Q1. Your client, Smith, is a farm equipment dealer in Cobb County, Georgia. On August 16, 2001, Smith sold a combine (used to harvest wheat and other grains) to Edwards, a resident of Shelby County, Tennessee, for $5,000 cash down and $95,000 payable in 120 monthly installments of $1,000 each (including interest), commencing September 1, 2001. To secure payment of the outstanding debt, Edwards signed a security agreement granting Smith a security interest in the combine.

A. Assuming that Smith took whatever steps were necessary to perfect his security interest in the combine no later than September 1, 2001, suppose that, on July 24, 2002, still owing Smith $84,000 (in other words, Edwards was current on her payments), Edwards traded the combine to another farm equipment dealer, Jones, located in Cherokee County, Georgia for a $75,000 tractor to use on Edwards’s “weekend farm” there. What would be Smith’s collateral as of August 1, 2002? Please explain.

Smith’s SI in the combine survives its “sale” to Jones. Edwards was free to sell or otherwise dispose of the combine unless there was a provision in the SA restricting its disposition. § 9-401. However, Smith’s perfected SI in the combine continues despite the disposition to Jones in the absence of an exception. § 9-315(a). The sale was not authorized. Nor was Jones a BOCB, because Edwards was not in the business of selling combines. Nor does the “garage sale” exception apply. Therefore, Jones is a BNOCB, and takes subject to Smith’s perfected SI. §§ 9-323(d) & (e) & 9-317(b). Thus, the combine is still Smith’s collateral.

Moreover, Smith has a collateral interest in the tractor as proceeds of the combine. If the FS described the collateral as “farm equipment” (an undefined term under Revised Article 9 that is, nonetheless, commonly used to describe equipment used in farming operations) or “equipment” (a term defined by § 9-102(33)), then the tractor should fit within the same description of collateral – unless we conclude that the tractor is a consumer good. If the FS described the collateral as “combine,” then the tractor will not fit within the same description of collateral. That said, an SI in the tractor – whether it is equipment, farm equipment, or a consumer good – may be properly perfected by filing a FS in the Tennessee secretary of state’s office – the same office in which Smith properly filed against the combine. Smith’s perfected SI in the combine continues in the tractor – as proceeds of the combine – without the necessity of a new filing. § 9-315(d)(1).
B. Assuming that Smith took whatever steps were necessary to perfect his security interest in the combine no later than September 1, 2001 and that Edwards was current on her payments through July 1, 2002, suppose instead that, on July 24, 2002, Edwards sold the combine for $75,000 cash and deposited the cash in a bank account with a prior balance of $15,000. Suppose, further, that on July 30, 2002, Edwards purchased a tractor from Jones for $60,000, to use on Edwards’s “weekend farm” in Cherokee County. Edwards wrote Jones a check in the amount of $30,000, drawn on the aforementioned bank account, and agreed to pay Jones the balance due in installments of $1,000 per month for 36 months, giving Jones a security interest in the tractor to secure Edwards’s obligation to make the installment payments. Assume that Jones properly perfected her security interest in the tractor on July 31, 2002.

1. What is Smith’s collateral as of August 1, 2002? Please explain.

Smith’s SI in the combine survives its sale to Jones for the same reasons provided in response to Part “A.”

Smith’s collateral interest in the proceeds of the combine is a trickier issue. A perfected SI continues in identifiable proceeds, §§ 9-102(64) & 9-315(a)(2), but becomes unperfected after 20 days unless § 9-315(d)(1) or § 9-315(d)(2) applies or the tractor fits within the description of collateral in the prior-perfected FS.

§ 9-315(d)(1) does not apply to the tractor, because it was purchased with cash proceeds. Therefore, in order for Smith’s perfected SI in the tractor to continue beyond 20 days, the tractor must fit within the description of collateral in Smith’s filed FS. § 9-315(d)(3) & cmt. 5. If it does, Smith will have a perfected collateral interest in the tractor after August 20, 2002; if it does not, Smith must file a new or amended FS, identifying the tractor as collateral, on or before August 20, 2002.

§ 9-315(d)(2) will extend Smith’s perfected collateral interest in the combine to the identifiable cash proceeds of the combine. Unfortunately, Edwards did not put the cash he received for the combine in a coffee tin, he deposited it in a bank account containing non-proceeds. Applying the LIBR, and assuming there were no additional transactions on the account, Smith will have a perfected SI in $60,000 of Edwards’s bank account: the lowest account balance between the time Jones deposited the $75,000 proceeds and the time Smith is asserting her rights to the proceeds.
2. Suppose that Edwards defaults on her debt to Jones after August 1, 2002, and Jones forecloses on the tractor. If Jones sells the tractor for $50,000 at the foreclosure sale, what would be Smith’s rights, if any, with respect to the proceeds of the foreclosure sale and/or the tractor following the foreclosure sale? Please explain.

Because Jones is a purchase money lender with respect to the tractor and because Jones perfected her PMSI within 20 days of when Edwards took possession, Jones’s PMSI in the tractor has priority over Smith’s prior-perfected SI in the tractor as proceeds of the combine. § 9-324(e). Therefore, Jones is entitled to retain the proceeds of the foreclosure sale, after first paying the expenses of sale, up to the outstanding debt owed by Edwards at the time of Edwards’s default. Jones’s PMSI secured a debt of $36,000 (including interest) or less. Therefore, Smith will be entitled to $14,000 – expenses of sale + amount paid by Edwards to Jones prior to Edwards’ default. Because Smith’s SI is subordinate to Jones’s PMSI, when Jones forecloses, Smith’s SI will be discharged. Therefore, Smith will no longer be able to claim the tractor as collateral.

3. Suppose, instead, that Edwards defaults on her debt to Jones after August 1, 2002, and Jones elects to strictly foreclose, what right(s), if any, does Article 9 grant Smith before Jones can accept the tractor in partial or full satisfaction of Edwards’s outstanding debt? Please explain.

If Smith had a SI in the tractor perfected by filing a conforming FS in the Tennessee secretary of state’s office no later than August 20, 2002, then Jones would be required to send Smith a written proposal to retain the tractor in full or partial satisfaction of Edwards’s debt to Jones, § 9-621(a)(2), and Smith would have the right to object to Jones’s proposed strict foreclosure, forcing Jones to proceed with a foreclosure sale, § 9-620(a)(2)(A).

Q2. Nevada Consumer Computers (NCC) is a Nevada corporation specializing in the retail distribution of personal computers to consumers. Established in 1998, NCC initially opened outlets only in California. Computer Systems Inc. (CSI) is a wholesale distributor of personal computers to customers in all parts of the United States. Until late 2001, CSI also distributed computers through its own retail outlets in Arizona, California, and Utah.

On September 3, 2001, CSI agreed to sell NCC all of CSI’s retail outlets, including each outlet's entire inventory, for $3.2 million, payable in 60 monthly installments, beginning October 1, 2001. NCC signed an installment note in this amount, and a security agreement granting CSI a security interest in NCC’s “present and future computer inventory and proceeds from the sale thereof.” CSI promptly filed in the Nevada Secretary of State’s office a financing statement setting out the names and addresses of the parties and describing the collateral as “computer inventory and accounts.”

The September 3, 2001 contract also committed NCC to purchase from CSI a percentage of CSI’s future inventory of personal computers, as calculated according to a
carefully drafted formula. The parties agreed that CSI would send these computers to a warehouse owned by an independent warehouse company in Parhump, Nevada. NCC would then direct the warehouse operator to forward the computers to the relevant outlets.

On July 1, 2002, NCC defaulted on its payments to CSI. On July 15, 2002, NCC voluntarily turned over to CSI all its accounts receivable and the inventory in all of NCC’s retail outlets. (N.B.: This just means that NCC allowed CSI to peacefully repossess.) CSI immediately notified all of NCC’s account debtors to make future payments to CSI. On July 22, 2002, NCC filed a voluntary bankruptcy petition to initiate a Chapter 7 proceeding, listing among its assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer inventory</td>
<td>$1,400,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$600,000</td>
</tr>
</tbody>
</table>

The bankruptcy trustee has hired you to evaluate whether she may avoid any security interest that CSI might have in NCC’s computer inventory and accounts. Ignoring the issue of preferences under Bankruptcy Code § 547, advise the trustee. Please explain.

Whether FCC’s trustee in bankruptcy may avoid some or all of CSI’s security interest in FCC’s inventory and accounts receivable will depend on whether CSI’s interests were attached and perfected prior to CSI’s bankruptcy filing.

A. Inventory

CSI has a perfected security interest in NCC’s inventory – both whatever original inventory items remain from the September 2003 sale and all inventory items NCC acquired from CSI after that date – and any identifiable proceeds thereof. The security interest attached to these inventory items: the signed security agreement adequately described the collateral, including after-acquired inventory and accounts; CSI gave value when it sold the outlets on credit; NCC received rights in inventory items when they were identified. §§ 9-203(b) & 9-204(a). § 9-301(1) directs CSI to file in the state where NCC is located. Because NCC is a corporation, it is located in its state of incorporation: Nevada. § 9-307(e). Filing a conforming financing statement with the Nevada Secretary of State effectively perfected the security interest. § 9-501(a). Because CSI’s interest was perfected at the time NCC filed bankruptcy, the trustee in bankruptcy, who we treat as a hypothetical judgment lien creditor, cannot avoid CSI’s interest. § 9-317(a).

When concluding that the security interest is perfected, the principal issue is whether the description in the security agreement and financing statement is adequate within the meaning of §§ 9-108 & 9-504, respectively – that is, whether the description of the after-acquired inventory allows a third party to identify the future property with sufficient certainty. The description satisfies the requirement that it refer at least to the “type” of collateral. §§ 9-108(b)(3) & 9-504(1). Authorization to state the “type” of collateral also excuses the need to refer explicitly to after-acquired inventory in the FS. In any event, courts generally construe “inventory,” without qualification, to automatically refer to both present and future inventory.
B. Accounts

The issue here is whether the accounts receivable NCC reports in its bankruptcy filing are identifiable proceeds of NCC’s inventory. If the accounts are identifiable proceeds of NCC’s inventory, CSI has an attached and perfected interest in NCC’s accounts even though its security agreement does not specifically identify “accounts” as part of its collateral. Because the accounts are non-cash proceeds of NCC’s inventory, CSI would only retain perfection and priority in them if filing in the same office in which CSI filed against the inventory could perfect an interest in the accounts. § 9-315(d)(1). The proper place to file against both NCC’s inventory and its accounts is the Nevada Secretary of State’s office.

If they are not identifiable proceeds of NCC’s inventory, then NCC does not have an attached – much less perfected – security interest in them, because the description of collateral in the security agreement does not include accounts – regardless of the fact that the description of collateral in the financing statement does. § 9-509 authorizes CSI to file a financing statement describing its collateral in the same way it was described in the security agreement. It does not authorize a secured creditor to list additional items or types of collateral without the express consent of the debtor. But, in any event, only attached and perfected security interests survive NCC’s bankruptcy filing.

C. Priority

Because the TiB stands in the shoes of a hypothetical lien creditor who became a judgment lien creditor on the day NCC filed bankruptcy, BC § 544(a)(1), the TiB would yield priority to any security interest in NCC’s personal property that attached and was perfected prior to NCC’s bankruptcy filing. As such, the TiB cannot avoid CSI’s security interest in NCC’s inventory or, to the extent that NCC’s accounts are identifiable proceeds of NCC’s inventory, in NCC’s accounts. To the extent that NCC’s accounts are not identifiable proceeds of NCC’s inventory, the TiB may avoid any interest CSI claims in those accounts.