Question MEE 5 – February 2026 – Selected Answer 1

(1) **Bank - Enforceable Security Interest?**

The first issue presented is whether Bank has a security interest in the flute that is enforceable against Joan?

Attachment

Under Article 9, a security interest is present when a creditor gives funds to a debtor and, in return, the creditor takes an interest in collateral to secure the payment in the event the debtor defaults. First, for a security interest to be valid, there must be attachment. Attachment confirms a security interest existing between the creditor and debtor. Attachment requires the following: (1) a security agreement between the debtor and creditor; (2) the creditor gives value to the debtor; and (3) the debtor has rights in the collateral.

Here, (1) there is a security agreement between Harmony and Bank because Harmony finances its business pursuant to a signed agreement with Bank under which Bank has loaned money to Harmony and will continue to do so from time to time. Additionally, Harmony granted Bank a security interest in all of Harmony's present and future inventory to secure its obligation to repay the loans. Additionally, (2) value was given by the creditor to the debtor because Harmony finances its business pursuant to a signed agreement with Bank. Lastly, (3) the debtor has rights in the collateral because Harmony has granted Bank a security interest in all of Harmony's present and future inventory to secure its obligation to repay the loans and it is very likely that Harmony has rights in its own inventory.

Thus, a court will likely find that the security interest between Harmony and Bank is attached.

Perfected

Under Article 9, to determine if perfection has occurred, the type of collateral involved must be classified. Inventory includes items that are sold by a business/business purpose. The most common way to perfect inventory is to file a financing statement. Perfection gives third parties notice that the creditor has a security interest against the debtor. In the financing statement, the collateral must be reasonably identified and cannot be "supergeneric."

Here, Bank perfected when it filed a properly completed financing statement in the appropriate filing office. Because the collateral has been classified as "inventory" to Harmony, it includes items sold by Harmony in its business. While an argument could be made that indicating the collateral as "inventory" is supergeneric, this argument will likely fail because "inventory" will likely be viewed as reasonably identifying the musical instruments that Harmony has available to sell to both its professional and amateur musicians (customers). Harmony only sells musical instruments and does not appear to have any other type of possible inventory besides musical instruments, so such an identification would likely reasonably identify what Harmony has in stock to sell.

Thus, a court would likely find that Bank perfected its security interest with Harmony when it filed its financing statement.

One of the ways a purchaser can avoid taking an item subject to a security interest, is if the purchaser made the purchase in the ordinary course of business. A buyer in the ordinary course of business is one who purchases an item for a business that deals in goods of the kind sold and has no knowledge of/buys without knowing about a present security interest.

Here, Walter would likely be regarded as a buyer in the ordinary course of business because he was a professional flutist and went to Harmony's showroom in order to purchase a flute for his professional performances (Harmony is one that deals in musical instruments). When Walter purchased the item on credit from Harmony, that represented a PMSI (seller's PMSI - Purchase Money Security Interest) because Harmony agreed to sell Walter the flute on credit and, in return, Harmony retained title to the flute until the last payment was made. However, when Walter made the transaction with Harmony, he was unaware of the financing arrangement between Harmony and Bank. Since Walter did not have knowledge of the security interest when he made the purchase, he would likely be regarded as a buyer in the ordinary course of business and would not take subject to the security interest. Since he would not take subject to the security interest, neither would Joan.

Therefore, a court would likely find that Bank does not have a security interest in the flute that is enforceable against Joan.

(2) **Harmony - Enforceable Security Interest?**

The second issue presented is whether Harmony has a security interest in the flute that is enforceable against Joan.

Under Article 9, when there is a consumer-to-consumer transaction, the buyer does not take subject to the security interest. A PMSI is a Purchase Money Security Interest that ordinarily has super-priority over other interests. Goods are items that are movable and identifiable. Consumer goods are goods that are for personal, family, or household use.

Attachment

See rules above for attachment.

Here, (1) There is an agreement because the transaction between Walter and Harmony was memorialized in a "credit sales agreement." (2) Harmony gave value to Walter in the firm of a PMSI by allowing Walter to put $300 down and make payments of $100 each month for the next 12 months to cover the total cost ($1,500). (3) Walter had rights in the collateral when he took the flute subject to the PMSI. The flute was likely inventory to Walter because he used the flute for his business as a professional flutist.

Thus, it will likely be found that the security interest attached.

Perfection

See above for riles on attachment.

Here, a PMSI in consumer goods automatically attaches. However, as stated, the flute is likely inventory to Walter because he is using it for his business as a professional flutist. Because the PMSI is not in consumer goods, it would likely not automatically perfect and, as a result, the security interest would likely be unperfected.

Thus, it will likely be found that the security interest is not perfected.

Here, as discussed above, Harmony has a PMSI in the flute it sold to Walter because Walter purchased it on credit and Harmony retained title until Walter made the last payment on the flute. However, when Joan purchased the flute from Walter, it was a consumer-to-consumer (garage sale type) transaction because Joan had no knowledge of any interest of Bank or Harmony in the flute. Additionally, because Joan bought the flute likely for personal purposes, it would be a consumer good to him. Even though there is a PMSI present, Harmony would likely not be able to enforce the security interest against Joan because he purchased it from another consumer (Walter) and the security interest could be regarded as being un-perfected.

Therefore, a court would likely find that Harmony does not have a security interest in the flute that is enforceable against Joan.

Question MEE 5 – February 2026 – Selected Answer 2

1(a). The issue is whether Bank has an enforceable security interest against Joan for the flute?

Creation of Bank's security interest

To attach a security interest, the secured party must give value, the debtor must hav rights in the collateral, and there must be an authenticated security agreement signed by the debtor. The security agreement must contain a description of the collateral with reasonable certainty and can include after-acquired property. A security interest in inventory can be perfected by filing a financing statement in the debtor's state of incorporation.

Here, Bank validly attached a security interest in the flute when it was in Harmony's possession. The Bank gave loans from time to time to Harmony, Harmony owned the flutes and sold them as inventory, and there was a signed security agreement describing the collateral as all present and future inventory. This description is sufficient to describe inventory as defined in Article 9 and thus is enforceable. And the Bank perfected its security interest by filing a financing statement in the appropriate office with the more generic collateral description of "inventory." Thus, Bank had a perfected security interest in the flute when Harmony held it out for sale.

Buyer in the ordinary course

A buyer may take free of a security interest if the buyer purchases the item in the ordinary course of business. For a buyer to take free of the security interest, the buyer must purchase the goods from a seller engaged in the business of selling the item (usually inventory), and purchase the item without knowledge that the purchase would violate the rights of any secured party. The buyer may even have knowledge of the security interest, the buyer just cannot know that the purchase would violate the secured party's rights in the property.

Here, Bank had a perfected security interest in the flute as Harmony's inventory. Walter then purchased the Flute from Harmony, which Harmony's business is selling musical instruments. And at the time of the purchase, Walter was unaware of the financing agreement with Bank or that the flute was subject to Bank's security interest.

Thus, because Walter purchased the flute from Harmony without knowledge that it would violate Bank's rights, Walter took the flute free from Bank's security interest. At that point, Bank no longer had any security interest in the flute and thus could not enforce a security interest against Joan.

2. Does Harmony have an enforceable security interest against Joan?

Creation of Harmony's security interest

Article 9 governs all secured transactions, even those transactions that are not described as secured transactions by the parties. If the form of the transaction is such that it looks like a security interest is being created, then Article 9 will govern and the secured party will need to perfect its interest in order to keep its priority claim. A purchase money security interest (PMSI) is created when the value given by the secured party is used to purchase the item. A PMSI in consumer goods is automatically perfected while a PMSI in inventory must be perfected by filing before the debtor takes possession.

Here, Harmony and Walter created a secured transaction through the credit sales agreement. Harmony sold the flute to Walter on credit and Walter agreed to make monthly payments for the full purchase price while Harmony retained title to the flute until it was fully paid off. While not called a secured transaction, the form of the transaction is a secured transaction and will be governed by Article 9. Thus, Harmony needed to perfect its security interest in the flute to maintain priority.

Because the flute was sold on credit, Harmony created a PMSI in the flute. The PMSI was in inventory, not consumer goods, because Walter used the flute in his profession at concerts and his business, and not for his own personal use. Therefore, the PMSI in the flute was not automatically perfected. Instead, Harmony needed to perfect the PMSI in the flute before delivering the flute to Walter. Harmony failed to file any financing statements so at the time of the sale to Walter, Harmony held an unperfected security interest in the flute.

Purchaser for value without knowledge of unperfected security interest

A transferee of an item takes subject to an unperfected and perfected security interest. A purchaser for value will take free of an unperfected security interest if the buyer purchases the item without knowledge of the security interest. A purchaser for value takes subject to a perfected security interest unless the secured party agrees to release the security interest.

Here, Harmony had an unperfected security interest in the flute when Walter sold the flute to Joan. At the time Joan purchased the flute for $900 in cash, Joan was unaware of any potential security interest held by Bank or by Harmony. Thus, by paying value for the flute without knowledge of Harmony's unperfected security interest, Joan took the flute free of Harmony's security interest. Thus, Harmony has no enforceable interest against Joan for the flute.

Question MEE 5 – February 2026 – Selected Answer 3

I assume that all parties acted in good faith at all times. I also assume that Bank's financing statement is the only relevant financing statement filed.

1. The issue is whether Bank has a security interest in the flute that is enforceable against Joan.

To have an enforceable security interest, the secured party must have an attachable and perfected security interest. The secured party is the party with a secured interest in collateral and a debtor is the party that owes the secured party an obligation secured by the collateral. Collateral is the property subject to a secured interest. In this case, the Bank is the secured property because it has a secured interest. The debtor is Harmony because it is the party that owes the Bank an obligation, which is teh money Bank loans to Harmony to finance Harmony's business. The collateral is Harmony's inventory as described in the financing statement.

For an interest to attach, the secured party must give the debtor value, the debtor must give the secured party rights in the collateral, and the parties must authenticate a security agreement. The security agreement must be in record form (written), describe the collateral adequately, and be signed by the parties (authentication). In this case, the Bank (secured party) gave the debtor (Bank) a loan (value) to finance its operations. In turn, Harmony granted bank a security interest (rights) in all of its present and future inventory to secure its obligation to repay the loan. There is also an authenticated security agreement because there is a signed agreement between Bank and Harmony that is written and describes the collateral as all present and future inventory. Therefore, the Bank's interest attached to Harmony's inventory.

Inventory is defined as a good that consists of raw materials, tools, or products used in the provision of services or sale of goods. It also consists of items used by a business in the short-term in the provision of its goods or services. The musical instruments held by Harmony are products held by Harmony in the sale of its goods to consumers (musical instruments). Therefore, inventory includes the flute at issue. Therefore, the bank's security interest attached to the flute.

For an interest to be perfected, the secured party must either possess the collateral, control the collateral, or file a financing statement. The financing statement must have the name of the debtor and secured party and describe the collateral, albeit less adequately than the security agreement is fine. In this case, Bank filed a financing statement in the appropriate filing office and lists Harmony Corporation as debtor, Bank as secured party, and describes the collateral as inventory. This is a properly made and filed financing statement, so Bank's interest in inventory is perfected. Therefore, bank's security interest in the flute was perfected.

A buyer in the ordinary course of business (BOCB) generally takes the collateral free of a perfected security interest. To fall within the BOCB exception, there must be a buyer who purchases the collateral from a seller (usually a merchant) who ordinarily sells the product in the ordinary course of the business. The buyer must purchase the collateral in good faith and in the ordinary course of their own business. In this case, six months ago Walter purchased the flute from Harmony's showroom for his professional performances. Harmony sells flutes in the ordinary course of its business as a seller of musical instruments and Walter purchases flutes in the ordinary course as a professional flutist. As assumed in the question, Walter also acted in good faith. Walter thus falls within the BOCB exception to a perfected secured interest and takes the flute not subject to the bank's perfect secured interest in the flute.

However, an interest in cash proceeds from the sale of secured collateral is automatically perfected and perfected indefinitely. In this case, Harmony entered into an arrangement where Walter would pay Harmony $1500 cash for the flute. Therefore, Harmony received cash proceeds in return for the flute, in which the Bank had a perfected security interest. Thus, the Bank has a perfected security interest indefinitely in the cash that Harmony will receive ($300 today and $1200 over the next 12 months) for the flute it sold to Walter. However, Walter only paid for the last five months, so Bank has a perfected security interest in $300 + $500 ($100 for 5 months) or $800 of cash proceeds from the sale of the flute.

A subsequent good-faith purchaser takes the good subject to the rights of the previous purchaser as long as they did not have notice of a secured interest in the good. In this case, Joan is a professional flutist that bought the flute from Walter one month ago for $900. She acted in good faith and had no notice of the interest of Bank in the flute. Therefore, Joan takes the flute free of Bank's perfected security interest because she is sheltered by the BOCB Walter. Therefore, Bank does not have an enforceable security interest against Joan.

2. The issue is whether Harmony has a security interest in the flute that is enforceable against Joan.

To have an enforceable security interest, the secured party must have an attachable and perfected security interest.

A lease arrangement that is not characterized as a secured transaction but is in substance a secured transaction will be treated as such. A lease arrangement is likely a secured transaction if it is on credit or at the end of the payments the debtor will own the property. In this case, when Walter bought the flute from Harmony's showroom six months ago, he could not afford to pay the $1500 purchase price so entered into a credit sales agreement with Harmony. He paid $300 up front and would pay $100 in twelve installments over the next year. At the end of the payments, title to the flute would be passed from Harmony to Walter. Because the lease arrangement was called a credit agreement and the facts show that at the end of the payments the debtor has the option to own the property, it is likely to be treated by a court as, in substance, a secured transaction.

For an interest to attach, the secured party must give the debtor value, the debtor must give the secured party rights in the collateral, and the parties must authenticate a security agreement. The security agreement must be in record form (written), describe the collateral adequately, and be signed by the parties (authentication). In this case, the secured party gave the debtor value (a professional flute). The debtor gave the secured party rights (Harmony retains the title while debtor pays them back). Finally, there was a security agreement because it is in record form memorialized in a credit sales agreement, authenticated because it is signed by Walter and Harmony, and describes the property as the flute sold on credit. Therefore, Harmony's interest in the flute attached six months ago.

For an interest to be perfected, the secured party must either possess the collateral, control the collateral, or file a financing statement. The financing statement must have the name of the debtor and secured party and describe the collateral, albeit less adequately than the security agreement is fine. In this case, Harmony did not file a financing statement, nor does it possess or control the flute as it gave it to Walter. Therefore, Harmony did not perfect its interest in the flute at any time.

A consumer buyer exception (garage sale exception) is an exception by which a consumer buyer who buys an item subject to a security interest in good faith from a consumer seller (not a merchant i.e. not ordinarily engaged in the commercial sale of such items) without knowledge of the security interest may take the property without the encumbrance of the security interest. If there is a filing statement that perfect the security interest, the consumer buyer still takes the collateral subject to the perfect security interest that was perfect by a financing statement filing. In this case, Joan is a consumer buyer because she is a professional flutist and is in the market for a flute that she uses for personal purposes (her job and profession). Walter was a consumer seller because he used the flute for professional personal purposes and is not regularly engaged in the commercial sale of flutes. Joan acted in good faith and bought the flute from Walter without knowledge of Harmony's security interest. Harmony did not file a financing statement. Therefore, Joan, as a consumer buyer, takes the flute free of Harmony's attached security interest. Thus, Harmony does not have an enforceable security interest against Joan.