Question 6 – July 2019 – Selected Answer 1

At issue is which creditor's claims have priority over the collateral.

A) First Bank has priority over Second Bank with regards to Manufacturer's equipment. At issue is which creditor receives priority when one creditor has a perfected PMSI and the other is a secured creditor. Under Article 9 of the UCC, a creditor becomes a secured creditor when attachment occurs. In order for there to be a valid attachment the creditor must give value to the debtor, the transaction must be evidenced in a contract (such as a security agreement), and the debtor must have rights in the property. In this instance, attachment occured in the case of both First bank and Second bank. First bank attached when Manufacturer signed a security agreement and the Bank transferred funds to Manufacturer. Second Bank also attached when they entered the security agreement and transferred funds to Manufacturer. Both First Bank and Second Bank's loans were secured by claims to Manufacturer's equipment. Between two secured creditors, the first to file or perfect their interest generally has priority. In order to perfect, the creditor must file a financing statement with the Texas Secretary of State, or have possession of the collateral, or have secured the debt as a Purchase Money Security instrument (PMSI), in which case the instrument is temporarily perfected for 20 days in the case of nonconsumer goods, or permanently perfected in the case of consumer goods. A PMSI is a security agreement in which a creditor loans money for the purchase of goods and acquires a security interest in the purchased goods. In the present case, Second bank filed their financing statement first (on March 10th) and would ordinarily had priority over First Bank, who perfected by filing five days later. However, the loan from first bank was a PMSI for the equipment. A secured creditor with a perfected PMSI enjoys superpriority over other perfected secured creditors, so long as they perfected their security interest within the 20 day period of temporary perfection. In the present case, First bank perfected their security interest 15 days after it attached, and therefore will be given superpriorty and will have priority over second bank in the equipment.

B) Second Bank will have priority over Third bank regarding Manufacturer's inventory. At issue is the proper characterization of property and which creditor has priority between a perfected secured creditor and a perfected secured creditor with a PMSI. Property is characterized according to its primary purpose. Equipment is property which shall be used in the course of the debtor's business, while inventory is that property which the debtor will sell in their ordinary course of business. In the present case, Second Bank loaned money in order for Manufacturer to purchase materials to make furniture. These materials would be classified as inventory, because the goods were intended to be made into furniture and sold as goods ordinarily sold by manufacturer. As a result, Second bank's loan to Manufacturer qualifies as a PMSI with regard to the inventory, because the loan was secured by a claim to Manufacturer's inventory and equipment. Additionally, Second bank perfected their security interest by filing a financing statement with the secretary of state on the day the loan was issued. Third bank also has a perfected security interest in the inventory, as they filed their financing statement on the same day that they secured their interest in Manufacturer's property. Here, the PMSI is not necessary to determine who would have priority, as Second bank was the first to file and perfect their interest in the inventory, and therefore has priority over other creditors who filed and perfected later as to the same collateral. As a result, Second bank has priority.

C) Fourth bank will have priority over Uncle regarding the installment contract, as a secured creditor generally has priority over a purchaser when that purchaser is not a buyer in the ordinary course of business. Between a secured creditor and a subsequent purchaser of collateral, the creditor has priority unless the buyer is protected as a buyer in the ordinary course of business. In the present case, Fourth bank took a security interest all notes and obligations related to Manufacturer's accounts receivable. They perfected that interest by filing a financing statement with the secretary of state on april 5th. The uncle purchased the installment contract on april 3rd and took possession of hte contract on the same day. Uncle would be protected and take priority over Fourth bank if he qualified as a buyer in the ordinary course of business. In order to be a buyer in the ordinary course of business, one has to purchase goods from a seller who is in the business of selling goods of that kind. The buyer must not have notice of the security agreement, must not know that the purchase violates a security agreement, and the security agreement must have been created by the seller. In the present case, Uncle cannot qualify as a buyer in the ordinary course of business because Manufacturer is not in the business of selling installment contracts. As a result, Uncle is an ordinary buyer and receives very little protection with regard to collateral over which a creditor has a security interest. Therefore Fourth Bank has priority over buyer and will be able to recover the installment contract from Uncle.

Question 6 – July 2019 – Selected Answer 2

A) First Bank has priority over Second Bank regarding the equipment, because it is a PMSI holder in equipment, and followed the relevant Article 9 rules. At issue is who has priority between two secured creditors. To have a security interest in collateral attach, there must be a security agreement, the creditor must give value for the collateral, and the debtor must have rights in the collateral. This will establish the creditor's security interest in the collateral. This only establishes the creditors rights with regard to the debtor, however. To secure its interest in the collateral relative to other secured creditors, the creditor's security interest must be perfected, following one of UCC Article 9's rules and methods for perfection. This is typically done by filing a financing statement with the secretary of state. Article 9 also has rules regarding who has priority between perfected secured creditors. Generally, betwen perfected secured creditors the first to file or perfect has priority over other perfected secured creditors. Note, however, that if a secured creditor has a purchase money security interest (PMSI), Article 9 provides "superpriority" rules.

Here, both First Bank and Second Bank had security interests in the Manufacturer's equipment. First Bank had a purchase money security interest (PMSI) in the equipment, however. This is evident from language in the facts that First Bank lent money to Manufacturer "to buy new equipment for manufacturing furniture". This is a financer-financed PMSI. Money was given to Manufacturer, from First Bank, to purchase equipment. Second Bank also had a security interest in the equipment. It did not have a PMSI in the equipment, however, because it did not lend money to Manufacturer to purchase the equipment, however. Second Bank filed a proper and valid financing statement on March 5th with the secretary of state with respect to its loan, and was thus perfected.

First Bank has priority, however. Despite the fact that Second Bank filed first, because First Bank had a PMSI in the equipment, it will enjoy "superpriority" so long as it follows the requirements under Article 9. To enjoy superpriorty, a PMSI holder in equipment must file a financing statement in the equipment no later than 20 days after delivery of the equipment. Here, First Bank filed its financing statement on March 15th. This is within 20 days of delivery, which ocurred on March 5th. As such, First Bank will enjoy "superpriority" over Second Bank, despite the fact that Second Bank filed first.

B) Second Bank has priority over the inventory. At issue is the classification of materials under Article 9. Article 9 provides several categories of collateral. One of these category types is inventory. Inventory is generally goods that are held out for sale to the public in the debtor's ordinary course of business, but inventory may also be material used by a manufacturer to manufacturer products that it holds out for sale to the public, as in this case. As such, Second Bank executed a valid security agreement in the materials that Manufacturer was to purchase to make furniture. This agreement covered inventory, and the materials will be classified as inventory. Note, also, that Second Bank also has a PMSI in the inventory, becuase the funds were issued for the explicity purpose of enabling manufacturer "to purchase materials" to make furniture. This thus creates a financer-financed PMSI in the materials purchased, which will thus be treated as inventory. As such, Second Bank can enjoy Article 9's special superpriority rules regarding PMSIs in inventory.

Third Bank validly took a security interest that attached in Manufacturer's inventory and filed a valid financing statement. Third bank was thus secured in the inventory and was perfected. It did not have priority over Second Bank, however, because it filed its financing statement after Second bank. Here, both second bank and third bank were perfected secured creditors. As such, the first to file a financing statemetn or perfect has priority. Second bank has priority because it filed on March 10th. Third Bank did not file until March 15th. Second Bank thus has priority over Third Bank in Manufacturer's inventory and does not need to rely on superpriority rules for inventory.

C) Fourth Bank will have priority with regard to the installment contract. At issue is whether Uncle was a buyer in the ordinary course.

Hotel's installment contract with Manufacturer will be categorized as a negotiable instrument. This installment contract is a negotiable instrument because its essentially a promissory note, as it is in writing (and presumably signed by the hotel) and it is a promise to pay amounts of money at specific times, (in installments). A security interest in the negotiable instrument may be perfected by filing or possession of the actual instrument itself. Thus, Fourth Bank, while it was not perfected until April 5th, was stil secured as to the note regarding accounts receiveable on the installment contract.

Manufacturer sold the note to Uncle. Uncle will try to claim some protections as a buyer in the ordinary course. To be a buyer in the ordinary course, the buyer must purchase in good faith, without knowledge that he was infringing on the rights of a secured party, goods in the ordinary course of the seller's business. The seller must be a merchant in goods of that kind. He will also claim this becuase he took the note with no knowledge that he was a buyer in the ordinary course. He will be unsuccsesful, however. Manufacturer manufactures and sells modular furniture. This is her ordinary business. She is not in the ordinary business of selling promissory notes and other negotiable instruments. Thus, he cannot claim this status, and Fourth Bank will have a superior interest in the note, despite not perfecting by filing until April 5th.

Question 6 – July 2019 – Selected Answer 3

As between an attached an unattached creditor, the attached will win. As between two attached creditors, the first to attach will win. As between a perfected and unperfected, the perfected creditor will win. Providing for PMSI rules, as between two perfected creditors, the first to perfect will win. If Manufacturer declares bankruptcy, an automatic stay will be imposed on that day and no later perfection attempts would be valid. Under the Texas UCC, the following parties have priority in the following assets:

A) First Bank has priority over second bank with regard to equipment. Collateral is categorized by its character in the hands of the debtor. As between two perfected creditors, the first to perfect will win. First, creditors must be attached. To attach the debtor must have rights in the collateral, there must be an authenticated agreement, and there must be value given. Both First Bank and Second Bank satisfied the elements of attachment. Perfection can occur automatically, by filing, by possession, or by control. First Bank obtained temporary automatic perfection for 20 days because First Bank took a PMSI in equipment and then obtained perfection by filing a proper financing statement within 20 days of Manufacturer receiving the equipment. A PMSI (purchase money security interest) is given special treatment when it comes to priority. A PMSI results when a debtor takes a loan directly for the items in which the creditor takes a security interest. Because the automatic perfection was effective on March 5th and then was solidified, Second Bank's March 10th financing statement will be second to First Banks. First Bank obtained perfection first, and so they have priority. There was only one instance in the facts provided of Manufacturer obtaining equipment, so the lack of "after acquired" statements will have no effect.

B) Second Bank has priority over Third Bank with regard to Manufacturer's inventory. On March 10th, Second Bank acquired an attached and perfected security interest in Manufacturer's inventory. This was also a PMSI in inventory because a PMSI results when a debtor takes a loan directly for the items in which the creditor takes a security interest. Second Bank filed and so did not need to rely on automatic perfection, but could have if they had notified other parties with interests in inventory and filed within 20 days from when Manufacturer took possession. The collateral of inventory can be perfected by filing a financing statement. Third Bank did not attach and perfect until March 15th. The statement "all of Manufacturer's inventory" will not give Third Bank a superior interest over Second Bank. Between two perfected creditors, the first to perfect will have priority. Additionally, a PMSI is superior to a non-PMSI. Third Bank's interest was not a PMSI.

C) Uncle has the installment contracts subject to Fourth Bank's security interest. At issue here is whether the Uncle took the collateral free and clear of Fourth Bank's Security Interest. A purchaser of collateral takes the asset free and clear of a security interest when they purchase for value in the ordinary course of business. It does not matter if they have notice of any interests in the asset. If there is evidence that, due to the value being sigificantly lower, that they knew something was wrong they will not take free and clear. Here, Uncle did take for value. There are no facts to indicate how much money was due under the installment contract so that cannot be analyzed. This likely was not however, a sale in the ordinary course of business. A manufactuer's ordinary course of business is selling those items that they manufacture. Here, the sale of modular furniture is the ordinary course of business for the Manufacturer in the fact pattern. The sale of an installment contract is not an ordinary sale for a furniture manufacturer. Because the Uncle did not purchase in the ordinary course of business, Fourth Bank's security interest will remain attached and perfected in the installment contract.