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NOTES

SECURITY INTERESTS IN INSURANCE PAYMENTS ON DESTROYED COLLATERAL AS "PROCEEDS" AND THEIR PRIORITY UNDER THE FEDERAL TAX LIEN ACT OF 1966

I. INTRODUCTION

Article 9 of the Uniform Commercial Code (UCC), covering secured transactions, replaced what has been called "the hodgepodge of pre-code chattel security law"2 with a uniform framework for regulating security interests in personal property and fixtures.3 The ever increasing complexity and sophistication of modern commercial financing transactions undeniably required such a uniform statute.

Article 9 abolished many of the largely formal state law distinctions between various types of pre-Code security interests4 and substituted the single term "security interest" for the various labels which had been used to distinguish security interests created under a variety of devices.5 In a secured transaction covered by article 9 there is a "debtor" (typically a borrower), and a "secured party" (typically a lender).

An innovative feature of the Code is its treatment of the concept of "proceeds." "Proceeds" are generated when, for example, a debtor sells the secured collateral to a third party and receives money or other consideration in return. Under article 9, the secured party's interest will normally extend to the consideration thus received.6 The Code defines "proceeds" broadly to include "whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. . . ."7

Although article 9 purports to cover all secured transactions involving personal property and fixtures, certain kinds of transactions are specifically excluded from its broad scope, chiefly because an adequate body of either state or federal law already existed.8 Section 9-104(g), for example, provides that article 9 does not apply "to a transfer of an interest or claim in or under any policy of insurance . . . ."9 Therefore, a conflict may arise when the secured party endeavors to claim priority in its security interest (e.g., insur-

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1. Unless otherwise indicated, references are to the 1962 version of the Uniform Commercial Code [hereinafter cited as UCC].
3. UCC § 9-101, Comment.
4. Id.
5. For example, conditional sales, factor's liens, chattel mortgages and assignments of accounts receivable. UCC § 9-101, Comment; see Coogan, Relationship of Article 9 of the Uniform Commercial Code to Pre-Code Chattel Security Law, 51 Va. L. Rev. 853, 856 (1965).
7. UCC § 9-306(1) (emphasis added).
9. UCC § 9-104(g).
SECURITY INTERESTS

ance proceeds) over that of a competing creditor asserting that the transaction
does not fall within the UCC's umbrella of protection.

A simple hypothetical\(^\text{10}\) will illustrate some of the problems involved. Assume that Debtor takes a loan from Bank—the secured party. As collateral for the loan, Debtor executes a security agreement which grants Bank a security interest in Debtor’s tractor. The financing statement, which is properly filed,\(^\text{11}\) also covers “proceeds”\(^\text{12}\) of the collateral. If Debtor subsequently trades in his tractor for a new tractor, Bank’s security interest in the original collateral will in all probability continue in the old tractor,\(^\text{13}\) and certainly in the new one as “proceeds” of the original collateral.\(^\text{14}\)

Suppose, however, that the original tractor, which was covered by a valid insurance policy, had been destroyed in an accident. Would Bank be entitled to the insurance payments as “proceeds” of the collateral by virtue of its original security interest in the tractor? This question, reduced to its simplest terms, asks whether insurance payments made to a debtor as a result of damage to or destruction of the collateral in a secured transaction can constitute “proceeds” of the collateral as defined in section 9-306(1)\(^\text{15}\) of the Code. If insurance payments can be “proceeds,” then, under the assumed facts, Bank’s security interest would extend to the insurance fund created when the tractor was destroyed.

Although commentators have been virtually unanimous in concluding that insurance can be UCC “proceeds,”\(^\text{16}\) courts which have considered the

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11. Filing is required to perfect Bank’s security interest. UCC § 9-302(1). In most cases, filing is a prerequisite to perfection. It is not, however, always necessary to perfect a security interest (see UCC § 9-302), and some interests cannot be perfected by filing; see UCC § 9-304.
12. Under the 1962 version of the Code, checking the “proceeds box” on the filed financing statement is necessary to continue a secured party’s perfected security interest in “proceeds” beyond ten days after the debtor receives the “proceeds.” UCC § 9-306(3)(a).
13. UCC § 9-306(2). Unless Bank “authorized” the trade-in. Id.
15. UCC § 9-306(1) provides: “ ‘Proceeds’ includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are ‘cash proceeds.’ All other proceeds are ‘non-cash proceeds.’ ” Compare UCC § 9-306(1) (1972 version).
question have, until recently, taken a contrary position. Courts have basically found three obstacles to the creation of a UCC security interest in insurance payments. First, the insurance exclusion contained in section 9-104(g) was held to bar such a security interest. Second, it was found that the words "sold, exchanged, collected or otherwise disposed of" in the "proceeds" definition applied only to a voluntary disposition of the collateral and not to the involuntary disposition which gives rise to an insurance fund. Third, the courts have held that because an insurance policy embodies a "personal contract" which does not attach to or run with the property insured, the secured party may not claim the insurance fund as "proceeds" of the collateral.

It is the contention of this Note, however, that the original intention of the Code's drafters was not to exclude insurance payments from the section 9-306(1) definition of "proceeds." This Note will also examine the priority problem of an intervening federal tax lien, based on assessments against Debtor for unpaid taxes, when filed subsequent to the date Bank's security interest in the insurance proceeds became perfected.

U.L. Rev. 453 (1969); Henson, Some "Proceeds" and Priority Problems under Revised Article 9, 12 Wm. & Mary L. Rev. 750, 757 (1971).


20. UCC § 9-306(1).


23. PPG Indus., Inc. v. Hartford Fire Ins. Co., 531 F.2d 58 (2d Cir. 1976), noted in 176 N.Y.L.J., July 22, 1976, at 4, cols. 1-2; see notes 63, 154 infra and accompanying text. See also note 16 supra and accompanying text.

24. See notes 80-182 infra and accompanying text.
II. BARRIERS TO SECURITY INTERESTS IN INSURANCE "PROCEEDS"

A. The Insurance Exclusion

As previously stated, certain types of transactions are excluded from the coverage of article 9 by section 9-104, primarily because the subject matter involved was deemed to have been adequately covered by prior statutes. Thus, section 9-104(g) provides that article 9 does not apply "to a transfer of an interest or claim in or under any policy of insurance . . . ." This subsection was held to bar the creation of a continuing UCC security interest in the insurance proceeds of damaged or destroyed collateral. The correct view, however, would appear to be that taken by commentators and the Second Circuit Court of Appeals in PPG Industries, Inc. v. Hartford Fire Insurance Co. that section 9-104(g) is not a bar to the creation of a security interest in the insurance "proceeds" of destroyed collateral. In PPG Industries, the Second Circuit held that the "exclusion applies only to situations where the parties to a security agreement attempt to create a direct security interest in an insurance policy by making the policy itself the immediate collateral securing the transaction." The official comment to section 9-104(g) indicates that the provision was intended to apply basically to life insurance policies and was perhaps not meant to cover the situation under discussion. As one textwriter has stated the problem:

There have been some cases suggesting that since subsection 9-104(g) excludes insurance from the general coverage of Article 9, insurance payments for damaged collateral cannot be proceeds under 9-306. While 9-104(g) might have been more

25. UCC § 9-104, Comment 7; see Coogan, Relationship of Article 9 of the Uniform Commercial Code to Pre-Code Chattel Security Law, 51 Va. L. Rev. 853, 855 & n.9 (1965).
26. UCC § 9-104(g) (emphasis added). Compare UCC § 9-104(g) (1972 version).
28. See 1 P. Coogan, W. Hogan & D. Vagts, Secured Transactions under the Uniform Commercial Code § 3A.03[c], at 207 (1976); R. Henson, Secured Transactions § 6-8, at 150-51 (1973); Coogan, The New UCC Article 9, 86 Harv. L. Rev. 477, 518 (1973); Henson, Insurance Proceeds as "Proceeds" under Article 9, 18 Cath. U.L. Rev. 453, 456 (1969).
29. 531 F.2d 58 (2d Cir. 1976).
30. Id. at 60. The court further stated that section 9-104(g) "would be triggered in cases where a debtor uses his life insurance policy as a means for securing a debt owed to the insurer. In contrast, there is no basis for concluding that the statutory exclusion was intended to extend to security agreements which both create a direct security interest in inventory and/or equipment and require the debtor to provide his creditor with further protection by insuring the collateral." Id.
31. UCC § 9-104, Comment 7 states: "Rights under life insurance and other policies, and deposit accounts, are often put up as collateral. Such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law." See also 1 G. Gilmore, Security Interests in Personal Property § 10.7, at 315 (1965).
32. Cf. Domain Indus., Inc. v. First Security Bank & Trust Co., 230 N.W.2d 165 (Iowa 1975) (UCC § 9-104(k) held not to exclude security interest in bank account which contained "proceeds" from the coverage of article 9).
artistically phrased, this argument proves too much; bank deposits are not generally within Article 9 either, but clearly bank deposits can constitute 9-306 proceeds.33

The more reasonable construction would seem to be to limit the insurance exclusion of section 9-104(g) to actual transfers of interest. Thus, courts have correctly construed this subsection to exclude from the coverage of article 9 assignments of the debtor’s interest in insurance payments after a loss had occurred.34 This does not mean that section 9-104(g) should be held to bar a continuing security interest in those payments as “proceeds.” This analysis is consistent with the policy of the UCC to protect transactions which attempt to create a security interest.35 Since the security agreement will normally provide that the secured party is entitled to the insurance proceeds, this construction would also tend to effectuate the intention of the parties.

B. The Requirement of a Voluntary Disposition of the Collateral

Courts36 found a second obstacle to the creation of a security interest in insurance proceeds in the somewhat ambiguous language of section 9-306(1).37 This subsection defines “proceeds” to include “whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. . . .”38 The first courts to consider the problem interpreted the words “otherwise disposed of” to refer only to a voluntary disposition of the collateral by the debtor and not to the involuntarily caused damage or destruction which gives rise to an insurance fund.39 Thus, in Quigley v. Caron,40 where the collateral was destroyed by fire, the Supreme Judicial Court of Maine held:

The insurance monies plainly do not come from a sale or exchange or collection of the security.

[Was the collateral] “otherwise disposed of”? We answer in the negative. In our view, the Code covers voluntary disposal and not a change from destruction by fire.41

33. 1 P. Coogan, W. Hogan & D. Vagts, Secured Transactions under the Uniform Commercial Code § 3A.03[c], at 207 (1976) (footnote omitted); Coogan, The New UCC Article 9, 86 Harv. L. Rev. 477, 518 (1973) (footnote omitted).
35. See UCC § 9-102(1)(a) which provides that article 9 applies “to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including . . . contract rights . . . .” UCC § 9-201 states in part: “Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.”
38. UCC § 9-306(1).
39. See cases cited in note 21 supra.
40. 247 A.2d 94 (Me. 1968).
41. Id. at 96. In Universal C.I.T. Credit Corp. v. Prudential Inv. Corp., 101 R.I. 287, 222
While this argument might be convincing in a grammatical sense, it is too narrow an interpretation of the Code.\textsuperscript{42} There appears to be no meaningful reason for distinguishing between voluntary and involuntary dispositions for the purposes of section 9-306. Furthermore, the distinction may lead to illogical results, especially since section 9-306(2) provides:

Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.\textsuperscript{43}

If the "other disposition" in the above subsection refers only to a voluntary transfer, then, under the hypothetical previously discussed,\textsuperscript{44} a secured party's perfected security interest in the debtor's "proceeds" would be defeated if Debtor accidently wrecked the tractor, but would continue were he to wreck it intentionally.\textsuperscript{45} Furthermore, the subsection provides that the security interest continues not only in the collateral but in "any identifiable proceeds" thereof. There is no reason why insurance proceeds can not be "identifiable" proceeds. Nevertheless, the narrow interpretation found further support in

A.2d 571 (1966), the collateral, a 1964 Diamond T tractor, was destroyed in an accident. The court stated: "We do not believe that the disposition referred to in this section [9-306(1)] can be construed to describe the demolition of the 1964 Diamond T and the subsequent compensation paid for its loss. This involuntary conversion of the tractor is not a disposition within the meaning of this particular provision of the code."

... What we believe to be controlling is the fact that the mishap whereby the 1964 Diamond T tractor was completely destroyed is not a disposition within the meaning of the code." Id. at 294-95, 222 A.2d at 575.

42. In re Hunter, 9 UCC Rep. Serv. 928 (S.D. Ohio 1971), was the first case to recognize this. Hunter involved an insured automobile which was subject to a perfected security interest. The security agreement obligated the debtor to insure the collateral " 'with loss payable clauses in favor of the secured party as its interest may appear.' " Id. at 929. The automobile was subsequently destroyed in an accident. In allowing the secured party to reach the insurance proceeds over the claim of the debtor's trustee in bankruptcy, the court held: "To read a question of intent, fault, or voluntariness into the statute for the purpose of defeating a security interest would serve only to rely on concepts or legal fictions that do violence to both ordinary semantics and practices in the market place. If one looks at the intent, then a debtor who deliberately wrecked his car would not defeat the secured party's interest, but one who suffered an accident beyond his control would. In either event, the collateral has been 'disposed of.' This court is unable to perceive any purpose in striking down a security interest and collateral clearly anticipated by the parties when they agreed specifically to carry insurance for such a loss or disposition of collateral as here involved." Id. at 930; see R. Henson, Secured Transactions § 6-8, at 148 (1973); Boroff, Insurance Proceeds under Section 9-306: Before and After, 79 Com. L.J. 442, 444 (1974); Gillombardo, The Treatment of Uniform Commercial Code Proceeds in Bankruptcy: A Proposed Redraft of Section 9-306, 38 U. Cin. L. Rev. 1, 3-4 (1969); Henson, Insurance Proceeds as "Proceeds" under Article 9, 18 Cath. U.L. Rev. 453, 453-54 (1969).

43. UCC § 9-306(2).

44. See notes 10-15 supra and accompanying text.

45. In re Hunter, 9 UCC Rep. Serv. 928, 930 (S.D. Ohio 1971); see the discussion of this case in note 42 supra.
Universal C.I.T. Credit Corp. v. Prudential Investment Corp.\textsuperscript{46} In that case, collateral which secured the debtor's obligation to the secured party was a 1964 Diamond T tractor.\textsuperscript{47} The tractor was completely destroyed in an accident and the secured party attempted to reach the insurance fund as "proceeds" of the collateral over the claim of an assignee of the debtor's interest in the insurance policy. The Rhode Island Supreme Court held for the assignee in part on the ground that "the mishap [which the court characterized as an involuntary conversion] whereby the 1964 Diamond T tractor was completely destroyed is not a disposition within the meaning of the code."\textsuperscript{48} Thus, under Universal C.I.T., if the debtor had intentionally wrecked his tractor, the secured party's security interest would have continued in the insurance proceeds pursuant to section 9-306. Such a distinction appears arbitrary and unreasonable. Whether the disposition is voluntary or involuntary,\textsuperscript{49} as a practical matter the collateral has been disposed of.\textsuperscript{50}

C. The "Personal Contract" Argument

Courts\textsuperscript{51} found a third reason to exclude insurance payments from the section 9-306(1) definition of "proceeds" in the traditional holding that an insurance contract is a "personal contract"\textsuperscript{52} between insurer and insured which does not "run" with the insured collateral.\textsuperscript{53} Thus, a secured party could claim no interest in the insurance fund merely by virtue of his security


\textsuperscript{47} The debtor obtained the 1964 tractor by trading in an older tractor which had been the original collateral securing the debt.

\textsuperscript{48} 101 R.I. at 294-295, 222 A.2d at 575; see note 41 supra.

\textsuperscript{49} One commentator has suggested that if the collateral were destroyed or stolen by a third party, the secured party's security interest would continue in it under § 9-306(2) and has called this result "self-evidently correct" despite the language of the Code. R. Henson, Secured Transactions § 6-8, at 148 (1973); Henson, Insurance Proceeds as "Proceeds" under Article 9, 18 Cath. U.L. Rev. 453, 454 (1969). It would also seem clear that the secured party should be entitled to the insurance proceeds even in such a situation under UCC § 9-306(1). Such would certainly be the result under UCC § 9-306(1) (1972 version); see notes 58-66 infra and accompanying text.

\textsuperscript{50} Obviously, the economic consequences are identical whether the collateral is damaged or destroyed voluntarily, involuntarily or through the actions of a third party.


\textsuperscript{53} 101 R.I. at 292, 222 A.2d at 574.
interest. In *Universal C.I.T.*, the court took the following approach to the problem:

"Proceeds" by definition under the code arises from either a sale, exchange, collection or other disposition of either the collateral or proceeds. Insurance moneys or proceeds, however, arise and are paid as the result of a contract. An insurance contract or policy, so called, pertains to the persons to the contract and not to the item insured. It is a personal contract which does not attach to or run with the property insured.\(^5\)

This approach appears to be objectionable on several grounds. First, other personal contract rights may serve as either collateral or "proceeds" under the Code.\(^5\) Second, once the insurer's liability has been ascertained, it is irrelevant whether payment is given to the secured party or debtor. And, third, the amount of the payments will usually be determined by the value of the insured property. Such payments stand in the place of the collateral as do any other "proceeds." Thus, where the security agreement covers "proceeds" and the insurance on the collateral is made payable to the debtor (or, a fortiori, to the secured party),\(^6\) the secured party should be entitled to the proceeds. As Professor Henson has pointed out, there is simply "no reason for general creditors to get a windfall in the form of insurance proceeds when they would have had no claim on the collateral had it not been destroyed."\(^7\)

\(^{54}\) Id. The court in *In re Levine*, 6 UCC Rep. Serv. 238 (D. Conn. 1969), also adopted this approach by holding that the secured party's perfected security interest in the "proceeds" of the debtor's inventory gave it no security interest in the compensation paid under a fire insurance policy when the inventory was destroyed. "[T]he insurance moneys flow from the personal contract of insurance and are not proceeds that come from the property insured." Id. at 241.

\(^{55}\) UCC § 9-102(1)(a). "'Contract right' means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." UCC § 9-106.

\(^{56}\) The situation is, of course, different where the insurance is made payable to a third party. The 1972 amendments to article 9 provide only that "[i]nsurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement." UCC § 9-306(1) (1972 version). According to the drafters, "[i]n the 'except' clause is intended to say that if the insurance contract specifies the person to whom the insurance is payable, the concept of 'proceeds' will not interfere with performance of the contract." UCC § 9-306(1), Reasons for 1972 Change. The revisions would thus affirm the result in *Distributor's Warehouse, Inc. v. Madison Auto Parts & Serv. Corp.*, 8 UCC Rep. Serv. 569 (Wisc. Cir. Ct. 1970). In that case, the collateral was covered by a pre-Code chattel mortgage. The mortgage note provided that the debtor agreed to insure the collateral in a manner satisfactory to the mortgagee. An insurance policy was taken out with the mortgagee named as loss-payee. When the collateral was destroyed by fire, other creditors with liens against the insured property claimed the insurance proceeds. The court held that the mortgagee was entitled to the insurance fund on the ground that "[a] policy of fire insurance is a personal contract which does not attach to the property insured." Id. at 573. The revised section 9-306(1) would render the personal contract approach taken by the court unnecessary.

III. EFFECT OF THE 1972 AMENDMENTS TO ARTICLE 9

In response to the decisions holding that insurance proceeds are not "proceeds" within the Code's protection, the National Conference of Commissioners on Uniform State Laws amended both sections 9-104(g) and 9-306(1). Section 9-104(g) now provides that article 9 does not apply "to a transfer of an interest in or claim in or under any policy of insurance, except as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312) . . . ." The revisions thus clearly dispose of the insurance exclusion problem. The amended section 9-306(1) now provides:

"Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement.

The reason for the new, explicit provision on insurance proceeds is "to overrule various cases to the effect that proceeds of insurance on collateral are not proceeds of the collateral." One commentator has termed the inclusion of insurance as "proceeds" in the revised Code "a remarkable deviation from the sponsors' habitual policy of not making amendments where the only purpose would be to overrule bad cases." The revisions conclusively indicate the drafter's original intent to include insurance proceeds within the definition of "proceeds."
insurance as "proceeds" and clearly dispose of the "personal contract" argument and the requirement of a voluntary disposition as far as insurance payments are concerned. Insurance, however, is not the only source of funds arising from an involuntary disposition of collateral or proceeds. In Hoffman v. Snack, the assignee of a financing agreement which had given the secured party a security interest in the debtor's automobile, was denied the right to intervene in a trespass action brought by the debtor against a third party who had been involved in an accident which resulted in the total destruction of the debtor's automobile. The court held that section 9-306(2) could not be extended to include cases where the collateral has not been transferred, but has simply depreciated or been destroyed without fault of the debtor. Thus, the assignee's security interest in "proceeds" could not include any sum that the debtor might recover from the third party tortfeasor. This result seemingly would be affirmed under the revisions since the 1972 amendments do not change the definition of "proceeds" in the first sentence of section 9-306(1) to include funds arising from the involuntary disposition of collateral or "proceeds."
Another problem may lie latent in the language of revised section 9-306(1). While the first sentence of that subsection provides that "'proceeds' includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds," its second sentence states only that "[i]nsurance payable by reason of loss or damage to the collateral is proceeds . . . ." The amended subsection does not state that insurance payable by reason of loss or damage to "proceeds" of the original collateral is "proceeds." This has led one writer to the conclusion that the result in *Universal C.I.T. Credit Corp. v. Prudential Investment Corp.*, might not be reversed by the 1972 amendments. For, in *Universal C.I.T.*, the destroyed tractor which gave rise to the insurance fund was not the original collateral, but a new tractor in part payment for which the debtor had traded in the original collateral. Thus, according to this writer, the insurance monies in *Universal C.I.T.* were paid in compensation for the destruction, not of the original collateral, but of its "identifiable proceeds." This situation is not expressly covered by section 9-306(1). The exclusion may have been inadvertent, but if not, it is indeed difficult to grasp the logic behind the distinction between insurance on collateral and insurance on "proceeds." It should be noted, however, that when the secured party in *Universal C.I.T.* discovered that the debtor had traded in the original collateral, it had him execute a second financing statement which covered the new tractor and also covered "proceeds."
Therefore, under revised section 9-306(1), the secured party's continuing security interest in "proceeds" would have extended to the insurance fund after all.

IV. IS A CONTINUOUSLY PERFECTED SECURITY INTEREST IN "PROCEEDS" PRIOR IN RIGHT TO A SUBSEQUENTLY FILED FEDERAL TAX LIEN?

Even if a secured party's security interest in "proceeds" can extend to insurance payments under both the 1962 and revised versions of the Code, the question remains whether such an interest can prevail against a claim based on a subsequently filed federal tax lien. A brief introduction to federal tax lien law is necessary to an understanding of this question.

The relative priority of the federal tax lien is an area of the law which is both complex and fraught with uncertainty. It is an area where the pronouncements of all but the highest court in the land have time and again proven unsafe to rely upon. It must thus be kept in mind that the labyrinthian complexity of federal tax lien law renders it difficult to predict accurately how the courts will decide questions which arise at the fringes of the law.

A federal tax lien arises at the time the tax is assessed. Assessment is the entry of the amount of the taxpayer's liability on the dockets of the Internal Revenue Service. Since assessment is a non-public, administrative act, the existence of the lien may be unknown to either the taxpayer or his creditors. The lien will continue to encumber both the presently-owned and after-acquired non-exempt property of the taxpayer until the tax liability "is satisfied or becomes unenforceable by reason of lapse of time."

It was early held that the priority of the federal tax lien is governed by the
familiar common law rule that the "first in time is the first in right." It was nevertheless also held that to take priority over a federal tax lien, a competing lien had to be "choate" before the federal lien arose. In order for a competing lien to be considered choate or "specific" and "perfected," the amount of the lien, the identity of the lienor and the property subject to the lien had to be definitely established.

The Supreme Court soon developed these requirements to the point where few competing liens could prevail against a subsequent federal tax lien. Thus, in United States v. Pioneer American Insurance Co., a mortgagee's claim for an attorney's fee was held inchoate and subordinate to filed federal tax liens even though the tax liens were filed after the mortgage was recorded, after the mortgagor had defaulted and after the foreclosure suit was instituted. Notice of the liens was, however, filed prior to the entry of judgment on the mortgagee's claim. Therefore, since the precise amount of the claim could not be established until the entry of judgment, the mortgagee's lien was deemed inchoate.

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86. See Rankin v. Scott, 25 U.S. (12 Wheat.) 177, 179 (1827), where Chief Justice Marshall stated: "The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction . . . ."


88. United States v. City of New Britain, 347 U.S. 81, 84 (1954). The choate lien doctrine is well summarized by the Supreme Court of New Jersey in Continental Fin., Inc. v. Cambridge Lee Metal Co., 56 N.J. 148, 265 A.2d 536 (1970). "Under that doctrine, a recorded federal lien, though subordinate to an earlier 'specific and perfected' state lien, takes priority over any so-called inchoate lien which is not specific and perfected. The state lien is said to be specific and perfected (or choate) when 'there is nothing more to be done—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established.'" Id. at 151, 265 A.2d at 537. Whether or not a competing lien is choate is, of course, a question of federal law. United States v. Security Trust & Sav. Bank, 340 U.S. 47, 49-50 (1950).

89. 346 U.S. at 84.

90. United States v. R.F. Ball Constr. Co., 355 U.S. 587 (1958) (per curiam) (subcontractor's assignment of all sums to become due for performance of his subcontract to a surety as security for any indebtedness he might incur to the surety held inchoate and subordinate to a federal tax lien which attached after the assignment was made); United States v. White Bear Brewing Co., 350 U.S. 1010 (1956) (per curiam) (mechanic's lien which was specific, prior in time and being enforced before the federal tax lien arose held inchoate even though everything possible under state law had been done to perfect it, because it was not yet reduced to a final judgment). Decisions favoring the federal lien were poignantly criticized by the commentators; see, e.g., Cross, Federal Tax Claims: Nature and Effect of the Government's Weapons for Collection, 27 Fordham L. Rev. 1 (1958); Kennedy, From Spokane County to Vermont: The Campaign of the Federal Government Against the Inchoate Lien, 50 Iowa L. Rev. 724 (1965); Kennedy, The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien, 63 Yale L.J. 905 (1954); McNally, Federal Tax Lien Priority: An Injustice to Creditors, 14 Hastings L.J. 52 (1962); Shanks, The Tax Lien Tamed, 8 U.C.L.A.L. Rev. 339 (1961); Wolson, Federal Tax Liens—A Study in Confusion and Confiscation, 43 Marq. L. Rev. 180 (1959).


92. Id. at 90-91.
The harsh nature of the choateness doctrine was, however, somewhat mitigated by the adoption of the so-called "no property" rule. Since the federal tax lien can only attach to "property and rights to property . . . belonging" to the taxpayer and since the extent of the taxpayer's property interest is determined by state law, where the applicable state law declares that the taxpayer has no rights in the property, there is "no property" to which the federal lien can attach. Thus in Aquilino v. United States, it was held that a federal tax lien could not attach to money due a taxpayer-general contractor under its construction contract with the owner, until a determination had been made by the state court whether or not the general contractor had a property interest in the sums due to the extent that its subcontractors remained unpaid.

While such an attitude was generally applauded by the bar, the "choateness" doctrine still posed formidable barriers to competing lien creditors and a "crescendo of criticism" arose calling for reform.

In 1966, therefore, Congress undertook a comprehensive revision of "the internal revenue laws concerned with the relationship of Federal tax liens to the interests of other creditors" which culminated in the enactment of the

96. Id. at 515-16. On remand, the New York Court of Appeals held that under New York law, a taxpayer-general contractor had no property interest in money due it from the owner under a construction contract with the owner to the extent that the taxpayer's subcontractors remained unpaid. Aquilino v. United States, 10 N.Y.2d 271, 282, 176 N.E.2d 826, 832, 219 N.Y.S.2d 254, 262 (1961); accord, United States v. Durham Lumber Co., 363 U.S. 522 (1960) (same under North Carolina law); United States v. Bess, 357 U.S. 51 (1958) (federal tax lien cannot attach to full insurance proceeds of a life insurance policy payable on taxpayer-beneficiary's death; it can only attach to the cash surrender value since, under New Jersey law, beneficiary's property interest extended only to the cash surrender value); In re Halprin, 280 F.2d 407 (3d Cir. 1960) (bankrupt's unearned, conditional right to payment under a contract in existence when the federal tax lien arose, did not constitute property of the bankrupt to which the federal lien could attach where the bankrupt subsequently assigned such conditional right to a bank as security for a loan).


The "no property" doctrine is clearly related to the choate lien doctrine. That is, where a creditor's lien is choate in the federal sense it will often be true that the taxpayer-debtor has no property rights under state law in the property subject to the lien. For in-depth discussions of the choateness and no property doctrines see 1 P. Coogan, W. Hogan, D. Vagts, Secured Transactions under the Uniform Commercial Code § 12.08 (1976); Babitt & Freiman, The Priority of Federal Claims: Selected Problems and Theoretical Considerations, 24 Case W. Res. L. Rev. 521, 535-49 (1973); Coogan, The Effect of the Federal Tax Lien Act of 1966 upon Security Interests Created under the Uniform Commercial Code, 81 Harv. L. Rev. 1369, 1373-80 (1968); Creedon, Assignments for Security and Federal Tax Liens, 37 Fordham L. Rev. 535, 538-61 (1969); Overman, Federal Tax Liens: A Guide to the Priority System of Section 6323 of the Internal Revenue Code, 16 B.C. Ind. & Com. L. Rev. 729, 731-38 (1975).

Federal Tax Lien Act of 1966 (FTLA). A major objective of the act was "to conform the lien provisions of the internal revenue laws to the concepts developed in [the] Uniform Commercial Code." The FTLA was also, in part, an attempt to reform the choateness doctrine and thus to eliminate some of the injustices to secured creditors and other competing lien holders which the doctrine had created. The act substantially strengthened the rights of private secured creditors against a competing federal tax lien. Initially, it must be observed that the FTLA codified much of the choateness doctrine. It would also seem clear, however, that it largely superseded the doctrine as far as certain protected interests are concerned. The Senate and House reports accompanying the bill which became the FTLA state:

This bill substantially improves the status of private secured creditors. . . . Various types of secured creditor interests already having, or given, priority status over tax liens are specifically defined, and it is provided that where those interests qualify under the definitions they are to be accorded this priority status whether or not they are in all other respects definite and complete at the time notice of the tax lien is filed.


102. Nevada Rock & Sand Co. v. United States, 376 F. Supp. 161, 168 (D. Nev. 1974); Coogan, The Effect of the Federal Tax Lien Act of 1966 upon Security Interests Created under the Uniform Commercial Code, 81 Harv. L. Rev. 1369, 1381 (1968). The House Report stated: "Under decisions of the Supreme Court a mortgagee, pledgee or judgment creditor is protected at the time notice of the tax lien is filed if the identity of the lienor, the property subject to the lien, and the amount of the lien are all established at such time. . . . Except as otherwise provided, subsection (a) of new section 6323 retains this basic rule of Federal law." House Report, supra note 97, at 35. However, the Report adds that "[t]he holder of a security interest has priority over a Federal tax lien if, at the time notice of the tax lien is filed, the security interest exists within the meaning of section 6323(h)(1)." Id.

The question, then, is to what extent the choateness doctrine was superseded by the enactment of the FTLA with regard to "security interests." It is submitted that the FTLA clearly rendered the choateness requirements inapplicable to such interests.\(^{104}\)

Section 6323(a) provides that a federal tax lien is not valid as against any "holder of a security interest" until notice of the lien has been filed.\(^{105}\) The Internal Revenue Code's definition of "security interest" is found in section 6323(h)(1):

The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a...


\(^{105}\) Int. Rev. Code of 1954, § 6323(a) provides in pertinent part: "The lien imposed by section 6321 shall not be valid as against any . . . holder of a security interest . . . until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate."

Prior to its amendment, the section had provided that "the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed . . . ." Int. Rev. Code of 1954, ch. 64, § 6323(a), 68A Stat. 779, as amended, Int. Rev. Code of 1954, § 6323(a). Despite this language, which would seem to dictate that the specified interests would always take priority over a tax lien until filed, the Supreme Court held that the interests were subordinate to a federal tax lien except to the extent that they were choate as of the date the federal lien was filed. E.g., United States v. Pioneer Am. Ins. Co., 374 U.S. 84 (1963); United States v. R.F. Ball Constr. Co., 355 U.S. 587 (1958) (per curiam). The reports accompanying the FTLA, however, give an overwhelming indication that the choateness test is not to be applied to the interests specified in the new section 6323(a) despite the fact that its language is substantially similar to that of the prior provision. "The substitution of 'holder of a security interest' for 'mortgagee' and 'pledgee' replaces the latter terms with a more general term used in the Uniform Commercial Code. More important, however, it is intended that, under the bill, the various types of interests defined in this provision are to have a priority over a nonfiled Federal tax lien if they come within the definitions of these terms . . . whether or not in all other regards they are definite and complete at the time notice of the tax lien is filed." Senate Report, supra note 97, at 3-4 (footnote omitted); House Report, supra note 97, at 3-4 (footnote omitted).
subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.\textsuperscript{106}

The House Report which accompanied the bill stated that "[t]he holder of a security interest has priority over a Federal tax lien if, at the time notice of the tax lien is filed, the security interest exists within the meaning of section 6323(h)(1)."\textsuperscript{107} The FTLA thus provides a precise definitional framework which, to a large extent, replaces the choateness requirements. If an interest meets the definitional requirements of section 6323(h)(1), it is protected against a subsequently filed tax lien regardless of whether the interest would have been considered choate under the pre-1966 standard.\textsuperscript{108}

The chief difficulty is determining the scope of the phrase "the property is in existence."\textsuperscript{109} It should first be noted that the FTLA's definition of a security interest appears closely analogous to that of the UCC.\textsuperscript{110} The phrase "protected . . . against a subsequent judgment lien"\textsuperscript{111} has substantially the same meaning as protection against the UCC's "lien creditor."\textsuperscript{112} Furthermore, under the UCC, a security interest cannot exist until the debtor has rights in the collateral and the secured party has given value.\textsuperscript{113} For this reason, it has been suggested that the Internal Revenue Code's requirement that the property be "in existence" is equivalent to the requirement that the debtor have rights in the collateral.\textsuperscript{114} If this is so, then there is no reason why "contract rights"\textsuperscript{115} owned by the debtor at the time a security agreement is executed, cannot be the subject of an effective security interest under the

\textsuperscript{106} Int. Rev. Code of 1954, § 6323(h)(1) (emphasis added). Compare UCC § 1-201(37) (1972 version): "Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation."

\textsuperscript{107} House Report, supra note 97, at 35.


\textsuperscript{110} See note 106 supra. One court has even gone so far as to suggest that whatever "is properly the subject matter of a 'security interest' under the Uniform Commercial Code would also be property under the Tax Lien Act of 1966 . . . ." Centex Constr. Co. v. Kennedy, 332 F. Supp. 1213, 1214 (S.D. Tex. 1971). See also Senate Report, supra note 97, at 3-4; House Report, supra note 97, at 3-4.


\textsuperscript{113} UCC § 9-204(1); UCC § 9-203 (1972 version).

\textsuperscript{114} Coogan, The Effect of the Federal Tax Lien Act of 1966 upon Security Interests Created under the Uniform Commercial Code, 81 Harv. L. Rev. 1369, 1383 (1968).

\textsuperscript{115} In the 1962 version of the UCC, a contract right is defined as "any right to payment under a contract not yet earned by performance . . . ." UCC § 9-106. The 1972 amendments have deleted the term. The concept is now included in the definition of "account." UCC § 9-106 (1972 version).
FTLA. 116 Virtually all commentators117 have agreed that contract rights can be property which is "in existence" within the meaning of section 6323(h)(1) and they are supported by some case authority.118 Thus, a perfected security interest in contract rights acquired by the debtor before the federal lien is filed should take priority over the federal tax lien.

The "proceeds" question is not substantially more difficult. Assume that a taxpayer-debtor enters into an agreement to secure a debt.119 Secured Party files a financing statement which also claims "proceeds."120 A tax assessment is then imposed against Taxpayer-Debtor, notice of which is properly filed. If Taxpayer-Debtor subsequently sells part of the collateral and receives proceeds of the sale that are identifiable, it is beyond dispute that, as of the date of the tax filing, Secured Party "had a security interest 'perfected' in [the] UCC sense"1121 and 'in existence' in section 6323(h)(1) terminology in . . . [the] proceeds."122 It is of no importance that the "proceeds" were received by the

116. Contract rights are clearly protected under Int. Rev. Code of 1954, § 6323(c)(2) as a kind of "commercial financing security"; see House Report, supra note 97, at 42.
118. The question was squarely faced in Centex Constr. Co. v. Kennedy, 332 F. Supp. 1213 (S.D. Tex. 1971) (bank's security interest in contract rights is prior in right to a subsequently filed federal tax lien). The court stated that "'contract rights' constitute personal property which is in existence, and effective so long as the lending agency is paying 'money or money's worth' If protected by proper filing, a security interest in such property should have priority over a subsequently filed Federal tax lien." Id. at 1215. For an interesting pre-FTLA case see Rockmore v. Lehman, 129 F.2d 892 (2d Cir. 1942), cert. denied, 317 U.S. 700 (1943). See also Hammes v. Tucson Newspapers, Inc., 324 F.2d 101 (9th Cir. 1963) (assignment of rights to payment under contract for sale of land held choate and prior in right to federal tax lien where assignment was made before tax lien was filed but assigned payments fell due after date of filing). The court stated: "The fact that the property subject to the lien is a present right to receive money in futuro does not make the lien inchoate, at least where the right is unconditional." Id. at 103. Continental Fin., Inc. v. Cambridge Lee Metal Co., 100 N.J. Super. 327, 241 A.2d 853 (L. Div. 1968), aff'd, 105 N.J. Super. 406, 252 A.2d 417 (App. Div. 1969) (per curiam), aff'd, 56 N.J. 148, 265 A.2d 536 (1970), is not to the contrary. While the superior court held for the government on the ground that a security interest in a contract right is necessarily contingent and inchoate, the supreme court found that there were no contract rights involved in the case and affirmed on the narrow ground that there was no enforceable contract between the debtor and the third party obliging the debtor to perform. 56 N.J. at 151-54, 265 A.2d at 537-39.
120. Under the 1972 amendments to article 9, the financing statement need no longer claim "proceeds"; see note 79 supra.
121. See UCC § 9-306.
debtor after the tax lien filing since virtually all forms of security must be reduced to cash before they can be used to discharge the debt secured.\textsuperscript{123}

Thus, it would appear that property protected by a section 6323(h)(1) security interest need not always be in actual existence as of the date of the tax lien filing, at least where such property is "proceeds" of the collateral within the meaning of section 9-306 of the UCC. A contrary result was reached in \textit{Federal Insurance Co. v. Billy's Burgers, Inc.}\textsuperscript{124} The court held that, although the secured party had a perfected security interest in the original collateral and the proceeds of the insurance policy were assigned to it in the security agreement, the secured party's interest in the proceeds did not exist under section 6323(h)(1) until the insurance company admitted it owed the money, which was subsequent to the date of the tax lien filing.\textsuperscript{125} The government's tax lien was therefore prior in right to the secured party's claim.\textsuperscript{126}

Two recent cases\textsuperscript{127} involving priority disputes in insurance funds between secured creditors and the federal government have reached interesting results on both the "proceeds" and priority questions. Both cases were decided under the FTLA and applied the 1962 version of the UCC.\textsuperscript{128}

\textit{Firemen's Fund American Insurance Co. v. Ken-Lori Knits, Inc.},\textsuperscript{129} involved a priority dispute between a secured party and the federal government over the rights in an insurance fund payable by reason of the destruction of the collateral by fire. The government's claim was based on various tax liens, notices of which were filed subsequent to the perfection of the secured party's security interest in the original collateral. The government, relying upon the \textit{Universal C.I.T.} and \textit{Quigley} decisions, argued that the secured party's

\begin{itemize}
\item \textsuperscript{123} Id. at 1385. Analytically this position presents at least one difficulty. Under the assumed facts, Taxpayer-Debtor had no rights in the proceeds until after notice of the tax lien was filed. It must be remembered, however, that a UCC security interest in "proceeds" is continuously perfected as of the date the security interest in the original collateral was perfected; see UCC § 9-306(3). It has thus even been suggested that the Internal Revenue Code's "in existence" requirement is equivalent to the UCC's definition of "perfection." Gamble, \textit{Secured Transactions: The Perfected Security Interest Versus Competing Claims}, 5 Cumberland-Samford L. Rev. 1, 18 (1974); cf. \textit{Donald v. Madison Indus., Inc.}, 483 F.2d 837, 845 (10th Cir. 1973).
\item \textsuperscript{124} 72 Civ. 1098 (S.D.N.Y., Feb. 16, 1973). \textit{Billy's Burgers} was effectively overruled in \textit{PPG Indus., Inc. v. Hartford Fire Ins. Co.}, 531 F.2d 58, 62 (2d Cir. 1976).
\item \textsuperscript{125} 72 Civ. 1098, at 8-9. The court appeared to assume, however, that the insurance payments were "proceeds" (under N.Y. U.C.C. § 9-306 (McKinney 1964)) and that the choiceness doctrine is no longer applicable to security interests under the FTLA. Neither issue, however, was even raised in the opinion.
\item \textsuperscript{126} 72 Civ. 1098, at 9.
\item \textsuperscript{128} New York has not adopted the 1972 amendments. See N.Y. U.C.C. § 9-306(1) (McKinney 1964). The revisions were introduced into the New York legislature on January 29, 1975 as S. 1794 and A. 2131, but have yet to be reported out of the Senate and Assembly Judiciary Committees; see N.Y. Legis. Record and Index S 174, A 198 (1975).
\item \textsuperscript{129} 399 F. Supp. 286 (E.D.N.Y. 1975).
\end{itemize}
interest did not extend to the insurance proceeds under section 9-306(1). In rejecting this argument the court distinguished Universal C.I.T. and Quigley on the ground that in neither of those cases was the debtor obligated by the security agreement to procure insurance for the protection of the secured party. The court buttressed its holding by finding that since: (1) both security agreements and the filed financing statements covered "proceeds"; (2) a rider to the second agreement assigned all sums payable under the insurance policy to the secured party as further security for its loan to the debtor; and (3) the secured party was named as the loss-payee on the policy, the intention of the parties that the secured party "have the status of a secured creditor with regard to the insurance proceeds" was clearly manifested. "While one of these steps alone might not have been sufficient," their cumulative effect was. Therefore, "[u]nder these circumstances, § 9-306(1) should be read to include insurance proceeds." This holding raises some interesting questions. The court was clearly attempting to give effect to the express intention of the parties that the secured party receive the insurance proceeds. But, in any event, the intention of the parties to a particular security agreement is not relevant to the question of whether, under the statute, insurance, payable by reason of loss or damage to the collateral, can be "proceeds" of the collateral. If they are "proceeds," it should make no difference that the secured party was named as loss-payee on the policy, or was assignee of "all sums which may become payable under such insurance" as long as its original security interest covered "proceeds" and was timely perfected. This is all that the Code requires. But, under the holding of Firemen's Fund, both of these steps would appear to be necessary to create a continuing security interest in insurance as "proceeds." Furthermore, the opinion does not make clear when the secured party's security interest in the insurance fund came into "existence" within the meaning of section 6323(h)(1) of the Internal Revenue Code so as to take priority over a subsequently filed federal tax lien. The court merely stated that the secured party's "lien became choate" at least at the date of

130. Id. at 290; see N.Y. U.C.C. § 9-306(1) (McKinney 1964).
131. 399 F. Supp. at 290.
132. Id. at 290-91.
133. Id. at 290.
134. Id. at 291.
135. Although the point was not discussed, it is arguable that, since the secured party was named as loss-payee on the policy and its claim exceeded the amount of the available insurance fund, the debtor had "no property" interest in the insurance payments to which the federal tax liens could attach.
136. See 399 F. Supp. at 290-91.
137. Id. at 290.
138. A precise resolution of this issue was unnecessary to the decision in the case since both the fire which resulted in the destruction of the collateral and the perfection of the two security agreements occurred prior to the federal government's filing of notice of its tax liens. Id. at 291.
139. Instead of interpreting the "in existence" requirement, the court in Firemen's Fund applied the traditional "choateness" test to the secured party's earlier competing lien. It would
the fire," and added that "it may well have become choate when, with the perfecting of the security agreement, [the secured party] obtained present rights in the insurance policy to receive payments in the future in the event of damage to the property."

The Second Circuit, in *PPG Industries, Inc. v. Hartford Fire Insurance Co.*, took a step towards resolving some of these difficulties. Car Color, Inc. (debtor), entered into a security agreement, dated September 28, 1970, with PPG Industries, Inc. (secured party), which gave PPG a security interest in all of Car Color's inventory and equipment, and in all "proceeds" of the inventory. The security agreement also provided that Car Color was to insure both the inventory and equipment for the benefit of PPG, that in the event of a loss the insurance company was to pay PPG directly, and that Car Color assigned to PPG all rights to receive the proceeds of the insurance policy. This agreement was properly filed by PPG on October 8, 1970.

Car Color subsequently obtained a $25,000 insurance policy from the Hartford Fire Insurance Company (Hartford), but the only named insured or loss-payee on the policy was Car Color. On December 23, 1971, Car Color's premises were destroyed by fire. When Hartford disclaimed liability, asserting that the fire was caused by arson attributable to the insured, Car Color sued, and, on April 25, 1973, obtained a $7,354.29 judgment retroactive to April 3, 1972, the date proof of loss had been submitted to the insurance company. The judgment covered "all losses" sustained as a result of the fire, apparently including some damage to tools and a wall. On June 26, 1973, PPG served Hartford with an execution of a default judgment in the amount of $12,300.90 that it had obtained against Car Color on April 14, 1972.

Meanwhile, on December 10, 1971 and March 27, 1972, the United States had imposed two tax assessments against Car Color for failure to pay its federal withholding tax. Notice of the tax liens for these assessments, which totaled $2,078.10, was properly filed by the government on May 4, 1972,
subsequent to the fire, but almost a year before Car Color obtained its judgment against Hartford.\textsuperscript{147}

\textit{PPG Industries} thus involved a priority dispute between the federal government and PPG over who was entitled to first priority in the insurance fund created when the debtor's premises were destroyed by fire. In affirming the district court's decision,\textsuperscript{148} the Second Circuit held that PPG had a valid and continuing security interest in the insurance proceeds which satisfied the "in existence" requirement of section 6323(h)(1) of the Internal Revenue Code so as to take priority over the government's subsequently filed tax liens.\textsuperscript{149}

In response to the government's assertion that no security interest can be created in insurance "proceeds," the court held that the UCC only excludes an insurance policy as original collateral but not insurance payments as "pro-

\begin{table}[h]
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\begin{tabular}{|l|l|}
\hline
\textbf{EVENT} & \textbf{DATE} \\
\hline
a) PPG and Car Color execute security agreement & 9/28/70 \\
b) PPG files security agreement and financing statement & 10/8/70 \\
c) Car Color obtains fire insurance policy from Hartford with itself named as loss-payee & 12/10/70 \\
d) First tax assessment imposed & 12/10/71 \\
e) Fire at Car Color & 12/23/71 \\
f) Second tax assessment imposed & 3/27/72 \\
g) Car Color submits proof of loss to Hartford & 4/3/72 \\
h) PPG obtains default judgment against Car Color & 4/14/72 \\
i) Tax liens filed & 5/4/72 \\
j) Car Color obtains judgment against Hartford & 4/25/73 \\
k) PPG serves Hartford with an execution of the prior default judgment & 6/26/73 \\
\hline
\end{tabular}
\caption{Chronological order of events.}
\end{table}

\textsuperscript{147} In chronological order, the events occurred as follows:

\begin{itemize}
\item [a)] PPG and Car Color execute security agreement
\item [b)] PPG files security agreement and financing statement
\item [c)] Car Color obtains fire insurance policy from Hartford with itself named as loss-payee
\item [d)] First tax assessment imposed
\item [e)] Fire at Car Color
\item [f)] Second tax assessment imposed
\item [g)] Car Color submits proof of loss to Hartford
\item [h)] PPG obtains default judgment against Car Color
\item [i)] Tax liens filed
\item [j)] Car Color obtains judgment against Hartford
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\item [h)] PPG obtains default judgment against Car Color
\item [i)] Tax liens filed
\item [j)] Car Color obtains judgment against Hartford
\item [k)] PPG serves Hartford with an execution of the prior default judgment
\end{itemize}

\textsuperscript{148} PPG Indus., Inc. v. Hartford Fire Ins. Co., 384 F. Supp. 91 (S.D.N.Y. 1974), aff'd, 531 F.2d 58 (2d Cir. 1976). The court discussed the Billy's Burgers decision (see text accompanying notes 124-26 supra) at some length before concluding that "[t]he instant case cannot be distinguished factually from Billy's Burgers. However, with all respect, this Court cannot agree with the result reached there." 384 F. Supp. at 97 (italics omitted).

\textsuperscript{149} PPG Indus., Inc. v. Hartford Fire Ins. Co., 531 F.2d 58 (2d Cir. 1976).
ceeds.” Furthermore, it supported the district court’s specific rejection of the reasoning behind the prior decisions which had held that insurance could not be “proceeds” under section 9-306. The Second Circuit went on to state that, although the 1972 amendments to article 9 have not yet been adopted by the New York legislature, the revisions are “a persuasive indication of the effect which § 9-306 was originally intended to have.” And, “[s]ince no New York court has ruled on this question, the fact that the state legislature had not yet enacted this amendment does not preclude a federal court from rendering a decision which is consistent with the original intention underlying § 9-306.”

*PPG Industries* thus appears to embrace the 1972 revisions as the present law of New York. However, theliberality of its holding was somewhat

150. Id. at 60; see notes 29-35 supra and accompanying text.
152. 531 F.2d at 61.
153. See note 128 supra.
154. 531 F.2d at 61 (emphasis added). This conclusion is supported by the official commentary and by the official reasons for the 1972 change; see note 63 supra and accompanying text. The holding would also seem to be correct as a matter of statutory construction. The Ninth Circuit, in holding that government crop “abandonment payments” are “proceeds” within the meaning of UCC § 9-306(1), stated that the broad definition of “proceeds” in that subsection indicates that the word “is to be given a broad and flexible content.” In re Munger, 495 F.2d 511, 513 (9th Cir. 1974). The court added that “[n]ot to include such payments within the term ‘proceeds’ would be to raise distinctions of form over the realities underlying this financing transaction, a result contrary to the intent of the Uniform Commercial Code.” Id. This argument would appear equally applicable to insurance payments. Furthermore, courts have recognized that they have a responsibility to liberally construe the UCC to promote its underlying purposes and policies; see, e.g., In re United Thrift Stores, Inc., 363 F.2d 11, 14-15 (3d Cir. 1966); National Shawmut Bank v. Vera, 352 Mass. 11, 16, 223 N.E.2d 515, 518 (1967); Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 335, 422 P.2d 366, 369 (1967).
155. But cf. General Motors Acceptance Corp. v. Allstate Ins. Co., 77 Misc. 2d 849, 355 N.Y.S.2d 78 (Dist. Ct. 1974). The secured party had a security interest in its debtor’s automobile. After the auto was wrecked by a driver insured by Allstate, the insurance company paid the debtor’s claim in the amount of $1,200. As part of the insurance settlement, the automobile covered by the secured party’s security interest was transferred by bill of sale to Allstate. The insurance company, however, allowed the debtor to keep the car (which was a total loss). When the debtor defaulted on his installment payments to the secured party, the latter sued Allstate (as owner of the auto) for the unpaid balance. In holding for the secured party, the court found that the insurance company was a buyer and since it was not a buyer in the ordinary course of business it took subject to the secured party’s interest by virtue of UCC § 9-201; see note 35 supra. The court does not mention proceeds but apparently assumes that insurance is proceeds since the case rests on the theory that the secured party was entitled to the insurance payments by virtue of its security interest and that Allstate, therefore, had an obligation to search the records to establish whether someone other than the debtor was entitled to the insurance monies. See 1B P. Coogan, W. Hogan & D. Vagts, Secured Transactions under the Uniform Commercial Code § 24.10[1], at 2522 (Cum. Supp. 1976).
156. 531 F.2d at 61.
diminished by the court's interesting dictum that the secured party might not be entitled to the insurance as "proceeds" where the debtor in the ordinary course of business takes out an insurance policy for his own benefit. If the insurance policy is acquired in this manner and for this purpose, there is no reason why the loss proceeds should be made available to a creditor with a security interest in the debtor's inventory. By allowing him to recover the proceeds in such a case, the secured creditor would be given a windfall simply because of the happenstance existence of an insurance policy.  

The court thus states that if Car Color had not taken out the insurance policy pursuant to the security agreement, PPG would not have been entitled to the insurance fund as "proceeds" under section 9-306. Under the amended section 9-306, this conclusion would seem to be erroneous and there appears little reason why the result should be different under the 1962 version of the Code. Insurance either is or is not "proceeds" of the collateral and if insurance is "proceeds," it should not matter what the debtor intends when it takes out the policy.

A return to the simple hypothetical suggested earlier may illustrate the problem. In consideration of a loan from Secured Party, Debtor executes a security agreement with Secured Party granting the latter a security interest in Debtor's tractor. The financing statement is properly filed and all other statutory requirements have been complied with. Debtor subsequently obtains a valid insurance policy on the tractor. This tractor is later completely destroyed in an accident. In jurisdictions which have adopted the 1972 amendments to article 9, the express language of section 9-306(1) would appear to give Secured Party a perfected security interest in the insurance proceeds regardless of what Debtor intended when it took out the insurance policy, even in the absence of an express agreement to insure. In fact, Secured Party would seem to be entitled to the insurance even if the Debtor had obtained a policy on the tractor for its own benefit well before the security agreement had been entered into. Nothing in the amended language of section 9-306(1), which provides only that "[i]nsurance payable by reason of loss or damage to the collateral is proceeds" indicates that the debtor's intention in obtaining the insurance policy is controlling on or even relevant to the question of whether or not a particular insurance fund is "proceeds." Thus, under the 1972 amendments, if the debtor has insured the collateral, the

157. Id. at 63 n.7.
158. The court was "not entirely convinced that the insurance policy taken out by Car Color was the specific one contemplated by the security agreement" but was "willing to accept the district court's stated conclusion that . . . the insurance obtained by Car Color was specifically intended to be further security for PPG's lien." Id. This language is all the more curious since PPG did not even attempt to argue that the policy had been obtained in compliance with the security agreement; see Brief for Appellee at 5, PPG Indus., Inc. v. Hartford Fire Ins. Co., 531 F.2d 58 (2d Cir. 1976).
159. See notes 136-37 supra and accompanying text.
160. See notes 10-15 supra and accompanying text.
161. See note 62 supra.
secured party should be entitled to the insurance payments regardless of what the debtor intended when obtaining the policy on the collateral. In *PPG Industries*, however, the court seems to have been particularly influenced by the parties' clearly expressed intention that the secured party receive the insurance payments. It may have overlooked the fact that a specific agreement to insure would not seem to be necessary to give the secured party rights in the insurance payments under the 1972 revisions. Thus, under the holding of *PPG Industries*, while a loss-payee clause is no longer necessary, an agreement to insure for the benefit of the secured party and an insurance policy obtained pursuant to that agreement may well be. The Second Circuit, therefore, appears not to have extended the 1972 amendments as far as the drafters had intended.

There may be a second problem with the holding of *PPG Industries*. Clearly, even under the 1972 amendments, a secured party with a continuing security interest in "proceeds" is only entitled to that portion of an insurance fund which arose from loss or damage to the secured collateral. It would not be entitled to that portion of the insurance payable by reason of damage to any of the debtor's other property. Thus, the insurance proceeds should be traced to the collateral.

The tracing issue was not discussed in *PPG Industries*. PPG's security interest in "proceeds" extended only to the proceeds of Car Color's inventory. Nevertheless, the judgment recovered by Car Color against the insurance company covered all of the losses which Car Color had sustained as a result of the fire and apparently included compensation for some damage to tools and a wall. Even though PPG clearly was not entitled to any portion of the fund not traceable to the destruction of Car Color's inventory, the Second Circuit affirmed PPG's right to all of the available insurance monies. In these circumstances, a remand to the district court in order to resolve the tracing issue would have been more appropriate.

162. See 531 F.2d at 63 n.7.
164. That is, property not covered by the security agreement.
165. See note 143 supra and accompanying text. The security agreement provided that "Borrower hereby grants to Secured Party to secure all of Borrower's Liabilities a security interest under the Uniform Commercial Code in the Inventory owned by Borrower at the date of this agreement; the Inventory at any time hereafter acquired by Borrower; [sic] all proceeds of such Inventory; and the Equipment which is used in Borrower's business, to secure the payment of all liability or liabilities of Borrower to Secured Party . . . ." Joint Appendix at 61, *PPG Indus., Inc. v. Hartford Fire Ins. Co.*, 531 F.2d 58 (2d Cir. 1976).
166. See notes 144-46 supra and accompanying text.
167. See *Firemen's Fund Am. Ins. Co. v. Ken-Lori Knits, Inc.*, 399 F. Supp. 286, 292 (E.D.N.Y. 1975), discussed in notes 129-41 supra and accompanying text, where the court denied summary judgment as to a portion of the insurance fund traceable to the loss of certain yarn because it was not known precisely what portion of the yarn was owned by each of the two corporate debtors. In *Firemen's Fund*, supra, this factual issue was held to be determinative of the rights of the various competing claimants to the portion of the fund attributable to the loss of the yarn. It may, as a practical matter, sometimes be difficult to accurately trace the insurance proceeds directly to the secured collateral, but the difficulties do not appear insuperable.
It is also apparent from the previous discussion of the choateness doctrine\textsuperscript{168} that PPG's security interest in the insurance proceeds was not choate under pre-FTLA standards as of either the date on which the federal tax liens arose,\textsuperscript{169} or the date on which they were filed,\textsuperscript{170} since the fund was not created until later.\textsuperscript{171} Indeed, the insurance company was still disclaiming liability as of the date on which notice of the liens was filed. Therefore, the property subject to PPG's lien was by no means established, and thus, under pre-1966 law, would have been deemed inchoate and subordinate to the federal tax lien.\textsuperscript{172} Yet, in \textit{PPG Industries}, the Second Circuit rejected the choateness doctrine and instead applied only the definitional requirements for a federally defined security interest contained in the Internal Revenue Code.

The district court had concluded its discussion of the "in existence" requirement of section 6323(h)(1) by holding that "the property which was the subject matter of the security agreement (here, the inventory), was clearly in existence, and . . . the proceeds of the insurance are merely the collateral in another form."\textsuperscript{173}

The Second Circuit, recognizing that priority conflicts involving federal tax

\begin{footnotes}
\item 168. See notes 87-96 supra and accompanying text.
\item 169. December 10, 1971 and March 27, 1972; see note 147 supra.
\item 170. May 4, 1972; see note 147 supra.
\item 171. That is, April 25, 1973, when Car Color obtained its judgment against the insurance company; see note 147 supra.
\item 172. But see \textit{Firemen's Fund Am. Ins. Co. v. Ken-Lori Knits, Inc.}, 399 F. Supp. 286, 291 (E.D.N.Y. 1975). However, the court was applying post-1966 law and should not, it would seem, have even discussed the choateness doctrine but rather should have confined itself to the definitional requirements of § 6323(h)(1).
\item 173. 384 F. Supp. at 97. Had PPG relied solely on the assignment to it of the proceeds of the insurance policy contained in the original security agreement, its claim would clearly have been held subordinate to that of the government. As the district court pointed out: "The law in New York is well settled that an assignment of a future interest in the proceeds of a claim is equitable only, and does not become a legal assignment until the proceeds have come into existence. . . . Moreover, the ripening of an equitable lien into a legal lien does not relate back to the date of the execution of the original instrument." Id. at 95 (citations omitted). An interesting case which the district court discussed at some length is \textit{Andrello v. Nationwide Mut. Fire Ins. Co.}, 29 App. Div. 2d 489, 289 N.Y.S.2d 293 (4th Dep't 1968) which was decided under pre-1966 law. In Andrello, the claim of two mortgagees of the debtor's real property to fire insurance proceeds payable by reason of damage to the mortgaged property was held prior in right to the government's claim based on tax assessments which were never properly filed, where the mortgage specifically provided that the debtor would keep the mortgaged property insured against fire loss for the benefit of the mortgagees. The court found that the mortgagees were "pledgees" of the insurance fund within the meaning of the pre-1966 § 6323(a) and thus took priority over the government's improperly filed (i.e., unfiled) tax liens. It should be noted that the term "pledgee" is included in the term "holder of a security interest" under the FTLA; see House Report, supra note 97, at 35. Thus, under the holding of Andrello the mortgagees would also be "holders of a security interest" in the insurance fund under the FTLA. This is, in fact, what the trial court in Andrello had held in mistakenly applying the amended section 6323(a) retroactively. 29 App. Div. 2d at 492, 289 N.Y.S.2d at 296-97.
\end{footnotes}
liens are to be resolved according to federal law,174 agreed with the district court's liberal interpretation of "in existence"175 and thereby repudiated the actual existence requirement which had been advocated in Billy's Burgers.176 The circuit court concluded:

If anything, the "existence" requirement of § 6323(h)(1) is satisfied by the existence of an available insurance policy. Any contrary result would penalize the very party responsible for the existence of this fund in the first place. As PPG rightfully points out, had Car Color not taken out an insurance policy, the Government would have had no assets against which its two claims could have been satisfied. Furthermore, the tax lien would clearly have been subordinate to PPG's security interest in the inventory and equipment if there had been no fire.177

The court's liberal interpretation of section 6323(h)(1) is consistent with both the policy of article 9178 and that of the FTLA179 to protect the interests of secured creditors as well as with the policy of the FTLA to conform the Internal Revenue laws to the business concepts of the UCC.180 It is therefore submitted that the Second Circuit was correct in holding that a continuing UCC security interest in insurance proceeds meets all the requirements for a federally defined security interest, so as to take priority over a federal tax lien filed after the security interest comes into actual existence.181 It is further submitted that the court was also correct in its determination that such a security interest comes into existence within the meaning of section 6323(h)(1) when the secured party perfects its security interest in the original collateral and the debtor obtains rights in an insurance policy covering the collateral which is payable to either the debtor or the secured party.182

176. See notes 124-26 supra and accompanying text. "[T]he district court's interpretation of [§ 6323(h)(1)] is the only one which makes sense from a policy standpoint. Admittedly the proceeds did not come into existence until a judgment was obtained against Hartford, however, the original security interest was not in the after acquired proceeds but in the debtor's inventory and equipment. When this was destroyed, PPG's security interest continued under 9-306(1), first in the existing insurance policy and then in the funds which were paid out of that policy." 531 F.2d at 62 (italics omitted).
177. Id. (italics and footnotes omitted). In the alternative, the court held that the case "fit within the statutory exception as a 'commercial transaction financing agreement' secured by inventory, with the insurance simply being a substitute for the inventory" under Int. Rev. Code of 1954, § 6323(c). 531 F.2d at 62 n.6. This holding would seem to be incorrect as a matter of statutory construction. Section 6323(c)(2) states unequivocally that property protected by § 6323(c) must be "acquired by the taxpayer before the 46th day after the date of the tax lien filing." Int. Rev. Code of 1954, § 6323(c)(2)(B); see Texas Oil & Gas Corp. v. United States, 466 F.2d 1040, 1051 (5th Cir. 1972), cert. denied, 410 U.S. 929 (1973). Notice of the tax liens was filed almost one year before the debtor (Car Color) acquired the insurance proceeds; see note 147 supra.
178. See note 35 supra and accompanying text.
179. See notes 100-03 supra and accompanying text.
180. See note 99 supra and accompanying text.
181. 531 F.2d at 62-63.
182. Id.
unanswered questions, the opinion in *PPG Industries* goes far towards clarifying some difficult problems involving UCC section 9-306, the relationship of the UCC to the FTLA and the relationship of the FTLA to the choateness doctrine.

V. CONCLUSION

It should be evident that insurance payments can be "proceeds" under the 1962 version of UCC section 9-306 and that the choateness doctrine has been superseded as to consensual security interests by the enactment of the FTLA. It should also be clear that both "proceeds" acquired after the tax lien filing date pursuant to a security interest perfected before that date and contract rights can be "property" which is "in existence" under section 6323(h)(1) of the Internal Revenue Code. Thus the holder of a security interest in insured collateral which is subsequently destroyed in an insured event should be entitled to the insurance proceeds over a government claim based on a subsequently filed tax lien to the extent that the security interest was perfected as of the date of the tax lien filing under the applicable provisions of the UCC.

A caveat is nevertheless in order. Because of the maze of conflicting decisions on the subject and the complexity of the issues involved, courts may not apply these principles with the same clarity and confidence as did the Second Circuit in *PPG Industries*. Furthermore, the result may be open to collateral attack on the insurance as "proceeds" issue by a contrary New York state court decision. In addition, two recent district court cases have shown that the *Quigley* and *Universal C.I.T.* line of cases still has some vitality. Furthermore, such corollary questions as whether payments by a manufacturer to a debtor in settlement of a breach of warranty claim on the secured

183. See notes 157-67 supra and accompanying text; note 177 supra.

184. Thus, the insurance policy must be obtained prior to the date on which the federal lien is filed. Otherwise the security interest in the insurance proceeds will not have been timely perfected. Under the UCC, the debtor must have rights in the collateral before the secured party's interest can attach. UCC § 9-204(1); UCC § 9-203 (1972 version). The debtor will, of course, not be the owner of any contract right under the policy to which this interest can attach until the policy is obtained.

185. *Hamilton Bank v. Bell*, 19 UCC Rep. Serv. 334 (E.D. Tenn. 1976), decided almost three weeks after *PPG Industries*, came to the opposite conclusion on similar facts. The district court, sitting in bankruptcy, there held that the bank's perfected security interest in the bankrupt's inventory and fixtures, which had been destroyed in a fire, did not extend to the insurance proceeds under the Tennessee Uniform Commercial Code. Tennessee has not adopted the 1972 amendments to article 9. The court noted the commentators' criticism of the *Quigley-* *Universal C.I.T.* line of cases but nevertheless found those cases "highly persuasive." Id. at 335. The court did not, however, cite *PPG Industries*.

In *Appliance Buyers Credit Corp. v. Stikes*, 18 UCC Rep. Serv. 576 (S.D. Ala. 1975), another bankruptcy case, neither the security agreement nor the filed financing statement covered "proceeds" of the collateral. But the district court stated in dictum that "even if the security agreement had included 'proceeds,' it has been authoritatively held that funds payable under a policy of insurance upon the destruction of the collateral do not constitute 'proceeds' within the meaning of the Uniform Commercial Code." Id. at 579.
collateral,\textsuperscript{186} or payments to a debtor by a third party tort-feasor in satisfaction of the debtor’s damage claim for tortious destruction of the collateral,\textsuperscript{187} can be “proceeds” have been answered in the negative by the courts. It remains to be seen whether the decision in \textit{PPG Industries}, or the adoption of the 1972 amendments to article 9 will affect the result in these cases. Thus, secured creditors should ensure that every possible step is taken under state law to strengthen their interest in any insurance payments which might arise by reason of loss or damage to collateral.\textsuperscript{188}

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\textsuperscript{188} In addition to perfecting the security interest in the original collateral and filing a financing statement which claims “proceeds” (in those states which have not adopted the 1972 amendments to article 9), such steps might include: (1) making the debtor agree to insure the collateral for the benefit of the secured party; (2) making the debtor execute an assignment of all sums which become payable under the insurance policy to the secured party; (3) arranging to have the secured party named as loss-payee on the insurance policy. This last step may be necessary as a practical matter even in states which have adopted the 1972 amendments; see note 79 supra.