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# **Cash Sellers, Secured Financiers and the Meat Industry: An Analysis of Articles Two and Nine of the Uniform Commercial Code**

by

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# CASH SELLERS, SECURED FINANCERS AND THE MEAT INDUSTRY: AN ANALYSIS OF ARTICLES TWO AND NINE OF THE UNIFORM COMMERCIAL CODE

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The American red meat eater has been one of the more publicized victims of the economic problems of the 1970's. News stories focused on the plight of the ultimate consumer of meat,<sup>1</sup> but rising meat prices and tight money have claimed other victims too—the cattle rancher,<sup>2</sup> the cattle feeder, the meat packer and the lending institutions which finance the operations of the packers. From 1958 to 1975 one hundred and sixty-seven meat packers failed, leaving livestock sellers with \$43,028,703 in unpaid bills.<sup>3</sup>

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<sup>1</sup> Raskin, *Outrage—But Little Impact*, N.Y. Times, April 8, 1973, § 4 (The Week in Review), at 1, col. 1; Charlton, *How Was It Possible*, *id.*, col. 4.

<sup>2</sup> "Cattle," in industry parlance, are any bovine animal including dairy cows, bulls, and overage breeding animals as well as steers. "Livestock" are living animals raised for meat, including hogs, lambs, sheep and cattle, but excluding poultry. "Meat," however, includes poultry as well as the meat from hogs, lambs, sheep and cattle. Interview with Clark Weaver, Vice President and General Counsel, Monfort Packing, Colorado (December 3, 1976) (notes on file with the author) [hereinafter cited as Weaver].

<sup>3</sup> The yearly breakdown of these losses, according to the Packers and Stockyards Administration, are as follows:

Year	No. of Packers	Original Amount Owed For Livestock	Amount Paid	Amount Still Owed
1958	7	\$ 568,679	\$ 95,726	\$ 472,953
1959	10	1,370,328	158,266	1,212,062
1960	7	408,853	235,335	173,518
1961	7	494,032	173,637	320,395
1962	17	1,612,163	6,733	1,605,430
1963	6	826,423	90,000	736,423
1964	3	115,098	33,007	82,091
1965	13	1,992,351	73,000	1,919,351
1966	9	2,189,099	363,582	1,825,517
1967	9	1,997,748	18,907	1,978,841
1968	10	1,041,371	—	1,041,371
1969	12	870,064	5,300	864,764
1970	14	2,021,342	450,000	1,571,342
1971	12	1,666,505	525,594	1,141,111
1972	11	843,544	110,251	733,293
1973	8	704,360	5,990	698,370

The response to the economic distress of cattle sellers involved the United States Congress,<sup>4</sup> the President of the United States,<sup>5</sup> state legislatures including the Texas Legislature,<sup>6</sup> and the many segments of the American meat industry. Much of the energy of all of these institutions was spent—or misspent—trying to understand the intricacies of the Uniform Commercial Code as it affects the meat industry and to decide on a policy level the best means for regulating the industry.

The economic situation within the meat industry also has produced significant litigation between the creditors of bankrupt packers. This article will discuss the litigation which arose from a dispute between cattle sellers and a finance company both caught by the bankruptcy of Samuels & Co., a Texas meat packer. On April 30, 1970, Samuels & Co., Inc., was adjudicated bankrupt. One of Samuels & Co.'s creditors was its long time financier, C.I.T. Corporation. At the time of the bankruptcy, Samuels & Co. owed C.I.T. over 1.8 million dollars; Samuels also owed fifteen Texas cattle sellers over 50 thousand dollars for delivered but unpaid for cattle. The contest between these two creditors in this seemingly commonplace bankruptcy<sup>7</sup> lasted from 1969 to 1976<sup>8</sup> and required the energy of six federal

1974	9	2,357,744	20,000	2,337,744
1975				
(first 3 mos)	3	24,314,127	—	24,314,127
	167	\$45,393,831	\$2,365,128	\$43,028,703

S. REP. NO. 932, 94th Cong., 2d Sess. 5, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3749, 3753.

By far the largest such bankruptcy was that of American Beef Packers, in 1975, which left over twenty-million dollars in bad checks in the hands of producers and sellers of livestock in thirteen states. *Amendments to Packers and Stockyards Act of 1921: Hearings on H.R. 8410 and Related Bills Before the Subcomm. on Livestock and Grains of the House Comm. on Agriculture*, 94th Cong., 1st Sess. 54 (1975) (statement of Sen. Henry Bellmon, Okla.) [hereinafter cited as *Hearings on H.R. 8410*]; *id.* at 124 (letter of Jon Wefald, Minnesota Dept. of Agriculture); *id.* at 72-73 (statement of B.H. Jones, Nat'l Livestock Ass'n).

<sup>4</sup> The House held three days of hearings on proposed bills to remedy the problem. *Hearings on H.R. 8410, supra* note 3. The Senate also held three days of hearings on proposed bills. *Livestock Marketing: Hearings on S. 1532 and S. 2034 Before the Subcomm. on Agricultural Production, Marketing and Stabilization of Prices of the Senate Comm. on Agriculture and Forestry*, 94th Cong., 1st Sess. (1975) [hereinafter cited as *Hearings on S. 1532*], and *Livestock Marketing: Hearings on S. 1532 [Amend. 1060], Before the Subcomm. on Agricultural Production, Marketing and Stabilization of Prices of the Senate Comm. on Agriculture and Forestry*, 94th Cong., 1st Sess. (1975) [hereinafter cited as *Hearings on S. 1532 (Amend. 1060)*].

The bill which was eventually adopted, H.R. 8410, was considered and passed in the House on May 6, 1976, and considered and passed (as amended) in the Senate on June 17, 1976. 122 CONG. REC. 4004-4028, 9697 (1976). The conference report was agreed to by the Senate on August 4, 1976, and by the House on August 30, 1976. 122 CONG. REC. 9224-28, 13,425-26 (1976).

<sup>5</sup> President's Message on the Packers and Stockyards Act. 12 WEEKLY COMP. OF PRES. DOC. 1334-35 (Sept. 13, 1976).

<sup>6</sup> Payment for Livestock Purchased for Slaughter Act. TEX. REV. CIV. STAT. ANN. art. 6910b (Vernon Supp. 19A 1976-77).

<sup>7</sup> The Samuels bankruptcy left only \$54,793 of unpaid bills for the purchase of livestock. As noted earlier, see text at note 3 *supra*, livestock sellers' losses from meat packer failures for the years 1958 to 1975 totaled \$43 million. See note 3 *supra* for a table of these losses.

<sup>8</sup> The matter first came before the federal courts when Samuels & Co. filed a plan of arrangement under Chapter XI of the Bankruptcy Act on May 23, 1969. The Supreme Court

courts<sup>9</sup> and twenty-five federal judges.

The six judicial opinions which emerged from this litigation reflect a fascinating conflict in the application of the Uniform Commercial Code. Six judges<sup>10</sup> were overly concerned with the particular equities of the industry at the expense of coherent legal analysis; ten judges<sup>11</sup> read the Code so literally that they overlooked both the underlying policy of the Code and economic constraints of the industry.

The broad goals of the drafters, proponents and supporters of the Code, adopted in Texas in 1965,<sup>12</sup> were uniformity and flexibility.<sup>13</sup> The Code prescribes the procedures, defines the rights, and allocates the risks of parties to various commercial transactions involving personal property. This framework is intended to reflect the economic realities of commercial practice.<sup>14</sup> The final opinion in *Samuels*<sup>15</sup> followed the interpretation of Articles 2 and 9 adopted by a majority of courts and was decided in favor of the financier, C.I.T. Corporation. This interpretation did not lead to an economically rational solution to the conflict between the unpaid cattle sellers and the secured lender.

The purpose of this article is to determine whether a more creative,<sup>16</sup> less literal, reading of the Code might have led the courts to integrate the interpretation of technical statutory language, and the resolution of the ambiguous relationship of Articles 2 and 9 of the Code with the economic realities and resulting equities of the meat industry. The thesis of this article is that this would have produced a better result than the actual outcome for both the Uniform Commercial Code and the industry.

This article has four parts. Part I describes the meat industry—the process by which cattle become food and the roles which individual and institutional actors play in this process. Part II is an overview of the statutory provisions which the courts used in attempting to sort out the relationships and interests of the actors who became parties to *In re Samuels*. Part III examines the wisdom of the various judicial approaches to this problem in the six *Samuels* opinions. The last section, Part IV, suggests a solution which

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finally terminated the litigation by denying certiorari in a memorandum opinion reported on October 4, 1976. *Stowers v. Mahon*, 429 U.S. 834 (1976).

<sup>9</sup> *In re Samuels & Co., Inc.*, No. BK 3-1314 (W.D. Tex., January 19, 1972) *rev'd* No. BK 3-1314 (N.D. Tex., November 24, 1972), *rev'd per curiam sub nom.*, *Samuels & Co., Inc. v. Mahon*, 483 F.2d 557 (5th Cir. 1973), *rev'd sub nom.*, *Mahon v. Stowers*, 416 U.S. 100 (1974), *on remand*, *Samuels & Co., Inc. v. Mahon*, 510 F.2d 139 (5th Cir. 1975), *rev'd en banc*, 526 F.2d 1238 (5th Cir. 1976), *cert. denied*, 429 U.S. 834 (1976).

<sup>10</sup> Referee Elmore Whitehurst, Fifth Circuit Judges Robert A. Ainsworth, Joe McDonald Ingraham, Griffin B. Bell, James P. Coleman and Walter Pettus Gewin.

<sup>11</sup> District Court Judge Sarah Tilghman Hughes, Fifth Circuit Judges John C. Godbold, John Minor Wisdom, Homer Thornberry, Irving L. Goldberg, David W. Dyer, Lewis R. Morgan, Charles Clark, Paul H. Roney and Thomas G. Gee.

<sup>12</sup> TEX. BUS. & COM. CODE ANN. tit. 1 §§ 1-101 *et seq.* (Vernon 1967). Since there are no substantive differences between the provisions of the U.C.C. dealt with in this article and the Texas enactment thereof, the U.C.C. will be cited directly. The reader should note that the Texas enactment has replaced hyphens with points and that with a few exceptions, it has changed numerical sequences to letter sequences and letter sequences to numerical sequences in denoting the subsections. Thus, *e.g.*, U.C.C. § 3-802(1)(b) becomes Texas § 3.802(a)(2).

<sup>13</sup> U.C.C. §§ 1-102(1) and (2), § 1-102, Comment 1.

<sup>14</sup> *Id.*

<sup>15</sup> 526 F.2d 1238 (5th Cir. 1976).

<sup>16</sup> *See, e.g., In re American Food Purveyors, Inc.*, 17 U.C.C. REP. 436 (N.D. Ga. 1974).

would have been in harmony with applicable law without ignoring economic reality.

# I. THE MEAT INDUSTRY, THE MONEY MARKET AND THE SAMUELS BANKRUPTCY

## A. *The Meat Industry*

The process by which a newborn calf becomes hamburger on the table is called the meat industry.<sup>17</sup> This industry produces the single most important source of protein in the American diet. It also accounts for approximately one-third of American farmers' total income.<sup>18</sup> The value of livestock merchandising transactions between 1971 and 1975 varied between 25.2 and 42.8 billion dollars.<sup>19</sup> The dollar volume of commerce in meat and livestock was about half that of automobile retail sales in the same years, about equal to department store retail sales, and about one-tenth of total retail sales.<sup>20</sup>

How do cattle get from the farmer's barn to the consumer's table? When a calf is ten to twelve months old, the farmer, known as a rancher, sells the calf to a feeder or a feedlot. The feeder grows or buys feedcorn and grain for the cattle, and pays the veterinarian's bills. When the cattle are fattened and the market seems favorable the feeder sells the livestock to a packer for slaughter.<sup>21</sup>

After purchasing the livestock from the feeder, the packer slaughters the cattle and prepares it for distribution to supermarket chains, "purveyors" or wholesale dealers, restaurants, hotels and other institutions.<sup>22</sup> It is from there that the meat reaches the consumer as roasts, steaks, hamburger and other prized adornments of the American table.

## B. *How the Meat Industry is Financed*

Each stage of the meat industry requires financing. The rancher gen-

<sup>17</sup> *Hearings on H.R. 8410, supra* note 3, at 21 (statement of Curtis Jones); *id.* at 24 (statement of William H. Heubaum).

<sup>18</sup> *Id.* at 59 (statement of John M. Damgard, U.S. Department of Agriculture).

<sup>19</sup> *Id.* at 107 (statement of C.T. Sanders, Director, Livestock Laws Reform Commission).

<sup>20</sup> These figures are taken from SANDERS, *MEASURING LIVESTOCK COMMERCE* 5 (1974) and *id.* at 4-5 (1975).

<sup>21</sup> Weaver, *supra* note 2.

Fifty years ago over 80% of all livestock was sold through large "terminal markets." H.R. REP. NO. 932, 94th Cong., 2d Sess. 4, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3749, 3752. The feeders sold their livestock to these great markets, who, in turn, sold them to the packers. By the mid-1950's the packers' buying pattern had changed from terminal markets to country auction markets, *Hearings on H.R. 8410, supra* note 3, at 97 (statement of R.E. Cunningham), thereby eliminating the intermediary terminal market. *Id.* at 70 (statement of B.H. Jones, National Livestock Feeders Association). The drive to reduce the cost of livestock continued and by 1973 the ten major meat packers bought more than three-quarters of their slaughter cattle, hogs, sheep and lambs directly from the feeder. *Id.* at 71. In 1976 the United States Department of Agriculture estimated that packers buy well over 80% of all livestock for slaughter from "country sources," *i.e.*, directly from the feeders. H.R. REP. NO. 932, 94th Cong., 2d Sess. 4, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3749, 3752.

<sup>22</sup> *Hearings on S. 1532 (Amend. 1060), supra* note 4, at 55 (statement of John Heath).

erally is financed by a local bank or credit association.<sup>23</sup> Depending on the particular rancher's general financial stability,<sup>24</sup> these lenders may take a mortgage (security interest)<sup>25</sup> in the rancher's property. The feeder pays the rancher by check or draft.<sup>26</sup> Apparently these payment and financing arrangements at the beginning of the chain have created no serious problems.<sup>27</sup>

Problems do begin, however, at the next step in the process, the feeder-packer link in the chain. Many feeders are small family operations which sell their whole year's production at one time to one buyer. They must sell when the livestock is ready and the market seems favorable.<sup>28</sup> There are two methods of determining the price of the cattle. First, the packer may buy the cattle "on the hoof" which means the price is determined by the live weight of the cattle when the cattle is delivered to the packer.<sup>29</sup> In the alternative, in a buyer's market, the cattle feeders may sell "grade and yield," as the plaintiff cattle sellers did in the *Samuels* case. This method postpones the determination of the price until the packer slaughters the livestock, chills the carcasses for approximately 24 hours, and the United States Department of Agriculture Inspector grades the carcasses.<sup>30</sup> The packer must pay the cattle seller the amount fixed on the business day after the price is set<sup>31</sup> by the carcass weight and the grade determined by the Department of Agriculture Inspector. Whatever pricing method is used, the packer is required by the Packers and Stockyards Act of 1921 to make "prompt payment" for the livestock purchased for slaughter.<sup>32</sup>

Where and how do the meat packers get the money to pay the cattle sellers? Since they must tender "prompt payment" to the sellers long before they have sold and received payment for the meat they process and package, packers need financing. They therefore borrow the money from banks, finance companies and other short term lenders. These lenders almost always ask packers to mortgage their assets as security for their loans.<sup>33</sup> In the language of the Uniform Commercial Code, the packers

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<sup>23</sup> Interview with Randy Cox, rancher, Great Falls, Montana (February 14, 1977) (notes on file with the author); ROBERTSON & WILLET, *THE ROLE OF ARIZONA BANKS IN SUPPLYING CREDIT TO ARIZONA'S AGRICULTURAL SECTOR*, Report No. 3, Dept. of Agricultural Economics, University of Arizona 4, 8, 41 (1974); *THE KANSAS NEBRASKA CATTLE FEEDLOT INDUSTRY-FEEDER CATTLE PROCUREMENT PRACTICES AND OPERATION CHARACTERISTICS*, Contribution No. 547, Dept. of Agricultural Economics, Kansas Agricultural Experiment Station 9, 11 (1975).

<sup>24</sup> Interview with Randy Cox, rancher, Great Falls, Montana (February 9, 1977).

<sup>25</sup> U.C.C. § 1-201(37).

<sup>26</sup> *Hearings on S. 1532 (Amend. 1060)*, *supra* note 4, at 37 (statement of Virgil Huseman, Kansas Livestock Association).

<sup>27</sup> *Id.*

<sup>28</sup> *Hearings on S. 1532*, *supra* note 4, at 46 (statement of Mrs. Jerry Corey).

<sup>29</sup> Weaver, *supra* note 2.

<sup>30</sup> Record Appendix at 23, *Stowers v. Mahon*, No. 73-1185 (5th Cir. 1973) (Findings of Fact by Elmore Whitehurst, Referee in Bankruptcy) [hereinafter cited as Record Appendix]. See also Packers and Stockyards Act of 1921, 7 U.S.C. §§ 201 *et seq.* (1970); 9 C.F.R. §§ 201.43, 201.99 (1976).

<sup>31</sup> 9 C.F.R. § 201.43(b) (1976). The parties may expressly agree otherwise before the purchase.

<sup>32</sup> Packers and Stockyards Act of 1921, 7 U.S.C. §§ 201 *et seq.* (1970). See text at notes 68-69 *infra* for a fuller explanation of the term "prompt payment," and the governing regulations.

<sup>33</sup> *Hearings on S. 1532 (Amend. 1060)*, *supra* note 4, at 38.

thereby give their lenders a "security interest"<sup>34</sup> in the packers' assets. These assets consist of accounts receivable,<sup>35</sup> inventory,<sup>36</sup> and equipment.<sup>37</sup> If the packer becomes economically unstable or fails, and is unable to pay back the loans or is "in default" under the terms of the loan agreement between the packer and lender, the lender can obtain repayment by taking possession of the packers' assets.<sup>38</sup>

Lending institutions require security for their loans to packers for two reasons: the uncertainty of packers' making money, and the enormous amount of money packers must borrow to operate.<sup>39</sup> The uncertainty arises from the fact that packers' earnings fluctuate widely in response to supply and demand relationships between the producers (ranchers and feeders) of beef on the one hand and the consumers (hotels, restaurants, supermarkets and eaters) of beef on the other. The industry is highly competitive and operates on a margin of less than one percent of sales.<sup>40</sup> Since 1960, one hundred sixty-seven American beef packers out of nine hundred have gone bankrupt.<sup>41</sup> The packers' need for money arises from the legal requirement that they make prompt payment to feeders. The packer is required by law to pay for livestock by the business day after the purchase or the business day following determination of final grade and yield.<sup>42</sup> However, the packers themselves are not paid for an average of sixteen days after the purchase period.<sup>43</sup> This waiting period is called the "float." As a result of the float, packers must borrow enough to finance their accounts receivable for at least sixteen days to provide the money to pay for the cattle purchases until the packers' customers in turn pay their bills.<sup>44</sup> With the packers' narrow profit margin, this need can be great. Packers require forty percent more cash when the price paid for cattle is fifty cents a pound than they do when it is twenty-five cents a pound. A swing of fifteen cents per pound

<sup>34</sup> U.C.C. § 1-201(37).

<sup>35</sup> An "account receivable" is money owed to the packers by their customers. U.C.C. § 9-106.

<sup>36</sup> U.C.C. § 9-109(4) defines "inventory" as goods held for sale "or if they are raw materials . . . or materials used or consumed in a business."

<sup>37</sup> U.C.C. § 9-109(2) defines "equipment" as goods used or bought for use primarily in a business (including farming or a profession). The Code definitions of "goods" in §§ 2-105 and 9-105(1)(f) include animals.

<sup>38</sup> U.C.C. § 9-503. Since one cannot literally take possession of an account receivable, the Code provides that the lender may notify the packers' customers to pay the lender directly. U.C.C. § 9-502(1).

<sup>39</sup> *Hearings on S. 1532 (Amend. 1060)*, *supra* note 4, at 51-53 (statement of John Heath, Illini Beef Packers, Inc.).

<sup>40</sup> *Id.*

<sup>41</sup> *Hearings on H.R. 8410*, *supra* note 3, at 62, 64 (statement of Bruce B. Wilson, U.S. Dept. of Justice).

<sup>42</sup> 9 C.F.R. § 201.43(b)(1976). See text at notes 68-69 *infra*.

<sup>43</sup> *Hearings on H.R. 8410*, *supra* note 3, at 24 (statement of William H. Heubaum, Iowa Beef Processors); *Hearings on S. 1532 (Amend. 1060)*, *supra* note 4, at 51-53 (statement of John Heath, Illini Beef Packers, Inc.).

<sup>44</sup> A representative of the beef packers gave the following example:

Assuming a given live cattle market, Illini Beef paid \$500,000 for 1,300 cattle the day it opened. It paid the same amount the next day and so on until 16 days had passed.

Then, theoretically, on the 17th day, \$500,000 came in as collections on outstanding receivables which matched the \$500,000 paid for live cattle on that day.

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thus can dramatically increase the packers' need for credit.<sup>45</sup> It is, therefore not surprising that lending institutions minimize their risks by almost always making only secured loans to packers.

Packers have their own devices for reducing the economic pressure created by the float and yet at the same time satisfying the technical legal requirements of "prompt payment." They carefully take advantage of postal holidays and the general slowness of the postal system. They frequently pay by checks issued on remote banks to extend collection time. These devices operate to delay the packers' actual payment to feeders.

Customers of packers have no legal constraints on the time of their payments for meat. Thus, they pay packers' invoices when their own cash position makes it comfortable to do so. The supermarket customer pays cash, but the supermarkets take seven to twenty-one days to pay the meat wholesaler. The restaurant goer frequently pays by credit card and the credit card organizations do not settle for seven to twenty days. The government does not pay the wholesaler for thirty to ninety days. Hotels, airlines, and other institutions also do not settle promptly. The wholesalers and other institutions which buy directly from the packers pass these delays back to the packers. Since packers often are able to pass some of the delay on to the cattle sellers despite "prompt payment" laws and regulations,<sup>46</sup> the cattle seller who has been relying innocently for protection on the Packers and Stockyards Act, on simple honesty, and on common knowledge that a check is as good as cash, is, effectively, supplying unsecured financing to the packers. And when a packer such as Samuels fails, the cattle sellers are left holding the dishonored checks.

### C. *The Samuels Litigation*

The plaintiffs in the *Samuels* litigation were fifteen cattle sellers who sold live cattle to Samuels & Co. for slaughter. Samuels & Co. was a large Texas meat packing company with weekly sales from its various plants generally totalling a million dollars.<sup>47</sup> Its principal financier for six years was C.I.T.<sup>48</sup> C.I.T. made weekly loans to Samuels and took a security interest in all Samuels' real estate fixtures, machinery, inventory and accounts receivable owned at the time of the agreement and acquired thereafter.<sup>49</sup> Samuels' inventory included livestock, carcasses, packaged and unpackaged meat.<sup>50</sup>

From May 12 to May 23, 1969, the fifteen plaintiff cattle sellers sold and delivered cattle to Samuels & Co. at their slaughtering plant in Mount

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Cash flow balance had been achieved, but also \$8 million in financing had been utilized. If \$2 million came from company funds—the percentage a well-financed beef slaughterer might have initially—then \$6 million came from lenders, a sizeable chunk considering the company may have only \$12 million in total assets.

*Hearings on S. 1532 (Amend. 1060), supra* note 4, at 52 (statement of John Heath).

<sup>45</sup> *Id.* at 51-53.

<sup>46</sup> See text at note 68 *infra*.

<sup>47</sup> Record Appendix, *supra* note 30, at 20.

<sup>48</sup> 526 F.2d 1238, 1242-43 (1976).

<sup>49</sup> Record Appendix, *supra* note 30, at 20, 25-26.

<sup>50</sup> *Id.* at 25-26.



Pleasant, Texas on a grade and yield basis.<sup>51</sup> After the price was determined, Samuels & Co. issued checks to the sellers totalling \$54,793.26.<sup>52</sup>

On May 23, 1969, C.I.T., "deeming itself to be insecure," refused to give Samuels a weekly advance of \$184,000 needed to continue Samuels' operations and began to liquidate its outstanding loans to Samuels.<sup>53</sup> Samuels & Co. filed a Chapter XI petition for reorganization under the Bankruptcy Act<sup>54</sup> later that day, and an operating receiver was appointed.<sup>55</sup> The checks issued to the fifteen cattle sellers immediately were stamped "no sufficient funds" and returned unpaid. The attempt to reorganize was unsuccessful and on April 30, 1970, Samuels & Co., Inc., was adjudicated a bankrupt.<sup>56</sup>

At that time, Samuels owed C.I.T. more than \$1,800,000,<sup>57</sup> and none of the sellers had been paid for his or her livestock.<sup>58</sup> The bankruptcy trustee indicated that the general unsecured creditors would receive nothing on their claims.<sup>59</sup> On May 20, 1970, to avoid classification as general unsecured creditors, the cattle sellers filed a petition with the United States District Court for the Northern District of Texas "for cattle sellers to reclaim property or payment."<sup>60</sup>

This was not an unusual confrontation in an unstable economy. Samuels, the packer-debtor, went bankrupt and the creditors, C.I.T. and sellers, were fighting literally over the bones and carcasses. The cattle sellers operated on a small margin, expected prompt payment, did not agree to take any risks of the packer's business and did not include any risk calculations in their prices. The secured lender, C.I.T., extended huge amounts of credit, minimized its risk by taking a security interest in everything and expected to be able to recover all of the money it had loaned. The bankrupt, Samuels, expected to be able to cover its own checks to the sellers with its weekly advance from C.I.T. C.I.T., after its careful weekly scrutiny of Samuels & Co.'s balance sheet, decided to minimize its losses and stopped supplying credit.

These were the economic realities underlying the legal confrontation in *Samuels*. Part II will analyze how the law classifies the conflicting interests, and the various ways in which these classifications affect the resolution of the confrontation.

## II. OVERVIEW OF THE STATUTES

The extensive litigation which purported to resolve the conflict in *Samuels* illustrates the difficulty of adapting broad general legal rules to complex and specific economic transactions. Priority between the two competing creditors, the cattle sellers and C.I.T., is entirely dependent on the legal classification of these creditors' interests. There are several possible

<sup>51</sup> *Id.* at 24.

<sup>52</sup> *Id.* at 23.

<sup>53</sup> *Id.* at 20.

<sup>54</sup> 11 U.S.C. § 701 *et seq.* (1970).

<sup>55</sup> Record Appendix, *supra* note 30, at 21.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 26.

<sup>58</sup> *Id.* at 22.

<sup>59</sup> *Id.* at 21.

<sup>60</sup> *Id.* at 22.

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statutory classifications which are found in the Packers and Stockyards Act of 1921 "regulating interstate commerce in livestock and livestock products,"<sup>61</sup> and the Uniform Commercial Code,<sup>62</sup> specifically Article 2 governing the sale of goods, and Article 9<sup>63</sup> regulating security interests in personal property.<sup>64</sup>

To determine the proper classification, the relevant, often conflicting, sections of each statute must be analyzed. Each statute will be examined separately, and their labyrinthian interaction traced.

### A. *The Packers and Stockyards Act of 1921*

The Packers and Stockyards Act of 1921 (PSA)<sup>65</sup> is a federal statute passed to give the Secretary of Agriculture close supervisory powers over the purchase and sale of livestock at the major terminal markets.<sup>66</sup> Samuels & Co., Inc., was a packer subject to the PSA and the regulations thereunder as a "person engaged in the business (a) of buying livestock in commerce for the purposes of slaughter, or (b) of manufacturing or preparing meats or meat food products for sale or shipment in commerce."<sup>67</sup>

In 1964 the regulations promulgated pursuant to the PSA were amended as follows:

b) *Purchasers to pay promptly for livestock.* Each packer, market agency or dealer purchasing livestock shall, before the close of the next business day following the purchase of livestock and the determination of the amount of the purchase price, *transmit or deliver to the seller or his duly authorized agent the full amount of the*

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<sup>61</sup> 7 U.S.C. §§ 181 *et seq.* (1970).

<sup>62</sup> TEX. BUS. & COM. CODE ANN. tit. 1 §§ 1-101 *et seq.* (Vernon 1967).

<sup>63</sup> U.C.C. §§ 9-101 *et seq.* (1962 version). After commencement of litigation in *In re Samuels & Co.*, Texas adopted the 1972 revisions to Article 9 of U.C.C., 1973 Tex. Gen. Laws §§ 9.101-9.507 (1974) codified as TEX. BUS. & COM. CODE ANN. tit. 1 §§ 9.101 *et seq.* (Vernon Supp. Vol. 3, 1976). Since these changes are not relevant to this discussion, all references to U.C.C. Article 9 are to the 1962 version unless otherwise indicated.

<sup>64</sup> In addition to the above-mentioned sources of law, the *Samuels* case also involved issues under the Bankruptcy Act. Samuels & Co. filed a petition on May 23, 1969 under Chapter XI of the Bankruptcy Act. Record Appendix, *supra* note 30, at 20-28. This is essentially an arrangement by which a debtor's business can continue to operate under the supervision of the court. 11 U.S.C. §§ 714, 732, 742 (1970). The packing company continued to operate under a court appointed receiver. Record Appendix, *supra* note 30, at 21. It appears that the cattle sellers believed that since Samuels' business was continuing under the direction of the court appointed receiver, they were not obligated to make a demand for reclamation. See Brief for Appellant at 19, *Stowers v. Mahon*, 483 F.2d 557 (5th Cir. 1973); Brief for Appellant at 5, *Stowers v. Mahon*, 526 F.2d 1238 (5th Cir. 1976).

Efforts to rehabilitate the company were unsuccessful. Samuels & Co. was declared a bankrupt on April 30, 1970 and a trustee was appointed. Record Appendix, *supra* note 30, at 21.

This article will not discuss the important Bankruptcy Act implications of the case, since the trustee did not assert any claim to the property in dispute on behalf of the estate.

<sup>65</sup> 7 U.S.C. §§ 181 *et seq.* (1970).

<sup>66</sup> The chief evil feared is the monopoly of the packers, enabling them unduly and arbitrarily to lower prices to the shipper who sells, and unduly and arbitrarily to increase the price to the consumer who buys. Congress thought that the power to maintain this monopoly was aided by control of the stockyards. *Stafford v. Wallace*, 258 U.S. 495, 514-15 (1922). For the historical events leading up to the passage of the PSA, see *id.* at 497-503.

<sup>67</sup> 7 U.S.C. § 191 (1970); Record Appendix, *supra* note 30, at 20, 23.

*purchase price*, unless otherwise expressly agreed between the parties before the purchase of the livestock.<sup>68</sup>

The amendment was designed "to establish a uniform rule regarding payment for livestock purchased by packers, market agencies and dealers consistent with (1) the established custom that sales of livestock are on a cash basis . . . ."<sup>69</sup>

In 1968 the regulations were again amended by adding detailed procedures for determining the price to packers of livestock by carcass grade, carcass weight or carcass grade and weight.<sup>70</sup> The regulations provide that "[e]ach packer . . . shall maintain the identity of each seller's livestock and the carcasses therefrom and shall, after the determination of the amount of the purchase price, transmit or deliver to the seller . . . [a detailed written account and explanation of the] final account."<sup>71</sup>

The *Samuels* case presented the question whether these PSA regulations give cattle sellers a "special"<sup>72</sup> kind of interest in the cattle sold that takes priority over an earlier Code security interest thereby giving the sellers priority over C.I.T. in the money realized from *Samuels & Co.*'s sale of the carcasses. If such an interest were created by the PSA the cattle sellers would be entitled to recover the amount of their unpaid checks out of monies which C.I.T. otherwise could claim as proceeds from inventory or accounts receivable subject to its security interest under the Code. If the PSA creates this type of priority, then C.I.T.'s Article 9 security interest would be subordinated to the special interest of the cattle sellers.

### B. *The Uniform Commercial Code*

If the PSA does not determine the priority issue,<sup>73</sup> the question is whether the Code imposes a statutory solution. The first step in this Code analysis is to select the controlling article of the Code by examining how the Code classifies the competing interests of C.I.T., the unpaid financier, and the unpaid cattle sellers.

It is perfectly clear that any enforceable interest of C.I.T., the secured lender, is an Article 9 security interest. The classification of the interest of the unpaid cattle sellers, however, is not at all clear. There are three possibilities:

(1) The interest of the cattle sellers is an unperfected purchase money security interest<sup>74</sup> under Article 9;

(2) the interest of the cattle sellers is the Article 2 right of an unpaid *credit* seller to reclaim goods from an insolvent buyer;<sup>75</sup> or,

<sup>68</sup> 9 C.F.R. § 201.43(b) (1976) (emphasis added).

<sup>69</sup> *Id.* at § 201.43(c).

<sup>70</sup> *Id.* at § 201.99.

<sup>71</sup> *Id.*

<sup>72</sup> *Samuels & Co., Inc. v. Mahon*, 483 F.2d 557, 559-60 (5th Cir. 1973).

<sup>73</sup> See *Mahon v. Stowers*, 416 U.S. 100, 107 (1974) (Court expressly held that PSA does not determine the priority issue in this case).

<sup>74</sup> U.C.C. § 9-107 reads in part: "A security interest is a 'purchase money security interest' to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price . . . ."

<sup>75</sup> U.C.C. §§ 2-702(2), (3). See text at notes 109-15 *infra*.

(3) the sellers' interest is the Article 2 right of an unpaid *cash* seller to reclaim goods from a buyer who fails to make payment.<sup>76</sup>

The Code's classification of the cattle sellers' interest is of critical importance. If the sellers' interest is classified as an Article 9 unperfected purchase money security interest, C.I.T. undoubtedly will prevail. If their interest is classified as the right of an unpaid credit or cash seller to reclaim the goods, the sellers may prevail. However, their right to the goods would still be subordinate to C.I.T.'s interest if C.I.T. is a subsequent good faith purchaser for value who acquired title to the goods from the defaulting buyer, Samuels.<sup>77</sup>

### 1. C.I.T.'s Article 9 Security Interest

In return for weekly "advances" Samuels gave C.I.T. the right, in the event of default, to take possession of Samuels' fixtures, machinery, inventory, accounts receivables and proceeds.<sup>78</sup> This is an institutionalized type of financing which in pre-Code days was called a chattel mortgage and assignment<sup>79</sup> and which under Article 9 is classified as giving C.I.T. a security interest in Samuels' property.<sup>80</sup> The security agreement<sup>81</sup> between C.I.T. and Samuels & Co. gave C.I.T. a security interest in property owned by Samuels at the time of the agreement but also contained an after acquired property clause<sup>82</sup> that provided for a security interest in property acquired at anytime after the date of the agreement.<sup>83</sup>

However, simply because a creditor has a security interest in a debtor's property, does not make that interest enforceable. A secured creditor cannot enforce its security interest until it has "attached"<sup>84</sup> to specific property of the debtor. A security interest attaches when three events have

<sup>76</sup> U.C.C. § 2-507(2); Comment 3, § 2-511(3). See text at notes 117-24 *infra*.

<sup>77</sup> U.C.C. § 2-403. See text at notes 125-43 *infra*.

<sup>78</sup> Record Appendix, *supra* note 30, at 20, 25-26.

<sup>79</sup> G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 11.2 (1965) [hereinafter cited as GILMORE].

<sup>80</sup> U.C.C. § 1-201(37) reads in part: "'Security Interest' means an interest in personal property or fixtures which secures payment or performance of an obligation . . . ." See GILMORE, *supra* note 79, at § 11.1.

<sup>81</sup> "'Security Agreement' means an agreement which creates or provides for a security interest." U.C.C. § 9-105(1)(h).

<sup>82</sup> Record Appendix, *supra* note 30, at 20.

<sup>83</sup> U.C.C. §§ 9-204(3) and (4) state:

(3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.

(4) No security attaches under an after-acquired property clause

(a) To crops which become such more than one year after the security agreement is executed . . . ;

(b) to consumer goods other than accessions (Section 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

The interest described in U.C.C. § 9-204 is often referred to as a "continuing general lien," U.C.C. § 9-204, Comment 3, or as a "floating lien." GILMORE, *supra* note 79, at § 11.7.

<sup>84</sup> U.C.C. § 9-204(1) reads:

A security interest cannot attach until there is agreement (subsection (3) of Section 1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

taken place; (1) there is agreement that it attach;<sup>85</sup> (2) value is given by the creditor; and (3) the debtor has rights in the collateral.<sup>86</sup> Two of these events clearly had occurred in *Samuels*. C.I.T. and Samuels & Co. had created a security interest by an agreement in writing—the requisite agreement—and C.I.T. had loaned Samuels & Co. money—the requisite value.<sup>87</sup> However, it is not clear whether the third requirement for “attachment” was satisfied, since it is not certain that Samuels had acquired rights in the collateral.<sup>88</sup> This is a critical question in *Samuels*.

The term “rights in collateral” is not defined anywhere in the Code.<sup>89</sup> However, the term “collateral” is defined as “the property subject to a security interest.”<sup>90</sup> In *Samuels*, the property claimed by C.I.T. as collateral was the unpaid for cattle. If Samuels & Co. had no interest in the cattle, it

<sup>85</sup> U.C.C. § 1-201(3) reads in part: “‘Agreement’ means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this title . . . .”

Although U.C.C. § 9-204(1) refers specifically to the foregoing definition of an “agreement,” U.C.C. § 9-203(1)(a) provides that “(1) . . . a security interest is not enforceable against the debtor or third parties unless (a) . . . the debtor has signed a security agreement which contains a description of the collateral . . . .” Despite repeated attempts, the author has not been able to obtain a copy of the signed agreement between C.I.T. and Samuels. However, throughout the litigation the existence of such an agreement has been assumed and has not been contested. Furthermore, it is unlikely that a finance company the size of C.I.T. would advance an amount in excess of \$1.8 million without a signed agreement.

In his findings of fact, Record Appendix, *supra* note 30, at 20, Referee Elmore Whitehurst stated that “[Samuels & Co., Inc.] operations were being financed by C.I.T. Corporation which as security had taken an all encompassing lien on Samuels’ real estate, fixtures, machinery, inventory and accounts receivable.” The Referee also found that

[a]t all times material to this action C.I.T. Corporation (C.I.T.) was the holder of a duly perfected security interest in all . . . inventory owned by the bankrupt or in which the bankrupt may have had an interest . . . [and] in accounts receivable of the bankrupt. At the time of filing of the Chapter XI petition the bankrupt was indebted to C.I.T. in an amount in excess of \$1,800,000.

*Id.* at 25. Furthermore, in an order pursuant to a reclamation petition of C.I.T. Corp., Record Appendix, *supra* note 30, at 42, the referee established a dollar amount of Samuels’ indebtedness “in accordance with the agreements between C.I.T. Corporation and the Debtor . . . .” It is interesting to note that no specific finding was made that a signed writing existed. This is perhaps due to a mistaken view that the existence of a perfected security interest obviated the necessity for a signed writing. The 1972 amendment to U.C.C. § 9-203(1)(a) (adopted in Texas by amendment in 1973, *supra* note 62), eliminates any confusion created by §§ 9-203 and 9-204. The confusion stemmed from the fact that under the two sections a creditor could have an attached and duly perfected security interest which was unenforceable in the absence of a written security agreement describing the collateral and signed by the debtor. The 1972 version of § 9-203 makes the signed writing a requirement of attachment so that a creditor who has a duly perfected security interest now also has an enforceable interest. See § 9-203 for definition of perfection. This was accomplished by eliminating from § 9-204(1) the reference to the Article 1 definition of an “agreement” and including the signed writing as a requirement for attachment in § 9-203.

<sup>86</sup> U.C.C. § 9-204(1).

<sup>87</sup> U.C.C. § 1-201(44) reads in part: “‘Value.’ Except as otherwise provided with respect to negotiable instruments and bank collections . . . a person gives ‘value’ for rights if he acquires them . . . (b) as security for or in total or partial satisfaction of a pre-existing claim . . . .”

The referee in his findings of fact, Record Appendix, *supra* note 30, at 26, found that “[a]t the time of the filing of the Chapter XI petition the bankrupt was indebted to C.I.T. in an amount in excess of \$1,800,000.”

<sup>88</sup> U.C.C. § 9-204(1).

<sup>89</sup> GILMORE, *supra* note 79, § 11.5.

<sup>90</sup> U.C.C. § 9-105(1)(a).

never acquired "rights in the collateral." Therefore C.I.T.'s security interest would have nothing to which it could attach, and C.I.T. would have no claim under its security agreement to the money Samuels received for the meat. If the cattle sellers retained sufficient rights in the unpaid for cattle so that Samuels' interest did not rise to the status of "rights in the collateral," then C.I.T.'s security interest in the cattle did not attach and hence was not enforceable.

Assuming, however, Samuels & Co. had these mysterious "rights" in the unpaid for cattle, then C.I.T. had an Article 9 security interest which had attached to the cattle. C.I.T. could then enforce this security interest against its debtor, Samuels & Co.<sup>91</sup> C.I.T. had also given the necessary statutory public notice of this interest by filing according to Article 9 requirements.<sup>92</sup> Therefore, its security interest, if it had attached, was also "perfected."<sup>93</sup>

## 2. Cattle Sellers' Interest

As previously noted, there are a variety of possible Code classifications that may cover the interest of the cattle sellers. The classification selected is critical because it may determine which of the competing parties prevails.

### a. *Sellers' Interest as Unperfected Purchase Money Security Interest (Articles 2 and 9)*

One theory is that the cattle sellers' interest in the unpaid for cattle was an unperfected Code purchase money security interest. A security interest is a purchase money security interest if it is taken or retained by the seller of the collateral to secure all or part of the price of goods sold.<sup>94</sup> A security interest is unperfected if no written agreement exists, if no attachment has taken place,<sup>95</sup> or if no proper filing has been made.<sup>96</sup> Article 9

<sup>91</sup> U.C.C. §§ 9-201, 9-203, 9-204.

<sup>92</sup> The referee found that C.I.T. was the holder of a duly perfected security interest in the inventory and accounts receivable of Samuels. Record Appendix, *supra* note 30, at 25. U.C.C. § 9-303 provides that a security interest is duly perfected when it has attached and when all of the steps required for perfection have been taken. In the case of a nonpossessory security interest, the step required is the filing of a financing statement. U.C.C. §§ 9-302, 9-304-306. In sections 9-401-403, the U.C.C. has adopted what is known as "notice filing," whereby in most cases the formal requirements of filing are limited to the filing of the address of the secured party from whom information concerning the interest may be obtained, a statement indicating what the collateral is, and the signatures of the debtor and the secured party. This differs from the earlier "transaction filing" which required a complete description of all collateral and of all the particular transactions involved. See GILMORE, *supra* note 79, §§ 15.2, 15.3.

<sup>93</sup> The effect of "perfection" of a security interest is to make that interest good as against lien creditors of the debtor. The validity of a perfected security interest as against other perfected security interests in the same property is determined by the priority provisions of Article 9. "Perfection" does not necessarily mean, however, that the security interest is good "against the world." See GILMORE, *supra* note 79, Introductory Note at 435.

<sup>94</sup> U.C.C. § 9-107(a). The section reads:

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

(a) taken or retained by the seller of the collateral to secure all or part of its price . . . .

<sup>95</sup> See note 84 *supra*.

<sup>96</sup> U.C.C. § 9-303.

provides that an attached, enforceable, properly recorded—that is, a duly perfected—security interest has priority over an unperfected security interest.<sup>97</sup>

An Article 9 security interest normally is created by an agreement in which a debtor gives its creditor a security interest in specific property to insure payment of the debt.<sup>98</sup> When the cattle sellers sold the cattle to Samuels & Co., they made no such agreement. They took checks as payment and assumed that the checks would not bounce.<sup>99</sup> This transaction appears to be a straight sale with no attempt to reserve any kind of security interest. Under Pre-Code Texas law seller and buyer were presumed to intend no passage of title until the check or draft was paid. If it were not paid, the seller was entitled to reclaim the cattle or its proceeds from the buyer or from subsequent purchasers such as C.I.T.<sup>100</sup>

Article 2 changes this result. Section 2-401 provides that:

insofar as situations are not covered by other provisions of this Article and matters concerning title become material . . . (1) . . . Any retention or reservation by the seller of title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest . . . (2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with respect to delivery of the goods, despite any reservation of a security interest . . . .

Consistent with the Code's general treatment of the concept of title,<sup>101</sup> Ar-

<sup>97</sup> U.C.C. § 9-301, Comment 1.

<sup>98</sup> U.C.C. § 9-102(1) reads in part:

(1) Except as otherwise provided . . . this chapter applies so far as concerns any personal property and fixtures within the jurisdiction of this state

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights . . . .

U.C.C. § 9-102, Comment 1 points out that "[w]hen it is found that a security interest as defined in Section 1-201(37) was intended, this article applies regardless of the form of the transaction or the name by which the parties may have christened it."

<sup>99</sup> In fact the checks would not have bounced if C.I.T. had not decided that it was economically unwise to advance any more money to Samuels & Co. and failed to make its weekly advance which would have been more than three times the amount of the checks outstanding to the cattle sellers.

<sup>100</sup> See, e.g., *Johnson v. Robinson*, 203 F.2d 135, 139 (5th Cir. 1953) (Seller brought an action to recover proceeds from third party buyer when the draft given to seller by buyer went unpaid for lack of authority to draw. The court found under Texas law that in cash sales title did not pass until the draft was paid and seller recovered.). *But cf.* *Valley Stockyards v. Kinsel*, 369 S.W.2d 19, 27 (Tex. 1963) (Seller brought an action to recover proceeds from a livestock company which purchased from buyer, a trader. The court, in a 5-3 decision, reversed a summary judgment for seller on grounds that in a cash sale the presumption that title does not pass until the draft is paid is rebuttable by a showing that the parties had a different intent.). See generally 2 S. WILLISTON, *THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT* §§ 341-43, 346 (1948).

<sup>101</sup> The single most important innovation of Article 2 is its restatement of [the responsibilities of the parties to a contract] in terms of operative facts rather than legal conclusions: where pre-Code law looked to "title" for the definition of rights and remedies, the Code looks to demonstrable realities such as custody, control and professional expertise.

title 2 makes it impossible for a seller of goods to retain "title" after the goods have been delivered to the buyer unless explicitly agreed otherwise. Any unilateral attempt to reserve title is transformed by this provision into the reservation by the seller of a security interest.

Under section 9-113 this security interest arising solely under the Article on Sales (Article 2) is subject to the provisions of . . . [Article 9] . . . except that to the extent that . . . the debtor . . . *does not lawfully obtain possession of the goods* . . .

(a) no security agreement is necessary to make the security interest enforceable; and

(b) no filing is required to perfect the security interest; and

(c) the rights of the secured party on default by the debtor are governed by the Article on Sales (Article 2).<sup>102</sup>

Thus, although section 9-113 makes a section 2-401 security interest subject to Article 9, it also creates an exception to this general rule in situations where the defaulting debtor has not obtained lawful possession of the contested goods. Accordingly, if Samuels & Co., by paying with checks that were later dishonored, did not "lawfully obtain possession" of the cattle, the Article 2 security interest of the cattle sellers would not be subject to those requirements of Article 9 which are enumerated in section 9-113. The cattle sellers' interest therefore would not be subordinated to the perfected security interest of C.I.T. by the priority rules of Article 9<sup>103</sup> because these priority rules do not apply to an Article 2 security interest.

If, however, Samuels & Co. did obtain lawful possession of the cattle, the cattle sellers' attempt to reserve title would be viewed as creating an Article 2 security interest, which is subject to Article 9.<sup>104</sup> Since this security interest was "taken or retained by the seller of the collateral to secure all or part of its price,"<sup>105</sup> it would be classified by Article 9 as a purchase money security interest. Moreover, since the cattle sellers did not follow Article 9's filing requirements, their security interest would be unperfected.

An unperfected security interest is almost always subordinate to a perfected security interest in the same property. Therefore, if the transfer by the cattle sellers to Samuels involved an attempted reservation of title—thereby creating a section 2-401 security interest—if Samuels' possession was lawful, and if C.I.T. had a perfected security interest, then C.I.T. would prevail.<sup>106</sup>

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Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 201 (1973). See also GILMORE, *supra* note 79, at § 11.8. U.C.C. § 9-202 and the comment thereto made it plain that while "title" may have application in the law for other purposes, the concept is not to be used in determining the rights, obligations and remedies applicable to secured transactions under the Code.

Also consistent with the Code's bypassing of the "title" concept are §§ 2-326 and 2-327 dealing with consignment sales and the rights of creditors. Section 2-326 distinguishes between the case where the goods are delivered for use and the case where the goods are delivered for resale. In the former case, the buyer's creditors may only reach the goods after the buyer's acceptance, while in the latter case they may reach the goods while in the buyer's possession. In the application of this section to the general creditors of the buyer, any words reserving title to the seller are to be disregarded.

<sup>102</sup> U.C.C. § 9-113 (emphasis added).

<sup>103</sup> U.C.C. §§ 9-301(1), 9-312.

<sup>104</sup> U.C.C. §§ 2-401, 9-113.

<sup>105</sup> U.C.C. § 9-107. See note 94 *supra*.

<sup>106</sup> See U.C.C. §§ 9-301(1), 9-312.



It follows from this analysis that the cattle sellers could have acquired priority over C.I.T. simply by following the requirements of section 9-312(3). That section provides that a later purchase money security interest<sup>107</sup> in inventory always can achieve priority over all prior conflicting non-purchase money security interests in the same property if proper filing is made and notice given to the other secured parties.<sup>108</sup>

b. *Sellers' Interest as Right to Reclaim the Goods (Article 2)*

Another theory is that the cattle sellers' interest is not an attempted reservation of title which the Code calls a security interest, but an Article 2 right to reclaim the goods for nonpayment. There are two distinct and different kinds of sellers' rights to reclaim unpaid for goods depending upon whether the sellers are classified as credit sellers or cash sellers.

i) *Credit Sellers: Right to Reclaim as Unpaid Credit Seller*

A credit seller's right to reclaim unpaid for goods is based on and limited by section 2-702(2). This section provides that "[w]here a seller discovers that the buyer has received goods on credit while insolvent, he may reclaim the goods upon demand made within ten days after receipt."<sup>109</sup> However, the section further provides that if the buyer has made "a misrepresentation of solvency" in writing to the seller within three months before delivery, the ten day limitation does not apply.

In order to be a credit seller under section 2-702(2), a seller must meet three requirements. First, the buyer must have received the goods on credit. In *Samuels*, the question arises whether the lapse of time between the delivery of the cattle to Samuels and the determination of the price and issuance of the check to the cattle sellers mandated by the "grade and yield" procedure made the sale a credit sale as a matter of law. If the time lapse did not have this effect, a further question arises whether the subsequent dishonor of the checks "defeat[ing] payment"<sup>110</sup> transformed the sale from a cash to a credit sale.<sup>111</sup>

<sup>107</sup> U.C.C. § 9-107. See note 94 *supra*.

<sup>108</sup> A seller always could get an absolute priority over a prior secured party by following the specific provisions of Article 9. U.C.C. §§ 9-312(c) (2), (3) would have required sellers to give C.I.T. notice before Samuels & Co. took delivery of the cattle, a harsh requirement in the face of established practice. The policy behind the purchase money security priority is to ensure that the Code's expanded floating lien provisions will not have the effect of prohibiting modernization by cutting off any subsequent financing with a new lender once a debtor has given a lien on after-acquired property for a prior loan. It should be noted, however, that the purchase money security priority has not been limited to the case of financing new equipment. See GILMORE, *supra* note 79, at § 11.7.

<sup>109</sup> U.C.C. § 2-702(2). Section 1-201 defines an insolvent as a person "who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law." U.C.C. § 1-201(23).

<sup>110</sup> U.C.C. § 2-511(3) and Comment 4. See also § 3-802.

<sup>111</sup> Several courts have suggested that in some circumstances a sale negotiated as a cash sale might be transformed into a credit sale. It is not clear, however, what would cause such a transformation. In *In re Colacci's of America, Inc.*, 490 F.2d 1118 (10th Cir. 1974), restaurant equipment was delivered to Colacci's restaurant in a cash sale. When the restaurateur could not pay, the seller left the equipment and returned frequently for payment over a four month

The second requirement of section 2-702(2) is that seller must have demanded reclamation of the goods within ten days after their receipt, unless the buyer made a written misrepresentation of solvency to the seller within three months before delivery. In these circumstances, the ten day limitation does not apply.<sup>112</sup> There is no evidence in the *Samuels* case of any demand made by cattle sellers upon the receiver within ten days of Samuels' receipt of their cattle, or at any other time prior to filing suit eleven months later. However, the cattle sellers conceivably could have escaped the time limits imposed by this section by arguing that the bad checks were written misrepresentations of solvency. Hence the sellers would be absolved from meeting the ten day requirement.<sup>113</sup>

Section 2-702(2)'s third requirement is that the seller reclaim the "goods" which were the subject of the credit sale. The goods in *Samuels* were cattle which were transformed and resold in a short time. Further,

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period before reclaiming the equipment. The court recognized that the sale was negotiated as a cash sale, but treated the seller as a credit seller. *Id.* at 1123. It is unclear whether the transaction became a credit sale on the facts because of the conduct of the seller or as a matter of law because the seller waived his right of reclamation under U.C.C. § 2-507(2) and Comment 3. In any case, the mere fact that the buyer did not pay does not seem to be sufficient cause to transform the sale as a matter of law from a cash sale to a credit sale. See also *In re Richardson Homes Corp.*, 18 U.C.C. REP. 384, 387 (N.D. Ind. 1975). Although on the facts, the sale involved appeared to be a cash sale, the court denied recovery to an unpaid seller seeking to reclaim against buyer's trustee in bankruptcy because seller had not made demand for reclamation within the ten day period of U.C.C. § 2-702 (dealing with credit seller). *Id.* at 387. Seller had based his action on U.C.C. § 2-507 (dealing with cash seller) but the court did not discuss the issue of whether the sale was a cash or credit sale. But see *Ranchers & Farmers Livestock Auction Co. v. First State Bank*, 531 S.W.2d 167, 169 (Tex. Civ. App. 1975) (dealing with cash seller).

<sup>112</sup> U.C.C. § 2-702(2) provides in full:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

*Id.*

<sup>113</sup> The theory that checks could be "written misrepresentations of solvency" within the meaning of U.C.C. § 2-702(2) was set out in dicta in *Theo. Hamm Brewing Co. v. First Trust & Savings Bank*, 103 Ill. App. 2d. 190, 195, 242 N.E. 2d 911, 915 (1968). Plaintiff brewing company was not allowed to escape from the § 2-702(2) ten day limitation for reclamation by claiming that defendant's check was a misrepresentation of solvency because plaintiff had not relied on the check in determining its course of dealing with defendant. *Id.* There was a factual showing that plaintiff knew independently of the check that defendant was insolvent at the time of the sale. *Id.* This theory was held to be inapplicable to the facts in *In re Creative Buildings, Inc.*, 498 F.2d 1, 3 (7th Cir. 1974) and *In re Bar-Wood, Inc.*, 15 U.C.C. REP. 828, 830 (S.D. Fla. 1974).

However, in *Amoco Pipeline Co. v. Admiral Crude Oil Corp.*, 490 F.2d 114 (10th Cir. 1974), the court permitted the seller to reclaim from the pipeline company (Amoco) on the basis of the buyer's having made a misrepresentation of solvency in the form of checks given to the seller on a prior sale. The seller relied on the checks in making a further sale to the buyer and when, after delivery of the oil to Amoco, the checks relied on were returned unpaid, the seller promptly notified Amoco to stop delivery. *Id.* at 117.

The import of these cases appears to be that a check may be a written misrepresentation of solvency under § 2-702(2) only if seller can make a factual showing that in determining its course of dealings in the sale in question, it relied on a check given in payment for a sale which occurred within three months of the sale in question.

these cattle were sold by court order.<sup>114</sup> Thus, there was little opportunity to reclaim the goods themselves. The question therefore is whether a credit seller's right to reclaim goods extends to a right to reclaim the proceeds of the sale of the goods.

If the transaction in *Samuels* was a credit sale, if the checks were written misrepresentations of solvency, and if the sellers' right to reclaim extends to the proceeds, then the cattle sellers had a right to reclaim under section 2-702(2). However, that section further provides that such reclamation "is subject to the rights of a . . . good faith purchaser under this Article (Section 2-403)."<sup>115</sup> Therefore, as a final point, it must be noted that the cattle sellers' right to reclaim as credit sellers would be subordinate to the rights of a good faith purchaser for value.<sup>116</sup> C.I.T.'s status as a good faith purchaser for value will be discussed in a later section.

## ii) Cash Seller: Rights to Reclaim as Unpaid Cash Sellers

Unlike the fairly straightforward delineation of the rights of the credit seller in section 2-702(2), there is no express provision in the Code giving a comparable right to reclaim to the cash seller. However, the courts seem to have relied on Sections 2-511(3), 2-507 and Comment 3 to section 2-507 as authority for granting that right.<sup>117</sup> These sections, dealing with cash sales, provide:

Section 2-511(3) . . . [P]ayment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

Section 2-507(2). Where payment is due and demanded on the

<sup>114</sup> The referee found as a fact that "[a]s a matter of necessity arrangements had to be worked out for the trustee under the direction of the court to sell the perishable meat on hand with proceeds to be held subject to the order of the court so that these contests could be fount (sic) out over money." Record Appendix, *supra* note 30, at 21.

Citing no case precedent, Judge Godbold contended in the Fifth Circuit en banc opinion in *Samuels v. Mahon*, 526 F.2d at 1245:

Moreover, § 2.507 and § 2.702 speak of a right to reclaim goods. Neither provision grants a right to go after proceeds of these goods. Where a right or interest in proceeds is recognized by the Code it is recognized expressly. *See, e.g.*, § 9.306. The right granted by § 2.507 is narrowly defined. I am unwilling to imply an extension to such a shortlived and precisely drawn remedy.

In the cases where the problem has arisen, recovery of proceeds has been permitted, without discussion of the proceeds question, where recovery of the goods was not possible. *See In re Mort Co.*, 209 F. Supp. 309 (E.D. Pa. 1962). Reclamation petitioner claimed money which trustee received for goods sold by the petitioner to the bankrupt two days before the bankrupt filed a voluntary petition. The bankrupt had paid for the goods upon delivery by a check which was dishonored. The petitioner, who had claimed within the ten day limit, was allowed to recover under § 2-507(2). *Id.* at 316. *See also Amoco Pipeline Co. v. Admiral Crude Oil*, 490 F.2d 114 (10th Cir. 1974); *In re American Food Purveyors, Inc.*, 17 U.C.C. REP. 436, 441 (N.D. Ga. 1974) (seller permitted to recover cases of fish sold to the bankrupt or the proceeds of any goods which had already been sold).

<sup>115</sup> U.C.C. § 2-702(3).

<sup>116</sup> U.C.C. § 2-403(1) gives a good faith purchaser for value from a defaulting buyer superior rights to those of an unpaid cash or credit seller. Therefore, if it is concluded that the cattle sellers have a right to reclaim the key question in this case becomes whether C.I.T. is a good faith purchaser for value.

<sup>117</sup> *See, e.g., In re Helms Veneer Corp.*, 287 F. Supp. 840 (W.D. Va. 1968); *In re Mort Co.*, 208 F. Supp. 309 (E.D. Pa. 1962); *Lawrence v. Graham*, 349 A.2d 271 (Md. App. 1975).

delivery to the buyer of the goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

Comment 3 to Section 2-507 states that the ten day limitation "within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here." This comment assumes that the language of the statute clearly implies a right to reclaim by a cash seller where the payment that is "due and demanded on the delivery to the buyer" is not made. This implication is further supported by Section 2-703(f) which gives a seller a right to "cancel" where the buyer "fails to make a payment due on or before delivery."<sup>118</sup> However, the statement in the comment that the ten day limitation explicitly imposed on the *credit* seller's right to reclaim applies to cash sellers, though relied on by some courts,<sup>119</sup> has no basis in the statute itself.

If the ten day limitation does not bar the cattle sellers' exercise of their right to reclaim, it is necessary to consider whether the "grade and yield" sale procedure meets the statutory definition of a cash sale. The issue is whether in the transaction between the cattle sellers and Samuels & Co. "payment [was] due and demanded *on delivery* to the buyer of the goods."<sup>120</sup> It could be argued that the PSA makes grade and yield cash sales impossible because payment is delayed for at least a day. "On delivery" is about as unequivocal as statutory language ever gets and a payment twenty-four hours later is not "on delivery." The cash sale concept already has been stretched to encompass goods paid for by check, but to classify this transaction, where checks were issued several days later, as a cash sale extends that concept to a point where it becomes very difficult to distinguish cash sales from credit sales.

However, the referee in bankruptcy found as a fact that the sale of the cattle was a cash sale.<sup>121</sup> This finding in addition to the fact that the lapse of time between delivery of the cattle and issuance of the checks was mandated by the PSA regulations<sup>122</sup> must be considered in determining whether the transaction was on a cash basis. Further, the referee found that sale of livestock on a grade and yield basis was a recognized custom and usage in the trade.<sup>123</sup>

<sup>118</sup> The confusing definition of "cancellation" in § 2-106(4) as having the same "effect" as termination questions whether the right to cancel provides a basis for reclamation of goods.

<sup>119</sup> *In re Helms Veneer Corp.*, 287 F. Supp. 840, 846 (W.D. Va. 1968) (Expressly relying on Comment 3 to U.C.C. § 2-507 and the § 2-507 cross reference to § 2-702, the court denied recovery to cash seller because he failed to demand reclamation within ten days.); *In re Kirk Cabinets, Inc.*, 15 U.C.C. REP. 746, 748 (M.D. Ga. 1974) (Court denied recovery for failure to reclaim within ten days. Discussed and adopted *Helms Veneer* rationale that Comment 3 to § 2-507 is intended as a cross reference to § 2-702.). See also *In re Mort Co.*, 208 F. Supp. 309, 310-11 (E.D. Pa. 1962) (Court allowed cash seller to recover under § 2-507 without discussion of ten day limit where seller had made demand for reclamation within ten days); *In re Richardson Homes*, 18 U.C.C. REP. 384 (W.D. Ind. 1975) (Court is unclear as to whether plaintiff is cash or credit seller); *Ranchers & Farmers Livestock Auction Co. v. First State Bank*, 531 S.W.2d 167 (Tex. Civ. App. 1975) (court is unclear as to status of seller). See generally R. NORDSTROM, HANDBOOK OF THE LAW OF SALES §§ 165, 166 (1970).

<sup>120</sup> U.C.C. § 2-507(2) (emphasis added).

<sup>121</sup> Record Appendix, *supra* note 30, at 23.

<sup>122</sup> See text at notes 68-71 *supra*.

<sup>123</sup> Record Appendix, *supra* note 30, at 23.

As in the discussion of a credit seller's right to reclaim, it is necessary to determine whether a cash seller's right to reclaim goods extends to a right to reclaim the proceeds. If it is concluded that the cattle sellers had a right as cash sellers to reclaim the proceeds, the question is reached again as to the status of this right to reclaim vis-a-vis a third party, C.I.T. The Code speaks of a buyer's, Samuels & Co.'s, "right as against the *seller* to retain or dispose of" the goods being "conditional on payment."<sup>124</sup> Comment 3 states that "these words are used as words of limitation to conform with the policy set forth in the bona fide purchaser sections of this Article." As with their status as credit sellers, then, the status of the cattle sellers' right to reclaim as cash sellers against C.I.T. will depend on C.I.T.'s rights under Section 2-403 as a good faith purchaser for value.

### 3. C.I.T.'s Status as a Good Faith Purchaser for Value (Article 2)

Section 2-403 consolidates prior statutory and case law "to state a unified and simplified policy on good faith purchase of goods."<sup>125</sup> This section provides:

(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale," or,

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

Under this section, *Samuels* presents two sets of questions. The first is the nature of the title which Samuels & Co. had to the cattle. If Samuels & Co. obtained either good or voidable title to the cattle and did so under a transaction of purchase, section 2-403 allows Samuels & Co. to transfer good title to a good faith purchaser for value. However, if Samuels & Co. never obtained title to the cattle or if the transaction between Samuels & Co. and the cattle sellers was not a purchase, then Samuels & Co. did not have the power to transfer good title to a good faith purchaser. If Samuels & Co. did in fact have a good or voidable title to the cattle, then the second question arises: whether C.I.T. was a good faith purchaser for value under section 2-403. If C.I.T. is not a good faith purchaser for value, its interest in the cattle will be subordinated to the cattle sellers' rights as cash or credit sellers to reclaim the proceeds from the sale of the cattle.

<sup>124</sup> U.C.C. § 2-507(2) (emphasis added).

<sup>125</sup> U.C.C. § 2-403, Comment, Purposes of Changes. For background on the development of the concept of good faith purchase in the law of sales and its relation to cash and credit sales, see Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1057-62 (1954).

a. *Samuels & Co.'s Ability to Transfer Good Title to C.I.T.*

Before C.I.T. can recover as a good faith purchaser for value, it must be determined that Samuels & Co. had the power to transfer good title to the cattle under 2-403(1). Section 2-403(1) confers this power upon "[a] person with *voidable title*" and provides that "[w]hen goods have been delivered under a *transaction of purchase* the purchaser has such power even though . . . b) the delivery was in exchange for a check which was later dishonored, or c) it was agreed that the transaction was to be a 'cash sale' . . . ." <sup>126</sup> Under this section, the first question is whether Samuels & Co. was capable of transferring good title as a "person with voidable title." The Code does not define "voidable title." Section 2-403(1)(b) nevertheless explicitly covers Samuels & Co.'s sale of cattle because Samuels took delivery of the cattle "in exchange for a check which was later dishonored." <sup>127</sup> Section 2-403(1)(b) may describe one transaction in a nonexclusive list of transactions which confer *voidable title on a transferor*. Alternatively, the provision may be one in an exclusive list of transactions in which a transferor whose title is *void* nevertheless has the power to transfer good title. In either case, Samuels & Co. would have had the power to transfer good title to C.I.T.

If section 2-403(1) is construed as a list of those with void title who can convey good title, it can be argued that the transaction in *Samuels* is not a "transaction of purchase." Section 1-201(32) defines a transaction of purchase as a "voluntary transaction creating an interest in property." Arguably, the sale of cattle to Samuels & Co. did not create an interest in property because the cattle were delivered in exchange for checks which the buyer knew would be dishonored. Lacking the buyer's intent to pay for the goods the contract was without an essential formal element and was void *ab initio*. If there were no agreement between Samuels and the sellers, the transaction was not a purchase and Samuels did not have the power to transfer good title to C.I.T. even if C.I.T. were a good faith purchaser for value.

b. *C.I.T.'s "Good Faith"*

If Samuels & Co. had the power to transfer good title to the cattle to C.I.T., it is necessary to consider whether C.I.T. was a good faith purchaser for value under 2-403. The Code defines good faith subjectively as "honesty in fact in the conduct or transaction concerned" <sup>128</sup> and objectively in the case of a merchant as "the observance of reasonable commercial

<sup>126</sup> U.C.C. § 2-403(1) (emphasis added).

<sup>127</sup> It might be argued that the real meaning of this sentence is that these situations are covered *only* when the transferor (Samuels & Co.) has voidable title and thus other state law would then determine the nature of transferor's title. This is a weak argument in view of the intent expressed in the comments. Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 221-22 n.70 (1963) [hereinafter cited as Peters]. Gilmore describes voidable title as "a vague idea, never defined, and perhaps incapable of definition, whose greatest virtue as a principle of growth may well have been its shapeless imprecision of outline." Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1059 (1953).

<sup>128</sup> U.C.C. § 1-201(19).

standards of fair dealing in the trade."<sup>129</sup> Because it held itself out as having knowledge or skill peculiar to the practices involved in the financing transaction, C.I.T. would be held to the good faith standard applicable to a merchant.<sup>130</sup> In *Samuels*, the determination of C.I.T.'s good faith depends on the weight given to its close knowledge of *Samuels & Co.*'s financial affairs and on its awareness that failure to make its regular weekly advance to *Samuels & Co.* might result in the dishonor of *Samuels'* outstanding checks to cattle sellers.<sup>131</sup>

c. *C.I.T. as a "Purchaser"*

The Code definition of purchase is broad, encompassing "taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property."<sup>132</sup> This definition seems broad enough to include a secured creditor whose interest in its debtor's property is created by agreement. Courts, relying on this definition of purchase, consistently have treated secured parties as Code purchasers.<sup>133</sup>

<sup>129</sup> A merchant is one who "by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction." U.C.C. § 2-104(1).

<sup>130</sup> See *id.* § 2-104, Comment 2.

<sup>131</sup> U.C.C. § 2-103(1) (b). See *Sherrock v. Comm. Credit Corp.*, 290 A.2d 648, 650-51 (Del. 1972) (nothing in the Code permits the section 2-103(1) (b) definition to apply to Article 9 transactions). But see *Mattek v. Malofsky*, 42 Wis.2d 16, 19-20, 165 N.W.2d 406, 408 (1969) (Section 1-201(19) honesty in fact standard applies only for consumers and § 2-103(1) (b) must always apply as between merchants because of its specificity).

<sup>132</sup> U.C.C. § 1-201(32). U.C.C. § 1-201(33) states that "'Purchaser' means a person who takes by purchase."

<sup>133</sup> See *United States v. Wyoming Nat'l Bank*, 505 F.2d 1064, 1067-68 (10th Cir. 1974) (unclear whether or not secured party has interest in after-acquired property, but court allows status of good faith purchaser to defeat unpaid seller under § 2-702(3)); *In re Daley*, 17 U.C.C. REP. 433, 435 (D. Mass. 1975) (on a fact situation almost identical to *Samuels*, secured party holding after-acquired property interest held to defeat unpaid credit seller under § 2-702(3) because secured party is good faith purchaser); *In re Hayward Woolen Co.*, 3 U.C.C. REP. 1107, 1111-12 (D. Mass. 1967) (secured party with after-acquired property interest qualifies as purchaser for value to defeat credit seller under § 2-702(3)); *Guy Martin Buick, Inc. v. Colorado Springs Nat'l Bank*, 184 Colo. 166, 519 P.2d 354 (1974) (bank took security interest in auto dealer's inventory and advanced cash to pay wholesale dealer, thereby becoming a purchaser for value under §§ 1-201(32), (33), (44)); *Swets Motor Sales, Inc. v. Pruisner*, 236 N.W.2d 299 (Iowa 1975) (credit company took security interest in auto dealer's inventory and advanced cash to pay wholesale dealer, thereby becoming a purchaser for value under §§ 1-201(32), (33), (44)); *Jordan v. Butler*, 182 Neb. 626, 156 N.W.2d 778 (1968) (unclear whether secured party took after-acquired property interest or not, court found that the "transaction reeks of fraud" in respect of the seller and intermediaries and held the secured party a purchaser, permitting him to prevail against sellers under § 2-702(3)); *First Citizen's Bank & Trust v. Academic Archives, Inc.*, 10 N.C. App. 619, 179 S.E.2d 850 (1971) (holder of perfected security interest in after-acquired property qualifies as purchaser to defeat credit seller's bid for reclamation under § 2-702(3)); *Stumbo v. Hult*, 86 Ore. 132, 444 P.2d 564 (1968) (*dictum*) (Holder of after-acquired property security interest is purchaser because of §§ 1-201(32), (33), (44)). But see *In re American Food Purveyors, Inc.*, 17 U.C.C. REP. 436 (N.D. Ga. 1974) (court concedes that § 1-201(33) may be broad enough to include the holder of an after-acquired security interest in the definition of a purchaser, but refuses to designate such a secured party as a good faith purchaser within the meaning of § 2-702(3) and finds that the secured party acquired no rights in the collateral at least for the 10 day period provided for in § 2-702).

As a secured party whose agreement with Samuels & Co. gave it a security interest in the debtor's after acquired property<sup>134</sup> C.I.T. appears to be a "purchaser." However, it is not clear that a security interest which automatically attaches to after acquired property the moment the debtor acquires rights in that property is a "voluntary transaction creating an interest in property."<sup>135</sup> It has been suggested that, under a correct reading of section 2-403(1), a secured party who relies solely on an after acquired property clause to defeat a seller's right of reclamation is not a purchaser since its interest is not created voluntarily.<sup>136</sup> On this rationale, C.I.T., whose interest in the cattle was created by the automatic operation of the after acquired property clause, was not a purchaser.<sup>137</sup>

d. *C.I.T. as a "Purchaser for Value"*

If C.I.T. is a Code purchaser, the question remains whether it is a purchaser for value. The Code definition of "value" includes the following: "a person gives 'value' for rights if he acquires them . . . (b) as security for or in total or partial satisfaction of a pre-existing claim."<sup>138</sup>

The general view among the few courts which have dealt with the question of value in this context is that a secured party whose security agreement with the buyer predates the seller's reclamation right has given "value" for its security interest in the debtor's after acquired property.<sup>139</sup>

<sup>134</sup> Record Appendix, *supra* note 30, at 20.

<sup>135</sup> U.C.C. § 1-201(32) (emphasis added).

<sup>136</sup> This view is attributed to Justice Robert Braucher, Massachusetts Supreme Judicial Court; Chairman, Subcommittee of the Permanent Editorial Board of the Uniform Commercial Code to consider Article Two; Reporter for the Article 9 Review Committee of the Permanent Editorial Board. Justice Braucher's view is outlined in a footnote in *Countryman, Buyers v. Sellers of Goods in Bankruptcy*, 1 N.M. L. REV. 435, 458-59, n.119 (1971) [hereinafter cited as *Countryman*].

<sup>137</sup> Note the court's treatment of a secured party relying solely on an after-acquired property clause in *In re American Food Purveyors, Inc.*, 17 U.C.C. REP. 436 (N.D. Ga. 1974). There the court said:

a construction of § 2-702(3) and § 2-403 favoring [the secured creditor as against the reclaiming seller] would violate the policy of . . . § 1-106(1) which requires that [reclaiming seller's] reclamation remedies under . . . § 2-702(2) should place it in as good a position as if [buyer] had performed. § 2-702(3) was never designed to protect Article 9 secured creditors, only Article 2 "purchasers," though the court is aware that the definition of purchaser is broad enough to include an Article 9 secured creditor.

*Id.* at 441.

For the majority view, see *Hayward Woolen Co.*, 3 U.C.C. REP. 1107 (D. Mass. 1967); W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE U.C.C. 304 (1964); Hogan, *The Marriage of Sales to Chattel Security in the U.C.C.: Mass. Variety*, 38 B.U. L. REV. 571, 580-81 (1958) [hereinafter cited as Hogan]; Note, *Selected Priority Problems in Secured Financing under the U.C.C.*, 68 YALE L.J. 751, 758 (1959).

<sup>138</sup> U.C.C. § 1-201(44).

<sup>139</sup> The court in *In re Hayward Woolen Co.*, 3 U.C.C. REP. 1107 (D. Mass. 1967) stated that "Textile's [secured party relying on after-acquired property clause] pre-existing claim constitutes value." *Id.* at 1111. However, the court also noted that

Textile's pre-existing claim is not the only consideration for its 'purchase' of the goods in issue. Textile made a further advance of \$25,000.00 to [Bankrupt] on December 7, 1965, which was roughly contemporaneous with the dates on which the [unpaid sellers] delivered the goods to Hayward (December 2, 3, 6, 7 and 9, 1965).



The rationale is that the secured party acquired its rights "as security for or in partial satisfaction of a pre-existing claim." Hence, the secured party would have given "value" as defined by the Code. However, there is a minority view which suggests that a secured party must show it made an additional advance in reliance on the buyer's possession of the goods in order to be a section 2-403 good faith purchaser for value.<sup>140</sup>

C.I.T.'s security interest in the after acquired cattle was taken as security for or in partial satisfaction of its pre-existing claims against Samuels based on the regular weekly advances it already had extended. On May 23, 1969, when C.I.T. refused to make its weekly advance, Samuels & Co. owed C.I.T. more than \$1,800,000.<sup>141</sup> Under the prevalent interpretation of a pre-existing debt as "value," C.I.T. gave value.

According to the minority view, however, C.I.T. did not give value for its rights to the cattle. The cattle was purchased between May 12 and May 23, 1969.<sup>142</sup> On May 23, C.I.T. refused to make its regular weekly advance "and began taking steps to liquidate its outstanding loans to Samuels."<sup>143</sup> Consequently, C.I.T. made no advance in reliance on Samuels & Co.'s possession of the cattle and did not give value.

### III. ANALYSIS OF THE SIX OPINIONS

Having examined the complexities of the applicable law, it is tempting to sympathize with all the courts who tried to find a path through the legal maze presented by the *Samuels* case. Some of the opinions clearly were dominated by a concern for an equitable balancing of the economic realities, and this concern led to faulty legal analysis.<sup>144</sup> The final en banc opinion of the Fifth Circuit, concurred in by nine members of the fifteen judge panel, was a literal, narrow reading of the Code producing a result which overlooked both the underlying policies of the Code and the economic constraints of the meat industry.<sup>145</sup> The six opinions<sup>146</sup> will now be examined to discover whether a solution might have been reached which would not have distorted the language of the Code, yet would have given recognition to the economic realities and practical constraints of the meat industry.

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*Id.* Thus, the advance of December 7 seems to have clearly been in consideration of the security interest in the goods and not in consideration of the pre-existing claim (after-acquired property clause). This case nonetheless has been widely cited for the proposition that a secured creditor can be a good faith purchaser for value as that term is used in § 2-403(1) on the strength of an after-acquired property clause alone. See, e.g., *United States v. Wyoming Nat'l Bank*, 505 F.2d 1064 (10th Cir. 1974); *In re Daley*, 17 U.C.C. REP. 433 (D. Mass. 1975); *Stumbo v. Hult*, 86 Ore. 132, 444 P.2d 564 (1968); *First Citizen's Bank & Trust Co. v. Academic Archives, Inc.*, 10 N.C. App. 619, 179 S.E.2d 850 (1971). But see *In re American Food Purveyors, Inc.*, 17 U.C.C. REP. 436 (N.D. Ga. 1974) (*Hayward Woolen* criticized).

<sup>140</sup> Countryman, *supra* note 136, at 458-59.

<sup>141</sup> Record Appendix, *supra* note 30, at 11.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> Record Appendix, *supra* note 30, at 20-29; 483 F.2d 557 (1973), 510 F.2d 139 (1975) (dissent); 526 F.2d 1238 (1976).

<sup>145</sup> 526 F.2d 1238 (5th Cir. 1976).

<sup>146</sup> See note 9 *supra*.

A. *Opinion 1*: In the Matter of Samuels & Co., Inc., No. BK 3-1314 (W.D. Texas September 29, 1971): *Decision for Cattle Sellers*.

On May 21, 1970, fifteen unpaid cattle sellers filed suit. On September 29, 1971 the referee in bankruptcy, Elmore Whitehurst, ordered the trustee in bankruptcy of Samuels & Co. to pay the cattle sellers the purchase price of their cattle.<sup>147</sup> Referee Whitehurst's findings of fact were later adopted by the federal district court judge<sup>148</sup> and became the basis for four subsequent opinions.

In addition to the facts outlined earlier in this article, the referee made the following findings: The cattle sellers had "considered" their sales to be cash sales and had intended that title to their cattle not pass until payment had been received.<sup>149</sup> He also found that "grade and yield" sales by cattle sellers are a recognized custom and usage in the trade,<sup>150</sup> and that until the livestock is graded and the yield determined, sellers can identify their particular livestock. However, after the livestock is graded and the yield determined and the meat processed, packaged and sold, the referee stated that it becomes "impossible to trace or identify a particular seller's livestock."<sup>151</sup> The referee further found that although there was no way to determine what actual disposition was made by the bankrupt, receiver or trustee of the meat from these particular animals "at least some of the carcasses of plaintiff sellers' cattle were on hand in Samuels' plant at the time the petition under Chapter XI of the Bankruptcy Act was filed" on May 23, 1969.<sup>152</sup> Referee Whitehurst also found that "C.I.T. knew or should have known of the manner by which the bankrupt bought livestock from the plaintiffs on a grade and yield basis"<sup>153</sup> and finally that Samuels & Co. was subject to the regulations of the PSA.<sup>154</sup>

Having made these findings of fact, the referee articulated his conclusions of law.<sup>155</sup> First, he concluded that the sales of cattle were cash sales and not credit sales. The referee stated that the cash sales were made pursuant to a method sanctioned by the United States Department of Agriculture, and that it would be difficult to conceive how under the circumstances the sellers could have followed a different method of making sales for cash. To consider the transaction a credit sale, the referee reasoned, would have been contrary to the intent of the parties and would have made the cattle sellers involuntary unsecured creditors of the bankrupt subordinate to the secured claims of C.I.T.<sup>156</sup>

In addition to concluding that the cattle were sold for cash, the referee

<sup>147</sup> Record Appendix, *supra* note 30, at 9-10.

<sup>148</sup> *Id.* at 31.

<sup>149</sup> *Id.* at 25.

<sup>150</sup> *Id.* at 23.

<sup>151</sup> *Id.* at 24.

<sup>152</sup> *Id.* at 25.

<sup>153</sup> *Id.* at 26.

<sup>154</sup> *Id.* at 23.

<sup>155</sup> The referee cited neither cases nor statutes (except the PSA). He used some of the terminology of the Code to describe the conflicting claims, *e.g.*, the "perfected security interest" of C.I.T., *id.* at 20, "the security interest of C.I.T. . . . did not attach." *Id.* at 27.

<sup>156</sup> *Id.* at 28.

ruled that title and ownership of the livestock did not pass from the sellers to Samuels & Co. until payment had been made to the sellers. Accordingly, the referee determined that the security interest of C.I.T. "could not and did not attach to the livestock in question."<sup>157</sup> Since C.I.T.'s security interest in Samuels' after acquired property had not attached to the particular cattle, C.I.T. did not have an enforceable security interest in that cattle. The referee further concluded that the cattle sellers were entitled to the proceeds of the sale of the cattle. He ruled that the cattle sellers did not have the burden of tracing the proceeds of the livestock after it had been converted to meat by the bankrupt and comingled with meat received from other sources in the course of its packing business. Since the particular sale of cattle occurred on the eve of bankruptcy, the referee ruled, it was incumbent on C.I.T. to show that the trustee of Samuels did not receive "a substantial part" of the proceeds of the sale of the cattle. In light of these conclusions, the referee found that the equities were with the cattle sellers and he ruled in their favor.<sup>158</sup>

The referee was no doubt accurate in finding that these sellers intended to make cash sales and intended that title would pass to Samuels & Co. only when the sellers received payment. This conclusion reflects economic reality. Unlike credit sellers, these cattle sellers were not relying for payment on the ongoing success of Samuels & Co. and its continued sales of meat to buyers in the food chain.<sup>159</sup> Instead, the cattle sellers were relying on Samuels' present solvency when they took checks which they assumed would be honored.

The referee's opinion reflects an understandable concern for the plight of the sellers. His view of the cash sale doctrine, while a valid interpretation of pre-Code law,<sup>160</sup> however, is not a proper interpretation of the Code. The Code does not permit a seller to reserve title after delivery of the goods. Sections 1-201(37) and 2-401 expressly preclude a seller from retaining title after delivery of goods to the buyer.<sup>161</sup>

As a long-term financier of various businesses throughout the country, C.I.T. was seriously threatened by the referee's conclusion which subordinated a perfected secured creditor, claiming by virtue of an after acquired property clause, to an unpaid cash seller claiming the proceeds of unpaid for goods.<sup>162</sup> Responding to this serious threat, C.I.T. appealed the decision of the bankruptcy referee to the federal district court.

<sup>157</sup> *Id.* at 27.

<sup>158</sup> *Id.* at 28-29. Pursuant to orders of the court, the receiver and trustee had paid the funds received from collections of accounts receivable and from sale of meat to C.I.T. to be held by C.I.T. subject to the rights of other parties to prove superior claims. Accordingly, the referee was ordering C.I.T. to pay the cattle sellers out of these funds.

<sup>159</sup> See Note, *The Owner's Intent and the Negotiability of Chattels: A Critique of § 2-403 of the Uniform Commercial Code*, 72 YALE L.J. 1205, 1220 (1963).

<sup>160</sup> See text at note 100 *supra*.

<sup>161</sup> U.C.C. § 2-401(1) provides in part: "Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest." Section 1-201(37) defining a security interest contains this same sentence with a cross reference to § 2-401. Article 2's restatement of contracting parties' rights and remedies in terms of the realities of the transactions concerned rather than in terms of "title" is generally regarded as Article 2's most important innovation. See Peters, *supra* note 101, at 201.

<sup>162</sup> Record Appendix, *supra* note 30, at 28-29.

B. *Opinion 2*: In the Matter of Samuels & Co., Inc., No. BK 3-1314 (N.D. Texas November, 24, 1972): *Decision for C.I.T.*

District Judge Hughes adopted the referee's findings of fact, but reversed his conclusions of law and found for C.I.T.<sup>163</sup> The principal points of Judge Hughes' decision eventually became the theory of the final opinion in the case, the en banc opinion of the Fifth Circuit Court of Appeals, four decisions and four years later.

Judge Hughes ruled that the sellers' interests in the cattle were reservations of title under section 2-401 and were therefore Article 2 security interests under section 1-201(37) and 2-401(1). Since the cattle sellers had not perfected their security interests according to the requirements of section 9-312, she ruled that the sellers' interests in the unpaid for cattle were therefore subordinate to C.I.T.'s perfected security interest.<sup>164</sup> She stated, that under section 2-403(1), the "[cattle] sellers, by making delivery of the livestock to the bankrupt without perfecting a security interest therein . . . [enabled Samuels & Co. to] . . . transfer good title to a good faith purchaser for value including C.I.T. and the Trustee . . ."<sup>165</sup> Thus, the court concluded that even a timely demand for reclamation under sections 2-702(2) and (3), which plaintiffs had not made, would not have affected C.I.T.'s title to the cattle.<sup>166</sup> Accordingly, C.I.T.'s perfected security interest prevailed over the cattle sellers' unperfected interest in the cattle.

The district court's decision was a short statement of the applicable rules under the Code. The unique portion of her opinion was her assumption that the sale to Samuels & Co. was a credit sale. This assumption contradicted the referee's finding of fact<sup>167</sup> as well as the later rulings of the circuit judges in their majority and dissenting opinions.<sup>168</sup> There can be no quarrel with the court's statement of the main issues raised by this case under Articles 2 and 9 of the Code, only with their resolution. Because the court's principal conclusions accorded with the final en banc opinion of the Fifth Circuit, they will be discussed together with that opinion.

Since the district court's decision raised extremely complex questions under the Code, the resolution of which would affect the business decisions of the cattle sellers, the sellers appealed.

<sup>163</sup> *Id.* at 31-33.

<sup>164</sup> Judge Hughes did not mention § 9-113, the provision which, in effect, subjects "a security interest arising solely under . . . (Article Two)" (emphasis added) to Article Nine only when the debtor (Samuels) "lawfully obtain[s] possession of the goods." See text at notes 269-93 *infra*.

<sup>165</sup> Record Appendix, *supra* note 30, at 31. But see § 9-301(3) defining trustee as lien creditor.

<sup>166</sup> *Id.* at 31-32. the district court in this unexplained conclusion was classifying the sale to Samuels & Co. as a credit sale. The court also based its decision on its belief that C.I.T. would prevail under § 2-326 and that plaintiff cattle sellers failed to establish their right to reclaim under the Bankruptcy Act because they did not positively identify the property either in its original or substituted form and did not establish that either C.I.T. or the trustee received "any such property or the proceeds therefrom." *Id.* at 23.

<sup>167</sup> *Id.* at 25.

<sup>168</sup> 510 F.2d at 146; 526 F.2d at 1241, 1251. The first decision at 483 F.2d 557 does not deal with this issue. Circuit Judge Gee in a concurring opinion said "the delayed pricing arrangement transformed the 'cash sale' into a credit transaction for all commercial purposes regardless of how the two parties characterized it." 526 F.2d at 1249.

C. *Opinion 3: Samuels & Co. v. Mahon*, 483 F.2d 557 (5th Cir. 1973): *First Panel Decision for Cattle Sellers*.

In the first decision of the Fifth Circuit Court of Appeals, a divided panel reversed Judge Hughes and remanded the case for reinstatement of the referee's judgment in favor of the cattle sellers. The court ruled that the regulations promulgated under the PSA, and not the Code, determine the priority of the conflicting claims of C.I.T. and the cattle sellers.

The majority of the three judge panel<sup>169</sup> stated the issue as follows:

Is the reserved purchase money security interest provision . . . [section 9-107(1) of the Code] applicable to what would otherwise have given Samuels voidable title under . . . (section 2-403) of the Code, or do the regulations promulgated under the Packers and Stockyards Act . . . comprise a course of dealing and usage of the trade so as to modify the Code provisions and permit the reservation of title to have effect against C.I.T.'s lien without perfection by filing under the Code § 9-301?<sup>170</sup>

In reaching its decision, the court pointed out that the course of dealing and trade usage mandated by the PSA reserved to the cattle sellers a special kind of interest in the cattle sold which is "more than an unperfected security interest subject to reclamation."<sup>171</sup> In addition, the court noted, the PSA regulations provide that once a check has issued from a packer, the carcass will be processed and its identity will be lost. Consequently, the cash seller loses the right to reclaim the goods.<sup>172</sup> The court concluded that:

The [PSA] regulations and cases, therefore, consider the *packer's obligation to be that of a fiduciary* . . . and the purpose of the act to be the protection of the producer's and consumer's purse. Where the packer defaults by the issuance of a bad check (and destroys the identity of the security by processing the carcasses into fungible meat products) the seller is the *beneficiary of a trust imposed by the remedial statute*.<sup>173</sup>

Thus, the court read the PSA as creating a trust for the benefit of the cattle sellers to enable the sellers to enforce their right to reclaim the cattle.

The majority opinion of the Fifth Circuit was attacked in a vigorous dissent by Judge Godbold. Judge Godbold asserted that neither the scope of the PSA nor its regulations requiring prompt payment supplanted "what might be called the commercial law of the states."<sup>174</sup> Thus, he accused the majority of ignoring the Code in order to produce what the majority considered a just result.

The Fifth Circuit shared the referee's concern for the unpaid cattle sellers. While Referee Whitehurst escaped the Code by pretending it did

<sup>169</sup> Circuit Judges Ingraham and Ainsworth. Judge Godbold dissented.

<sup>170</sup> 483 F.2d at 560.

<sup>171</sup> *Id.* at 563.

<sup>172</sup> See text at note 71 *supra*. See Record Appendix, *supra* note 30, at 24.

<sup>173</sup> 483 F.2d at 563 (emphasis added).

<sup>174</sup> *Id.* (Godbold, J., dissenting).

not exist, the circuit judges avoided the district court's interpretation of Articles 2 and 9 by referring to a federal statute, the PSA.

In effect, the ruling of the Fifth Circuit forced the long term secured creditor of the meat packer, C.I.T., rather than the unpaid cash seller of the cattle, to bear the risk of the packer's non-payment for cattle inventory. It seemed unjust to the court, as it had to the referee,<sup>175</sup> that the secured financier should be repaid by monies derived from goods whose sellers had remained unpaid.

C.I.T. was not yet ready to give up.<sup>176</sup> It petitioned for rehearing and then for rehearing en banc.<sup>177</sup> Both petitions were denied and C.I.T. applied for certiorari to the United States Supreme Court.<sup>178</sup>

D. *Opinion 4: Mahon v. Stowers*, 416 U.S. 100 (1974): *Decision Reversed*.

The Supreme Court granted certiorari,<sup>179</sup> reversed the Fifth Circuit's decision and remanded the case for disposition under the Texas Business and Commercial Code (U.C.C.).<sup>180</sup> The Court stated that it found "no evidence in either the [PSA] or the regulations that packers are to hold *cattle* or *carcasses* in trust until the sellers actually convert into cash the checks given them as payment for each sale."<sup>181</sup> The Court noted that the PSA regulations explicitly impose trust relationships in some situations by requiring custodial accounts. The absence of a provision requiring packers to establish trust accounts on behalf of sellers until payment was actually received the Court reasoned, suggests that the Secretary of Agriculture expected "that cattle sellers, making sales to packers in the ordinary course of business, would assume the normal risks of insolvency which any seller assumes."<sup>182</sup> The Court asserted that:

[PSA] and Regulations 201.42 and 201.99 comprise a course of

<sup>175</sup> See text at note 158 *supra*.

<sup>176</sup> By this stage in the proceedings C.I.T. must have incurred legal fees close to, or more than, the \$55,000 at issue here; the finance company was represented at the three proceedings by a large Dallas law firm. See vol. V. Martindale Hubbell Law Directory, 951B-52B (199th ed. 1977). The firm filed extensive briefs on their behalf. Because of the nature of C.I.T.'s financing operations, however, the issue of the priority of C.I.T.'s security interest in its debtor's after acquired property over an unpaid seller's right to reclaim the goods or their proceeds was critical to C.I.T. Many of C.I.T.'s loans were used by the debtors as the major sources of financing for their operations. In part, C.I.T.'s security for those loans was the after acquired property of the debtor whose sellers were unpaid at the time of the debtor-buyer's bankruptcy. As in the case of the American Beef Packer Bankruptcy, see note 3 *supra*, the amounts owed to unpaid sellers can be enormous. It was therefore to C.I.T.'s advantage to litigate this vital question in an underfinanced case involving \$55,000 owed to fifteen cattle sellers, instead of litigating the issue when it arose in the context of a \$22,000,000 loss to cattle sellers from thirteen states.

<sup>177</sup> 483 F.2d 557.

<sup>178</sup> *Id.*

<sup>179</sup> 416 U.S. 100, 114 (1974).

<sup>180</sup> The Supreme Court did not designate a "winner" in its opinion.

<sup>181</sup> 416 U.S. 100, 106-07 (1974) (emphasis added). The recent amendment to the PSA remedied this omission by explicitly requiring that packers establish trust accounts for the monies received from the sale of meat and meat products until the sellers are paid. Payment in the case of check is defined as payment by the bank on which the check is drawn. See note 238 *infra*.

<sup>182</sup> *Id.* at 112.

dealing and usage of the trade known to both the bankrupt packer and C.I.T. which had financed it for an extended period. While we hold that the Act and regulations do not *ex proprio vigore* override the provisions of Texas law determining priorities, we do not mean to say that a course of conduct mandated by the Act or regulations might not, just as any other course of conduct, be relevant or even dispositive under the state law.<sup>183</sup>

The Court then remanded the case to the Fifth Circuit with directions to apply the Code.<sup>184</sup>

The Supreme Court ruled that nothing in the PSA or the regulations themselves established a fiduciary relationship which would override the Code or establish a special priority in bankruptcy for the cattle sellers.<sup>185</sup> However, the Court went to some length to suggest to the Fifth Circuit that it could be found on remand that the course of conduct between the cattle sellers and Samuels & Co., which was mandated by the federal regulations, gave the cattle sellers priority under the Code. The case returned to the Fifth Circuit on remand.

E. *Opinion 5: Samuels & Co., Inc. v. Mahon*, 510 F.2d 139 (5th Cir. 1975):  
*Second Panel Decision for Cattle Sellers.*

In its first decision the Fifth Circuit panel seemed to concede that C.I.T. would prevail under the Code<sup>186</sup> and used the PSA as a vehicle for avoiding this result. Having been told by the United States Supreme Court that the Code and not the PSA was controlling, the same panel was forced to analyze the relevant issues in the context of the Code. However, the Fifth Circuit did not follow the course suggested by the Supreme Court. Instead it based its second decision—again for the cattle sellers—on a strained reading of Articles 2 and 9.<sup>187</sup>

Referring to sections 2-507 and 2-511 of the Code, the court ruled that the sale by plaintiff cattle sellers to Samuels & Co. was a cash sale which gave the cattle sellers a right to reclaim as against Samuels & Co.<sup>188</sup> In analyzing sections 2-507 and 2-511, the court suggested that:

the underlying philosophy of the common law cash sale doctrine has been embodied here . . . the existence of a valid contractual relationship between the buyer and seller is dependent upon the buyer's completing his part of the bargain and paying for the merchandise. When the buyer fails to pay he no longer has even the right to possess the goods.<sup>189</sup>

The court then stated that the sellers' failure to assert their right to reclaim within ten days did not bar their action for three reasons. First, the

<sup>183</sup> *Id.* at 113-14.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* at 107.

<sup>186</sup> 483 F.2d at 559, 560.

<sup>187</sup> 510 F.2d 139 (5th Cir. 1975). Circuit Judges Ainsworth and Ingraham again constituted the majority and Judge Ingraham again wrote the opinion.

<sup>188</sup> *Id.* at 144-48.

<sup>189</sup> *Id.* at 146.

underlying purpose of the ten day limitation—the early identification of claims and the preservation of all creditors' rights in order to assure equitable distribution of the bankrupt's estate—had been achieved in this case with the appointment of the trustee.<sup>190</sup> Second, "the facts show that the cattle sellers had made a good faith attempt to comply with . . . the Code"<sup>191</sup> in that the cattle sellers had "apparently"<sup>192</sup> believed that Samuels continued to conduct normal operations after filing the Chapter XI petition and that accordingly "there was no need for them to assert their rights under the Code until after the adjudication of straight bankruptcy."<sup>193</sup> Finally, since most of the cattle had been destroyed by the time the petition in bankruptcy had been filed,<sup>194</sup> it would have been "an exercise in futility" for the cattle sellers to assert their right to reclaim.<sup>195</sup> In light of these considerations, the court concluded that "strict application of a ten day limitation on the right to reclaim would be unwarranted."<sup>196</sup>

The Fifth Circuit also ruled that the unpaid cattle sellers' right to reclaim was superior to C.I.T.'s unattached security interest.<sup>197</sup> In the court's view the cattle sellers' interest was not a reservation of title which would become an unperfected security interest under sections 2-401(1) and 9-113, because section 2-401 does not apply to cash sales. This conclusion was supported by the explicit provisions of section 9-102 and the comments thereto, which limit the application of Article 9 to transactions intended to create security interests.<sup>198</sup>

In the alternative, the court concluded that even if the cattle sellers had an unperfected security interest, C.I.T.'s perfected security interest still would not prevail. The court reached this result by determining that even if Samuels' possession of the cattle and its right to begin slaughtering the cattle and packaging the meat gave it "rights in the collateral" so that C.I.T.'s security interest in after acquired property attached to that cattle,<sup>199</sup> these rights were only conditional. Upon its failure to make payment under the contract, Samuels had no right to retain or dispose of the property. Since Samuels' "defeasible interest in the property . . . terminated when it failed to pay," the court ruled that "[C.I.T.'s] right, derived solely from the rights of the debtor [Samuels], also terminated."<sup>200</sup>

<sup>190</sup> *Id.* at 147. The court noted that C.I.T. had filed a petition for reclamation within two months of Samuels' Chapter XI petition which had resulted in a hearing and order by the referee. This hearing "apparently" involved "extensive disclosure of Samuels' financial affairs," and the referee's order expressly reserved for further consideration "any question pertaining to conflicting claims of liens or lien priorities." The referee's order on C.I.T.'s reclamation petition was included in the Record Appendix, *supra* note 30, at 41-45.

<sup>191</sup> 510 F.2d at 148. These facts do not appear in the referee's findings of fact. Record Appendix, *supra* note 30, at 20-27. These conclusions were apparently based on the cattle sellers' brief. Brief for Appellant at 9-10, *Stowers v. Mahon*, 483 F.2d 557 (5th Cir. 1973).

<sup>192</sup> *Id.*

<sup>193</sup> *Id.*

<sup>194</sup> The referee found that "at least some of the carcasses were on hand in the bankrupt's plant at the time the . . . Chapter XI petition was filed." Record Appendix, *supra* note 30, at 24-25.

<sup>195</sup> 510 F.2d at 148.

<sup>196</sup> *Id.*

<sup>197</sup> *Id.* at 148-51.

<sup>198</sup> *Id.* at 148-49.

<sup>199</sup> U.C.C. § 9-204(1). See text at notes 84-86 *supra*.

<sup>200</sup> 510 F.2d at 150.



After concluding that the cattle sellers as cash sellers had a right to reclaim which was superior to C.I.T.'s security interest, the circuit court decided that C.I.T. was not a good faith purchaser for value whose interest would have priority over the sellers' right to reclaim.<sup>201</sup> The court noted that the Code definition of "purchase" includes "any . . . voluntary transaction creating an interest in property."<sup>202</sup> Since Samuels had no rights in the cattle as a consequence of its failure to make payment, C.I.T. had no rights in the cattle. Lacking rights in the cattle, C.I.T. had no "interest" in that property and could not be a "purchaser" under section 2-403(1).<sup>203</sup>

The court also determined that C.I.T. lacked good faith. The court stated that "implicit in the term good faith is the requirement that C.I.T. take its interest in the cattle without notice of the outstanding claims of others."<sup>204</sup> However, C.I.T. had notice of the cattle sellers' outstanding claims due to its familiarity with Samuels & Co.'s operations. Thus, the court concluded that C.I.T. was neither a purchaser nor in good faith, and could not prevail over the cattle sellers by virtue of section 2-403(1).<sup>205</sup>

The court closed its opinion with a general appeal to the "equitable principles . . . [which] . . . govern the exercise of Bankruptcy jurisdiction," stating that:

We do not believe that the drafters of the Code intended for the unpaid sellers to walk away from this transaction with nothing, neither their goods nor the purchase price, while the mortgagee enjoys a preferred lien on that for which it refused to advance payment. Based on our understanding of the Code, such a result is unsupportable.<sup>206</sup>

Judge Godbold again dissented. In his own words, he reached his conclusion

not as a product of revealed truth, but rather of a meticulous and dispassionate reading of Articles Two and Nine and an understanding of the Code as an integrated statute whose Articles and Sections overlap and flow into one another in an effort to encourage specific types of commercial behavior. The Code's overall plan, which typically favors good faith purchasers, and which encourages notice filing of nonpossessory security interests in personalty through the imposition of stringent penalties for nonfiling, compels a finding that the perfected secured party here should prevail.

My brothers have not concealed that their orientation in the case before us is to somehow reach a result in favor of the sellers of cattle, assumed by them to be "little fellows," and against a

<sup>201</sup> *Id.* at 151-53.

<sup>202</sup> U.C.C. § 1-201(32). See text at note 132 *supra*.

<sup>203</sup> 510 F.2d at 153.

<sup>204</sup> The court cited only § 1-201(19) and "honesty in fact in the conduct or transaction concerned" and did not mention § 2-103(1)(b) applying to merchants, "the observance of reasonable commercial standards of fair dealing in the trade."

<sup>205</sup> *Id.* at 152. The court mentioned but did not discuss the requirement of § 2-403(1) that C.I.T. be a good faith purchaser *for value*.

<sup>206</sup> *Id.* at 153.

large corporate lender, because it seems the "fair" thing to do. We do not sit as federal chancellors confecting ways to escape the state law of commercial transactions when that law produces a result not to our tastes. Doing what seems fair is heady stuff. But the next seller may be a tremendous corporate conglomerate engaged in the cattle feeding business, and the next lender a small town Texas bank. Today's heady draught may give the majority a euphoric feeling, but it can produce tomorrow's hang-over.<sup>207</sup>

C.I.T. petitioned the Fifth Circuit for a rehearing en banc which was granted.

F. *Opinion 6: Samuels & Co., Inc. v. Mahon*, 526 F.2d 1238 (5th Cir. 1976): *En Banc Decision for C.I.T.*

On February 17, 1976, six decisions after the petition was filed and almost six years later, the Fifth Circuit Court of Appeals sitting en banc reversed its previous majority opinion (hereinafter "panel decision"),<sup>208</sup> affirmed the district court opinion,<sup>209</sup> adopted Judge Godbold's second dissenting opinion as the majority opinion en banc and found for C.I.T.

In the en banc opinion, written by Judge Godbold, the court reached four major conclusions. First, C.I.T. was a good faith purchaser for value entitled to prevail over sellers under section 2-403(1). The court reached this conclusion by first stating that the Code's definition of "purchaser" as one who takes "by . . . any . . . voluntary transaction creating an interest in property" was broad enough to include an Article 9 secured party such as C.I.T.<sup>210</sup> Since purchasers can take from defaulting cash buyers under section 2-403(1), the court determined that a defaulting cash buyer must, by definition, have sufficient rights in the property, "however marginal"<sup>211</sup> to allow attachment of the security interest. If this were not the intent of the Code, section 2-403(1)(b) would be meaningless since that subsection provides expressly that a good faith purchaser for value can acquire good title from a buyer who had paid for the goods with a bad check. Therefore, the court concluded, Samuels had "rights in the collateral" upon its receipt of the cattle and C.I.T.'s security interest attached at that time.<sup>212</sup>

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<sup>207</sup> *Id.* at 154. Judge Godbold's view of the majority decision was generally shared by commentators. See Note, *The Right of an Unpaid Cash Seller to Reclaim Goods is Superior to the Floating Lien of an Inventory Financer*, 9 CREIGHTON L.R. 412, 417 (1975); Note, *Seller's Right to Reclaim Has Priority Over a Perfected Security Interest*, 7 ST. MARY'S L.J. 462, 466 (1975). But see Dugan, *Cash Sale Sellers Under Articles 2 and 9 of the U.C.C.*, 8 U.C.C.L.J. 330 (1976). For comments on the first panel decision see Note, *Priority of Liens in Secured Transactions - Packers of Stockyards Act Alters U.C.C.*, 42 FORDHAM L. REV. 716 (1974); Note, *Federal Regulations of Meat-packers Supersede the Priority in Bankruptcy of a Perfected Security Interest Under the Uniform Commercial Code*, 52 TEX. L. REV. 570 (1974).

<sup>208</sup> In order to avoid confusion, the second majority opinion of the Fifth Circuit panel at 510 F.2d 139 will be referred to as "the panel decision" and the majority as "the panel."

<sup>209</sup> The en banc opinion also affirmed and explicated the principal bases of the district court's original decision relying on Articles 2 and 9 of the Code. See text at notes 163-66.

<sup>210</sup> 526 F.2d at 1242.

<sup>211</sup> *Id.* at 1243.

<sup>212</sup> *Id.*

Once C.I.T.'s security interest properly attached, the court determined, it did not terminate upon Samuels' nonpayment. The "whole point of Article Nine is the continuity of perfected security interests *once they have properly attached*, despite subsequent loss of control or possession of the collateral by the debtor. § 9-201."<sup>213</sup> The court recognized that, as against the sellers, Samuels' failure to pay deprived it of the *right* to retain or dispose of the goods. However, the court also noted that the Code expressly gives a seller in a cash sale the power to transfer good title to a good faith purchaser for value when goods have been delivered even though the goods were paid for by a check later dishonored.<sup>214</sup> Thus, C.I.T. was a purchaser.

The court then decided that C.I.T. had acted in good faith. The court stated that, rather than requiring lack of knowledge of third party claims as an element of good faith, the Code, under Articles 1 and 2, requires only honesty in fact, reasonable commercial behavior and fair dealing. "The Code's good faith provision requires 'honesty in fact,' . . . it hardly requires a secured party to continue financing a doomed enterprise."<sup>215</sup>

The Fifth Circuit opinion did not discuss "value" in the context of C.I.T.'s qualifications as a good faith purchaser for value under section 2-403. However, in ruling that C.I.T. had a "perfect[ed] Article Nine security interest which extend[ed] to the goods claimed by the seller[s],"<sup>216</sup> the court ruled that Samuels' preexisting indebtedness of \$1.8 million constituted value for the purposes of the attachment of C.I.T.'s security interest.<sup>217</sup> Thus, the court concluded that C.I.T. was a good faith purchaser for value under section 2-403.

As its second major conclusion, the court ruled that the unpaid cattle sellers' interest was an unperfected security interest under sections 2-401(1) and 9-113. The panel had ruled that section 2-401(1) does not apply to cash sales and therefore that the cattle sellers retained an interest greater than a security interest. Characterizing this as a "restrictive interpretation" of section 2-401(1), without justification in the policies of the section or the language of the Code, the court noted that many courts have applied section 2-401(1) to cash sales.<sup>218</sup> The Fifth Circuit also expressly rejected the panel's view that Article 9 governs only consensual security interests and that no such interest was intended here: "While it is true that many interests governed by Article Nine are consensual, . . . the Code clearly subjects Article Two security interests arising not by consent but by operation of law to Article Nine."<sup>219</sup> Accordingly, the sellers' interest in the cattle was subject to Article 9. Since the sellers did not satisfy Article 9's filing and notification requirements, the court concluded that the cattle sellers had an unperfected security interest.

The third major conclusion was that C.I.T., as the holder of a perfected Article 9 security interest in the collateral claimed by the sellers, would prevail over the sellers' unperfected security interest under Article 9.

<sup>213</sup> *Id.* at 1247 (emphasis in original).

<sup>214</sup> *Id.*

<sup>215</sup> *Id.* at 1243-44, citing U.C.C. § 1-201(19).

<sup>216</sup> 526 F.2d at 1242.

<sup>217</sup> *Id.*

<sup>218</sup> *Id.* at 1246.

<sup>219</sup> *Id.* at 1247, citing U.C.C. § 9-102 & Comment.

Since the three requirements for attachment under section 9-204(1), agreement, value, and rights in the collateral, were satisfied, C.I.T.'s security interest attached to the cattle. In the court's opinion, the security interest in Samuels' after acquired inventory was authorized by the 1963 security agreement which remained in effect. C.I.T.'s preexisting debt constituted "value," and upon delivery of the cattle Samuels acquired sufficient "rights in the collateral."<sup>220</sup>

The court observed that the sellers never perfected their purchase money security interest under section 9-312, which would have given them priority over C.I.T. Under Article 9's priority rules, an unperfected security interest is subordinate to a perfected security interest. Therefore, the court necessarily concluded that the sellers' interest was subordinated to C.I.T.'s interest and that "in this case [the sellers] lose the whole of their interests."<sup>221</sup>

The court's final conclusion was that the sellers' right to reclaim is subject to the rights of good faith purchasers for value and was waived by the cattle sellers' failure to reclaim within ten days. The court called the cash seller's right to reclaim a "judicially-confected right"<sup>222</sup> which is never good as against third parties who are good faith purchasers from the buyer. This right is strictly limited by "the Code's absolute requirement in Section 2-507, Comment 3, invariably adhered to by the courts, that demand for return be made within 10 days after receipt or else be lost."<sup>223</sup> In addition, the right to reclaim in either cash or credit sales does not extend to the proceeds of the goods. Whenever the Code recognizes an interest in proceeds "it does so expressly."<sup>224</sup>

A new petition to the Supreme Court for certiorari was denied on October 4, 1976.<sup>225</sup> Judge Godbold's en banc opinion is therefore the final law of the *Samuels* case. It was, as he stated himself, "a meticulous reading of Articles Two and Nine."<sup>226</sup> It was indeed meticulous, but misguided.

#### IV. ECONOMIC REALITY, PIECEMEAL SOLUTIONS AND THE CODE

##### A. *Economic and Legislative Context*

Thus endeth the long, unhappy saga of the fifteen cattle sellers, Samuels & Co., and C.I.T. The conclusion is undesirable for a number of reasons. From an economic perspective, the rule of *Samuels* is undesirable because it increases transaction costs in the meat industry, and because it inefficiently allocates the burden of the risk of meat packer losses.

Under the *Samuels* decision, in order to prevail over prior perfected non-purchase money security interests cattle sellers have to comply with the

<sup>220</sup> 526 F.2d at 1242-43. The court did not discuss the additional requirements for perfection and enforceability of a security interest, *viz.*, filing and the existence of a security agreement.

<sup>221</sup> *Id.* at 1248, *citing* U.C.C. §§ 9-201, 9-301, 9-312(5).

<sup>222</sup> 526 F.2d at 1244.

<sup>223</sup> *Id.* at 1244-45.

<sup>224</sup> *Id.* at 1245.

<sup>225</sup> 429 U.S. 834(1976).

<sup>226</sup> 526 F.2d at 1241.

filing and notification requirements of section 9-312(3) of the Code. This section provides:

A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and

(b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and

(c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

To have perfected its security interest under section 9-312(3), therefore, each cattle seller would have had to give the required notice to all prior holders of conflicting security interests in the buyer's property before the seller delivered any cattle. The seller would have had to give this notice to all secured parties known to the sellers to have interests in the same type of inventory and to all secured parties who had filed a financing statement covering the same type of inventory. This means that each cattle seller would have had to check the records in the office of the Secretary of State in Austin to ascertain which secured lenders had filed financing statements covering security interests in the inventory of each buyer. In addition, before delivering the cattle to a buyer, each seller would have had to file a financing statement in the Secretary of State's office signed by the proper officer of that buyer.

In the case of the livestock seller who sells to many different buyers the practical effect of compliance with these requirements would be total disruption of the existing pattern of business practices in selling and shipping of livestock. Every livestock seller would have to retain a lawyer in Austin to check the records for prior security interests. Delivery would be delayed for several days while financing statements signed by the buyer were sent to Austin for filing. The cattle would have to be fed with costly grain for several days longer before slaughter.<sup>227</sup> The total cost of the production of beef certainly would be increased.

It might be assumed that the ultimate consumer, the meat eater, would bear the entire increase in cost. However, the issue is not so simple. The ability of the different actors in any industry to shift costs depends on many factors including the elasticity of supply and demand.<sup>228</sup> Un-

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<sup>227</sup> Interview with Randy Cox, rancher, Great Falls, Montana (Feb. 9, 1977) (notes on file with the author).

<sup>228</sup> Reflection will show that in an industry in which a slight rise in price will drastically reduce the amount customers will purchase, it will be nearly impossible for a firm to shift a cost forward. Conversely, the firm can shift costs most easily when the amount purchased will

doubtedly, it is much easier to eliminate a transaction cost than to predict who will bear it. And even if one could analyze the meat industry and determine the distribution of a transaction cost within it, this should be no guide to lawmaking. The Code extends to every industry, cash sellers in every industry who take payment by check are affected by this decision, and there is no reason to expect that the distribution of a transaction cost within one industry will resemble the distribution of the same cost in any other industry. Thus all that can be concluded with certainty is that the *Samuels* rule would increase the total cost of beef production.

The second undesirable effect of the *Samuels* rule is its inefficient and expensive allocation of risk. The rule of *Samuels* is that a perfected secured creditor, such as C.I.T., relying solely on an after acquired property clause will prevail as a good faith purchaser for value over a cash seller, such as the cattle sellers, exercising a right of reclamation. This rule applies even when the demand for reclamation is made within the proper time limit. As between the cattle sellers and C.I.T., this rule places the risk of *Samuels'* insolvency on the cattle sellers. The issue here is not one of equity between the little cattle sellers and the big finance company. After all, a feedlot may be a tax shelter for wealthy investors and a lender a credit union owned by small shareholders investing retirement income. The issue is a conflict between an *already existing efficient* mechanism for risk pooling as against an unequipped, uninformed risk evaluator.

Accurate information about business risk is expensive. A centralized organization whose specialty is risk evaluation can achieve information economy.<sup>229</sup> Lending institutions, such as C.I.T., can accurately and efficiently estimate failure probability, evaluate the cost to a lender of the borrower's default and distribute these costs through its interest rates. In contrast, it would be very costly for many individual cash sellers, such as the cattle sellers, to obtain this kind of information, and they usually would not have the expertise to evaluate such information accurately. If the ignorant take risks, they are likely to be wrong and incur a loss, thereby increasing the transaction costs and the total social costs. The allocation of the risk to C.I.T. therefore would provide the least expensive, most effective risk pooling and the entire industry would benefit.<sup>230</sup>

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drop almost not at all when the price goes up. Similarly, the firm will find it easy to shift costs to customers where any decline in price results in a drastically reduced supply, and hard to shift costs where supply changes little with price. At the same time, even if it cannot raise its selling price to cover an increased cost, it may be able to maintain its profit by reducing the price it pays for factors of production. See generally E. MANSFIELD, *MICROECONOMICS, THEORY AND APPLICATION*, 101-10, 253-55, 408-09 (2d ed. 1970).

<sup>229</sup> Evaluation of the risk that a loan will not be repaid is, of course, at the essence of the decision making process of all lenders—banks, C.I.T., General Motors Acceptance Corporation. This evaluation is reflected in the decision whether to lend and then in the interest rates charged to the borrower. Thus the critical special expertise of a lender is risk evaluation.

<sup>230</sup> Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 501-02, 507-09 (1976). See also K. ARROW, *ESSAYS IN THE THEORY OF RISK BEARING* 134-36 (1971).

In industries where the cash seller is the sole source of the buyer's inventory (e.g. automobile manufacturer selling to dealer) this rationale may be thought to be less persuasive. Giant manufacturers may well have the resources and expertise to evaluate accurately and efficiently their dealers' financial strengths and weaknesses. These suppliers may in fact already be in the risk evaluation business. But even in the one supplier situation there is generally a lending institution which is extending credit to the buyer by paying the supplier on a cash

The undesirable economic consequences of the *Samuels* rule would primarily affect cattle sellers, whose financial stability also has been threatened by other events. Their financial stability already has been undermined by the failure of one hundred sixty-seven meat packers from 1958 to 1975. These failures resulted in the loss of over forty-five million dollars by American livestock sellers. The 1975 bankruptcy of American Beef Packers, Inc., the "grand-daddy of all packer failures,"<sup>231</sup> left livestock sellers with bad checks totalling over twenty million dollars. Over forty million dollars has been collected in receivables from the livestock sold since the bankruptcy filing.<sup>232</sup> None of this money has gone to pay the livestock sellers.<sup>233</sup>

The state and federal response to these crippling losses by cattle sellers has been legislation creating new statutory priorities for cattle sellers which would exempt them from the application of the general scheme of Article 9 of the Code. The Texas legislature passed a law specifically for the protection of sellers of livestock for slaughter.<sup>234</sup> That statute gives livestock sellers, upon delivery of the livestock to the purchaser, an attached, perfected lien on "such animal, its carcass, all products therefrom, and proceeds thereof,"<sup>235</sup> in order to secure payment of the purchase price. This lien has priority over any other lien or perfected security interest in the livestock, its carcass, all products therefrom and proceeds thereof.<sup>236</sup> The federal legislative response was to create another kind of exception to Article 9.<sup>237</sup> After extensive congressional hearings, Congress amended the PSA to establish a trust for unpaid cash sellers of livestock in their livestock and its proceeds in the hands of the packer.<sup>238</sup>

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basis, and it is highly inefficient to *require* a duplication of the credit extending function. "The ultimate objective of the credit process is to minimize the overall social costs of capital through a complex allocation of costs, including the disutility of the risk, between the borrower and the lender." Posner, *supra* at 509. It would, of course, be possible for cattle sellers to create an entirely new lending risk evaluating institution and/or insurance company of their own of some kind. This inquiry has been limited to who is the superior risk bearer in this situation given the existing institutions.

<sup>231</sup> *Hearings on H.R. 8410, supra* note 3, at 72-73 (statement of B.H. Jones, National Livestock Feeders Association).

<sup>232</sup> *Id.*

<sup>233</sup> *Id.*

<sup>234</sup> PAYMENT FOR LIVESTOCK PURCHASED FOR SLAUGHTER ACT, TEX. REV. CIV. STAT. ANN. art. 6910b (Vernon Supp. 19A, 1976-77).

<sup>235</sup> *Id.* § 4.

<sup>236</sup> *Id.* §§ 5, 7.

<sup>237</sup> Article 9 does expressly exempt from its coverage liens "given by statute or other rule of law for services or materials." Section 9-104(c) Comment 3 explains that the drafters had in mind liens determined in large part by local conditions and "far removed from ordinary commercial financing." Cattle seller's liens would seem to have everything to do with ordinary commercial financing.

<sup>238</sup> The amendment to the PSA, Act of September 13, 1976, Pub. L. No. 94-410, 90 Stat. 1251 (codified at 7 U.S.C. § 196 (1976)), states in part:

§ 206(a). It is hereby found that a burden on and obstruction to commerce in livestock is caused by financing arrangements under which packers encumber, give lenders security interest (sic) in, or place liens on, livestock purchased by packers in cash sales, or on inventories of or receivables or proceeds from meat, meat food products, or livestock products therefrom, when payment is not made for the livestock and that such arrangements are contrary to the public interest. This section is intended to remedy such burden on and obstruction to commerce in livestock and protect the public interest.

## CASH SELLERS AND SECURED FINANCERS

All of this legislative activity should have been unnecessary. Unpaid cash sellers who exercise their right to reclaim their goods or the proceeds within a time limit which is reasonable under all the circumstances, should prevail *under the Code* over a secured creditor claiming only by virtue of an after acquired property clause. Both the policies and the provisions of the Code are consistent with this result.

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(b) All livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat, meat food products, or livestock products derived therefrom, shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers: *Provided*, that any packer whose average annual purchases do not exceed \$500,000 will be exempt from the provisions of this section. Payment shall not be considered to have been made if the seller receives a payment instrument which is dishonored: *Provided*, that the unpaid seller shall lose the benefit of such trust if, in the event that a payment instrument has not been received within thirty days of the final date for making a payment under section 409, or within fifteen business days after the seller has received notice that the payment instrument promptly presented for payment has been dishonored, the seller has not preserved his trust under this subsection. The trust shall be preserved by giving written notice to the packer and by filing such notice with the Secretary.

(c) For the purpose of this section, a cash sale means a sale in which the seller does not expressly extend credit to the buyer . . . .

Sec. 410. No requirement of any State or territory of the United States, or any sub-division thereof, or the District of Columbia, with respect to bonding of packers or prompt payment by packers for livestock purchases may be enforced upon any packer operating in compliance with the . . . prompt payment provision of section 409 of this Act . . . . *Provided*, That this section shall not preclude a State from enforcing a requirement, with respect to payment for livestock purchased by a packer at a stockyard subject to this Act, which is not in conflict with this Act or the regulations thereunder: *Provided further*, That this section shall not preclude a State from enforcing State law or regulations with respect to any packer not subject to this Act . . . .

The major difference between the PSA amendment and the Texas statute, see text and notes 235-36 *supra*, is that while the Texas statute creates a lien effective automatically upon delivery of the livestock to the buyer, the PSA amendment requires that the trust be preserved by notice to the packer and the Secretary after a specified time. To some degree, both statutes create preferences which overlap areas covered by the Bankruptcy Act, §§ 1-755, 11 U.S.C. §§ 1-1255 (1970).

For the purposes of the Bankruptcy Act, a statutory lien is a "lien arising *solely* by force of statute upon specified circumstances or conditions," 11 U.S.C. § 1(29a) (1970) (emphasis added). Collier suggests that a statutory trust designed to protect one class of creditors should be treated as the functional equivalent of a statutory lien, 4 COLLIER ON BANKRUPTCY, ¶ 67.25(2) (1976). The courts may well take a different view, however, since the PSA trust requires the cattle seller to file with the Secretary in order to preserve the trust, and thus it could be argued that although the trust functions like a statutory lien, the trust does not arise solely by force of statute.

Assuming, however, that the courts would be willing to treat the PSA cattle sellers' trust as a statutory lien, § 67(b) of the Bankruptcy Act, 11 U.S.C. § 107(b) (1970), would make both the federal trust and the Texas lien valid against the trustee since they were established by statute to protect an economic class, provided they were not invalidated by § 67(c) of the Act, 11 U.S.C. § 107(c). This would be true even if there remained some legal proceedings prerequisite to the realization of benefit from the liens. 4 COLLIER ON BANKRUPTCY, 67.20(9) (1976). Briefly, section 67(c)(1) of the Bankruptcy Act invalidates the following liens against the trustee: (1) Statutory liens which become effective only upon the insolvency of the debtor, (2) statutory liens which are not enforceable against a bona fide purchaser on the date of the bankruptcy, and (3) statutory liens for rent. Since neither the federal trust nor the Texas lien in favor of cattle sellers falls into any of the § 67(c)(1) exclusions, they would be valid against the trustee.

Since the PSA amendment only applies to packers purchasing more than \$500,000 on



The *Samuels* rule applies to similar conflicts between cash sellers and secured lenders in all industries governed by the Code. There is every reason to believe that when the rule has similar effects on another industry which has access to the federal government, there again will be particular legislation to protect that industry's cash sellers. One of the purposes of the Code was to create broad general rules applicable to all commercial transactions. This purpose is defeated by piecemeal legislative solutions to the universal problems of risk allocation.

### B. *Proposed Solution Under the Code*

The Fifth Circuit's interpretation of the Uniform Commercial Code is not flexible enough to provide an equitable resolution to this very real economic conflict between unpaid cash sellers and secured financiers. The en banc opinion expressed the view that the sellers' losses were easily avoidable, since the sellers "merely" had to comply with the Code's filing provisions in order to perfect their purchase money security interests which would then have priority over C.I.T.'s security interest.<sup>239</sup> "As it happens," the court remarked, "the sellers did not perfect."<sup>240</sup> Of course the sellers did not perfect; the steps required for perfection, as discussed above, typically would be impractical, cumbersome and expensive. It seems ludicrous to interpret the Code in a manner which disrupts business patterns developed to decrease expenses of production,<sup>241</sup> and which compels a cash seller to increase costs in order to protect itself against bad checks.<sup>242</sup> A better understanding of the commercial transactions involved coupled with a more creative, less mechanical reading of the Code leads to an equitable resolution of this conflict, a conflict not unique to the meat industry.

This proposed solution under the Code is based on the following major premises. First, the transactions in question were cash sales and *Samuels'* failure to pay gave the cattle sellers a right of reclamation. Second, the cattle sellers did not lose their right to reclaim by their delay. Third, the cattle sellers' right to reclaim extended to the proceeds of the

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an annual average, and since the amendment expressly disavows preemption regarding packers not covered by the amendment, only the Texas statute applies where cattle sellers deal with the smaller packers. Sellers dealing with larger packers, however, may find a conflict as to whether the PSA amendment or the Texas statute is the applicable lien law for purposes of the Bankruptcy Act. This would be of particular importance if the courts refused to treat the PSA trust as a statutory lien.

It is clear that the PSA amendment preempts all contrary state laws, but preemption is unclear in the situation where the state law has the same purposes but affords more protection. A full discussion of constitutional preemption is beyond the scope of this article. It is submitted, however, that the PSA amendment ought not to preempt the Texas statute. The intent of Congress in passing the PSA amendment was to provide a minimum safeguard for cattle sellers. Rather than being an obstacle to this purpose, the Texas statute provides greater protection to the cattle sellers by making perfection of the lien automatic upon delivery of the cattle. Furthermore, the language of the statute explicitly permitting states to enforce statutes which do not conflict with the PSA is strong support for the argument that Congress has not occupied the field. See *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 143 (1962), approved in *De Canas v. Bica*, 424 U.S. 351, 356 (1976). See Burke, *Secured Transactions*, 32 BUS. LAW. 1133, 1152 (1977).

<sup>239</sup> 526 F.2d at 1247.

<sup>240</sup> *Id.* at 1244.

<sup>241</sup> See note 22 *supra*.

<sup>242</sup> See text at notes 21-22 *supra*.

cattle. Fourth, C.I.T. was not a good faith purchaser for value who prevails over an unpaid cash seller exercising a right to reclaim. Fifth, even if the cattle sellers lost their right of reclamation due to delay, they had a perfected Article 2 security interest in the cattle which was not subordinate to C.I.T.'s perfected Article 9 security interest. This solution will now be examined in detail.

1. The Transactions between the Cattle Sellers and Samuels & Co. were Cash Sales and Samuels' Failure to Pay gave the Sellers a Right to Reclaim.

The decisions in the case, the referee's findings of fact as to the intent and understanding of the sellers,<sup>243</sup> and the realities of the economic relationships between cattle sellers and packers all support the conclusion that the transactions in the *Samuels* case were cash sales.<sup>244</sup> The delay imposed by the PSA regulations<sup>245</sup> of approximately forty-eight hours from the time of delivery of the cattle to the issuance of the checks by Samuels was a long standing usage of the trade.<sup>246</sup> This delay did not change the understanding of the parties about either the nature of the transaction or its legal effect. Although a cattle seller always would prefer to sell on the hoof for immediate payment based on live weight, in a buyer's market the seller usually does not have the leverage to do so. The PSA regulations provide that when a seller sells on a grade and yield basis, the packer must pay within two or three days. The cattle sellers in *Samuels* by selling on a grade and yield basis, were not relying on Samuels' future receivables to enable Samuels to pay for the cattle. Rather, they were relying on Samuels' *present* solvency, and they viewed the checks as cash payment.<sup>247</sup>

It could be argued, of course, that under the literal language of the Code the transaction in *Samuels* was not a cash sale. Section 2-507(2), dealing with cash sales, states that "where payment is due and demanded on the delivery to the buyer of the goods, the buyer's right as against the seller to retain or dispose of them is conditional upon his making the payment due." There is no question that payment was neither "due" nor "demanded" by the sellers on delivery of the cattle to Samuels. Thus, under a literal reading of section 2-507(2) the transaction was not a cash sale. Such a construction, however, would transform every seller on a grade and yield basis into a creditor. Cash sales under the grade and yield regulations of the PSA would be impossible.

A narrow, literal construction of the concept of the cash sale<sup>248</sup> has been expressly rejected by the Code in its treatment of payment by check. Section 2-511 makes it clear that payment by check although "conditional and defeated as between the parties by dishonor" does not convert a trans-

<sup>243</sup> Record Appendix, *supra* note 30, at 24.

<sup>244</sup> See U.C.C. §§ 2-507(2), 2-511(3).

<sup>245</sup> See text at notes 55-58 *supra*.

<sup>246</sup> Record Appendix, *supra* note 30, at 23.

<sup>247</sup> The obvious question is why the cattle sellers do not ask for certified checks from packer-buyers. The equally obvious answer is that the sellers do not have sufficient economic leverage to do so.

<sup>248</sup> For a history of the doctrine of cash sale, see 2 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT, §§ 342-44 (1948). Professor Williston explained in § 343 that "[c]onfusion may be caused by use of the words 'cash sale' or 'terms cash' by businessmen. In business dealings these words are frequently used

action into a credit sale.<sup>249</sup> The purpose of this section is explained in Comment 4 as the recognition of payment by check as a "commercially normal and proper practice" which "is not to be penalized in any way."

An analogous approach should be taken to the type of transaction in *Samuels*. The delivery of goods with payment postponed for the sole purpose of determining the price by weighing and grading—and only for the period required to make that determination—is a normal commercial practice which is not understood or intended by the parties as a credit sale.<sup>250</sup> The construction of these transactions as cash sales by the Fifth Circuit in its panel and en banc decisions, therefore, was not an extension of the concept of cash sales, but rather was a proper characterization of a way to achieve a statutory purpose which is also economically desirable.

## 2. Cattle Sellers did not Lose their Right of Reclamation by Failing to Make a Demand for the Goods within Ten Days.

Sections 2-507(2) and 2-511(3) contain no express statement of a cash seller's right to reclaim unpaid for goods in the event of dishonor of a check or a buyer's insolvency. The implication of this right from the language of these provisions, however, is entirely logical. Comment 3 to section 2-507 states that the ten day limitation on the exercise of a credit seller's right of reclamation applies to cash sellers.

If the statute itself had imposed a ten day limitation on a cash seller's right to reclaim, Judge Godbold's statement in the en banc opinion that "the Code's ten day provision is an absolute requirement,"<sup>251</sup> would be defensible. But the ten day limitation comes from the Comment, not the statute. This raises the question of the force of the Comments to the Code.

The Comment to the Title states that the drafters intended the comments to be an "aid in uniform construction . . . in viewing the [U.C.C.] as an integrated whole and to safeguard against misconstruction."<sup>252</sup> There is no indication that the Texas legislature considered the comments before adopting the Code. It would seem clear that when a statutory provision, such as 2-507(2), does not support a statement in a comment, the comment should be rejected.<sup>253</sup>

when in reality a short period of credit is contemplated. In such a case it is clear that there is no cash sale in the legal sense." Speaking directly to the situation where negotiable paper is given in a supposed 'cash sale,' he continues that:

A very common kind of transaction where the transfer of the property in goods is conditional on the buyer's performance of his promise is where the buyer is, by the terms of the bargain, to give negotiable paper. In such a case there is less reason to construe the bargain as a transfer of the property with a lien in favor of the seller for the desired security than where the bargain calls for payment of the price in cash, since negotiable paper may be executed at any time when the parties have made up their minds that the property shall pass; whereas the actual payment of the price may be inconvenient at the time when the bargain is agreed upon.

*Id.* § 344.

<sup>249</sup> See text at note 117 *supra*.

<sup>250</sup> Record Appendix, *supra* note 30, at 24.

<sup>251</sup> 526 F.2d at 1245.

<sup>252</sup> U.C.C. Title, Comment. The Texas Business and Commerce Code (U.C.C.), *supra* note 12, omits this comment.

<sup>253</sup> See *Consolidated Film Indus. v. United States*, 547 F.2d 533, 536 (10th Cir. 1977).

If a court chose to analogize a cash seller's right of reclamation to a credit seller's right, the cattle sellers in the *Samuels* case might well have lost their right to reclaim the cattle by their failure to reclaim within ten days. The ten day limitation on the credit seller's right of reclamation, however, does not apply if a "misrepresentation of solvency has been made to the particular seller in writing within three months of the delivery" of the goods.

On the facts of *Samuels* it is reasonable to assume that the packing company knew of the likelihood that the checks it issued to pay for this cattle would be dishonored. *Samuels & Co.* certainly knew its own shaky financial condition. Therefore, it also must have known that C.I.T. might refuse the next weekly advance. On the basis of these facts the issuing of these checks could be analogized to a misrepresentation of solvency. If the purpose of the misrepresentation exception is to penalize a buyer's deliberate misrepresentations of solvency to a seller, this policy would dictate that this exception be applied to the cash seller as well. And if the view that Comment 3 to section 2-507 controls here is accepted, then as between cattle sellers and *Samuels & Co.*, the sellers had an unlimited time in which to make a demand for reclamation of their goods.

Alternatively, if the better position is taken that the statute, and not the Comment, controls, then there is no statutory time limit on a cash seller's right of reclamation. However, both the absence of *any* statutory time limit on a cash seller's right of reclamation and the rational policy need for *some* time limitation, argue for the use of a flexible time limit such as a "reasonable time." It is necessary to place a time limit on the cash sellers' right to reclaim, "to promptly disclose and identify the claim[s] in the bankrupt's estate so that other creditors' claims are not prejudiced."<sup>254</sup> The reasonableness of the time should be judged by whether any creditor of, or purchaser from, the defaulting buyer relied on the buyer's possession of the goods.

In *Samuels* the cattle sellers filed their petition on May 20, 1970, one year after *Samuels & Co.* filed a petition for reorganization under Chapter

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(court refused to follow the Comment to 9-302(1) on grounds that Utah had not adopted the comment and a more equitable result could be reached on the plain words of the statute); *In re Bel Air Carpets*, 452 F.2d 1210, 1211, 1212 (9th Cir. 1971) (The court rejected the statement in U.C.C. § 2-702(2) Comment 2 that a written misrepresentation of solvency must be "dated within three months of the delivery" (emphasis added). Citing policy, the court adopted the view that such a misrepresentation must be *delivered* within three months to fall under § 2-702(2).); *Wright v. Bank of Cal.*, Nat'l Ass'n, 276 Cal. App. 2d 485, 490, 81 Cal. Rptr. 11, 14 (1969) ("The plain language of the Statute cannot be varied by reference to the comments."); *Frericks v. General Motors Corp.*, 278 Md. 304, 314-15, 363 A.2d 460, 464 (1976) (court held that under § 2-607 there is no notice of injury required for non-"buyers," specifically rejecting Comment 5 because (1) the comments were not enacted by the legislature and (2) the statutory language itself clearly mandated this result, thus making it unnecessary to reach the Comment). *But see* Editor's note, 20 U.C.C. REP. 1361 (1977).

The 1952 edition of the Code, § 1-102(f), provided: "The comments of the National Conference of Commissioners on Uniform State Laws and the American Law Institute may be consulted in the construction and application of this Act but if text and comment conflict, text controls." The 1957 edition of the Code deleted this provision as recommended by the 1956 Recommendations of the Editorial Board for the Uniform Commercial Code. The reason presented was that "... the old comments were clearly out of date and it was not known when new ones could be prepared." Revised Comments were prepared for the 1957 and 1958 editions but § 1-102(f) has never reappeared. *See generally* Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 WISC. L. REV. 597.

<sup>254</sup> 510 F.2d at 147.

XI and three weeks after Samuels & Co. was adjudicated a bankrupt.<sup>255</sup> However, as the panel opinion emphasizes, extensive disclosures of Samuels' financial affairs had taken place two months after the filing of the Chapter XI petition at a hearing before Referee Whitehurst.<sup>256</sup> This hearing was pursuant to a petition for reclamation filed by C.I.T. on July 23, 1969. The referee's order expressly "reserved for further consideration any question pertaining to conflicting claims or lien or lien priorities."<sup>257</sup> Thus, C.I.T. knew of the cattle sellers' outstanding claims two months after Samuels' insolvency and could not have been prejudiced by the cattle sellers' delay.

Since no actual creditors were harmed, and C.I.T., the competing creditor, had knowledge of the sellers' claim soon after the defaulting buyer's receipt of the goods, the purpose of a time limitation is satisfied. In a situation such as this, the sellers should not be barred from asserting their claim.<sup>258</sup>

### 3. The Right of Reclamation of the Goods includes the Right to Reclaim the Proceeds of those Goods.

The purpose of the reclamation right is to give a defrauded seller the right to recover from a defrauding buyer. The Code is silent as to the rights of sellers to reclaim the proceeds of the unpaid-for goods. To say that this right, as between the parties, is cut off by transformation of the goods into proceeds defeats the statutory purpose. In *Samuels*, any right to reclaim, limited to the goods, was illusory because the goods—meat—were sold under the direction of the court "with proceeds to be held subject to the order of the court."<sup>259</sup> In addition, the PSA regulations required that the goods—livestock—be transformed into proceeds—meat—immediately upon delivery.<sup>260</sup> A buyer's compliance with the requirements of the applicable federal law should not deprive a defrauded seller of his Code right to reclaim. The cattle sellers' right to reclaim should include the right to reclaim the proceeds of the cattle.

### 4. C.I.T. is not a Good Faith Purchaser for Value and cannot take Good Title from Samuels & Co. under Section 2-403(1).

The Fifth Circuit en banc opinion accurately observed that C.I.T.'s status as a "purchaser" under the Code is "of great significance to a proper understanding and resolution of this case under Article Two and Article Nine."<sup>261</sup> However, the court was wrong in concluding that C.I.T. was a "purchaser" of Samuels & Co.'s after acquired property. A perfected secured creditor should not be considered a good faith purchaser for value

<sup>255</sup> Record Appendix, *supra* note 30, at 3, 6.

<sup>256</sup> *Id.* at 41.

<sup>257</sup> *Id.* at 44-45.

<sup>258</sup> The panel decision's reasoning on this question is extremely persuasive and is an interpretation and application of the Code that is "limited to its reason." U.C.C. § 1-102, Comment 1.

<sup>259</sup> Record Appendix, *supra* note 30, at 21.

<sup>260</sup> See text at notes 55-58 *supra*.

<sup>261</sup> 526 F.2d at 1242-43.

within section 2-403(1) as to after acquired property when it has not made an additional advance in reliance on the buyer's possession of the specific property involved. Without such reliance, the secured creditor has not entered into a voluntary transaction with respect to the after acquired property.

The Code defines a purchaser as someone who takes by "sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or other *voluntary* transaction creating an interest in property."<sup>262</sup> This definition is broad enough to encompass a security interest, which is an interest in the debtor's property given by the debtor to the creditor. It is not broad enough, however, to include an interest of a secured creditor which arises *automatically* by virtue of an after acquired property clause.<sup>263</sup> It is true that C.I.T.'s interest in Samuels & Co.'s after acquired property was created by a voluntary transaction in the sense that Samuels & Co. voluntarily gave this interest to C.I.T. at the time of the original security agreement. However, C.I.T.'s interest in the after acquired cattle attached automatically by operation of law at the mystical moment when Samuels & Co. had sufficient "rights in the collateral."<sup>264</sup> As of that moment it is impossible to say that C.I.T. took its interest in the cattle by a voluntary transaction. If C.I.T.'s "rights" in the cattle did not arise voluntarily, C.I.T. cannot be a Code purchaser.

The requirement that a purchaser under section 2-403(1) be a purchaser in good faith further illustrates that the Code requires a voluntary transaction. Assuming that C.I.T.'s purchase of all Samuels' inventory then owned or thereafter acquired by virtue of the security agreement made it a purchaser of the after acquired cattle, the question still remains whether C.I.T. was a purchaser *in good faith*. It makes no sense to look at C.I.T.'s knowledge and actions at the time of the original security agreement in order to determine this issue. C.I.T. had *no* interest in cattle and proceeds until Samuels acquired them years after the original security agreement. What has to be determined is the moment when C.I.T. was required to have good faith.

The en banc opinion looked to the moment C.I.T. failed to make its weekly advance to Samuels and observed that it is not bad faith to discontinue financing a doomed enterprise.<sup>265</sup> This, though, was not the proper moment at which to measure C.I.T.'s good or bad faith. Under section 2-403(1) C.I.T. must be a good faith "purchaser," that is, C.I.T. must be in good faith at the moment of "purchase."

<sup>262</sup> U.C.C. § 1-201(32) (emphasis added). See cases cited at note 133 *supra*.

<sup>263</sup> See text and note 137 *supra*.

<sup>264</sup> U.C.C. § 9-203(1). When Samuels & Co. received delivery of the cattle it had not only the right but the legal duty to slaughter the livestock immediately so that it could be chilled and weighed for pricing. See text at notes 80-83 *supra*. This would seem to meet the "rights in the collateral" test as it has been defined by the courts. See COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE Ch. 4, § 4.06 (1966) [hereinafter cited as COOGAN, HOGAN & VAGTS] and cases cited therein. See text at notes 89-90 *supra*. It would of course be possible to take the view of the Fifth Circuit panel decision that C.I.T.'s security interest had not attached because Samuels did not have sufficient rights in the collateral. 510 F.2d at 150-51. In view of the facts of this case, this result does not seem to be persuasive.

<sup>265</sup> 526 F.2d at 1243.

The moment at which C.I.T. could have become a purchaser was at delivery of the cattle to Samuels & Co., when C.I.T.'s security interest in the cattle attached. Examining C.I.T.'s good faith at that moment presents a dilemma. C.I.T.'s good faith at that moment turns on whether C.I.T.'s knowledge and behavior at that time met the Code definition of good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."<sup>266</sup> If a creditor is not conscious that a transaction has occurred no honesty or observance of reasonable commercial standards with respect to that transaction is possible.<sup>267</sup> Since there is no evidence that C.I.T. had any knowledge of the delivery of the cattle to Samuels by any of the sellers, it had no faith of any kind at that moment. Therefore, C.I.T. could not have been a purchaser in good faith.

C.I.T.'s status as a purchaser and its good faith would be different if C.I.T. had made an advance in reliance on Samuels' possession of this cattle. Then C.I.T. would have been a Code purchaser of the cattle. Samuels would have told C.I.T. of its possession of the cattle; C.I.T. would have advanced money in reliance on the cattle and its proceeds as security, and C.I.T.'s security interest would be the result of a voluntary transaction. On those facts, the state of C.I.T.'s knowledge as to Samuels' title and C.I.T.'s actions could be examined in the light of the Code definition of good faith. In *Samuels*, however, there was no such voluntary transaction to create C.I.T.'s interest in the after acquired cattle.<sup>268</sup> As a result, C.I.T. should not have been held to be a good faith purchaser for value who could obtain good title from Samuels & Co. under section 2-403(1).

5. Even if the Cattle Sellers lost their Right of Reclamation Due to Delay, They have a Perfected Article Two Security Interest in the Cattle which is not Subordinate to C.I.T.'s Perfected Article Nine Security Interest.

The district court<sup>269</sup> and the Fifth Circuit en banc<sup>270</sup> ruled that, under sections 2-401 and 9-113, the sellers' interests in the cattle were limited to security interests subject to Article 9. Both courts concluded that the priority rules of Article 9 subordinated the sellers' unperfected purchase money security interests to C.I.T.'s perfected security interest in the cattle and its proceeds as after acquired property. These decisions ignored the provisions of section 9-113. This section exempts from Article 9 filing requirements a

<sup>266</sup> Section 2-103(1)(b). See text and notes 128-31 *supra*.

<sup>267</sup> The law may give the creditor (C.I.T.) certain status as a result of the transaction between the cattle sellers and the buyer-debtor (Samuels & Co.), but good faith and bad faith have nothing to do with that status.

<sup>268</sup> The Code requirement of a voluntary transaction also has an arguable effect on the question whether a secured party whose security interest predates a seller's reclamation rights has given value for a security interest in the debtor's after acquired property. Under a minority view, the secured party must show that it made an additional advance in reliance on the buyer's possession of after acquired property as collateral in order to have given value. Under the generally accepted view, a preexisting claim constitutes value for a security interest in after acquired property. See text and notes 138-43 *supra*. Under the minority interpretation of value, C.I.T., to qualify as a good faith purchaser for value, would have to prove that when it made its weekly advance to Samuels & Co., it relied on Samuels' possession of the after acquired cattle. Since this showing also goes to the questions of purchase and good faith, the issue of value need never be reached.

<sup>269</sup> Record Appendix, *supra* note 30, at 31-33.

<sup>270</sup> 526 F.2d at 1247.

## CASH SELLERS AND SECURED FINANCERS

security interest arising solely under Article 2 when the debtor does not lawfully obtain possession of the goods.<sup>271</sup> The section provides:

A security interest arising solely under the Article on Sales (Article Two) is subject to the provisions of this Article except that to the extent that and so long as the debtor does not have or *does not lawfully obtain possession* of the goods

- (a) no security agreement is necessary to make the security interest enforceable; and
- (b) no filing is required to perfect the security interest; and
- (c) the rights of the secured party on default by the debtor are governed by the Article on Sales (Article Two).<sup>272</sup>

Under section 9-113, if the cattle sellers had a security interest in the cattle which arose solely under Article 2 and if Samuels & Co. did not lawfully obtain possession of the cattle, the courts' classification of Samuels' interest as an unperfected purchase money security interest is incorrect.

It is clear that the sellers had "security interests" in the cattle arising solely under Article 2. The referee found that the cattle sellers intended that title to the cattle would not pass to Samuels until payment was received.<sup>273</sup> Under section 2-401, such a retention of title by the seller after delivery of the goods is limited in effect to a reservation of a security interest.<sup>274</sup> The only question, then, is whether Samuels & Co. lawfully obtained possession of the cattle.

No court ever considered this issue. Hence, Samuels & Co.'s knowledge of its own financial condition when it took delivery and issued the checks to pay for the cattle can only be inferred from the facts in the record. Samuels took delivery of the cattle and issued checks to the cattle sellers between May 12 and May 23, 1969.<sup>275</sup> On May 23, C.I.T. refused to make its weekly advance and on the same day Samuels filed a plan of arrangement under Chapter XI of the Bankruptcy Act.<sup>276</sup> The Fifth Circuit, in its first panel decision, noted that "C.I.T. became insecure . . . upon learning that Samuels intended to file a plan of arrangement under Chapter XI."<sup>277</sup> In a large company with a number of plants and total weekly sales as high as one million dollars,<sup>278</sup> the decision to file under the Bankruptcy Act is not made and acted on in one day. At the very least, when it obtained possession of the cattle and issued these checks to the cattle sellers, Samuels & Co. had to have been aware of its precarious financial position. It is not unreasonable to assume that Samuels & Co. knew that the checks would be dishonored when presented for payment.

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<sup>271</sup> Section 9-302(1)(f) also lists this exception to requirement of filing for perfection.

<sup>272</sup> U.C.C. § 9-113 (emphasis added).

<sup>273</sup> Record Appendix, *supra* note 30, at 25. See text at note 98 *supra*.

<sup>274</sup> See text at notes 100-01 *supra*.

<sup>275</sup> Record Appendix, *supra* note 30, at 24.

<sup>276</sup> *Id.* at 20, 21.

<sup>277</sup> 483 F.2d at 559. The fact that Samuels intended to file prior to C.I.T.'s failure to make its weekly advance does not appear in the Referee's findings of fact. Record Appendix, *supra* note 30, at 28-29.

<sup>278</sup> *Id.* at 20.



The question then is whether taking delivery of goods and the issuance of bad checks in payment with this knowledge constitute unlawfully obtaining possession of the goods. The phrase "unlawfully obtaining possession" is not defined anywhere in the Code so we must look to other state law.<sup>279</sup> Non-Code contract law in Texas seems to be that a buyer's intent not to pay for goods is required to support rescission and reclamation by the seller, but that this intent can be shown by the fact that the buyer has no reasonable expectation of being able to pay.<sup>280</sup> If Samuels & Co. intended to file a Chapter XI petition on May 23, its officers were unlikely to have a reasonable expectation of being able to pay checks issued to cattle sellers between May 12 and May 23.

Under the Texas Penal Code a person obtains property unlawfully if that person induces the owner to consent by words or conduct which create "a false impression of law or fact that is likely to affect the judgment of another in the transaction" and that the actor does not believe to be true.<sup>281</sup> Surely, the issuing of a check creates the impression on the recipient that

<sup>279</sup> U.C.C. § 1-103 reads in part: "*Supplementary General Principles of Law Applicable.* Unless displaced by the particular provisions of this title, the principles of law and equity, . . . shall supplement its provisions."

<sup>280</sup> Under Texas common law, fraud would sustain rescission and reclamation if it were proved to be "fraud in fact, involving moral turpitude or intentional wrong"; a "mere intent not to pay for goods when the bill becomes due . . . [was] . . . insufficient . . . [for there] . . . must be intent never to pay for the goods . . . ." *Higginbotham-Bartlett Co. v. Powell*, 270 S.W. 193, 195 (Tex. Civ. App. 1925) (court refused to disturb jury finding that buyer did not have intent to defraud where buyer knew his assets exceeded his debts at time of sale). The intent not to pay for goods, however, could be "evidenced by circumstances, as by the fact that purchaser had no reasonable expectation of being able to pay for [the goods] . . . ." *Boerner v. Cicero-Smith Lumber Co.*, 298 S.W. 545, 547 (Tex. 1927) (court found insufficient evidence of intent not to pay where solvent credit purchaser made purchases in the usual course of business).

In the extreme case, the Texas Supreme Court found that where two buyers of a used car had given the seller a \$50 check drawn on a bank where they had no funds, the buyers had unlawfully obtained possession of the auto and the seller could cancel the sale and retake possession. *Weatherford v. Aetna Ins. Co.*, 385 S.W.2d 381, 383 (Tex. 1964) (the issue was whether seller's insurance covered buyers while they were unlawfully in possession; the court determined it did not).

The majority of jurisdictions agree with this result. *See, e.g.*, *Goldstein v. Stainless Processing Co.*, 465 F.2d 392, 394 (7th Cir. 1972) (court allowed cancellation of contract where buyer gave seller a check with a stop payment order on it as security for delivery of nickel); *Mulroney Mfg. Co. v. Weeks*, 185 Iowa 714, 717-18, 171 N.W. 36, 37-38 (1919) (buyer delivering bad check to seller to induce delivery constitutes fraud, permitting seller to reclaim goods sold despite buyer's subsequent bankruptcy).

*See generally* 4A COLLIER ON BANKRUPTCY, ¶ 70.41, at 486 (1976); 3 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT, §§ 631-37 (rev. ed. 1948); Annot., 59 A.L.R. 418 (1921).

<sup>281</sup> The Texas Penal Code in various sections provides:

§ 31.06. Presumption for Theft by Check

(a) If the actor obtained property . . . by issuing . . . a check . . . for the payment of money, when the issuer did not have sufficient funds in or on deposit with the bank . . . for the payment in full of the check . . . as well as all other checks or orders then outstanding, his intent to deprive the owner of property under Section 31.03 of this code [Theft] . . . is presumed . . . if:

(2) payment was refused by the bank or other drawee for lack of funds or insufficient funds, on presentation within 30 days after issue, and the issuer failed to pay the holder in full within 10 days after receiving notice of that refusal.

the check will be honored. If between May 12 and 23 the officers of Samuels & Co. knew or must have known that the checks would not be honored and that payment would not be made, there is an excellent argument that they obtained the cattle by inducing a false impression on the part of the cattle sellers. By either standard, Samuels would have unlawfully obtained possession of the cattle.

If Samuels obtained possession of the cattle unlawfully, it is clear under section 9-113 that the cattle sellers had perfected Article 2 security interests in the cattle. How section 9-113 affects the outcome of the conflict between those Article 2 security interests and C.I.T.'s perfected Article 9 security interest in the same cattle is not clear. Section 9-113(c) provides that "the rights of a secured party on default by a debtor are governed by [Article 2]," as opposed to Article 9.<sup>282</sup> If the cattle sellers lost their right of reclamation by their delay, then resolution of the conflict between the sellers' and C.I.T.'s interests depends largely on the interpretation of this subsection.

There are two possible interpretations of section 9-113(c). The more literal interpretation is that 9-113(c) makes inapplicable to the cattle sellers' interests only the Article 9 provisions which deal with procedures on default, while the priority rules of Article 9 still apply. The second interpretation is that section 9-113(c) exempts the cattle sellers' interests from the Article 9 priority provisions as well. Under the first interpretation cattle sellers might possibly prevail over C.I.T. and at a minimum would share pro rata with C.I.T. in the proceeds of the cattle. Under the second interpretation the cattle sellers would prevail.

A literal reading of section 9-113(c) leads to the conclusion that this subsection was intended solely to make part 5 of Article 9, entitled "Default," inapplicable to security interests arising solely under Article 2. Indeed, Comment 2 of section 9-113 states "paragraph (c) makes inapplicable the default provisions of Part 5 of this Article . . ." This indicates that all other provisions of Article 9, with the exception of the filing and security agreement requirements explicitly made inapplicable by sections 9-113(a)

§ 31.03. Theft

(a) A person commits an offense if, with intent to deprive the owner of property:

(1) he obtains the property unlawfully;

...

(b) Obtaining or exercising control over property is unlawful if:

(1) the actor obtains or exercises control over the property without the owner's effective consent; . . .

§ 31.01. Definitions

In this chapter:

...

(2) "Deception" means:

(A) creating or confirming by words or conduct a false impression of law or fact that is likely to affect the judgment of another in the transaction, and that the actor does not believe to be true;

...

(4) "Effective consent" includes consent by a person legally authorized to act for the owner. Consent is not effective if:

(A) induced by deception or coercion; . . .

<sup>282</sup> This provision is discussed at notes 271-73 *supra*.

and (b) but including the priority rules, *are* applicable.<sup>283</sup> There could be no other reason for the statute to give Article 2 security interests perfected status than to protect them in priority clashes governed by Article 9.

Cattle sellers' interests are in the nature of perfected purchase money security interests because the attempted reservation of title was "by the seller . . . to secure . . . [the] price."<sup>284</sup> These interests are entitled to purchase money priority over C.I.T.'s non-purchase-money perfected security interest if the conditions of this special priority mandated by section 9-312(3) have been met.<sup>285</sup> As previously discussed, these conditions include not only filing a financing statement, made unnecessary here by section 9-113, but also giving notice to C.I.T. prior to Samuels' receiving possession of the cattle.<sup>286</sup> It would seem that the 9-113(b) exemption from filing to perfect should be read to include an exemption from the notice requirement. The purpose of section 9-113 is to protect the defrauded seller who has delivered the goods by exempting him from formal requirements which, by the nature of the situation, he would never have fulfilled. To read the 9-113(b) exemption from filing as leaving intact the notice requirement in this situation is to deprive all defrauded sellers of inventory who have delivered goods to the buyer of the intended protection of section 9-113.

If the notice requirement of section 9-312(3) is still applicable to the cattle sellers' security interests, the sellers would not be entitled to a purchase money priority over C.I.T. since no notice was given. The priority clash then would be governed by the "first to perfect" rule of section 9-312(5) (b).<sup>287</sup> C.I.T. had complied with the requirements for perfecting its security interests in Samuels' existing inventory; but that security interest could not attach to the cattle in question and therefore could not be perfected as to that cattle until Samuels & Co. acquired rights in the cattle.<sup>288</sup>

<sup>283</sup> White and Summers take the position that §§ 1-201(37), 9-102 and 9-113 "read together and literally require that all such priority clashes [between Article Two security interests exempted from the Article Nine provisions by § 9-113 and Article Nine security interests] be resolved under Article Nine." J. WHITE AND R. SUMMERS, *UNIFORM COMMERCIAL CODE* 781 (1972). See also HOGAN, *supra* note 137, at 583 n.50.

<sup>284</sup> U.C.C. § 9-107(a). See note 94 *supra*.

<sup>285</sup> U.C.C. § 9-312(5) provides in part:

In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows:

. . .  
(b) in the order of perfection unless both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) and, in the case of a filed security interest, whether it attached before or after filing.

The 1972 version of this section gives priority to the security interest which was either filed or perfected first, whichever occurred earlier. See Coogan, *The New U.C.C. Article Nine*, 86 HARV. L. REV. 477, 507-08 (1973). Since C.I.T. filed long before this transaction it would prevail over the cattle sellers under that rule, as would all perfected security interests in after acquired property. This is an additional argument for the purchase money priority argument discussed above, since it is the only way to protect the seller under the 1972 version of the Article 9 priority rules.

<sup>286</sup> See text at notes 226-27 *supra*. This notice requirement applies only to purchase money security interests in inventory. The livestock in this case became inventory in the hands of Samuels & Co. which was not engaged in "farming operations." See U.C.C. § 9-109(3), (4).

<sup>287</sup> See note 285 *supra*.

<sup>288</sup> U.C.C. §§ 9-303(1), 9-204(1), 9-302.

## CASH SELLERS AND SECURED FINANCIERS

The cattle sellers' section 2-401 "security interest" in the cattle also became perfected under section 9-113 at the moment when the debtor, Samuels, acquired rights in the cattle. Since Samuels presumably acquired rights in the cattle with respect to C.I.T. and the sellers at the same moment, both security interests were perfected simultaneously. Under the literal interpretation of section 9-113(c), the sellers would share with C.I.T. pro rata in the proceeds of the cattle even if the sellers were subject to 9-312(3) notice requirements.<sup>289</sup>

The second interpretation of section 9-113 is that it exempts Article 2 security interests from the key provisions of Article 9, including the priority provisions.<sup>290</sup> This interpretation is based on the rationale that it is otherwise meaningless to refer a defrauded seller who has parted with his goods to the default provisions of Article 2 while subjecting him to the priority provisions of Article 9. Such a seller's only meaningful Article 2 remedy is cancellation under section 2-703(f) and replevy of the goods.<sup>291</sup> If this right is subordinate to interests of perfected secured creditors of the buyer in

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<sup>289</sup> Under the equitable doctrine of marshaling of assets, C.I.T. would have to exhaust all of Samuels' other assets before claiming the proceeds of the cattle. The doctrine has been applied by the Texas courts: "[I]f one creditor by virtue of a lien or interest can resort to two funds, and another to one of them only, the former must seek satisfaction out of that fund which the latter cannot touch." *New Brunswick Fire Ins. Co. v. Girduer*, 28 S.W.2d 193, 196 (Tex. Civ. App. 1930). See, e.g., *Moody Day Co. v. Westview Nat'l Bank, Waco*, 452 S.W.2d 572, 574 (Tex. Civ. App. 1970); 2 POMEROY, *EQUITY JURISPRUDENCE*, § 410 (1941).

<sup>290</sup> "Until Article Nine thus [by the debtors obtaining lawful possession of the goods] applies in full, its other provisions have a very limited application, *at best*, to a 9-113 situation." COOGAN, HOGAN & VAGTS, *supra* note 264, at ch. 4, § 4.07 n.51 (emphasis added). No cases have been found on this issue.

<sup>291</sup> U.C.C. § 2-703 provides in part:

Where the buyer . . . fails to make a payment due on or before delivery . . . , the aggrieved seller may

- (a) withhold delivery of such goods;
- (b) stop delivery by any bailee . . .
- (c) proceed under the next section respecting goods still unidentified to the contract;
- (d) resell and recover damages . . .
- (e) recover damages for non-acceptance . . .
- (f) cancel.

The Code definition of cancellation in § 2-106 is as follows:

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

Under Texas common law, the terms "cancellation" and "rescission" appear to be interchangeable. Thus, when a used car dealer received a bad check as a down payment on an auto and attempted to repossess the auto, the court agreed that he had the right to cancel the sales contract and repossess the auto since the buyer had unlawfully obtained possession. *Wea-therford v. Aetna Ins. Co.*, 385 S.W.2d 381, 382 (Tex. 1964). Williston, however, explains that "while termination (under the U.C.C.) discharges all obligations on both sides which are still executory, leaving rights based on prior breach or performance surviving, in case of cancellation, besides the foregoing, the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance." 1 S. WILLISTON, *THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT*, § 9d (1972 Supp.).

after acquired property, the sellers' Article 2 rights on default are illusory.<sup>292</sup> The language of section 9-113(c) providing that "the *rights* of the secured party on default by the debtor are governed by . . . (Article 2)" was not intended to include only *procedures* on default, but the full exercise of the rights of an unpaid seller under Article 2. This reading of section 9-113 would give the cattle sellers the right to cancel their contract with Samuels and to replevy the proceeds of their goods free of C.I.T.'s security interest.<sup>293</sup>

The language of section 9-113 is ambiguous. Its purpose is clear: to give defrauded sellers who have parted with their goods all of the protection of perfected secured creditors. This could have been achieved under either of these interpretations of section 9-113. If the cattle sellers' interests were subject to Article 9 priority rules by 9-113, they should have had purchase money priority over C.I.T.'s competing claim, or at least a pro rata share of proceeds. If these interests were exempt from the Article 9 priority rules under 9-113(c), the cattle sellers should have been given the right under section 2-703(f) to cancel and replevy the proceeds of their goods.

### CONCLUSION

The Fifth Circuit in *Samuels* transformed cash sellers into secured creditors. The *Samuels* rule will increase transaction costs and social costs in every industry governed by the Code. This discussion has attempted to demonstrate that a careful, technical, and close reading of Articles 2 and 9

<sup>292</sup> See Peters, *supra*, note 127, at 218-21 and cases cited, discussing the arguments in support of the view that the right to cancel includes the right to replevy the goods. U.C.C. § 1-106 and the comments support this view. That section provides in part:

(1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . .

(2) Any right or obligation declared by this Act is enforceable by action unless the provision declaring it specifies a different and limited effect.

<sup>293</sup> As to the extension of the right to replevy the goods to the right to replevy the proceeds see text at notes 259-60 *supra*. Under pre-Code Texas Law where a seller has cancelled the sale because of the buyer's fraud and seeks to recover the goods, seller has a superior claim to that of an attaching creditor since the subsequent attaching creditor obtains no better right to the property than the fraudulent purchaser. *Blount-Decker Lumber Co. v. Farmer's Lumber Co.*, 211 S.W. 247, 247-48 (Tex. Civ. App. 1919) (Court reversed lower court holding for creditor where bankrupt buyer had procured lumber from seller by misrepresentation as to his solvency. Seller was permitted to reclaim lumber.). See also *Mulroney Mfg. Co. v. Weeks*, 185 Iowa 714, 717-18, 171 N.W. 36, 37-38 (1919) (Where insolvent buyer delivered bad check to induce delivery, court found seller could reclaim the goods from the bankrupt or his trustee and that such a reclamation did not work a preference in violation of the Bankruptcy Act.).

In this type of action, "the seller is regarded not as a general creditor but as the proper owner repossessing goods from one who has wrongfully deprived him of possession." Note, *Selected Priority Problems in Secured Financing Under the Uniform Commercial Code*, 68 YALE L. J. 751, 759 (1959). Collier explains that "the intervention of bankruptcy between bargain and rescission has not been allowed to interfere with the right to rescind and reclaim; the trustee in bankruptcy takes little to the bankrupt's property subject to the retroactive divestment effected by such a rescission." 4A COLLIER ON BANKRUPTCY, ¶ 70.41 (1976). 3 S. WILLISTON, *THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT*, § 636 (rev. ed. 1948).

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of the Code, together with an understanding of the actual transactions to which the Code was being applied in *Samuels*, could have led to a recovery by the cattle sellers. Indeed, it should have led to their recovery. The opposite result has justified another special exception to the Code's general scheme—the state statutes and the amendment to the PSA creating a special priority for unpaid sellers of cattle to meat packers. This result ill serves the Code's purpose and policy of simplifying and clarifying the law of commercial transactions.