Credit Transactions -- Security Agreement Stipulating That on Sale of the Security Property the Security Attaches to the Proceeds

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unlawful\textsuperscript{34} acts causing damage to the property prior to his avoidance of the contract.\textsuperscript{35} The only relief available for the adult in the normal case is the right to regain whatever remains in the minor’s possession at the time of disaffirmance.\textsuperscript{36}

Surely the policy of the law should be to discourage rather than countenance fraud, recklessness, and lawlessness in the adults of tomorrow. Several states have met this problem with statutory provisions\textsuperscript{37} requiring as a condition to disaffirmance that the infant, if over eighteen at the inception of the contract, restore the consideration or pay its equivalent to the party from whom it was received. This has the effect of requiring the more mature infant to pay for the depreciation and beneficial use and to account for any damages done to the property, while at the same time preserving his right of avoidance. It is hoped that our Legislature will consider enacting such a statute, in view of the tremendous number of purchases of personalty made by minors today.

\textbf{Richard von Biberstein, Jr.}

\section*{Credit Transactions—Security Agreement Stipulating That on Sale of the Security Property the Security Attaches to the Proceeds}

In \textit{Presley E. Brown Lumber Co. v. Textile Banking Co.},\textsuperscript{1} a furniture manufacturer, who was financially impoverished, needed raw materials in the form of core stock, the base to which veneer is applied. The plaintiff-lumber company had such stock to sell but was unwilling to sell to the furniture manufacturer on credit. An agreement was reached whereby the lumber company would consign the core stock to the furniture manufacturer. Title to the raw materials was to remain in the plaintiff until the finished product was sold, at which time the title to the raw materials was to transfer over to the proceeds of sale, including accounts receivable, in proportion to the value of the raw materials in the finished product. The manufacturer was to be the agent to collect the accounts and hold the funds in trust for the plaintiff. This agree-

\textsuperscript{35} Where a statute gives the adult an interest in the chattel, however, the infant is liable for losses sustained through the minor’s failure to notify the adult of the chattel’s seizure and sale under forfeiture proceedings. Williams v. Aldridge Motors, Inc., 237 N.C. 352, 75 S.E.2d 237 (1953).
\textsuperscript{36} McCormick v. Crotts, 198 N.C. 664, 153 S.E. 152 (1930); Hight v. Harris, 188 N.C. 328, 124 S.E. 623 (1924); Chandler v. Jones, 172 N.C. 569, 90 S.E. 350 (1916); Pippen v. Mutual Benefit Life Ins. Co., 130 N.C. 23, 40 S.E. 822 (1902). A minor who avoided a compromise of his legacy has been required to account for the property received under the compromise upon asserting a claim for the legacy. Tipton v. Tipton, 48 N.C. 552 (1856).
\textsuperscript{37} CAL. CIV. CODE § 35 (1954); IDAHO CODE ANN. § 32-103 (1948); MONT. REV. CODES ANN. § 64-107 (1953); N.D. REV. CODE § 14-1011 (1943); OKLA. STAT. Tit. 15, § 19 (1937); S.D. CODE § 43.0105 (1939).

\textsuperscript{1} 248 N.C. 308, 103 S.E.2d 334 (1958).
ment was recorded. The core stock was furnished, the furniture was produced and sold, and accounts receivable came into existence. The furniture manufacturer, again in need of money, sold these accounts receivable to the defendant banking company. In the face of the notice provided by the recordation, the banking company collected the accounts and refused to pay the proceeds to the plaintiff-lumber company.

The lumber company demanded the proceeds, without success, and finally, in this action, sued for the proceeds alleging the agreement explained above. The trial court sustained a demurrer to the plaintiff's cause of action and the Supreme Court on appeal affirmed on the ground that this was a conditional sale of the lumber with permission in the buyer to resell,\(^2\) that when the finished furniture was sold, all the plaintiff-lumber company had was a contractual right to payment from the debtor or assignment by it of the proportion owed to plaintiff from the sales.

The court pointed out that the 1945 Assignment of Accounts Receivable Act\(^3\) as it existed at the time this litigation was commenced was applicable to "a presently subsisting right . . . under an existing contract."\(^4\) Thus, the agreement here could not come under this act because the sales contracts giving rise to the accounts were not yet made at the time of the attempted assignment of a proportion of the accounts to arise from the sale of the furniture after it was manufactured. However, since 1957 the statute allows a creditor to accept an assignment of accounts receivable which are to arise in the future.\(^5\)

May a creditor of a prospective debtor who has unstable credit relations get a lien on the proceeds by stipulating in the security agreement that on sale of the property the security attaches to the proceeds? It seems he can obtain such a lien on proceeds through various routes.

One route is through the Factors' Lien Act.\(^6\) This act is designed for a money lender who advances money on the security of raw materials, goods in process, or finished goods. If the provisions of the act are complied with, and the debtor then sells the security property in the ordinary course of business, the lien attaches, without further act or formality, to the proceeds of the sale, including accounts receivable. However, this is limited to a creditor who advances money within the terms of the act and is not extended to one who supplies raw materials as did the plaintiff-lumber company.

\(^2\) The court did not discuss why a valid consignment was not created. For a collection of cases on consignments, see Annot., 63 A.L.R. 355, 368 (1929). Had a valid consignment been created, the plaintiff-lumber company could have controlled the proceeds.


Another route is through a trust receipt arrangement. Trust receipts are usually used in a three party transaction, as is typical in the automobile wholesale business between the distant manufacturer, the local bank, and the local dealer. Usually, a distant seller will forward goods and their title or bill of lading to a local bank with good credit standing and receive payment immediately. The bank then lets the local buyer take the goods in return for a trust receipt. The holder of the trust receipt has title to the goods until they are sold; when sold, the title attaches to the proceeds. This type of arrangement is provided for in Section 10 of the Uniform Trust Receipts Act.7

Another route would be through Section 9-306 of the Uniform Commercial Code8 which has now been enacted in Pennsylvania,9

7 Uniform Trust Receipts Act § 10 provides:
Where, under the terms of the trust receipt transaction, the trustee has no liberty of sale or other disposition, or, having liberty of sale or other disposition, is to account to the entruster for the proceeds or any disposition of the goods, documents or instruments, the entruster shall be entitled, to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of disposition by the trustee, as follows:
(a) to the debts described in Section 9 (3); and also
(b) to any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) of goods, documents or instruments, if said proceeds were received by the trustee within ten days prior to either application for appointment of a receiver of the trustee, or the filing of a petition in bankruptcy or judicial insolvency proceedings by or against the trustee, or demand made by the entruster for prompt accounting; and to a priority to the amount of such proceeds or value; and also
(c) to any other proceeds of the goods, documents or instruments which are identifiable, unless the provision for accounting has been waived by the entruster by words or conduct; and knowledge by the entruster of the existence of proceeds, without demand for accounting made within ten days from such knowledge, shall be deemed to be such a waiver.

8 Uniform Commercial Code § 9-306 provides in part:
(2) "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.
(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless
(a) a filed financing statement covering the original collateral also covers proceeds; or
(b) the security interest in the proceeds is perfected before the expiration of the ten day period."


Massachusetts, \(^{10}\) Kentucky, \(^{11}\) and Connecticut. \(^{12}\) This act replaces all other acts relating to forms of security and authorizes under limitations a lien on proceeds of any sale of security property. Section 9-306 of the act is based on Section 10 of the Uniform Trust Receipts Act but covers many other types of security arrangements.

Apart from statute, the common law in North Carolina hitherto has apparently permitted one to obtain a lien on proceeds of resale of security property when the debtor assigns the future accounts receivable to the creditor. This is subject to the qualification that if the creditor permits the debtor to have the proceeds of the accounts receivable without accounting for them or replacing the accounts with other accounts of like quality and value, the assignment will be deemed fraudulent in law under the rule of Benedict \(v.\) Ratner. \(^{13}\)

Manufacturers Fin. Co. \(v.\) Armstrong, \(^{14}\) held that unless the debtor had been accorded "unfettered dominion over the accounts and the funds collected from them," \(^{15}\) the contract involved, which assigned accounts receivable to arise in the future, was otherwise valid. Applying this case, the plaintiff-lumber company would have had a valid lien on the proceeds of resale by the furniture manufacturer since the agreement specifically provided that the proceeds were to be held in trust and turned over to the creditor.

In In re Steele, \(^{16}\) a mortgage of accounts receivable was held invalid because "in effect it was agreed that the mortgagor might use the proceeds of collections on the accounts as he saw fit." \(^{17}\) The court said in dictum that the chattel mortgage of accounts receivable due and to become due was otherwise valid even as to the accounts to arise in the future. The same Assignment of Accounts Receivable Act was in effect when this case was decided as when the contract between the plaintiff-lumber company and the furniture manufacturer was entered and contested. Applying the dictum of this case, the lumber company could have recovered the accounts receivable from the banking company.

The security in the instant case was not invalid by reason of its after acquired property feature. Hickson Lumber Co. \(v.\) Gay Lumber Co. \(^{18}\) is the leading case in North Carolina saying you can mortgage property to be acquired in the future; in other words, that you can mortgage the next cast of your net. The court in Hickson recognized the common law rule "that nothing can be mortgaged that is not in existence and

\(^{10}\) Effective October 1, 1958. \(^{21}\) OHIO BAR 1099, 1103 (1958).
\(^{11}\) Effective July 1, 1960. \(^{21}\) OHIO BAR 1099, 1103 (1958).
\(^{13}\) 268 U.S. 353 (1925).
\(^{14}\) 78 F.2d 289 (4th Cir. 1935).
\(^{15}\) 78 F.2d at 292.
\(^{16}\) 122 F. Supp. at 948 (E.D.N.C. 1954).
\(^{17}\) 150 N.C. 282, 63 S.E. 1045 (1909).
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does not at the time belong to the mortgagor, for a person can not convey that which he does not own; but it is now well settled," the court continued, "that equity will give effect to a contract to convey future-acquired property, whether real or personal. Equity considers that done which the mortgagor has agreed to do, and treats the mortgage as already attaching to the newly acquired property as it comes into the mortgagor's hands. . . . In North Carolina a mortgage upon after-acquired property, being enforceable *inter partes*, becomes, upon registration, valid, and enforceable against subsequent purchasers, because the registration is an effectual notice as against the world." 20

In the *Presley E. Brown Lumber Co.* case, since the agreement was recorded and the court held it was a conditional sale, following *Hickson* the plaintiff would have had a lien on the accounts receivable the instant they came into existence by sale of the security property.

**CONCLUSION**

As has been shown above, except for the old Assignment of Accounts Receivable Act, there seem to be no common law policy reasons in North Carolina against allowing one to assign accounts receivable to arise in the future. 21 Whether the court was correct or incorrect in the *Presley E. Brown Lumber Co.* case, the fact remains that clarification is needed in this field.

In 1955, the General Assembly amended the Factors' Lien Act to provide for a lien on proceeds of resale of security property by those who advance money under the Act. 22 In 1957, the General Assembly amended the Assignment of Accounts Receivable Act to allow assignments of accounts receivable which are not yet in existence. 23 A third step needs to be taken by the General Assembly to enact a statute authorizing security agreements which provide for a transfer of the lien from the security property to the accounts receivable or other proceeds arising from its sale. Or a statute could be enacted following the model of Section 9-306 of the Uniform Commercial Code. 24

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19 150 N.C. at 286, 63 S.E. at 1047.
20 150 N.C. at 288, 63 S.E. at 1048.
21 For cases approving this policy in other jurisdictions, see McIntyre v. Hauser, 131 Cal. 11, 63 Pac. 69 (1900); Liddle v. Hernandez, 72 Colo. 585, 211 Pac. 821 (1923); Lathrop v. Schlauger, 113 Neb. 14, 201 N.W. 654 (1924); Brookside Granite Co. v. Latti, 83 N.Y. Misc. 384, 144 N.Y. Supp. 1042 (1913); James River Bank v. Hansen, 51 S.D. 13, 211 N.W. 976 (1927); Kramer v. Burlage, 234 Wis. 538, 291 N.W. 766 (1940); Carpenter v. Forbes, 211 Wis. 648, 247 N.W. 857 (1933); Black Hawk State Bank v. Accola, 194 Wis. 29, 215 N.W. 433 (1927); Annot., Agreement or order to pay obligation out of the proceeds of any sale or mortgage that may be made as creating an equitable mortgage, 101 A.L.R. 81, 87 (1936).
24 See note 8 supra.