect outside the preference period at the time the bank’s security interest attached, as the court found, there would be no preferential transfer in the first place. See id.; 11 U.S.C. § 547(e) (1988). Even if the transfer occurred within the preference period, the transfer would be contemporaneous and not on account of an antecedent debt. See DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 509 (2d ed. 1990). The trustee therefore could not recover even from the seller-beneficiary. Id. at 594-95. Hence, the Compton court’s determination that recovery cannot be had against the direct transferee requires holding that, for purposes of § 11 U.S.C. § 547(e)(2)(A), a transfer occurs when the advance is made.


137. Id. This conclusion does not depend on a controversial notion of a security interest under nonbankruptcy law. In particular, it does not require deciding whether Article 9 consistently incorporates a unitary or multiple notion of a security interest. See Coogan, supra note 7, at 867-68 (1959); 2 Grant Gilmore, supra note 28, § 35.6 at 935-36; Jeanne
Assigned unsecured claims are avoidable as preferences when treated as secured upon assignment. Suppose C3 assigns to C1 its $50 unsecured claim within the preference period. Also, suppose that C1 holds a $50 secured claim perfected outside the preference period under a security agreement that secures "all debt owed by the debtor to C1 or its assignee, however acquired." The assignment of C3's $50 unsecured claim may be analyzed as an indirect preference. C3's claim is an antecedent debt owed by the debtor to C3.\textsuperscript{138} When C3 assigns its claim to C1, a transfer of the debtor's property to C1 occurs under section 547(e)(2)(A).\textsuperscript{139} The transfer takes effect when C1's security interest in the debtor's assets is increased by the amount of C3's claim ($50). C1's security interest in turn is increased when C3 assigns its unsecured claim to C1 — here, within the preference period.\textsuperscript{140} Because C1 holds a perfected security interest in the debtor's assets, perfection occurs at the same time as the transfer takes effect. The transfer to C1 therefore occurs within the preference period. The transfer is also on account of an antecedent debt and for the benefit of C3 because C1 would not have purchased C3's claim unless the assigned claim were secured. Additionally, the price C3 received from C1 for the assigned claim presumably was greater than the value of the claim absent the assignment, as well as under a Chapter 7 distribution. Otherwise, C3 would not have

\textsuperscript{138} See 11 U.S.C. § 547(b).
\textsuperscript{140} \textit{Id.}
sold its claim to C1.\textsuperscript{141} C3 indirectly benefits from the debtor’s transfer of a security interest to C1 on account of the antecedent debt owed C3 by the debtor. The bankruptcy estate is correspondingly diminished by the assignment to C1 of C3’s claim.\textsuperscript{142} C3’s assignment to C1 of its unsecured claim constitutes a preferential transfer under section 547.\textsuperscript{143}

Bankruptcy law recognizes this explicitly in the case of setoffs.\textsuperscript{144} Section 533 allows within the preference period, subject to exceptions, a creditor to setoff a claim it holds against the debtor by a claim a debtor holds against it.\textsuperscript{145} One exception restricts the claims the creditor can use to exercise its right of setoff.\textsuperscript{146} The restriction is that claims against the debtor acquired by the creditor within the preference period cannot be used.\textsuperscript{147} Thus, the trustee could recover from C1 if C1 had used an unsecured claim assigned from C3 within the preference period to offset a claim the debtor held against it.\textsuperscript{148} A setoff is considered a secured claim,

141. C3 will demand a price for its unsecured claim no less than the value of its claim in a Chapter 7 liquidation of the debtor’s estate. C1 will offer a price no greater than the value of C3’s claim when secured (upon assignment), less the transaction costs to it of effecting the assignment. The price agreed to within the range of agreement points as usual will depend on the bargaining power of C1 and C3. Assume that the value of C3’s unsecured claim in bankruptcy is less than its face value. Therefore it cannot be inferred that the price C1 pays C3 for its claim, when less than the face value of C3’s claim, is not greater than the value of C3’s claim in a Chapter 7 liquidation of the debtor’s estate. For the operation of this mistaken inference in the application of the earmarking doctrine, see Barry Adler, Bankruptcy’s Earmarking Doctrine (forthcoming) (on file with the author).


145. Id.


147. See 11 U.S.C. § 553(a)(2)(B)(i) (1988) ("except to the extent that . . . such claim was transferred, by an entity other than the debtor, to such creditor—after 90 days before the filing of the petition").

not a security interest, under both the Bankruptcy Code and state law,\textsuperscript{149} and its exercise can constitute a preferential transfer.\textsuperscript{150} Section 553 operates to insulate setoffs from preference attack under section 547.\textsuperscript{151} Because section 553 in effect allows a type of preferential transfer, but excludes from its operation claims acquired by the creditor within the preference period,\textsuperscript{152} the logical inference is that section 547 also treats as preferential claims assigned to a creditor within the preference period.\textsuperscript{153}

The characterization of C3's assignment as an indirect preference is justified because the consequence of C3's assignment of its unsecured claim to C1 is the same as if a direct preference had occurred.\textsuperscript{154} Suppose C1 held a perfected secured claim of $50 under a security agreement containing a future advances clause. Suppose too, as before, that C3 held an $50 unsecured claim. Subsequently, C1 lends the debtor $50. The debtor in turn retires C3's debt for an amount greater than the value of C3's claim in a Chapter 7 liquidation but less than the face amount of the claim. A direct preference has occurred. Payment by the debtor to C3 is a transfer on account of an antecedent debt held by C3 within the preference period which gives C3 more than it would receive in a Chapter 7 distribution.\textsuperscript{155} If the other elements of a preference are satisfied, the transfer by the debtor to C3 constitutes a voidable direct preference.\textsuperscript{156} The consequence of an assignment from C3 to C1 is the same: C3 receives more than it would in a Chapter 7 liquidation. If so, how this is achieved does not affect its characterization as a preference under section 547.\textsuperscript{157} The fact that in the one case the debtor's property is transferred to C3 and in the other case it is transferred to C1 is irrelevant.

Bankruptcy policy justifies treating post-assignment advances and assigned unsecured claims differently. The goal of predominant bankruptcy

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\textsuperscript{149} See 11 U.S.C. § 553(b) (1988) to the extent that C1 improves its position by reducing the extent that its claims against the debtor exceed the debtor's claims against it within the preference period. \textit{Id.} The trustee also can recover this amount from C3, the assignor, under 11 U.S.C. § 550(a). See 11 U.S.C. § 550(a) (1988).


\textsuperscript{152} See 11 U.S.C. § 553(a) (1988) ("Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor . . . .")


\textsuperscript{154} Id.


\textsuperscript{156} Id.

\textsuperscript{157} Id.
policy is the prevention of creditor behavior that fails to maximize the collective interest of creditors. A post-assignment advance amounts to unilateral action by a creditor that does not diminish the bankruptcy estate: the transfer of a security interest to the creditor and the advance to the debtor offset each other. Preference attack therefore is unjustified. An assignment of an unsecured claim to a secured creditor can amount to opting-out behavior by creditors (C1 and C3) that diminishes the bankruptcy estate. This occurs when an assignment is such that the value of the claim held by the assignee (C1) exceeds the value of the claim held by the assignor (C3). The bankruptcy estate is diminished by the amount of the difference in that value. Because unrestricted floating secured treatment allows the possibility, bankruptcy policy limits its effect.

The conclusion is only that bankruptcy policy and law restricts floating secured status. It is not that unrestricted floating secured status fails to operate under Article 9 outside of bankruptcy. This simple point is missed by the Fretz court. The court states that "[t]he intervention of the debtor's bankruptcy before the assignment truncated any possible transformation of unperfected, unsecured interests into perfected security interests. Otherwise, the policies of the Bankruptcy Act would be greatly disserved." The statement is correct as a matter of bankruptcy policy. However, the Fretz court and case law following Fretz infer from this conclusion about floating secured status under Article 9: that an assignment can never transform an unsecured claim into a secured claim. The inference is invalid.

Article 9 and the notice-based cases presented in Part III.A, justify unrestricted floating secured status. Such status is consistent with restricting floating secured claim treatment in bankruptcy.

IV. OBJECTIONS TO UNRESTRICTED STATUS

This Part considers and rejects objections to unrestricted floating secured status. As with all rules governing secured credit, unrestricted floating secured status can be conceived of contractually. So conceived, it is a

158. See THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 12-13 (1986); Jackson & Scott, supra note 123, at 160.
contractual term between an initial creditor and the debtor stating two priority rules. One rule pertains to post-assignment advances: generally, advances made by the assignee of a secured claim and security agreement after their assignment have the priority of the assigned claim. The other rule pertains to assigned unsecured claims: roughly, unsecured claims have the priority of secured claims when assigned to a secured creditor holding secured claims under a security agreement containing an “all debts owed” clause. As a contractual term, both priority rules can be assessed in the same way that any contractual term can be assessed. That is, one can ask whether an initial creditor and a debtor would agree to the term. Accordingly, the objections below are divided into debtor- and creditor-based objections. As in Part III, Article 9 and its underlying behavioral assumptions are taken as given.

A. Debtor-Based Objections

1. Gilmore’s Paternalism

One debtor-based objection to unrestricted floating secured status is paternalistic. An “all debts owed” clause in a security agreement, if unrestricted, allows a secured creditor or its assignee priority over all of the debtor’s assets. Such priority might diminish the debtor’s (expected) welfare, where the debtor’s welfare is at least partially independent of the debtor’s preferences.\(^{161}\) Unrestricted floating secured status instead might interfere with the debtor’s welfare, suitably defined, by allowing “too large” an encumbrance in its assets.\(^{162}\) Alternatively, unrestricted floating secured status might allow the debtor the means to make inferior decisions to borrow.\(^{163}\) If so, the debtor’s preferences and therefore the terms of its

\(^{161}\) See James Griffin, Well-Being 7-72 (1986) (discussing alternative conceptions of welfare); see also 3 Joel Feinberg, The Moral Limits of the Criminal Law: Harm to Self 58-61 (1986) (analyzing the relationship between welfare and preferences that has to obtain for paternalism to be coherent).


\(^{163}\) Cf. Alan Schwartz, The Enforceability of Security Interests in Consumer Goods,
hypothetical agreement with an initial creditor are irrelevant. A debtor's fully informed preferences to issue unrestricted floating secured debt might make it worse off, as judged by some preference-independent standard of welfare. Accordingly, limitations on floating secured status are justified. The objection to unrestricted floating secured status therefore is paternalistic.\textsuperscript{164}

Gilmore's influential objection to unrestricted floating secured status can also be read as paternalistic. In \textit{Security Interests in Personal Property}, Gilmore both reports and seemingly endorses then-existing case law on the matter.\textsuperscript{165} Gilmore first considers the assignment of unsecured claims to a secured creditor and the priority of future advances.\textsuperscript{166} He notes that dragnet clauses in security agreements can operate to encumber property that would otherwise be exempt under bankruptcy law.\textsuperscript{167} Gilmore also notes cases in which the operation of such clauses appear inequitable and unconscionable.\textsuperscript{168} He concludes that dragnet clauses are limited by "a rule of reason and good faith."\textsuperscript{169} The implication is that the limitation is partly justified by the welfare of the debtor, even if the debtor agreed to the dragnet clause. Turning to future advances, Gilmore makes his well-known recommendation that section 9-204(3) be limited by a "relatedness" or "same class" requirement: future advances are covered by an initial security agreement only if they are related to, or of the same class, as the initial advance.\textsuperscript{170} He justifies the limitation by the restrictions placed on dragnet

\begin{thebibliography}{99}
\bibitem{26} J. \textsc{Law \\& Econ.} 117, 156-60 (1983); Robert E. Scott, \textit{Rethinking the Regulation of Coercive Creditor Remedies}, 89 \textsc{Colum. L. Rev.} 730, 778-82 (1989) (both considering and rejecting restrictions on consumer mortgages based on consumers' difficulty in assessing consequences of granting mortgages).

\bibitem{164} See generally Feinberg, \textit{supra} note 161, at 8-21; \textsc{Michael J. Trebilcock, The Limits of Freedom of Contract} 146-163 (1993). The form of paternalism present in the objection in the text is a close variant of what Feinberg calls "hard paternalism": the view that protection of the actor from the harmful consequences of its act is a reason for regulation. Feinberg, \textit{supra} note 161, at 12. Because the text only considers the form of a paternalistic objection, not its details, specific accounts of the debtor's welfare or defects in judgments about the consequences of granting a floating secured claim need not be considered. \textsc{Trebilcock, supra} at 146-63.

\bibitem{165} See 2 \textsc{Gimore, supra} note 28, §§ 35.1-35.5. For doubts that Gilmore accurately summarizes the state of then-existing case law on the matter, see Justice, \textit{supra} note 6; Campbell, \textit{supra} note 66.

\bibitem{166} 2 \textsc{Gimore, supra} note 28, at 917-21.

\bibitem{167} See 2 \textsc{Gimore, supra} note 28, § 35.2, at 918 ("... but, if the device works and the mortgage covers his exempt property, he is being deprived of the chance of making a fresh start through a discharge in bankruptcy, which he also ought to have.").

\bibitem{168} \textit{Id.} § 35.2, at 919-20.

\bibitem{169} \textit{Id.} § 35.2, at 920.

\bibitem{170} \textit{Id.} § 35.5, at 932-33.
\end{thebibliography}
clauses.171 Apparently, the thought is that if dragnet clauses limit the type of preexisting claims secured, they also limit the type of advances secured. Hence, limitations on future advances seemingly are justified as enhancing the welfare of the debtor, its preferences aside. Gilmore's objection to unrestricted floating secured status can be read as a paternalistic objection.172

The paternalistic objection is unpersuasive because it relies on an implausibly strong connection between floating secured status and the debtor's welfare. The objection makes two assumptions. One assumption is that the debtor's welfare, suitably defined, is implicated in issuing debt covered by dragnet clauses. The other assumption is that floating secured claims affect the debtor's welfare differently than other sorts of security interests. Without the first assumption, the objection would not be paternalistic. Without the second assumption, the objection would not be

171. See id. § 35.5 at 932 ("However 'covered by the security agreement' is to be read, § 9-204(5) [now § 9-203(3)] should certainly not be taken to overrule the so-called 'dragnet' cases under pre-Code law." (citation to the discussion in § 35.2 of the "dragnet" clause cases omitted); cf. id. § 35.2 at, 920 ("The courts have dealt in much the same way with attempts to misuse the future advance clause.").

172. It is worth comparing Gilmore's well-known hostility to the floating lien in this respect. Gilmore (and the Code drafters) recommended statutory recognition of the floating lien because its equivalent could be achieved under pre-Code law. See, e.g., U.C.C. § 9-204 cmt. 2 (1992) (describing the nineteenth century "prejudice" against floating liens and noting that its "inarticulate premise has much to recommend it."); 2 NEW YORK LAW REVISION COMMISSION, REPORT AND RECORD OF HEARINGS ON THE UNIFORM COMMERCIAL CODE FOR 1954, at 1180 (1954) ("If it were possible to choose between a rule completely validating, as Article 9 does, the after-acquired property interest, and a rule under which no after-acquired property interest, no floating charge of any sort would be recognized, I might well myself, on grounds of policy, be inclined to choose the latter"); 1 GILMORE, supra note 28, § 11.7, at 360 (the case "rests not so much on the merits or the positive excellence of the floating lien as on an argument of fait accompli."); Grant Gilmore, The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions Of A Repentant Draftsman, 15 GA. L. REV. 605, 627 (1981) ("If we had listened to what the courts were trying to tell us, we might have come closer to the mark."); Grant Gilmore, Chattel Security: II, 57 YALE L.J. 761, 776 (1948) ("[T]here is no good reason to perpetuate the common-law prejudice against a floating charge.").

Gilmore's hostility was in part based on paternalistic reasons. See 1 GILMORE, supra note 28, § 11.7, at 360 (case against floating lien includes claim that "the law should protect a necessitous borrower against himself by refusing to allow him to encumber all the property he may ever own in order to secure a present loan"—case not rejected). The pre-Code law concerning floating secured status was as hostile as it was to the floating lien, according to Gilmore's report. Id. However, unlike the floating lien, pre-Code law did not allow the equivalent of floating secured status to be achieved. Gilmore approved of pre-Code law's hostility to both the floating lien and floating secured status. Id. He did so in both cases on partly paternalistic grounds. Id. The difference in the recommended treatment of the two devices under the Code was that floating secured status could be denied while floating liens could not be prevented in practice.
one peculiar to floating secured claims. However, neither assumption is sound. Debtors can range from penurious to wealthy individuals and from limited partnerships to limited liability companies and corporations. Given the diversity in holdings and identity of debtors, the required welfare-effects of security interests of any sort cannot be gauged, even as generalizations. Floating secured claims have no systematic effect on a debtors’ welfare. The point here is neither that a preference-independent notion of welfare is incoherent nor that talk of personal integrity or autonomy—two candidate notions of welfare—is inapposite in the case of some debtors (e.g., corporations, limited partnerships). The point is simply that there is no correlation between the debtor’s welfare, suitably defined, and floating secured status. The paternalistic premise of the objection is unsupportable.

Furthermore, there is no support for the objection’s second assumption: that floating secured status differentially affects the debtor’s welfare. Assume some level or type of encumbrance which diminishes the debtor’s welfare, again in the suitably specified sense required by the paternalistic objection. Also assume that an “all debts owed” clause in a security agreement operates to impair the debtor’s welfare. The debtor’s welfare can be impaired to the same extent by issuing secured debt to other creditors. For instance, suppose the assignment of a $50 unsecured claim to CI works to impair the debtor’s welfare by being treated as a $50 secured claim upon its assignment. The same impairment occurs if the debtor grants the assignor a security interest to secure the unsecured debt. More generally, Article 9 allows the same welfare-effecting encumbrances that floating secured status allows. Thus, the paternalistic objection is a complaint about the extent of asset-based financing allowed by Article 9. It is not an objection to unrestricted floating secured status itself.

173. See, e.g., U.C.C. § 9-201 (1992) (security agreements effective according to its terms, except as otherwise provided by Article 9); U.C.C. § 9-203(1)(1992) (security interest in collateral effective against Debtor upon attachment); U.C.C. § 9-205 (1992) (Debtor’s continued use of collateral does not of itself render a security interest in it invalid. A similar point was recognized by Article 9’s drafters as a reason for their grudging recognition of the floating lien. See U.C.C. § 9-204 cmt. 2 (1991) (“This Article decisively rejects it [i.e., restrictions on floating liens] not on the ground that it was wrong in policy but on the ground that it was not effective.”); see also 2 NEW YORK LAW REVISION COMMISSION, supra note 172, at 1180-81, 1192-93 (testimony of Gilmore and Ireton); 1 GILMORE, supra note 28, § 11.7, at 360; see also supra text accompanying note 172. The point in the text is being used for a different purpose: to show that unrestricted floating secured status is irrelevant to the paternalistic objection.

174. For instances where limitations are placed on security interests in consumer credit contracts, see American Fin. Serv. Ass’n v. FTC, 767 F.2d 957, 992 (D.C. Cir. 1985) (Tamm, J., dissenting) (arguing that the ban on nonpossessory nonpurchase security interests in household goods is based on paternalistic belief that low-income debtors would be better off without credit extended to them); see also FTC Unfair Credit Practices, 16 C.F.R. § 444.2 (a)(4) (1995); U.C.C.C. §§ 3.301, 5.116, 7A U.L.A. 116-17, 179-80 (1994); see Scott, supra note 163, at 776-82 (criticizing paternalistic justifications of such limitations).
2. Unreceived Value

Another debtor-based objection to unrestricted floating secured status is based on the lack of value received. The objection is limited to the assignment of unsecured claims being treated as secured upon assignment. The assignment operates to increase the security interest in the debtor's collateral because the previously unsecured claim is secured upon assignment. Assuming that the assignee is oversecured, the value of a secured claim is equal to the face amount of the claim. The assignment increases the value of the unsecured claim assigned by an amount equal to the difference between its face amount and the value of the claim when unsecured. The assignee in turn will buy the claim from the assignor for no more than that difference. But the consideration for the assignment flows to the assignor, not the debtor. The debtor receives nothing for the increased encumbrance of its assets, a result allowed by unrestricted floating secured status. Hence, the objection concludes, unrestricted floating secured status would not be preferred by the debtor.

This objection fails. To begin, current law allows the same result. It simply does so by indirect means, through two transactions. Suppose, as before, that C1 is an oversecured creditor holding a $50 perfected secured claim under a security agreement containing an "all debts owed" clause. C3 holds an unsecured claim of $50. Under current law, C1 first can advance the debtor $50. The advance clearly would be covered by the security agreement. Then, the debtor in turn can retire C3's debt with the funds advanced. The result of the two transactions is that C1 holds a $100 perfected secured claim against the debtor. The $50 advance has the same priority as the initial advance. Granting unrestricted floating secured status allows C1 to hold a $100 perfected secured claim directly, as a result of one transaction: C3's assignment of its claim to C1. The result is the same.

To be sure, the results can be different. In particular, the extent of C1's security interest can differ as between the "indirect" and "direct" transactions. Because the value of C3's unsecured claim is less than its face amount, the debtor will neither offer $50 for it nor will C1 offer $50 to buy

175. The difference is bounded by the amount by which the assignee is oversecured.

176. See Justice, supra note 6, at 914-15 (except for instances of creditor forbearance, debtors receive no new benefit from substituting one creditor for another).

177. In jurisdictions which impose a "relatedness" limitation on advances, the advance might have to be related to the debt contemplated in a valid security agreement. See, e.g., In re Kazmierczak, 24 F.3d 1020, 1022 (7th Cir. 1994); Onawa State Bank v. Simpson (In re Simpson, 403 N.W.2d 791, 793 (Iowa 1987) (all requiring relatedness); Lansdowne v. Security Bank of Coos County (In re Smith & West Constr., Inc., 28 B.R. 682, 683-84 (Bankr. D. Or. 1983). The possibility does not affect the example.

the unsecured claim from C3. C3 therefore cannot credibly demand from
the debtor (or C1) $50 for its unsecured claim, and the debtor will require
less than a $50 advance from C1 to retire C3’s claim. The amount by
which C1’s security interest is increased also will be less than $50 in the
“indirect” transaction. In the “direct” transaction C1 will offer and C3 will
accept less than $50 for the assignment. Upon assignment, C1’s security
interest in debtor’s assets is increased by $50, the face amount of the
assigned claim.

The difference in the extent of C1’s security interest may be important
as a matter of bankruptcy law and policy. If C3 receives more from C1
than it would receive in a bankruptcy distribution, C1’s increased security
interest may be a voidable preference. However, this difference in
result is irrelevant under Article 9. The existence, not the extent, of a
security interest is important to creditors, and therefore to the debtor.

Article 9 allows the difference in result.

More importantly, the objection from unreceived value fails on its own
terms. For it is false that the debtor does not receive value. The assertion
that no value is received conflates value ex post and ex ante. The debtor
may not receive value when an unsecured claim is assigned to a secured
creditor. Value may not obtained by the debtor ex post. However,
floating secured status may be valuable to the debtor ex ante because its
presence can reduce the interest charge on a secured loan as compared to
alternative forms of secured financing. As an illustration, consider two
alternative strategies for secured financing:

(1) the debtor issues unsecured debt to a number of creditors;
subsequently, the debtor converts the unsecured debt held by each creditor
into secured debt;

(2) the debtor issues unsecured debt to a number of creditors and
secured debt to a creditor; subsequently, the secured creditor acquires the
unsecured debt and converts it into secured debt having the same priority
as the secured debt already held by the creditor.

Both strategies for secured financing result in the same amount of secured
debt issued, and both require the conversion of unsecured into secured debt.

179. See supra text accompanying note 141. An alternative device for attacking C1’s
increased security interest in bankruptcy is by valuation. In Drubner v. Gaslight Village, Inc.
(In re Gaslight Village Inc.), 8 B.R. 866, 871 (Bankr. D. Conn. 1981), the court used the
amount the assignee paid for a claim, not its face amount, to value it for purposes of
adequate protection. The Gaslight court’s device is limited in at least two ways. First, it
only applies to valuation for purposes of adequate protection, not more generally, as the court
admits. See id. at 871. Second, the device obviously can operate only in bankruptcy.

180. See supra part III.A.-B.

181. “May not” because the assignment can be alternative to the unsecured creditor
obtaining a lien on the debtor’s nonexempt and unencumbered assets. The assignment in this
case benefits the debtor ex post.
However, they vary as to the costs of doing so and the resulting priority of the converted debt. The costs of converting secured debt in strategy 1 is less than in strategy 2, as shown in Part III.A.182 The conversion in strategy 1 requires security interests to be granted to multiple creditors. Strategy 2 only requires the granting of a security interest to a single creditor. The direct costs of converting unsecured into secured debt are greater in strategy 1 than in 2.

More important are the differing priorities of the secured claims. Assuming that the creditors file financing statements at the time they obtain secured claims, the priority of their claims in strategy 1 dates from the time the debt is converted.183 Priority in strategy 2 relates back to the time the initial secured debt was created by the secured creditor.184 Hence, the secured debt in (2) has higher priority than it would have in (1). Because priority partially determines the interest charge of a loan, the interest charge for the secured debt in (2) is less than the charge in (1).

Unrestricted floating secured status functions as strategy 2. The reduced interest charge associated with it is a savings to the debtor. Therefore, the savings serves as value received by the debtor ex ante. Because unrestricted floating secured status gives priority to the initial secured creditor over intervening secured creditors and all unsecured creditors,185 intervening creditors will increase the interest charges on their loans. Whether the debtor prefers to grant unrestricted floating secured status to a creditor depends on the net effect on its total debt bill. If the unrestricted floating secured status reduces the interest charges demanded by a secured creditor more than it increases interest charges demanded by other creditors, the debtor will prefer to grant such status to a creditor.186 Otherwise, the debtor will not prefer to grant the status. There is a possibility that unsecured loans from a number of creditors initially might be cheaper to obtain than secured loans because discreet creditors can have a cost advantage at both selling and extending credit to the debtor.187 Obtaining secured credit from one or more creditors may have higher costs. Subsequently, economies in administering loans could reduce the cost of issuing

182. See supra pp. 385-97.
184. See id.
185. See supra pp. 372-73.
187. See Mian & Smith, supra note 95, at 76.
secured debt to below that of unsecured debt. Because strategy 2 avoids the cost of creating multiple security interests with different priorities present in strategy 1, the debtor could prefer (2) to (1). The appearance of “all debts owed” clauses in security agreements is consistent with the possibility.\footnote{See supra pp. 388-89.}

This point should not be misinterpreted. The conditions necessary for the possibility previously mentioned may not always occur. There may be other conditions under which a debtor would prefer to grant a creditor the unrestricted floating secured status described by strategy 2. And the conditions necessary for a debtor to prefer strategy 2 over strategy 1 might not be those present for typical debtors. The point is simply that debtors sometimes can benefit from the reduced costs associated with granting unrestricted floating secured status. Security agreements drafted by commercially sophisticated parties under current law provide evidence consistent with this point. So too is law in some states giving effect to broadly drafted cross-collateralization clauses in mortgage or deed of trust instruments.\footnote{See supra note 64.} Hence, inferring from the absence of value conferred on the debtor \textit{ex post} that the debtor does not benefit \textit{ex ante} from an “all debts owed” clause is a mistake.

3. \textit{Ex post} Lien Enhancement

A final debtor-based objection appeals to a consequence of granting a creditor floating secured status. The consequence is that the creditor unilaterally can control the timing and extent of encumbrances on the debtor’s assets. Assume that a debtor initially adopts a financing plan requiring a particular mix of unsecured and secured debt. Assume also that the secured debt is covered by a security agreement containing an “all debts owed” clause. After the secured debt has been issued, the secured creditor can purchase any amount of the unsecured debt. Upon purchase, the unsecured debt is treated as the secured debt held by the creditor, with the same priority. Liens on collateral thereby are enhanced. In this way the secured creditor unilaterally can alter the extent of debt secured by the debtor’s assets.\footnote{See Schroeder & Carlson, supra note 137, at 430 n.67.} Unrestricted floating secured status therefore may alter the debtor’s financial contracting by altering the debtor’s financing plans. The complaint associated with the consequence of “buying up unsecured claims” probably is based on \textit{ex post} lien enhancement.

This objection is weak because it confuses unilateral lien enhancement with control over the debtor’s financing plans. Only the security agreement converts unsecured debt assigned to a secured creditor into secured debt. Unsecured debts remain unsecured claims when assigned but not covered by

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\textsuperscript{188.} See supra pp. 388-89.
\textsuperscript{189.} See supra note 64.
\textsuperscript{190.} See Schroeder & Carlson, supra note 137, at 430 n.67.
an "all debts owed" clause in a security agreement. Since the debtor is a party to the security agreement, a secured creditor cannot unilaterally enhance the liens it holds against the debtor. Here, unilateral lien enhancement is the consequence of a bargained-for term which allows unrestricted floating secured claims. As a bargained-for term, floating secured status is an element of the debtor's financial contracting. Accordingly, the debtor can contract for the extent of lien enhancement, if any, the debtor desires. The debtor will prefer to grant a creditor unrestricted floating secured status only if doing so reduces its total debt bill.\textsuperscript{191} Alternatively, the debtor can restrict the collateral covered by a security agreement containing an "all debts owed" clause or, in issuing unsecured debt, the debtor can restrict its assignment. The latter two devices limit a secured creditor's ability to enhance the status of claims the secured creditor holds. All three devices allow the debtor to select by contract the extent of floating secured status, if any, in its financing plan. The objection mistakes the right to unilaterally enhance liens, which a creditor can acquire, for a lack of control over a financing plan, which the debtor retains.

B. Creditor-Based Objections

1. Claim Value Dilution

One creditor-based objection relies on the effect of floating secured claims on the value of claims held by intervening creditors. The objection is that floating secured claims diminish the value of claims held by intervening creditors. Suppose $C_I$ is an oversecured creditor holding a $50 perfected secured claim in debtor's only asset, which is valued at $100. $C_3$ holds an unsecured claim of $50. $C_2$, an intervening unsecured creditor, also holds a $50 unsecured claim. If $C_3$ assigns its claim to $C_I$ and the assigned claim does not receive floating secured status, the value of $C_2$'s claim is $25 (25/50 \times 50 = 25)$. If the assigned claim is given floating secured status, the value of $C_2$'s claim is diminished to zero. The same dilution in value in $C_2$'s claim occurs if $C_3$'s post-assignment advance of $50 receives floating secured status.

The objection based on claim value dilution comes in strong and weak versions. A strong version finds the value of claims held by $C_2$ to be diluted in both assignments of unsecured claims to $C_I$ and post-advances by $C_3$, the assignee. Accordingly, objection is to all forms of floating secured status. The weak version distinguishes between assignments to $C_I$ and post-assignment advances made by $C_3$.\textsuperscript{192} Assignments of unsecured claims to $C_I$, if given floating secured status, reduce the pool of assets available to $C_2$. Thus, the value of $C_2$'s claim is reduced. Post-assignment advances,
if given floating secured status, need not have the same effect. Post-
assignment advances augment the assets available to C2 at the same time as
the assignment reduces the assets available to C2. Such advances need not
reduce the value of intervening creditors' claims. Accordingly, the weak
version of the objection is only to granting floating secured status to
assigned claims.

Both the strong and weak versions of the objection fail. Treating
assigned unsecured claims as secured need not dilute the value of interven-
ing creditor’s claims, even as a general matter. First, assignment of
unsecured claims can be an alternative to the assignor satisfying its claims
from the debtor’s assets. Forestalling satisfying a claim is a benefit to the
debtor.193 Also, forestalling may have a value to intervening creditors that
offsets the reduction in assets available to them for distribution. If so, there
is no reduction in claim value. Second, accurate calculation of claim values
does not support the assertion of claim value dilution. If an assignment of
an unsecured claim occurs, its price will be between the face value of the
claim and what would be received on a pro rata distribution to unsecured
creditors.194 Hence, the value of unsecured claims held by intervening
creditors will, in part, depend on the likelihood that their claims will be
purchased by a secured creditor. Nothing can be said a priori about the
likelihood of purchase. Because both reasons are as likely to obtain in any
particular case as not, claim value dilution cannot be assumed as a general
matter. Thus, strong and weak versions of the objection based on claim
value dilution fail.

The weak version faces an additional difficulty: it requires that the
distinction between assignments of unsecured claims and post-assignment
advances corresponds to claim value dilution and claim value enhancement
(or neutrality), respectively. The weak objection must suppose that, in
general, assignments of unsecured claims reduce the value of claims held by
intervening creditors and that post-assignment advances enhance the value
of their claims. The latter correspondence is implausible because advances
are a vastly over-inclusive proxy for value enhancement (or neutrality).
Advances may be linked to the debtor’s acquisition of specific assets, in
which case a purchase money security interest can be obtained or they may
augment the debtor’s working capital. Also, they may be used by the debtor
to retire outstanding debt. Advances linked to specific assets generally
increase the value of assets available to intervening creditors. The other two
sorts of advances are less likely to do so systematically.195 Given the

193. See supra p. 411.
194. See supra note 141.
195. Cf. Hideki Kanda & Saul Levmore, Explaining Creditor Priorities, 80 VA. L.
Rey. 2103, 2139-40 (1994) (comparing risks of replacing critical equipment and acquiring
new inventory); George G. Triantis, A Free-Cash-Flow Theory of Secured Debt and Creditor
Priorities, 80 VA. L. Rev. 2155, 2159 (1994) (proposing to limit managerial discretion over
different effects of different types of advances on the value of intervening creditors’ claims, the inference from advances to value-enhancement (or neutrality) is unsafe. Thus, the weak version of the objection based on claim value dilution relies on a questionable basis.

2. Unproductive Precautionary Investments

Another creditor-based objection assumes the truth of the objection based on claim value dilution. This objection asserts a consequence of claim value dilution as an objection to floating secured status: unproductive investments by intervening creditors in preserving claim value. Assume that granting floating secured status to claims assigned to, or by, the filing creditor results in reducing the value of claims held by intervening creditors. Where the filing creditor is oversecured, the assignment operates to transfer some of the value of the intervening creditor’s claim to the filing creditor. The consequence is that the intervening creditors take precautions against the assignment. For instance, suppose again that C1 is an oversecured creditor holding a $50 perfected secured claim in a debtor’s asset valued at $100. As before, C2 is an intervening creditor holding a $50 unsecured claim. C3, also as before, holds a $50 unsecured claim. Suppose C3 assigns its claim to C1. If assigned claims are given floating secured status, the value of C2’s claim is reduced from $25 ($25/50 x 50 = 25) to $0 ($25/25 x 0 = 0). C2 will expend up to $25, according to the objection, to avoid C3’s assignment to C1 reducing the value of its claim by $25. The objection states that such precautionary investments are unproductive expenditures. The floating secured status is, in this respect, like tariffs or theft, according to the objection. It too induces unproductive precautionary investments in preserving claim value.

The objection is unpersuasive. Floating secured status does not induce the stipulated consequence: the making of unproductive precautionary investments by intervening creditors. Intervening creditors are compensated ex ante to bear reductions in claim value. Given filing notice, an intervening creditor knows that the filing creditor has priority as to any secured free cash.


loans it makes to the debtor. Absent a subordination agreement, the intervening creditor treats its loan as unsecured and charges a commensurate interest rate. Floating secured status does not affect this charge.\textsuperscript{199} Thus, the enhanced interest charge compensates the intervening creditor \textit{ex ante} for any reduction in the value of the claims it holds. The creditor does not have to invest in precautions to avoid uncompensated reductions in claim value. Accordingly, the analogy of floating secured status to tariffs or theft is inapposite: floating secured status, unlike tariffs or theft, does not induce precautionary investments against transfers of assets.

The objection’s assumption that floating secured status is a simple transfer of value from intervening to filing creditor also is false. The assumption relies on the objection based on claim value dilution, which itself is unpersuasive.\textsuperscript{200} Whether floating secured status involves a welfare-invariant transfer of value depends on the effects of assignment on claim value. Generalizations about these effects do not support the assumption of welfare-invariance of assignments. Floating secured status can increase the value of unsecured claims held by intervening creditors.\textsuperscript{201} Also, floating secured status can increase the value of claims held by the assignee. Changes in scale economies in monitoring costs over time may favor the filing creditor holding the balance of outstanding debt issued by a debtor. Reduced costs associated with avoiding collective action problems among creditors as bankruptcy approaches can also favor a single creditor holding the balance of debt. If these circumstances occur, assignment can increase the value of claims assigned. The point here is not that the possibilities show that assignments are welfare-increasing transfers of claims, but rather that assignments cannot be assumed to involve only welfare-invariant transfers. The analogy of floating secured status to tariffs or theft is inapposite. Tariffs or theft typically involve welfare-invariant redistributions of resources.\textsuperscript{202} Floating secured status can involve welfare-enhancing transfers of claims.

\section*{V. Conclusion}

A common working assumption is that the primary conveyancing principles employed in Article 9 are derivation principles: the transferee of interests covered by Article 9 obtains only the interests its transferor possesses. Floating secured claims are an unrecognized and defensible exception to derivation principles.\textsuperscript{203} They arise under conveyancing principles that allow for laundering: the assignee’s acquisition of greater

\textsuperscript{199} See \textit{supra} pp. 378-80.

\textsuperscript{200} See \textit{supra} part II.B.

\textsuperscript{201} See id.

\textsuperscript{202} See \textit{supra} notes 161-62.

interests than are possessed by the assignor. The notice filing scheme of Article 9 and its behavioral assumptions about creditor behavior justify recognition of such claims. A case for laundered security interests under Article 9 exists. Arguments in case law denying assigned claims floating secured status are either inconsistent or unconvincing. Other objections to floating secured claims fail. The recently completed Article 9 Study Committee’s proposals for revision are silent about conveyancing principles in general and floating secured claims in particular. A revised Article 9 should recognize floating secured claims.

This leaves the different justifications of floating secured claims under Article 9 and laundered interests recognized by other commercial law rules. The justification of laundering under other commercial law rules is Kaldor-Hicks efficiency. Under prescribed conditions, transfers of goods, instruments, documents of title, certificated securities, money, and chattel paper allow transferees to take free of claims against the assets transferred. Such rules impose costs on intervening claimants to these assets, which claimants take precautions to optimally minimize. Greater offsetting benefits to ultimate transferees and indirect beneficiaries justify laundering only in these cases, if at all. Claimants of goods and negotiable documents of title, for instance, risk having them transferred free of claims. The risk reduces the value of the claimants’ rights to the goods and negotiable documents of title, respectively. The possibility of laundering enhances the value of goods and negotiable documents of title in the hands of transferees.

The justification of floating secured claims is different. Here laundering imposes no cost on intervening creditors. Consider in schematic form the four types of assignments identified in Part I.

Simple Example: C1 is a prior perfected oversecured creditor, C2 is an intervening unsecured creditor, and C3 is a later unsecured creditor. C1’s interest is created under a security agreement containing an “all debts owed” clause. C3 assigns its unsecured claim to C1.

Variant (1): The same as in the Simple Example, except that C3 subsequently assigns to C1 its perfected nonpurchase money security interest.

Variant (2): The same as in the Simple Example, except C1 subsequently assigns to C3 its secured claim along with the security agreement between it and the debtor. C3 then makes a secured loan to debtor.

Variant (3): The same as in the Simple Example, except C3 makes an unsecured loan to the debtor. C1 subsequently assigns to C3 its secured claim along with the security agreement.

205. See supra text accompanying notes 1-5.
206. See supra pp. 371-73.
The possibility of an assignment giving the assignee greater rights than the assignor possessed does not reduce the value of C2’s claim. It is not a cost that C2 optimally minimizes. Article 9’s scheme of notice filing assures this. C1’s filing puts C2 on notice that C1 has priority up to the value of collateral described. C2 values its claim on the assumption that a creditor (C1) has that priority. Assignments to or from C1 which retain C1’s priority do not affect C2’s assumption.207 Hence, the value of C2’s claim is not reduced by assignments which augment the rights of the assignee while retaining C1’s priority.208 The assignment in the Simple Example and Variant (1) gives C1 priority in the collateral described in C1’s financing statement. The assignment in Variants (2) and (3) gives C3 the priority of C1’s claims. Because all of the assignments enhance the assignee’s rights, while retaining C1’s priority, the value of C2’s claim is not reduced. Floating secured status therefore does not impose costs on intervening creditors.

207. See supra text accompanying note 157.
208. Under some conditions, assignments can enhance the value of claims held by C2; see supra text accompanying note 157.