

Question 4 – July 2013 – Selected Answer 1

(1) The lawnmower

Carl has priority in the lawnmower.

Under Texas law, attachment requires (1) value given by the creditor, (2) a contract (security agreement, usually), and (3) the debtor has rights in the collateral. Perfection requires attachment as well as an act of perfection, including the signing and filing of a financing statement. From most kinds of property, attachment can occur through possession, where the creditor takes possession of the property. Possession can also constitute an act of perfection.

Here, the two claimants to the lawnmower are Carl and the Bank. Carl loaned Landscape money and took a security interest in the lawnmower. Carl did not sign a security agreement or financing statement with respect to the lawnmower. However, he took possession in it. This is enough to satisfy the second element of attachment, since it places the world on notice of the interest. When Carl took possession of the lawnmower, this also constituted an act of perfection. A creditor can perfect by taking possession of property. Thus, Carl is a perfected, secured creditor with respect to the lawnmower.

The Bank is also a perfected and secured creditor with respect to the lawnmower. It took a security interest in all of Landscape's equipment, and because the lawnmower is a good used for business purposes, and was not inventory to be sold or consumed, it was equipment. Thus, the bank took a security interest in it. It also perfect by filing a financing statement. As between two secured perfected creditors, the first to (1) file a financing statement, or (2) perfect prevails. Here, Carl was the first to perfect or file a financing statement, since he perfected before the Bank either filed a financing statement or perfected, so it prevails.

(2) Wheelbarrows, shovels, and rakes

The bank has priority in the wheelbarrows shovels and rakes.

These items would also be equipment, since they are goods used for business purposes and are not inventory that is sold or consumed in the business. The Bank is the only party that appears to have any interest in this equipment. It has attached with respect to the property since it filed a security agreement. It is fine that the security agreement says "all of Landscape's equipment and tools now owned and hereafter acquired." This is sufficiently specific because it labels the type of goods--equipment and tools--that it has an interest in, and is not as broad as "all of Landscape's assets." Also, it is fine that the Bank took an interest in after-acquired property. Security interests are valid in after-acquired property. Thus, the Bank is the only creditor that appears to have any interest in such property, so it will prevail.

It is also worth noting that when a debtor changes its name, the perfected creditor will continue to be perfected with respect to property owned by the debtor at the time of the name change, and any property acquired within 4 months of the name change. However, after four months have passed, there is no longer perfection unless a new security agreement and financing statement are filed with the new name.

Thus, here, the Bank retains a perfected interest in the wheelbarrows, shovels, and rakes Landscape owned at the time of the new change and acquired within 4 months of the name change. However, the Bank will not be perfected to any equipment acquired 4 months after the name change.

(3) The table saw.

The bank has priority with respect to the table saw.

The table saw is again equipment, since it is not inventory sold or consumed in the business, and is used for business purposes. Thus, the Bank has interest in the table saw, since it is after-acquired equipment. Also, the Bank still has interest in the saw because, as discussed above, the table saw was purchased within 4 months of Landscape's name change.

Equipment (the company selling the table saw) has no security interest at all in the table saw; it sold the saw for cash and took no security interest in it.

Thus, again, the Bank appears to be the only creditor with any real claim to the table saw, and because it is secured and perfected with respect to the saw, it will prevail.

(4) The plywood

Lumber prevails as to the plywood.

The plywood is inventory. Inventory is goods used for business purposes and either sold or consumed in the business. Because Builder will be used the plywood to build houses, it will be considered inventory rather than equipment. The parties with possible security interests in the plywood are Lumber, who has a security agreement covering the plywood, but has not filed a financing statement, and possibly the Bank. However, the Bank only has an interest in equipment and tools now owned and hereafter acquired. Because the lumber is inventory and not equipment, the Bank does not have a valid interest in it. Thus Lumber has priority in the plywood. Lumber is secured with respect to the plywood because a security agreement was filed, and although a financing statement was filed, he prevails, since the Bank did not have an interest in the plywood at all, as it was inventory.

(5) The hand tools

Tools have priority in the hand tools.

The hand tools will be considered equipment since they are used for business purposes and are not inventory. The parties with a possible interest in the Tools are (1) Tools, who sold Builder the tools, has a security agreement covering the tools, and perfected its interest in the tools on April 16 by filing a financing statement, and (2) the Bank, who had an interest in all of Landscape's tools after-acquired. As mentioned, Builder is only perfected with respect to equipment and tools acquired within 4 months of the name change, or 4 months after February 15 (June 15th).

Here, we have two perfected secured creditors. As between two perfected secured creditors, generally the first to (1) file a financing statement, or (2) perfect prevails. However, there is an exception for purchase money security interests, where the creditor takes an interest in the very property that it sells the debtor. For PMSIs in equipment, the creditor will prevail over a prior secured creditor if he perfects within 20 days of the debtor taking possession.

Here, Tools is a PMSI creditor, since it took an interest in the tools it sold Builder. It also perfected within 20 days of Builder receiving the tools. So it will prevail over a prior secured creditor even though it perfected later. Thus, Tools has priority.

Question 4 – July 2013 – Selected Answer 2

1. Lawnmower

Carl has priority in the lawnmower. At issue is whether Carl or Bank has a priority in the lawnmower. Interest in collateral attaches when the creditor gives value, an agreement is made, and the debtor has rights in the collateral. An agreement can be evidenced either by a security agreement signed by the debtor, or by possession or control of the collateral by the creditor. An interest in equipment can be perfected either by filing a financing statement with the Secretary of State or by possession of the collateral. If there are two perfected security interests, the first to perfect or file has priority.

Here, both Bank and Carl have attached an interest in the lawnmower. Carl gave Landscape \$1000 in value, they agreed to use the lawnmower as collateral, and Landscape owned the lawnmower. Their agreement is evidenced by Carl's possession of the lawnmower, and Carl also perfected his agreement when he took possession on January 3. Bank gave Landscape \$10,000 in value, Landscape signed a security agreement that gave Bank an interest in Landscapes equipment now owned or after-acquired, and Landscape already owned the lawnmower. The Bank's interest was perfected when it filed a financing statement that day on January 15. Because Carl perfected first by possession, Carl has priority interest in the lawnmower.

2. Wheelbarrows, Shovels and Rakes

Bank has priority in the wheelbarrows, shovels, and rakes. At issue is whether Bank's security agreement properly covers Landscape's existing equipment and tools. A proper security agreement must state with adequate specificity what collateral is covered by the agreement. "All equipment" is sufficiently specific. Here, Bank's security agreement covered "all equipment now owned or after-acquired." Landscape currently owned the wheelbarrows, shovels, and rakes. Carl's security interest covered only the lawnmower he had possession of, and no other party had any security interest in Landscape's equipment. Thus, Bank has priority in the wheelbarrows, shovels, and rakes.

3. Table Saw

Bank has priority in the table saw. At issue is whether Bank's security agreement adequately covered a table saw acquired after their agreement and after a name change. A security agreement may permissibly cover after acquired equipment and inventory. Additionally, a financing statement filed with the Secretary of State is valid to perfect newly acquired items for four months after a company changes its name and a creditor has notice of the name change. Landscape changed its name to Builder on February 15. The same day, it provided notice of this name change to Bank by changing the name on its accounts at Bank to Builder. Bank did not refile its financing statement under the new name. However, its prior financing statement was still good for four months to perfect on newly acquired equipment. Because the table saw was bought less than four months after the name change, Bank's financing statement covering after-acquired equipment was still valid. Because no other creditor had an interest in Builder/Landscape's equipment, Bank is the only creditor with interest, and Bank is validly perfected. Bank has priority in the table saw.

4. Plywood

Lumber has priority in the plywood. At issue is whether an unperfected secured creditor can have priority in plywood over a perfected creditor in equipment. A creditor validly attaches when he gives value, has a security agreement, and the debtor has rights to the collateral. Here, Lumber gave Builder the plywood, Builder has rights to the plywood, and Lumber and Builder signed a security agreement. Lumber has a validly attached security interest in the plywood. Here, the plywood is inventory, because Builder will use it to create the houses -- its product. A purchase money security interest in inventory is only perfected with priority with the creditor provides notice to all other creditors with an interest in inventory because the security interest attaches. Here, Lumber did not do that, so Lumber is not perfected. However, Lumber is the only creditor with a security interest in inventory, because Bank's interest only covers equipment and tools and Tools interest only covers the hand tools purchased at Tools. Thus, Lumber has priority as the only creditor with any interest in the plywood.

5. Hand Tools

Tools have priority in the hand tools. At issue is which of two perfected creditors has priority in equipment. Generally, between two perfected creditors, the first to file or perfect has priority in the security interest. However, a purchase money security interest in equipment is automatically perfected for 20 days. As long as the interest is perfected some other way within those twenty days, the date of perfection relates back. A validly perfected purchase money security interest has a super priority over previously filed perfected interests. Here, Bank has a security interest in all after- acquired equipment and tools. Thus, Bank's interest attached when Builder bought (gained rights to) the hand tools. Because April 15 is still within four months of February 15, Bank's financing statement is still valid and thus its security interest in the tools is still perfected. However, Tools gave value (the tools) to Builder, signed a security agreement, and Builder had rights to the tools, so Tools has validly attached its security interest. Because Tools gave Builder the money for the tools by allowing Builder to buy them on credit, Tools' interest in the hand tools is a purchase money security interest. Hand tools for a building contractor are equipment. Because it was a PMSI in hand tools, it was automatically perfected for 20 days. Tools perfected by filing the next day, which related back to the date of purchase. So both Bank and Tools have perfected security interests in the hand tools. Normally, Bank would have priority because it filed on January 15, long before Tools perfected on April 15. But because Tools has a PMSI in equipment, it has a super priority specifically in those hand tools. Thus, Tools has priority in the hand tools.

Question 4 – July 2013 – Selected Answer 3

The issue here is what priority based on attachment and perfection does each of the creditors have. Under Texas Commercial Code law, creditors may be unsecured or secured. Unsecured means that there is simply a promise to repay the debt, but there is no security, so the creditor is out of luck if debtor fails to pay. With secured creditors, they may encumber collateral as security for a promise to repay. To be a secured creditor, you must have attached your interest meaning: (1) there was value given in the form of a loan or credit usually (2) there was an agreement such as a security agreement setting forth the duties of both parties (3) the debtor had rights in the collateral it encumbered. After attachment occurs, factor that can help determine priority when multiple creditors are involved is perfection. Perfection of a security interest depends on the type of collateral being encumbered but generally can be done by filing a financing statement with the secretary of state giving notice to the world of the interest. There are also special rules concerning perfection such as a purchase money security interest, these will be discussed in turn below.

1. The lawnmower

Carl has a superior priority interest in the lawnmower. The issue here is who has priority. Under Texas law, a special rule for perfection of an interest is whether the good is in possession of the creditor. If the good is in possession then that attached interest is automatically perfected for the duration that he holds possession. While the holder may want to file a financing statement anyways, he is not required to, but will lose perfection if he gives up possession. Here, Carl is holding possession of the lawnmower. Since the lawnmower is also equipment, Bank has also a security interest as it is "equipment now owned." Bank's interest is attached because it gave value of a loan, there was a security agreement, and Landscape owned it having rights in the collateral of equipment and tools now or hereafter acquired. Bank also perfected its interest by filing a financing statement with the secretary of state. Given these two competing perfected interests, Carl will win because he perfected first and has possession of the mower.

2. The wheelbarrows, shovels, and rakes.

Bank has priority in the wheelbarrows, shovels, and rakes. As discussed above, attachment of Bank's interest to the equipment owned now or after acquired had occurred. The wheelbarrows, shovels, and rakes are equipment. Also, Bank had a perfected interest because it filed the financing statement. Since Bank is the only creditor, perfected or otherwise, that is claiming rights in wheelbarrows, shovels, and rakes, it has priority.

3. The table saw

Bank has a superior interest in the table saw. As discussed above, Bank has a valid perfected security interest in the equipment owned or after acquired of Landscape. The table saw would count as equipment or tools, and it was after acquired. However, a special rule applies here. Under Texas law, if a debtor changes its name, the secured creditor will continue perfection for after acquired collateral for 4 months automatically, but will have to refile or perfect using the new name of the debtor beyond the 4 month period. Here, Bank is still automatically perfected in the table saw because March 30 is still within 4 months. Furthermore, although Builder purchased the saw from Equipment, Equipment has no security interest in the saw because it is not a creditor since Builder purchased the saw with cash. Therefore, Bank has priority in the table saw.

4. The plywood

Lumber has priority in the plywood. Lumber attached its interest because it gave value to debtor based on credit, there was a security agreement, debtor had rights in the collateral through the special rule of a purchase money security interest, or PMSI. Under this special rule, the debtor is simultaneously receiving goods based on credit so it has "rights in the collateral" and the creditor may encumber it. Further, the PMSI is automatically perfected in inventory if perfected before delivery of the collateral and notice has been given to any other secured creditors with respect to that collateral. These rules are only necessary if priority is in issue. However, Bank has no interest because lumber is inventory, not equipment or tools. Therefore, priority is not issue, Lumber is the only creditor secured by the plywood, and therefore, Lumber has priority.

5. Hand tools

Tools has priority in the hand tools. Tools has attached security interest because it gave value, there was a security agreement, and the debtor had rights in the collateral. Because it was issuing credit for purchase of the tools, Tools has a PMSI. However, Bank also has a perfected interest, as discussed above, in the equipment or tools after acquired. It would seem that Bank would win since it was first in

time to file or perfect, however, there are special rules concerning PMSI. The PMSI will win in priority if it perfected within 20 days of debtor receiving the property. This rule applies to equipment which a hand tool is. Tools perfected by filing a financing statement the day after Builder received the tools. Therefore, the PMSI will win in priority and Tools has priority in the tools over Bank.