

Question 12 – July 2018 – Selected Answer 1

(A) Bank cannot recover possession of New TV from Amy because Amy took New TV free of Bank's security interest as a buyer in the ordinary course.

Article 9 of the UCC applies to consumer goods--those are goods used in for home use. Here, the New TV was purchased by Amy to use in her home, and therefore it is covered by Article 9.

Under Article 9 of the UCC, to obtain a security interest in collateral, attachment as to the collateral must occur. Attachment occurs when the secured party gives value for it, the security interest is created, and the debtor has rights in the collateral. Here, Bank, the secured party, gave ABC a Loan in exchange for the security interest in ABC's inventory--thus, Bank gave sufficient value. The security interest in the inventory was created through an authenticated security agreement that sufficiently described the collateral. Moreover, ABC had rights in its inventory. The facts also indicate that Bank properly perfected its security interest in the inventory to secure the Loan. As such, Bank had a security interest New TV because it was considered ABC's inventory. Under Article 9, a security interest will generally follow the collateral into the hands of subsequent purchasers, such as Amy. However, Amy will take New TV free from Bank's security interest if Amy can show that she is a buyer in the ordinary course. A purchaser is a buyer in the ordinary course if they: (i) purchased the collateral from a seller who deals in goods of that kind; (ii) had no knowledge of a violation of the security agreement; (iii) seller created the security interest in the collateral; (iv) buyer purchased in good faith; and (v) buyer did not purchase livestock. Here, Amy purchased New TV from ABC, a seller of televisions. Moreover, Amy had no knowledge of any violation, nor is there any evidence of bad faith. Finally, she purchased inventory, not livestock, and ABC created the security interest in New TV. Therefore, Amy will take New TV free from Bank's security interest as a buyer in the ordinary course.

Bank will thus not be able to recover possession of New TV from Amy. Instead, Bank's security interest will follow the proceeds of this sale into the down payment and the Agreement.

(B) XYZ Credit has rights to the installment payments Amy is obligated to make on New TV under Agreement.

As mentioned above, Bank's perfected security interest in New TV follows the proceeds of ABC's sale of the collateral to Amy rather than the New TV itself. The proceeds at issue include the \$200 downpayment and Amy's Agreement to pay \$50 per month until the balance is paid off. Bank's interest in the proceeds is only perfected for 20 days--thereafter, the Bank must act to perfect unless the new collateral would be covered by the same security agreement description as originally filed. Here, the Agreement is a promissory note that would not be considered "inventory" as Bank's original security agreement described. Therefore, Bank must take action to perfect in the Agreement. The Agreement is considered a promissory note, otherwise known as chattel paper because it is a security interest coupled with a promissory note. Bank may perfect by noting its security interest on the Agreement or by possession.

Here, there are no facts to indicate how much time has passed since sale to Amy. Assuming Bank is still perfected in the proceeds of New TV, Bank's interest in Agreement would follow the

Agreement into the hands of XYZ Credit. The exception to this rule is if a subsequent purchaser gave new value for the chattel paper and the security interest was not otherwise noted on the chattel paper. Here, there is no evidence that the Agreement noted Bank's security interest in it. As such, when XYZ purchased the Agreement from ABC and asserted its rights by notifying Amy to pay it instead of ABC, XYZ purchased chattel paper for new value and without notice of Bank's security interest. Therefore, XYZ has the rights to the installment payments Amy is obligated to make on New TV under Agreement.

(C) Capitol can recover possession of Old TV from Joe because Capitol's security interest follows the collateral and the "garage sale" exception is not satisfied here.

The first issue is whether Capitol's security interest in Old TV was perfected--this is because Capitol's priority depends on if attachment plus one of the four acts of perfection have occurred: filing, possession, control, or automatic perfection. Capitol Appliances is presumably the store who sold Amy her Old TV--an appliance. Thus, when Capitol Appliances retained a security interest in the good sold to Amy, this created a purchase money security interest (PMSI). A PMSI can be created in two ways: (i) where the seller of the good secures the purchase price by creating a security interest in the good sold; or (ii) where the lender loans money to lender to purchase goods and takes a security interest in those goods. The one created here by Capitol Appliances is the former, what's called a "seller PMSI." PMSIs in consumer goods automatically perfect without any further action from Capitol Appliances. Therefore, Capitol's failure to file a financing statement for its transaction with Amy when she bought Old TV does not render Capitol out of luck. Instead, because Capitol's security interest is perfected in Old TV, the general rule is that this security interest follows the collateral into the hands of subsequent purchasers.

Here, that means that when Amy sold Old TV to Joe, Joe took Old TV subject to Capitol's PMSI. So, unless an exception applies, Capitol would be able to recover possession of Old TV from Joe. The "garage sale" exception may be proven if Joe can show: (i) the collateral is a consumer good in the hands of seller (Amy); (ii) the collateral is a consumer good in the hands of buyer (Joe); (iii) buyer had no knowledge that security interest existed; (iv) and buyer purchased in good faith.

Here, though Old TV was a consumer good--good purchased for use in the home--in Amy's hands, it was not a consumer good in Joe's hands. This is because Joe placed Old TV for sale in his used appliance store. Therefore, even though there is no evidence that Joe knew there was a security interest in Old TV and it's probable he bought in good faith, he cannot satisfy prong (ii). Thus, Capitol Appliance, as a PMSI creditor of Old TV, may recover possession of Old TV from Joe.