Problem

Boudreaux, a manufacturer and seller of pirogues, borrows $10,000 from Thibodeaux. To secure repayment of the loan, Boudreaux grants Thibodeaux a UCC Article 9 security interest in “my equipment, my inventory, and my accounts.” At the time, Boudreaux’s equipment consists of (1) a Craftsman chainsaw, (2) a Craftsman hatchet, and (3) a set of Craftsman wood-carving tools. At the time, Boudreaux’s inventory consists of (1) a red pirogue and (2) a blue pirogue. At the time, Boudreaux’s accounts receivable consist of (1) $200 owed to Boudreaux by Menard for the purchase of a purple pirogue last week and (2) $200 owed to Boudreaux by Naquin for the purchase of an orange pirogue just yesterday.

Time flies. As it does so, Boudreaux’s “asset portfolio” changes. First, he sells his old Craftsman chainsaw for $500. With that very same $500, he buys a new Home Depot chainsaw. Second, after his Craftsman hatchet breaks, he discards it and, then, using some money he’d received from his father as a birthday present, buys a new Home Depot hatchet. Third, he builds a new green pirogue for sale. Fourth, he sells the old red pirogue to Oubre, on credit, for $200. Fifth, he collects $200 cash from Menard, in payment of the old account receivable that Menard had owed him. This $200 cash Boudreaux stuffs under his mattress, where it’s NOT mixed with any other cash.

Of the assets that Boudreaux now has, which are encumbered by the security that he had granted to Thibodeaux? Why?

Solution

(1) “Old” assets. – Let’s start with the assets that Boudreaux had at the time at which he first granted the security interest and that he still has: (a) the set of Craftsman wood-carving tools, (b) the blue pirogue, and (c) the account receivable that Naquin owes him. The wood-carving tools qualify as “equipment”; the blue pirogue, as “inventory”; and the account receivable, as an “account”. Because these were “present” property of Boudreaux – he already had them when he granted the security interest --, they were encumbered. And nothing has happened since then that might have caused them to become “un-encumbered”.

(2) “New” assets. – Now, let’s consider the assets that Boudreaux did not acquire until after he granted the security interest: (a) the Home Depot chainsaw, (b) the Home Depot hatchet, (c) the green pirogue, (d) the account receivable that Oubre now owes him, and (e) the $200 cash payment he got from Menard.

(a) The Home Depot chainsaw. – Inasmuch as the security agreement did not, at the moment at which it was entered into, cover the Home Depot chainsaw (that’s so because (i) the debtor can’t grant a security interest in what he doesn’t own and (ii) Boudreaux didn’t then own that chainsaw), the security agreement will be deemed to cover that chainsaw only if one of the following is true: (i) (α) that chainsaw is “after-acquired collateral” and (β) the security agreement covers such after-acquired collateral or (ii) (α) that chainsaw is “identifiable proceeds” of some of the original collateral (i.e., “old” assets) and (β) the security agreement covers such proceeds.

(i) The Home Depot chainsaw as “after-acquired collateral”. – There are two distinct questions here: (α) Does this chainsaw qualify as “after-acquired collateral”? and (β) If so, does the
security agreement cover after-acquired equipment?

(a) There can be no doubt that the Home Depot chainsaw qualifies as “after-acquired collateral”. It’s clearly “equipment”, see UCC 9-102(a)(33), which is one of the categories of collateral referred to in the security agreement; it’s clearly “after-acquired”, that is, it was not acquired until “after” the security interest had already been granted.

(b) But the mere fact that the Home Depot chainsaw is “equipment” does not, standing alone, justify the conclusion that it is encumbered by Thibodeaux’s security interest. Why not? Because, at least as a general rule, when a debtor grants a security interest in a certain category of thing “X” (e.g., “equipment”), he is understood to encumber only his “present Xs” (e.g., “present equipment”), that is, the Xs that he then owns, but not his “after-acquired Xs” (e.g., “after-acquired equipment”), that is, the Xs he acquires thereafter. Thus, when Boudreaux granted Thibodeaux a security interest in his “equipment”, the analysis must start with the presumption that Boudreaux granted Thibodeaux a security interest in only his “present” equipment, that is, that which Boudreaux had at that time, i.e., the Craftsman chainsaw, (2) the Craftsman hatchet, and (3) the set of Craftsman wood-carving tools, but not in his “after-acquired” equipment, such as the Home Depot chainsaw.

The presumption that the encumbered property includes only the debtor’s “present Xs” may, however, be overcome. That is, there are certain circumstances in which the debtor will, extraordinarily, be understood to have granted a security interest in not only his “present Xs”, but also his “after-acquired Xs”. What circumstances are these? Well, it depends. On what? On the jurisdiction. In some jurisdictions, which we may, for ease of reference, call “conservative”, the presumption will be overcome if and only if the granting clause of the security agreement specifically refers to “after-acquired Xs” or the equivalent thereof (e.g., “new Xs”). In other jurisdictions, which we may, for ease of reference, call “liberal”, the presumption will be overcome (1) if the granting clause of the security agreement specifically refers to “after-acquired Xs” or the equivalent thereof or (2) if the category “X” consists of the kind of thing that, by its very nature, “turns over” quickly and inevitably, such as “inventory” and “accounts”.

Is the present-property-only presumption overcome here as to the Home Depot chainsaw? NO! Let’s suppose, first, that we’re in a “conservative” jurisdiction. We face, then, only one question: Did the granting clause of the security agreement include language like “after-acquired equipment”? The answer, here, is “no”. So, if our jurisdiction is conservative, the presumption stands. Let’s suppose, next, that we’re in a “liberal” jurisdiction. We face, then, two questions: (1) Did the granting clause of the security agreement include language like “after-acquired equipment”? (2) Is “equipment” the kind of thing that, by its very nature, “turns over” quickly and inevitably? We already know that the answer to the first question is “no”. The same is true of the second question: “equipment”, unlike “inventory” and “accounts”, is not the kind of thing that, by its very nature, “turns over” quickly and inevitably. Thus, even if our jurisdiction is “liberal”, the presumption still stands.

For these reasons, the new chainsaw cannot be regarded as encumbered on that the theory that it qualifies as covered “after-acquired collateral”.

(ii) The Home Depot chainsaw as “identifiable proceeds of original collateral” – There are two distinct questions here: (a) Does this chainsaw qualify as “identifiable proceeds” of some original collateral? and (b) If so, does the security agreement cover such proceeds?

(a) Yes, indeed, the chainsaw qualifies as “identifiable proceeds”. In fact, it’s “proceeds” of “proceeds” of original collateral. Why? Because it was “acquired upon the sale . . . or other disposition of collateral”, see UCC 9-102(a)(64)(A): Boudreaux started with the Craftsman
chainsaw, which was “collateral”; then he “sold” that chainsaw, generating “proceeds” of that collateral, i.e., the cash price he got for it; these proceeds, in turn, became “collateral”, see 9-315(a)(2); then, he “disposed of” this cash collateral (proceeds of original collateral) to acquire the new chainsaw.

(b) And, yes, indeed, the security agreement does, in fact, cover such proceeds. Per 9-315(a)(2), any grant of any security interest is understood to extend to the “identifiable proceeds” of the any and all original collateral, unless the agreement provides otherwise. Here, the agreement did not provide otherwise.

For these reasons, the new chainsaw should be regarded as encumbered on the theory that it qualifies as covered “proceeds”.

(b) The Home Depot hatchet. – The framework for analysis is the same here as it was for the Home Depot chainsaw. The second half of the analysis is, however, different, as is the ultimate conclusion to which the analysis leads.

(i) The Home Depot hatchet as “after-acquired collateral”.

(a) The new hatchet is “after-acquired equipment” for the same reasons that the new chainsaw is “after-acquired equipment”.

(b) Even so, as we saw before in our analysis of the new chainsaw, the security agreement did not cover after-acquired equipment.

For these reasons, the new hatchet cannot be regarded as encumbered on the theory that it qualifies as covered “after-acquired collateral”.

(ii) The Home Depot hatchet as “identifiable proceeds of original collateral”. – The new hatchet, unlike the new chainsaw, is not “identifiable proceeds of original collateral”. Why not? Because the hatchet doesn’t fall into any of the subcategories of “proceeds” found in UCC 9-102(a)(64). It certainly doesn’t fall into subcategory (A), the subcategory into which the new chainsaw fell. Why not? Because of the “source” of the funds with which the new hatchet was acquired. Whereas the new chainsaw was acquired with funds generated by the “sale” of original collateral, i.e., the old chainsaw, the new hatchet was acquired with funds that had nothing to do with the “sale” or “other disposition” of any of the original collateral; to the contrary, the new hatchet was acquired from an “outside” source of value, namely, a donation made to Boudreaux by his father.

For these reasons, the new hatchet cannot be regarded as encumbered on the theory that it qualifies as covered “proceeds”.

(c) The green pirogue. – The framework for analysis is the same here as it was for the chainsaw and the hatchet; but the content of the analysis is different.

(i) The green pirogue as “after-acquired collateral”.

(a) The green pirogue, unlike the new chainsaw and the new hatchet, is not “equipment”. But it is “inventory”, see 9-102(a)(48)(B). And “inventory” is one of the categories of collateral referred to in the security agreement. Further, the green pirogue was “after-acquired”, for it was not created until after the security interest had been granted.

(b) Does the security agreement cover this “after-acquired inventory”? The answer depends on the jurisdiction. If our jurisdiction is conservative, then the answer is “no”. Why? Because the security agreement doesn’t, in so many words, say anything about “after-acquired inventory”. But if our jurisdiction is liberal, then the answer is “yes”. Why? Because “inventory” is the kind of thing that, by its very nature, “turns over” quickly and inevitably.

(ii) The green pirogue as “identifiable proceeds of original collateral”. – This is a toughie. Here, the new pirogue was “made”, not purchased, by Boudreaux. That means that
Boudreaux added his labor to the raw materials from which the pirogue was constructed (timber, pitch, paint, etc.). Even if we could trace the source(s) of those raw materials to funds generated by the “sale” or “other disposition” of this or that piece of original collateral, this labor input represents “outside” value. And it may well be that the addition of this input of “outside” value takes the end product (the new pirogue) out of the category of “proceeds”, see UCC 9-102(a)(64). But perhaps one could argue that the new pirogue constitutes “proceeds” of the sources of the raw materials to the extent of the value of the those sources. Who knows? In any event, we can’t tell from the hypothetical what the source(s) of the raw materials was (were). For all we know, those funds may have been donated to Boudreaux by his father. And, if that was the case, then, of course, the “proceeds” argument would collapse.

(d) The account receivable that Oubre owes Boudreaux. –
   (i) The new account receivable as “after-acquired collateral”. –
      (a) Though the account receivable is neither “equipment” (as are the new chainsaw and the new hatchet) nor “inventory” (as is the new pirogue), it is, nevertheless, an “account”, see UCC 9-102(a)(2). And the security agreement refers to “accounts” as well as to “equipment” and “inventory”. Further, this new account is “after acquired”: Oubre did not incur his debt toward Boudreaux until after Boudreaux had granted his security interest.
      (β) For the same reasons given in the analysis of the new pirogue, whether the security agreement covers after-acquired accounts “depends” on whether the jurisdiction is “conservative” or “liberal”. If conservative, then “no”; if liberal, then “yes”.
   (ii) The new account receivable as “identifiable proceeds of original collateral”. –
      (a) The new account receivable indisputably qualifies as “identifiable proceeds of collateral”. Why? Because it was “acquired upon the sale . . . of collateral”, here, the red pirogue. The new account receivable, in fact, represents the obligation to pay the price of that pirogue.
      (β) For the same reasons given in the analyses of the new chainsaw, the security agreement does, in fact, cover such proceeds.

(e) The $200 cash payment Boudreaux got from Menard. –
   (i) The cash as “after-acquired collateral”. – This dog won’t hunt. The cash is not “equipment”; it’s not “inventory”; and it’s not “accounts”. Thus, even if the security agreement covered “after-acquired collateral” as well as “present collateral”, the agreement wouldn’t touch the cash.
   (ii) The cash as “identifiable proceeds of original collateral”. – The analysis here parallels that given for the new account receivable. The only difference is that whereas the new account receivable was proceeds of “inventory”, the cash is proceeds of an “account”, i.e., the account receivable that Menard had owed Boudreaux. Thus, the cash, like the new account, should be regarded as encumbered on the theory that it constitutes covered “proceeds”.