

**Secured Transactions
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Sample Exam Questions - Set #1 - Model Answers

1.1. In August 2001, David and Angelyn Hook borrowed \$100,000 from High Plains Credit Association (“HPCA”), pursuant to a promissory note, which matured in March 2002, and secured through a security agreement covering “all crops planted or grown on the hereinafter described land and the products thereof and proceeds thereof, and all crops planted or grown upon the hereinafter described land within five years from the date hereof.” The security agreement required the Hooks to insure the collateral with companies acceptable to HPCA “against such casualties and in such amounts as [HPCA] shall require with a standard mortgage clause in favor of [HPCA],” and authorized HPCA “to collect such sums which may become due under any of said policies and apply same to the obligations hereby secured.” HPCA perfected its security interest shortly after the promissory note and security agreement were signed. The financing statement described the collateral using the same language as the security agreement: “All crops planted or grown on the hereinafter described land and the products thereof and proceeds thereof, and all crops planted or grown upon the hereinafter described land within five years from the date hereof.”

For their 2001 cotton crop, the Hooks purchased crop insurance from HPCA’s affiliated insurance agency, High Plains Insurance Company (“HPIC”). The policy included the following language: “You may assign to another party your right to an indemnity for the crop year.... The assignee will have the right to submit all loss notices and forms as required by the policy.”

In February 2002, the Hooks received crop insurance proceeds of approximately \$55,000 for 2001 cotton crop losses. But, instead of using those proceeds to reduce the HPCA debt, David Hook paid \$30,000 to another creditor to satisfy the balance due on two vehicles (which were exempt property); paid annual land lease payments (including \$10,000 to his father-in-law); and used the balance for expenses.

On June 1, 2002, the Hooks filed a Chapter 7 bankruptcy petition. HPCA has filed an adversary proceeding in bankruptcy court, asserting its prior-perfected security interest(s) in (1) the cash proceeds of the HPIC insurance policy paid to the Hooks and/or (2) the two vehicles which David Hook used proceeds of said policy to pay off – at least to the extent of the \$30,000 diverted from the insurance proceeds.

Evaluate HPCA’s claims.

This question is based on *In re Cook*, 169 F.3d 271 (5th Cir. 1999). The threshold issue is whether the insurance proceeds are “proceeds” of “crops planted or grown on the hereinafter described land . . . within five years from the date hereof.” If so, then the insurance proceeds are collateral for HPCA’s perfected security interest. (The question assumes that there is no prior perfected interest in the same crops, product, and proceeds. The question also assumes that the insurance proceeds were paid for losses on some or all of the “hereinafter described land.”)

§ 9-102(64)(E) defines “proceeds” to include “[i]nsurance payable by reason of loss . . . or damage to the collateral.” § 9-102(12)(A) extends a valid security interest in proceeds to proceeds of those proceeds. *See* § 9-102 cmt. 13.c. Therefore, if HPCA had a perfected security interest in the insurance proceeds, it should also have had a perfected security interest in whatever was purchased with those proceeds – at least for the first 20 days after the collateral was translated into proceeds. *See* § 9-315(d) & (e)(2).

But, did HPCA’s perfected security interests in the insurance proceeds and the proceeds of the insurance proceeds stay perfected? § 9-315(c) provides that a security interest in proceeds perfects automatically if the security interest in the original collateral from which the proceeds arose was perfected at the time the proceeds arose. For cash proceeds, HPCA’s only real hurdle will be proving that they are “identifiable.” *See* § 9-315(d)(2).

What about the vehicles-as-proceeds? § 9-315(d)(1) provides that the security interest in proceeds is continuously perfected if (A) a filed financing statement covers the original collateral, (B) the proceeds (the vehicles) are collateral in which a security interest may be perfected by filing in the office where the financing statement on the original collateral has been filed, and (C) the proceeds (the vehicles) were not purchased with cash proceeds. HPCA filed a financing statement against crops, product, and proceeds. HPCA’s financing statement on the crops, product, and proceeds would have been properly filed in the Secretary of State’s office of the state of the Hooks’s residence. Absent a certificate of title law, the vehicles would be either consumer goods or farm equipment in the Hooks’s hands. In either case, they would be properly filed against in the Secretary of State’s office of the state of the Hooks’s residence. (If we are in a certificate of title jurisdiction, once the Hooks take ownership of the vehicles any security interest in them should be noted on the certificate of title. Filing in the Secretary of State’s office would not perfect HPCA’s interest. As such, § 9-315(d)(1) is not satisfied. However, having not covered certificates of title in any depth, I would not assume you to consider them unless specifically instructed.) So far, so good. However, because the vehicles were purchased with the cash proceeds of the insurance policy, § 9-315(d)(1)(C) is not satisfied. Because the vehicles are not, themselves, cash proceeds, § 9-315(d)(2) is also not satisfied. So, the only way that HPCA could be continuously perfected in the vehicles as proceeds beyond the 20-day window (and we are well beyond it here), is if the description of collateral in the financing statement HPCA filed would include the vehicles; and, therefore, satisfy § 9-315(d)(3).

The FS describes HPCA’s collateral as: “All crops planted or grown on the hereinafter described land and the products thereof and proceeds thereof, and all crops planted or grown upon the hereinafter described land within five years from the date hereof.” Two questions arise here. First, can the use of the term “proceeds” in the description of collateral satisfy the

requirement of § 9-315(d)(3) that the FS describe the collateral in such a way as to include the non-cash proceeds? § 9-108 addresses the sufficiency of a collateral description in a security agreement. § 9-504(1) incorporates § 9-108 by reference for purposes of determining whether a collateral description in a financing statement is adequate. The test is whether the description “reasonably identifies” the collateral. § 9-108(a). Naturally, the Code does not define “reasonably identifies.” However, § 9-108(b) gives some examples, one of which is that the description is such that the collateral is “objectively determinable.” § 9-108(b)(6). HPCA could make a pretty good argument that one could objectively determine that the vehicles were purchased with the cash proceeds of the insurance policy and that the cash proceeds of the insurance policy were proceeds of the crops. Second, the description in the FS explicitly includes “proceeds []of” “[a]ll crops planted or grown on the hereinafter described land,” but it does not explicitly include proceeds of “all crops planted or grown upon the hereinafter described land within five years from the date hereof.” Without getting into a full-blown discussion of rules of construction, my guess is that a court will feel sufficiently uncomfortable about having to agree with HPCA’s argument on the first point that it will be happy to hold HPCA to the letter of its FS and say that, having (1) explicitly distinguished between planted or grown crops and crops to be planted or grown within five years and (2) explicitly included proceeds with respect to currently planted or grown crops but not with respect to crops to be planted or grown within five years, HPCA is not entitled to claim that the description includes proceeds of crops to be planted or grown within five years. So, unless the Hooks’s 1997 cotton crop had already been planted as of the date of their FS, they probably cannot take advantage of § 9-315(d)(3). But, that’s just a guess.

Interestingly, the Fifth Circuit never addressed the continuity of HPCA’s perfection. It merely ruled that the Bankruptcy Court had erred in finding that HPCA did not have a prior-perfected interest in the insurance proceeds. I added the question about the vehicles-as-proceeds.

If you launched into the lowest intermediate balance rule (LIBR), you were truly a glutton for punishment, because the question did not tell you anything about the debtors’ bank account.

1.2. On May 8, 2002, Quickie Finance extended a renewal loan to Pattie and Latrell Baskin totaling \$2,620.80. This loan was evidenced by a combined promissory note and security agreement which encumbered specific items of personal property, all of which were separately identified on “Schedule A” attached to the document. In connection with a previous loan, which was renewed by this particular transaction, the debtors had executed a UCC-1 Financing Statement which had been filed for record with the Nevada Secretary of State in August 2001. The collateral covered by the financing statement was described as follows:

Consumer Goods--consisting of personal property of all kinds and types located on or about Debtor’s residence stated above BUT NOT INCLUDING HOUSEHOLD GOODS as defined in FTC Rule, Code of Fed. Regs. § 444.1(i).

On June 17, 2002, the debtors purchased two diamond nugget watches and a diamond nugget ring from Fly-by-Night Marketing Corporation for a total time price of \$1,059.60. The total time price was secured by the items purchased as evidenced by a retail installment sale agreement/consumer credit installment contract executed by Latrell Baskin. No financing statement was filed in connection with this transaction since it was considered a purchase money security interest in consumer goods. Fly-by-Night Marketing Corporation assigned the contract to Quickie Finance on or about July 23, 2002, the date of the invoice introduced into evidence as Quickie Finance Exhibit 2.

Answer the following questions:

A. Is the description of collateral in Quickie Finance’s financial statement sufficient?

This question is based on *In re Boykins*, 120 B.R. 71 (Bankr. N.D. Miss. 1990). The court found that the description of collateral in the financing statement satisfied the precursor to § 9-108, because it was substantially more narrow than an “all assets” or “all consumer goods” description that other courts have found to be insufficient. Specifically, the court wrote:

the description of the secured collateral in the financing statement . . . can be broken down into the following constituent elements:

- A. Consumer goods
- B. . . . of all kinds and types
- C. Located on or about debtor’s residence stated above; and
- D. Not including household goods as defined in FTC Rule, Code of Fed. Regs. § 444.1(i).

. . . . This Court is of the opinion that a prudent third party would be put on notice to a sufficient extent to make inquiry, in this case of [Quickie] Finance, to ascertain the items of collateral encumbered by the [Quickie] Finance security agreement. The items set forth on “Schedule A” could be then identified with particularity to the third party.

. . . .

. . . . The language in the financing statement does identify with sufficient particularity the “type” of collateral which is encumbered in order to provide reasonable notice to a third party to inquire further. . . .

Boykins, 120 B.R. at 75.

Thus, the *Boykins* court is in accord with *In re Schmidt*, which required mere “inquiry” notice, and with *In re Legal Data Systems*, which held that inquiry notice could be satisfied in a financing statement by (1) indicating the types of collateral covered or (2) describing the items of collateral covered. Here, the financing statement did the former.

B. Does Quickie Finance have a perfected security interest in the watches and ring?

The watches and the ring are consumer goods, § 9-102(23), in which Fly-by-Night had an automatically perfected PMSI. § 9-309(1). Fly-by-Night’s assignment of that PMSI to Quickie Finance did not change the nature of the security interest nor did it “un-perfect” it. § 9-310(c). Which is a good thing, because Quickie’s financing statement would not be sufficient to pick-up these after-acquired consumer goods. § 9-204(b).

1.3. On September 1, 2001, Mary J. Townsend bought a Squanto computer from the local Squanto dealer in her hometown of Enterprise. The dealer financed the purchase and Mrs. Townsend executed a retail installment contract, which the dealer assigned to Squanto Credit Company. Mrs. Townsend soon fell behind in her payments on the contract. She was notified of her arrears by letter and by a visit from an employee of Squanto Credit. Mrs. Townsend does not dispute that she was in default on the contract as of May 1, 2002.

The contract provided in part that in the event of default,

Seller shall have all the rights and remedies of a Secured Party under the Uniform Commercial Code, including the right to repossess the Property whenever the same may be found with free right of entry, and to recondition and sell the same at public or private sale.

Mrs. Townsend damaged the computer and took it to Mr. Wizard’s Computer Shoppe for repairs. While it was at the shop, on May 22, 2002, it was noticed by Jenny Boles, a Squanto employee who among other duties repossesses computers. Boles ascertained that the computer was the one purchased by Mrs. Townsend, and then informed the manager of Mr. Wizard’s, James Hinds, of her intention to repossess it. Hinds testified that he replied, “No, you cannot repo it unless you contacted her (Mrs. Townsend) and it is okay.” Hinds testified that Boles then told him “she had seen her, and it was okay.” Boles testified that she could not remember whether Hinds asked her whether she had contacted Mrs. Townsend, but that she was “positive” that she did not tell Hinds that she had Mrs. Townsend’s permission to repossess the computer. Hinds and Boles agree that Hinds then told Boles that Boles could have the computer if she would pay the repair bill. Boles did pay the bill and repossessed the computer on May 23, returning it to the Squanto dealer.

Mrs. Townsend has brought an action for conversion, claiming that Boles wrongfully repossessed her computer when he took it from Mr. Wizard’s Computer Shoppe under “false pretenses.” Is she correct? Please explain.

This question is based on *Thompson v. Ford Motor Credit Corp.*, 550 F.2d 256 (5th Cir. 1977). Squanto Credit (“SC”) lent Townsend the money to buy the computer that serves as collateral for her loan from SC. Therefore, SC has a PMSI in the computer. If the computer is consumer goods, the PMSI perfects automatically. § 9-309(1). If the computer is not consumer goods, SC must properly file a financing statement in order to perfect its security interest. The question makes no mention of filing, so SC may be in trouble. Right? Wrong!

The dispute here is between a debtor and its secured creditor. No other claimant is involved. The issue here is attachment, not perfection. The PMSI attached when SC gave value to Townsend – that is, when Townsend took possession of the computer. See § 9-203(b). Once SC has an attached security interest, both § 9-609 and the terms of the security agreement authorize SC to use self-help to repossess the computer in the event of a default by Townsend – as long as SC can do so without a breach of the peace. Lying to a third-party about the debtor’s “agreement” that the SC can take the collateral from the third-party is not a breach of the peace. See *K.B. Oil v. Ford Motor Credit* (p. 60).

1.4. Jessie Dean Bernard (Bernard), Pauline Henry Chandler (Chandler) and Jessie Mae Taylor (Taylor) are all individual debtors who purchased household goods or furnishings in successive transactions from Deepwell Furniture Co., or its sister company, ABC Furniture Co. (hereinafter referred to collectively as “Deepwell”). The initial sale and all subsequent sales were consummated by the respective buyer executing a retail installment contract in favor of Deepwell. The purchase price was payable in monthly installments with interest, and a security interest was retained by Deepwell in the items listed in the contract.

Between February 2001 and April 2002, Bernard entered into ten separate installment contracts with Deepwell. Chandler entered into two contracts, dated June 19, 2002 and July 1, 2002. Taylor entered into three contracts, dated August 3, 2001, March 1, 2002, and July 2, 2002. With each succeeding purchase, the buyers executed a new contract, which incorporated not only the purchase price of the new merchandise, but also the balance remaining on the previous contract(s). Credits for finance charge refunds and insurance rebates were applied.

Bernard, Chandler, and Taylor each separately filed, on or after July 1, 2002, for relief pursuant to Chapter 13 of the Bankruptcy Code. Deepwell filed a timely objection to confirmation, alleging that its claim was secured by a purchase money security interest, not only in the collateral listed on the most recent contract, but in all of the merchandise purchased from Deepwell.

The Bankruptcy Code provides that the court may not confirm a Chapter 13 plan over the objection of the holder of an allowed secured claim unless the creditor either (1)

accepts the plan, (2) receives its collateral by way of abandonment, or (3) is paid, with interest, an amount equal to the value of the collateral securing the debt over the life of the plan, with the creditor retaining its lien on the collateral. 11 U.S.C. § 1325.

Bernard and Chandler have proposed to pay to Deepwell an amount equal to the value of the collateral listed on their most recent contract plus interest. Taylor has proposed to abandon the collateral listed on the most recent contract and to retain the remainder of the collateral lien free.

Were Deepwell's claims against Bernard, Chandler, and Taylor perfected at the time they filed bankruptcy? Explain.

This question is based on *In re Shaw*, 209 B.R. 393 (Bankr. N.D. Miss. 1996). The first issue is attachment – that is, did the creditor (Deepwell) and its debtors (Bernard, Chandler, and Taylor) have valid contracts that gave Deepwell an interest in collateral in which Bernard, Chandler, and Taylor had rights? The various retail installment contracts appear to be valid – *i.e.*, they are in writing, executed (*i.e.*, signed) by the debtors, and supported by consideration, and the debtors had rights in the collateral – and purport to give Deepwell a security interest in the items of collateral listed on each contract. § 9-203(b). So, as between Deepwell and its debtors, Deepwell was secured.

Did Deepwell have automatically perfected PMSIs in consumer goods under § 9-309(1)? If so, Deepwell would have been perfected at the time each debtor filed bankruptcy despite the fact that Deepwell does not appear to have taken any additional actions – other than the execution of the security agreements themselves – to perfect its security interests in the debtors' collateral.

Certainly, the items purchased by Bernard, Chandler, and Taylor appear to be consumer goods. Moreover, it appears as to each new purchase by Bernard, Chandler, and Taylor, Deepwell advanced credit to facilitate the purchase of the goods that would then become collateral for Deepwell's loan to Bernard, Chandler, and Taylor. The catch is that Deepwell was not satisfied with taking a security interest in each purchase; rather, each retail installment contract "rolled-in" the unpaid balance on any prior contract(s) and identified as collateral all as-yet-unpaid-for goods purchased by each debtor from Deepwell. When a creditor consolidates a purchase-money loan with a non-purchase money loan, the security interest created by the purchase-money loan loses its PMSI status. *See* § 9-103(f).

A PMSI cannot exceed the price of what is purchased in the transaction that created the PMSI. Put another way, if collateral is used to secure a debt other than its own purchase price, the creditor's original PMSI in the collateral is transformed into a non-PMSI. The *Shaw* court rightly concluded that, at most, Deepwell had a PMSI as to only the goods newly acquired under the last retail installment contract between Deepwell and each debtor. The purchases of those goods were financed by the money lent under those contracts. However, as to the not-yet-fully-paid prior purchases, Deepwell lost its PMSI status when it carried those goods forward as collateral for subsequent contracts. And, because Deepwell did not file against any of those not-

yet-fully-paid prior purchases, it was unperfected as to all non-PMSIs. Of course, some courts would find that Deepwell lost its PMSI status as to all of the collateral when it “mixed” purchase-money and non-purchase-money financing in the same security agreement. Fortunately for the real-life “Deepwell,” the *Shaw* court was not so inclined.