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SECURITY INTEREST V. NON-CODE INTEREST: AN ANALYSIS OF THE RAMIFICATIONS OF UTICA NATIONAL BANK & TRUST v. ASSOCIATED PRODUCERS

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In Utica National Bank & Trust v. Associated Producers the Oklahoma Supreme Court faced an unusual priority conflict between an article 9 perfected security interest and a non-code interest. Because the prior perfected security interest was held subordinate to the noncode interest, the exact nature of the prevailing interest and the reasons for its priority are of considerable interest to those concerned with the law of secured transactions. This article explores the specific

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2. Statutory references in this article are to the Oklahoma Uniform Commercial Code, OKLA. STAT. tit. 12A, unless otherwise noted.
3. It should be noted that the opinion, written by Justice Opala, concerns other issues. There can be little doubt that these issues were correctly decided, and there should be no controversy over these aspects of the decision. The court properly concluded that the property subject to the competing claims was accounts, rather than contract rights. The distinction has been eliminated by the recent adoption of the 1972 Article Nine Uniform Amendments in Oklahoma, but was important in this case due to prior law. Likewise, the court properly resolved the choice of law question by
nature of the noncode claim and the reasons for its success against a perfected security interest. Specifically, the author seeks to determine whether Utica:

1) Represents merely an extraordinary exception to the general rules of priority, unlikely to be repeated again or
2) provides a new avenue of attack on the Uniform Commercial Code system of priorities for personal property security interests.

The case arose out of the coal mining operations of Lamb Coal Company (Lamb). In October 1974, Associated Producers Company (Broker) advanced $30,000 to Lamb in return for the right to act as sales agent for the coal mined by Lamb. This advance was to be repaid by deduction of a $1.25 tonnage fee from the proceeds of each ton of coal shipped by Lamb. According to the court's opinion, the Broker's right to this tonnage fee was not contested and therefore was not an issue in the case.

The dispute arose when Lamb assigned all of its accounts and the accounts' proceeds to Utica National Bank (Bank) as collateral for loans. At the same time, the Broker was collecting these same proceeds as sales agent and was claiming a portion of the proceeds as reimbursement for additional monies owed to it by Lamb. In essence, the Broker and the Bank were asserting a claim on the same proceeds of Lamb's accounts. When Lamb defaulted on the bank loans, the Bank sued claiming that its security interest in the accounts' proceeds was entitled to priority. The Broker also claimed priority; therefore, the stage was set for a classic confrontation.

THE BASIC ISSUE

The major issue in the case was the priority dispute between the Broker and the Bank, with both asserting a prior claim on the proceeds from the sale of Lamb's coal. The Bank claimed a perfected security interest in the funds as proceeds of accounts. Pursuant to article 9 of the Uniform Commercial

referring to the law of the place where the assignor of the accounts kept its records. This choice of law was made pursuant to Okla. Stat. tit. 12A, § 9-103(1). This led to the application of the Kansas Uniform Commercial Code, which is nonetheless identical to the Oklahoma Code in all respects relevant to this inquiry.
Code, the Bank was the only party to have properly perfected such an interest.

The Broker's claim, on the other hand, arose out of the course of conduct of the parties. Pursuant to the contract with Lamb, the Broker found customers for Lamb's coal. Lamb shipped the coal directly to the purchaser and billed the Broker by invoice for the purchase price. After deducting its tonnage fee and commission, the Broker paid those invoices twice monthly, whether it had received payment from the respective purchaser or not. Sometimes the payments subsequently made to the Broker by the purchasers were less than the amounts previously paid by the Broker to Lamb, due to discrepancies in the BTU content of the coal actually delivered. As the court summarized:

This meant that the Broker would receive less than the invoice price after having already remitted the full amount to Lamb. These overpayments came to be described by the Broker as "unwitting advances." It is the Broker's position that it may recoup these overpayments out of any funds collected from customers, regardless of whether the funds came from the very customer who had exacted a "penalty." The Bank contends the Broker is not entitled to credit for payments in excess of collections actually received from customers after due adjustments.\footnote{622 P.2d at 1063.}

Thus, the issue was the relative priority of the Bank's article 9 perfected security interest versus the Broker's claim for repayment of "unwitting advances." However, the resolution of this issue was dependent upon the nature of the Broker's claim.

If the Broker's claim was in the nature of a consensual debt, arising out of the brokerage contract and secured by recourse to the proceeds of Lamb's accounts receivable, then the Broker/Lamb transaction resembles a secured transaction. In that event it would seem that article 9 would be applicable. Section 9-102 provides in part: "[T]his Article applies . . . to any transaction (regardless of its form) which is intended to create a security interest in personal property . . . including
accounts...” If article 9 governs priority, the “first in time” rule of section 9-312 would be invoked and the Bank would prevail, because it was the first and only contestant to file and perfect a security interest. On the other hand, if the Broker’s claim was not a contractual debt but rather some other form of obligation, there is the possibility that Article 9 would not apply, and the dispute would have to be resolved by noncode law.

The court embraced the latter view and determined that the Broker was acting as a common law agent and that the priorities of the parties were governed by principles of common law agency rather than the Code. The court suggested a parallel between the Broker’s claim and an action for an equitable accounting, cited the law of set-off, and stated that to allow the Bank to prevail would wrongly enable it to assert rights greater than its assignor. This suggests several possibilities regarding the nature of the Broker’s claim and the meaning of the decision. Each will be explored separately as a means of analyzing the basis for the decision and its possible ramifications.

THE LAW OF AGENCY

There is little doubt that the Code is supplemented by the law of agency. Nor is there much doubt that Lamb and the Broker had an agency relationship. Rather, the central issue is whether the Broker’s claim arising out of this agency relationship, is governed by article 9. If so, the Broker’s failure to comply with the article 9 perfection requirements is fatal to its cause.

At the outset the position of the Broker may seem tenuous, as the coverage of article 9 appears to be all inclusive with regard to priority claims based on contractual relationships. This is manifested in the broad language of 9-102(1)(a) which states; “this Article applies to any transaction (regardless of form) which is intended to create a security interest

6. 622 P.2d at 1065.
7. Id.
8. 622 P.2d at 1065, n.16.
"..." Likewise, §9-202 states "this Article ... applies whether title to collateral is in the secured party or in the debtor."

An illustrative case is In re Joseph Kanner Hat Co., where an "absolute assignment" of a relocation claim was found to be subject to article 9 and the assignee lost the priority dispute because of a failure to file a financing statement. This and similar cases prompted Professor Barkley Clark to state as a "rule of thumb" that "if the property involved may qualify as an 'account' ... the creditor must perfect in Article 9 in all cases. ..."10

Furthermore, there are numerous cases evidencing failed efforts to avoid the perfection and priority rules of article 9 by characterizing the relationship as one of agency rather than a secured transaction. For example, in General Electric Co. v. Pettingell Supply Co., Pettingell was a wholesaler of lamps and other electrical goods. He sold goods delivered to him as "serving agent for General Electric, consignor company," and distributed GE products to other GE agents at GE's direction. Upon Pettingell's insolvency, GE sought recovery of a large number of lamps held by Pettingell as GE's agent. Pettingell's assignee, representing the other creditors, argued that the relationship between GE and Pettingell was a consignment. Thus, pursuant to section 2-326 GE would be required to meet certain additional requirements in order to be protected. One of the alternatives would be to comply with the filing requirements of article 9.13

GE had met none of these requirements, but instead relied on an argument that may sound familiar in view of Utica decision. GE contended that section 2-326 (and its incorporation of article 9) applies only when the parties' relationship is that of buyer and seller — in effect only when there is a se-

9. 482 F.2d 937 (2d Cir. 1973).
12. 199 N.E.2d at 329.
13. 2-326(3)(c). This case was decided under the 1962 version of the Code. The 1972 uniform amendments, effective in Oklahoma October 1, 1981, impose even more stringent requirements. See the revised sections OKLA. STAT. tit. 12A, § 2-326; OKLA. STAT. tit. 12A, § 9-114.
cured credit sale — and not to the GE/Pettingell relationship of principle and agent. The court rejected this argument, on grounds that the transactions between GE and Pettingell were in fact sales, as evidenced by Pettingell’s resales to other parties. Therefore, the goods were “delivered . . . for sale” within the meaning of section 2-326(3). However, the court specifically left open the possibility of a different result if Pettingell’s sole authority had been to act as agent.14

Although Pettingell seemed to turn on the language of section 2-326, the case has some relevance to the Utica problem. Pettingell was both an agent and a buyer/debtor of GE, in much the same way that the Broker was both an agent and a creditor of Lamb in Utica. Yet, unlike the Utica case, the Pettingell court held that the agency relationship did not shield the debtor/creditor relationship from the requirements of article 9. One may see a distinction in that Pettingell was acting partially on his own behalf, as seller, and only partially as an agent, while it can be argued that the Broker in Utica was acting solely as agent for Lamb. Certainly, the Pettingell court viewed the distinction as a crucial one, specifically declining to consider whether the result would be the same when the relationship was solely that of principle and agent.15 A few years later a New Jersey court was presented with precisely that issue.

In Vonins, Inc. v. Raff,16 Vonins was a seller of plumbing and heating parts, and Crest was an installer. These parties agreed that Crest would assign all of its installation contracts to Vonins, who would then use Crest as subcontractor for installation under those and any new contracts obtained by Vonins. Vonins occupied the second floor of Crest’s building and both Vonins and Crest displayed signs on the exterior of the building. Pursuant to the contract, Vonins stored supplies with Crest for installation. The agreement was subsequently terminated, but only a small part of the stored supplies had been returned to Vonins when Crest became insolvent and made an assignment for the benefit of creditors. The trial

14. 199 N.E.2d at 329.
15. Id.
court held that Vonins had priority over Crest’s assignee because the assignee had no better rights than the assignor, who was subject to Vonins under the contract.  

The Appellate Division rejected the trial court’s view, and pointed out that an assignee for the benefit of creditors takes not only the rights of the assignor but represents consenting creditors as well. The court further pointed out that the relative priorities of these creditors, and Vonins, depend not on the law of assignments but on basic principles governing the priority of creditors’ claims, including the Code. As the court summarized it, “[t]he basic issue here involved is whether the assignee by virtue of the Uniform Commercial Code has greater rights than [Vonins] to the materials delivered pursuant to the 1963 Vonins-Crest agreement . . . .” The court cited Pettingell as representing a similar problem, and specifically adopted the reasoning of that case. On appeal Vonins argued that Pettingell was inapplicable because that case additionally involved a sales relationship, whereas Crest’s position was strictly that of subcontractor-agent. Again, this may sound like the rationale in Utica. Yet, the Vonins court did not consider the distinction significant and concluded that the relationship was sufficient to constitute a consignment subject to the Uniform Commercial Code.

Pettingell and Vonins represent unsuccessful efforts to avoid the consequences of the Code priority system by characterizing the relationship as one of principle and agent rather than creditor and debtor. In both cases the courts went beyond this veil and found Uniform Commercial Code transactions in fact though not in form. Most other consignment

17. 243 A.2d 836, 842. Compare this to the admonition in Utica Nat’l Bank & Trust v. Associated Prod. 622 P.2d at 1066, that the bank as assignee could have no greater rights than its assignor-Lamb.
18. 243 A.2d at 840.
19. The fact that the agreement is couched in “subcontractor,” as opposed to sales, terminology is not dispositive of the issue here involved. The agreement ostensibly was executed to protect the accounts receivable due the related supplier under its former sales arrangement with Crest. To allow plaintiff to prevail would be to allow Vonins, by the use of this ambiguous contract, to secure an advantage over all innocent creditors of Crest. This is the very evil that the Code seeks to prevent.
243 A.2d at 841.
cases have been in accord.  

It might seem that these cases lend credence to the Bank’s contention that the agency relationship between Lamb and the Broker should not insulate the Broker’s claim for repayment of its advances from the priority and perfection requirements of article 9. However, these consignment cases were decided with regard to the provisions of section 2-326, which specifically incorporates article 9 at section 2-326(3)(c). Section 2-326 clearly is not applicable in the Utica context, as the Broker-Lamb relationship in no way resembled a consignment. Furthermore, section 9-102(2) specifically names consignments as a type of contract that is subject to article 9. There is no mention of agency or brokerage contracts. Therefore, the consignment cases, although couched in terms of agency problems, are brought within the coverage of article 9 because they are consignments, not because of the agency aspects. Whether agency debts and claims outside the context of the consignment problem should be covered or excluded by article 9 remains unresolved.

There is authority for the Utica court’s conclusion that claims arising from an agency relationship are not governed by the Code. The Official Comment to the “scope” provision of article 9 states that section 9-104 “excludes certain transactions where the security interest . . . arises under . . . common law by reason of status and not by consent of the parties.” Arguably that was the case in Utica, where the Broker’s “unwitting advances” arose out of his status as broker, and not by contract. Moreover, the Code specifically excludes from the coverage of article 9 any liens “given by stat-


22. *See, e.g.,* Restatement (Second) of Agency § 464. Justice Opala cogently articulated these considerations in the context of a workman’s compensation claim:

The master-servant relationship that is the *sine qua non* element of every compensation claim is a mixed notion of *contract* and *status*: contract because it is generally consensual, i.e. voluntary; and status because in some instances it may be imposed not as the result of an intentional private act but *involuntarily* as a legal consequence attached by the rule of law to the conduct and interaction of the parties.

ute or other rule of law for services . . . ."^^ Arguably the Broker was exercising a right, in the nature of a lien, established by the law of agency, obtained in return for brokerage services. If the Broker's claim can be characterized as "a claim for wages, salary, or other compensation" it is excludable under section 9-104(d), although such a characterization would not be free from doubt.

However, one may experience a feeling of discomfiture at the prospect of allowing any and every obligation that arises from an agency relationship immunity from article 9 and article 9 secured creditors. First, there is no evidence that such a result was intended by the drafters of the Code, who would be more inclined to consider the substance of the transaction than its form.^^ Secondly, there is the problem of determining where to draw the line, i.e., deciding when the agency relationship predominates (providing priority for the agent's claim), and when the other aspects of the transaction govern so as to bring it within the Code (as in the consignment cases). Finally, there is the danger of a secured creditor leapfrogging prior claims by organizing and characterizing his transaction as an agency obligation. It was this danger that was alluded to by the appellants in the Utica case.^^ The appellants contended that the Utica decision "creates a loophole" resulting in a situation whereby a lender can avoid compliance with article 9 "merely by establishing itself as the collecting agent of its debtor's accounts."^^ Two examples were used to illustrate this danger.

In example one^^ the debtor is a retailer whose existing creditors have prior security interests in the retailer's accounts, perfected under article 9. A subsequent creditor, wishing to leapfrog over these prior claims, arranges to be appointed the retailer's "agent" for purposes of collecting the retailer's accounts. The retailer's account debtors are in-

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23. OKLA. STAT. tit. 12A, § 9-104(c) (emphasis added).
26. Appellant's Brief at 8.
27. Id. at 8-10.
structured to make payments directly to the "agent," who then obtains repayment of his loan to the retailer by deducting a portion of each payment as a "brokerage commission." Upon the retailer's insolvency or default the "agent" claims priority as to all account proceeds which it has or will collect, under the common law of agency.

Though not identical to the Utica situation, this example could be within the scope of an overly broad interpretation of Utica which could lead to the successful use of such an "agency" device as a means of circumventing the established priority rules of article 9. This type of circumvention could largely negate the salutory purposes accomplished by the enactment of article 9, including its priority system based on the order of perfection and the relative certainty that came with the abolition of different priority rules for different types of secured credit. This danger should be enough to alert us to the need to carefully define the basis for the Utica decision, so as to avoid abuse of the agency concept.

Appellant's example two\(^{28}\) is similar to the first, except that an insider of the debtor arranges to have himself appointed collection agent, advances funds to the debtor, and subsequently begins to reimburse himself from proceeds of the accounts as he collects them on behalf of the debtor. Again, the apparent injustice of allowing this "agent" to prevail over prior parties combines with the obvious similarity to Utica in a fashion that may alarm anyone concerned with accounts receivable financing. Nor is it enough to simply say that the courts would never allow such a blatant miscarriage of justice. It is easily conceivable that the complexities of an actual case could obscure the injustice that is apparent in this simple example.

Therefore, it is not sufficient to explain Utica merely on the basis that the law of agency controls. To paint the issue with such a broad brush is to invite misuse of the decision; indeed, it raises the possibility of expanding the exception (Utica) so as to swallow the rules of article 9. In these circumstances it is prudent to examine the other points raised in the Utica decision to determine if a more narrowly defined inter-

\(^{28}\) Id. at 10-12.
pretation can be made. Fortunately for this endeavor the Utica decision contains much more than a mere reference to the law of agency.

**EQUITY AND EQUIitable SUBROGATION**

The Utica opinion suggested that the Broker's claim was analogous to an action for an equitable accounting,\(^\text{29}\) and stated that in such a case the Broker clearly would be entitled to prevail.\(^\text{30}\) The cases cited as authority\(^\text{31}\) indicate that the agent's claim is equitable in nature. The court also cited section 1-103 for the proposition that the Code is supplemented by principles of equity.\(^\text{32}\)

Granted, the Code is supplemented by principles of equity, and an agent's claim may be viewed as equitable in nature, yet the question of priorities between an equitable claimant (the Broker) and a perfected secured creditor (the Bank) remains undecided. This issue has been hotly contested in the context of a surety's right to equitable subrogation versus a secured creditor's perfected security interest. This problem typically arises in the context of a construction contract. The builder may seek to raise funds by borrowing from a bank, granting the bank a security interest in the construction contract\(^\text{33}\) and its proceeds as collateral for the loan. The bank normally perfects and thereby obtains a prior claim under article 9. However, in the typical case the builder also obtains a completion bond — an insurance contract assuring the owner of the project that if the builder defaults the surety will pay to complete the project. In return, the surety obtains a right to any of the contract proceeds due the builder under the contract. In effect, the surety promises to step into the shoes of the builder upon his default, paying the builder's liabilities and in turn claiming his accounts and contract rights. If the builder does default, both the surety and the bank will be

\(^{29}\) 622 P.2d at 1065.
\(^{30}\) *Id.* at n.17 (citing Gulf Coast Western Oil Co. v. Trapp, 165 F.2d 343 (10th Cir. 1948); Cline v. McKee, 186 Okla. 366, 98 P.2d 25 (1940); Field v. Spencer, 176 Okla. 57, 54 P.2d 146 (1936).
\(^{31}\) *Id.*
\(^{32}\) 622 P.2d at 1065, n.16.
\(^{33}\) Labeled an "account" under the 1972 Uniform Revisions, at section 9-106.
claiming the same contract proceeds. The bank will claim a perfected security interest in the contract and its proceeds as the collateral for its loan to the builder. The surety will claim the same contract proceeds on grounds that it paid to complete the project and is entitled to reimbursement from funds owed the builder under the construction contract.

The early cases seemed to favor the bank's position on grounds that the surety's bond created a consensual security interest in the insured builder's contract rights, and that this constituted an unperfected security interest subordinate to the bank's perfected security interest under article 9. However, National Shawmut Bank v. New Amsterdam Casualty Co. departed from these cases and held that the surety's claim was based on the equitable right of subrogation. The fact that such a right was also recognized in the insurance contract did not abrogate the equitable origin of the claim. Therefore, the surety's claim was not consensual, was not created by contract, and was not governed by the Code. Most of the subsequent cases followed National Shawmut Bank. The Oklahoma Supreme Court did so in Mid-Continent Casualty Co. v. First National Bank & Trust Co.

The reasoning in Mid-Continent may sound familiar to someone contemplating the basis for the Utica decision. As in Utica, a claim founded on equitable considerations was given priority over a perfected security interest. But the problem must be dissected somewhat further to determine whether an analogy is valid. In both cases one claimant was asserting an equitable interest and it is clear that a truly equitable claim is excluded from the article 9 perfection requirements (which

35. 411 F.2d 843 (1st Cir. 1969).
37. 531 P.2d 1370 (Okla. 1975). Prior to his appointment to the bench, Justice Opala wrote an article discussing this case and the problem of equitable subrogation. See M. Opala, Forensic Assault by Performing Surety on the UCC-Built Citadel of Contract Funds' Assignee with Perfected Security Interests, 47 No. 2 O.B.J. Q-58 (Supp. 1976). There is no indication, however, that this issue played any direct role in the Utica decision.
apply only to contractual claims). However, it is one thing to say that an equitable claim is exempt from the perfection requirements of article 9, and quite another to say that an equitable interest, per se, is entitled to prevail over a prior perfected security interest. The author submits that the National Shawmut Bank case stands for the former proposition but not for the latter.

Assuming that the equitable claim involved is indeed a bona fide equitable claim (and not merely a device designed to avoid article 9), it is clear that the perfection rules of article 9 are not applicable. This merely says that the equitable claim is not automatically subordinated on account of the insurer's failure to perfect. It eliminates article 9 as a basis for resolving the priority dispute, but it does not in itself suggest how the issue should be resolved. Specifically, it does not answer the Utica question of whether an equitable claim has priority over a prior, perfected security interest. This is a separate question that is not answered by a mere recognition that the issue is outside the Code.

This question was answered in National Shawmut Bank, but it was answered in a way which clearly makes the rationale of that case inapplicable to a case like Utica. In National Shawmut Bank the surety's right of equitable subrogation was given priority over the competing security interest. However, it was not given this priority merely because it was an equitable interest. It was given priority because the surety was subrogated to the claims of those it paid. The claims paid included the owner of the project and the workers and materialmen who had furnished the labor and materials to build the project. Through subrogation to the rights of those it paid, the surety stepped into the shoes of the builder and the owner of the project, as well as the materialmen and workers. By taking an assignment of the builder's contract rights as collateral for the loan, the bank stepped only into the shoes of the builder. Thus, the surety represented the rights of the builder, owner,

38. OKLA. STAT. tit. 12A, § 9-102(1) restricts article 9 to transactions "intended to create a security interest" and sales of accounts or chattel paper. OKLA. STAT. tit. 12A, §§ 9-203 and 9-204 make it clear that a security interest requires a contractual relationship. The examples provided at OKLA. STAT. tit. 12A, § 9-102 are all contractual arrangements.
workers and materialmen, whereas the bank represented only the rights of the builder. The priority conflict between the surety and the bank was thereby transformed into an extension of the conflict between the builder, the owner, and the suppliers and workers. Between these parties, the workers and the owner would be entitled to prevail against the builder, and hence against the bank. Since the owner, workers and materialmen would prevail over the bank, and the surety has the rights of these parties, the surety likewise prevails over the bank.\textsuperscript{39}

The key factor is that the surety is subrogated not only to the rights of the builder (also the source of the bank's rights), but additionally is subrogated to the rights of the project owner and the workers and materialmen.\textsuperscript{40} It is this subrogation that permits the surety to prevail, not merely its status as an equitable claimant. This crucial subrogation distinction has no counterpart in \textit{Utica}.

In \textit{Utica}, there was no one for the Broker to be subrogated to except Lamb, and Lamb was subject to the Bank's security interest. There were no workers nor materialmen with superior interests to whom the Broker could be additionally subrogated. Without this subrogation to workers and materialmen with superior rights, the Broker's right of equitable subrogation is of no benefit and is certainly not dispositive of the priority issue. As the agency-assignment cases are not dispositive because they turn on the consignment rather than the agency issues, likewise, the equity-surety cases are not dis-

\textsuperscript{39} "[T]he surety, on payment, succeeds to all the rights of the owner, contractor, and subcontractors . . . . Since the bank could not prevail against the subcontractor, neither can it prevail against the surety who has paid the subcontractor's claims." Opala, supra, note 37 at Q-60, (citing Fidelity and Casualty Co. of New York v. The First Nat'l Exchange Bank of Virginia, 193 S.E.2d 678, 684 (Va. 1973)). This priority is not dependent on the lien rights of the workers and materialmen, and thus does not require that these lien rights be preserved. See, e.g., Mid-Continent Casualty Co. v. First Nat'l Bank & Trust Co., 531 P.2d 1370, 1376 (citing Framingham Trust Co. v. Gould-Nat'l Batteries Inc., and American Casualty Co. v. Framingham Trust Co., 427 F.2d 856 (1st Cir. 1970)), and Opala, supra note 37. However, for a case that denied priority to a surety because the lien rights had not been protected under state law, see Corpus Christi Bank & Trust v. Smith, 525 S.W.2d 501 (Tex. 1975).

\textsuperscript{40} See National Shawmut Bank v. New Amsterdam Casualty Co., 411 F.2d at 845; Mid-Continent Casualty Co. v. First Nat'l Bank and Trust Co., 531 P.2d at 1375-76; Opala, supra note 37, at Q-60.
positive because they depend on the surety's subrogation to workers and materialmen who are not a part of the *Utica* problem. If one is to look to equity for an explanation of why the Broker prevailed, one must look to some theory of equity which does not rely upon the doctrine of subrogation.

**AN EQUITABLE LIEN THEORY**

There remains the possibility of the Broker claiming an equitable lien of some sort, not dependent on the concept of subrogation. One of the problems associated with this theory is the difficulty of establishing one of the recognized bases for such a lien. Although a rather vague concept,\(^{41}\) equitable liens traditionally have been imposed only in limited circumstances, for example where the defendant has committed fraud or some other tortious offense and has been unjustly enriched as a result.\(^{42}\) Since there was no mention of such offense in the *Utica* case this lien theory is inapplicable. However, equitable liens also may be used to "save" a contractual arrangement that fails as a legal lien due to some technical defect.\(^{43}\)

In one sense it may refer to a lien created by express or at least implied-in-fact agreement of the parties, as where a borrower agrees that a certain fund or piece of property will stand as security for his debt. Such liens are "equitable" in the sense that they may have failed to comply with some requirement of a "common law" lien, but are recognized and enforced in the courts of equity.\(^{44}\)

Sometimes these liens are called "equitable mortgages,"\(^{45}\) and it is possible that the *Utica* case may be explained as an example of this. Aside from the difficulty of establishing a rec-

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41. "Defining an 'equitable lien' is like trying to define poetry: The educated reader senses its presence but comes to grief when he tries to put the business in words." T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST, T 9-203 [A] [9], 9-101 (1978).
43. Id.
44. Dobbs, supra note 42 at 249.
ognized basis for such a lien, however, there is the simple matter that the Code was intended to abolish equitable liens as a device for circumventing the requirements and priority of security interests. Specifically, the Code states:

The theory of equitable mortgage, insofar as it has operated to allow creditors to enforce informal security agreements against debtors, may well have developed as a necessary escape from the elaborate requirements of execution, acknowledgement and the like which the nineteenth century chattel mortgage acts vainly relied on as a deterrent to fraud. Since this Article reduces formal requisites to a minimum, the doctrine is no longer necessary or useful.

Moreover, even if a basis for an equitable lien is recognized, there remains the crucial question of priority. Without the vital doctrine of subrogation that determines priority in the construction surety cases, the equitable lien is dependent on general principles of lien priorities. There is nothing to indicate that equitable liens are to be given any kind of "super-priority" over competing legal interests. Quite the contrary, there are indications that unrecorded equitable liens are not favored in a priority conflict. For example, it has long been established that a bona fide purchaser prevails over a pre-existing equitable lien on the same property. It is also clear that a secured creditor can qualify as a bona fide purchaser under the Code, which suggests that perfected secured creditors may be entitled to priority over equitable liens. Furthermore, "[u]pon the question of the superiority of liens, between such as are called legal and those which are called equitable, it is a maxim, coeval with the law of equity, that 'where equities are equal the law must prevail.'" In Oklahoma, the courts have dis favored "secret" liens that do not appear of public re-

46. See generally McClintock, Pomeroy and Dobbs, note 42 supra.
50. Durfee, supra note 48 at 88 (quoting Fisk v. Potter, 2 Keyes 64, 73 (N.Y. 1865)).
cord, subordinating such to a perfected security interest even when the secret lien was prior in time.\textsuperscript{51} When the legal lien is prior in time there seems little doubt that it is entitled to priority.\textsuperscript{52}

One of the more interesting cases in this area is \textit{Warren Tool Co. v. Stephenson}.\textsuperscript{53} This case involved a letter to a bank instructing the bank to satisfy a debt owed the plaintiff from certain checks to be deposited with the bank. The court indicated that such a letter could create an equitable lien on the proceeds of the check, enforceable even though the check was wrongfully diverted and never deposited with the bank. After deciding that such a lien could exist in this case, the court drew a distinction between an equitable lien and an equitable assignment:

The doctrine of equitable lien is a rule of substantive law, grounded on equitable principles, which recognizes or declares a \textit{security interest} based upon the agreement or, in certain kinds of cases not here relevant, the relationship of the parties, even though such \textit{security interest} is imperfect and may be given only limited priority where the rights of third parties have intervened.\textsuperscript{54}

Thus, it would seem that an equitable lien, if not abolished by the Code, at least should be treated as a form of security interest subjected to the article 9 priority rules (and perhaps even the article 9 perfection/notice requirements).\textsuperscript{55} Yet, even if the equitable lien is wholly outside the influence of article 9, it would still be subject to the general "first in time, first in right" priority system recognized for other liens by title 42. Specifically, section 15 of the Oklahoma Statutes provides that "[o]ther things being equal, different liens upon the same property have priority according to the time of their


\textsuperscript{52} The equitable lien "will not be preferred to a prior lien on the lands by judgment." C. Beach, Jr., \textit{Commentaries on Modern Equity Jurisprudence} § 289, at 332 (1892).


\textsuperscript{54} 161 N.W.2d at 142 (emphasis added).

\textsuperscript{55} Okla. Stat. tit. 12A, § 9-301(1)(b), suggesting that liens are subject to the code's "first-in-time" priority system based on the date the lien was obtained. However, the definition of lien creditor at § 9-301(3) indicates that this may be limited to legal liens.
creation, except in cases of bottomry and respondentia."

If, as it appears, the bank was the first to obtain its "lien," it would seem that treating the Broker's claim as a non-code equitable lien would result in subordination of the Broker's interest to that of the bank. Thus it does not appear that the theory of equitable lien is helpful in explaining the ramifications of the Utica decision.

**Equitable Accounting**

Without the additional element of equitable subrogation or equitable lien, there seems to be little basis for treating Utica as an example of an equitable accounting. An equitable accounting normally is available only if the legal remedy is inadequate, as in cases when the facts are considered too complex for a jury to comprehend, or when there has been a breach of a fiduciary obligation and the defendant has unique knowledge as to the extent of lost profits. There is no indication that this was the case regarding the issue under consideration in Utica. Hence an analysis of equitable accounting sheds little light on the meaning of the case.

**The Assignment Issue**

The Utica opinion states that it would be incorrect to give the Bank priority because that would have the effect of giving the assignee-Bank a greater right in the proceeds than that which Lamb could have asserted for itself. The absurdity of this result is at once apparent. The Bank can have no greater right in the accounts' proceeds than its assignor-Lamb. If the law were otherwise, the Bank—qua secured creditor—could create for itself rights in proceeds its very own assignor would be powerless to harness.

Treating the problem purely as one of common law as-

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assignment, this is certainly true. There could be no quarrel with the court’s conclusion that an ordinary assignee steps into the shoes of the assignor and can have no greater rights than those of the assignor. However, it is also true that one of the purposes of the Uniform Commercial Code is to change that and to create specially protected classes of persons with rights greater than those of their assignors. A creditor with a properly perfected article 9 security interest is one of these protected persons.

For example, sections 9-301(1)(a) and 9-312(5), read together, award a perfected secured creditor priority over any and all unperfected security interests in the same collateral, regardless of the dates of perfection and attachment. Obviously, this is a better position than that enjoyed by the debtor, who is subject to the claims of all of his creditors, including the unperfected secured creditors. Furthermore, section 9-301(b) suggests that a perfected security interest has priority over any lien acquired subsequent to the perfection. Lien creditor is broadly defined at section 9-301(3) to include an assignee for the benefit of creditors, a trustee in bankruptcy, and any creditor “who has acquired a lien on the property involved by attachment, levy or the like . . . .” All of these represent claims assertable against the debtor but not against a prior perfected security interest. Again, it is apparent that the perfected secured creditor can enjoy rights greater than those of his assignor/debtor, and is far more than a mere assignee. Once the security interest attaches, it is enforceable against the debtor with respect to the collateral.

By mere attachment, the secured creditor obtains rights superior to those of the debtor.

Thus it is clear that the Bank, as secured party, could indeed have greater rights than its debtor-assignor. In fact, it would seem that the very purpose of article 9 and an article 9 security interest is to encourage commerce by providing these


60. Perhaps the most famous of these is the “holder in due course.” See, e.g., Okla. Stat. tit. 12A, §§ 3-302 and 3-305. Also consider some of the protections “good faith purchasers for value,” Okla. Stat. tit. 12A, § 2-403(1), and “buyers in the ordinary course of business,” Okla. Stat. tit. 12A, § 2-403(3).

special rights to those who voluntarily extend credit and comply with the provisions of the Code.\textsuperscript{62}

Other courts have had difficulty wrestling with this problem. One of the best known examples is \textit{International Harvester Credit Corp. v. American Nat'l Bank}.\textsuperscript{63} That case involved a priority dispute between a prior perfected security interest with an after acquired property clause, and a later credit-seller of farm equipment who failed to comply with the Code requirements for perfecting a purchase money security interest pursuant to section 9-312. According to article 9, priority would go to the first to file. However, the Florida Supreme Court awarded priority to the credit-seller, even though the other creditor was the first to file, and the reasoning of the court bears some resemblance to the "assignment" language in \textit{Utica}.

The stated bases for the \textit{International Harvester} decision were unarticulated "contractual constitutional requirements and equitable principles."\textsuperscript{64} However, most of the court's discussion of the issues involved basic concepts of contractual assignments. The court found that "[t]here really are no conflicting security interests in this situation. That security interest retained by the subsequent seller . . . never passes to the buyer-debtor and thus never becomes subject to the earlier creditor's claim of security interest. . . ."\textsuperscript{65} In effect the court seems to be saying that the debtor cannot assign to the creditor any greater interest than he got from the credit-seller by stating "[i]n this respect we note that the statute grants the priority in the debtor's . . . property . . . The debtor, while acquiring the physical property, only acquires an interest therein under a sales contract; it is this interest then which is . . . subject to the earlier security right . . . ."\textsuperscript{66} In

\textsuperscript{62} \textit{See Matter of Samuels & Co.}, 526 F.2d 1238, 1247 (5th Cir. 1976). The court stated that "[t]he whole point of Article Nine is the continuity of perfected security interests once they have properly attached, despite subsequent loss of control or possession by the debtor." The court rejected the argument that the rights of the secured creditor are identical to those of the debtor. \textit{See also United States v. Wyoming Nat'l Bank of Casper}, 505 F.2d 1064 (10th Cir. 1974).

\textsuperscript{63} 296 So. 2d 32 (Fla. 1974).

\textsuperscript{64} \textit{Id.}

\textsuperscript{65} \textit{Id. at} 34.

\textsuperscript{66} \textit{Id.}
other words the prior secured creditor stands in the shoes of the debtor and has no greater rights than the debtor has against third party claimants. Stripped of its verbage about after-acquired property this is the same reasoning evinced by the previously quoted language from *Utica*. The result in *Utica* was that the Bank’s security interest could only attach to the debtor’s rights, i.e. the debtor’s “equity” in the accounts after the offset of the Broker’s claim. This was precisely the result in *International Harvester*, albeit in a different context.

So it seems that the *Utica* case gleams support from the Supreme Court of Florida. However, in reading *International Harvester* one also should give consideration to the opposing view, forcefully set forth by Chief Justice Carlton in his dissenting opinion.67 His basic position is that despite the use of the term “equity” the issue is one of priority under article 9. Chief Justice Carlton stated that “[t]he Code recognizes only a single form of contractual lien on personal property — a “security interest.”68 As Justice Carlton pointed out “[w]hat could be more equitable than a system which gives priority to any party only if he gives proper notice to other parties so that they are not injured.”69

Justice Carlton noted that the majority opinion would create a different system:

> Under the majority’s reasoning, to be entirely logical, we must also say that *any time* a debtor uses a collateral property in which there is already outstanding security interest he may only give a security interest in his “equity” in the property. It is elementary that the debtor’s “equity” in the property would be that amount of its value over and above the amount necessary to satisfy the first secured debt. Therefore, each security interest attaches to separate elements of the property, and they can never conflict. What we have done, in effect, is establish a system of priorities-based upon the order of attachment. The first interest to attach has priority; if there is anything left over, it goes toward sat-

67. Id. at 35.
68. Id. at 41.
69. Id. at 43.
isfaction of the second interest to attach.  

Arguably, the same system could be said to result from the language in Utica which indicated that the Bank's security interest was limited to Lamb's interest (i.e. equity) in the accounts. It makes interesting conjecture to contemplate what would have resulted from specific application of such a system in the Utica case. If, as it appears, the Bank's security interest was the first to attach, and if it covered all of Lamb's accounts and accounts' proceeds, Lamb would have had no equity left to transfer to the Broker under any theory. If the Bank as assignee stands in no better position than Lamb at the time of the assignment (by execution of the security interest), then it would seem that the Broker could take no greater rights than its assignor/principle (Lamb) had at the time the Broker obtained its interest. It was considered essential to the Broker's case that it obtained its claim by reason of "unwitting advances" rather than as a contractual debt. Thus, its claim could not relate back to its October 1974 contract. Thus, the Broker's claim would not originate until each shipment of coal was billed and paid for. This would render the Broker subordinate to the Bank as to all shipments made subsequent to the Bank's December 1974 security interest, because the debtor would have no equity in such accounts or accounts' proceeds, having already granted it to the Bank as security for its loan. Such reasoning is clearly erroneous under the Code, and it still would not have resulted in priority for the Broker. Thus, the theory of assignment does not provide an adequate explanation for the basis and meaning of the Utica decision.

SET-OFF

In drawing a parallel between Utica and an action for an equitable accounting, the Oklahoma Supreme Court suggested that "[t]he allowance sought for 'advanced' payments (in excess of collections) would be a proper offset."  

70. Id. at 44.
71. 622 P.2d at 1065 nn.14, 15. In this context a contractual debt would look a lot like an unperfected article 9 security interest. The Utica decision emphasizes that the Broker's claim was not a contractual debt.
72. 622 P.2d at 1065. The International Harvester case has been criticized, and
possibility that the *Utica* case may be explained as a simple matter of set-off.

The right of set-off is a time-honored remedy that recognizes the right of a creditor to refuse to pay money to someone who is indebted to him.\(^7\) Furthermore, although grounded in equity and sometimes referred to as a "lien," the right of set-off is in fact a doctrine "independent of any lien theory."\(^7\) Therefore, a set-off theory can operate independently of the "first-in-time" priority baggage of the equitable lien concepts. Moreover, section 9-104(i) specifically excludes set-off rights from article 9 of the Code. Thus it might seem that in *Utica* the Broker's right to a set-off was of paramount importance in his effort to overcome the "first-in-time" requirements of the Code and lien priority systems.

Unfortunately, the cases do not bear this out. The section 9-104(i) exclusion is usually taken to mean that a set-off claim is exempt from the filing and perfection requirements of article 9, but that the priority of a set-off claim is nonetheless subject to the article 9 "first-in-time" priority rules.\(^7\) Although most of the reported cases involve bank deposits, the conclusion is inescapable that the courts consider bank set-off rights subject to the normal "first-in-time" limitation.\(^7\) In *Utica* this would seem to subordinate the Broker's claim to a set-off to the bank's prior perfected security interest in the


\(^7\) 622 P.2d at 1065, n.17.

\(^7\) *See, e.g.*, *Fletcher v. Rhode Island Hosp. Trust Nat'l Bank*, 496 F.2d 927 (1st Cir. 1974), *cert. denied*, 419 U.S. 1001 (holding that set-off is a form of self-help and therefore does not constitute state action).


account proceeds.

The cases involving bank deposits are not directly applicable in the *Utica* context. Normally the relationship between bank and depositor is not one of agent and principle, and several of the bank deposit cases turn on the bank's knowledge of the competing security interest at the time of the set-off, rather than the parties' status. The factual distinctions between the cases make direct comparison impossible. Moreover, even in the bank context, "[t]he priority of the holder of a perfected security interest in a certificate of deposit over a bank's right of set-off is still a debatable question." Therefore, the law of set-off is not sufficient to explain the *Utica* case; however, it may be a factor to be considered in conjunction with other aspects of the case.

**Conclusion**

Among the theories considered in this article, two stand out as representing the soundest bases for the *Utica* decision. The agency (status) theory alone would provide a basis for extending priority to the Broker, outside the strictures of article 9. However, in unrestrained form this theory also contains the seeds for the possible destruction of the Code priority system. It simply makes it too easy for a creditor to clothe himself in the garb of an agent as a means of circumventing article 9. Therefore, it is important to find a narrower ground as an explanation of the *Utica* decision.

The other sound basis for the *Utica* decision is the law of set-off, a claim clearly established outside the Code. This theory, alone, is insufficiently developed in this context to stand as a sole explanation for the result.

In tandem, however, the two concepts of agency and set-

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77. Normally the relationship is one of debtor-creditor. See, e.g., Washington Steel Corp. v. TW Corp., 602 F.2d 594 (3rd Cir. 1979). OKLA. STAT. tit. 12A, § 4-201 grants agency status to collecting banks but not payor banks.

78. Supra note 77.

79. The bank set-off cases cited in supra note 77 involves the right to set-off loans against a deposit represented by a certificate of deposit pledged to another creditor.

off provide the parameters for a satisfactory interpretation of the case. If the Broker prevailed because he had a non-contractual claim that arose in the course of his conduct as an agent, the claim is properly viewed as a non-code interest. If the priority of that claim was established on the basis of set-off against money due the agent’s principle, the Broker’s rights have been defined in a sufficiently narrow fashion to minimize abuse.

Under this interpretation, three elements would be necessary before an agent could overcome the priority of a Code security interest. First, there would have to be a bona fide agency relationship, rather than an arrangement contrived to avoid article 9. Secondly, the claim of the agent against the principle would have to arise out of the course of the agency relationship, in an inadvertent and non-consensual fashion; for example, the Broker’s “unwitting advances.” In effect it would have to be a claim based on status, not contract. Thirdly, the priority of the Broker’s claim would be limited to funds in his possession or control, as a “set-off.” This latter requirement would prevent the agent from claiming priority as to uncollected accounts, as the Broker (or other collecting agent) only obtains the rights to set-off upon receipt of collected proceeds.

This view would avoid the harsh and unfair results suggested by the examples in the Appellant’s Brief. In Example One, a creditor assumes the status of a collection agent and successfully claims “all of the account proceeds which it has collected or will collect in the future . . . .” Under the suggested interpretation of Utica this would be impossible because in the example none of the suggested required elements are present. In the example, the purported agency relationship was a mere device intended to improve priority, and therefore fails the first test. But even if that is not apparent, the second requisite is clearly absent. The creditor’s claim is obviously a contractual debt, and was consensual rather than inadvertent or “unwitting.” It is also evident under the suggested interpretation that the “agent” cannot successfully

81. Brief for Appellant at 8-10.
82. Id. at 10 (emphasis added).
claim proceeds to be collected in the future. The right of set-off extends, at most, to funds held by the agent. When the secured creditor (the Bank in this case) forecloses on its accounts' collateral it can obtain title to the accounts and revoke the agency, depriving the "collecting agent" of any claim whatsoever to future accounts' proceeds. If the "agent" seeks to prevent this by procuring an irrevocable contract, he emphasizes that his claim is contractual in nature and therefore is subject to article 9.

It is thought that the suggested interpretation of Utica will prevent the case from becoming precedent allowing an overly broad attack on article 9. In effect, it is suggested that the case should be viewed with an eye toward Chief Justice Carlton's comments in his dissenting opinion in International Harvester:

The Uniform Commercial Code has been highly praised for its effectiveness . . . . The reasons for the Code's effectiveness are that it is simple, explicit, clear and complete. Almost every situation is expressly covered by the Code's provisions and, where there are exceptions to the rules the exceptions are clearly spelled out. Concerning Article Nine of the Code, as previously mentioned, it replaced many devices formerly used to encumber personal property . . . with a "single lien" called a security interest, and it set out simple and specific rules for determining priorities among conflicting security interests in the same property.83

Justice Carlton noted that the purpose of article 9 was to make "sweeping changes" in the old "title" and "lien" theories, and to overcome the previous confusion stemming from different priority rules for different lien theories.84

Since the success of the Code is based on its simplicity and its certainty, courts should make every effort to interpret its provisions simply, literally, and absolutely. By creating judicial exceptions, changing definitions, and interpreting the Code extremely broadly, we will eventually reproduce the morass of confused commercial law the Code was designed to correct.85

83. 296 So. 2d at 44.
84. 296 So. 2d at 45.
85. Id.
These considerations argue for a narrow interpretation of the *Utica* decision.