1. (25 minutes)

On January 15, 2012, Cann Finance Co. (“Cann”) entered into an Inventory Lending and Security Agreement (the “Cann Agreement”) with Akhator Distribution Co., a distributor of electronics. Akhator buys electronics from manufacturers and resells them to retailers. Under the agreement, Cann would lend up to 80% of the value of Akhator’s inventory, but all loans would be at Cann’s discretion. The Cann Agreement described the collateral as “now existing and hereafter acquired inventory” and included a future advance clause. Cann filed a properly completed financing statement in the correct location on January 17, 2012. Cann immediately loaned several hundred thousand dollars. Akhator ordered inventory and began selling to its customers.

Epps Bank (“Epps”) entered into an Accounts Lending and Security Agreement (the “Epps Agreement”) with Akhator on July 1, 2013. The Epps Agreement describes the collateral as “now existing and hereafter acquired accounts and proceeds thereof.” Having assured itself that Akhator’s accounts had significant value, Epps advanced funds to Akhator and filed a properly completed financing statement in the correct location on July 2, 2013.

Unable to continue making loan payments or to meet its other obligations, Akhator filed a chapter 7 bankruptcy petition on December 1, 2016. As of the date of the petition, Akhator had inventory with a value of $3 million, and accounts with a value of $2 million, all of which reflect amounts owed by retailers for the purchase price of electronics sold to them by Akhator.

Among Cann, Epps, and the bankruptcy trustee, who has priority in the accounts and why?

Student Model Answer:

Cann, the inventory lender, entered into a security agreement with Akhator covering the inventory. The agreement contained an after acquired property clause [hereinafter AAP] and future advance clause. For Cann’s security interest to attach, it must be enforceable. §9-203(a). For it to become enforceable, there must be an authenticated security agreement, value must be given, and the debtor must have rights in the collateral. §9-203(b). Here, Cann and Akhator had a security agreement. Value was given when Cann advanced loans to Akhator. Akhator had rights in the collateral when they obtained an ownership interest in the inventory purchased with the funds. Thus, Cann has an enforceable security interest. Moreover, Cann filed a financing statement on 1/17/12. A security interest may be perfected by filing as to all kinds of collateral except deposit accounts and money. UCC §§ 9-310, 9-312(b). Cann’s filing, therefore, perfected its interest in the inventory. Cann is a perfected secured party as of 1/17/2012.

Epps, another lender, entered into a security agreement with Akhator covering accounts receivable and proceeds. The agreement contained an AAP clause. For Epps’ interest to attach, it must be enforceable. §9-203(a). For it to become enforceable, there must be an authenticated security agreement, value must be given, and the debtor must have rights in the collateral. §9-203(b). Here, Epps and Akhator had a security agreement. Value was given when Epps advanced loans to Akhator. Akhator had rights in the collateral because they have the accounts, which arise from inventory sales. Thus, Epps has an enforceable security interest. Moreover, Epps filed a financing statement on 7/2/2013. A security interest may be perfected by filing as to all kinds of collateral except deposit accounts and money. UCC §§ 9-310, 9-312(b). It should be noted that the collateral here is accounts receivable. These are different than deposit accounts and can be perfected by filing. Epps filing, therefore, perfected its interest in the accounts receivable. Epps is a perfected secured party as of 7/2/2013.

Lastly, Akhator filed for bankruptcy on 12/1/2016. The trustee in bankruptcy is considered a judicial

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1 These answers are drawn, with very minor corrections, from actual answers that received perfect or near-perfect scores. So don’t be intimidated by them, but use them as ways of considering how you might effectively structure your answer.
lien creditor said to be a hypothetical judicial lien creditor in all of the debtor's property beginning on the date the bankruptcy petition is filed. Thus, the trustee in bankruptcy is a lien creditor as of 12/1/2016.

With respect to priority in the accounts, Cann is senior to Epps who is senior to the trustee in bankruptcy. Between Cann and Epps, both perfected secured parties, priority goes to whichever party was the first to either file or perfect. UCC § 9-322(a)(1). This is the general rule for priority between secured parties that have security interests in the same collateral. Here, the parties have interest in different collateral. Cann has an interest in inventory and Epps has an interest in accounts receivable and proceeds. You would think Epps would be senior to Cann because it specified accounts receivable. However, Akhator sells the inventory which gives rise to the accounts. Under UCC § 9-102(a)(64), the accounts are proceeds of the inventory. A security interest attaches to identifiable proceeds of collateral whether or not the security agreement specifically so provides. UCC §§ 9-203(f), 9-315. The accounts, if they are identifiable proceeds of the inventory, which the facts tell us they are, are proceeds of the inventory. Thus, Cann's prior perfected security interest in the inventory attaches to the accounts and is senior to Epps later perfected security interest. Moreover, a prior perfected security interest in the collateral has priority over a judicial lien creditor's interest in the same collateral. UCC § 9-317(a)(2). Both Cann and Epps perfected their security interest prior to the bankruptcy petition date.

Therefore, both Cann and Epps are senior to the trustee in bankruptcy.

Professor Answer and Comments:

The order of priority is Cann—Epps—Trustee.

Both security agreements appear to be valid and enforceable, in that they are agreements to secure Akhator’s specified obligations with the collateral (i.e., they appear to grant Cann and Epps each a security interest); their description of the collateral is sufficient pursuant to 9-108(e). Akhator had rights in the collateral; and Akhator appears to have authenticated them. 9-203(a). Both Cann and Epps duly filed financing statements, thus perfecting their respective interests.

We are asked to ascertain priority as to the accounts. Epps of course has a perfected s.i. in the accounts because they are in his security agreement and financing statement. Does Cann? The fact that the Cann Agreement and financing statement don’t expressly include “accounts” is of no moment. These accounts are proceeds of the inventory because they were acquired upon the disposition of that inventory. 9-102(a)(64)(A). (This is very analogous to question 7 on Sample Exam 1.) Pursuant to 9-315(d), Cann’s security interest remained perfected because the three conditions of (d)(1) are met (filed financing statement covers the original collateral, inventory and accounts are both perfected by filing in the same office, and they weren’t acquired with cash proceeds but rather upon the disposition of inventory). Cann’s financing statement has not lapsed as of the bankruptcy petition date. Thus, Cann has a valid and perfected s.i. in the $2mm of accounts.

Who wins as between Epps, Cann, and the bankruptcy trustee?

Both Cann and Epps prevail over the bankruptcy trustee because they had perfected security interests in the accounts prior to the bankruptcy filing.

Cann prevails over Epps pursuant to 9-322(a)(1), because it was the first to perfect. The filing date as to its original collateral is imputed to be also the filing date as to its proceeds. 9-322(b)(1); Comment 9 to 9-324. Ex. 2. There is no exception allowing account lenders to prime prior perfected lenders.

Thus, Cann is senior to Epps as to the accounts, and the trustee will take any leftovers.

Note: When this exam was administered, several people included answers concerning the inventory, which is not what this question was about—this question is concerned with accounts only. A number of people were also distracted by PMSI issues that really weren’t necessary or helpful in resolving the issue presented. (For instance, the special rights granted to lenders with PMSI in inventory in 9-324(b) are irrelevant here because first of all they don’t cover accounts and second of all because we have no indication that either Epps or Cann took the required steps to receive this benefit. Again, my model answer to Sample Exam 1, Question 7, is on point.)
Adding to the facts of problem 1: Assume that Akhator’s bankruptcy proceeding is still pending as of February 1, 2017, and no additional UCC filings have been made by either Cann or Epps.

Does that change your answer to problem 1, and why? If so, please re-specify the priorities and explain what changed and why; and also explain what could/should have been done to ensure no change in result.

Student Model Answer:

This problem hinges on the failure to file a continuation statement and its ramifications on respective priority.

To have continuous perfection, a secured creditor must file a continuation statement within five years of the original filing of the financing statement. UCC 9-515(a) and (c). Epps’ financing statement is still effective; he filed his original financing statement on July 13, 2013 and it will remain effective until July 13, 2018. Here, Cann has failed to file a continuation statement to continue its effectiveness. As a result, the financing statement lapsed on January 17, 2017. Cann should have filed a continuation statement during the six months prior to the five year lapse. There is no exception to the filing of the continuation statement because of a bankruptcy proceeding; and the filing of a continuation statement during bankruptcy will not be a violation of the automatic stay. The effect of the failed continuation statement is detrimental to his security interest with respect to Epps. When a financing statement lapses, it is deemed unperfected and never to have been perfected against purchasers for value, which include secured creditors. This is retroactive unperfection. UCC 9-515(c). The result is that Cann is no longer perfected against Epps.

Purchasers for value does not include bankruptcy trustees. As such, there is no retroactive unperfection with respect to bankruptcy trustees. The bankruptcy trustee’s lien arose at the date of the bankruptcy petition, which was December 1, 2016. At that date, Cann’s financing statement was still effective. Thus, Cann’s financing statement will still remain effective against the bankruptcy trustee.

(1) Epps
(2) Cann
(3) Bankruptcy Trustee

Professor Answer and Comments:

As of January 16, 2017, that is, after five years have passed from its filing date, Cann’s financing statement lapsed, and this is not tolled during bankruptcy. See 9-515, and Cmt 4. Cann is therefore, from that date onward, junior to any lien creditor (including a bankruptcy trustee) as well as retroactively unperfected as to any competing secured creditor. 9-515(c). Thus, Epps is now senior to Cann.

However, Cann remains senior to the bankruptcy trustee, because the trustee is deemed to have a lien arising as of the petition date and at that date, Cann was still perfected. 9-317(a)(2); see 9-515 Cmt. 3 ex. 2; also problem 22.1.d in the book (and page 389). (This question is also very analogous to the Sample Exam 1, Question 3.) In other words, Cann isn’t retroactively unperfected as to a lien creditor (like the trustee), which isn’t a “purchaser” under the UCC.

Thus, there has been a change, and the order is now Epps—Cann—Trustee.

What should have happened? Cann should have filed a continuation statement before lapse. 9-515(c). Cann could have done so without even seeking relief from the automatic stay. 9-515 Cmt 4; Bankr. Code 362(b)(3).

Obviously, when this exam was administered, if a student got the wrong answer in (1), I took that into account and awarded as much partial credit as possible.

3. (15 minutes)
Adding to the facts of problem 1: On September 12, 2016, an unpaid supplier of Akhator obtained a judgment lien on $500,000 worth of inventory (which is now located in the sheriff’s impound facility). That same day, the supplier checked the UCC records under Akhator’s name, saw Cann’s filing, and sent a letter by certified mail (a) informing Cann about its levy on Akhator’s inventory and (b) demanding that Cann cease lending funds to Akhator immediately. Cann received the letter but made no response. On November 20, 2016, Cann made an advance to Akhator in the amount of $100,000.

To what extent does Cann have priority over the supplier with respect to this $100,000 advance, and why?

Student Model Answer:

Under 9-323(b), future advances have priority over a lien creditor (1) in all cases for 45 days following attachment of the lien (2) beyond 45 days if the secured creditor makes the advance without knowledge of the lien and (3) beyond 45 days pursuant to a commitment that made without knowledge of the lien. A future advance clause is not a commitment. A commitment is contractual obligation to lend. In this case, the advance was made over 45 after the supplier obtained a judgment. If Cann made the advance made the advance without knowledge the lien or they had a contractual obligation to lend, then the advance would have priority. It appears from the facts that Cann did have knowledge of the lien because they were sent notice. The contract said that future advances were to be made at Cann’s discretion, so that does not appear to be a commitment to lend. If this is not considered a commitment to lend, the advance will not receive the priority as of the date that Cann's original financing statement was filed. Thus, the supplier/lien creditor would have priority over the $100,000.

Professor Answer and Comments:

Future advances are covered under the security agreement, as is permitted under the UCC, see 9-204(c). Cann will remain senior pursuant to 9-323(b) as to any advance made less than 45 days after the levy, but will be junior as to advances made more than 45 days after the levy, unless there was either (i) a commitment to lend or (ii) Cann lacked knowledge of the lien. The November 20 advance is well outside of the 45-day safe harbor. (Note: When this exam was administered, surprising number of people miscalculated this. I tried to award partial credit...)

Is the advance protected anyway? Cann will argue that it didn’t have knowledge of the lien, and/or that it was under a commitment to lend pursuant to 9-323(b)(2). (This problem is analogous to, but leads to a different result from, Sample Exam 1, Question 10; see also casebook problem 29.4.)

The knowledge argument seems weak. The supplier will argue that Cann had notice of the levy by virtue of its letter. That seems right. The letter is surely sufficient to provide knowledge, right!? If it’s not, I can’t imagine what would be enough to impart knowledge.

The obligation argument also seems weak. Cann might suggest that it had obligation to lend because Akhator was within the debt to value ratio for the collateral. But the supplier would point out that the problem explicitly states that all loans were at Cann’s “discretion,” Thus, it seems that Cann was not obliged to loan the funds.

Thus Cann is junior to the supplier as to the second payment.

4. (15 minutes)

Stevie Jobs (“Jobs”) missed some car payments, in default of her agreement with her car lender, Macintosh Finance (“Mac”). As it was entitled to do, Mac peacefully repossessed her car. It sold the car at a private auction attended by fifty car dealers from around the state. The balance on her car loan was $33,000 when she stopped making payments, and she accumulated an additional $7,000 in unpaid interest while unemployed. Mac gave Jobs proper notice of the sale. The car sold for $30,000 even though it was likely worth
$42,000. Mac incurred $1,000 in expenses ($800 in repo and storage costs; $200 in sale fees). Jobs’ contract says nothing about which party will pay sale expenses/fees.

Do either Mac or Jobs owe the other party any money at this point, and why? If so, how much?

Student Model Answer:

An obligor is liable for any deficiency remaining after an article 9 sale under 9-615. If Mac seeks a deficiency judgment, Jobs would owe a $11,000 deficiency to Mac. Jobs should still owe the $1,000 sale expenses even though the contract was silent as to which party would pay for the sale expenses. The default rule is that the sale price will first be used to pay the expenses of the sale (this does not include things like attorney's fees which are nonadvances and would have to be agreed to in the security agreement) and then the remaining amount goes to the party who foreclosed. Here $1,000 of the $30,000 would be used to pay off the sale expenses and then $29,000 would go to Mac. The seller is reimbursed for the expenses of the sale. However, since the proceeds are insufficient, Mac may seek a deficiency judgment as Jobs is liable for a deficiency under 9-615. Jobs owed 40,000 (the unpaid interest would be lumped in with the total sum due) and the car only sold for 30,000. Since the proceeds would be used to pay the expenses of the sale that leaves 29,000 as proceeds for Mac and Mac should be reimbursed for the sale expenses. Since Mac got 29,000 in proceeds and Jobs owes 40,000 total on the loan, Jobs is liable for 11,000 if Cann sues for a deficiency. It does not matter that the car was probably worth $42,000 as the debtor was given proper notice and the sale seems commercially reasonable under the facts. More information would be needed to analyze whether Jobs could attack the sale price on the grounds of commercial reasonableness of the sale.

Professor Answer and Comments:

This was almost certainly a commercially reasonable sale. UCC 9-627(b)(3) pretty much says that dealer auctions are acceptable, and fifty dealers seems like significant exposure to the market. A sale generating less than the FMV of the collateral does not necessarily make a sale commercially unreasonable. In light of this law, there isn’t any basis for Jobs to challenge the sale price, even though it was for less than she thinks the car was worth.

Thus, Jobs owes Macintosh a deficiency, which are permitted under Article 9. 9-615(d)(2).

How much is the deficiency? In addition to the amounts owing under the contract, Macintosh’s sale expenses appear to be modest and therefore reasonable, so it can add them to Jobs’ balance, even though they are not mentioned in the contract. 9-615(a)(1).

The deficiency is $11,000, calculated as follows: $33,000 balance + $7,000 arrearages + $1,000 sale expenses = $41,000. $41,000 minus the $30,000 sale price = $11,000. [When this exam was administered, I gave full credit to answers that correctly stated the equation based on dollar amounts that resulted from earlier mistakes in the problem, although of course, students lost points for the earlier mistakes.]

Note: When this exam was administered, a number of answers referenced state anti-deficiency statutes, and/or whether the price differential shocked the conscience, both of which are relevant in the real estate context (covered in casebook assignment 4)—but which are not really relevant in the Article 9 context (covered in assignment 5), where Article 9 itself is the anti-deficiency statute (see, e.g., “Article 9 of the Uniform Commercial Code governs the foreclosure of security interests in personal property,” page 36; page 82, which gives the example of a foreclosed-upon car and describes the UCC as the anti-deficiency statutes that governs with personal property; and casebook problem 5.1.a, which is roughly analogous to this question), and where commercial reasonableness generally reigns.

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2 Please note that while it was the highest-scoring one in the class, this answer isn’t perfect; it received 26 out of 30 available points. See professor comments for some more detail.
Higgs Beverages, Inc. ("Higgs") is a seller of containers (called "growlers") used to hold beer. The growlers are high-end and are paid for by the customers over time. Each contract between Higgs and its customer consists of a promissory note and security agreement giving Higgs a lien on the newly purchased growler.

In late 2015, Higgs began having financial difficulties and sought out loans from several lenders.

In January 2016, Higgs successfully applied for financing from Boson Bank ("Boson"), which (via a valid security agreement) took a security interest in Higgs’ growlers and customer contracts. On January 2, 2016, Boson disbursed the funds and filed a financing statement covering the growlers and stating the debtor’s name as "Higginson Beverages, Inc." That same day, Boson took possession of the customer contracts but did not file a financing statement with respect to them.

In February, Higgs successfully applied to Electron Bank ("Electron") for a loan secured (via a valid security agreement) by the growlers as well as the customer contracts. On February 2, 2016, Electron disbursed the funds and filed a financing statement covering the growlers and the contracts. The financing statement stated the debtor’s name as “Higgs Beverages Co.” Electron inadvertently failed to enter any information in the spot on the UCC form where the secured creditor’s mailing address is supposed to go. But the filing officer accepted the filing anyway. That same day, Electron disbursed the funds to Higgs.

On April 1, Higgs filed for chapter 7 bankruptcy.

As between Boson, Electron, and the trustee: What priority (if any) do the parties have (a) in the growlers and (b) in the customer contracts, and why?

Student Model Answer:

Under §544(a) of the Bankruptcy Code, a bankruptcy trustee is permitted to avoid secured creditors who have errors in their security agreements or financing statements. This is important to note in assessing whether the bankruptcy trustee gets priority over Boson or Electron. Boson filed its financing statement covering Higgs' growlers on January 2, 2016. This is when the security interest was created because the security agreement was created earlier. The financing statement had an error in the debtor's name, however—instead of "Higgs Beverages, Inc.,” Boson stated that the name was "Higginson Beverages, Inc." This name error is seriously misleading under §9-506(a) because, using standard search logic, a search for the correct name would not lead to a finding of the name given by Boson. "Higgs" is materially different from Higginson," so it would not be effective even though it was probably still accepted by the filing officer because an incorrect debtor name is not enough reason to reject a financing statement under §9-516 as long as there is a debtor's name given.

Electron created a security interest in Higgs' growlers and customer contracts on February 2, 2016. The financing statement indicated that the debtor's name was "Higgs Beverages Co." This error is not seriously misleading because under standard search logic, ending noise words are ignored, so when "Higgs Beverages Inc." is searched, "Higgs Beverages Co." would come up as a result. Although the financing statement was blank for the secured creditor's mailing address, the filing officer accepted it anyway. Under §9-516(b)(4), the financing statement should have been rejected by the filing officer. However, since it was accepted anyway, it is still effective against lien creditors if it is missing something other than the names of the debtor and creditor. For this reason, the bankruptcy trustee would lose to Electron because it would be in the role of a lien creditor whose lien was not created until April 1. Under In re Duckworth, a bankruptcy trustee will be unconstrained by constructive notice and can avoid a security interest by its defects even if they are not seriously misleading. However, under §9-317(a)(2) and §9-323(b), the trustee in the ideal lien creditor role will defeat unperfected security interests for which no effective financing statement and security agreement exist, but they will lose to other security interests. For these reasons, the bankruptcy trustee would have priority over Boson for the growlers because its financing statement was seriously misleading. Electron would have priority over the
trustee regarding the growlers because its interest was properly perfected at the time of the bankruptcy filing.

As for the contracts, these sound like chattel paper under §9-102(a)(11) because they are records that evidence a monetary obligation and a security interest. For chattel paper, possession under §9-313 is the preferred type of perfection. Filing under §9-312 is also optional. For these reasons, Boson had the preferred perfection for the customer contracts, meaning it would have priority over both the trustee and Electron because it was first in time to have proper perfection of the customer contracts. Electron would be subordinate to Boson for the aforementioned reasons, but would have priority over the trustee because Electron still had proper perfection in the customer contracts at the time of bankruptcy filing. The trustee would be subordinate to both regarding the customer contracts.

Professor Answer and Comments:

(a) The Growlers. Priority in the growlers is Electron—Trustee (then theoretically Boson might be listed third and have some residual rights, but practically speaking, there won’t be any interest left after the bankruptcy trustee liquidates whatever is left to the bankruptcy estate).

Boson’s financing statement is invalid because the name is “seriously misleading” and would not show up on a search based on the standard search logic. Some people seemed a bit uncertain on this, but a financing statement with a “seriously misleading” debtor’s name is ineffective, period (this isn’t a 9-338 issue). See, e.g., pages 306-07, and problem 30.3.a. Thus, Boson is unperfected as to the growlers.

By contrast, Electron’s mistake will pass muster under the standard search logic, which ignores “ending noise words” like “corp.” and “inc.,” and which ignores punctuation errors like the omitted comma here. See page 307. Also, although Electron omitted the s.c. address and should have had its financing statement rejected per 9-516(b)(4), a record that is accepted despite the absence of such data is still effective, see 9-516(d) and 9-516 Cmt 4. Electron is perfected in the growlers.

Pursuant to 9-317, therefore, Electron has priority over the trustee in bankruptcy in the growlers; and because Boson has no valid financing statement but Electron does, Electron is senior to Boson, 9-322.

Because Boson was unperfected and has not filed an effective financing statement, 9-317, the trustee (in the position of a judicial lien creditor, Bankr. Code s. 544), will prevail over Boson. (See, e.g., pages 306-07 which make this pretty explicit.)

(b) The Contracts. Priority in the contracts is is Boson—Electron—Trustee.

The contracts are probably chattel paper because they evidence both a monetary obligation and a security agreement in goods, §9-102(a)(11). I don’t think that the contracts are instruments, see 9-102(b)(47), because (as the problem expressly says) they include a security agreement, but even if they were, the outcome would be the same because the ideal way to perfect in instruments is by possession, see 9-330(d). Because they fit these prior categories better, I also don’t think the contracts are accounts or general/payment intangibles, but if you answered that way and explained that filing was the best way to perfect in such collateral, see 9-312, and otherwise reasoned through the problem properly, then partial credit was awarded.

Thus, Boson has priority in the contracts because possession is superior to filing when the collateral is chattel paper, §9-330(b). The ineffective financing statement is irrelevant here.

Although it loses to Boson, Electron has priority over the trustee because even if not preferred, filing is still a legitimate way to perfect in chattel paper (§9-312(a)).

6. (40 minutes)

Wildcat Mini-Golf (“Wildcat”) runs a mini-golf course that features wildcat and other animal statues. The statues decorate the golf course and serve as obstacles that the mini-golfers have to work around.

In order to purchase the land for the course, Wildcat obtained a mortgage loan from Commonwealth Bank (“Commonwealth”). The mortgage includes the real property, “all improvements thereto, and all fixtures thereon, whether presently existing or coming to exist hereinafter.” The mortgage was duly recorded in the county real property records as of January 1, 2015.
Several months after the original purchase of the course, and advised by several lawyers, Stoops Bank ("Stoops") loaned funds to Wildcat and obtained a security interest in Wildcat’s “deposit accounts as they currently exist or may come to exist in the future” on March 1, 2015.

At the end of the day on April 15, manager Benny Snell ("Snell") deposited that day’s revenues of $1,500 in Wildcat’s bank account at Stoops, which before that deposit had a balance of $0.

A couple of days later on his way to work, Snell stopped by a yard sale and saw a large statue called “Sad Cardinal” that would be a perfect addition to Wildcat’s mini-golf course. Snell withdrew $800 from Wildcat’s account with Stoops and used it to buy the Sad Cardinal. Excitedly, Snell and his employees installed the statue on the grounds of the golf course. They affixed the statue to a small concrete platform with series of bolts and permanent attachment devices; they also hollowed it out and installed plumbing inside it such that Sad Cardinal would sprout tears when golfers failed to properly putt.

Several months later, when he noticed that Sad Cardinal’s plumbing wasn’t working properly, Snell hired an excellent plumber he knew, Boom Williams ("Williams") to repair the system (no other construction was ongoing at Wildcat’s facility at that time). Wildcat failed to pay him promptly for his work. Shortly thereafter, Williams properly filed a mechanic’s lien, on June 15, 2015.

As it happens, Sad Cardinal was so sad that it made all the children cry, which added to Wildcat’s financial problems. About six months later, Wildcat filed for chapter 7 bankruptcy.

(a) Among Commonwealth, Stoops, Williams, and the bankruptcy trustee: What priority (if any) do the parties have in the Sad Cardinal, and with what priority, and why?

(b) Would your answer to (a) change if Williams had also entered into a security agreement with Wildcat at the time he did his repair work, with Sad Cardinal as collateral to secure his repair costs, and made a proper fixture filing at that time? Why or why not?

Student Model Answer:

Commonwealth
The mortgage loan from Commonwealth Bank will cover the statues if they are a fixture. Fixtures are so related to particular real property that an interest in them arises under real property law. There is a test from Cliff’s Ridge Skiing Corp that said that a something is a fixture when it is (1) properly annexed/attached to the realty (2) is adapted or applied to the use of the real property, and (3) is intended to be permanently attached. The statues in this case appear to be a fixture because they were attached to the realty, were adapted or applied to the use of the real property and debatable were "intended" to be permanently attached. This is given the fact that the statue was affixed to a small concrete platform, with a series of bolts and permanent devices. A security interest in a fixture may be properly perfected with a mortgage filing in the county real estate office. In this case, that is Commonwealth Bank did. Assuming that the statues were a fixture, Commonwealth Bank was properly perfected in them as of January 1, 2015.

Stoops
Stoops was perfected in the deposit accounts. Although it appears that the statues were a proceed of the deposit account, there was a change in the collateral that went from the deposit account, to cash, to the statute. This type of change makes Stoops not perfected in the statue. It fails the test under 9-315(d)(1) because it violates the same office rule and it was acquired with cash proceeds (because it appears that the money was withdrawn -- i assume as cash -- to buy the statues. Because of this, Stoops probably is not perfected in the statues. However, Stoops will remain perfected in the $700 that remains in the account.

Williams
Williams obtained a mechanic's lien on statute because he worked on the statue. Because there was not construction, the mechanic's lien has the date or priority as of the recording of the claim of the lien because it was an alteration. This appears to be an enforceable security interest. A mechanic's lien covers the entire property, however this was probably an alteration lien because there wasn't any construction and fixing the statue does not seem to be enough to constitute construction. These rank in the order in which they were recorded so the mortgage will have priority over the mechanic's lien unless Williams has a right to remove the statues or there is a subordination agreement. Thus the date for the alteration lien will be the date that it was
filed which was June 15, 2015.

(a) The mortgage was filed and perfected before the construction lien so the order of priority will be Commonwealth Bank, Williams, Trustee, and Stoops (because stoops was not perfected so no priority). See above for analysis.

(b) A prior perfect mortgage beats a fixture filing unless the mortgage gives the debtor the right to remove the fixtures or the fixture filing is a PMSI. Here, it does not appear that there was a right to remove the fixtures and this isn’t a PMSI, so Commonwealth would still beat Williams. However, since Williams had a perfected security interest, Williams would beat both Stoops and the bankruptcy trustee so the order of priority would be: Commonwealth, Williams, bankruptcy trustee, and Stoops (because stoops was not perfected so no priority). See above for analysis.

Professor Answer and Comments:

(a) Commonwealth—Williams—Trustee (again, in theory Stoops might have residual interest, but it will be extinguished in the bankruptcy).

Stoops is unperfected with respect to the Sad Cardinal. Cardinal appears to be proceeds of Stoops’ security interest in Wildcat’s deposit account. However, it is not perfected because it has been more than 20 days since the purchase, and Stoops does not meet any of the exceptions in §9-315(d)(1). It was originally perfected by control under §9-104(a)(1) rather than by its financing statement because control is the only way to perfect in deposit accounts, §9-312(b)(1). Because the deposit account and Cardinal cannot be perfected in the same filing office, Stoops doesn’t meet prong (A) or (B) for the same office rule in §9-315(d)(1). The proceeds are not cash, §9-315(d)(2). The trustee therefore prevails, see 9-317, and Williams prevails, see 9-334(e).

Commonwealth has priority by virtue of its mortgage filing on January 1, 2015. 9-334(b), and Comment 5, and general principles of real estate law (see, e.g., page 553).

Williams has a mechanic’s lien effective as of the date of filing, June 15, 2015. Because it is later, Williams’ interest is second in priority to Commonwealth’s. See page 547.

Both Commonwealth and Williams will be prior to the bankruptcy trustee, because they are real estate encumbrancers prior to the levy. See generally 9-334.

(b) Nothing would change if Williams had also made a duly authorized fixture filing against the Cardinal. He would still have been subordinate as to Commonwealth against the Cardinal, and would therefore not have had the right to remove it, although he still would have been prior to the trustee.

7. (30 minutes)

Blue Grass Flowers, Inc. ("Flowers") recently upgraded its shops, purchasing new display cases and a supply of the vases that customers can purchase with their flower arrangements. Flowers bought these items from Blossoms Supply, Corp. ("Supply"), which is in the business of selling such equipment and inventory. Flowers obtained the money for the purchase by approaching Goldenrod Bank ("Goldenrod") for a loan. Goldenrod sent the funds directly to Supply on June 5, and that same day, Goldenrod obtained a signed promissory note from Flowers. Supply delivered the items to Flowers on June 10, and that same day, Goldenrod filed its financing statement covering Flowers’ “equipment and vases.” In addition, Flowers and Goldenrod signed a security agreement on July 5.

Back on January 1, Sally Shopper ("Shopper") slipped on some water in a Flowers store and collided into a shelf of glass vases. Shopper sustained major injuries, sued, and won a judgment. Shopper obtained a writ of execution, and the sheriff levied on Flowers’ new display cases and vases on June 15.

Around this same time, Flowers also incurred a debt to Poplar Bank ("Poplar"). On June 1, Poplar filed a financing statement, obtained a security agreement, and obtained a promissory note. Poplar disbursed the loan funds to Flowers on June 20, after its financing statement appeared in the filing office’s system. Both the
financing statement and security agreement described the collateral as “inventory and equipment, whenever acquired.”

Please rank Goldenrod, Shopper, and Poplar in order of their priority and explain.

Student Model Answer:

With respect to Goldenrod, the first issue is whether Goldenrod is perfected by as a PMSI in consumer goods. Although the obligation is purchase money as the obligation was incurred for value given to enable the debtor to acquire rights in the collateral, this does not qualify as consumer goods since Flowers purchased the supplies for its business. Goldenrod also failed to perfect a regular PMSI because the Goldenrod was not authorized to file a financing statement. A secured party must have permission from the debtor before it can file a financing statement. A signed security agreement normally authorizes a secured party to file a financing statement. Here the security agreement was not signed until after the financing statement was already filed, so it does not seem that Goldenrod had authorization from the debtor to file. Even if the financing statement was authorized by the debtor, the security interest did not attach under 9-203(b) until July 15.

Shopper is a lien creditor and Shopper's date of priority is June 15 under either the majority or minority rule since shopper both obtained a writ of execution and levied on June 15.

Poplar's priority date is June 1. In order for a secured party's priority date is the earlier of filing or perfecting and one of the 9-203(b)(3) attachment conditions must have been met. Flowers filed on June 1 and also obtained a security agreement which meets a requirement for attachment in 9-203(b). So Poplar's priority date is June 1.

Poplar is first priority because it filed its financing statement on June 1 and met a 9-203(b)(3) condition by obtaining a security agreement. Shopper is second priority because Shopper levied and delivered the writ to the Sheriff on June 15 which would satisfy both the minority and majority rules. Goldenrod is last in priority because Goldenrod did not have permission to file a financing statement from the debtor since the security agreement had not been signed by the debtor at the time of filing. Also, when goldenrod filed, it had not met a 9-203(b)(3) requirement.

Professor Answer and Comments:

The order of priority is Poplar—Shopper—Goldenrod.

Poplar has a security interest in the items as after-acquired equipment (countertops and display cases) and inventory (vases). Poplar beats Shopper under §9-317(a)(2)(B) because it had a security agreement and financing statement on June 1, before the levy.

What about Poplar v. Goldenrod? Poplar beats Goldenrod too, pursuant to the 9-322 “first to file or perfect” rule. True, Goldenrod is a PMSI lender because it provided funds to enable Flowers to acquire the collateral, and Flowers, in fact, acquired the property with those funds. But there are several problems for Goldenrod. First, its financing statement may not be valid. Financing statements need only include an “indication” of collateral, and usually specifically including “after-acquired” isn't necessary (and in any case this may not ever be after-acquired, since it had been acquired at the time of filing), but because it was filed before the security agreement was signed, it would need express authorization to file, and we are not told whether it has such authorization here. Second, Goldenrod does not benefit from its PMSI status because it attached so late. Although it filed its financing statement within 20 days of the debtor receiving the collateral, it did not obtain its security agreement until after the 20 days. Therefore, it did not perfect (see §9-308(a): attachment is required for perfection) within 20 days of delivery, as required to beat a pre-existing secured creditor (like Poplar) under §9-324. (When this exam was administered, a couple of people bravely made the argument that maybe the promissory note and other earlier documents were in themselves enough for the security interest to attach; although I suppose it might get minor partial credit, I think this is ultimately
contrary to the fact pattern as laid out and you should avoid making arguments that are too much of a strain. Pay attention to the fact pattern!)

Moreover, although the vases are inventory, Goldenrod did not follow the §9-324(b) steps to take advantage of the special rules protecting PMSIs in inventory. Thus, all that is actually required, as between the two secured creditors, is to look at who wins under 9-322. That is Poplar.

Goldenrod also loses to Shopper. Again, this threw a lot of people off. Goldenrod did not achieve full perfection or obtain a financing statement and security agreement before the levy. Thus it straightforwardly failed the test of 9-317(a)(2)(A) and (B). Also, Goldenrod did not attach (i.e., didn’t have a security interest) before the levy and therefore although it filed the financing statement timely, it cannot avail itself of §9-317(e) (providing special PMSI protection to a secured creditor from a levy arising “between the time the security interest attaches and the time of filing”; see Cmt. 8; here the levy arose prior to attachment, so this section doesn’t apply.)

8. (15 minutes)

Barbara Buyer (“Buyer”), plans to purchase certain goods (the “Assets”) being offered at a foreclosure sale initiated by Middle Inc. (“Middle”), which is owed $100,000 secured by the Assets. In addition to Middle’s valid interest, Buyer’s investigation of the Assets has revealed the following liens: A security interest held by Senior Enterprises (“Senior”) in the amount of $100,000, which is senior to Middle’s, and a security interest held by Junior Corporation (“Junior”) in the amount of $150,000, which is junior to Middle’s.

Buyer is willing to pay $300,000 to own the Assets—free of any of the above liens.

Assume the sale is going forward as planned. The expenses with respect to the sale will be $200.
(a) What is the most Buyer should pay at this foreclosure sale, and why?
(b) If she wins at the auction and pays that amount, what will each creditor receive from the auction proceeds? Please explain your answer.

Student Model Answer:
The most that Buyer should bid at the sale is $200,000. This is because once the sale is completed, both Middle and Junior’s liens will be discharged, but Senior’s will not. This is because in a foreclosure sale, the lien of the party initiating the sale as well as any subordinate liens are discharged at the end of the sale. Senior’s lien, however, will remain, and the Assets will remain subject to it. This is because, as the general rule, security interests continue notwithstanding sale. Because Buyer knows that she will still have to pay Senior’s $100,000 lien to own the Assets free and clear after the sale, she should deduct this amount from the $300,000. This leaves the $200,000 bidding max. If Buyer wins at the sale, and pays $200,000, the $200 sale expenses will first be paid (most likely to the sheriff or official), and then the rest will go to the liens discharged by this sale. That means $100,000 to Middle, in satisfaction of its lien, and then $99,800 to Junior. Junior will then likely have a deficiency claim for the rest of the debt owed against the debtor, but not against Buyer.

Professor Answer and Comments:
(a) The lien being foreclosed on and all liens junior to it are extinguished by a foreclosure sale. Because the foreclosure sale has been initiated by Middle, Middle’s and Junior’s liens will be extinguished at the sale. Senior’s lien is senior to Middle’s, so Senior’s security interest will remain on the collateral through the foreclosure sale. To account for that fact, Buyer should keep $100,000 at the ready to pay Senior’s lien off. That leaves her $200,000 of her budget. That is the most that she should bid at the auction.
Thus, Buyer should not pay more than $200,000 at the auction.
(b) If $200,000 is the winning price, then $200 will go to pay the sale expenses (to the sheriff or whoever conducts the sale); then Middle will get $100,000, and Junior will get $99,800 (i.e., the remaining amount less the $200 for sale). [I awarded partial credit on this problem for people who used the correct reasoning even if they used incorrect premises or made other small mistakes like who bears the costs of sale or how to do the
Despite it not having been paid in full, Junior’s lien will be discharged will have an unsecured claim for the remaining amount owed to it; Junior will have to pursue a deficiency if it can and wants to. Although this is not part of the answer to this question (which asks only about the auction proceeds), Buyer will then be left to deal with Senior and will presumably have to pay something like the amount it is owed, $100,000.

Note: When this exam was administered, some students got bogged down in credit bidding or FMV or strategic or bifurcation issues that really aren’t implicated when we’re simply asking, (a) what’s the most that Buyer should pay, and (b) if she wins, where will that money go. Make sure and answer the question asked!