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## A Comment on Wyoming's New Accounts Receivable Statute

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## CONCLUSION

The Taft-Hartley Act attempts to create an atmosphere and an attitude in which an agreement is inevitable. It does not compel agreement; and yet under present decisions are not the employers compelled, in effect, constantly to yield more ground to the union demands? This is a harsh inquiry that must receive fair attention by the Board and federal courts. Legislation over the state of mind of employer or union is impossible; thus it is imperative that the over-all conduct in negotiation be used and compared with that of those negotiators who have accepted collective bargaining as a workable postulate in daily industrial living. This application would supplement the administrative and judicial interpretations standing alone and would serve to halt the threatened pressures on the employer.

The emphasis in successful labor-management relations must continue to lie on the process of good faith collective bargaining in order to safeguard not only the legitimate interests of labor unions, but also those of employers, individual employees, and, of primary import, the American public, whose stake in the process of collective bargaining is of great importance.

The Act now requires that both parties act in good faith in bargaining and also provides remedies for failure to perform in that manner, but the Congress, the National Labor Relations Board, and the courts must continue to contribute definiteness to the term to better enable those gathered around the bargaining table to interpret it.

Administrative and judicial regulation of the collective bargaining procedure into predetermined channels is certainly not a wholesome solution. Should it ever become possible for the unions or management to simply present themselves before the Board at any instance of balkiness on the part of a bargaining opponent, it would lead to destruction of the very negotiation the Act was promulgated to protect. Harmonious labor relations are the natural result of accepted standards or policies tempered with a spirit of mutual trust, good-will and respect, all of which aid in giving underlying sustenance to the rather naked statutory term "good faith."

ALAN K. SIMPSON

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A COMMENT ON WYOMING'S NEW ACCOUNTS  
RECEIVABLE STATUTE

The Wyoming Legislature in 1957, keeping pace with the prospective commercial development of the state, adopted a new act relating to the assignment of accounts receivable.<sup>1</sup> The legislation endeavors to make the practice of accounts receivable financing more useful by eliminating

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1. Wyo. Comp. Stat. §§ 39-1401 to 39-1416 (Supp. 1957).

some of the problems which confront the lender who wishes to take this type security. Assigning money owing to a firm from its customers is one of the best ways a small business can provide itself with short term capital. It enables the businessman to purchase or process the products he sells, which in turn increases his capacity to bring new accounts into existence. More so than inventories, accounts receivable are inherently excellent security. Next to cash and marketable securities, they are the most liquid assets on the balance sheet. They are preferable to inventories in that they are further along in the chain of business activity and are self-liquidating, whereas inventories require sale before they can be applied to the debt.

The lender, who takes an assignment of accounts receivable as security for a loan, has been confronted with various problems adversely affecting this security. Some of these problems are: the effect of retention of control of the accounts by the assignor, priority as between two assignees of the same account, and the validity of such assignments in the event of the assignor's subsequent bankruptcy. This note deals with the historical development of these problems, and the solutions provided by the new Act.<sup>2</sup>

One of the earliest decisions affecting accounts receivable financing was *Benedict v. Ratner*<sup>3</sup> decided in 1925 by the Supreme Court of the United States. There the Court enunciated the principle that the reservation of unrestricted control over the proceeds of the accounts receivable by the assignor "imputes fraud conclusively because of the reservation of dominion inconsistent with the effective disposition of title and creation of a lien."<sup>4</sup> This rule has a detrimental effect on borrowers who desire to keep the notoriety of an assignment to a minimum. They feel that if their customers know their accounts have been assigned to another, it would be indicative of financial distress. This may curtail further business dealings with those customers, and hence impair the borrower's potential business expansion. The rule of the *Ratner* case was generally considered applicable in all bankruptcy proceedings. Now, however, it does not apply to such proceedings unless it properly expresses the state law.<sup>5</sup> Before the passage of the new Act, Wyoming had neither judicial decision nor statute indicating what the state law would be in situations where proceeds of assigned accounts remained in the assignor's possession. As will be seen hereafter, this problem is now taken care of by express provision.

A further problem resulted from the amendment of the preference section of the Bankruptcy Act by the Chandler Act of 1938.<sup>6</sup> Prior to this Congress had enacted several amendments to Section 60 of the Bankruptcy Act in an effort to protect the general creditors by strengthening the laws

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2. All references to "the Act" refer to the act cited supra note 1, unless other reference is clearly stated.

3. 268 U.S. 353, 45 S.Ct. 566, 69 L.Ed. 991 (1925).

4. 69 L.Ed. at 999.

5. Act of July 1, 1898, c. 541, § 70 (e) (1), 30 Stat. 544, as amended 11 U.S.C. § 110 (1952 ed.).

6. Act of June 22, 1938, c. 575, § 60, 52 Stat. 840, 11 U.S.C. § 96 (1952 ed.).

of preference, but these efforts were not very effective. In the case of *Sexton v. Kessler & Co.*,<sup>7</sup> the Court upheld a transfer executed but not disclosed by recording or change in possession until immediately before bankruptcy. The Chandler Act sought to overcome these early decisions validating both equitable liens perfected within four months of bankruptcy and secret transfers made on the eve of bankruptcy. This legislation provided:

A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy . . . a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein. . . .<sup>8</sup>

In one of the earliest cases to construe this section, the United States Supreme Court held in *Corn Exchange Bank v. Klaunder*,<sup>9</sup> that a trustee in bankruptcy prevailed over an assignee of a corporation's accounts receivable because the debtors obligated on the assigned accounts had not been notified of the assignments. This case had its origin in Pennsylvania which recognized the English rule as stated by *Dearle v. Hall*,<sup>10</sup> that, among successive assignees, the first to notify the debtor prevails. Since a hypothetical second assignee who was a bona fide purchaser could have cut off the rights of the bank by giving notice to the debtors obligated on the assigned accounts, the rights of the first assignee, the bank, were not perfected. Therefore, the transfer was deemed made immediately before bankruptcy for purposes of Section 60, and was thus voidable as a preference. The ruling of this case stunned many of the commercial banks and finance companies that had been lending on assignments of accounts receivable on a non-notification basis.

Although the Pennsylvania or English rule involved in the *Klaunder* case is a minority rule in the United States, the majority rule, referred to as the "American rule," and as stated in the case of *Salem Trust Co. v. Manufacturer's Finance Co.*,<sup>11</sup> also met with difficulties. This rule provides that the first assignee in point of time prevails irrespective of notice to the debtor. But, in the case of *In re Vardaman Shoe Co.*,<sup>12</sup> the court held that even in a state following the American rule, an assignment of accounts receivable is vulnerable to attack by a trustee in bankruptcy because the rights of the assignee could be cut off by a hypothetical bona fide purchaser who obtained either payment, judgment, or a novation.<sup>13</sup> Other

7. 225 U.S. 90, 32 S.Ct. 657, 56 L.Ed. 995 (1912).

8. *Supra* note 6.

9. 318 U.S. 434, 63 S.Ct. 679, 87 L.Ed. 884, 144 A.L.R. 1189 (1943).

10. 38 Eng.Rep. 475 (1828).

11. 264 U.S. 182, 44 S.Ct. 266, 68 L.Ed. 628, 31 A.L.R. 867 (1924).

12. 52 F.Supp. 562 (E.D.Mo. 1943).

13. 52 F.Supp. at 565.

courts have upheld an assignment of accounts receivable in jurisdictions following the American rule irrespective of the exceptions noted in the *Vardaman* case.<sup>14</sup>

Prior to the enactment of the new statute, the Wyoming Supreme Court had never been faced with the problem of priority between successive assignees of the same account. This problem is now clearly solved in the various provisions of the Act. Section 39-1403 provides the form of the notice of the assignments of accounts receivable that is to be filed. When the assignee files this notice in both the office of the Secretary of State and of the County Clerk in which the assignor has his or its principal place of business,<sup>15</sup> all assignments previously executed or executed within a year thereafter become protected. The assignee's claim is then good against everyone except those holding judicial liens on account at the time his assignment was filed, assignments perfected prior to his, prior assignments of which he had *written* notice at the time he received his assignment, and any written contract by him as to priorities.<sup>16</sup> There is no need for notice to the debtor to perfect the assignment. In fact, the English or Pennsylvania rule of *Dearle v. Hall* is expressly repudiated in Section 39-1402. The American rule of priority of the first assignment is somewhat modified in that priority is not now dependent on the earliest assignment, but on the earliest filing.<sup>17</sup> However, in cases where none of the assignees have filed a notice of assignment, Section 39-1410 codifies the American rule preferring the earliest assignment of the account.

Often an assignor desires to assign accounts that would come into existence in the future. The courts generally refuse to recognize such assignments because the subject of the assignment must either be in existence or at least have a potential existence at the time of the assignment.<sup>18</sup> The Act seems to provide a similar rule for assignment of accounts coming into existence in the future. Section 39-1401 provides:

(1) "Account" or "accounts receivable" means an existing or future right to payment of money (a) under an existing contract. . . .

A similar provision has given some difficulty in Texas because of an apparent failure to understand the theory of notice filing.

Article 260-1 of the Texas statutes was identical with the provision of Section 39-1401 of the Wyoming Act as above quoted. Under this law, the Texas Court of Civil Appeals in the case of *Keeran v. Salley*,<sup>19</sup> invalidated an assignment of an account that came into existence at a date

14. *In re Rosen*, 157 F.2d 997 (3d Cir. 1946).

15. Wyo. Comp. Stat. § 39-1401 (Supp. 1957).

16. Wyo. Comp. Stat. § 39-1406 (Supp. 1957).

17. Wyo. Comp. Stat. § 39-1406 (Supp. 1957); see *Donn v. Auto Dealers Inv. Co.*, 385 Ill. 211, 52 N.E.2d 695 (1944), in which the court allowed the defendant, who first advanced funds and took a trust receipt, priority over the plaintiff who first filed notice with the secretary of state.

18. *In re Estate of Nelson*, 211 Iowa 168, 233 N.W. 115, 72 A.L.R. 850 (1930).

19. 244 S.W.2d 663 (Tex. 1951); see *Oklahoma Oxygen Co. v. Citizens State Bank and Trust Co.*, 274 P.2d 372 (Okla. 1954).

subsequent to the filing of the notice. This case involved a bank which had filed a notice that A intended to assign one or more accounts to the bank. This notice specified that it was to be effective for three years. Within that period, A entered into a construction contract and intended to assign the proceeds of that contract to the bank. However, prior to actual notice of the new contract to the bank, B, a creditor of A, garnished the right of payment under the contract. The court held that the original notice did not give the bank a prior right to the fund impounded by the writ of garnishment for the reason that the contract which gave rise to the account here involved was obviously not in contemplation when the notice was executed. Thereafter, the Texas legislature amended Article 260-1 in 1955 to provide:

. . . that accounts receivable means an existing or future right to the payment of money presently due, or to become due (a) under an existing contract or under a future contract entered into during the effective period of the notice of assignment.

The decision in the *Salley* case was followed in *Republic National Bank v. Vial*.<sup>20</sup> The court there held that filing of a notice of an assignment did not protect later assignments of accounts not in existence at that time. Thus in this case the trustee in bankruptcy prevailed over the assignee as to such accounts collected within four months before the assignor's bankruptcy.

By these decisions, the Texas courts have frustrated the purpose of the recording Act. They have mistakenly emphasized the importance of the definition of "Account" or "accounts receivable," rather than looking to the provisions on the effect of the filed notice. Section 39-1403, which is similar to the Texas statute, provides for the contents of the notice that is to be filed. The notice merely states that the assignor has assigned or intends to assign one or more accounts receivable to the assignee. Nowhere does it indicate that the contents of any contract must be set out. Therefore, once the notice has been filed, the assignor can assign his accounts to the assignee-lender as security for a loan. The filing gives notice to all persons that the debtor has assigned or intends to assign his accounts, and thus affords persons dealing with or intending to deal with the borrower, adequate opportunity to find out the facts as to his situation. To compel the lender to ascertain whether such accounts were new, and then to further make him file a new notice to protect them, would render the use of accounts receivable financing unprofitable and useless.

Even though a single notice should be sufficient for the statutory period, additional instruments of assignment must, as previously indicated, be executed periodically to take care of new accounts. However, one must distinguish an open and running account from that of accounts under future contracts. Section 39-1402 validates the addition of items to an account even though added subsequent to the date of the assignment. An

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20. 232 F.2d 785 (5th Cir. 1956).

open account is an account based upon running or concurrent dealings between the parties, which has not been closed, settled or stated, and in which the inclusion of further dealings is contemplated.<sup>21</sup> So if an assignor, who has assigned an account of his vendee, enters into some new contract with that vendee, it appears by Section 39-1402 that a new assignment might not be required.

By virtue of the Act, the *Benedict v. Ratner* rule concerning the effect of an assignor having unrestricted control over the proceeds of an assigned account has been eliminated in Wyoming. Section 39-1411 provides that neither the retention by the assignor of the property which gave rise to the account, nor dealing with the assigned accounts as his own, will affect the validity of the assignment. This is a good rule, for a borrower should be permitted to pledge his accounts receivable from time to time, and still retain in his business the proceeds of such accounts as they liquidate from day to day in the same manner as he may place a lien on his other business assets.

The situation is different where the merchandise which gave rise to the assigned account is returned to the vendor-assignor. The courts have held that the entire transaction is void if the assignor is permitted to assert full control over all the returned property and deal with it as his own.<sup>22</sup> In *Zydney v. New York Credit Men's Ass'n.*<sup>23</sup> the court held that a trustee in bankruptcy prevailed over an assignee of accounts receivable of a bankrupt because the bankrupt was permitted to keep the goods returned by customers and treat those goods as his own. The Act deals with the situation in which merchandise was sold but is subsequently returned to the vendor-assignor and is in his possession. Even though failure to require an accounting for such goods will not invalidate the assignment as against creditors, Section 39-1412 provides that a bona fide purchaser of that property will prevail over even a protected assignee of the account. Hence, the assignee must be on constant guard to protect himself should such property be returned to the vendor-assignor.

Following the *Klauder* decision, there has been various legislation enacted as a part of the general wave of opposition throughout the states to the unduly restrictive effect on the extension of business credit. There have been three types of statutes enacted for accounts receivable financing in an effort to avoid this decision and protect the lenders of money. They are the book marking statutes, validation statutes and the recording type as adopted in Wyoming.

The book marking procedure is used in only two states,<sup>24</sup> and it consists of the assignor merely marking in his books that such accounts have been assigned. There is no publicity of the assigned accounts what-

21. *Plunkett-Jarrell Grocery Co. v. Terry*, 222 Ark. 784, 263 S.W.2d 229, 44 A.L.R.2d 917 (1954).

22. *Lee v. State Bank and Trust Co.*, 54 F.2d 518 (2d Cir. 1930).

23. 133 F.2d 986 (2d Cir. 1940).

24. Pennsylvania and Georgia.

soever, but the bad feature of this method is that it is very easy for a borrower to make improper notations on his books and mislead other assignees.

The validation statutes substantially amount to legislative codification of the American or non-notification rule, that is, priority as to assignments depends on their dates rather than the notification to the debtor. Some of the advantages attributed to this form are the absence of technicalities, formalities and hampering or delaying extension of credit. However, there is still the possibility that secret assignments of the same account may be made in this procedure.

The recording type, as adopted in Wyoming, has now become the legislation most generally used in the United States for accounts receivable financing. It eliminates the possibility of the borrower misrepresenting the accounts already assigned, and the possibility of executing secret assignments. Of course, by recording the notice of an assignment of accounts receivable in a public office, notice is given that many borrowers in the past have preferred to keep silent. However today, in view of the improved standing of accounts receivable financing and the public notice given to many other security transactions, borrowers seldom object to public knowledge of assignment of their accounts receivable.

Congress also felt the adverse effect of the *Klauder* decision, and in March 18, 1950, it again amended Section 60 of the Bankruptcy Act. The bona fide purchaser test of the Chandler Act was eliminated. Section 60 as presently amended provides in part:

A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy. . . . A transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. . . . (Emphasis added.)

In line with this new amendment to Section 60, Wyoming's recording Act in Section 39-1406 points out when an assignment of an account receivable becomes so perfected that there can be no subsequent lien superior to the rights of the perfected claim. Hence, the difficulties encountered in the *Klauder* case cannot arise in Wyoming.

The legislature passed this Act for the purpose of promoting trade and commerce, and to eliminate fraud in connection with secret assignments.<sup>25</sup> The Act should fulfill the objectives of the legislature. It will protect and thereby encourage people to lend money on this relatively new type of security and should result in additional capital being injected into business.

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25. The Title of Senate File No. 3 as introduced in the Senate of the Wyoming Legislature in 1957.