A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code

Keith G. Meyer

I. INTRODUCTION

Article 9, which governs conflicts concerning security interests in personal property, was included in the Uniform Commercial Code (U.C.C.) in 1962. Since 1962 Article 9 has been changed significantly twice. Substantial amendments were made in 1972, and in 1999 Article 9 was completely revised. Revised Article 9 (R9) is the product of years of study and drafting by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute.

* E.S. and Tom W. Hampton Professor of Law, University of Kansas. B.A. Cornell College, 1964; J.D., University of Iowa, 1967. Professor Meyer wishes to thank the University of Kansas School of Law Postlethwaite Fund for its support and Amy Cline for her fine research and editing assistance.

1. Article 9 has a language all of its own. The person granting credit may become a “secured party” by contracting for a “security interest” in property called “collateral” to secure an obligation of the “debtor.” See U.C.C. Rev. § 9-102(a)(72) (2000) (defining “secured party”); id. § 9-102(a)(12) (defining “collateral”); id. § 9-102(a)(28) (defining “debtor”). The contract is a “security agreement.” Id. § 9-102(a)(73). Security interest is defined to be “an interest in personal property or fixtures which secures payment or performance of an obligation.” U.C.C. § 1-201(37) (2000).

The creation of an enforceable security interest requires more than an appropriate security agreement. The secured party must give value and the debtor must have rights in the collateral. U.C.C. Rev. § 9-203. Once these three requirements are satisfied, the security interest attaches to the specific property subject to the security interest and is enforceable against the debtor upon default. Id.

To achieve maximum protection, the secured party must “perfect” its security interest. This normally requires some step beyond attachment such as the secured party filing a financing statement or taking possession of the collateral. Id. § 9-308(a).

The perfected secured creditor will in many instances prevail over other creditors and purchasers of the goods subject to a perfected security interest. See id. § 9-317(a) (listing the classes of persons who take priority over an unperfected security interest).

2. The National Conference of Commissioners on State Laws (NCCUSL), an organization of state governments started in 1892 whose purpose is to draft and secure enactment of uniform state laws on a wide variety of subjects, became interested in developing a single comprehensive commercial code covering all aspects of commercial transactions (contract, payment, and credit). The NCCUSL is dedicated to ascertaining what private state law would benefit from model legislation and drafts two types of proposed legislation: (1) uniform acts which apply to legal problems common to all states, where uniformity of treatment is very important; and (2) model acts which involve problems common to all states but where uniformity is not important. The National Conference of Commissioners on Uniform State Laws, About Us (2001), at http://www.nccusl.org/nccusl/aboutus.asp.
(ALI). The revision process followed in revising Article 9 is not without controversy. Moreover, only time will tell whether R9 will produce

Members who serve without compensation are called Commissioners and come from the fifty states plus the District of Columbia, Puerto Rico and the Virgin Islands. Most are practicing lawyers, but some are judges and law professors. Each state normally selects four commissioners. Each state's delegation, however, has only one vote on whether proposed acts should be approved by the Commission. Each Commissioner must try to persuade his or her state legislature to adopt its proposals. Id.

An established process exists for determining when the NCCUSL will draft proposed legislation. Initially, a study committee of Commissioners will be formed by the Permanent Editorial Board (PEB) of the U.C.C. when an area covered by the Uniform Commercial Code is involved. Suggestions for changes can come from the PEB, individual Commissioners, the American Law Institute (ALI) or its members, and third parties such as the American Bar Association. Once the Executive Committees of the NCCUSL and the ALI decide to proceed, a drafting committee is formed. This committee will have a Reporter who is a legal expert in the subject matter of the proposed statute. The product of the drafting committee is presented to, and must be approved by, the membership of the NCCUSL, as well as by the ALI membership when the U.C.C. is involved. For a general discussion of the process see the text accompanying infra note 3. Id.

3. The ALI has about 2500 members (professors, judges, and practicing lawyers), who are elected for life. It is funded by gifts, dues, receipts from the sale of publications, and returns on investments. The NCCUSL conceived the idea of a Uniform Commercial Code and sought the help of the ALI, which has a wider membership, greater prestige, and more financial support. The ALI has formulated a comprehensive series of Restatements of common law. Examples are the Restatements of Agency, Conflict of Laws, Contracts, Judgments, Property, Restitution, Security, Torts, and Trusts. Many of these are in their third edition. Other areas covered include the Law Governing Lawyers, Suretyship and Guaranty, and Unfair Competition. The American Law Institute, Bylaws and Rules of Council (1994), at http://www.ali.org/ali/BYLAWS2001.htm.

The ALI has been involved with codification projects, model acts, and studies, including the Model Penal Code, the U.C.C., Principles of Corporate Governance, a Federal Securities Code and various federal taxation proposals. Id.


4. Previous drafts of R9 may be found on the Internet at http://www.law.upenn.edu/bll/ucl.htm (last updated July 11, 2001).

Both the NCCUSL and the ALI work on revisions and both approve changes, but the NCCUSL alone directs the effort to persuade states to adopt the new version of the U.C.C. The ALI revision process typically starts with a study committee and a group of advisors. If changes are needed, a drafting committee is appointed. The drafting committee will contain academics, representatives of the various industries affected, and consumer advocates, who will attempt to develop a code that has broad appeal so that special interest groups will not derail states from adopting it. It must also be noted that currently, the American Bar Association plays an important role in the development process. For a thorough discussion of the Article 9 revision process, see Marianne B. Culhane, The UCC Revision Process: Legislation You Should See in the Making, 26 CREIGHTON L. REV. 29 (1992).

The process for the creation of proposed legislation is not without its critics. Some have argued that the process is a closed society dominated by pro-business advocates, and that it is too rigid in its approach to re-thinking uniform acts. See Kathleen Patchel, Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code, 78 MINN. L. REV. 83, 88 (1993) ("The uniform laws process, as currently structured, is almost custom-made for the drafting and enactment of pro-business legislation."); Edward L. Rubin, Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4, 26 LOY. L.A. L. REV. 743, 743–88 (1993) (describing the lack of representation of consumer interests and the drafting committee's unwillingness to consider economic analysis or empirical research during the revision process); Alan Schwartz & Robert E. Scott, The Political Economy of Private Legislatures, 143 U. PA. L. REV. 595, 651 (1995) ("[T]heory suggests that a private legislature with
results that justify the considerable resources devoted to its creation and the costs connected with its implementation. Rather than writing about these broad issues, I have limited the scope of this Article to providing a basic understanding of R9's treatment of Purchase Money Security Interests (PMSIs). In the course of this discussion, I will consider when and how a PMSI is created and discuss the priority rules governing conflicts between a PMSI holder and other creditors. Although some references are made in this piece to the pre-1999 version of Article 9 which is referred to here as Former Article 9 (F9), this article focuses primarily on R9, which sets July 1, 2001 as its effective date. For whatever reason, the Kansas Revisers of Statutes did not include R9 in the 2000 Statutory Supplement to the Kansas Statutes Annotated, chapter eighty-four. Consequently, until the 2001 Statutory Supplement is published, R9 may only be found in the 2000 Kansas Session Laws, chapter 142.

Before turning to the discussion of PMSIs, it is appropriate to sketch out some of the general changes made by R9. While the core concepts of F9, such as scope, attachment, perfection, priorities, and

a membership similar to that of the ALI and NCCUSL and procedures similar to theirs will have a strong status quo bias and sometimes will be captured by powerful interests.

). For other articles discussing revision issues and processes, see Peter A. Alces & David Frisch, On the UCC Revision Process: A Reply to Dean Scott, 37 WM. & MARY L. REV. 1217 (1996) (arguing that interest groups have not captured the drafting process); Edward L. Janger, Predicting When the Uniform Law Process Will Fail: Article 9 and the Race to the Bottom, 83 IOWA L. REV. 569 (1998) (considering the effect of secured credit on societal concerns such as safety and the benefits and drawbacks of the uniform law creation process); Fred H. Miller, Realism Not Idealism in Uniform Laws—Observations From the Revision of the UCC, 39 S. TEX. L. REV. 707 (1998) (discussing the realities of the uniform drafting process).

The revision process is normally slow. It often takes years for changes to be made, approved by the NCCUSL and the ALI, and for all of the states to adopt the changes. Interestingly, R9 proved to be an exception when it was adopted in all states within three years of its approval by the ALI and the NCCUSL.

5. As of July 1, 2001, all states have enacted R9. Alabama, Mississippi, and Florida made it effective after July 1, 2001. 1 SEC. TRANS. GUIDE (CCH) ¶ 4991 (July 17, 2001). Revised 9 became effective in Connecticut on October 1, 2001. Id.

6. U.C.C. Rev. § R 9-109 (2000). This section provides in part:

(a) [General scope of article.] Except as otherwise provided in subsections (c) and (d), this article applies to:

(1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;

(2) an agricultural lien;

(3) a sale of accounts, chattel paper, payment intangibles, or promissory notes;

(4) a consignment;

(5) a security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5), as provided in Section 9-110; and

(6) a security interest arising under Section 4-210 or 5-118.
default are continued, significant changes have occurred. For example, instead of fifty-five sections there are now 135 with many sub-parts, and changes were made to at least twenty-five other U.C.C. sections. Most section numbers have been changed. Except for definitions that affect the whole code, which are found in U.C.C. section 1-201, R9’s definitions are placed in one section, 9-102, which has eighty main parts with sub-parts. The number of transactions covered by Article 9 has been expanded. For example, R9 now covers the sale of promissory notes and payment intangibles. A security interest may now be created in payment obligations arising out of the sale, lease or license of all kinds of tangible and intangible property, including such things as license fees payable for the use of software. Other types of property that may now be made subject to a security interest include non-consumer deposit accounts, commercial tort claims, payment intangibles and health care

(b) [Security Interest in secured obligation.] The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

8. Perfection is designed to give public notice of a security interest. Id. §§ 9-308–316, 9-502 cmt. 2. Revised section 9-308 defines perfection:
(a) [Perfection of security interest.] Except as otherwise provided in this section and Section 9-309, a security interest is perfected if it has attached [under §§ 9-203–204] and all of the applicable requirements for perfection in Sections 9-310 through 9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

In general, depending on the type of collateral, perfection can occur in five different ways: (1) secured party files a financing statement in a public office; (2) secured party takes possession of the collateral; (3) secured party obtains control; (4) the security interest is noted on the certificate of title; and (5) perfection can occur automatically upon attachment of the security interest under revised section 9-203(b). Id. §§ 9-310–316.

10. Id. §§ 9-601–624.
11. Id. § 9-102.
12. Id. § 9-109(a)(3). Payment intangibles are a special kind of general intangible. The sale of general intangibles is not covered under F9 and R9. However, R9 covers the sale of payment intangibles.

The term “general intangibles” is defined in revised section 9-102(a)(42) to be “any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter of credit rights, letters of credit, money, and oil, gas, or other minerals before extraction.” The term includes payment intangibles and software. “Payment intangible means a general intangible under which the account debtor’s principal obligation is a monetary obligation.” Id. § 9-102(a)(61).

13. Id. §§ 9-109(a)(1), 9-102(a)(2).
14. Id. §§ 9-109(a)(1), 9-109(c)(13), 9-102(a)(29). Revised section 9-102(a)(29) provides that “[d]eposit account’ means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.” See also infra note 129.
15. Id. §§ 9-109(a)(1), 9-109(c)(12), 9-102(a)(13). “Commercial tort claim” means a claim arising in tort with respect to which: (A) the claimant is an organization; or (B) the claimant is an
receivables. While the Uniform version covers certain statutory agricultural liens, the Kansas version does not. Revised Article 9 recognizes the electronic revolution by beginning to move away from the need for a signed piece of paper to establish a security agreement. Revised Article 9 refers to “authentication” of a “record” instead of a signed writing. Revised Article 9 also recognizes electronic collateral such as electronic chattel paper.

The filing system has been modernized. All filings are now made with the secretary of state except for fixtures, timber to be cut, as extracted collateral, and transmitting utilities, which are filed locally. All filings can be made electronically. The name of the debtor for the financing statement has been clarified. Trade names are legally insufficient. If the debtor is a registered organization, the name on the fi-

individual and the claim: (i) arose in the course of the claimant’s business or profession; and (ii) does not include damages arising out of personal injury to or the death of an individual.” Id. § 9-102(a)(13).

16. Id. § 9-102(a)(61); supra note 11.
17. Id. §§ 9-109(a)(1), 9-102(a)(2), 9-102(a)(46). “Health care receivables” is a new term. Such receivables were considered an account under F9 and would have been treated as an account under R9 had R9 not defined them separately. However, revised section 9-102(a)(46) provides: “‘Health-care insurance receivable’ means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided.”


“Agricultural lien” means an interest, other than a security interest, in farm products:

(A) Which secures payment or performance of an obligation for:

(i) Goods or services furnished in connection with a debtor’s farming operation; or

(ii) rent on real property leased by a debtor in connection with its farming operation;

(B) which is created by statute in favor of a person that:

(i) In the ordinary course of its business furnished goods or services to a debtor in connection with a debtor’s farming operation; or

(ii) leased real property to a debtor in connection with the debtor’s farming operation; and

(C) whose effectiveness does not depend on the person’s possession of the personal property. Agricultural lien shall not include statutory liens.


The key to this definition is the last sentence, which states that agricultural liens do not include statutory liens. Under the 2000 Kan. Sess. Laws ch. 142 § 2, the definition of statutory lien includes all of the possible liens that could be an agricultural lien. Statutory lien is also defined: “Statutory lien” means liens created by K.S.A. 2-1319, 2-2608, 2-3007, 34-239, 47-836, 58-201, 58-203, 58-204, 58-207, 58-218, 58-220, 58-221, 58-241, 58-242, 58-2524, 58-2525, 58-2526, 58-2527, 58-2528, 84-7-209 and amendments thereto. Id.

20. Id. § 9-102(a)(31).
21. Id. § 9-501.
22. Revised section 9-503(c) states: “A financing statement that provides only the debtor’s trade name does not sufficiently provide the name of the debtor.” However, revised section 9-506 continues the minor error rule. It provides that a financing statement substantially complying with the requirements of Part 5 is effective even if it has minor errors or omissions, unless those errors or
nancing statement must show the name of the debtor indicated on the public record of the jurisdiction in which the debtor is organized. A failure to provide the correct name of the debtor is a seriously misleading error unless “a search of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if any, would disclose a financing statement that fails to sufficiently provide the debtor’s name.” Revised Article 9 also makes perfection easier. Instruments can be perfected by filing. The requirement of the debtor’s signature has been eliminated so long as the person filing is authorized, which occurs automatically if the description in the financing statement is the same as in an “authenticated” security agreement. Super-generic descriptions, such as “all assets of the debtor,” are sufficient in the financing statement but not in the security agreement.

Revised Article 9 treats consumer credit transactions differently from F9 in many areas. Unlike non-consumer transactions where the security agreement may, among other things, describe the collateral by type (e.g., equipment, inventory, documents), description by type is not proper when the collateral is consumer goods, a security entitlement or a securities account. Consumers must be given a variety of special notices when a security interest is being foreclosed. If a secured creditor fails to meet the notice or commercially reasonable requirements of disposition, different rules apply to consumer transactions as to deficiency judgments under R9. In section 9-626(a), R9 specifically limits coverage to non-consumer cases. Interestingly, the Kansas version of R9 removes the non-consumer limitation, which apparently means that con-

omissions make the financing statement seriously misleading. Revised section 9-506(c) provides: “If a search of the records of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor . . . the name provided does not make the financing statement seriously misleading.”

23. Id. § 9-503(a).
24. Id. § 9-506(c).
25. Id. § 9-509.
26. Id. §§ 9-504, 9-108(c).
27. See, e.g., id. § 9-102(22)–(25) (defining consumer debtor, consumer goods, consumer goods transaction, and consumer obligor); id. § 9-108(h)(3) & (e) (stating when description by type is insufficient); id. §§ 9-612–616 (discussing notice and commercially reasonable requirements of disposition); id. § 9-626(b) cmt. 4 (establishing rules that apply to actions arising out of consumer transactions in which deficiency or surplus is an issue).
28. Id. § 9-108(e).
29. Id. §§ 9-612–616. Remember that the Uniform Consumer Credit Code applies in Kansas, and that the creditor must give the consumer notice of the right to cure ten days after default. KAN. STAT. ANN. § 16a-5-110 (1995).
30. U.C.C. Rev. § 9-626(a).
sumer defaults are to be covered by the Kansas version of section 9-626. 31 This change raises an interesting issue. Prior to July 1, 2001, in consumer cases covered under the Kansas version of the Uniform Consumer Credit Code, a non-complying secured creditor was denied a deficiency—the absolute bar rule applied. 32 In non-consumer cases, R9 rejects the absolute bar rule and adopts the rebuttable presumption rule in creditor misbehavior cases. 33 The secured party need not prove compliance with the default provisions unless compliance is placed in issue, and then the secured party has the burden to show compliance. 34 If the creditor cannot prove compliance, this failure will reduce the secured party’s deficiency to the extent that the failure to comply affected the price obtained at the foreclosure sale. 35 Revised sections 9-626(3)(B) and (4) provide that the value of the collateral is deemed to equal the unpaid debt, and that the noncomplying creditor is not entitled to a deficiency unless the creditor seeking a deficiency proves by independent evidence that the price produced at the sale was reasonable. 36 This is the so-called rebuttable presumption rule. 37 Thus the creditor must prove what the collateral would have been sold for at a commercially reasonable sale, and that this amount is less than the unpaid debt.

In short, R9 is full of changes. Many have made the Code more amenable to the electronic age fast encompassing us. Some have brought needed clarity, while others contain unexpected surprises. Rather than writing a general survey article, I have chosen to focus on the changes affecting one area—Purchase Money Security Interests (PMSIs).

II. PURCHASE MONEY SECURITY INTERESTS (PMSIs) IN GENERAL

A. Introduction

Whether a security interest is a PMSI, as defined in revised section 9-103, is important in several contexts. 38 One is perfection. 39 Most

33. U.C.C. Rev. § 9-626(a) cmt. 3.
34. Id. § 9-626(a).
35. Id.
36. Id. §§ 9-626(3)(B), 9-626(4).
37. See id. § 9-626 cmt. 3 (explaining the mechanics of the rebuttable presumption rule).
38. Id. § 9-103.
PMSIs in consumer goods are "automatically" perfected upon attachment; no filing or possession by the secured party is required. A number of special priority rules apply to conflicts between other creditors and PMSI holders. For example, a PMSI perfected by filing "before or within 20 days after the debtor receives delivery of the collateral" has priority over certain buyers', lessees' and lien creditors' interests "which arise between the time the security interest attaches and the time of filing." Another special rule applies to conflicts between PMSI holders and other secured parties. The normal priority rule dealing with more than one secured party claiming the same collateral is set forth in revised section 9-322, which provides that the first to file wins unless another rule applies. Revised section 9-324 provides a number of exceptions to revised section 9-322. For example, a qualifying PMSI holder in equipment, inventory, or livestock may achieve priority over security interests perfected earlier in time of filing. Finally, under 11 U.S.C. § 522(f)(1)(B), a debtor in bankruptcy can avoid a nonpossessory, nonpurchase money security interest to the extent it would impair the

39. Id. § 9-309(1). See also supra note 7 (explaining perfection as defined in revised section 9-309).

40. U.C.C. Rev. § 9-203(b). Attachment requires that the secured party give value, that the debtor have rights in the collateral, and that a security agreement exist. Id. "Value" is defined very broadly in section 1-201(44). "Rights" are not generally defined, but revised section 9-203(b)(2) provides that the debtor must have rights or "the power to transfer rights in the collateral to a secured party." The debtor can obtain this power through any of the traditional bodies of law mentioned in section 1-103, or through specific Code provisions as in section 2-403(1)(b). The third requirement is that the debtor must have authenticated a security agreement unless the secured party has possession of the collateral, or the collateral must be a certificated security in registered form delivered to the secured party pursuant to a security agreement, or the collateral must be deposit accounts, electronic chattel paper, investment property or letter-of-credit-rights over which the secured party has control under revised section 9-104, 9-105, or 9-107 pursuant to the debtor's security agreement. "Security agreement" is defined in revised section 9-102(a)(73), and the definition of "agreement" is in revised section 1-201(3).

Under R9, "authentication" of a "record" is the key to attachment rather than the signing of a piece of paper entitled "Security Agreement." "Authenticate" is defined in section 9-102(a)(7) as meaning: "(A) to sign; or (B) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record." "Record," except as used in "for record," "of record," "record or legal title," and "record owner," means information that is inscribed on a tangible medium, or which is stored in an electronic or other medium and retrievable in perceivable form. Id. § 9-102(a)(69).

41. Id. §§ 9-309(1), 9-310(b), 9-313(a). This rule does not apply to vehicles required to be registered and subject to a certificate of title. Id. §§ 9-309(1), 9-311. It is very important to note that Kansas' version of R9 does not continue the $3000 limitation that was applied to a PMSI in consumer goods under 19. KAN. STAT. ANN. § 84-9-302(1)(d) (Supp. 2000).

42. U.C.C. Rev. § 9-317(e).

43. Id. See also infra notes 203–209 and accompanying text.

44. U.C.C. Rev. §§ 9-322(a), 9-322(f)(1), 9-322 cmr. 4. See also infra notes 99–100 and accompanying text.

45. See infra notes 107, 125, 152 and accompanying text.
debtor's ability to claim an exemption in certain assets. These special rules apply only if a secured party can qualify as a PMSI holder. Thus, it is appropriate to first examine the definition of a PMSI.

46. When the debtor is an individual, states and Congress have concluded that the public interest is not served by allowing the creditor to make the debtor a pauper. Accordingly, both state and federal law recognize that certain property of an individual debtor is protected from the claims of a creditor seeking property without the consent of the debtor; in other words, the property is exempt from involuntary seizure. Probably the most important property of a debtor is wages, which are protected under federal law as well as in some states. Consumer Credit Protection Act, 15 U.S.C. §§ 1671–1677 (1994). E.g., Kan. Stat. Ann. § 60-2310 (1994). Except for wages and outside of bankruptcy, state law defines what property cannot be seized by a creditor in the judicial debtor collection process. While state exemptions vary widely, some states exempt the following categories of property: the family residence and household furnishings; the clothing and personal effects of the debtor and the debtor's family; the family car; and the tools and other personal (movable) property used in the debtor's occupation. E.g., Kan. Stat. Ann. § 60-2304. These protections do not apply to most consensual security interests given by the debtor, except as provided by 11 U.S.C. § 522(f)(1). This statute provides in part:

(O)(1) Notwithstanding any waiver of exemptions but subject to paragraph (3), the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—

(B) a nonpossessory, nonpurchase-money security interest in any-

(i) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor;

(iii) professionally prescribed health aids for the debtor or a dependent of the debtor.


The Kansas exemptions are found in the Kansas Statutes Annotated, section 60-2304. It provides:

Every person residing in this state shall have exempt from seizure and sale upon any attachment, execution or other process issued from any court in this state, the following articles of personal property:

(a) The furnishings, equipment and supplies, including food, fuel and clothing, for the person which is in the person's present possession and is reasonably necessary at the principal residence of the person for a period of one year.

(b) Ornaments of the debtor's person, including jewelry, having a value of not to exceed $1,000.

(c) Such person's interest, not to exceed $20,000 in value, in one means of conveyance regularly used for the transportation of the person or for transportation to and from the person's regular place of work, except that the value limitation specified in this subsection shall not apply when the means of conveyance is a vehicle designed or equipped, or both, for handicapped persons, as defined in K.S.A. 8-1,124 and amendments thereto.

(d) A burial plot or crypt or any cemetery lot exempt from process pursuant to K.S.A. 17-1302 and amendments thereto.

(e) The books, documents, furniture, instruments, tools, implements and equipment, the breeding stock, seed grain or growing plants stock, or the other tangible means of production regularly and reasonably necessary in carrying on the person's profession, trade, business or occupation in an aggregate value not to exceed $7,500.
B. **PMSI Defined and the Tracing Requirement**

A PMSI is a special type of security interest for which the normal attachment requirements, as well as the special purchase money definitional elements in revised section 9-103, must be satisfied. In general, a PMSI can be obtained only in goods or some types of software but not intangibles; and like under former section 9-107, it is created when a secured party provides the credit that enables the debtor to obtain the collateral.

---


For a recent Bankruptcy decision applying these rules see In re Hill, Nos. KS-97-099, 97-13437, 1998 WL 208809 (B.A.P. 10th Cir. Apr. 20, 1998). See also infra note 74.

47. See U.C.C. F. § 9-203 (2000) (setting forth the formal requisites for the attachment and enforceability of security interests under F9); U.C.C. Rev. § 9-203 (giving the formal requisites for the attachment and enforceability of security interests under R9). See also supra note 32.

48. U.C.C. Rev. § 9-103.

49. Id. § 9-103(a)(1). See infra notes 86–87 and accompanying text. Again, under R9, a PMSI cannot be obtained in an intangible. See id. § 9-103 cmt. 5 (explaining that “[s]ubsections (b) and (c) limit purchase-money security interest to security interests in goods, including fixtures, and software.”). Revised section 9-102(a)(75) provides that “[s]oftware’ means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.”

50. Former section 9-107 provided:

A security interest is a “purchase money security interest” [PMSI] to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.


Revised section 9-103(a)–(b) defines a PMSI as follows:

(a) [Definitions.] In this section:

(1) “purchase-money collateral” means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(2) “purchase-money obligation” means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(b) [Purchase-money security Interest in goods.] A security interest in goods is a purchase-money security interest:

(1) to the extent that the goods are purchase-money collateral with respect to that security interest;

(2) if the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(3) also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.
Revised section 9-103(b)(1) contains the basic definition, which provides: "A security interest in goods is a purchase money security interest . . . to the extent that the goods are purchase-money collateral with respect to that security interest." 51 "Purchase money collateral" 52 means goods or software that secures a "purchase-money obligation," which is defined as "an obligation of an obligor 53 incurred as all or part of the price of the collateral, or for value given to enable the debtor to acquire rights in or use of the collateral if the value is in fact so used." 54 Under these definitions, like under former section 9-107, two types of PMSIs in goods or software can exist. One is held by sellers to secure the buyer's obligation to pay, and the other is held by a qualifying lender. 55

While a seller can normally establish the PMSI without difficulty, lenders must show that the loan "enabled" the debtor to acquire the good and that the money was in fact used to purchase the good; i.e., the funds must be traced. 56 The tracing problem is solved by the lender issuing a check to the seller of the good or a joint payee (debtor and seller) check. The enabling requirement can present an issue if the purchase is made a long time after the loan or if the debtor purchases the good before the loan is in fact made. For example:

July 1

Farmer's tractor breaks irreparably during harvest and must be replaced immediately. He calls his banker, who tells him that the bank will loan him the money but that it will take about five days to

U.C.C. Rev. § 9-103.
51. Id. § 9-103(b)(1).
52. Id. § 9-103(a)(1).
53. Revised Article 9 uses two terms: "debtor" and "obligor." Revised section 9-103 refers to an obligor. "Obligor" is defined in part to mean "a person that, with respect to an obligation secured by a security interest . . . (i) owes payment or other performance of the obligation . . . ." Id. § 9-102(a)(59). "Debtor" is defined in part to mean "a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor . . . ." Id. § 9-102(a)(28)(A).
54. Id. § 9-103(a)(2). See supra note 50.
56. It would appear that the cases construing former section 9-107 are still relevant here. U.C.C. Rev. § 9-103 cmt. 3. See, e.g., Chrysler Credit Corp. v. B.J.M., Jr., Inc., 834 F. Supp. 813, 830–31 (E.D. Pa. 1993) (finding a security interest not perfected when it was filed improperly), aff'd, 30 F.3d 1485 (3d Cir. 1994); In re Freeman, 956 F.2d 252, 255 (11th Cir. 1992) (holding that a "first in first out" payment allocation method is insufficient to determine which goods "secure their own purchase price"); MBank Alamo Nat'l Ass'n v. Raytheon Co., 886 F.2d 1449, 1452 (5th Cir. 1989) (finding that a credit advance does not create an interest in accounts receivable as collateral under the U.C.C.).
process everything. After this conversation, Farmer purchases a new tractor from Dealer on an unsecured basis.

July 6 Farmer obtains a loan and signs the security agreement granting Lender a security interest in the equipment as of July 6. Lender immediately issues Seller a check to pay for Debtor's purchase.

Did this loan enable Debtor to purchase the equipment? Would it make any difference if Farmer told Seller that the bank would loan him the money for the purchase on July 1 but that it would not be available until at least July 6?

Comment 3 to revised section 9-103 provides:

The concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price.57

Notwithstanding the comment, it appears that the enabling requirement raises a question of fact to be determined on a case-by-case basis. Moreover, the enabling requirement should not be rigidly construed to exclude all transactions where the debtor first acquired the collateral on an unsecured basis. This is particularly true if the seller would not have made the sale without the lender's commitment to make the loan. Certainly, the nexus between the purchase and the loan must be very close—months and years cannot pass. One of the architects of original Article 9, the late Grant Gilmore, argued in his treatise about Article 9 that "[i]f the loan transaction appears to be closely allied to the purchase transaction, that should suffice."58 While it is not clear what kind of proof would be required to tie the loan and the sale together, it would seem that a lender should be able to make its case if the loan and sale were virtually contemporaneous and both Seller and Debtor understood

57. U.C.C. Rev. § 9-103 cmt. 3.
58. 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 29.2 (1965).
that the sale would not happen without the loan. From a strategic standpoint, the lender should make the loan directly to the seller and before the acquisition.

C. Transformation and Dual Status

Under former section 9-107, questions arose concerning whether a properly created PMSI could be transformed into a non-PMSI when a refinancing or consolidation of debts occurred. For example, consider a refinancing. A debtor in financial difficulty gets the financing seller or lender to agree to reduce the amount of the monthly payments and extend the duration of debt. The refinancing is done by canceling the original security agreement and substituting a new security agreement embodying the new terms. Some courts held that such refinancing created a new loan and that the proceeds of the loan were not used to acquire rights in the collateral. Thus, no PMSI existed. Other courts disagreed. The transformation issue also arose under F9 when a seller who had a PMSI sold additional goods to the debtor, and the parties entered into a new security agreement covering the old and new debts and the old and new collateral (cross-collateralization). Again, some courts held that a transformation occurred, while others rejected the transformation rule in favor of the “dual status” doctrine. The “dual status” doctrine holds that the mere presence of a non-PMSI does not destroy the purchase-money aspect of the original transaction. Thus, a PMSI remained under the new security agreement to the extent that it

59. Former section 9-107(b) had the same enabling requirement as revised section 9-103(a)(2) and therefore should be considered. U.C.C. F. § 9-107(b); U.C.C. Rev. § 9-103(a)(2); supra note 50. See, e.g., Valley Bank v. Estate of Rainsdon, 793 P.2d 1257, 1262 (Idaho Ct. App. 1990) (finding the loan not enabling because Rainsdon already owned the cows); N. Platte State Bank v. Prod. Credit Ass'n, 200 N.W.2d 1, 5 (Neb. 1972) (finding that a loan given a month and a half after sale is not enabling).

60. E.g. In re Mathews, 724 F.2d 798, 800 (9th Cir. 1984) (holding that “refinancing or consolidating loans by paying off the old loan and extending a new one extinguishes the purchase money character of the original loan because the proceeds of the new loan are not used to acquire rights in the collateral”).

61. E.g. In re Billings, 838 F.2d 405, 409 (10th Cir. 1988) (holding that a finding that the “refinancing of a purchase money loan does not automatically extinguish the creditor’s purchase money security interest in the debtor’s collateral comports with the scheme of the UCC”); see also In re Hill, Nos. KS-97-099, 97-13437, 1998 WL 208809, at *2 (B.A.P. 10th Cir. Apr. 20, 1998) (holding that Kansas rejects the transformation argument).
secured the price of the original goods even though the security agreement also secured the price of other items.62

Revised Article 9 rejects the transformation rule in non-consumer cases. First, the basic definition of a PMSI in revised section 9-103(b)(1) recognizes the "dual status" rule by providing that a security interest in goods is a PMSI to the extent that the goods are purchase-money collateral; i.e., to the extent that the goods secure a purchase-money obligation incurred with respect to the goods. Revised section 9-103(f) specifically rejects the transformation rule in non-consumer transactions. It states:

[No loss of status of purchase-money security interest in non-consumer-goods transaction.] In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:
(1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;
(2) collateral that is not purchase-money collateral also secures the purchase-money obligation; or
(3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.63

A properly created PMSI is not destroyed when the purchase-money collateral also secures an obligation that is not a purchase-money obligation, when collateral that is non-purchase-money collateral also secures an obligation that is a purchase-money obligation, or when a purchase-money obligation has been renewed, refinanced, or consolidated. Thus, a security interest in collateral may be both a PMSI and a non-PMSI. This revision does not appear to change Kansas law.64

This "dual status" rule adopted by revised section 9-103(f) may present application problems. Consider the following hypothetical:

Jan. 1  Lender holds a PMSI in Equipment #1 to secure an enabling loan of $100,000. Debtor needs more money and refinancing.

62. E.g. Pristas v. Landau of Plymouth, Inc., 742 F.2d 797, 801 (3d Cir. 1984) (holding that "to apply the 'dual-status' doctrine, it is necessary to determine the extent to which a particular item continues to secure its own price and the extent to which payment of other purchases is affected").
63. U.C.C. Rev. § 9-103(f).
64. See supra note 61.
May 1 Lender makes another loan of $50,000, and a new security agreement reflecting the change is executed.

Nov. 1 Debtor defaults with an unpaid debt of $150,000, and Equipment #1 is worth $150,000.

Does Lender still have a PMSI?

Under revised section 9-103(b)(1), the PMSI continues to the extent that the good secures a purchase-money obligation incurred with respect to the good. Of the obligations secured by Equipment #1, only $100,000 is a purchase-money obligation under revised section 9-103(a)(2).65

Controversy regarding the extent to which a PMSI remains can also arise when a debtor makes a payment on the new loan. Continuing the above example, if Debtor makes a $10,000 payment on the $150,000 debt, one must determine the extent to which the security interest that remains is a PMSI. When the extent to which a security interest is a PMSI depends on the application of payments to a particular obligation, the payment must be applied in accordance with any reasonable method of application to which the parties agree (e.g., “FIFO” (first in, first out)).66 In the absence of agreement, the payments are applied to obligations that are unsecured.67 If more than one obligation is secured, they are applied to obligations secured by purchase-money interests in the order in which those obligations were incurred.68

A final comment must be made concerning Kansas’ version of R9 and consumer goods. As previously noted, R9 specifically restricts the rules dealing with dual status, transformation, and payment rules to commercial transactions. Revised section 9-103(h) states in relevant part:

The limitation of the rules in subsections (e), (f), and (g) [burden of proof] to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper

65. U.C.C. Rev. § 9-103(a)(2); see also id. cmt. 7 (discussing generally transformation and dual status).
66. Id. § 9-103(e)(1); see also id. cmt. 7 (discussing generally allocation of payments).
67. Id. § 9-103(e)(3)(A) and cmt. 7.b.
68. Id. § 9-103(e)(3)(B).
rule in consumer-goods transactions and may continue to apply established approaches.69

The Kansas legislature omitted the uniform version of revised section 9-103(h) from the Kansas Statutes Annotated.70 The negative inference is that the transformation rules, rules of application of payments, and burden of proof rules apply to consumer-goods transactions in Kansas. Careful consideration must be given to prior law, including the Uniform Consumer Credit Code,71 to determine if there are any conflicts. One potential conflict concerns multiple cross-collateral involving consumer credit sales and the application of payments to the debts.72

Under F9, many of the cases involving the issue of whether a PMSI existed or had been transformed into a non-PMSI involved consumer debt. Consumers filing a bankruptcy petition were interested in transforming a PMSI into a non-PMSI because current Bankruptcy Code section 522(f)73 permits the debtor (the person filing for bankruptcy) to avoid certain non-possessory non-PMSIs in consumer goods in certain exempt property.74 The Kansas rule dealing with the refinance of a consumer purchase money loan and an additional loan secured by the same collateral appears to be that the intent of parties determines whether a refinanced debt is transformed into a non-PMSI.75 Arguably, this rule has been changed by the Kansas Legislature's failure to include any language limiting the transformation rules of revised section 9-103 to non-consumer transactions. The Kansas version of revised section 9-103(g) provides that "[a] secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security

69. Id. § 9-103(h).
71. KAN. STAT. ANN. §§ 16a-3-301 to 16a-3-303 (2000).
72. Id. § 16a-3-302 ("[A] seller in a consumer credit sale may secure the debt arising from the sale by contracting for a security interest in other property if as a result of a prior sale the seller has an existing security interest in the other property."); id. § 16a-3-303 (providing that payments of debts arising from two or more consumer credit sales or debts consolidated into one debt are applied to debts arising from the sale first made).
74. See supra note 46 and accompanying text.
75. See In re Hill, Nos. KS-97-099, 97-13437, 1998 WL 208809, at *2 (B.A.P. 10th Cir. Apr. 20, 1998) (applying the rule that "intent of the parties determines whether a refinanced debt will retain its purchase money character"); In re Gibson, 16 B.R. 257, 266 (Bankr. D. Kan. 1981) (holding that "when notes are renewed or consolidated ... the original notes and security interests are not extinguished absent the intent to make a novation"); Fourth Nat'l Bank v. Hill, 181 Kan. 683, 695, 314 P.2d 312, 322 (1957) (demonstrating the intent requirement in chattel mortgage law, which was replaced by Article 9); see also In re Moody, 97 B.R. 605, 607 (Bankr. D. Kan. 1989) (holding "that if the original debt is refinanced by a third party, then the lien loses its purchase-money status").
interest is a purchase-money security interest.” While intent will play a part in determining the extent of a PMSI, it is not the controlling factor.76

Also, non-PMSIs in household goods are unenforceable under certain other federal rules. For example, the Federal Trade Commission’s Rule on Credit Practices make it an unfair act or practice for lenders or retail installment sellers to take a non-PMSI in household goods.77 Lenders are subject to similar rules.78 Finally, recall that in Kansas the Uniform Consumer Credit Code, sections 16a-3-301 to 3-303, regulates consumer credit sales, the application of payments if multiple PMSIs are involved, and cross-collateral situations, but does not affect consumer loans.79

D. Cross-Collateral, After-Acquired Property Clauses, and Purchase Money Financing of Inventory

Uncertainty existed under F9 when an inventory financier—who had a PMSI in a particular good that was sold and the proceeds of which were not used to extinguish the PMSI debt—tried to claim the PMSI debt was secured by other collateral. Consider this example:

Jan. 1
Secured Party (SP) loans Debtor (D) $3000, which enables D to buy IBM #1, and the money is in fact used to buy IBM #1. D specifically grants SP a security interest in IBM #1 and “in all inventory acquired in the future including but not limited to all after-acquired inventory financed by SP.”

Jan. 5
SP loans D $4000 to buy IBM #2, which D buys. SP signs the same agreement as on January 1 except the agreement now refers specifically to IBM #2.

76. See supra notes 64–65 and accompanying hypothetical. The creditor will have to trace the funds by showing that the debt, claimed to be a purchase-money debt, enabled the debtor to obtain the collateral. This tracing really does not involve the intent of the parties.
77. 16 C.F.R. § 444.2(a)(4) (2001).
78. See 12 C.F.R. § 227.13(d) (2001) (describing a similar provision for banks); id. § 535.2(a)(4) (describing a similar provision for savings associations).
Jan. 9  D buys from Apple Computer, Inc. five Apple computers for cash (not supplied by SP).

Feb. 1  D sells IBM #1 to a buyer "in the ordinary course" for cash, but does not use the cash to pay off the January 1 loan of $3000.

May 1  D defaults on its two loans, still owing $7000. D's inventory consists of IBM #2 and the five Apple computers.

Does SP have a $7000 PMSI in IBM #2, even though the unpaid debt for the computer is only $4000?

Under F9, it seems that SP could not have a PMSI in IBM #2 for the debt secured by IBM #1, which was sold because the debt and the collateral did not correspond with one another. The drafters of R9 appear to have specifically rejected the prior rule. Revised section 9-103(b)(2) states:

A security interest in goods is a purchase-money security interest . . . if the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest . . . .

In our example, the remaining IBMs are purchase-money collateral, and they secure the debt for the sold IBM because SP #1 "held" a PMSI in the computer before it was sold. SP #1 does not have a PMSI in the Apple computers because no money was supplied to purchase them. It should be noted that the secured party asserting a PMSI has the burden of proof.

In summary, absent the treatment of cross-collateral clauses in inventory financing in revised section 9-103(b)(2), the dual status approach would probably apply; and the inventory financier's security in-

80. U.C.C. F. § 9-107 (2000); id. cmts. 1–2; see also Southtrust Bank of Ala. v. Borg-Warner Acceptance Corp., 760 F.2d 1240, 1243 (11th Cir. 1985) (holding that "a PMSI requires a one-to-one relationship between the debt and the collateral").
81. See supra notes 47–59 and accompanying text.
82. U.C.C. Rev. § 9-103(g) (2000).
terest would only partially be a PMSI. The result would be the same if
the secured party had been a credit seller.83 Finally, revised section 9-
103(b)(2) only applies to collateral that is inventory. Thus, cross-
collateral clauses covering collateral such as consumer goods or equip-
ment are not covered by this section and must be measured against
other law.

Some have argued that under F9 the mere inclusion of an after-
aquired property clause84 in a security agreement creating a PMSI trans-
formed the PMSI into a non-PMSI. At least as to inventory that is or
has been subject to a PMSI, revised section 9-103(b)(2) clearly rejects
this argument. Revised section 9-103(f)(2) also rejects the automatic
transformation rule. It provides that ““[i]n a transaction other than a
consumer-goods transaction, a purchase-money security interest does
not lose its status as such, even if . . . collateral that is not purchase-
money collateral also secures the purchase-money obligation . . . .”85
Thus, for inventory and non-inventory, the inclusion of an after-
aquired property clause does not automatically destroy a PMSI. This is
also the case with the inclusion of a future advance clause.86

E. Purchase Money Security Interests in Software

While it was unclear under F9 what type of collateral was eligible to
be made subject to a PMSI, revised section 9-103 specifically provides
that a PMSI may only be created in goods and, in certain circumstances,
in software.87 In other words, the drafters decided not to permit a PMSI
in intangible collateral. The software must be related to the good that is
subject to a PMSI as specified in revised section 9-103(c). The debtor
must acquire an interest in the software through an integrated transac-
tion in which the debtor acquires an interest in the goods, and the inter-
est in the software must be acquired for the principle purpose of using
the software in the goods.88 Thus, a creditor who finances the debtor’s
acquisition of the goods and the related software can obtain a PMSI in

83. Id. § 9-103(b)(2) and cmt. 4.
84. See id. § 9-204(a) (“Except as otherwise provided in subsection (b), a security agreement
may create or provide for a security interest in after-acquired collateral.”).
85. Id. § 9-103(f)(2).
86. Id. §§ 9-204(c), 9-103(f)(1); see id. 9-102(a)(75) (defining the term “software”); supra note
49.
87. Id. § 9-103(c).
88. Id. § 9-103(c)(1), (2).
both. An example would be the purchase of a computer with certain installed software. However, it is very important to note that a computer program "embedded" in the goods is considered part of the goods. Examples of "embedded software" include the Basic Input Output System (BIOS) in a computer and the ABS brakes in most cars today. The definition of a good in revised section 9-102(a)(44) provides in relevant part:

The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded.

F. Consignments

The drafters of R9 were concerned that a consignment creates an ostensible ownership problem for a consignee's creditors. For example, a financier of a consignee's inventory might rely upon the consigned goods to extend further loans. Accordingly, revised section 9-109(a)(4) provides that R9 applies to a consignment. Revised Article 9 treats a consignment as the functional equivalent of a PMSI. Under revised section 1-201(37), the interest of the consignor is a security interest. The attachment, perfection and priority rules apply, while the default and enforcement rules of revised section 9-601 do not.

Revised section 9-102(a)(20) defines a consignment to be a transaction, regardless of its form, where: (1) a person delivers goods for sale to

89. Remember that the attachment and perfection requirements for both the good and the software must be satisfied. See supra notes 8 & 40.
90. Also note the definition of "general intangible" in revised section 9-102(a)(42), which includes software. See also id. § 9-102 cmts. 5.d. & 25. Finally, note that revised section 9-102 comment 4.a. states:
The definitions of "goods" and "software" are also mutually exclusive. Computer programs usually constitute "software," and, as such, are not "goods" as this Article uses the terms. However, under the circumstances specified in the definition of "goods," computer programs embedded in goods are part of the "goods" and are not software.

91. Id. § 9-102 cmt. 4.a.
92. Id. § 9-601(g).
a merchant\textsuperscript{93} who deals in goods of that kind under a name other than that of the person delivering; (2) the transaction does not create a security interest; (3) the merchant is not known by its creditors to be substantially engaged in selling the goods to others; (4) with respect to each delivery, the aggregate value of the delivered goods is $1000 or more at the time of delivery; and (5) the goods are not consumer goods\textsuperscript{94} immediately before delivery. Unfortunately, R9 fails to provide any guidance as to how one determines when a consignment-like transaction secures an obligation of the merchant; i.e., when a security interest is involved. This lack of guidance is surprising when one compares the elaborate provisions of revised section 1-201(37) defining when a lease creates a security interest.\textsuperscript{95}

Once the transaction is determined to be a consignment, the consignor (deliverer) is considered to have a PMSI in the inventory of the consignee (possessor) for purposes of R9. Accordingly, conflicts between the consignor and a creditor having a perfected security interest in

\textsuperscript{93} Id. § 2-104.

\textsuperscript{94} Id. § 9-102(a)(23).

\textsuperscript{95} Revised section 1-201(37) provides in part:

\begin{quote}
Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

(a) the original term of the lease is equal to or greater than the remaining economic life of the goods,

(b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,

(c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or

(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that

(a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,

(b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

(c) the lessee has an option to renew the lease or to become the owner of the goods,

(d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.
\end{quote}
the consignee merchant's inventory are governed by revised section 9-324(b).\textsuperscript{96}

In Kansas, R9 replaces chapter 84, section 9-114 of the Kansas Statutes Annotated and changes section 2-326 to be consistent with the U.C.C.'s new treatment of consignment. The major change in Kansas law is that a consignor can no longer defeat a perfected inventory financier of the consignee by showing that the consignor's interest was evidenced by a sign indicating the merchant sells consigned goods.\textsuperscript{97} The Kansas Legislature did not change its non-uniform provision in section 2-326(4) which provides that goods which were consumer goods before delivered to consignee cannot become the property of the consignee unless the consignee purchases and fully pays for them.\textsuperscript{98}

III. PMSI Priority Rules When the Conflict is Between a Prior Perfected Security Interest and a Perfected PMSI

A. Introduction

The basic priority rule when two perfected secured creditors claim the same collateral is that priority dates from the time a filing is first made or the time a security interest is first perfected, whichever is earlier. Consider this example:

Jan. 1   SP #1 loans money to D, who grants SP #1 a security interest (SI) in all equipment (EQ) D presently owns and any after-acquired equipment. D owns EQ #1. SP #1 perfects by filing a proper financing statement in the proper place.

Feb. 1   D purchases EQ #2 with cash not supplied by any creditor.

Feb. 9   SP #2 loans money to D, who grants SP #2 a SI in EQ #1 and EQ #2. SP #2 perfects by filing a proper financing statement in the proper place.

\textsuperscript{96} See infra Part B.3 (dealing with PMSIs in inventory). Conflicts between other creditors and buyers are governed by Revised Article 9.

\textsuperscript{97} 2000 Kan. Sess. Laws ch. 142 § 139.

\textsuperscript{98} Id.
Aug. 1 D defaults on both loans.

Who has priority?

SP #1 has priority as to both pieces of equipment. The basic priority rule when the conflict is between two perfected secured parties is that priority dates from the time a filing is first made so long as attachment occurs. This result is fair because SP #2 is deemed to know the first-to-file rule and could have learned of SP #1’s interest by checking under Debtor’s name for filed financing statements, which are of public record. The first-to-file rule also applies to after-acquired property. Priority dates from the time of filings, not perfection.99

PMSIs in certain circumstances are treated differently under R9 and given a priority often called a “super-priority.” For example:

Jan. 1 SP #1 loans money to D, who grants SP #1 a security interest (SI) in all equipment (EQ) D presently owns and any after-acquired equipment. D owns EQ #1. SP #1 perfects by filing a proper financing statement in the proper place.

Feb. 1 D purchases EQ #2 from seller, who obtains a PMSI and files a proper financing statement in the proper place.

Aug. 1 Debtor defaults on both loans.

Who has priority as to EQ #2?

Assuming that seller can establish a PMSI, seller will defeat SP #1 even though SP #1 has a perfected security interest in EQ #2 and filed first.100 In other words, the PMSI holder is given a super-priority.

Advocates of this change cite a variety of reasons for providing a purchase money creditor a super-priority over the first-to-file. The most common rationale is that this priority makes it possible for the debtor to obtain additional secured financing, and to break the monopoly power

100. See U.C.C. Rev. § 9-322(a), (f)(1) (defining priorities and limitations among conflicting security interests); see also infra note 106.
of the first-to-file secured creditor who will not provide additional financing.\textsuperscript{101} Some scholars argue that PMSI creditors should have a super-priority because they do not threaten preceding secured creditors as unsecured creditors would.\textsuperscript{102} Another broad reason is that the super-priority does not substantially impair the first-to-file secured creditors. These creditors can bargain for and obtain from the debtor covenants and “events of default” that prohibit or restrict the debtor from obtaining PMSI financing. Also, the PMSI financier supplies new value that must be used to obtain a new asset.\textsuperscript{103} And, as we will see, the inventory financier must be given notice by subsequent PMSI holders.\textsuperscript{104} This notice enables the inventory financier to protect itself.

Regardless of the reasons, R9, like F9, provides two ways to break the monopoly of the first-to-file or -perfect rule: a subordination agreement or proof of a PMSI.\textsuperscript{105} This part of the article will discuss revised section 9-324, which contains a set of rules that overrides the first-to-file or -perfect rules.

B. Conflicts Between a PMSI in Goods Other Than Inventory or Livestock and a Prior Perfected Security Interest in the Same Goods

Revised section 9-324(a), which in general tracks former section 9-312(4), provides that a perfected PMSI in goods other than inventory or livestock has priority over a conflicting security interest in the same goods or their identifiable proceeds, if the PMSI was perfected when the debtor obtained possession or within twenty days thereafter. Consider the following hypothetical:

101. See, e.g., Thomas H. Jackson & Anthony T. Kronman, Secured Financing and Priorities Among Creditors, 88 YALE L.J. 1143, 1167 (1979) (suggesting that “the purchase-money priority is best thought of as a device for alleviating the situational monopoly created by an after-acquired property clause”).

102. See, e.g., Philip Lacy, Conflicting Security Interests in Inventory and Proceeds Under the Revised Article 9 of the Uniform Commercial Code, 41 S.C. L. REV. 247, 277 (1990) (stating that first-to-file secured creditors are not substantially impaired because “the floating liener retains priority in collateral other than that financed by the purchase-money lender”); see also Hidecki Kanda & Saul Levmore, Symposium on Revision of Article 9 of the Uniform Commercial Code: Explaining Creditor Priorities, 80 VA. L. REV. 2103, 2138-41 (1994) (providing a law and economics perspective on this view).

103. U.C.C. Rev. § 9-103(a).

104. See id. § 9-324(b)(2)-(4) (defining the process by which the holder of a perfected PMSI must give notice to the holder of an otherwise perfected security interest in inventory).

105. U.C.C. F. §§ 9-312(3), 9-316 (2000); see U.C.C. Rev. §§ 9-324(a), 9-339 (defining the priority of a PMSI in former section 9-312(3) and revised section 9-324(a), and stating that a subordination agreement by a person entitled to priority is enforceable under the U.C.C. under former section 9-316 and revised section 9-339).
Jan. 2 Dealer borrows $100,000 from Bank for working capital and grants a security interest in "all equipment now owned or hereafter acquired." Bank perfects by filing a proper financing statement with the secretary of state on January 5.

Feb. 10 Dealer buys and takes delivery from ABC Manufacturing Co. of a new machine to be used in its business, and agrees to pay for the machine over four years. ABC obtains an enforceable security interest in the machine and files a proper financing statement in the proper place on February 15.

If Dealer goes broke, who has priority as to the new piece of machinery?

Under the first-to-file rule, Bank would win because its security agreement covered after-acquired property and because it filed first. However, ABC can defeat Bank by establishing all the requirements of revised section 9-324(a). First, ABC must establish a PMSI under revised section 9-103. ABC can do this because the new machine is "purchase-money collateral" for a "purchase-money obligation." The security interest secures Dealer's obligation to pay the purchase price.

Next, the machine is being used in Dealer's business and therefore is classified as equipment, not inventory. ABC also filed five days after Dealer took delivery, which is well within the twenty-day grace period. Thus, ABC has priority as to the machine because all the requirements of revised section 9-324(a) are satisfied. What if the machine were to be

106. U.C.C. Rev. § 9-324(a). This section provides:
[General rule: purchase-money priority.] Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in Section 9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.
107. Id. § 9-103(a)(1).
108. Id. § 9-103(a)(2); see supra notes 51–59 and accompanying text.
109. See U.C.C. Rev. § 9-102(a)(33) (giving the U.C.C. definition of "equipment"); id. § 9-102(a)(44) (defining "goods"); id. § 9-102(a)(48) (defining "inventory"); see also infra note 108 and accompanying text.
exchanged for Machine #2? Machine #2 is an identifiable proceed of the new machine.\textsuperscript{110} ABC’s super-priority continues under 9-324(a), which extends the super-priority to identifiable proceeds,\textsuperscript{111} assuming ABC’s security interest in proceeds is perfected.\textsuperscript{112}

Now assume the same basic facts of the above hypothetical except that on February 10, ABC delivered the machine to Dealer for testing to determine whether the machine would work for Dealer’s purposes. On March 1, Dealer decides to buy the machine and signs the installment contract, a proper security agreement, and a proper financing statement. On March 15, ABC files the financing statement. The issue raised here is whether ABC can establish that it perfected its security interest within twenty days of debtor receiving possession. Like F9, R9 does not define possession. This means that under R9, courts may look to common law rules as well as other provisions of the U.C.C. to determine what constitutes possession.\textsuperscript{113}

The question of when the debtor obtained possession for purposes of starting the twenty-day period running was frequently litigated under F9.\textsuperscript{114} A recent example is \textit{Citizens Bank of Americus v. Federal Financial Services, Inc.}\textsuperscript{115} In this case, the court held that, notwithstanding the fact that debtor had possession of the collateral for seven weeks, “possession” of the collateral is only established when the debtor acquires ownership of the collateral and executes a promissory note evidencing its obligation to pay the purchase price.\textsuperscript{116} Here the debtor obtained physical possession for demonstration purposes only, and the collateral was not owned by the debtor until the note and sale agreement were


\textsuperscript{111} Proceeds are broadly defined in revised section 9-102(a)(64) to include any property acquired upon the sale, lease, exchange, or other disposition of the collateral. The proceeds can be either cash, defined in revised section 9-102(a)(9), or noncash, defined in revised section 9-102(a)(58). Subsection 9 defines cash proceeds to mean “proceeds that are money, checks, deposit accounts, or the like.” \textit{id.} § 9-102(a)(9). “Identifiable” is not defined except as to commingled proceeds. See \textit{id.} § 9-315(b)(1)–(2) (defining when commingled proceeds are identifiable).

\textsuperscript{112} See \textit{id.} § 9-315(c)–(e) (defining how proceeds become perfected and unperfected).

\textsuperscript{113} See U.C.C. § 1-103 (stating that unless displaced by particular provisions of the U.C.C., common law principles of law and equity supplement the U.C.C.); \textit{see also} U.C.C. Rev. § 9-313(e), (f) (defining perfection of security interest when collateral is in the possession of a person other than the debtor and when a secured party delivers collateral to a person other than the debtor).

\textsuperscript{114} See, e.g., Brodie Hotel Supply, Inc. v. U.S., 431 F.2d 1316, 1318 (9th Cir. 1970) (defining “debtor” and explaining a debtor’s obligations); \textit{see also} Color Leasing 3, L.P. v. FDIC, 975 F. Supp. 177, 178 (D. R.I. 1997) (holding that the twenty-day period begins when the debtor establishes his obligation).


executed. This case represents the majority view under F9 that the key to possession was not when the debtor received physical possession of the collateral, but when the person possessing the collateral became a debtor. Former section 9-105(1)(d) defined a debtor as a “person who owes payment or other performance.”

While revised section 9-324(a) still provides that the twenty-day grace period begins to run from the time the “debtor” receives possession, the term “debtor” is defined differently. A debtor is, among other things, “a person having an interest . . . in the collateral, whether or not the person is an obligor . . . .” 117 Collateral is defined to mean “the property subject to a security interest.” 118 Obligor means, among other things, “a person that, with respect to an obligation secured by a security interest in . . . collateral, (i) owes payment or other performance of the obligation.” 119 Possession remains undefined.

Comment 3 to revised section 9-324 recognizes that a debtor may obtain physical possession of the good before deciding to buy the good on secured credit. It notes that a person can have possession of a good pursuant to a bailment or lease arrangement, and that neither a true bailment nor a true lease is governed by R9. 120 The comment goes on specifically to state: “Accordingly, the 20-day period in subsection (a) does not commence until the goods become ‘collateral’. . . . , i.e., until they are subject to a security interest.” U.C.C. section 1-201(37) defines “security interest” to mean “an interest in personal property or fixtures which secures payment or performance of an obligation.” Thus, it appears that the twenty-day period does not begin to run until a debtor-creditor relationship is created and the creditor has obtained a security interest which has attached under revised section 9-203. Attachment requires that the debtor have rights in the collateral, that value has been given, and that a proper authenticated agreement has been executed. 121 The issue of when the twenty-day period begins to run also arises if the

118. Id. § 9-102(a)(12).
119. Id. § 9-102(a)(59).
120. The owner of property that is placed in the possession of another person should file a financing statement if third parties could be misled. Such a filing will eliminate potential problems should the relationship change to a creditor-debtor one. Former section 9-408 and revised section 9-505 authorize consignors, bailors and lessors to file a financing statement. U.C.C. F. § 9-408 (2000); U.C.C. Rev. § 9-505.
121. U.C.C. Rev. § 9-203(a)-(b).
debtor physically receives goods that must be assembled and/or tested, or when the debtor takes possession of goods in stages.\textsuperscript{122}

In summary, on its face revised section 9-324(a) appears to be easily satisfied. The holder of a PMSI in non-inventory who files within twenty days of the debtor receiving possession of the collateral can defeat a prior perfected secured creditor without having to search the records to discover earlier secured creditors or to provide any notice to these creditors. It is probably easy for sellers to control when the debtor obtains possession and file before transferring the good. Lenders, on the other hand, face some dangers. First, they must prove that the advance was in fact used to purchase the good and that the loan enabled the debtor to buy the good, which normally requires that the good be purchased after the advance or substantially contemporaneously with it. Next, lenders must be certain when the debtor obtains possession of the goods and file within twenty days. The lender can avoid this issue by filing a financing statement before it releases any funds. Finally, another potential problem is the possibility that the previous secured creditor will declare the debtor in default when it learns of the lender’s PMSI.

C. Inventory

Revised section 9-324(b), which states the requirements for a PMSI holder in inventory to obtain a super-priority, is very similar to former section 9-312(3). Just as it has for non-inventory, the person asserting PMSI priority has the burden to prove that it has a PMSI in the appropriate inventory.\textsuperscript{123} However, unlike under revised section 9-324(a), an inventory PMSI holder must search the public records and give an appropriate written notice to the creditor who has a perfected security interest in the debtor’s inventory.\textsuperscript{124} The notice must state that the credi-

\textsuperscript{122} Courts struggled with this issue under Former Article 9. Compare \textit{In re Ultra Precision Indus.}, Inc., 503 F.2d 414, 417 (9th Cir. 1974) (holding that the time period did not begin to run until assembling and testing was complete), \textit{with In re Michaels}, 156 B.R. 584, 587 (Bankr. D. Vt. 1989) (holding that the time period began when the debtor had “physical control”). Revised Article 9’s response to these cases is found in revised section 9-324, comment 3, which concludes that in assembly and testing cases “the buyer ‘takes possession’ within the meaning of subsection (a) when, after an inspection of the portion of the goods in the debtor’s possession, it would be apparent to a potential lender to the debtor that the debtor has acquired an interest in the goods taken as a whole.”

\textsuperscript{123} U.C.C. Rev. § 9-324(b)(4). Inventory is defined in revised section 9-102(a)(48). See infra note 132.

\textsuperscript{124} Revised section 9-324(b) provides:

\textit{[Inventory purchase-money priority.]} Subject to subsection (c) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority
tor has or expects to obtain a PMSI in the debtor's inventory and describe the inventory. It is not clear how specific the description must be. Arguably, the "reasonably identifies" standard for security agreement descriptions of revised section 9-108(a) should be the benchmark. But note that revised section 9-108(b) gives examples of reasonable identification that include identification by type of collateral or by category. If the new inventory is not unique or easily identified, these two kinds of descriptions arguably do not help the existing creditor identify the goods subject to the PMSI. Given the very general description requirement under revised section 9-504 for financing statements, perhaps the drafters expected a general description to be sufficient because it would put the existing creditor on notice that another creditor might have a claim to some of debtor's inventory. Any reasonable creditor could investigate and could obtain the security agreement creating the PMSI. On the other hand, it is not unreasonable to require the PMSI holder to provide a specific description of the inventory in order to get a super-priority. In any event, an adequate written notice must be received by the prior perfected creditor within five years before the debtor receives possession of the inventory.\textsuperscript{125} The PMSI holder must also perfect before the debtor receives possession of the inventory.\textsuperscript{126} If these requirements are satisfied, the PMSI holder will have priority as to the financed inventory as well as to certain proceeds of the inventory.\textsuperscript{127}

---

over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in Section 9-330, and, except as otherwise provided in Section 9-327, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

1. the purchase-money security interest is perfected when the debtor receives possession of the inventory;
2. purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
3. the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and
4. the notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

\textit{Id.} § 9-324(b); \textit{Id.} cmt. 4 (explaining the notice requirement).

\textsuperscript{125} \textit{Id.} § 9-324 cmt. 5.

\textsuperscript{126} Revised section 9-324, comment 5, makes clear that a PMSI holder who holds a possessory PMSI in inventory that has not been delivered to the debtor does not have to give notice to earlier filers. This section codifies \textit{Kunkel v. Sprague National Bank}, 128 F.3d 636, 646 (8th Cir. 1997).

\textsuperscript{127} \textit{U.C.C. Rev.} § 9-324(b).
Unlike that for non-inventory, the definition of proceeds is quite limited. Proceeds include only identifiable cash proceeds\textsuperscript{128} received by the debtor on or before delivery of the inventory to a buyer, and chattel paper\textsuperscript{129} or instruments\textsuperscript{130} to the extent provided by revised section 9-330(b) and (e).\textsuperscript{131} If cash proceeds are deposited in a bank account, revised section 9-327 controls priority to the extent there is a conflict with the priority rules of revised section 9-324.\textsuperscript{132} If the bank where the deposit account is located has a security interest in the deposit account, it will trump the PMSI holder under revised section 9-327.\textsuperscript{133}

\textsuperscript{128} ld. § 9-102(a)(9) (defining “cash proceeds”); id. § 9-102(a)(64) (defining “proceeds”); see also supra note 111 (explaining revised section 9-102(a)).

\textsuperscript{129} In revised section 9-102(a)(11), “chattel paper” means:

- a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, . . . or a lease of specific goods . . . .

- The term does not include (i) charters or other contracts involving the use or hire of a vessel . . . .

\textsuperscript{130} ld. § 9-102(a)(11). If a transaction is evidenced by both a security agreement or lease and by an instrument or series of instruments, “the group of records taken together constitutes chattel paper.”

\textsuperscript{131} ld.

\textsuperscript{132} Revised section 9-102(a)(47) states:

- “Instrument” means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

\textsuperscript{133} ld. § 9-102(a)(47). The Kansas definition is different. The 2000 Kansas Session Laws, chapter 142 section 9-102(47), provide that “instrument” means a negotiable instrument, a writing that would otherwise qualify as a certificate of deposit (defined in subsection (j) of K.S.A. 84-3-104, and amendments thereto) but for the fact that the writing contains a limitation on transfer, or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment.”

\textsuperscript{134} The super-priority of a PMSI in inventory will carry over to proceeds consisting of chattel paper if the PMSI holder can satisfy the requirements of revised section 9-330. Under revised section 9-330(a), “[a] purchaser of chattel paper has priority over a security interest . . . . claimed merely as proceeds of inventory subject to a security interest if:” (1) the purchaser, acting in good faith and (2) in the ordinary course of his or her business, (3) gives new value, (4) takes possession of the paper, and (5) the paper itself does not indicate that it has been assigned to one other than the purchaser. Revised section 9-330(e) provides that for purposes of section 9-330(a), the holder of a PMSI in inventory is considered to have given new value. Thus, if the PMSI holder can establish the other requirements, its super-priority continues in the chattel paper.

\textsuperscript{135} ld. § 9-324 cmt. 8.

\textsuperscript{136} Unlike F9, R9 expands the scope of Article 9 to cover non-consumer deposit accounts as original collateral, i.e., not proceeds. Former Article 9 covered only deposit accounts containing proceeds from the sale or disposition of the original collateral. See id. § 9-101(a)(1) (specifying the scope of R9); id. § 9-101(d)(13) (stating that R9 does not apply to an assignment of a deposit account in a consumer transaction); id. § 9-109 cmt. 16 (stating that under R9, deposit accounts are governed by the common law). A deposit account is “a demand, time, savings, passbook or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.” ld. § 9-102(a)(29). This new definition makes clear that a non-negotiable
The following hypothetical illustrates the basic application of revised section 9-324(b).

Jan. 1 Jane Doe owns and operates a business that sells all kinds of computers. Bank loans money to Jane and obtains a perfected security interest in all of Jane’s certificate of deposit is a deposit account if it is not an instrument as defined in revised section 9-102(47) and U.C.C. section 3-104. But Kansas’ version of the definition of instrument in the Kansas Statutes Annotated, chapter 84, section 3-104 appears to continue to define an instrument for purposes of Article 9 to include a certificate of deposit, even if the certificate contains a provision limiting its transferability (i.e., the certificate is not a negotiable instrument under U.C.C. section 3-104). Kan. Stat. Ann. § 84-3-104 (1996).

The basic priority rule is found in revised section 9-327. A security interest held by a secured party having control of the deposit account has priority over a conflicting security interest held by a secured party that does not have control. Id. § 9-327(1). Security interests in deposit accounts may be perfected only by “control” of the account. Id. § 9-312(b)(1).

A secured party has control of a deposit account if: (1) the secured party is the bank with which the deposit account is maintained; (2) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or (3) the secured party becomes the bank’s customer with respect to the deposit account. Id. § 9-104(a). Once the secured party obtains control of the deposit account, its security interest is perfected. The security interest remains perfected so long as the secured party retains control. Id. § 9-314(b).

The following scenario illustrates security interests in a deposit account as original collateral: Debtor, a business, has a checking account with Bank. Bank can obtain a security interest in the value of the checking account. This is original collateral. Control is established when Bank obtains a security interest in the checking account. An authenticated security agreement is not required, but attachment must occur and a security agreement must exist.

This scenario explains security interests in a deposit account as proceeds: Capital Federal loans Debtor money and obtains a perfected security interest in Debtor’s inventory. Debtor sells the inventory for cash and deposits checks and cash into Debtor’s checking account with Bank. Assume that the only money deposited in the checking account comes from the sale of Debtor’s inventory. The checking account contains the proceeds of Capital Federal’s security interest in the inventory. Capital Federal has a perfected security interest in the proceeds. See id. § 9-203(f) (explaining that the attachment of a security interest in collateral gives the secured party the right to proceeds); id. § 9-315(a)(2) (stating that a security interest attaches to any identifiable proceeds of collateral); id. § 9-315(c)-(d) (explaining that a security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected, but will become unperfected in twenty-one days unless certain conditions are met).

A classic conflict arises when Debtor has granted Bank (in which the deposit account is maintained) a security interest in the checking account as original collateral and Capital Federal is also a secured creditor who has a perfected security interest in cash proceeds deposited in the deposit account. Unless a control agreement is executed between Bank or Capital Federal and the debtor, or Capital Federal becomes the customer of Bank for purposes of the checking account, Bank wins under revised section 9-327 because it has control. See id. § 9-327 (stating the rules of priority among conflicting security interests in the same deposit account); id. § 9-104 (explaining when a secured party has control of a deposit account). A similar rule exists for set-offs. Id. § 9-340.
present and after-acquired inventory. Jane has 100 IBM computers.

Jan. 20 Apple Computer gives an appropriate written notice to Bank that Apple intends to sell five Apple computers to Jane Doe on credit and obtain a perfected security interest in them. Apple also files a proper financing statement covering the five Apple Computers in the proper place.

Feb. 1 Apple Computer sells Jane five Apple Computers on credit, obtains from Jane a perfected security interest in all five, and delivers the Apples to Jane’s business.

Feb. 5 One Apple is sold to Joe, who pays with a Visa credit card, and another Apple is sold to Janet, who pays by check.

Feb. 6 One Apple is sold to Sid on credit. Sid is given ninety days to pay.

Feb. 10 Jane defaults on both loans. Her inventory consists of 100 IBM computers and two Apple computers. She has a Visa receipt showing the sale to Joe, Janet’s check, and a sales receipt showing the sale to Sid, who was given ninety days to pay.

Bank claims priority over everything under revised section 9-322(a) because it filed first as to the inventory, and this priority carried over to the proceeds.

What is Bank entitled to?

Bank is entitled to the 100 IBM computers because Apple does not have a security interest in the IBMs, and a perfected secured creditor
defeats an unsecured creditor. Assuming both creditors have perfected security interests in the two Apples, and that the check, Visa slip and Sid’s obligation are proceeds, Bank will prevail unless Apple can utilize revised section 9-324(b). Revised section 9-324(b) applies inasmuch as the computers are inventory because they are goods held for resale. Apple should win as to the two remaining Apples. Apple must establish a PMSI under revised section 9-103. Apple can do this because the Apple computers were “purchase-money collateral” for a “purchase-money obligation”; the security interest secures Dealer’s obligation to pay the purchase price. Apple can also establish the other requirements of revised section 9-324. It filed a proper financing statement before the debtor received possession of the inventory, and it gave appropriate written notice before the debtor received possession of the inventory.

While Sid’s obligation is a proceed of the inventory, it is classified as an account under R9 and is not covered by revised section 9-324(b).

134. See id. § 9-201(a) (explaining that unless a specific provision provides otherwise, a security agreement is effective according to its terms between parties, against purchasers of the collateral, and against creditors). The negative inference from revised sections 9-322(a)(2) and 9-317(a) is that if a perfected secured creditor can defeat a lien creditor that has an interest in specific property, it can surely defeat an unsecured creditor that has no interest in debtor’s property. See id. § 9-102(a)(52)(A) (stating that “[l]ien creditor’ means . . . a creditor that has acquired a lien on the property involved by attachment, levy, or the like”).

135. Revised Article 9 states:
“Inventory” means goods, other than farm products, which:
(A) are leased by a person as lessor;
(B) are held by a person for sale or lease or to be furnished under a contract of service;
(C) are furnished by a person under a contract of service; or
(D) consist of raw materials, work in process, or materials used or consumed in a business.
Id. § 9-102(a)(48).

136. See id. § 9-103(a)(1) (defining purchase-money collateral); see also id. § 9-103(a)(2) (defining purchase-money obligation); supra notes 50–59 and accompanying text.

137. Revised section 9-102(a)(2) defines the term “account,” and subsection (i) applies here. The definition is:
“Account”, except as used in “account for”, means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-
Revised section 9-324(b) provides a super-priority only for identifiable cash proceeds, which do not include accounts. "Cash proceeds' means proceeds that are money, checks, deposit accounts and the like." Thus, the first-to-file rule of revised section 9-322(a) controls, and Bank wins.

Revised Article 9 has broadened the definition of an account. Revised section 9 defines an account to mean, among other things, "a right to payment of a monetary obligation, whether or not earned by performance . . . (vii) arising out of the use of a credit or charge card or information contained on or for use with the card . . . ." Thus, if Jane has not received money for the Visa receipt, it will be classified as an account and the super-priority rule of revised section 9-324(b) will not apply, as the above discussion of Sid's obligation demonstrates. It is not clear whether the drafters focused on the fact that defining the right to payment represented by the use of a Visa credit card as an account may substantially limit a PMSI holder's right to identifiable proceeds because many people use the credit card as cash. Moreover, the definition of cash proceeds covers checks, which in many ways are not as close to true cash as an approved Visa card transaction is. It must also be noted that if the Visa card issuer has already transferred the payment to Jane's bank, the proceeds are now the deposit account. Arguably the payment is cash proceeds of the Apple, but was it received before delivery of the Apple to the buyer? No! In effect the payment is proceeds of an account. And as indicated above, R9 contains a new section dealing with deposit account priority issues. Finally, if one of the buyers of an Apple had paid in part by trading in some good, the super-priority would not apply to the trade-in, which is a non-cash proceed.

In summary, revised section 9-324(b) dealing with PMSIs in inventory is quite different from revised section 9-324(a)'s treatment of

credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

138. See supra note 111 (discussing "proceeds").
139. See supra note 132; see also supra note 111 (making the first-to-file rule applicable to perfected security interests in proceeds unless one of the special rules applies).
140. See supra note 111 (explaining revised section 9-102(a)).
PMSIs in non-inventory. First, revised section 9-324(b) provides no twenty-day grace period for filing; it requires the financing statement to be filed before the debtor obtains possession of the inventory.\textsuperscript{145} Next, the secured party must give an appropriate written notice before delivery of the goods.\textsuperscript{146} Lastly, revised section 9-324(b)'s treatment of proceeds is very different. The super-priority is generally limited to identifiable cash proceeds received on or before delivery of the inventory to a buyer.\textsuperscript{147}

\section*{D. Conflicts Between PMSIs in Software and Prior Perfected Security Interests}

As discussed earlier in Part II.B, a PMSI can be obtained in goods and included software if the debtor acquires the software for the principal purpose of using the software in the goods.\textsuperscript{148} Thus, a creditor who finances the debtor's acquisition of the goods and the related software can obtain a PMSI in both, assuming the description in the security agreement covers the goods and the software. Likewise, a prior perfected creditor can obtain a perfected security interest in both the goods and software. Conflicts between the first-to-file and the subsequent PMSI holder are resolved under revised section 9-324(f). This section provides that the holder of a PMSI in software has priority in the collateral and identifiable proceeds to the extent provided for under the other relevant subsections of revised section 9-324. Thus, revised section 9-324(a) applies if the good containing the software is non-inventory, and revised section 9-324(b) applies if the good containing the software is inventory to the debtor. If both creditors have a PMSI, revised section 9-324(g) (discussed below) applies.\textsuperscript{149} Again, the creditor must obtain a perfected PMSI in both the goods and the software.

\section*{E. PMSIs in Livestock and Prior Perfected Security Interests}

Revised Article 9 changes the priority rule governing conflicts between a PMSI in livestock that are farm products\textsuperscript{150} and prior perfected

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.} § 9-324(b).
\item \textit{Id.}
\item \textit{Id.}
\item \textit{See supra} notes 89–90 and accompanying text.
\item \textit{See infra} Part II.B.7.
\item Revised section 9-102(a)(34) provides:
\end{enumerate}
\end{footnotesize}
security interests in the same livestock. Former Article 9 had no special rule for livestock and treated livestock that were farm products as non-inventory. Under revised section 9-324(d), livestock that are farm products are generally treated like inventory. Revised section 9-324(d) provides that a “purchase money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock” and in their identifiable proceeds (subject to the rights of a lender with a security interest in deposit accounts), and in “identifiable products in their unmanufactured states.” In order to qualify for the purchase money priority, the secured party must meet several requirements: (1) the purchase money security interest must be perfected before the debtor receives possession of the livestock; (2) the purchase money secured party must send an authenticated notification to the holder of the conflicting security interest; (3) the holder of the conflicting security interest must receive the notification within six months before the debtor receives possession of the livestock; and (4) the notification must state that the purchase money secured party has or expects to acquire a purchase money security interest in the described livestock of the debtor. 151

A few potential issues with revised section 9-324(d) merit discussion. The first concerns compliance with the notice requirements. Questions may arise as to the adequacy of the description of the livestock in the notice that must be sent to earlier-filed secured creditors. Revised section 9-324(d)(4), like revised section 9-324(b)(4) covering inventory, requires in part that the notice “describes the livestock [inventory].” 152 Because the language is exactly the same as that in revised section 9-324(b) dealing with inventory, the earlier discussion of notice requirements for inventory also applies here. The comments to revised section 9-324 raise another issue concerning notice: where must the notice be sent? Comment 6 to revised section 9-324 specifically provides

“Farm products” means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(A) crops grown, growing, or to be grown, including:
   (i) crops produced on trees, vines, and bushes; and
   (ii) aquatic goods produced in aquacultural operations;

(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(C) supplies used or produced in a farming operation; or

(D) products of crops or livestock in their unmanufactured states.

U.C.C. Rev. § 9-102(a)(34). Revised section 9-102(a)(35) states that “‘farming operation’ means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.”

151. Id. § 9-324(d).

152. Id. § 9-324(d)(4). See supra notes 124, 126 and accompanying text.
that the PMSI holder complies with the notice requirements if notice is sent to the address found on the earlier secured creditor's filed financing statement, even if that address turns out not to be current or accurate. This issue can also arise with respect to inventory.

The scope of revised section 9-324(d) is not entirely clear. The collateral must be livestock that are farm products, and this term is defined. For a good to be a "farm product," the debtor must be engaged in a farming operation, and the good must be a crop, aquatic good produced in an aquacultural operation, livestock including aquacultural operations, supplies used in a farming operation, or products of crops or livestock.\(^{153}\) A farming operation is defined as "raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation."\(^{154}\) Courts struggled with what constituted a farming operation under F9, which defined farm products in the same way as R9 except that the debtor had to have possession and there was no reference to aquaculture.\(^{155}\) Some courts narrowly construed the term "farming operation" by limiting it to a traditional farming operation, while others defined it more broadly.\(^{156}\)

\(^{153}\) Comment 4.a. to revised section 9-102 states that "the terms crops and livestock are not defined." Revised section 9-102(a)(34) defines farm products. See supra note 150.

\(^{154}\) U.C.C. Rev. § 9-102(a)(35).

\(^{155}\) Compare U.C.C. F. § 9-109(3) (2000) (defining farm products to require that the debtor have possession), with U.C.C. Rev. § 9-102(a)(35) (expanding the definition to include reference to aquaculture).


Part-time farmers can operate a farming operation. See 11 U.S.C. § 101(17) (1994) (defining farmer based on percentage of income); see also Blease, 24 U.C.C. Rep. Serv. at 454 (holding that "equipment must be used directly to perform tasks customarily done on farms"); Armstrong v. Corn Belt Bank, 55 B.R. 755, 761 (D. Ill. 1985), aff'd, 812 F.2d 1024, 1027 (7th Cir. 1987) (stating that rent income does not make lessor a farmer); In re Dakota Lay'd Eggs, 57 B.R. 648, 656 (Bankr. D. N.D. 1986) (holding that "the determination must be made by considering the character of the business" and the source of its income).

A number of courts have considered the farming operation issue. See In re Houts, 31 U.C.C. Rep. Serv. 338, 344–45 (N.D.N.Y. 1981) (holding that a tree and landscaping nursery is a farming operation); see also In re Frazier, 16 B.R. 674, 681 (Bankr. N.D. Tenn. 1981) (holding that caring for trees and shrubs is a farming operation). But note that in Frazier, plants and shrubs in cultivation were farm products, whereas mature and ready-for-sale stock was inventory. Frazier, 16 B.R. at 681. For cases dealing with breeding syndicators, see Estate of A.R. Levis v. Blankinship-Cooper, Inc., 43 B.R. 231, 236 (Bankr. N.D. Tex. 1984) (holding that breeding rights in a horse were properly characterized as goods); North Ridge Farms, Inc. v. Trimble, 37 U.C.C. Rep. Serv. (CBC) 1280,
Revised Article 9 does not define "livestock." The term clearly includes all types of cattle such as bulls, steers, heifers, cows, dairy cows, pigs, and sheep. But what about poultry, ostriches, domestic deer, or exotic animals such as llamas? The definition of farm products which refers to livestock, including aquatic goods produced in aquacultural operations, suggests that the drafters contemplated a broad definition of livestock. The comments to F9 indicate that livestock included fowl under that version of Article 9. Interestingly, most farmers would not use the term livestock to cover poultry. While the Official Comments to revised section 9-324 do not refer to fowl, it seems clear that there was no intent to change the law in this area. Comment 11 to revised section 9-324 discusses aquatic goods, such as catfish raised on a catfish farm, and includes some interesting language. It notes that, while catfish are farm products within the definition of "farm products," the definition does not indicate whether they are crops or livestock. This question must be resolved by the courts on a case-by-case basis. The negative inference is that courts will determine in all cases whether a farm product is a crop or livestock. In addition, comment 4.a. to revised section 9-102 specifically states that the terms "livestock" and "crops" are not defined.

The priority rule of revised section 9-324(d) expressly states that it applies only to livestock that are "farm products." Accordingly, this section implies that livestock may yet be "inventory" under R9. This is the case if such livestock are held by a debtor other than a debtor engaged in farming operations. While this status is not as significant as

---

1286 (Ky. Ct. App. 1983) (stating that horse owners who race horses do not run a farming operation); In re Bob Schwermer & Assoc., Inc., 27 B.R. 304, 308 (Bankr. N.D. Ill. 1983) (stating that race horses are not farm products).


157. Dictionary definitions of the term "livestock" vary. For example, the MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (10th ed. 1999), defines livestock as "animals kept or raised for use or pleasure; esp: farm animals kept for use and profit." The 1984 WEBSTER'S NEW WORLD DICTIONARY (2d ed. 1984) defines livestock as "domestic animals," the first definition of animals being "any living organism except a plant or bacterium" and the second definition referring to "any such organism other than a human being, esp. a mammal or, sometimes any four-footed creature."

158. See U.C.C. F. § 9-109 cmt. 4 (providing that livestock includes fowl).

159. U.C.C. Rev. § 9-324 cmt. 11.

160. Id.

161. Id. § 9-102 cmt. 4.a.

162. Id. § 9-324(d).

163. While running a feedlot is a farming operation, cattle trading is not. See Security Nat'l Bank v. Bellville Livestock Comm'n Co., 619 F.2d 840, 850 (10th Cir. 1979) (holding that because the debtor was a cattle feeder rather than a cattle trader, his cattle should have been considered "farm products"); Farmers State Bank v. Webel, 446 N.E.2d 525, 529 (Ill. App. Ct. 1983) (holding that a
it was under F9 in that inventory and livestock are generally treated the same, the devil is in the details. Revised sections 9-324(b) and (d) differ as to the length of the effectiveness of notice (five years for inventory and six months for livestock). Proceeds are also treated differently. The super-priority rule governing livestock extends to all “identifiable proceeds,” which presumably would include amounts owed by a livestock processor to a debtor who has sold livestock but will be paid after delivery of the livestock to the processor. The priority also extends to all identifiable products in their unmanufactured states. Conversely, the purchase-money priority rule for inventory extends only to “identifiable cash proceeds . . . to the extent . . . received on or before the delivery of the inventory to a buyer.” And, a security agreement description or a financing statement description which describes the collateral as “all farm products” will be fatally defective if the collateral is determined to be inventory.

F. Purchase Money Security Interest in Crops

All types of crops grown, growing or to be grown are treated as personal property under Article 9 and can be made subject to a perfected

business that bought and sold feeder pigs was a marketing agency within the meaning of the Comment to U.C.C. section 9-109, and that the business was therefore selling inventory and not farm products; see also Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099, 1102 (8th Cir. 1970) (holding that the plaintiff cattle-owner’s “fattening’ of livestock [fell] within the explicit terms of [U.C.C. section 9-109(3)]”); Burlington Nat'l Bank v. Strauss, 184 N.W.2d 122, 125 (Wisc. Ct. App. 1971) (holding that “[l]ivestock whether it makes sense to a dairy farmer or not, is classified as ‘farm products’ and not as inventory by sec. 409.109(3)” of the Wisconsin code); cf. Mountain Credit v. Michiana Lumber & Supply, 498 P.2d 967, 969 (Colo. Ct. App. 1972) (holding that a logging operation was not a farming operation); In re Maike, 77 B.R. 832, 839 (Bankr. D. Kan. 1987) (holding that a puppy kennel was a farming operation).

It should also be noted that cattle cease to be classified as farm products and become part of the packer’s inventory after they have been slaughtered and packed, notwithstanding the fact that there was an oral agreement between the seller and the packer that title would not pass and price would not be determined until carcass grade was determined. First Nat'l Bank v. Smoker, 286 N.E.2d 203, 209 (Ind. Ct. App. 1972); see also In re Underbakke, 60 B.R. 705, 708 (Iowa 1986) (concluding that farm products include milk). Former U.C.C. section 9-109(3) defines farm products to include milk, and read together with section 522(b)(1) of the Bankruptcy Code, this section leads to the conclusion that a secured creditor who has a perfected security interest in the debtor’s cows and their milk prepetition has a continuing interest in the milk produced post-petition. 11 U.S.C. § 522(b)(1) (1998); U.C.C. F. § 9-109(3). Revised 9 does not change this result.

164. U.C.C. Rev. § 9-324(d).
165. Id.
166. Id. § 9-324(b).
security interest. When more than one secured creditor claims an interest in the same crops for production expenses, such as fertilizer, chemicals, pesticides, fuel, and seed, the normal first-to-file rule governs unless some special provision applies. Revised Article 9 has no special PMSI provision for crops. Accordingly, a farmer financier who obtains a security interest in a farmer's present and future crops and files a proper financing statement has continual priority for five years, absent subordination. This conflict can arise in a number of situations. Consider the following examples:

Feb. 1, 2000  Bank loans Producer $40,000 to be used to produce his 2000 corn crop and for other operating expenses. Producer signs a proper security agreement granting Bank a security interest in this 2000 corn crop and any crops to be produced in the next four years. A proper financing statement is filed in the proper place.

April 1, 2000  Producer buys $10,000 worth of seed and chemicals from the local co-op elevator on credit and grants Elevator a perfected security interest only in his 2000 corn crop.

Sept. 1, 2000  Producer defaults on his obligations to both Bank and Elevator. Assume Producer made no payments to Bank or Elevator and that the crop is worth $40,000 and $30,000 of the Bank's loan was used for crops and $10,000 for other expenses.

Who wins?

Because R9 has no special PMSI provision for crops, Elevator, who has a PMSI in the crops, loses to Bank who filed first and has priority over Elevator as to $40,000 under revised section 9-322(a)(1).

168. Id. §§ 9-102(a)(44)(iv), 9-334(i); U.C.C. F. §§ 9-105(b), 9-203; see also Moritz Implement Co. v. Matthews, 265 Kan. 179, 185, 959 P.2d 886, 890 (1998) ("[A]ll forms of crops . . . are personal property"); U.C.C. § 2-105(1) (defining "goods" to include "the unborn young of animals and growing crops").

169. U.C.C. Rev. § 9-322.
Now consider this second example:

May 1, 2001  Producer in the above example is still in default on its obligations to both Bank and Elevator.  
Producer obtains from PCA a $40,000 loan to produce his 2001 corn crop.  PCA obtains a perfected security interest in the 2001 corn crop.

May 4, 2001  Producer plants the 2001 corn crop.

Sept. 1, 2001  Producer defaults on his obligation to PCA.  
PCA is owed $40,000, Bank is owed $40,000 from the 2000 loan, and the 2001 crop is worth $40,000.  
Bank and PCA claim priority in the 2001 crop.

Under former section 9-312(2) it was possible for a creditor supplying the credit for the purchase of inputs—including seed, fertilizer, and chemicals—to obtain a PMSI and a super-priority over a prior perfected secured creditor in limited circumstances. The crop production financier was required to meet the following criteria: (1) it must have had a perfected PMSI in the crops; (2) it must have given new value in the form of a loan or credit sale to enable the debtor to produce the crops during the current production season; (3) it must not have given the value more than three months before the crops became growing crops; and (4) the obligation owing to the prior perfected secured party must have been overdue more than six months before the crops became growing crops. Thus, this rule made it possible, in limited circumstances, for a farmer who was in default on a loan from a lender with a perfected security interest in present and after-acquired crops to obtain

170.  U.C.C. F. § 9-312(2).
171.  Id.  A Kansas Bankruptcy court once held that a production lender had priority over a prior perfected secured party to the extent of new value given to debtors for production costs, and that the six-month requirement was satisfied because one of debtor's installment payments to the prior creditor was more than six months past due.  In re Cress, 89 B.R. 163 (Bankr. D. Kan. 1988); see also Salem Nat'l Bank v. Smith, 890 F.2d 22, 23 (7th Cir. 1989) (holding that a production loan has priority to the extent the earlier interest secures obligations due more than six months before the crops were planted).
production financing for a new crop. In the second example above, PCA would have prevailed over Bank under former section 9-312(2) even though Bank has a perfected security interest in the 2001 crop because Bank’s security agreement covered after-acquired property, and Bank filed first. PCA has a perfected PMSI in crops. It supplied credit to enable the debtor to produce a crop during the current production year, the credit was extended within three months of the crop becoming growing, and debtor had been in default on his obligation to Bank more than six months before the corn crop was planted. On the other hand, Bank would win under revised section 9-322(a)(1). This means that as long as Bank’s debt remains unpaid and its financing statement is effective, Producer will probably be unable to obtain financing for a new crop unless Bank will forgive the unpaid debt or subordinate, or unless Producer is able to use some legal remedy such as a bankruptcy reorganization.

During the revision process, a number of groups, including farmers and input suppliers, argued that R9 should include a provision that gave special protection to creditors supplying production money. In essence, these groups argued that crops should be treated like livestock and inventory. Those opposed argued, among other things, that unlike PMSIs in inventory and livestock, the new value supplied for crop production inputs cannot easily be traced to identifiable new collateral obtained by the debtor. They also argued that less credit would be available to farmers because the general financier of a producer normally lends money for more than just production inputs and relies upon the excess proceeds of a crop over production costs to secure the underwriting of the entire lending relationship. Moreover, lenders and suppliers are working out a system to deal with production input financing. Finally, the opponents noted that lenders have an overall experience with the producer and look at the big picture, as opposed to agricultural suppliers who are often interested only in facilitating the sale of their products and do not necessarily have an over all understanding of the debtor’s financial situation. The drafters of R9 decided not to add a special provision for creditors supplying production inputs because no consensus was reached regarding the appropriateness of a special priority for production-money financing. The drafters, apparently convinced that former section 9-312(2) was ineffective and difficult to understand and apply,
eliminated it without replacing it.\textsuperscript{172} Consequently, the first-to-file rule applies to conflicts concerning crops, even when a subsequent creditor could establish a PMSI in the crops.

The drafters did create a so-called Model Provision for Production-Money Priority, which is found in Appendix II to Revised Article 9.\textsuperscript{173}

\textsuperscript{172} The author was a member of the Article 9 Task Force of the Subcommittee of Agricultural and Agri-Business Financing of the Committee on Commercial Financial Services of the Business Law Section of the American Bar Association. The Reporters involved in the drafting of R9 did not have much understanding or background in agriculture financing and met with the committee and representatives of the Task Force a number of times. The Reporters and the drafting committee were given a final report that made clear that the Task Force could not reach consensus on section 9-312 and that many of the committee members believed that 9-312(2) was unworkable. The final version of R9 did not include former section 9-312(2) or a similar provision and it seems clear that the drafting committee concluded that it was too controversial given the strong diversity of opinion as to the need for this type of provision. See Final Report, Recommendation No. 8 Working Document No. 6-48 of the Article 9 Task Force of the Subcommittee of Agricultural and Agri-Business Financing of the Committee on Commercial Financial Services of the Business Law Section of the American Bar Association p. 6. (Materials on file with the author).

\textsuperscript{173} Appendix II is much broader than former section 9-312(2) in that it does not require the debtor to be in default on a previous debt. The provisions of the appendix are analogous to the PMSI rules for inventory and livestock under revised section 9-324(b) and (d), but more complex. The text of Appendix II follows. It is discussed in an article by Jason Finch, The Making of Article 9 Section 9-312(2) into Model Provision Section 9-324A: The Production Money Security Interest: Finally a Sensible "Superpriority" for Crop Finance, 5 Drake J. Agric. L. 381 (2000).

APPENDIX II. MODEL PROVISIONS FOR PRODUCTION-MONEY PRIORITY

Legislative Note: States that enact these model provisions should add the following definitions to Section 9-102(a) following the definition of "proceeds" and preceding the definition of "promissory note," renumbering paragraphs in 9-102(a) accordingly:

(1) "Production-money crops" means crops that secure a production-money obligation incurred with respect to the production of those crops.

(2) "Production-money obligation" means an obligation of an obligor incurred for new value given to enable the debtor to produce crops if the value is in fact used for the production of the crops.

(3) "Production of crops" includes tilling and otherwise preparing land for growing, planting, cultivating, fertilizing, irrigating, harvesting, and gathering crops, and protecting them from damage or disease.


(a) A security interest in crops is a production-money security interest to the extent that the crops are production-money crops.

(b) If the extent to which a security interest is a production-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) in accordance with any reasonable method of application to which the parties agree;

(2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order: (A) to obligations that are not secured; and

(B) if more than one obligation is secured, to obligations secured by production-money
While it was not included in the Uniform Act, there was sufficient interest in a scheme that provided special priority to production input suppliers that the drafters of R9 felt it appropriate to give states who might want to deal with this issue a suggested model provision. Kansas, along with most states, did not adopt Appendix II.174

G. Conflicts between Two Perfected PMSI Holders

It is possible for conflicts between two perfected PMSI holders to arise in two situations where Debtor acquires a good subject to a PMSI. One is when a seller and lender each has a PMSI. Consider this example:

July 2, 2001  John Deere Dealer agrees to sell Farmer a $50,000 new tractor on terms calling for 20% down, with the remaining $40,000 to be paid over four years. Bank files a proper financing statement in the proper place, issues a $10,000 check payable to Dealer, and obtains a security interest in the tractor.

July 4, 2001  Farmer signs the installment contract granting Dealer a security interest, and Dealer files a proper financing statement in the proper place and delivers the tractor to Farmer.

security interests in the order in which those obligations were incurred.
(c) A production-money security interest does not lose its status as such, even if:
(1) the production-money crops also secure an obligation that is not a production-money obligation;
(2) collateral that is not production-money crops also secures the production-money obligation; or
(3) the production-money obligation has been renewed, refinanced, or restructured.
(d) A secured party claiming a production-money security interest has the burden of establishing the extent to which the security interest is a production-money security interest.

Legislative Note: This section is optional. States that enact this section should place it between Sections 9-103 and 9-104 and number it accordingly, e.g., as Section 9-103A or 9-103.1.

174. At least Idaho, Maine, Mississippi, North Carolina, Vermont, Wisconsin, and Wyoming have adopted some form of Appendix II. E-mail from John M. McCabe, NCCUSL Legislative Director/Legal Counsel, to Keith G. Meyer, Professor of Law, University of Kansas School of Law (Oct. 6, 2001, 07:07 CST) (on file with author).
July 7, 2002  

Farmer defaults on both the loan and the installment contract, and the tractor is only worth $40,000 while Bank is owed $10,000 and Dealer $40,000. Assume that each has a PMSI to the extent of the credit supplied.

Who has priority?

Former Article 9 provided no clear answer. Three possibilities existed: (1) priority could be based on the first-to-file rule; (2) priority could be awarded to a favored type of PMSI holder; and (3) PMSI holders could rank equally and priority could be awarded on a pro rata basis. Most courts used the first-to-file rule on the theory that this was the default rule under former section 9-312(5). Revised Article 9 endorses possibility number two above and awards priority to the seller. Specifically, revised section 9-324(g)(i) provides that if one of the PMSIs is held by a seller, the seller PMSI gets priority over a lender PMSI. Thus, in the hypothetical above, Dealer gets 100% of its unpaid debt satisfied while Bank gets nothing. Interestingly, the drafters in Comment 13 rely on the Restatement (Third) of the Law of Property Mortgages to support this seller-preferred rule, notwithstanding the fact that Article 9 does not apply to pure real estate transactions. The Comment states:

[T]he equities favor the vendor. Not only does the vendor part with specific real estate rather than money, but the vendor would never relinquish it at all except on the understanding that the vendor will be able to use it to satisfy the obligation to pay the price. This is the case even though the vendor may know that the mortgagor is going to finance the transaction in part by borrowing from a third party and giving a mortgage to secure that obligation. In the final analysis the law is more sympathetic to the vendor's hazard of losing real estate previously owned than to the third party lender's risk of being unable to collect from an interest in real estate that never previously belonged to it.

175. U.C.C. F. § 9-312(5).
176. See, e.g., John Deere Co. v. Production Credit Ass'n, 686 S.W.2d 904, 907–98 (Tenn. Ct. App. 1984) (ruling that two conflicting PMSIs were governed by the first-to-file or -perfect rule).
177. U.C.C. F. § 9-312(5) (providing that unless otherwise provided, conflicts between perfected secured creditors are controlled by the first-to-file or -perfect rule).
179. Id. § 9-324 cmt. 13.
The other situation involving a conflict between two PMSIs is where two lenders each have a PMSI. Here, the first-to-file or -perfect rule applies. In short, a PMSI for the seller will have priority over an enabling loan. Multiple PMSI loans will rank in order of filing.

It must be noted that Revised Article 9 is arguably inconsistent in its priority rules among multiple PMSIs. For example, priority in investment property under revised section 9-328(1) is given to the secured party who has control. Revised section 9-328(2) goes on to provide that if two or more secured parties have control, priority is determined by who obtained control first. Under revised section 9-328(6), priority is awarded on a pro rata basis among creditors when perfection occurs without control and the debtor is a broker or securities intermediary. In fact, revised section 9-328 does not recognize purchase-money security at all in the way that revised section 9-324(a) recognizes it for goods. Remember also that revised section 9-327(4), dealing with priority as to deposit accounts, gives a secured party who has perfected by control priority over a bank that has perfected first by filing.¹⁸¹

H. Conflicts Between a PMSI in Fixtures and a Real Estate Encumbrancer or Owner of Real Estate

Except for construction mortgages,¹⁸² a PMSI in fixtures has priority over a real estate encumbrancer or an owner of real property if the debtor is in possession of the real estate or has an interest of record and the PMSI is perfected by a fixture filing¹⁸³ made before the goods become fixtures or within twenty days thereafter.¹⁸⁴ Revised Article 9 defines a fixture to be “goods that have become so related to particular real property that an interest in them arises under real property law.”¹⁸⁵ Thus, local law controls what constitutes a fixture.¹⁸⁶ Common examples of fixtures include furnaces, built-in window air conditioners, built-in dishwashers, and curtain rods. This conflict arises when Debtor fi-

---

¹⁸⁰. Id. § 9-324(g)(2).
¹⁸¹. U.C.C. Rev. § 9-327(4); see supra note 130 and accompanying text.
¹⁸². U.C.C. Rev. § 9-334(b).
¹⁸³. See id. § 9-102(a)(40) (defining a fixture filing as “the filing of a financing statement covering goods that are or are to become fixtures and satisfying section 9-502(a) and (b). The term includes the filing of a financing statement covering goods of a transmitting utility which are or are to become fixtures.”).
¹⁸⁴. Id. § 9-334(d).
¹⁸⁵. Id. § 9-102(a)(41).
¹⁸⁶. See id. § 9-102(a)(41) (providing that state real property law determines what is a fixture).
nances the purchase of a house by borrowing money from Bank and signs a properly recorded real estate mortgage granting Bank an interest in the house. A year after the purchase, the furnace fails, and Debtor buys a furnace from Seller pursuant to an installment sales contract. Debtor grants Seller a PMSI in the furnace, and Seller makes a fixture filing before the furnace is installed. If Debtor defaults on both obligations, Seller has priority as to the furnace.\footnote{U.C.C. Rev. § 9-334(d).} It bears repeating that a fixture filing must be made before the good becomes a fixture or within twenty days.\footnote{Id. § 9-334(d)(3).} As to real property interests that arise subsequent to the goods becoming fixtures, the fixture financier will win so long as it has made a fixture filing \emph{any time before} the subsequent real estate interest arises.\footnote{Id. § 9-334 cmt. 7 (emphasis added).}

Another exception to the first-to-file rule is provided for a PMSI in readily removable replacements of domestic appliances that are consumer goods.\footnote{See id. § 9-102(a)(23) (defining consumer goods as "goods that are used or bought for use primarily for personal, family, or household purposes").} Under revised section 9-334(e)(2)(C), a perfected security interest in a fixture has priority over a conflicting interest in real property if, "before the goods become fixtures, a security interest is perfected by \emph{any method permitted}" by R9 and the fixtures are replacements of readily removable domestic appliances that are consumer goods.\footnote{Id. § 9-334(e)(2)(C) (emphasis added).} This rule does not apply to original installations.\footnote{Id. § 9-334 cmt. 8.} The principal effect of this rule is that a secured creditor financing a consumer's purchase of a replacement appliance, such as a built-in dishwasher, does not have to worry about prior recorded real estate interests.\footnote{Id.} Moreover, assuming a PMSI in a consumer good, perfection is automatic upon attachment, and no financing statement needs to be filed.\footnote{Id. §§ 9-309(1), 9-310(b)(2), 9-334 cmt. 8; see also id. § 9-203(b) (stating the rules of attachment and enforceability).}

Consider this illustration:

Joe purchases a ten year-old house. The house is a duplex, or a two-family dwelling. Joe lives in one part and leases out the other. The built-in dishwashers in both units have to be replaced. Joe purchases two dishwashers from ABC Appliances
on credit and signs an installment sales contract. He also signs a proper security agreement granting ABC a security interest in both dishwashers. ABC does not make a fixture filing. The dishwashers are installed and become fixtures under local law.

When Joe defaults, ABC discovers that the duplex is subject to a properly recorded real estate mortgage, which was recorded before the dishwashers were installed.

Who has priority between the real estate mortgagee and ABC?

To have priority over the real estate interest, ABC must establish that the dishwashers are readily removable replacements of domestic appliances that are consumer goods, and that before the dishwashers became fixtures, ABC’s security interest was perfected by any method permitted by Article 9. The term “domestic appliances” is not defined. Comment 8 to revised section 9-334 clearly indicates that replacements of domestic appliances being used by a family are not to be considered permanent improvements. The dishwashers are clearly replacements, and the one on the side Joe lives in is considered a “consumer good” because it is being used for personal and family purposes. ABC’s security interest attached when Joe signed the security agreement and the purchase contract. ABC has a PMSI in this dishwasher because Joe’s obligation was incurred to buy the dishwasher. A PMSI in consumer goods is automatically perfected upon attachment. Thus, ABC has a perfected security interest in the dishwasher on Joe’s side because the PMSI was in a consumer good; and it therefore has a super-priority. ABC does not have a super-priority as to the dishwasher installed in the rental unit because it is not a replacement of an appliance being used as a consumer good. This dishwasher is classi-
fied as equipment due to the fact that it is used in a rental unit, which is considered a business use.\textsuperscript{202}

I. Priority Conflict Between a PMSI and a Buyer Not in the Ordinary Course (BNOC)

A buyer not in the ordinary course (BNOC) is basically a person who buys from someone who is not in the business of selling goods of that kind.\textsuperscript{203} Under F9, a BNOC defeated an unperfected secured creditor (one who had made no public filing) when the BNOC had given value, took delivery before the security interest was perfected, and had no actual knowledge of the security interest.\textsuperscript{204} Unless the BNOC was a transferee in bulk, the PMSI holder had to be perfected at the time of delivery; i.e., there was no grace period for the PMSI holder to file. Revised Article 9 changes this rule. A PMSI perfected by filing “before or within 20 days after the debtor receives delivery of the collateral”\textsuperscript{205} has priority over a BNOC as well as over a lessee\textsuperscript{206} interest which arises “between the time the security interest attaches and the time of filing.”\textsuperscript{207}

J. Priority Conflict between PMSI and a Lien Creditor

A lien creditor\textsuperscript{208} is a creditor that has acquired a lien on specific property of the debtor by seizure, levy, or the like. This normally means

\textsuperscript{202} See id. § 9-102(a)(33) (defining “equipment”); see also id. § 9-102 cmt. 4.a. (indicating no intent to change Former Article 9’s definition of equipment); U.C.C. F. § 9-109(2) (2000) (defining equipment as a good used or bought for use in business).

\textsuperscript{203} U.C.C. § 1-201(9). “Buyer in ordinary course of business” means:

[A] person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind.

“Buying” may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

\textsuperscript{204} U.C.C. F. § 9-301(1)(c).

\textsuperscript{205} U.C.C. Rev. § 9-317(e).

\textsuperscript{206} Id.; see also id. § 9-321(c) (discussing the priority of a lessee in the ordinary course of business).

\textsuperscript{207} Id. § 9-317(e).

\textsuperscript{208} “Lien creditor” means:
that an unsecured creditor obtains a judgment or a writ of execution and has a public official (such as a sheriff) seize or take control of specific personal property of the debtor. A PMSI perfected by filing “before or within 20 days after the debtor receives delivery of the collateral” has priority over lien creditors’ interests “which arise between the time the security interest attaches and the time of filing.”

IV. CONCLUSION

While Revised Article 9’s treatment of PMSIs incorporates many of the key concepts from Former Article 9, there are some important changes. A PMSI remains a special kind of security interest which is defined in revised section 9-103, not section 9-107. The basic definition in section 9-103 is more complicated, but it continues to recognize that a PMSI can be created in two basic ways. A seller, who sells on credit a good or software and retains a security interest to secure the buyer’s payment, has a PMSI. Also, when a lender makes an advance or incurs an obligation “to enable the debtor to acquire rights in or the use of collateral,” and the money advanced is “in fact so used,” the lender has a PMSI. Unlike F9, R9 clearly limits a PMSI to goods and certain software and excludes intangibles. A major reform is that R9 recognizes that a security interest in non-consumer collateral can be both a PMSI and a non-PMSI. Interestingly, the Kansas version of R9 omits the uniform version’s restriction to non-consumer collateral, but it is unclear whether the omission was intentional. Revised section 9-103 also for the first time explicitly authorizes cross-collateralization of PMSIs in inventory. And a new section applying to non-consumer transactions provides default payment rules if a PMSI depends on the application of a payment to a particular obligation and the parties could not agree upon a reasonable method. Last, revised section 9-103 ex-

(A) a creditor that has acquired a lien on the property involved by attachment, levy, or the like;
(B) an assignee for benefit of creditors from the time of assignment;
(C) a trustee in bankruptcy from the date of the filing of the petition; or
(D) a receiver in equity from the time of appointment.

Id. § 9-102(a)(52).
209. Id. § 9-317(e).
210. Id.
211. Id. § 9-103.
212. Id. §§ 9-103(c), 9-102(a)(44) & (75).
213. Id. § 9-103(f).
214. Id. § 9-103(b)(2).
215. Id. § 9-103(e).
pands the definition of a PMSI by making a consignor interest in non-
consumer goods consigned to a merchant a PMSI.216

Whether a security interest is a PMSI remains important in a num-er of areas. As under F9, most PMSIs in consumer goods are auto-
thematically perfected upon attachment under R9.217

A number of special priority rules, some new and some old, apply to
conflicts between a PMSI holder and other creditors or purchasers. For
example, a PMSI perfected by filing "before or within 20 days after the
debtor receives delivery of the collateral"218 has priority over certain
buyers', lessees' and lien creditors' interests "which arise between the
time the security interest attaches and the time of filing."219 This rule
changes prior law, where there was no grace period for the secured party
to file when the conflict involved a buyer not in the ordinary course or a
lessee. As to conflicts between two perfected creditors, like F9, R9 pro-
vides two ways for a creditor to break the monopoly of the first-in-time,
first-in-right rule: executing a subordination agreement;220 or establishing
a PMSI. Revised section 9-324 provides a number of exceptions to the
first-to-file or -perfect rule under revised section 9-322. For example,
a qualifying PMSI holder in equipment, inventory, livestock, software, and
fixtures may achieve priority over earlier perfected interests. The rules
dealing with equipment, inventory, and fixtures are essentially the same
as they were under F9. However, livestock that are farm products are
now treated like inventory. If a secured creditor with a PMSI in live-
stock wants to obtain a super-priority, the secured creditor must perfect
before the debtor obtains possession of the livestock and provide an
appropriate authenticated notice to perfected secured creditors before
the debtor obtains possession of the livestock. As to software, the
PMSI holder has priority in the software and identifiable proceeds to the
extent provided for under the other relevant subsections of revised sec-
section 9-324.221 Revised section 9-324(a) applies if the good containing
the software is non-inventory, and revised section 9-324(b) applies if the
good containing the software was inventory to the debtor. Another new
PMSI priority rule governs priorities among competing PMSI holders. A
PMSI for the price has priority over an enabling loan and multiple ena-

216. Id. § 9-103(d).
217. Id. § 9-309(1).
218. Id. § 9-317(e).
219. Id.
220. Id. § 9-339.
221. Id. § 9-324(f).
bling loans rank in order of filing. Finally, unlike F9, R9 has no special priority rule for crop production financiers.

As with much of R9, the section numbers dealing with PMSIs have been changed and the provisions dealing with PMSIs have become more complicated and represent an attempt to micro-manage credit transactions. Many of the changes are designed to resolve ambiguities and conflicts that existed under F9. Whether R9 will make secured transactions work more smoothly and with less frequent litigation remains to be seen.

222. Id. § 9-324(g).