SECURED TRANSACTIONS ANALYSIS

(Secured Transactions II.D., E.; III.B.; IV.A., B., C.)

ANALYSIS

Legal Problems:

(1) Does Bank have an enforceable and attached security interest in the collateral described in the loan agreement?

(2) Does Bank’s security interest cover
   (a) Acme’s rights to payment from customers who obtained repair services from Acme on credit?
   (b) the used violins that are for sale in Acme’s store?
   (c) the violins in Acme’s possession that it is repairing for others?
   (d) the wood used by Acme in repairing violins?
   (e) the Gambretti plane?

(3) Does Bank’s security interest cover the Red Rosa violin after its sale to the violinist?

(4) Is Bank’s security interest superior to the interest of a judicial lien creditor in the same property?

DISCUSSION

Summary

Bank has an enforceable and attached security interest in the property described in the loan and security agreement—Acme’s “inventory and accounts.”

The amounts owed to Acme by customers for violins repaired on credit are “accounts” covered by Bank’s security interest. The used violins for sale in Acme’s store are “inventory” covered by Bank’s security interest. The violins that Acme is repairing for others are not subject to the security interest because they are not held by Acme for sale or lease and thus are not “inventory.” The wood used in repairing violins is “inventory” subject to Bank’s security interest. The Gambretti plane is equipment, rather than inventory or accounts, and not covered by Bank’s security interest.

Although the Red Rosa violin was inventory subject to Bank’s security interest, Bank’s interest was cut off by the sale of Red Rosa to a buyer in ordinary course of business.

Because Bank’s enforceable and attached security interest was perfected, it is superior to the rights of a judicial lien creditor that arose subsequent to perfection.

Point One (15%)

Bank has an enforceable and attached security interest in the property described in the loan and security agreement.
A security agreement is enforceable and attached if the three criteria described in UCC § 9-203(b) are satisfied. The first criterion is that “value has been given.” UCC § 9-203(b)(1). This is satisfied by the loan from Bank to Acme. The second criterion is that the debtor “has rights in the collateral or the power to transfer rights in the collateral to a secured party.” UCC § 9-203(b)(2). This is satisfied with respect to Acme’s inventory and accounts. The third criterion is satisfied because Acme has authenticated (signed, in this case) a security agreement that provides a description of the collateral. UCC § 9-203(b)(3)(A). Thus, since all three criteria have been satisfied, Bank’s security interest in the property described in the loan and security agreement is enforceable and attached.

**Point Two(a) (10%)**

Acme’s rights to payment from customers who obtained repair services on credit are “accounts” subject to Bank’s security interest.

Bank’s security interest covers “accounts,” as the term is defined in the Uniform Commercial Code. Acme’s rights to payment for repair services provided on credit are accounts because they are “right[s] to payment . . . for services rendered or to be rendered.” UCC § 9-102(a)(2)(ii). Thus, these rights to payment are subject to Bank’s security interest.

**Point Two(b) (5%)**

The used violins that are for sale in Acme’s store are “inventory” subject to Bank’s security interest.

Bank’s security interest covers “inventory.” The used violins that are for sale in Acme’s store are “inventory” under UCC § 9-102(a)(48) because they are “. . . goods . . . which . . . are held by a person for sale . . . .” Thus, those violins are subject to Bank’s security interest.

**Point Two(c) (10%)**

The violins in Acme’s possession that it is repairing for others are not covered by Bank’s security interest because they are not “inventory” and are not owned by Acme.

Bank’s security interest does not cover the violins that Acme is repairing for their owners. This conclusion can be reached in either of two ways. First, those violins are not “inventory” because they are not held by Acme for sale or lease. UCC § 9-102(a)(48)(B). Second, because the violins are not owned by Acme, but rather are owned by the individuals who brought them to Acme to be repaired, the security interest would not attach because Acme has neither rights in those violins nor the power to transfer rights in them to a secured party. UCC § 9-203(b)(2).

[NOTE: An examinee might argue that Acme has some rights in the violins it holds for repair because it has lawful possession of them, the right to repair them, the right to collect payment for repairs, and (in some jurisdictions) the right to assert an artisan’s lien if a repair bill is unpaid. An examinee who makes an argument of this sort should also note that these limited rights will not...]

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help Bank for two reasons. First, as already noted, the violins don’t fall within the scope of the security interest in any event, because they are not “inventory” or “accounts.” Second, even if the violins held for repair were within the scope of the security agreement, Bank’s rights against the owners of the violins would be no greater than Acme’s and it could, at best, arrange for repairs to be performed and collect amounts due. Moreover, while it is possible that, because Acme deals in violins and the owners of the violins brought to Acme for repair entrusted them to Acme, buyers in ordinary course of business of those violins would get good title to them under UCC § 2-403(2), that provision does not give rights to secured parties.]

Point Two(d) (5%)
The wood used by Acme in repairing violins is “inventory” and subject to Bank’s security interest.

Bank’s security interest in inventory covers the wood that Acme uses to repair violins. “Inventory” includes “raw materials” that are consumed in the business of the debtor. See UCC § 9-102(a)(48)(D) and cmt. 4(a). Thus, Bank has a security interest in the wood as inventory.

Point Two(e) (5%)
The Gambretti plane is not included in Bank’s collateral.

The Gambretti plane that Acme uses to shape the violins it repairs is not “inventory” because it is not held for sale or lease by Acme and does not otherwise fit into the other categories of “inventory” under UCC § 9-102(a)(48). Rather, the Gambretti plane is “equipment” (see UCC § 9-102(a)(33)) and not covered by Bank’s security interest.

Point Three (25%)
The Red Rosa violin was subject to Bank’s security interest prior to its sale, but the violinist was probably a buyer in ordinary course of business and therefore took the violin free of Bank’s security interest under UCC § 9-320(a).

Bank’s security interest in inventory covered the violin “Red Rosa” when it was held by Acme for sale. UCC § 9-102(a)(48). Furthermore, under UCC § 9-315(a)(1), except as otherwise provided in Article 9 “a security interest . . . continues in collateral notwithstanding sale . . . unless the secured party authorized the disposition free of the security interest . . . .”

Here, there are no facts to indicate that Bank authorized the disposition of Red Rosa free of its security interest. Nonetheless, the violinist’s interest in Red Rosa is likely to prevail over Bank’s security interest because the violinist probably qualifies as a “buyer in ordinary course of business.”

Under UCC § 9-320(a), “. . . a buyer in ordinary course of business . . . takes free of a security interest created by the buyer’s seller, even if the security interest is perfected and the buyer knows of its existence.” Under UCC § 1-201(b)(9), a buyer in ordinary course of business is “a person that buys goods in good faith, without knowledge that the sale violates the rights of
another person in the goods, and in the ordinary course from a person . . . in the business of selling goods of that kind.”

Acme is in the business of selling rare violins like Red Rosa, and the violinist apparently bought Red Rosa in the ordinary course of Acme’s business. There are no facts to indicate that the purchase was in bad faith or irregular in any way. Although the violinist was aware of Bank’s security interest in Acme’s inventory, there was no indication that the sale to the violinist violated any of Bank’s rights. Thus, while the violinist was aware of the existence of the security interest, that knowledge does not disqualify the violinist as a buyer in ordinary course who takes free of a security interest. See UCC § 9-320(a). As a buyer in ordinary course of business, the violinist would take Red Rosa free of Bank’s security interest.

**Point Four (25%)**

Bank’s security interest in its collateral was perfected; therefore, the security interest is superior to the rights of a judicial lien creditor that arose subsequently.

A security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected. UCC § 9-317(a)(2). Thus, if Bank’s security interest was not perfected at the time that creditor obtained its judicial lien, the security interest would be subordinate to that lien. Bank’s security interest was perfected, however. A security interest is perfected when it has attached and the other elements of perfection have been satisfied. UCC § 9-308(a). As described in Point One, Bank’s security interest in its collateral was attached. The filing of the financing statement was sufficient to perfect this attached security interest. UCC § 9-310(a). Thus, both elements of perfection were satisfied and Bank’s security interest was perfected before the lien creditor obtained its lien. Therefore, the security interest is superior to the rights of the lien creditor. See also UCC § 9-201(a).