

## Question MEE 5 – July 2023 – Selected Answer 1

### Attachment

Article 9 of the UCC governs all secured transactions. In order to have an enforceable security interest, the party's security interest must first "attach." Attachment occurs when (1) the creditor gives value, (2) debtor has rights in the collateral, and (3) there is an authenticated and signed security agreement, or the party takes control or possession of the collateral. Additionally, transactions that are entered into that are, in their essence and effect, function as a secured transaction, will be treated as such.

The security agreement must list the debtor, secured creditor, and describe the collateral. The collateral must be sufficiently describes. A creditor cannot take an interest in "all the personal property" of a debtor. This is against public policy and is not specific enough to be enforceable.

#### **(1) Supplier's interest in the machine**

Here, Supplier has an enforceable security interest in the machine. Supplier gave value by financing the machine, the debtor, Company, had rights in the collateral, and the parties signed a writing that described the machine. Thus, while not explicitly stating that this is a security agreement, Supplier and Company effectively entered into a security agreement whereby the Supplier held an enforceable security interest in the machine.

#### **(2) Lender's interest in the machine**

Here, Lender provided Company with a \$1,000,000 loan and retained a security interest in "all of Company's personal property." Obtaining a security interest in all of a debtor's personal property is void against public policy and the Lender's security interest failed to attach despite them having a signed security agreement. Because of this overly broad classification of collateral, Lender does not have an enforceable security interest in the machine.

#### **(3) BigBank's interest in the machine**

Here, BigBank provided Company with a \$750,000 loan. In return, Company retained a security interest in all of company's current and present equipment. Equipment is a catchall category and encompasses anything that is used in a business. The machine that was acquired by Company was being used for business purposes, and as such, is classified as equipment. Company and BigBank signed a security agreement and

Company had rights in the collateral. Thus, BigBank has an enforceable security interest in the machine since the machine is presently owned and is classified as equipment.

**Perfection: What is the order of priority of the interests in the machine?**

Perfection of a security interest dictates whether a creditor has superior rights over the collateral of another competing creditor. In order to perfect a security interest, the party can, depending on the collateral type, file a financing statement, take control or possession of the collateral, or there is automatic perfection for PMSIs in consumer goods. Filing a financing statement perfects a security interest in everything except for deposit accounts, cash, or letters of credit. The financing statement must state the debtor's name, secured creditor's name, and a description of the collateral. Between two secured creditors, the first to perfect their security interest or file a financing statement has the superior claim.

BigBank has the first priority as a perfected secured creditor. BigBank's interest attached on April 3 and then perfected its interest by filing a financing statement on May 4th. BigBank included the names of both the debtor and secured creditor and a description of the collateral. Since the financing statement included the machine as equipment, the financing statement perfected BigBank's interest in the machine. Thus, BigBank has a perfected and superior security interest in the machine.

Supplier has the second priority as an unperfected general creditor. While Supplier has a security interest in the machine, Supplier failed to perfect their security interest by failing to file a financing statement. Thus, Supplier's interest is inferior to BigBank.

Lender has the last and third priority as an unsecured creditor because Lender's security interest never attached due to the broad description of collateral. Thus, Lender's interest is inferior to both BigBank and Lender takes priority over the machine, and Lender will be the last to recover.

**Question MEE 5 – July 2023 – Selected Answer 2**

**1a. Supplier's interest in the machine**

The Supplier is likely to have an enforceable interest in the machine.

The issue here is whether the Supplier has an enforceable interest in the machine. For there to be an enforceable interest, this means there has to be attachment. Under the

rule for attachment, there are three requirements: (1) security agreement (though can have possession or control), (2) value (consideration), and (3) the debtor has to have rights in the collateral. The transaction here is a lender based PMSI (purchase money security interest). While that is not inherently important for attachment, it could be important for priority.

Here, there is likely to be attachment. The value given between both parties was money in exchange for a machine. The debtor has rights to the machine because he will take actual possession of it. The final question is whether there was a security agreement. To be a valid security agreement, it needs to have the parties names, a signature, and a valid description of the property. Here, there was a clear description of the machine and the parties signed and memorialized the agreement. The parties had their names and obligations on the paper. With that, it is likely to be a valid security agreement. Therefore the three requirements for a security agreement and for attachment are met. Because attachment occurred, Supplier has an enforceable interest in the machine.

### **1b. Lender's interest in the machine**

The Lender is not likely to have an enforceable interest in the machine.

The issue here is whether the Lender has an enforceable interest in the machine. For there to be an enforceable interest, this means there has to be attachment. Under the rule for attachment, there are three requirements: (1) security agreement (though can have possession or control), (2) value (consideration), and (3) the debtor has to have rights in the collateral.

As with above, the debtor has rights in the collateral because he has possession of the machine. Further there is value given for the same reason as there was value given above with the Supplier. Once again, attachment hinges on whether there is a valid security agreement. The facts say that there was some sort of an agreement signed, however, the issue is whether it meets the requirements for a security agreement. As with above there are three requirements for a valid security agreement.

One of the requirements is that there has to be a valid description. A valid description can be one that clearly designates the property at issue, it can also be described by its UCC category. Here this would be a good (equipment to be specific). However, the description cannot be too broad or general. A security interest that says "all of my assets" is not valid due to it being too broad. While that might be a sufficient description on the financial statement (as it is here), security agreements require more specific descriptions. Here, Lender described the collateral as "all of Company's

personal property." This is unlikely to be a sufficient description because it is too broad. Therefore, this is not a valid security agreement. Conclusively, because this is not a valid security interest, Lender has no enforceable interest in the machine.

### **1c. Big Bank's interest in the machine**

BigBank is likely to have an enforceable interest in the machine.

The issue here is whether BigBank has an enforceable interest in the machine. For there to be an enforceable interest, this means there has to be attachment. Under the rule for attachment, there are three requirements: (1) security agreement (though can have possession or control), (2) value (consideration), and (3) the debtor has to have rights in the collateral.

Here, as with the above two questions, there is both value given and the debtor has rights in the collateral. Money for an interest (or property) is valid consideration, and the debtor has rights to the collateral because he possesses it currently. The remaining requirement is whether there is a valid security agreement. As stated above, to be a valid security agreement it must have a signature, the names of the parties and the obligations, and an adequate description of the collateral. The first two requirements (signature, names and obligations) are valid here because the company filling out the loan agreement would qualify. The remaining question is whether the description of the collateral is sufficient. To be a valid description for the security interest, it needs to properly define the goods. This can be done with the UCC classifications. Here, BigBank described the machine as equipment which is a UCC classification making the description sufficient. BigBank is also allowed to add in that it is present and future equipment because it indicates that if Company gets more equipment, BigBank also has a security interest in that too. Therefore, the security agreement is sufficient because all of the requirements are met making attachment occur here. Conclusively, because there is attachment, BigBank has an enforceable interest in the machine.

### **2. Priority of interests in machine**

The order of priority is likely to be: 1. BigBank, 2. Supplier, 3. Lender

The issue here is what is the order of priority when there are multiple parties claiming a security interest in one machine. The order of priority depends on perfection. First to file or perfect generally has priority. To perfect (tell the world about the debt), there needs to be attachment (telling the two parties about the debt). If there is no attachment, that means the party is just an unsecured party even if they filed. Unsecured creditors are generally always at the bottom of priority. Because Lender is

the only party with no enforceable security interest, it is unperfected and unsecured and will be the last party with priority.

This leaves BigBank and Supplier. BigBank filed while Supplier did not. This would tend to lean towards the idea that BigBank automatically wins because it is the only perfected party (perfected by filing). However, this would be wrong. Because Supplier is a PMSI (as noted above) there are exceptions that could place Supplier at a higher priority level than BigBank. Unfortunately for Supplier, the rule is for PMSI in consumer goods (automatically perfected). Because it is a PMSI in equipment, it will still beat BigBank in a priority fight if after 20 days of the transaction Supplier filed a financing statement. However again, here, the Supplier never filed a financing statement. Therefore, the only perfected interest is BigBank and they will have the first priority. Supplier is still a secured creditor which will still beat an unsecured creditor. Supplier will be second because it will still beat Lender. Therefore, the order of priority will be 1. BigBank, 2. Supplier, 3. Lender.

### **Question MEE 5 – July 2023 – Selected Answer 3**

#### **1. Applicable law: Secured Transactions are governed by Article of the UCC.**

##### **(a) Supplier does have an enforceable interest in the machine.**

The issue is whether the supplier has an enforceable interest in the machine.

To obtain an enforceable interest in a piece of collateral, a secured party must attach. To properly attach, a secured party must have (1) executed a signed security agreement identifying the collateral, (2) given value to the debtor, and (3) the debtor must have rights in the collateral. When an installment contract is actually a security agreement, then it is governed under Article 9 as if it was a contract for a security interest. Retaining title does not matter if the debtor is in possession of the collateral, so therefore he has possessory rights in the machine. A purchase money security interest is one where the lender gives the buyer credit to purchase the item that is secured. Collateral can be defined as either consumer goods, inventory, farm products, or equipment, which is the catch all category for anything that does not fall into the first three categories.

Here, Company and Supplier contracted for the purchase of a machine for use in the company's business through an installment contract. The machine is defined as equipment under article 9 of the UCC because it is not inventory, consumer goods, or farm products. (1) They memorialized this agreement in a signed writing, thus

satisfying the first requirement for attachment. (2) Further, the second element is met because the Company was given the machine. (3) The last element is likely satisfied because the installment contract is more similar to a PMSI which grants credit to a buyer to purchase the collateral, and the debtor was given the right to possess the machine and would own it at the end of the installment contract. Therefore, the Supplier would have an enforceable interest in the machine until the installment contract is paid off.

**(b) Lender does not have an enforceable interest in the machine because it did not properly identify the collateral in the financing statement.**

The issue is whether the lender has an enforceable interest in the machine given the generic identification of the collateral in the financing statement.

To obtain an enforceable interest in a piece of collateral, a secured party must attach. To properly attach, a secured party must have (1) executed a signed security agreement identifying the collateral, (2) given value to the debtor, and (3) the debtor must have rights in the collateral. The collateral secured by the agreement must not have a super generic description such as all personal property. Super generic descriptions are those that give too broad and unspecific identification of the collateral. Phrases like all of the debtor's personal property are too vague under Article 9. Collateral can be identified by its Article 9 collateral classification.

Here, the company borrowed \$1,000,000 from Lender with a signed loan agreement that secured the loan by granting a security interest in "all of Company's personal property." This is too generic to establish the requirements under Article 9. Thus, the interest did not attach because the first element of attachment was not met.

Therefore, the lender does not have an enforceable security interest in the machine.

While the super generic statement on the Lender's filed financing statement is allowed under Article 9, this would have no effect on attachment because you cannot perfect an interest you do not have.

**(c) Big Bank does have an enforceable interest in the machine.**

The issue is whether Big Bank has an enforceable interest in the machine.

To obtain an enforceable interest in a piece of collateral, a secured party must attach. To properly attach, a secured party must have (1) executed a signed security agreement identifying the collateral, (2) given value to the debtor, and (3) the debtor

must have rights in the collateral. The collateral secured by the agreement must not have a super generic description such as all personal property. Additionally, financing statements can contain after acquired property clauses under Article 9.

(1) Here, Company and Big Bank entered into a loan agreement signed by both parties under which Company received \$750,000 secured by "all of company's present and future equipment." This would be a proper identification of the collateral because it uses a description of the collateral, "equipment," that is proper under Article 9. Therefore, BigBank has satisfied the requirement of a security agreement indentifying the collateral.

(2) The Company was given value by Big bank because it loaned the company \$750,000. Therefore, this element is satisfied.

(3) Finally, the debtor did have rights in the collateral because even though the Supplier's agreement with the Company stated that they retained title of the machine, the debtor was in possession of it, and that contract is likely considered a PMSI under Article 9.

Thus, Big Bank has an enforceable security interest in the machine.

## **2. The order of priority of the enforceable security interest in the machine is**

The issue is which of the enforceable security interests in the machine are perfected and thus have priority over the others.

Generally, priority is determined by the order of perfection. However, a perfected PSMI has priority over a perfected security interest that is not a PMSI. Perfection is typically done by filing a financing statement in the proper filing officer. PMSIs in consumer goods automatically perfect, but PMSIs in other goods must be perfected by filing a filing statement. Filings must contain the name of the parties and the identity of the secured collateral. IN financing statements, super generic identifications are generally okay.

Here, the agreement between Lender and Supplier was likely a PMSI, but since it was not in a consumer good, but rather equipment, it does not automatically perfect. Further, since Supplier did not file a financing statement in the proper office, their interest in the machine is not perfected. Big Bank did file a financing statement in the proper office that met the above requirements.

Therefore, Big bank would have first priority in the machine, followed by Supplier's unperfected PMSI in the machine. Since Lender did not have an attached security interest in the machine, it has no rights to the collateral despite filing a proper financing statement.