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Perfection by Possession in Article 9: Challenging the Arcane but Honored Rule

DAVID A. EBROON*

INTRODUCTION

In a secured transaction, a secured party may seek to obtain perfected status by taking possession of collateral. Perfection often hinges, however, on whether the means of perfection are acceptable as prescribed by the Uniform Commercial Code ("U.C.C." or "Code"). For example, consider the situation where a creditor attempts to take possession of collateral by locking the debtor out of the premises where the collateral is situated,1 or the scenario where a debtor gives a creditor keys to a safety deposit box containing the collateral, but the creditor does not take physical possession of the collateral,2 or the well-known case where a vendor of eight Arabian horses retains possession of registration papers for the horses, but not the animals themselves.3 Section 9-305 of the Code indicates that in order to attain perfected status, "possession [of the collateral] may be by the secured party himself or by an agent on his behalf."4 The drafters of the Code, however, declined the opportunity to define the term "possession," intending that its meaning be fleshed out by case law.5

Although the result of a secured party taking actual, physical possession of collateral is evident,6 assessing the effects of section 9-305 in less graphic circumstances is more problematic. Thus, despite recognizing an outer boundary for satisfactory possession, the issue as to what constitutes valid perfection by possession remains. This Note will evaluate the most common arrangements used to perfect collateral by possession: agents, bailees with

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5. "Possession" is one of the few terms employed by the Code for which it provides no definition. Finance Company of America v. Hans Mueller Corp. (In re Automated Bookbinding Servs., Inc.), 471 F.2d 546, 551-52 (4th Cir. 1972). This view is corroborated by the Code not including the term possession in its "definitions" sections. See U.C.C. §§ 1-201, 9-105.

notice, escrow arrangements, and field warehouses. The analysis will challenge the arcane, but honored, rule that collateral under the dominion of the debtor is ineligible to be perfected by possession.

I. THE BASICS

In a secured transaction, there is always the possibility that competing parties will lay claim to the same collateral. The Code provides a framework to resolve such disputes. Article 9, which governs secured transactions, distinguishes between a "perfected" and an "unperfected" security interest.\(^7\) The former confers a priority that is superior to later, perfected creditors, subsequent purchasers, or one assuming the status of a trustee in bankruptcy.\(^8\) An additional consideration in priority disputes is the form of the collateral pledged.\(^9\) Although not all third-party claims can be resolved by asking whether the security interest has been perfected, the value of such status ought not be underestimated. Thus, the questions that remain are how a creditor can procure this perfected status, and what policy the Code attempts to service in adopting these guidelines.

A typical secured transaction creates the problem of ostensible ownership. Subsequent to a debtor pledging certain collateral to a creditor, there remains the risk that the debtor will exploit the same collateral as security to acquire additional credit. As a result, the Code has adopted a "notice" scheme to eliminate this problem.\(^10\) The goal is to provide "notice to the world" that certain collateral is encumbered by the claims of a secured party:

The basic idea is that the secured creditor must do something to give effective public notice of his interest; if he leaves the property in the debtor's possession and under his apparent control, the debtor will be . . . enabled to sell the property to innocent purchasers or to induce other innocent persons to lend money to him on the strength of his apparently unencumbered assets.\(^11\)

The Code provides two distinct resolutions to the ostensible ownership problem. The most common method is the filing of a financing statement\(^12\)

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7. U.C.C. §§ 9-301, 9-303.
8. In most cases, the third-party claimant will be a statutory or judicial lienor, sometimes known collectively as a "lien creditor." Between a secured creditor and a lien creditor, the secured party loses to a party who has become a lien creditor before the security interest became perfected. U.C.C. § 9-301(1)(b).
9. See infra notes 20-23 and accompanying text.
11. GILMORE, supra note 6, § 14.1, at 438. "[Filing] alerts a prospective creditor or buyer that the property in question may be encumbered and that further inquiry is necessary." DONALD W. BAKER, A LAWYER'S BASIC GUIDE TO SECURED TRANSACTIONS § 3-4[A], at 138 (1983).
12. A financing statement:
gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives the mailing address of the debtor, and contains a statement indicating the types, or describing the items, of collateral.
U.C.C. § 9-402(1).
in the proper location. The Code also allows for taking possession of collateral as a means of perfection. The common law theory of pledges provides a rationale for this alternate means of perfection. Under pre-Code law, the debtor’s physical delivery of collateral to a secured party was labeled a pledge, deemed valid if the pledgee had the power to dispose of the collateral. The premise was that if a creditor retained possession of the property in which the creditor claimed a security interest, other creditors of and purchasers from the debtor could not be misled because the debtor no longer had the opportunity to use the same collateral in another transaction.

One of the first Supreme Court cases dealing with perfection by possession declared, “[P]ossession ought to be certain and not equivocal. If it is ambiguous, if the things pledged [might] deceive the other creditors... the pledge would be endangered.” The “notice to the world” paradigm is now reflected in the language of section 9-305. If a secured party maintains possession of the collateral, the problem of ostensible ownership is eliminated and proper notice is established.

13. U.C.C. § 9-401 identifies the appropriate location for filing within a state. Each jurisdiction may adopt procedures ranging from central filing to local filing. The details of what constitutes a proper filing are beyond the scope of this Note.

14. "A security interest in [collateral] may be perfected by the secured party’s taking possession of the collateral." U.C.C. § 9-305. A financing statement need not be filed to perfect “a security interest in collateral in possession of the secured party under Section 9-305.” U.C.C. § 9-302(1)(a). In order to be effective, collateral must be taken by lawful means. Usually, this connotes the permission of the debtor, although taking possession by legal process, such as a writ of replevin, has been deemed satisfactory. See Engelsma v. Superior Prods. Mfg. Co., 212 N.W.2d 884 (Minn. 1973). But see McCrackin v. Hayes, 163 S.E.2d 246 (Ga. App. 1968) (holding that a secured party in physical possession of a promissory note did not satisfy the Code requirement for possession under § 9-305 because the note was executed by an individual without the proper authority).

Regardless of their common purpose, perfection by filing and perfection by possession have distinct traits. When a security interest is perfected by filing, the time of perfection will be allowed to "relate back" to a time prior to actual filing. For example, a purchase-money secured party that files within 10 days of a debtor taking possession of collateral may relate the date of filing back to the date of the debtor’s possession. U.C.C. § 9-301(2). Section 9-305 makes it clear, however, that when collateral is perfected by possession, there can be no perfection prior to delivery of the collateral to the secured party. “A security interest is perfected by possession from the time possession is taken... U.C.C. § 9-305 (emphasis added). The Code formally eliminates the "equitable pledge" doctrine developed at common law, whereby perfection could relate back to the date of the original security agreement despite the fact that delivery was not tendered until a later date. See, e.g., Johnson v. Burke Manor Bldg. Corp., 48 F.2d 1031 (7th Cir. 1931).


18. Casey v. Cavaroc, 96 U.S. 467, 482 (1877); see also RICHARD F. DUNCAN & WILLIAM H. LYONS, THE LAW AND PRACTICE OF SECURED TRANSACTIONS: WORKING WITH ARTICLE 9 § 3.03, at 3-14 to 3-21 (1987).

19. This principle is highlighted in Tri-State Envelope of Md., Inc. v. Americans with Hart, Inc., 688 F. Supp. 769 (D.D.C. 1988), where, although the secured party took possession of the debtor’s fund-raising proceeds, a technicality in the federal election laws forced the secured party to simultaneously credit and debit the collateral to the debtor’s account. The trustee, in an attempt to deny perfected status, alleged that the secured party did not maintain continuous possession of the collateral as required by the Code. The court disagreed, declaring “Cases and commentators universally [recognize] that the primary purpose behind requiring creditors to take possession of certain collateral is to advise third
With respect to the type of collateral which is eligible for perfection by possession, pre-Code law examined custom and commercial usage. The modern view, while maintaining this spirit, is considerably more proscriptive. Section 9-305 indicates that only security interests in specific collateral are perfectible by possession: letters of credit and advices of credit, goods, instruments, money, negotiable documents, or chattel paper. Security interests listing collateral lacking physical attributes are known as pure intangibles. They include accounts and general intangibles, and may be perfected only by filing.

II. POSSESSION BY A THIRD PERSON

Pre-Code law recognized that, under certain circumstances, a third person in possession of collateral could perfect a pledge on behalf of the secured party. The thrust of pre-Code law was to ensure that the third person, and thus the collateral itself, was not under the dominion of the debtor. The court held that the underlying purpose of perfection by possession was not defeated because the debtor did not have a realistic opportunity to re-pledge the collateral.

20. "We may refer to the established custom as evidence of what has long been understood as the law; for, as this court held... such usages are to be judicially recognized as part of the law." Dale v. Pattison, 234 U.S. 399, 411 (1914) (holding the secured party claiming an interest in 210 barrels of whisky had priority despite the fact that the collateral was left in the possession of the debtor because this was consistent with the current custom).

21. U.C.C. § 9-305. A security interest in chattel paper may be perfected either by filing or possession. U.C.C. §§ 9-304(1), 9-305. Filing, however, does not provide the secured party with complete protection. Section 9-308 provides that certain purchasers of chattel paper take priority over an existing security interest perfected by filing. Possession is the safer and more prudent means of perfection since a perfected conflicting security interest cannot materialize when the original secured party has possession. If, for any reason, the secured party cannot or will not take possession of the collateral, the next best option is to stamp the chattel paper itself to show the secured party's interest. See DUNCAN & LYONS, supra note 18, § 3.03[3][a].

Similarly, a security interest in negotiable documents may be perfected either by filing or possession. U.C.C. §§ 9-304(1); 9-305. As with chattel paper, filing is not the most desirable means of perfecting a security interest in a negotiable document because § 9-309 provides that a holder to whom the negotiable document has been "duly negotiated" takes priority over a security interest perfected by filing. A financing statement is not deemed adequate notice to the new holder of collateral subject to a prior security interest.

With respect to securities, § 8-321(2) defines a perfected security interest in certificated shares as a "security interest so transferred pursuant to agreement by a transferee who has rights in the security to a transferee who has given value." Thus, no party can acquire a security interest in shares of certificated stock without taking actual possession of the stock certificates. For uncertificated shares, there can be no transfer of possession because no certificate exists. Under § 8-313(1)(b), perfection of uncertificated shares occurs when the security interest is registered in the name of the secured party. See ROBERT L. JORDAN & WILLIAM D. WARREN, SECURED TRANSACTIONS IN PERSONAL PROPERTY 68-70 (3d ed. 1992).

22. "General Intangibles" are defined as any personal property other than goods, accounts, chattel paper, documents, instruments, and money. U.C.C. § 9-106.

23. U.C.C. § 9-304, cmt. 1; see also In re Granite City Coop. Creamery Ass'n, 7 U.C.C. Rep. Serv. (Callaghan) 1083 (Bankr. D. Vt. 1970) (holding that a security interest in accounts receivable may not be perfected by possession).

24. Specifically, the third person must (1) have been chosen by the debtor and the creditor; (2) know of the arrangement; and (3) accept the obligation. See American United Life Ins. Co. v. Fischer, 130 F.2d 643 (8th Cir. 1942), cert. denied, 318 U.S. 767 (1943).
modern view of third-person possession is patterned after this view. Official comment 2 to section 9-305 declares, "[I]t is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party." Contemporary decisions consistently hold that a debtor's dominion over the collateral is inappropriate. Such decisions, however, appear to be grounded more in blind obedience to the strict language of the Code and deference to precedent than in sensible and informed deliberation. This Note will demonstrate that allowing perfection even when the debtor retains dominion over the collateral would not materially obstruct the intent of section 9-305, nor would it undermine secured transactions generally.

A. Agency

Occasionally, a debtor will not permit a creditor to take possession of collateral, or the creditor may be unable or unwilling to do so. The parties may agree, however, to allow an agent of the secured party to take possession of the collateral. Since the drafters of the Code intentionally left the definition of a bona fide agent ambiguous, the perception as to who is a valid agent is usually inconsistent between parties to a particular transaction or among the various courts.

1. Fundamental Principles of an Agent in Possession

Courts will most likely reject a secured party's assertion of agency if the debtor retains possession of the collateral. Consider Heinicke Instruments Co. v. Republic Corp., where Heinicke Instruments Company ("Heinicke") granted Samuel Bergman shares in Philip Morris, Inc., as security for a loan. Bergman instructed Heinicke to forward the shares to him as soon as they were issued. However, a delay in the approval of the stock made immediate delivery impossible. Before the issuing corporation had an opportunity to deliver the shares, Republic Corporation ("Republic") attached the shares as a judicial lienor and challenged Bergman's perfected status. Bergman alleged that Heinicke was his agent pursuant to section 9-305.

The Ninth Circuit held that Heinicke was not an agent because he was not acting on Bergman's behalf. The court reasoned that the agreement failed to provide notice to prospective creditors of the debtor's "collateral commitment," and that simply because Bergman labeled Heinicke an agent did not

26. An agent is defined as "one who acts for or in place of [the principal] by authority from him . . . with power to do the things [the] principal may do." BLACK'S LAW DICTIONARY 63 (6th ed. 1990).
27. The Code expressly permits agents to perfect by possession on behalf of the secured party. U.C.C. § 9-305, cmt. 2.
28. Heinicke, 543 F.2d 700 (9th Cir. 1976).
29. Id. at 702.
necessarily make him one with respect to section 9-305. Accordingly, the court deemed the security interest unperfected. This result exemplifies the statutorily sound portion of section 9-305: When collateral is in the possession of the debtor, a potential creditor has no indication that the collateral may already be pledged. Thus, a secured party is discouraged from pronouncing a debtor in possession of collateral as his agent.

In addition, courts tend to deny perfection in situations where adequate notice is not apparent. For example, in *Hutchison v. CIT Corp.*, Herco Corporation and Aggregate Transport, Incorporated (collectively known as the “Debtors”) granted a security interest in two pieces of mining equipment to R.H. Kelly. Kelly did not file a financing statement with respect to the collateral, and the Debtors later pledged the same mining equipment to C.I.T. Lease Corporation (“C.I.T.”). C.I.T. promptly perfected its security interest. Throughout the relevant time period, both pieces of equipment were located on the property of Falcon Coal Company (“Falcon”). As a favor to Kelly, Falcon’s night-watchman told Kelly’s grandson that he would “keep an eye on the equipment.” When the Debtors went bankrupt, Kelly claimed priority over C.I.T., alleging the night-watchman was his agent in possession.

The Sixth Circuit rejected this assertion, holding that the actions of the night-watchman provided insufficient notice to C.I.T. In addition, there was no evidence that Kelly ever exercised dominion or control over the equipment while it was on Falcon’s property. The court ultimately held that a third party can perfect a security interest by possession only if the possession is unequivocal, absolute, and notorious.

pledged corporate shares to Ann Mathews as collateral for her guarantee of certain loans made by Dominion. The shares split two for one, but Dominion never delivered the newly created shares to Mathews. Dominion then declared bankruptcy and the trustee sought to frame Mathews' security interest in the new shares, due to her lack of possession, as unperfected. Mathews asserted that Dominion had acted as an agent in possession. In ruling that the collateral was perfected by possession, the court fundamentally ignored Heinicke, declaring that Mathews retained possession "as a matter of law when the pledge was made." Although the trial court decision in Mathews was ultimately reversed by the Fourth Circuit in an unpublished decision, the trial court's analysis demonstrates that some courts consider perfection by an agent in a conspicuously fact-specific manner, assigning significance as they deem fit.

In FDIC, a bank had perfected a security interest in certificated securities by possession but failed to take possession of additional shares issued as dividends, which the debtor ultimately delivered to a third party. The court held that, despite the language in the security agreement covering stock dividends, the secured party was not perfected, rejecting the argument that the secured party had an "equitable lien" on the dividend shares. Although one would be hard-pressed to distinguish Mathews and FDIC on the facts, one explanation for their differing results is that courts, given minimal guidance by the Code, tend to rely on their own sense of justice.

The case of In re Barney has been derided for stretching the agency principles in section 9-305 too far. In Barney, Clyde Barney gave Rigby Loan and Investment Company ("Rigby") a security interest in potatoes. The collateral was held by the debtor's attorney. The court held that the attorney could retain possession of the collateral as an agent of the secured party while simultaneously serving as the attorney for the debtor because the attorney was bound by law to act in good faith on behalf of both parties. One commentator argues that the reasoning in Barney violates the "control of the debtor" reasoning described above. The control of the debtor argument, however, appears misplaced because the definitive criterion for valid perfection should not rest on whether the debtor has dominion over the collateral, but rather if a prospective creditor, stepping into the situation, would be misled by the arrangement. This case typifies the misguided conclusions that many courts
reach because their decisions are rooted in the unsound language of section 9-305 rather than in a logical analysis.

2. A Response: Agency by Operation of Law

The common law has fashioned the doctrine of "constructive possession" to circumvent limitations imposed by the language of the Code. In many instances, however, courts appear reluctant to employ the doctrine. Consider In re Staff Mortgage & Investment Corp.,43 where Andrew and Hazel Huffinan, pursuant to an investment arrangement, invested their savings with Staff Mortgage and Investment Corporation ("Staff"). The Huffmans took, as security, an assignment of promissory notes payable to Staff. Staff stapled a document termed "Corporation Assignment of Deed of Trust" to the notes to effectuate the assignment, but never physically delivered the instruments to the Huffmans. When Staff went bankrupt, the Huffmans sued to recover the collateral notes. The trustee in bankruptcy insisted the notes were unperfected.

The district court ruled that Staff served as an agent for the Huffmans and declared that the Huffmans retained constructive possession of the collateral. The Ninth Circuit reversed, adhering to the language of section 9-305 almost verbatim: "Possession may be by the secured party himself or by an agent on his behalf... [but] the debtor or a person controlled by him cannot qualify as such an agent for the secured party."44

The court held that recording the notes in the county where the land was located was "not sufficient notice to perfect a security interest in pledged instruments,"45 and that the arrangement failed "to provide notice to prospective creditors that the debtor no longer [had] unfettered use of his collateral."46

The validity of this decision is difficult to discern. First, as discussed above, when a debtor has possession of collateral, there is a presumption of inadequate notice to a prospective creditor. In this case, however, the Corporation Assignment was stapled to the notes. The attached warning should serve as sufficient warning because a prospective creditor possessing even an average business acumen would be prompted to inquire as to the significance of the Corporation Assignment. Arguably, the debtor could deceive a creditor simply by removing the attached assignment or misrepresenting its significance. The Code, however, should not regulate the acceptable standard of notice by contemplating the range of possible actions the debtor may take in the course of the transaction. To do so would make perfection by possession obsolete. One could argue, for example, that a debtor could retake collateral from a creditor in possession by theft, thereby negating notice to potential creditors. The mere contingency of this event is insufficient to deny perfected status. A perfection by possession analysis must develop a

43. Huffman v. Wikle (In re Staff Mortgage & Investment Corp.), 550 F.2d 1228 (9th Cir. 1977) (quoting U.C.C. § 9-305).
44. Id. at 1230.
45. Id.
46. Id. at 1231 (quoting In re Copeland, 391 F. Supp. 134, 151 (D. Del. 1975) (citations omitted)).
perspective as to what a potential creditor stepping into the situation would perceive, not the possible scenarios of notice destroyed.

This latter view was adopted in *Copeland v. Stewart*, where A. Michael Stewart assigned the rights of a promissory note to Edith M. Copeland. Stewart retained possession, but indorsed the note as follows: "This note is hereby assigned as collateral to our note payable to Edith Copeland." Subsequently, a judgment creditor of Stewart attached the note. Copeland asserted that Stewart was her agent in possession of the collateral.

The court agreed, declaring the note constructively delivered to the secured party because notice of the assignment was evident to any potentially interested party:

[A]nyone attempting to take the note from the possession of the [secured party] or its agent . . . would be put on notice . . . that the maker would not make payment without the concerted action of the [secured party]. . . .

At the time of the levy [Copeland] had in effect reduced the note to possession by use of process of the court.

The *Copeland* court's sophisticated analysis cuts to the heart of section 9-305 because of the importance the court placed on a potential creditor's perspective of the transaction. The paramount consideration is the potential creditor's impression concerning the state of the collateral. This reasoning is rare in perfection by possession decisions today, and will continue to be so until state legislatures amend section 9-305 to guide the judiciary.

### B. Bailee with Notice

Article 7 of the U.C.C. defines a bailee as "[a] person who . . . acknowledges possession of goods and contracts to deliver them." In contrast to an agent in possession, a bailee with notice maintains possession of the collateral by virtue of a pre-existing relationship with the debtor, but is not controlled by or under the dominion of the debtor for purposes of perfection. When collateral is in the hands of a bailee, Article 9 validates possession as a means of perfection "from the time the bailee receives notification of the secured party's interest." Since section 9-305 demands that the debtor not dominate the bailee and in order to maintain perfected status, a pledgee must craft an

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48. Id. at 862.
49. Id. at 867-68.
50. U.C.C. § 7-102. Note, however, that Article 9 does not define the term "bailee," as used in § 9-305(2). Accordingly, some courts have looked to state law for the definition. See, e.g., In re Atlantic Computer Systems, Inc., 135 B.R. 463 (Bankr. S.D.N.Y. 1992).
52. U.C.C. § 9-305. "A security interest in goods in the possession of a bailee . . . is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest . . . ." U.C.C. § 9-304(3).
arrangement to ensure that the debtor does not directly or indirectly regulate the collateral.\(^5\)

Although the present standard creates a bright-line test, an examination of its strict requirements reveals substantial flaws. Under some circumstances, a bailee under the dominion of the debtor still furnishes adequate notice to the world. Assume a potential creditor is negotiating with a debtor who lacks possession of the collateral he is attempting to pledge. Such creditor would undoubtedly be prompted to inquire into potential conflicting claims to the collateral: Why does the debtor lack possession? Why does this particular bailee have possession? Is a competing security interest in this collateral probable? The strong likelihood of a reasonable inquiry into the arrangement ensures that a potential creditor will not be misled, and, simultaneously, grants a certain degree of flexibility and convenience to the parties of the transaction.

An illustrative case is *In re Rolain*,\(^5\) where Northwest Bank ("Northwest") loaned $163,000 to United Corporations of Minnesota ("UCM"), which in turn executed a promissory note. UCM used a note from one of its debtors ("Owen note") as collateral to secure its own note. Northwest wished to take possession of the Owen note, but UCM refused. Eventually the parties agreed UCM's attorney, Mannikko, would hold the Owen note. When UCM went bankrupt, Northwest asserted perfection by possession, alleging Mannikko served as a bailee with notice. UCM's trustee in bankruptcy challenged this claim, insisting Northwest failed to conform with the Code's requirements for valid possession.

The Eighth Circuit held that, despite the bailee's close relationship with the debtor, Northwest had perfected its security interest by possession because the debtor did not have unfettered use of the collateral and could not repledge it.\(^5\) Moreover, if Rolain had somehow attempted to repledge the collateral, his "lack of possession would notify the third party creditor that the note was encumbered."\(^5\) In addition, assuming Rolain had in fact regained the ability to repledge the collateral, by theft for example, the Code indicates perfection would cease the moment possession terminated.\(^5\) Thus, in order to maintain his perfected status, the creditor must compel the bailee to maintain physical possession.\(^5\)

\(^5\) See, e.g., Hale v. Kontaratos (*In re Kontaratos*), 10 B.R. 956 (Bankr. D. Me. 1981). "[I]t has been frozen law for fifty years that the possession which perfects a pledge [must be by] the pledgee himself or [by] some third party who is independent of the pledgor." *Gilmore,* supra note 6, § 14.2, at 440.

\(^5\) Rolain v. Bergquist (*In re Rolain*), 823 F.2d 198 (8th Cir. 1987).

\(^5\) Id. at 202.

\(^5\) Id.

\(^5\) U.C.C. § 9-305.

\(^5\) Another interesting example of the bailee-with-notice concept occurred where a debtor granted a dealer a purchase money security interest in two tractors. The dealer assigned its interest to General Motors Acceptance Corp. ("GMAC"), and the tractors were then returned to the dealer for maintenance and repair. The court declared that GMAC was a secured party in possession of the collateral because the dealer was a bailee with notice of GMAC's claim. Clearly, GMAC was more lucky than it was smart in this case because it was simply by chance that the collateral was returned to the possession of...
1. Bailments by Operation of Law

With respect to bailees, as with agents, some courts have partially embraced a revised reading of section 9-305 by developing the "constructive bailment" doctrine. Consider *In re Crabtree*,\(^59\) where the Bank of Cumberland ("BOC") lent Mississippi Coast Properties, Inc. ("MCP") $350,000 in exchange for a security interest in a promissory note. BOC subsequently transferred its interest in the note to C. H. Butcher, Jr., but failed to deliver the note. In a ruling befitting equity over statutory language, the court held:

> Though ordinarily created by delivery and acceptance pursuant to an agreement, a bailment may result from conduct, though neither foreseen nor contemplated. Because [Butcher] was entitled to receive the [collateral] when he acquired the debtor's note, BOC became a constructive, or involuntary, bailee on Butcher's behalf through its unintentional retention of the [collateral].\(^60\)

Thus, the court viewed BOC as Butcher's constructive bailee and granted him a perfected security interest in the note.\(^61\)

Nonetheless, the constructive bailee doctrine has distinct limitations. Consider *In re Julien*,\(^62\) where Oakland Gin Company ("Oakland") agreed to sell the Julien Company ("Julien") bales of cotton on behalf of certain cotton producers. Pursuant to the agreement, the producers brought their cotton to Oakland where it was ginned and loaded for shipment onto trucks owned or hired by Oakland. Oakland then completed nonnegotiable bills of lading, supplied by Julien. Shortly thereafter, Oakland submitted drafts accompanied by the bills of lading to Julien's bank for payment.

Meanwhile, the cotton was to be transported to Julien's warehouse. Once at the warehouse, it became known as "flow through cotton," or cotton which was to be shipped to ultimate purchasers, for example textile mills, within hours or days of its arrival. Because of this arrangement, it was not subject to the issuance of warehouse receipts. A flow through transaction was advantageous in that fewer warehouse charges were involved and, particularly for Julien, the cotton could be shipped much faster. A potential disadvantage for Oakland, however, was that possession of the cotton and evidence of ownership by, for example, a warehouse receipt, was relinquished prior to Oakland's receipt of payment. Julien then failed to pay for four ninety-bale

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60. *Id.* at 532. The court noted that Butcher's assignees of the collateral were not protected by BOC's constructive possession because BOC did not have adequate notice of their interest as required by the Code: "UCC's 9-305 makes the receipt of 'notification' of the secured party's interest by a 'bailee' the critical event that triggers an ipso facto possession in the secured party." *Id.* at 532 n.12 (quoting *Kontaratos*, 10 B.R. at 956) (emphasis in original).
61. For a discussion justifying the "constructive bailment," see Ingersoll-Rand Financial Corp. v. Nunley, 671 F.2d 842 (4th Cir. 1982), where the court held that "no particular ceremony or actual meeting of minds is necessary [for a valid bailment]; it is the element of lawful possession, however created... that creates the bailment..." *Id.* at 845.
truckloads which were shipped to its warehouse. Oakland contacted Federal Compress, Julien’s warehouse managing agent, and demanded return of the cotton. Federal Compress refused and, subsequently, Julien filed for bankruptcy.

Julien’s trustee in bankruptcy claimed that by relinquishing physical possession of the cotton prior to receipt of payment, Oakland merited the status of an unsecured creditor. Oakland disputed this contention, asserting that Federal Compress was a bailee with notice pursuant to section 9-305. The bankruptcy court declared that although there was no explicit agreement, the covenant by its nature created a security interest for Oakland.63 The court then rejected Oakland’s assertion that the warehouse served as a bailee for both Oakland and for the debtor. The court deemed insufficient Oakland’s demand for return of the cotton with respect to perfecting its security interest because the warehouse itself was owned by the debtor and its manager was an agent of the debtor.64 Oakland argued this was not the parties’ intention and implored the court to confer “constructive bailee” status upon Federal Compress because “everyone knew and understood that the cotton was . . . from Oakland.”65 The court also rejected this argument, writing that “the belief held by the warehouse manager is not the equivalent of an actual legal obligation to redeliver the cotton to Oakland.”66 The court then upbraided Oakland for its failure to perfect properly its security interest or give timely notice to the warehouse. Taken together, these factors, according to the court, made Oakland an unsecured creditor.

Accordingly, although the constructive bailment doctrine reflects an enlightened view of section 9-305, its impact is restricted to narrow, fact-specific scenarios. The Code’s drafters must be willing to accede to modern commercial practice and sound reasoning, both of which demand a step back from the draconian limitations the Code now imposes upon bailees.

2. The Double Pledge Dilemma: Who Bears the Burden of Notice?

The bailee with notice doctrine creates the possibility that two secured parties will claim a security interest, perfected by possession, in the same collateral. This situation occurs when a “junior” security interest notifies a secured party in possession, known as a “senior” security interest, of its

63. The court stated that:

[Even though the original intention was that [Julien] would receive payment upon delivery of the bills of lading . . . prior to placement of the cotton at the warehouse, the actual result is that [Julien] retained the bills of lading after shipment and placement of the cotton. Under [U.C.C. § 2-401] this result [creates] a security interest.

Id. at 996.

64. Id. at 997 (“[T]he warehouse was controlled by and thus was exclusively an agent . . . for the debtor.”).

65. Id.

66. Id. at 998. Oakland’s notification of its asserted interest to the cotton came after Oakland had delivered the cotton and after it had learned of the dishonored drafts. Section 9-305 does not allow perfection to “relate back.” See supra note 14 and accompanying text.
interest in certain collateral. The junior security interest may also attempt to take possession of the collateral. Although both parties cannot use the same collateral as security, the junior pledgee's interest attaches to the remaining equity cushion, namely the value of the collateral over and above the senior's interest. As the label indicates, the junior security interest is compromised because the senior security interest has priority. In addition, if the senior security interest returns the collateral to the debtor for any reason whatsoever, the junior security interest loses its perfected status.

The double pledge is illustrated by *In re Reddington/Sunstar Limited Partnership*, where Union Planters National Bank ("Union Planters") and Merchants Bank ("Merchants") entered into a loan agreement with the debtor, Reddington/Sunstar Limited Partnership ("Reddington"). Union Planters requested that Reddington assign and endorse certain notes, denominated "Investors Notes," to the bank as security for the repayment of the indebtedness owed by the debtor to the bank. The indebtedness owed to Merchants was also secured by these Investors Notes. Merchants, however, subordinated its indebtedness in all respects to that of Union Planters. A branch of Union Planters agreed to serve as trustee for both banks, and took possession of the notes. The arrangement provided that, "while any balance remains outstanding under the [Union Planter's] Agreements, [Union Planter's] possession of the Investors Notes ... shall constitute possession of the Investor Notes as a bailee for purposes of perfecting [Merchants Bank's] ... security interest." Reddington went bankrupt and, while Union Planters was paid in full, the debtor asserted that Merchants was not perfected for failure to satisfy the elements of section 9-305. The bankruptcy court disposed of the case as a standard double-pledge arrangement, declaring:

> [W]hether [the junior lienholder] had a perfected security interest ... turns on whether [the senior lienholder] ... possessed the [collateral] as the agent or bailee of [the junior lienholder] within the meaning of Section 9-305. Where, as in the instant case, the senior secured party in possession of the collateral acknowledges and accepts the instructions of the pledgor to deliver the collateral to the junior secured party after the debt to the senior secured party is satisfied, then the senior secured party is considered to possess the collateral as the agent or bailee of the junior secured party.

Thus, the court determined that Merchants had fully complied with section 9-305 and therefore retained a perfected security interest.

Although the guidelines for a valid double pledge are straightforward, the rules concerning burden of notice requirements are unclear. Initially, some courts held that notice could come either from the debtor or the secured

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69. *Id.* at 2 (alterations in original).
70. *Id.* at 5 (alterations in original).
party. Recent cases involving double pledge arrangements, however, suggest that it is the debtor who must notify the bailee in possession of a security interest in the collateral. For example, in In re Kontaratos, Peter Kontaratos gave a security interest in certain corporate securities to Roger Hale, but pledged the same collateral to Depositors Trust Company of Southern Maine (“DTC”). DTC did not know of Hale’s security interest when it perfected the shares by possession. When Kontaratos went bankrupt, Hale notified DTC of its interest and demanded the right to redeem the stock, arguing that he relied on DTC as a bailee upon giving them notice.

First, the court considered technical issues with respect to the law of bailments, holding that a bailment is a contract by which a bailor entrusts a bailee with possession of certain collateral. Accordingly, the giving of notice by a junior security interest cannot compel a senior security interest to hold or surrender possession of collateral in contravention of the pledge agreement. Hale’s notice and demand upon DTC and DTC’s failure to object to Hale’s characterization does not automatically transform DTC into a bailee with notice. The court declared:

[T]he requirements of 9-305 cannot be interpreted to conscript [DTC] into involuntary service as the agent [of Hale] . . . . [A] pledgee in possession of [collateral] should [not] be compelled, following performance by, and without the approval of, the pledgor, to hold or surrender possession of the collateral contrary to the terms of their pledge agreement, on mere notification by a secured party.

In other words, a senior secured party is not empowered to veto the creation of a secondary pledge. The same party, however, cannot be compelled to hold or surrender the collateral on mere notification by a competing interest. The debtor is the only party that can modify the bailment contract between the debtor and the senior secured party. Secondly, the court held that the junior pledgee’s interest attaches to the remaining equity cushion, that is, the value of the collateral over and above the senior’s interest. The debtor technically controls this remainder interest. Thus, the junior security interest may not perfect his own interest through mere notice because, absent notification by the debtor, the senior security interest is not in possession of the same collateral in which the junior pledgee has an interest.

Some commentators argue that this latter rationale inappropriately frames the mission of the notice requirement. One commentator aptly captures Kontaratos’ shortsighted arguments:

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73. Id. at 966.
74. Id. (footnote omitted).
75. Id. at 969.
Given that the primary purpose of Article 9 is its public notice function, the analysis should not turn on whether the pledgor technically retains a right of control over collateral by virtue of the fact that he has not amended the terms of the original bailment contract. Rather, the analysis should focus on the risk of misleading third party creditors with respect to the status of the pledgor's equity interest in the collateral. It is the pledgee's dissemination of the vital fact that a second pledge has been created that really effectuates public notice, and that, by itself, has nothing to do with the identity of the notice-giver. From a practical standpoint, then, whether notice comes from the pledgor or the junior pledgee is irrelevant because once a potential creditor discovers the existence of a first pledge he can always question the pledgee in possession about the existence of other liens.76

III. ESCRov ARRANGEMENTS

The term “escrow” involves a situation whereby an obligor delivers a document to a neutral third person to be held until a specified event occurs. When the stated event occurs, the third person relinquishes the document to the obligee.77 Courts are inclined to inquire as to whether both the secured party and the debtor agreed to place the property in the hands of a specified third party. Courts also consider the reliance interests of potential creditors and the adequacy of notice that the debtor’s collateral may be encumbered.78 A great deal of litigation has surrounded the manner in which escrow arrangements comport with section 9-305.

Originally, the law surrounding escrow arrangements mirrored that of traditional section 9-305 analysis. In re Dolly Madison Industries, Inc.79 involved a sale of stock accomplished by the execution of an escrow agreement. In order to secure payment of the purchase price, the parties drafted a purchase agreement which created a security interest in the stock and immediately placed it in escrow. The parties stipulated that, “upon [the debtor’s default, the escrow agent] shall deliver the [stock] certificates to [the creditor], whereupon [the creditor’s] rights and obligations in and to the shares . . . shall be those of a secured party holding collateral under the provisions [of Article 9].”80 The trustee in bankruptcy successfully argued that the escrow arrangement: (1) was not a pledge since the escrow holder was not technically an agent or bailee; and (2) even assuming it was a pledge, it became effective too late because attachment of the security interest did not occur until after the debtor filed for bankruptcy. Dolly Madison suggests that the majority of escrow arrangements cannot satisfy section 9-305 because

76. Sawyer, supra note 71, at 832 (footnotes omitted). Professor Barkley Clark feels this method “seems wrong” because a junior secured party can never be sure of its perfected status unless all three parties agree to the arrangement. CLARK, supra note 42, ¶ 7.08[2][b], at 7-22.
80. Id. at 1040 (emphasis in original).
most escrow agents are neutral custodians, rather than agents of the secured party.81

Recent decisions, however, have disregarded Dolly Madison in favor of a more reasoned analysis. Presently, the leading case with respect to escrow arrangements is In re Copeland,82 where Lammont Copeland ("Copeland") personally guaranteed payment on a $2.7 million loan by Pension Benefit Fund, Inc. ("Pension Benefit") and agreed to pledge shares of Christiana Securities Company stock as security. Pursuant to an escrow agreement, Wilmington Trust Company ("Wilmington Trust") was designated as escrow holder of the pledged stock. Three years later, Pension Benefit defaulted on the loan. Pension Benefit notified Copeland and Wilmington Trust of the unpaid balance and demanded Wilmington Trust surrender the escrowed shares. To preempt Pension Benefit's lien on the escrowed shares, Copeland filed for bankruptcy. The trustee relied on Dolly Madison in arguing that Pension Benefit's interest in the shares was unsecured. The court rejected this argument, stating "we are reluctant to infer that the parties intended to alter the normal sequence of events by which a security interest attaches and becomes perfected under the Code."83 Copeland then attempted to assert that Pension Benefit's security interest was not perfected by Wilmington Trust's possession of the stock, because Wilmington Trust was an agent of both parties.84 The court disagreed, relying heavily on the import of notice:

It does not follow . . . that possession of the collateral must be by an individual under the sole dominion and control of the secured party . . . . Rather, we believe that possession by a third party bailee, who is not controlled by the debtor, which adequately informs potential lenders of the

81. See CLARK, supra note 42, ¶ 7.08(3), at 7-27; see also Stein v. Rand Constr. Co., 400 F. Supp. 944 (S.D.N.Y. 1975), where Rand Construction Co., Inc. ("Rand") was awarded a contract to erect certain facilities for the state of New Jersey. Rand subsequently hired Seaway Floor and Paving Company, Inc. ("Seaway") as a sub-contractor. As per its usual course of business, Rand had prepared a form sub-contract which contained a requirement for the execution of a performance bond. When Seaway objected, the parties negotiated a deal by which Seaway put a $25,000 certificate of deposit in escrow. The certificate of deposit was to be held by George Bohlinger, Jr. ("Bohlinger"), an attorney to whom "Rand generally referred its legal matters," but who also did some legal work for Seaway. Id. at 948. When Seaway went bankrupt, the trustee challenged Rand's assertion that Bohlinger was its "agent in possession" of the collateral.

The court noted that during the relevant time period, the interest from the certificate of deposit was paid to Seaway rather than to Rand, a "fact inconsistent with Rand's position that it had the requisite 'possession' of the certificate of deposit." Id. Secondly, the court deemed that for the escrow holder to be an agent of any one party to an escrow agreement is "inherently inconsistent with the nature of an escrow agreement." Id. The court declared:

Fundamental to the existence of an escrow is the transfer of the escrow instrument into the hands of a third party as depository. . . . [T]he escrow agent is not empowered to act for either party. Although he may be an agent for one of the parties in other respects, with respect to the instrument in escrow his powers are solely limited to those stipulated in the escrow agreement. Id. (emphasis in original). Thus, the delivery of the certificate of deposit to Bohlinger was not delivery to Rand, and Rand's security interest was not perfected by possession.

82. In re Copeland, 531 F.2d 1195 (3d Cir. 1976).
83. Id. at 1202.
84. Id. at 1202. Copeland cited Dolly Madison to support his contention that the simultaneous existence of an escrow and a pledge is a legal impossibility. Id. at 1203.
possible existence of a perfected security interest satisfies the notice function underlying the “bailee with notice” provision of Section 9-305.

In [this case], the collateral was held by Wilmington Trust pursuant to the terms of both the pledge and escrow agreements. Regardless of whether Wilmington Trust retained the stock as an escrow agent or as a pledge holder, its possession and the debtor’s lack of possession clearly signaled future creditors that debtor’s ownership of and interest in the stock were not unrestricted. As an independent, institutional entity, Wilmington Trust could not be regarded automatically as an instrumentality or agent of the debtor alone. There was consequently no danger that creditors would be misled by its possession.85

The Copeland court identified the relevant questions in an escrow arrangement analysis: (1) “Is the escrow agent controlled in any way by the debtor?”; and (2) “Are potential creditors adequately apprised of the arrangement?” Even more significantly, the court pointed out that perfection by possession need not be by a third party under the dominion of the secured party. The potential for perfection exists as long as the third party is neutral, and not under the control of the debtor.86

Courts are slowly recognizing the structural flaws and limitations of section 9-305 with respect to escrow arrangements. It is impracticable, however, to expect judges to refute the language of the Code in favor of logic and fairness. Instead, state legislatures should amend the Code to reflect custom and commercial realities prevalent in secured transactions today.

IV. INVENTORY FIELD WAREHOUSES

A field warehouse is a warehouse located on the premises of the debtor. The warehouse usually consists of all or a portion of the debtor’s screened or

85. Id. at 1204.
86. CLARK, supra note 42, ¶ 7.08[3], at 7-26 to 7-27. The principles established in Copeland were subsequently affirmed and extended in Cedar Rapids Meats, Inc. v. Hager (In re Cedar Rapids Meats, Inc.), 121 B.R. 562 (Bankr. N.D. Iowa 1990), where the debtor, Cedar Rapids Meats, Inc. (“C.R. Meats”), satisfied Iowa’s worker’s compensation insurance requirements by depositing $2 million in escrow to serve as a guarantee fund for the payment of worker’s compensation claims. Merchants National Bank of Cedar Rapids, Iowa (“MNB”) served as the escrow agent. The agreement provided that if C.R. Meats failed to pay worker’s compensation claims properly, it would be considered “in default” and a state agency (“Insurance Commissioner”) would acquire the escrowed amount. C.R. Meats, realizing that it could not pay compensation claims, attempted to preempt the Insurance Commissioner’s claim by declaring bankruptcy and asserting that the Insurance Commissioner did not properly perfect its security interest. The bankruptcy court disagreed, holding that “an escrow agent serving both parties can qualify as a bailee/agent under Section 9-305.” Id. at 571. Despite the fact that the parties explicitly entered into an escrow agreement, the court relied on “substantial, if not overwhelming, evidence” that the parties intended to create a security agreement. Id. at 572. Additionally, it noted that MNB served simultaneously as escrow agent and bailee with notice, perfecting the Insurance Commissioner’s security interest. Id. The court declared:

The purpose of [§ 9-305] is to give notice to all potential creditors that the property was being used as collateral and could not be repledged. That purpose is satisfied here. As Section 9-305 envisions, all potential creditors of C.R. Meats would be on notice that the funds were encumbered since the funds were held by MNB, the escrow agent. Hence, based on the holding of Copeland . . . this Court finds that the Commissioner held a perfected security interest in funds held by an escrow agent.

Id.
blocked off premises or a designated area on the debtor's premises to which access is exclusively controlled by the field warehouseman, and leased to the warehouseman for a nominal sum. The warehouseman issues a warehouse receipt in the name of the secured party. The receipt may be nonnegotiable, naming the secured party as the entity entitled to the collateral. It may also be negotiable, giving the bearer of the receipt the right to the collateral. In either case, the secured party can perfect its interest by using the warehouse and the warehouseman as a bailee.

The warehouseman issues a warehouse receipt in the name of the secured party. The receipt may be nonnegotiable, naming the secured party as the entity entitled to the collateral. It may also be negotiable, giving the bearer of the receipt the right to the collateral. In either case, the secured party can perfect its interest by using the warehouse and the warehouseman as a bailee. Under the traditional field warehouse analysis, withdrawals of collateral are permitted only at the request of the secured party. The rationale for this is most obvious when the collateral is inventory: the secured party perfects his interest by possession but is still able to disburse the inventory to the debtor quickly and inexpensively. In some cases, however, the warehouseman also serves as an employee who answers to the debtor.

Section 9-305 indicates, as discussed above, that the party in possession of the collateral may not be the debtor himself nor a party controlled by him. How can these conflicting principles be reconciled? The answer lies in relatively formal restrictions developed to regulate the use of field warehouses. The language of section 9-305 makes clear that if a debtor attempts to serve as warehouseman for the same collateral he has pledged, implying the warehouse arrangement is a sham, the courts will deem the secured party unperfected. If, however, the secured party fashions an arrangement consistent with the Code's notice requirement for pledged collateral, implying a legitimate field warehouse, then the courts will deem the secured party perfected. As usual, a cautious secured party in warehouse situations should always file regardless of the warehouse arrangement—she has nothing to lose and everything to gain.

CONCLUSION

In an official comment, the Code indicates that "[t]he debtor or a person controlled by him cannot qualify as . . . an agent for the secured party." Case law has followed this requirement scrupulously, with most courts weighing the underlying principles as the integral components of any section 9-305 decision. The drafters of the Code profess this criterion without

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88. Davenport & Murray, supra note 17, § 4.04(e).
89. Id.
90. U.C.C. § 9-305 cmt. 2.
92. Id.
93. Davenport & Murray, supra note 17, § 4.04(e).
94. U.C.C. §§ 9-305 cmt. 2.
95. It may be helpful to categorize the cases discussed in this Note in the following manner: (1) collateral controlled by the secured party; (2) collateral controlled by an independent party; (3) collateral jointly controlled by the secured party and the debtor; and (4) collateral controlled by the debtor. The potential ramifications of such a classification on § 9-305 are beyond the scope of this Note.
scrutinizing its underlying logic or significance. A judicious scrutiny does not support such a rule because “notice to the world” may be achieved in a less constrictive fashion. Collateral in the possession of a third party adequately cautions potential creditors that the collateral may already be pledged merely by the fact that the debtor is not in possession. At a minimum, this situation would cause a reasonable potential creditor to inquire into the unusual circumstances. For this notion to have legitimacy, the secured party’s perfected status must end precisely when the third party relinquishes possession. This scheme is consistent with the commercial custom and satiates the underlying blueprint of the Code.

A major step toward this view was taken in In re Atlantic Computer Systems, Inc., where International Business Machines, Inc. (“IBM”) entered into a standard purchase agreement with a credit-worthy IBM customer (“End User”) for the purchase of IBM equipment. End User granted IBM a purchase-money security interest in the equipment. Prior to taking delivery of the equipment, however, End User brought in Atlantic Computer Systems, Inc. (“Atlantic”) as a financial intermediary. End User, Atlantic, and IBM each executed an Assignment Agreement (“Assignment”) transferring End User’s rights and obligations under the Purchase Agreement to Atlantic. If Atlantic defaulted, the Assignment granted End User the option to purchase the equipment by assuming Atlantic’s obligations. Atlantic contemporaneously entered into a lease with End User (the lessee) stipulating that End User could not remove or relocate the equipment without Atlantic’s express consent and that Atlantic had a right to inspect the equipment and approve any maintenance done. End User was also obligated to keep the equipment free and clear from all claims and encumbrances of any kind. Essentially, this slew of documents transformed End User from a contract purchaser of the equipment to a bailee for Atlantic, the new owner of the equipment.

When Atlantic failed to satisfy its obligations under the lease agreement, IBM sought to exercise its rights as a perfected, secured party under section 9-305. IBM presented a simple and elegant argument. It asserted that the lease arrangement created a bailment, and End User had known about IBM’s security interest. End User, as a lessee of Atlantic, thus fit the broad definition of bailee with notice described in section 9-305. Through a myriad of policy arguments, Atlantic asserted that (1) End User was not a bailee; (2) not all bailees can qualify as proper bailees under section 9-305; and (3) the bailees did not have the type of notice of IBM’s security interest that is required for perfection by possession.

The court agreed with IBM, albeit grudgingly. Taking a broad view, the

97. IBM had negligently failed to file a financing statement with respect to the computers.
98. “[T]his finding is not made with ease, because, in this Court’s opinion, the sort of expansive interpretation of bailee with notice . . . could, in many instances, conflict with the goals of the Uniform Commercial Code and undermine the public notice function of the filing system governing perfection of security interests.” Atlantic Computer, 135 B.R. at 466.
court concluded that the lease arrangement was the equivalent of a bail- 
ment and, although counter-intuitive, section 9-305 does not require "that possession of the collateral be by an individual under the sole dominion and control of the secured party." Essentially, it was immaterial that End User was the debtor's bailee and not the secured party's bailee. Section 9-305 does not require that a bailee have any relationship with the secured party in order for the bailee's possession of the collateral to be considered "possession" by the secured party. The court did not agree with the view taken by some courts that a bailee under section 9-305 may not have an "interest" in the collateral. If any such limitation is to be written into section 9-305, "it could only involve an interest which would deter the bailee from fulfilling his or her notice duty." No such interest existed under the circumstances of the present case because while End User did have a leasehold interest in the equipment, they had an interest in assuring that additional liens were not placed on the equipment. The Atlantic court concluded:

It is clear that the theory behind Section 9-305 is served by the [bailee's] possession of the equipment. Prospective third party creditors, seeing that the Debtor lacks possession of the equipment, will be put on notice that the Debtor does not have unfettered control over the equipment. In theory, this will lead them to make inquiries concerning the equipment which in turn will bring to light IBM's security interest.

Although the Atlantic case does not fully embrace the position that a third party subservient to the debtor may maintain perfectible collateral, the court does recognize the irrationality of the rule in its present state. Cases such as Atlantic facilitate the rejection of the present rule, but such movement is limited and exclusionary. Instead, state legislatures must make fundamental changes in the specific language of the statute in order to legitimize the concept of third party possession.

A possible permutation to section 9-305 (in italics) might read as follows:

A security interest in letters of credit and advices of credit (subsection (2)(a) of Section 5-116), goods, instruments (other than certificated securities), money, negotiable documents, or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. The collateral shall be deemed perfected for the duration that the agent or bailee maintains physical possession of the collateral, regardless of which party controls or has dominion over such agent or bailee. The collateral shall be deemed unperfected from the moment possession is relinquished. A security interest is perfected by possession from the time possession is taken without a

99. The court justified this by claiming that the point was well settled under New York law. Id.
100. Id. at 467.
101. Id.
103. Atlantic Computer, 135 B.R. at 468.
104. Id. at 470 (emphasis in original).
relation back, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.¹⁰⁵

Assuming that most instances of physical possession are not in dispute,¹⁰⁶ the proposed amendment simply takes the principles now applicable to a secured party in possession and extends them to a third party in possession. In addition, the proposed amendment efficiently eliminates uncertainty with respect to whether a third party was under the dominion of the debtor. Instead, the focus is on whether the third party had actual physical possession of the collateral. Such a bright-line test permits participants to plan their affairs without fear of unpredictable decisions. Moreover, courts are given an opportunity to apply a standard they have yearned to enforce, free from the foolish constraints imposed by the Code.

¹⁰⁵. The italicized permutation is based on the principles, discussed in this Note, that courts should strongly emphasize.
¹⁰⁶. See supra note 6 and accompanying text.