

Question MEE 1 – February 2022 – Selected Answer 1

(1) The bank does not have an enforceable security interest in the portable welding machine because the man does not have rights in the portable welding machine.

The issue is whether the bank has an enforceable security interest in the portable welding machine. Any loan in exchange for collateral is governed by Article 9 of the UCC. To create an enforceable security interest, the security interest must attach. To create attachment, the debtor must have rights in the collateral (meaning he owns it or properly possesses it), both the debtor and the secured party must give value, and there must be an authenticated security agreement that properly names the collateral. If any of these elements fail, a secured party will not have an enforceable security interest.

The man does not have rights in the portable welding machine. The welding machine would be considered equipment because the man was using it to perform truck repairs, which the man is in the business of doing. The machine belonged to the man's mother, but she made it clear to the man that he could not use her welding machine. He only had permission to use the barn itself. Since the man did not properly own or possess the portable welding machine, he did not have rights in the portable welding machine.

The man and the bank both gave value. Value means that both sides gave something of value in the agreement. For the bank, its value was the loan itself. It loaned the man \$50,000. For the man, his value was the welding machine that he offered in collateral for the loan.

The man and the bank have an authenticated security agreement that describes the collateral. On the day of the loan, the man and the bank signed a loan agreement that described the collateral as "all my equipment, including equipment hereafter acquired."

In conclusion, because the man does not have rights in the welding machine, the bank's security interest is not attached and the bank does not have an enforceable security interest in the portable welding machine.

(2a) The bank does have an enforceable security interest in the diesel-engine repair tools.

The issue is whether the bank has an enforceable security interest in the diesel-engine repair tools. The requirements for creating an enforceable security interest are listed above. One additional rule is that in order to have attachment in collateral that the debtor acquires after the security agreement, the security agreement must explicitly state that it covers anything acquired after the date of the security agreement.

The man has rights in the diesel-engine repair tools. The man bought these tools on June 10, which was 9 days after he signed the security agreement with the bank. Because he properly owns the tools, the man has rights in the tools. The tools would be considered equipment because they are used to fix the diesel-engines that he repairs in the course of his business.

The man and the bank both gave value. For the bank, this was the loan itself when it loaned the man \$50,000. For the man, his value was the security interest in equipment that he owned then or would acquire later.

The man and the bank have an authenticated security agreement that describes the collateral. On the day of the loan, the man and the bank signed a loan agreement that described the collateral as "all my equipment, including equipment hereafter acquired." Because the agreement explicitly states that it covers equipment that he acquired after the date of the security agreement, the collateral was properly described in a way that covers the specialized tools.

In conclusion, because all three requirements for attachment are met, the bank does have an enforceable security interest in the diesel-engine repair tools.

(2b) The tool seller has an enforceable security interest in the tools.

The issue is whether the tool seller has an enforceable security interest in the diesel-engine repair tools. The requirements for creating an enforceable security interest are listed above. One additional rule is that any loan given for the debtor to purchase something specific will be considered a purchase money security interest.

The man has rights in the diesel-engine repair tools. The man bought these tools on June 10 directly from the tool seller. He paid \$1500 down and had an agreement to pay the remaining \$13,500 over a period of two years. Because the man properly owns the tools pursuant to his purchase agreement with the tool seller, the man has rights in the tools.

The man and the tool seller both gave value. For the tool seller, this was the \$13,500 loan that the man was paying off in installments over two years. For the man, this was the collateral in the specialized tools.

The man and the tool seller have an authenticated security agreement that describes the collateral. On the day the man bought the tools, he signed a written agreement that granted the seller a security interest in the tools to secure his obligation to pay the remaining \$13,500.

In conclusion, because all three requirements for attachment are met, the tool seller does have an enforceable security interest in the specialty tools that it sold the man. The interest is a purchase money security interest because the loan was given by the tool seller in order for the debtor to purchase the tools.

(2c) The tool seller has priority over the bank when it comes to the tools.

To perfect a security interest, a secured party can file a financing statement that describes the inventory sufficiently. Once this statement is filed, a party's security interest is perfected and this ensures that he maintains proper rights against other secured parties who are claiming an interest in collateral. As a general matter, between two perfected security interests, the first secured party to file or perfect takes priority on the collateral. However, in the case of a purchase money security interest, that secured party will have priority over an earlier security interest in equipment if it files a financing statement within 20 days of delivering the equipment to the debtor.

Both the bank and the tool seller have perfected security interests in the tools. The bank filed a financing statement that listed the collateral as "all equipment, including equipment hereafter acquired." The tools are equipment, as established above. Accordingly, the bank has a perfected security interest in the tools. The tool seller also filed a financing statement that listed the collateral as "diesel-engine repair tools." Accordingly, the tool seller also has a perfected security interest in the tools.

The bank filed and perfected first, but the tool seller has a purchase money security interest that takes priority over the bank. As discussed above, the tool seller has a purchase money security interest. The tool seller filed a financing statement the next day after the man bought the tools, which is within the 20 days required in order for its security interest to take priority over the bank.

In conclusion, the tool seller has priority over the bank when it comes to the tools because even though it perfected after the date that the bank did, it was a purchase

money security interest that met the requirements to take priority over earlier security interests like the bank had in the equipment.

Question MEE 1 – February 2022 – Selected Answer 2

1. Portable welding machine

The bank does not have an enforceable security interest in the portable welding machine. At issue is whether the man has rights in the welding machine.

Article 9 of the UCC governs security interests in goods. When a creditor has a right to look to a debtor's collateral for the repayment of a loan to the debtor, the creditor has a security interest in that collateral. In order for a security interest to attach to collateral, (1) there must be a valid security agreement (or possession or control by the creditor), (2) the debtor must have rights in the collateral, and (3) value must be given by the creditor. The security interest is any writing signed by the debtor that evidences an intent to create a security interest, and sufficiently describes the collateral. Standard UCC category descriptions such as "equipment" are sufficient. Once the last of the three requirements above are met, the security interest attaches.

Here, there is a valid security agreement in the form of a loan agreement, signed by the man and creating a security agreement "in all my equipment including equipment hereafter acquired." Under Article 9, equipment means tangible goods used that are not inventory (things that regularly are sold or used up in the conduct of a business) and are not consumer goods (items used for personal or household use). The welding machine is equipment because it is not inventory and is being used in a business (so it is not a consumer good). A security agreement may create a security interest in after acquired property if the agreement so states. This means that the creditor automatically has a security agreement in any property falling within the description in the security agreement as soon as it is acquired, without further action.

Requirement 3 is satisfied because the bank gave value in the form of the business loan. However, the second requirement is not satisfied. The debtor has no rights in the collateral. The bank may argue that he does because he is using the welding machine in his business. However, the man does not own the welding machine and he is using it in his mother's barn against his mother's express instructions that he may not use it. Thus, the bank has no security interest in the welding machine.

2. Diesel-engine repair tools

(a) Bank's security interest in the tools

The bank has an enforceable security interest in the tools. At issue is whether the security interest with bank encompasses the tools. As discussed above, all the requirements for a security interest must be met: a valid security agreement, rights in the collateral, and value given. Here, as set out above, there is a valid security agreement between bank and the man covering the man's equipment, and including an after-acquired property clause. The after acquired property clause was also included in the financing statement. This means the security interest automatically encompasses all of the equipment the man acquired after the security agreement with bank was signed. The tools are equipment because they are goods used in the business that are not inventory or consumer goods. Unlike with the welding machine, the man has rights in the tools because he purchased them himself. Value was given when the bank loaned the man \$50,000. Thus, the bank has an enforceable security interest in the tools.

(b) Tool seller's security interest in the tools

The tool seller has an enforceable security interest in the tools. the man signed a written security agreement granting the seller a security interest in his "diesel engine repair tools." Specific descriptions of property that adequately identify the collateral are also permissible under Article 9 in a security agreement. The tool seller loaned the man money to buy the tools, and man acquired rights in the tools by purchasing them and taking possession of them to use in his business. Thus the tool seller has an enforceable security interest in the tools

(c) Priority of bank's and tool seller's security interests

The tool seller's security interest in the tools has priority over that of the bank's. The issue is whether the tool seller's purchase money security interest (PMSI) has priority of the bank's security interest despite the fact that the bank filed before the tool seller.

When more than one creditor has a valid security interest in the same collateral, the one with priority will have superior rights in the collateral over the creditor without priority. Priority is created by perfecting a security interest. Perfection can be established by filing a proper financing statement in the appropriate filing office, or by obtaining possession or control of collateral in certain instances. The general rule under article is that the first creditor to file or perfect has priority. The bank filed its financing statement first, so ordinarily it would have priority.

However, a special rule exists for PMSIs. A PMSI exists when the loan advanced by the creditor is secured by the collateral it was used to purchase. A PMSI in equipment has priority over other prior perfected security interests if, before or within 20 days after the debtor obtains possession of the equipment, the creditor files a financing statement in the appropriate office. Here, the tool seller "promptly" filed a financing statement covering the tools. Assuming that "promptly" means the statement was filed within 20 days after the man obtained possession of the tools, the tool seller's PMSI has priority over the bank's security interest.

Question MEE 1 – February 2022 – Selected Answer 3

1. Does the bank have an enforceable security interest (SI) in the portable welding machine?

No, as explained below.

Article 9 applies here. Article 9 covers transactions that are intended to create a SI in goods--anything movable at the time of sale, and the welding machine, being portable, qualifies. A security interest represents the right of a creditor (C) to satisfy the unpaid obligation of a debtor (D) through the possession and disposition of D's collateral, which incentivizes and thereby is designed to "secure" the repayment of the obligation that D owes to C.

Collateral can be tangible or intangible. The collateral at issue here--the portable welding machine--is tangible. Tangible collateral can consist of (1) consumer goods (2) inventory (3) farm products and (4) equipment. Consumer goods are goods for household, family, or personal use. Inventory is goods that a business sells or uses. Farm products are farm products. Equipment is a catchall category that includes anything that does not qualify under any other category. Here, the portable welding machine is equipment. It's self-evidently not a consumer good or a farm product. It could arguably be inventory since it's used in the business, but that's a bit of a misnomer here. Inventory in this sense of the word would be something like fuel, a fungible commodity that's a floating and regular business need, not a singular piece of equipment. Thus, the machine is equipment collateral, which affects the analysis of later questions.

For an SI to arise in the first place, it must be created. Without a SI, C has no enforceable right against D; he is instead an unsecured creditor who, in the event of D's default, has to commence a suit against D for damages and then obtain, execute, and levy upon a judgment. To become a secured C, and to thus have an enforceable

right to collateral vis-a-vis D, C must satisfy a process called attachment. Plainly said, attachment is how a C creates a security interest.

Attachment has three elements. First, C must give value to D. Here, this element is met. The bank gave the man a 50k business loan. Second, C must either take possession of the collateral or control it or enter into a valid security agreement (SA) with D. A valid security agreement is the most common way of satisfying this element, and, indeed, it's satisfied here. A valid security agreement must be a writing authorized by the debtor that sufficiently describes the collateral. Here, the man signed the agreement, which identifies the parties and the collateral, including after-acquired collateral (Article 9 permits this). Super generic descriptions can invalidate a security agreement. An argument exists here that "all my equipment" is too generic, but given the small size of the business, the SA probably passes muster. Third, for attachment to occur, D must also have rights to the collateral, given that he's transferring an interest in the collateral to C. D doesn't have to necessarily own the collateral, but that's usually the case. At a minimum, he must have some sort of interest in the property.

Here, however, the man has no interest in the welding machine, not even a de minimus one. His mom owns it. His mom also made it clear to her son that he could use the barn but not her welding machine. Hence, the man has no right to create a SI in the collateral. Attachment didn't occur. If attachment didn't occur, then, by definition, the bank can't have an enforceable SI in the welding machine.

2a. Does the the bank have an enforceable SI in these tools?

This answer hereby incorporates all legal rules and law set out above as if fully set forth herein.

Yes, the bank has an enforceable SI in the tools against the man. Although his SA with the bank didn't create an SI in the welding machine, it did create one in other equipment that the man owned. Of course, the man didn't own the tools until June 10, 9 days after he and the bank created their SA in equipment. Although this is true, the parties SA had an "after-acquired" clause. Parties who create a SI are allowed to identify currently existing collateral AND other collateral that the debtor acquires after the parties enter into their agreement. There are certain exclusions, such as for consumer goods acquired more than 10 days after the SA, but nothing that applies in this situation.

2b. Does the tool seller have an enforceable SI in the tools?

This answer hereby incorporates all legal rules and law set out above as if fully set forth herein.

Yes. The tool seller has a purchase money security interest (PMSI) in the man's equipment, one that's been perfected by filing.

First, the requirements for a valid attachment are met. There's value, there's a valid security agreement, and the man has an interest in the goods. Thus, the three elements of attachment are satisfied.

Second, the type of SI is a PMSI. A PMSI is a SI in which C either seller or lender finances D's purchase of the very goods that serve as collateral in the parties agreement. Here's it's seller financing. They tool seller sold the man the goods and took back a SI in them, subject to the man repaying the tool seller in monthly installments over a two year period. Notably, the goods aren't consumer goods (which would automatically perfect them) since the goods are being used in the man's business, thus making them equipment.

As set out above, the tool seller has an enforceable SI in the tools.

2c. Whose interest, if they both have one, has priority?

The interest with priority depends on whether the bank and the tool seller have enforceable interests against parties *besides* the man. For that to be true, they must have perfected SIs. Attachment gives the parties enforceable interests against the man, but only perfection can give them enforceable interests against each other and against other creditors. One can attach without perfection, but perfection can't occur w/out attachments. Here, both parties have attached.

They've also both perfected. Perfection is about method. Like attachment, it can occur through C's possession and control of the collateral. It can also occur automatically for a PMSI in consumer goods. None of these apply. The last way, and most common, is through the filing of a valid financing statement (FS). An FS is good for five years. It must be filed in the appropriate state office. It must adequately identify the parties and describe the collateral (seriously misleading errors can invalidate a FS, especially with the debtor's name). In this case, the bank filed an FS on June 1, so it's SI was perfected as of that date (it's FS is compliant). Likewise, the tool seller perfected his PMSI in equipment by filing a compliant FS on June 11.

Perfection governs priority. Perfection is a race. The baseline rule is that the first C to perfect prevails in a competing dispute with another creditor. Under the baseline rule,

the bank would have priority. But there are exceptions to the baseline rule. A major one is why PMSIs are so important. They can grant a C what's called super priority to collateral. Super priority means that the C has preference over an *earlier in time* perfected SI. To obtain super priority in a PMSI in equipment, C has what's called a 20-day window. If C files his FS w/in 20 days of D taking possession of the collateral, then C gets super priority over earlier perfected creditors.

This is exactly what occurred here. The bank perfected first. The tool seller perfected later. But it had a PMSI in equipment and easily fit w/in the 20 days window. Accordingly, the tool seller has preference to the tools over the bank.