

## **Perfection and Priority Rules for Purchase Money Security Interests**

The UCC's general rule of priority is that the first creditor to file a financing statement or perfect its security interest is entitled to priority in collateral. An exception exists where a creditor extends credit to enable the debtor to purchase the collateral, and the creditor complies with statutory requirements for obtaining special purchase money priority (often referred to as "superpriority"). The purchase money superpriority exception allows the purchase money creditor to have superior priority over earlier-filed security interests (most often, earlier-filed "blanket liens" held by other creditors).

### **Purchase Money Priority Rules for Equipment**

To obtain purchase money superpriority in equipment collateral, the creditor must satisfy two requirements:

1. the credit extended by the creditor must actually be used by the debtor to purchase the collateral; and
2. the creditor must properly file a financing statement covering the collateral within twenty days of the date the debtor takes possession of the collateral.

Meeting the second requirement requires attention by the creditor to determine when the debtor actually receives the equipment. The twenty day perfection window must be strictly complied with, or the creditor will not receive superpriority for its security interest.

Filing a financing statement beyond the twenty day deadline will, of course, perfect the creditor's security interest. But if the twenty day deadline is missed, the creditor will be subject to the normal "first to file or perfect" rule of priority, meaning that earlier-filed security interests will have priority in the collateral regardless of the fact that the creditor provided purchase money.

#### *Example 1*

On March 1, Bank extends a line of credit to Farmer. Farmer grants Bank a security interest in all "equipment and farm products, now owned or hereafter acquired." Bank properly files a financing statement on March 10, with the financing statement containing blanket language.

On October 1, Farmer approaches FinanceCo to request a loan for the purchase of a combine. FinanceCo agrees to make the loan, and once the specific combine is identified for purchase FinanceCo disburses the funds for the purchase directly to the equipment dealer. Farmer signs a security agreement granting FinanceCo a security interest in the combine. Farmer takes delivery of the combine on November 1. On November 26, FinanceCo properly files a financing statement describing the combine by brand, model, and serial number.

Farmer subsequently defaults on his obligations to Bank and FinanceCo. Who has priority in the combine? Bank.

Since FinanceCo did not file its financing statement within twenty days of the date Farmer took possession of the combine, the "first to file or perfect" rule applies. Because Bank's financing statement was filed before FinanceCo's, Bank is entitled to priority.

This is true even though FinanceCo is a purchase money creditor; and even though FinanceCo's financing statement specifically describes the combine while Bank's financing statement uses generic blanket language regarding equipment.

### *Example 2*

Assume similar facts as above, but that instead of filing a financing statement on November 26 FinanceCo files its financing statement on November 16.

Who has priority in this situation? FinanceCo.

It extended the purchase money used to acquire the combine, and properly filed a financing statement covering the combine within twenty days after Farmer received possession.

As the above examples illustrate, a creditor will not receive special priority simply because the creditor extended the purchase money for the collateral. The creditor must timely file its financing statement within the twenty day window.

To help the creditor comply with the twenty day filing deadline, the creditor should require the borrower to sign a written confirmation of the date that the borrower first took possession purchased equipment.

Although purchase money status alone will not result in special priority, it is a requirement for special priority. If the credit extended by the lender is not actually used to purchase the equipment, the lender will not be entitled to superpriority in the equipment.

### *Example*

On March 1, AgLender extends a line of credit to Farmer. Farmer grants AgLender a security interest in all "inventory, equipment, and farm products, now owned or hereafter acquired." AgLender properly files a financing statement on March 2, with the financing statement containing blanket language.

On July 1, Farmer visits Bank to request a loan for the purchase of a new combine. Farmer shows the Bank loan officer a paper printout from the equipment dealer detailing the make, model, serial number, and retail price of the combine.

After meeting with Farmer and reviewing the documents regarding the combine, Bank agrees to make the loan. Bank disburses \$180,000 directly to Farmer, an amount equal to eighty percent of the retail price of the combine. On the same date, Farmer signs a security agreement granting Bank a security interest in the combine.

On July 20, Farmer acquires the combine from the dealer. Instead of using all of the funds provided by Bank, Farmer transfers several items of equipment to the dealer as trade-ins for the combine. After considering the traded equipment, only \$70,000 remained as purchase price for the combine. Farmer pays this amount to the dealer, using the funds loaned by Bank. Farmer uses the rest of the loan funds to buy a bass boat, two jet skis, and an above-ground swimming pool.

Bank, unaware that much of the loan funds were used for purposes other than buying the combine, files its financing statement on July 30.

When Farmer defaults on his obligations to AgLender and Bank, who has priority in the combine? Bank filed its financing statement within the twenty day window, but only \$70,000 of its total loan amount was actually used to purchase the combine. Thus, Bank has first priority up to the amount of \$70,000. As to the remainder of the Bank loan amount, AgLender has priority as its financing statement was filed first.

On rare occasions, there may be more than one purchase money creditor for a single item of equipment. If each such creditor properly files its financing within the twenty day window, each will obtain priority over other non-purchase-money debts. But how does one determine priority between the two purchase money creditors?

There is a special priority rule of which banks must be aware. In a priority dispute between two perfected purchase money creditors, a security interest in favor of a seller will take priority over a security interest in favor of a creditor who merely extended an “enabling loan,” meaning a loan which enabled the borrower to acquire the collateral. As banks will usually be in the latter category, this rule is important.

### *Example*

Farmer wants to purchase a tractor from Dealer. Dealer is willing to finance one half of the tractor’s purchase price. Farmer obtains a loan from Bank for the other one half of the purchase price, and submits the loan proceeds to Dealer. Farmer grants a security interest in the tractor to both Bank and Dealer. Farmer receives possession of the tractor on February 1. Bank files its financing statement on February 2. Dealer files its financing statement on February 15. Farmer defaults on both obligations.

Who has priority in the tractor? Dealer. As Dealer was the seller of the equipment, it has superior priority even though the bank was also a purchase money creditor, and even though the bank filed its financing statement first.

Because of this special priority given to sellers, equipment finance companies generally insist that a buyer grant a security interest directly to the dealer/seller, with the finance company then taking an assignment of the dealer’s interest immediately after the sale.

When obtaining a security interest in farm equipment (whether or not a purchase money security interest is involved), it is wise to include a specific description of the equipment in the financing statement. If possible, the equipment should be described by make, model, and serial number. This is because Georgia’s version of the UCC has a unique provision, specific to farm equipment, that permits a mechanic’s lien to take priority over an earlier-filed security interest in the same equipment unless that security interest is perfected by a financing statement that specifically describes the item of equipment at issue.

On a purchase money loan for a single item of equipment, this is usually an easy requirement to satisfy. But with scenarios such as operating loans, where the creditor takes blanket security interests in all of the borrower’s many items of equipment, more effort is necessary.

A creditor should request that the borrower provide detailed lists of equipment owned by the borrower. The creditor can then file a financing statement covering all equipment then owned or thereafter acquired, “including without limitation” the list of equipment (the list can be attached as an exhibit to the financing statement). In this manner, the creditor gets extra protection against mechanic’s liens, but does not lose the benefit of a blanket security interest that will be perfected as to equipment acquired after the financing statement is filed.

Finally, the creditor must always determine whether the equipment at issue might be considered a “motor vehicle” requiring a certificate of title under Georgia law. This will be obvious for collateral such as cars and pickup trucks, but also is important to items such as heavy trucks and mobile equipment.

For vehicles requiring a certificate of title, perfection of the lender’s security interest is governed by state motor vehicle title laws, rather than the UCC. In other words, merely filing a financing statement describing the vehicle will not be sufficient to perfect the lender’s security interest. The lender must have its interest properly noted on the certificate of title.

### **Purchase Money Priority Rules for Livestock Collateral**

The requirements for obtaining purchase money superpriority in livestock collateral are more extensive and involved than obtaining superpriority in equipment. A purchase money lender will have priority over an earlier-filed interest in livestock collateral only where all of the following are met:

1. the credit extended by the purchase money lender must have actually been used by the debtor to purchase the livestock;
2. the purchase money lender must be perfected as to the livestock when the debtor acquires the livestock (the lender must have properly filed a financing statement covering the livestock **before** the debtor takes possession of the livestock);
3. the purchase money lender must have sent a signed, written notice to the earlier-filed secured lender, which notice must describe the livestock collateral and state that the purchase money lender has, or expects to acquire, a purchase money security interest in the described livestock; and
4. the earlier-filed secured lender must have received the notice within six months before the debtor takes possession of the purchase money livestock collateral.

The requirements for written notice (items 3 and 4) apply only where the competing lender has filed a financing statement covering livestock before the purchase money lender files its own financing statement. If the competing lender has not filed such a financing statement by this time, the purchase money lender can obtain priority without sending the written notice to the competing lender.

The purchase money lender should send each notice by both regular mail and certified mail (return receipt requested), in order to obtain documentation of the competing lender’s receipt of the notice. The notice should be sent to the competing lender at the address shown on that lender’s financing statement filed with regard to the debtor.

It is important to remember that a superpriority interest in livestock requires the purchase money lender to file a financing statement **before** the debtor takes possession of the purchase money livestock collateral. Unlike purchase money interests in equipment, there is no “twenty day window” or other grace period within which the lender may file after the debtor takes possession of livestock collateral.

Filing after the debtor takes possession does not mean that the purchase money lender will be unperfected, but rather merely that the “first to file or perfect” rule of priority will apply and the lender will be subject to earlier-filed security interests. Likewise, failure to comply with applicable notice requirements will not cause the purchase money lender to be unperfected, but will merely mean that the

“first to file or perfect” rule will apply between the purchase money lender and the competing lender that did not receive the required notice.